



Commonwealth of Pennsylvania

ECONOMIC & BUDGET UPDATE

Education Policy and Leadership Center

February 28, 2020

Background: Independent Fiscal Office

IFO begins operations September 2011

Nearly all states have a fiscal office

- But they are housed within the state legislature | PA is unique
- All have a governing board composed of legislators
- Bi-partisan vs non-partisan

Duties span a wide range of issues:

- Revenue estimates (how much revenues are available?)
- Performance based budgeting | Tax credit reviews
- Special Studies: property tax reform, natural gas, minimum wage

Today's Presentation: Three Parts

State demographics and economy

- Labor market still robust | consumers drive growth
- Auto loan delinquencies at all time high | mortgage refis double

State budget

- What are the revenue trends?
- What is the longer-term outlook?

Some miscellaneous budget topics

- Property tax: replace with income and sales tax?
- Tax burden rankings: how does PA compare to border states?
- Natural gas: how is the market doing?

PA Population Snapshot

Age	Number (000s)			Change (000s)		Avg. Growth	
	2015	2020	2025	2015-20	2020-25	2015-20	2020-25
0 to 19	3,040	2,965	2,901	-75	-64	-0.5%	-0.4%
20 to 64	7,569	7,414	7,210	-154	-204	-0.4%	-0.6%
65 to 79	1,562	1,837	2,092	276	254	3.3%	2.6%
80+	<u>616</u>	<u>625</u>	<u>704</u>	<u>9</u>	<u>79</u>	<u>0.3%</u>	<u>2.4%</u>
Total	12,786	12,842	12,906	56	65	0.1%	0.1%

Note: Average growth is the compound annual average growth rate over the time period.

Source: Historical data from U.S. Census Bureau. Forecast by IFO.

PA Economic Growth Rates

	Annual Growth Rates or Change				
	2017	2018	2019	2020	2021
Real Gross Dom Product	0.6%	2.6%	2.1%	1.9%	1.9%
Wages and Salaries	4.0%	4.3%	4.4%	3.9%	4.0%
Philadelphia CPI-U	1.3%	1.3%	2.0%	1.8%	1.9%
Net Payroll Jobs (000s)	58.8	65.6	45.6	45.4	45.7

Source: Historical data from the U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.

PA Demographics Cause Tight Labor Market

	Number of Residents (000s)					
	2015	2016	2017	2018	2019	2020
Population Change	<u>-3.5</u>	<u>-2.6</u>	<u>5.4</u>	<u>13.3</u>	<u>1.1</u>	<u>16.7</u>
1 Births less Deaths	8.4	9.9	1.7	2.3	1.1	1.3
2 International Migration	31.8	38.0	31.0	31.7	19.5	--
3 Domestic Migration	-43.7	-50.4	-27.4	-20.7	-19.6	--
Residents Age 20-64	-23.9	-32.5	-32.2	-26.7	-30.6	-32.4
Net Payroll Jobs	46.2	48.6	58.8	65.6	45.6	45.4
Unemployment Rate	5.3%	5.4%	4.9%	4.3%	4.0%	--

Source: Historical data from the U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.

PA Net Payroll Job Gains (000s)

	2017	2018	2019
Wholesale-Retail	-7.8	-2.9	-4.4
All Government	0.2	-0.3	3.1
Manufacturing	2.0	6.3	-3.6
Construction	9.9	7.0	5.4
All Other Sectors	6.2	10.8	4.9
Transportation-Storage	7.3	9.1	7.1
Leisure-Hospitality	9.1	4.9	6.1
Professional-Administrative	5.3	3.5	6.5
Healthcare-Social Assistance	<u>26.4</u>	<u>27.2</u>	<u>20.5</u>
Total Net Jobs	58.8	65.6	45.6

Source: U.S. Bureau of Labor Statistics, Current Employment Statistics. Excludes self-employed. 2019 is preliminary.

