

# REVENUE AND ECONOMIC UPDATE

Fiscal Year 2020-21

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Independent Fiscal Office | October 2020





## **About the Independent Fiscal Office**

The Independent Fiscal Office (IFO) provides revenue projections for use in the state budget process along with impartial and timely analysis of fiscal, economic and budgetary issues to assist Commonwealth residents and the General Assembly in their evaluation of policy decisions. In that capacity, the IFO does not support or oppose any policy it analyzes, and will disclose the methodologies, data sources and assumptions used in published reports and estimates.

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The Independent Fiscal Office was created  
by the Act of Nov. 23, 2010 (P.L.1269, No.120).

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## INDEPENDENT FISCAL OFFICE

October 29, 2020

The Honorable Members of the Pennsylvania General Assembly:

The Independent Fiscal Office (IFO) issues this report as an update to its official revenue estimate released in June 2020. Typically, the IFO would release a five-year revenue and economic outlook report in November. However, due to the partial-year budget, the IFO has postponed release of that document to a future date. This October update may be used in its place as the forecasts are largely based on the same data. However, this report only updates revenue projections for FY 2020-21 and does not consider future years. Nor does it contain projections of expenditures for this fiscal year or future years because a full-year budget has not been approved.

This report uses the latest economic data through October 23, 2020 and revenues received for the first four months of the fiscal year. The data suggest that the state will face unique short- and long-term challenges due to the lingering impact of the COVID-19 pandemic. At this point, it is not known whether the federal government will enact additional stimulus. If stimulus is enacted, it would increase the revenue estimates contained in this report.

Questions or comments regarding the contents of this report are welcome and can be submitted to [contact@ifo.state.pa.us](mailto:contact@ifo.state.pa.us).

Sincerely,

A handwritten signature in blue ink that reads "Matthew J. Knittel".

Dr. Matthew J. Knittel  
Director

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# Economic Update

The Pennsylvania economic forecast is based on the latest data published by the U.S. Bureau of Economic Analysis and the U.S. Bureau of Labor Statistics through October 23, 2020. All forecasts in this section are by the IFO.

## Pennsylvania Economic Forecast

**Table 1.1** displays a summary of the Pennsylvania economic forecast used by the IFO for its Official Revenue Estimate (released June 2020) and this October update. Compared to the June 2020 forecast, the IFO projects a smaller contraction of real GDP, a smaller reduction in wages and salaries paid to workers, the same magnitude of average job losses and slightly stronger inflation as measured by the Philadelphia CPI-U for calendar year (CY) 2020. Overall, the economic forecast is quite similar to the June 2020 forecast.

However, the forecast for CY 2021 has been revised down for all economic variables, with the exception of inflation. The latest employment data for CY 2020 reveal rapid labor market improvement in May, June and July, but much more modest gains in August and September. That outcome is explored further in tables contained in this section.

**Table 1.1**  
**Pennsylvania Economic Forecasts**

June 2020 Forecast	Annual Growth Rate or Change			
	2018	2019	2020	2021
Real GDP	2.6%	2.3%	-5.6%	5.5%
Wages-Salaries	4.3%	4.2%	-3.2%	5.0%
Net Payroll Jobs (000s)	69	56	-453	310
Philadelphia CPI-U	1.3%	2.0%	0.5%	1.5%
October 2020 Forecast	2018	2019	2020	2021
Real GDP	1.9%	2.4%	-4.6%	3.0%
Wages-Salaries	4.3%	4.3%	-2.0%	3.8%
Net Payroll Jobs (000s)	68	54	-450	100
Philadelphia CPI-U	1.3%	2.0%	0.9%	1.5%

Note: Payroll jobs exclude self-employed and independent contractors.  
Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. All forecasts by IFO.

The Revenue Outlook section of this report details increases to the IFO’s official estimate of General Fund revenues for FY 2020-21 as revenues have outperformed expectations for the first four months of the fiscal year. An important factor that drives that outcome is the substantial federal stimulus monies that have been injected into the state economy. **Table 1.2** contains (1) IFO estimates of foregone labor income due



to the COVID-19 pandemic and related mitigation efforts and (2) state and federal unemployment compensation payments plus the economic impact payments received by Pennsylvania residents.

**Table 1.2**  
**Stimulus and UC Payments More Than Offset Lost Labor Income**

	CY 2020	Notes
<b>Lost Labor Income</b>		
Wages and Salaries	-\$20.8	6% reduction vs. no-pandemic scenario
Self-Employment (see note)	-3.2	15% reduction vs. no-pandemic scenario
Tip Income	<u>-1.5</u>	high degree of uncertainty
<b>Total</b>	<b>-25.5</b>	
<b>Unemployment Comp and Individual Stimulus</b>		
State Unemployment Compensation (UC)	\$5.2	average of \$330 per week
Federal Pandemic Unemployment Comp (FPUC)	15.9	program has concluded
Pandemic Unemployment Assistance (PUA)	7.0	much higher than anticipated
Other Federal Assistance	3.1	lost wage assistance and extensions
Economic Impact Payments	<u>11.0</u>	6.6 million PA recipients
<b>Total</b>	<b>42.3</b>	
<b>Other Federal Provisions</b>		
Paycheck Protection Program (PPP)	\$20.7	disbursed April to June
SNAP Benefits	1.0	

Note: Figures in dollar billions. Self-employment estimate excludes distributions to S corporation shareholders because owners do not pay self-employment tax on distributions. It also excludes any reductions in unreported self-employment income. See footnote 1 in text.

The IFO estimates that wage and salary income declines by roughly \$20.8 billion in CY 2020. There is a fair degree of certainty with that estimate but the true figure could be roughly 5 to 10 percent higher or lower. There is much more uncertainty regarding foregone self-employment income due to the pandemic, and the estimate assumes that 15 percent (\$3.2 billion) of the self-employment income reported to the Social Security Administration is foregone due to the pandemic. That percentage is more than twice the level of estimated lost wage income (6 percent). The table assumes lost tip income of \$1.5 billion, and that estimate has a high degree of uncertainty. Overall, the IFO assumes foregone labor income of \$25.5 billion for CY 2020.<sup>1</sup>

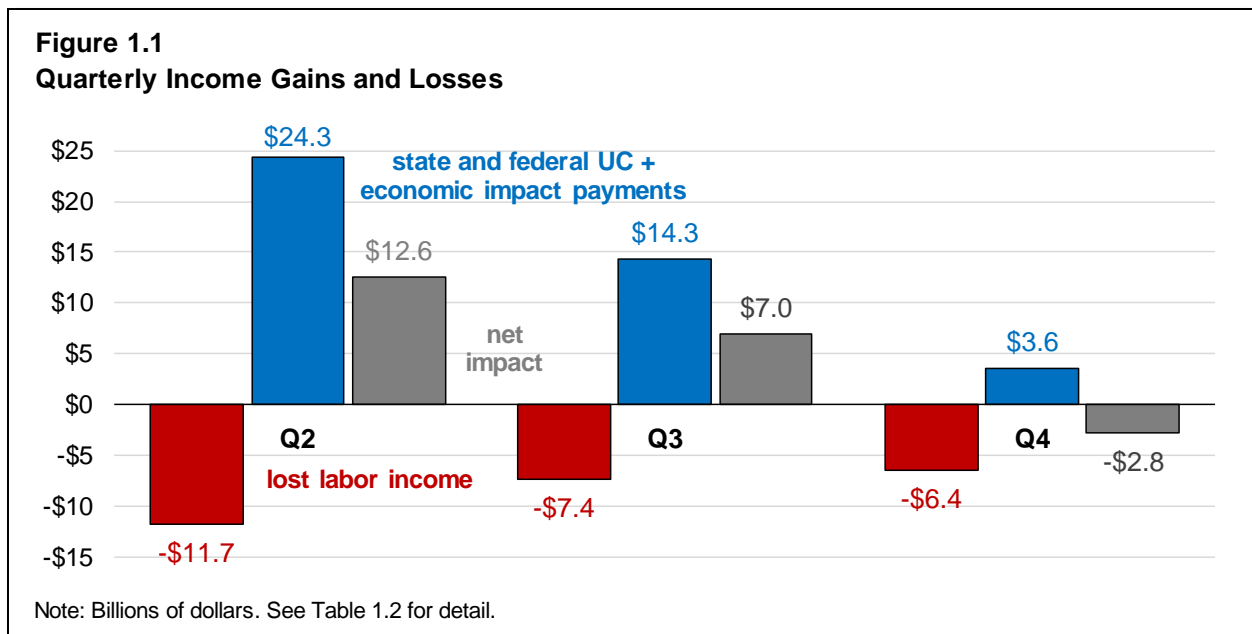
By comparison, the unemployment compensation and economic impact payments inject \$42.3 billion into the state economy, which more than offsets lost labor income. It is important to note that the economic impact payments were received by 6.6 million residents, and not just those who lost employment. If those payments are excluded, then targeted replacement income still exceeds lost labor income by nearly \$6.0 billion. It should also be noted that the Pandemic Unemployment Assistance (PUA) program runs through the end of the calendar year. Recent program data suggest that 750,000 to 850,000 recipients are receiving