PA Cash Income Sources (\$ billions)

	2006	Share	2018	Share	AAGR
Wages-Salaries	\$248.0	59.8%	\$348.1	58.0%	2.9%
Net Business Income	\$41.2	9.9%	\$58.7	9.8%	3.0%
Capital Income	\$52.1	12.6%	\$67.6	11.3%	2.2%
Retirement Income	\$62.0	15.0%	\$107.6	17.9%	4.7%
Income Maintenance	<u>\$11.5</u>	<u>2.8%</u>	<u>\$17.9</u>	<u>3.0%</u>	<u>3.7%</u>
Total Cash Income	\$414.9	100.0%	\$599.8	100.0%	3.1%

Notes: Billions of dollars. AAGR is average annual growth rate. Net Business Income includes sole proprietors, partnerships and S corporations. Capital income includes capital gains, interest and dividends, rent and royalties. Retirement income includes Social Security, IRA withdrawals and DB-DC pensions. Income Maintenance includes UI, SNAP and other miscellaneous programs. Income sources include adjustments for unreported income based on IRS Tax Gap studies.

Sources: Internal Revenue Service, U.S. Bureau of Economic Analysis, Social Security Administration. Computations by IFO.

Budget Outlook Highlights

Revenues: exceed estimate for FY 2019-20

- Most gains are in inheritance tax and escheats
- Labor market stronger than expected | inflation weaker
- Recent windfalls in sales and corporate net income taxes

Expenditures concentrated in three agencies

- Education (41%) | Human Services (38%) | Corrections (8%)
- All other agencies are ~13% | includes debt service (3%)
- Demographic pressures and healthcare costs
- Lottery under financial pressure due to lack of jackpots

Structural Imbalance in General Fund

	Fiscal Year (\$ billions)					
	19-20	20-21	21-22	22-23	23-24	24-25
Net Revenues + Lapses	\$34.6	\$35.8	\$36.9	\$37.7	\$39.1	\$40.5
growth rate		3.4%	3.0%	2.3%	3.6%	3.6%
Expenditures + Supplementals	-\$35.1	-\$36.8	-\$37.9	-\$39.1	-\$40.2	-\$41.5
growth rate		4.8%	3.0%	3.2%	3.0%	3.2%
Current Year Differential	-\$0.4	-\$0.9	-\$1.0	-\$1.3	-\$1.2	-\$1.1