<sup>1</sup> The estimate excludes any impact the pandemic has on unreported labor income. Recent IRS tax gap studies find that roughly one-half of self-employment income is not reported. See <https://www.irs.gov/pub/irs-pdf/p1415.pdf>.



regular weekly payments. However, the latest data from the U.S. Social Security Administration (2017) show that only 714,000 state residents reported self-employment income. Hence, the PUA data suggest that either a very high proportion of self-employed lost employment and/or there is a very large amount of students and part-time workers who would ordinarily not qualify for unemployment compensation who are receiving payments. A number of states have noted that the program has been subject to widespread identity and other fraud.<sup>2</sup>

**Figure 1.1** shows the quarterly breakdown of the data in Table 1.2 and illustrates the concentration of federal transfer payments in the second and third quarters. For 2020 Q2, lost labor income is estimated at \$11.7 billion, while offsetting state and federal unemployment compensation plus economic stimulus payments totaled \$24.3 billion, a net impact of \$12.6 billion. In 2020 Q3, the net impact declined to \$7.0 billion. For 2020 Q4, the analysis projects a net impact of -\$2.8 billion as the FPUC and LWA (Lost Wage Assistance) programs expire.<sup>3</sup>



## Pennsylvania Payroll Employment

**Table 1.3** displays the year-over-year change and growth rate of payroll employment (excludes self-employed) for the months of April (peak job loss), July and September. The data show total job loss of 1.06 million in April and significant recovery through July as the state economy recouped 523,000 payroll jobs. However, for the latest two months, the state economy recouped only 63,000 jobs relative to the peak losses in April. The forecast assumes further modest job recovery for the remainder of the calendar year.

<sup>2</sup> For example, see “Widespread Unemployment Fraud is Overwhelming State Systems” at <https://www.govern-ing.com/security/Widespread-Unemployment-Fraud-Overwhelms-State-Systems.html>.

<sup>3</sup> The analysis does not assume that further significant federal stimulus will be enacted. If enacted, it would increase the revenue estimates contained in this report.

**Table 1.3**  
**Payroll Employment Recovers Quickly, then Stagnates**

	YOY Number Change (000s)			YOY Percent Change		
	Apr	Jul	Sept	Apr	Jul	Sept
<b>Total</b>	<b>-1,062</b>	<b>-539</b>	<b>-477</b>	<b>-17.5%</b>	<b>-8.9%</b>	<b>-7.8%</b>
Construction	-104	-19	-15	-40.1	-6.8	-5.6
Manufacturing	-77	-38	-36	-13.3	-6.6	-6.3
Retail-Wholesale	-155	-86	-62	-18.9	-10.3	-7.5
Transport-Storage	-27	-20	-14	-9.1	-6.8	-4.5
Professional-Technical	-28	-27	-23	-5.6	-5.3	-4.7
Admin-Waste Manage	-53	-33	-27	-16.8	-10.3	-8.3
Education	-42	-9	-36	-16.1	-4.3	-15.0
Healthcare	-89	-39	-34	-10.9	-4.7	-4.1
Social Assistance	-31	-16	-8	-13.3	-6.7	-3.2
Arts-Entertainment	-58	-34	-21	-60.9	-27.3	-19.5
Accomm-Food Service	-280	-138	-128	-58.6	-28.2	-26.8
Other Services	-86	-42	-33	-32.8	-15.9	-12.8
All Government	-17	-15	-27	-2.3	-2.2	-3.7
All Other	-17	-25	-13	-3.7	-5.5	-2.9

Note: Data are not seasonally adjusted. Figures for September are preliminary. YOY is year-over-year.  
Source: U.S. Bureau of Labor Statistics, Current Employment Statistics and State and Area Employment.

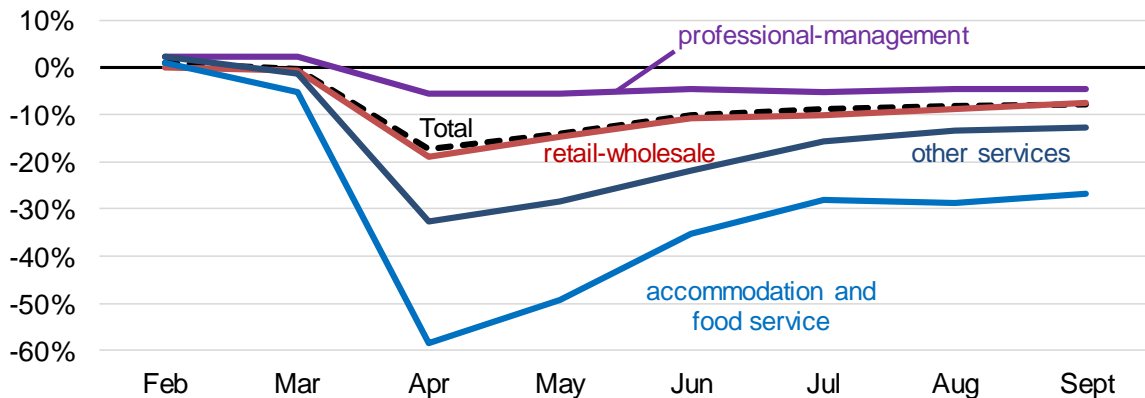
For September, the accommodation and food service (26.9 percent), retail-wholesale trade (12.9 percent) and manufacturing (7.6 percent) sectors comprise nearly one half of total job losses relative to the level from the prior year. For recent months, the jobs data show weakness in the education and government sectors.<sup>4</sup> That outcome is due to the fact that the table uses non-seasonally adjusted data and the start of the school year coincided with job losses for those sectors.

**Figure 1.2** depicts year-over-year job loss trends since February. The figure illustrates the much less dramatic impact that the pandemic had on the professional-management service sector (8.1 percent of all payroll jobs in September 2019) relative to the accommodation-food service (7.9 percent) and the other services (4.3 percent) sectors.<sup>5</sup> It has been widely noted that lower-wage jobs have been disproportionately impacted by the pandemic.

<sup>4</sup> The government sector includes local school districts and state supported higher education institutions. The education sector includes other colleges and universities, junior colleges, technical and trade schools, as well as private and charter schools.

<sup>5</sup> Other services include personal services such as barbers and hair and nail salons. It also includes repair and maintenance services and dry cleaners.