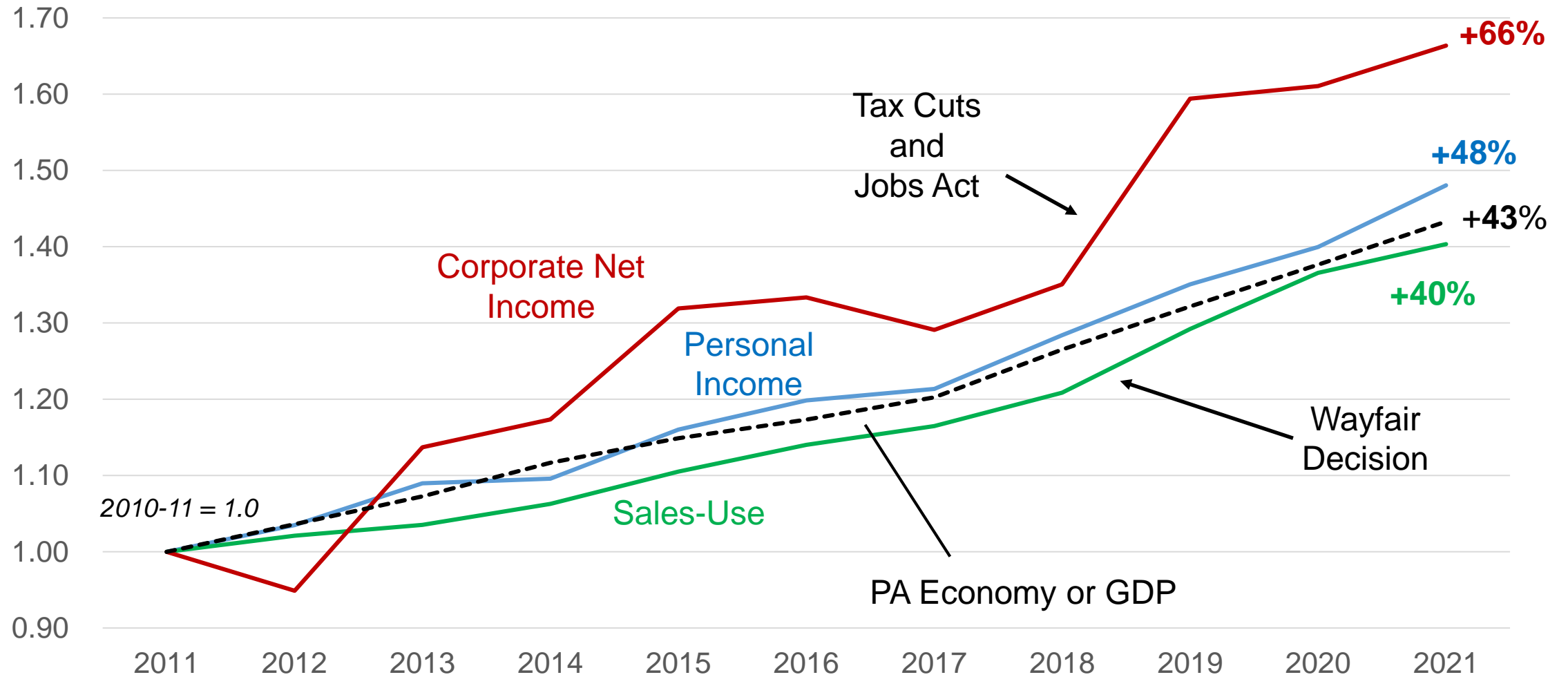
Note: Billions of dollars. Net revenues deduct refunds and include lapses. Assumes future one-time measures are not utilized.
Source: Economic and Budget Outlook: FY 2019-20 to FY 2024-25, IFO (November 2019).

Revenues July 2019 to February 2020

	Actual Revenues (\$ millions)			IFO Estimate	
	Amount	Growth	Adjust	Amount	\$ Diff
General Fund	\$20,880	3.4%	4.3%	\$20,581	\$298
Corporate Net Income	1,748	0.5		1,703	45
Sales - Non-Motor	6,649	3.5	5.7	6,675	-26
Sales - Motor Vehicle	1,020	5.8		996	23
Income – Withholding	7,147	3.7	4.4	7,122	26
Income – Other	1,544	13.1		1,515	30
All Tobacco	786	-5.8		786	0
Inheritance	751	11.0		677	74
Realty Transfer	367	6.6		349	18
All Other	868	-9.2		760	108

Note: Millions of dollars. Adjusted column controls for (1) \$115m sales tax transfer and \$28m higher CFA transfer and (2) \$74m withholding transfer this year and \$25m last year.

Strong Revenue Growth Over Past Decade



Lottery and Other New Games

	2015-16	2016-17	2017-18	2018-19	2019-20
Traditional Game Sales					
Instant Tickets	\$2,973	\$2,782	\$2,939	\$3,093	\$3,190
Multi-State Lotto	\$496	\$369	\$424	\$507	\$310
Numbers and In-State Lotto	<u>\$846</u>	<u>\$850</u>	<u>\$837</u>	<u>\$904</u>	<u>\$904</u>
Total Sales	\$4,135	\$4,001	\$4,201	\$4,503	\$4,404
Growth	8.3%	-3.2%	5.0%	7.2%	-2.2%
iLottery Sales	--	--	\$21	\$381	\$585
Sports Wagering Tax (34%)	--	--	--	\$7.3	\$41.0
iGaming Tax (34%/14%)	--	--	--	--	\$6.2
Note: Millions of dollars. Sports Wagering and iGaming excludes local share assessments or county grants (13% for iGaming slots).					

State and Local Tax Burden Ratios

	PA	U.S. Avg	Difference
Personal Income	2.62%	2.23%	+0.39%
Sales-Use	1.91%	2.45%	-0.54%
All Property	2.87%	3.04%	-0.17%
Gaming-Liquor-Tobacco	0.68%	0.41%	+0.27%
All Other	<u>2.21%</u>	<u>1.82%</u>	<u>+0.39%</u>
Total Taxes	10.29%	9.95%	+0.34%

Note: Percentage is the ratio of the state-local revenue to modified state personal income. Figures for U.S. represent an unweighted average across all states (all states have same weight). Excludes any severance tax.

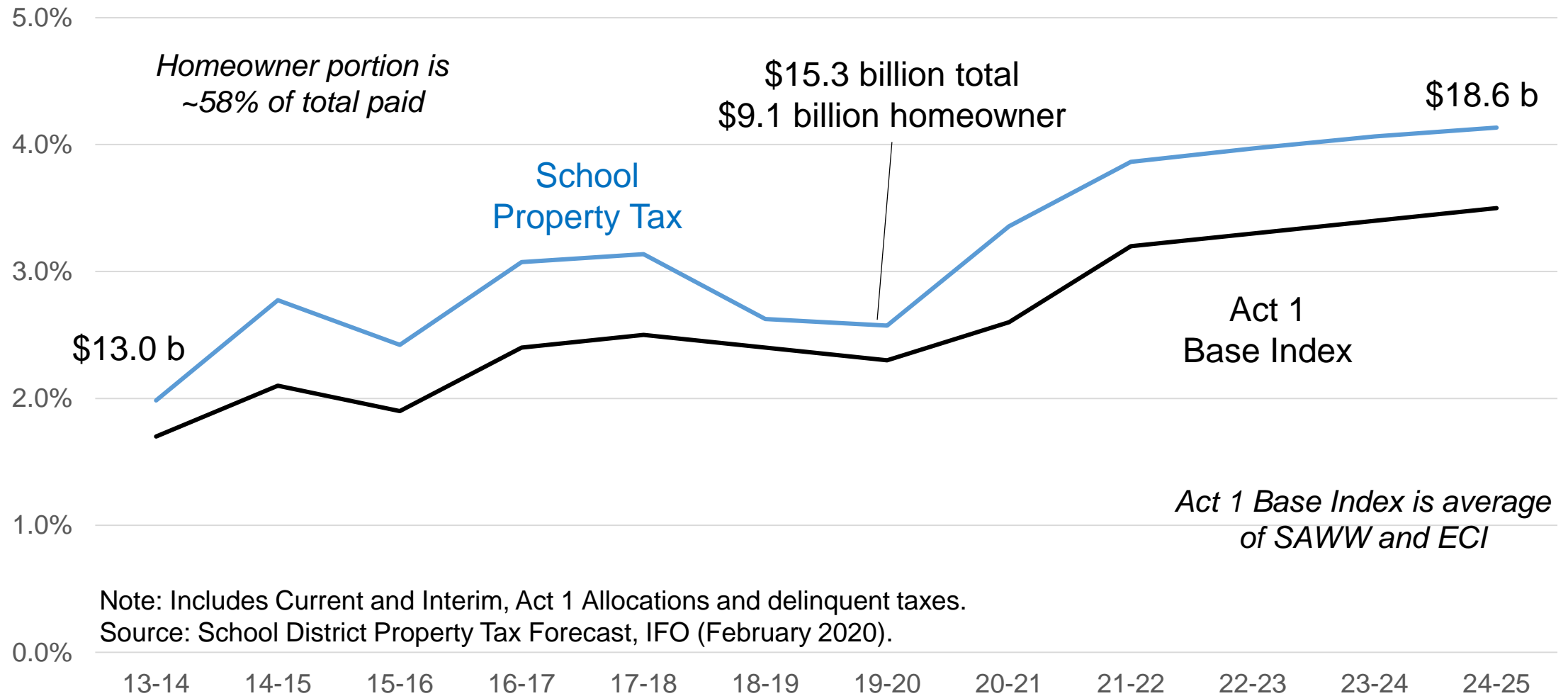
Source: State and Local Taxes: A Comparison Across States, IFO (January 2020).