**Figure 1.2**  
**Annual Change in Payroll Employment by Sector**



## Recent Economic and Revenue Trends

The section concludes with a display of recent economic and revenue trends since the start of the calendar year. **Table 1.4** displays the quarterly annualized or year-over-year growth rate (real GDP, personal income, wages and CPI-U), change (payroll employment and labor force) or relevant levels (average unemployment rate) for CY 2019 and the first three quarters of CY 2020. For real GDP, very preliminary data suggest an economic contraction of 34.0 percent in 2020 Q2. Due to the significant injection of federal monies, personal income increased by 12.0 percent from the prior year. Wages and salaries paid declined by 6.4 percent in Q2 and 2.7 percent in Q3.

**Table 1.4**  
**Recent Pennsylvania Economic Growth Rates or Change**

	2019	2020 Q1	2020 Q2	2020 Q3	Notes
Real GDP	2.4%	-5.8%	-34.0%	--	data are very preliminary
Personal Income	3.6%	2.6%	12.0%	--	Q2 includes federal transfers
Wages and Salaries	4.3%	3.6%	-6.4%	-2.7%	stronger than expected
Philadelphia CPI-U	2.0%	2.6%	0.0%	0.4%	data are final
Unemployment Rate	4.4%	5.4%	14.0%	10.4%	excludes discouraged workers
Change Payroll Jobs (000s)	54	28	-849	-506	expect long-term job loss
Change Labor Force (000s)	68	92	-17	-156	women leaving labor force

Notes: Real GDP is quarterly annualized growth rate. Wage growth for 2020 based on adjusted withholding. Change in Payroll Jobs and Labor Force is annualized change during quarter. Labor market data are not seasonally adjusted.

Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics.

The bottom part of the table considers the state labor market. Based on the average unemployment rate during the quarter, unemployment appears to have improved significantly in 2020 Q3, and the latest reading for September 2020 is 7.7 percent (not seasonally adjusted). The recovery of payroll jobs drove most of that outcome. However, the contraction of the labor force also drove that result as 156,000 residents

left the labor force compared to the prior year. Given the uncertain job prospects, it is unclear if those individuals will return. For September, U.S. data show that four times as many women than men left the labor force.

For CY 2021, the forecast assumes that only 100,000 additional payroll jobs (average for entire year) will be recouped. If that occurs, then the level of payroll employment will remain below the CY 2019 level by 350,000 jobs, and policymakers should anticipate significant challenges in regards to long-term unemployment. Many technical and structural factors support a scenario where lost jobs are not recovered including: new consumer spending patterns (e.g., more in-home dining), more online shopping, less travel, greater automation, more teleworking and reduced production capacity due to the elimination of numerous small businesses.

**Table 1.5** contains a comparison of year-over-year revenue growth rates for the four-month mitigation period (March to June) and the four-month recovery period (July to October). The figures used to compute growth rates were adjusted for any one-time shifts to provide tax relief or miscellaneous transfers. The table illustrates the dramatic contraction of revenues in the mitigation period. Especially notable was motor vehicle sales tax (due to dealer closures), cigarettes (due to processing delays) and realty transfer (due to the inability to show homes).

	Mitigation Mar to Jun	Recovery Jul to Oct	Notes
<b>General Fund Tax Revenue</b>	<b>-9.2%</b>	<b>0.4%</b>	
Corporate Net Income	-12.3	-5.2	profits holding up well
Sales - Non-Motor	-7.1	3.2	UC payments, lack of travel
Sales - Motor Vehicle	-33.6	20.6	pent-up demand
PIT - Withholding	-4.4	-2.4	better than expected
PIT - Non-Withheld	-8.9	-6.6	meets expectations
Cigarette	-39.2	8.6	processing, COVID impact
Inheritance	5.9	-11.7	
Realty Transfer	-30.9	6.2	pent-up demand, low rates
All Other Tax	-7.7	2.0	

Notes: Growth rates control for \$2.0 billion shifted to recovery period for tax relief and miscellaneous one-time transfers. Excludes non-tax revenues. PIT is personal income tax.