State and Local Tax Burden Rankings

	NY	NJ	MD	OH	PA	VA
Personal Income	1	20	3	18	19	11
Sales-Use	21	38	42	17	39	44
All Property	6	3	28	27	24	21
Total Taxes	1	8	12	23	20	34

Note: Based on the ratio of state-local tax revenue to modified state personal income. Total Taxes excludes severance taxes.
Source: State and Local Taxes: A Comparison Across States, IFO (January 2020).

Growth Rate of School Property Tax to Increase



School District Revenues: FY 2017-18

Source	Amount	Percent
Property Tax	\$13,511	44.6%
Earned Income	\$1,592	5.3%
Other Local Sources	\$2,347	7.8%
Act 1 Allocations (slots)	\$533	1.8%
State (excludes Act 1)	\$10,962	36.2%
Federal	\$897	3.0%
Other (debt related)	<u>\$439</u>	<u>1.4%</u>
Total	\$30,282	100.0%

Note: Millions of dollars. State monies include contributions to PSERS (\$2.3 billion).
Source: Pennsylvania Department of Education.

Income and Property Tax Shares by Income Level

Income Group	All Homeowners			Age 65+ Homeowners		
	Income	Prop Tax	Burden	Income	Prop Tax	Burden
<\$40k	5.1%	14.8%	9.9%	11.4%	27.6%	10.1%
\$40k to \$80k	16.7%	22.8%	4.6%	25.0%	29.9%	5.0%
\$80k to \$150k	32.9%	31.5%	3.2%	28.4%	23.9%	3.5%
\$150k to \$200k	13.9%	11.6%	2.8%	9.6%	6.5%	2.8%
+\$200k	<u>31.4%</u>	<u>19.2%</u>	<u>2.1%</u>	<u>25.6%</u>	<u>12.1%</u>	<u>2.0%</u>
Total	100.0%	100.0%	3.4%	100.0%	100.0%	4.2%

Note: Income and Property Tax percentages are shares of total for each group. Burden is ratio of Property Tax to Income. Income excludes any capital gains.
Source: U.S. Census Bureau, American Community Survey 2018 1-Year Estimates. Computations by IFO.

Replacing Homeowner School Property Tax

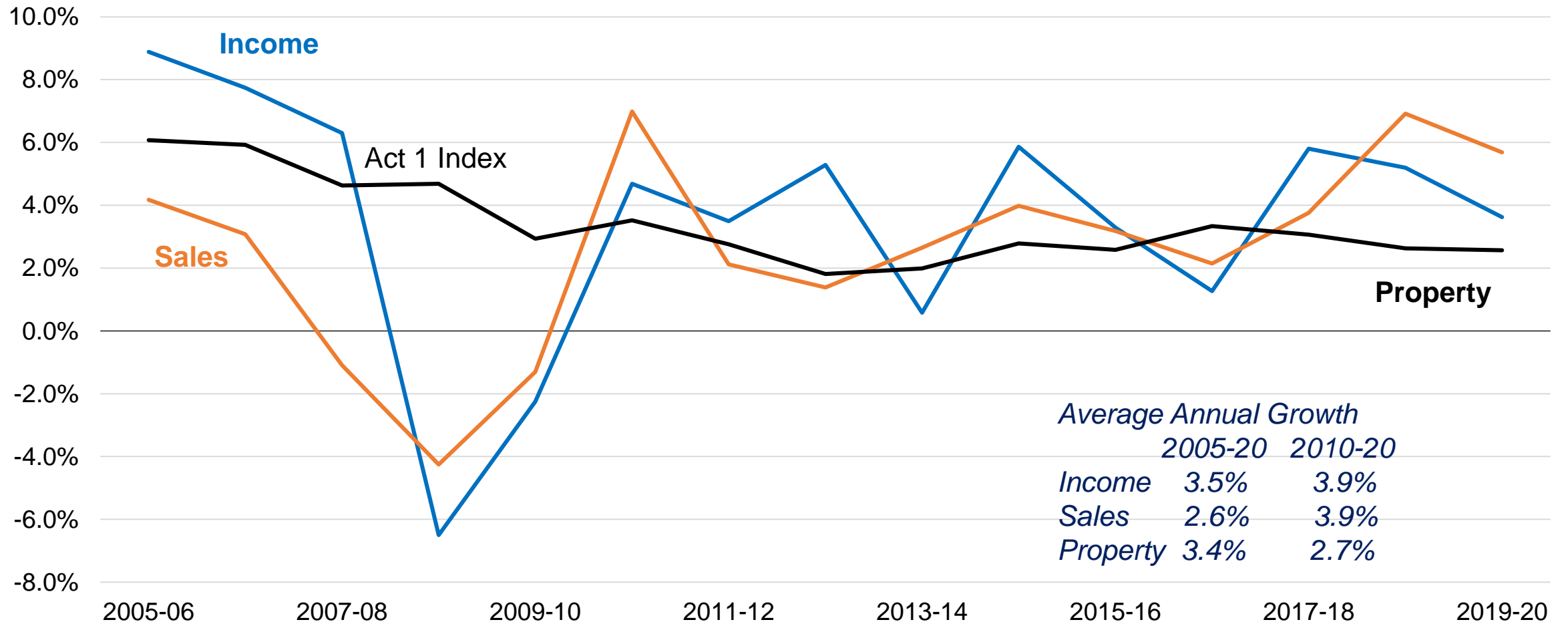
Personal income tax: raise rate (3.07%) and/or expand base

- Replace homeowner school property tax: ~+2.0 ppts
- Note: this excludes renters (but no good data on renter burden)
- Tax retirement income: Social Security, IRAs, pensions
- PA one of only 3 states that does not tax retirement income

Sales tax: raise rate (6.0%) and/or expand base

- Replace homeowner school property tax: ~+4.5 ppts
- Tax groceries: ~+\$1.8 billion (excludes WIC-SNAP purchases)
- Tax clothing: ~+920 million
- Other: basic cable services, non-prescription drugs, amusements

Revenue Growth and Volatility Comparison



Note: Property tax includes current and interim collections and Act 1 allocations, excludes delinquent collections. FY 2019-20 figures are estimates by the IFO.

PA Natural Gas Statistics

	2014	2015	2016	2017	2018	2019
Total Production (bcf)	4,069	4,596	5,094	5,364	6,123	6,822
Growth	31.2%	13.0%	10.8%	5.3%	14.1%	11.4%
New Wells Spud	1,350	783	503	810	779	610
Growth	13.7%	-42.0%	-35.8%	61.0%	-3.8%	-21.7%
Henry Hub Price	\$4.37	\$2.62	\$2.52	\$2.99	\$3.15	\$2.57
Regional PA Hub Price	\$2.99	\$1.36	\$1.47	\$2.09	\$2.59	\$2.10
PA Impact Fee (\$ millions)	\$224	\$188	\$173	\$210	\$252	\$198
Effective Tax Rate	2.3%	6.3%	4.5%	2.8%	2.2%	2.1%

Notes: Production and wells spud are from PA Department of Environmental Protection. Prices are from Bentek Energy. Units are \$ per MMBtu. Impact fee historicals are from the PA Public Utility Commission, based on drilling year, not year of receipt. 2019 is estimated by the IFO. All computed Effective Tax Rates are calculated by the IFO. See IFO website for additional detail.

Wrap Up

Executive Budget relies on policy options, funding shifts and one-time measures to close gap

- Combined reporting (\$240 million) | Minimum wage (\$133 million)
- State Police Fee (\$136 million)
- Unclear whether they will be enacted

Various long-term demographic concerns

- Declining birth rates | Contracting labor force
- Rapid growth age 80+ (healthcare costs accelerate)

Policymakers should consider recession scenarios

- Rainy Day Fund = \$340 million
- Recommended: 5% (\$1.8b) or 2 months operating (\$6.0b)

Questions

Presentation posted on the IFO website

<http://www.ifo.state.pa.us/>

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