By contrast, the recovery period reveals modest revenue growth driven by strong growth of motor vehicle sales (pent-up demand, aversion to public transportation), solid gains for non-motor sales (pent-up demand, federal unemployment and stimulus, lack of out-of-state travel, computer and appliance purchases) and cigarette (processing issues and psychological impact of pandemic) tax revenues.

# Revenue Outlook

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In June 2020, the IFO released its official FY 2020-21 General Fund revenue estimate of \$35.87 billion.<sup>6</sup> Based on actual revenue collections through October 2020 and the current economic outlook, the IFO's updated revenue estimate for FY 2020-21 is \$36.52 billion, \$650 million above the IFO's official estimate. (See **Table 2.1.**) This revision is largely driven by sales and use tax (SUT) collections, which have substantially outperformed expectations (+\$580 million) for the first four months of the fiscal year. The text that follows provides a brief description of the factors that motivate revisions to the estimate by major revenue source for FY 2020-21.

## Corporate Net Income

The updated FY 2020-21 corporate net income tax (CNIT) estimate is \$3.31 billion, an increase of \$120 million from the IFO's official estimate. Compared to the prior fiscal year, year-to-date collections through October are down roughly 5.2 percent, after accounting for the extended TY 2019 due date that shifted some prior year collections to the current fiscal year. The increase in the CNIT estimate reflects an improved corporate profit outlook and assumes that domestic non-financial corporate profits contract by 10 percent in CY 2020 (the IFO's official estimate projected a 20 percent decline) and grow by 5 percent in CY 2021.<sup>7</sup>

## Sales and Use

The updated SUT estimate of \$11.94 billion is \$490 million above the IFO's official estimate, with an increase in both non-motor (\$400 million) and motor vehicle (\$90 million) projections. Total SUT collections through October are growing at a rate of 5.6 percent relative to the prior year after adjusting for the reinstatement of the pre-payment requirement (after a temporary suspension in response to the pandemic) and one-time transfers. This increase in consumer spending is inconsistent with the current level of Pennsylvania unemployment and is likely driven by several factors, including: (1) substantial federal transfer payments distributed in 2020 Q2 and 2020 Q3, (2) a significant increase in home refinancings that likely lowered household monthly payments, and (3) a shift in spending from out-of-state travel, gasoline, etc., to home furnishings, electronics and other taxable household goods.

Consumer expenditures are expected to fall in the coming months, with less federal support flowing to households in 2020 Q4. E-commerce sales remain strong due to the continued shift of consumer purchases to online platforms in response to the COVID-19 pandemic. After months of limited activity in the spring, pent-up demand for motor vehicles increased motor vehicle collections for the first few months of the fiscal year, but is expected to wane by the end of CY 2020.

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<sup>6</sup> The estimate reflects the IFO's official estimate released on June 22, 2020.

<sup>7</sup> The estimate assumes that forgivable loans under the Paycheck Protection Program (PPP) will be treated as non-taxable. If forgivable loans are effectively taxed, that treatment would have significant revenue implications for corporate net and personal income taxes.

## Personal Income

The updated FY 2020-21 personal income tax (PIT) estimate is \$15.35 billion and reflects a \$30 million reduction from the IFO's official estimate, with increases in withholding (+\$30 million) and quarterly (+\$60 million) payments more than offset by a reduction in annual payments (-\$120 million). The reduction in the PIT annual projection is largely the result of delayed payments that were expected in July 2020 (current fiscal year), but were received at the end of June (prior fiscal year). Withholding collections through the first four months of the fiscal year declined 2.4 percent after adjusting for one-time transfers.

The COVID-19 pandemic will continue to impact withholding and non-withholding collections through the remainder of FY 2020-21, due to continued unemployment, lower wage growth and reduced non-withheld earnings (e.g., net profits, capital gains, dividends, interest and rental payments).

## Other Revenue Sources

Other notable updates to the revenue estimates include:

- The updated FY 2020-21 estimate for cigarette tax revenues is \$921 million, or \$40 million higher than the IFO's official estimate. The unusually strong collections through October are largely the result of delayed processing during the early months of the pandemic. This strength is not expected to continue through the remainder of the fiscal year.
- Higher than anticipated collections for sports wagering and iGaming yields a \$25 million increase in the IFO's estimate for gaming tax revenues. Demand for online games that can be played from home have benefited from the impact of the pandemic.
- The licenses and fees estimate is increased by \$20 million primarily related to additional gaming licenses that have been approved or will be approved in the current fiscal year.
- The Treasury estimate is reduced by \$15 million to reflect lower General Fund cash balances.
- The FY 2020-21 estimate for minor and repealed collections is increased by \$10 million due to wine excise and fireworks tax collections that have exceeded expectations.
- The liquor profits transfer estimate (\$185 million) remains unchanged in the updated forecast. It is unknown if the pandemic has impacted the Liquor Control Board's ability to make this annual transfer.

**Table 2.1**  
**Adjustment to Revenue Estimate for FY 2020-21**

	June 2020 Estimate		October 2020 Estimate		Dollar Change
	Amount	Growth	Amount	Growth	
<b><u>Total General Fund</u></b>	<b>\$35,874</b>	<b>11.1%</b>	<b>\$36,524</b>	<b>13.2%</b>	<b>\$650</b>
<b><u>Total Tax Revenue</u></b>	<b>35,208</b>	<b>11.4</b>	<b>35,843</b>	<b>13.4</b>	<b>635</b>
<b><u>Total Corporation Taxes</u></b>	<b>5,060</b>	<b>4.6</b>	<b>5,160</b>	<b>6.6</b>	<b>100</b>
Corporate Net Income	3,188	12.8	3,308	17.0	120
Gross Receipts	1,005	-9.0	1,005	-9.0	0
Utility Property	38	1.0	38	1.0	0
Insurance Premiums	447	-5.6	437	-7.7	-10
Financial Institutions	382	-2.9	372	-5.4	-10
<b><u>Total Consumption Taxes</u></b>	<b>12,896</b>	<b>5.2</b>	<b>13,426</b>	<b>9.5</b>	<b>530</b>
Sales and Use	11,452	5.9	11,942	10.4	490
Non-Motor	9,893	4.7	10,293	8.9	400
Motor	1,559	14.2	1,649	20.8	90
Cigarette	881	-4.7	921	-0.3	40
Other Tobacco Products	127	-0.3	127	-0.3	0
Malt Beverage	23	0.6	23	0.6	0
Liquor	412	12.7	412	12.7	0
<b><u>Total Other Taxes</u></b>	<b>17,252</b>	<b>18.9</b>	<b>17,257</b>	<b>18.9</b>	<b>5</b>
Personal Income	15,379	19.8	15,349	19.6	-30
Withholding	10,767	2.1	10,797	2.4	30
Quarterly	2,147	40.5	2,207	44.4	60
Annual	2,465	222.8	2,345	207.1	-120
Realty Transfer	544	9.2	544	9.2	0
Inheritance	1,196	10.6	1,196	10.6	0
Gaming	178	24.2	203	41.7	25
Minor and Repealed	-44	0.5	-34	23.0	10
<b><u>Total Non-Tax Revenue</u></b>	<b>667</b>	<b>0.2</b>	<b>682</b>	<b>2.5</b>	<b>15</b>
State Store Fund Transfers	185	0.0	185	0.0	0
Licenses and Fees	152	14.0	172	29.0	20
Treasury	27	-10.0	12	-60.8	-15
Escheats	205	-5.8	205	-5.8	0
Other Miscellaneous	29	-9.3	39	22.2	10
Fines, Penalties & Interest	69	1.9	69	1.9	0

Note: Figures in dollar millions. Due to rounding, detail may not sum to total. Growth rates based on the unrounded amounts. The June 2020 estimate reflects the IFO's official estimate released on June 22, 2020.