

*Commonwealth of Pennsylvania*  
**Economic and Budget Outlook**

Fiscal Years 2016-17 to 2021-22



# Welcome

- ▶ **Matthew Knittel** | **Director, Independent Fiscal Office**
  - Overview, Demographic and Economic Outlook
  
- ▶ **Don Boyd** | **Rockefeller Institute of Government**
  - Presentation on Public Pension Funding Risk
  
- ▶ **Mark Ryan** | **Deputy Director, Independent Fiscal Office**
  - Revenues, Expenditures and Fiscal Outlook

# A Preview of the Results

- ▶ **January 2016: ~\$1.9 to \$2.7 Billion Structural Deficit.**
  - Roughly 6% to 7% of General Fund revenues.
  - Driven by DHS, Pensions and temporary payment delays.
- ▶ **Summer 2016: Enactment of Policy Changes.**
  - Adds \$1.1 billion of new revenue this year.
  - \$674 million permanent; \$386 million temporary.
- ▶ **November 2016: ~\$1.7 to \$3.0 Billion Structural Deficit.**
  - Roughly 5% to 7.5% of General Fund revenues.
  - *Why is there no change in the deficit?*

# Four Factors Motivate the Result

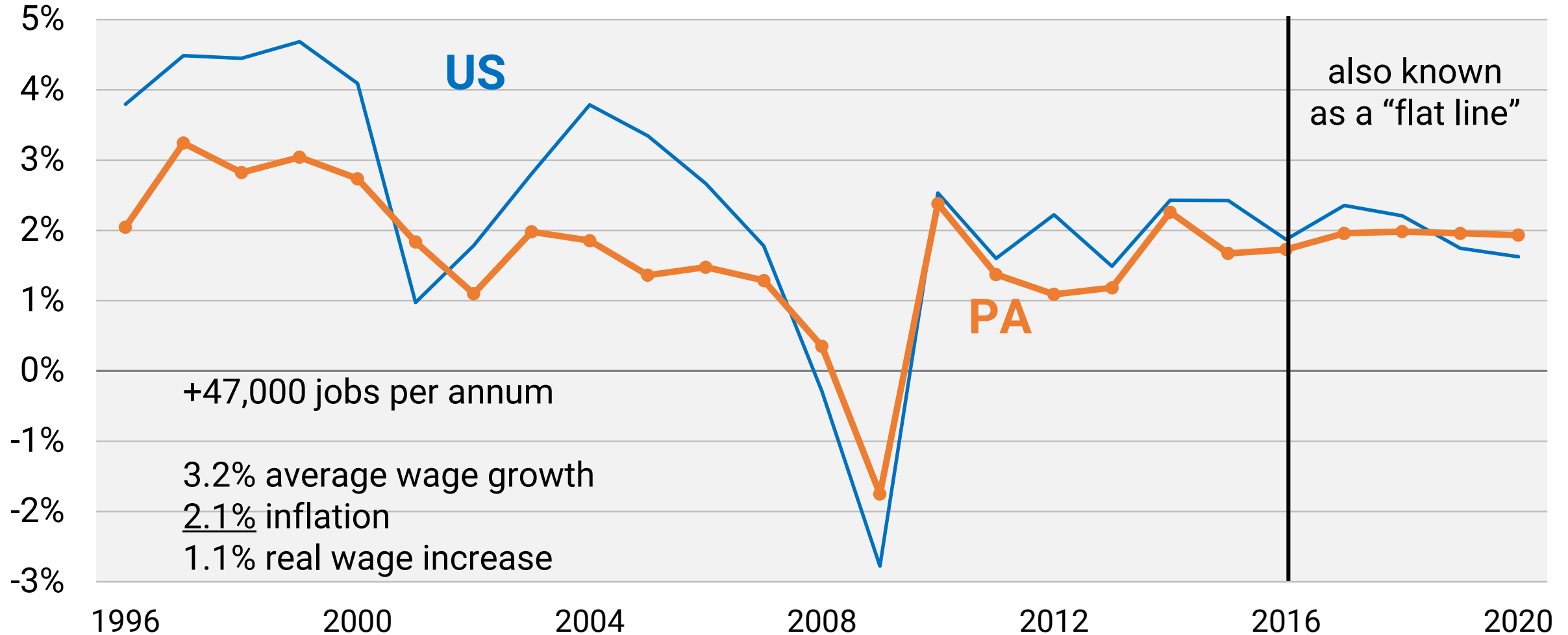
- ▶ **Theme: Short-Term Savings, but Long-Term Costs.**
  - Medicaid expansion: full phase-in of state share (10%) by 2020.
  - JUA Loan (\$200 million) and PlanCon (no appropriation this year).
- ▶ **Economy Hits Soft Patch in Third Quarter.**
  - A \$200 million hit to revenues.
  - Appears temporary. Outlook is improving.
- ▶ **Shift from MLF to General Fund (\$300 million by 21-22).**
- ▶ **Long-Term Fundamental Imbalance.**
  - After FY 2017-18, Revenues grow  $\sim +3.6\%$ , Expenditures  $\sim +4.1\%$ .
  - The  $0.5\%$  differential equal to  $\sim \$175$  million increase in deficit.

# Some Important Caveats

- ▶ **Not Exactly a Forecast. A Controlled Simulation.**
  - What happens if PA economy has “normal” growth?
  - Assumes no recession over next five years.
- ▶ **No New State or Federal Policy Changes.**
  - But, the Governor must bring budget into balance.
  - What about the federal government? Taxes? ACA?
- ▶ **“Discretionary” Spending Grows With Inflation.**
  - Need not happen. It is an assumption.
  - Policymakers control that outcome.

# Converge to “Normal” Economic Growth

## Real GDP Growth



# Demographic Outlook

Projections from the Pennsylvania State Data Center  
Official State Demographer  
Based on 2015 U.S. Census Estimates

# Three Demographic Takeaways

## ▶ **No Surprise: A Rapidly Aging Population.**

- First Baby Boomers turn age 65 in 2012.
- PA is 6<sup>th</sup> oldest state based on median age (40.7 years).

## ▶ **A Surge in Retirements During the Next Decade.**

- Just starting. Labor force participation rates also climb for 65+.
- Impact on economy unclear. Productivity and wages lower?

## ▶ **New Data Suggest Int'l Migration Much Higher.**

- Domestic migration changes from positive to negative (net outflow).
- International migration into PA revised much higher.



# PA Snapshot: 2005 to 2015

Age Cohort	Number of Residents (000s)			Gain or Loss (000s)		Avg. Annual Growth	
	2005	2015	2025	2005-15	2015-25	2005-15	2015-25
0-19	3,226	3,041		-185		-0.6%	
20-39	3,122	3,257		135		0.4%	
40-59	3,622	3,484		-137		-0.4%	
60-79	1,900	2,404		504		2.4%	
80+	<u>580</u>	<u>616</u>		<u>36</u>		<u>0.6%</u>	
<b>Total</b>	<b>12,450</b>	<b>12,803</b>		<b>353</b>		<b>0.3%</b>	

Note: thousands of residents.

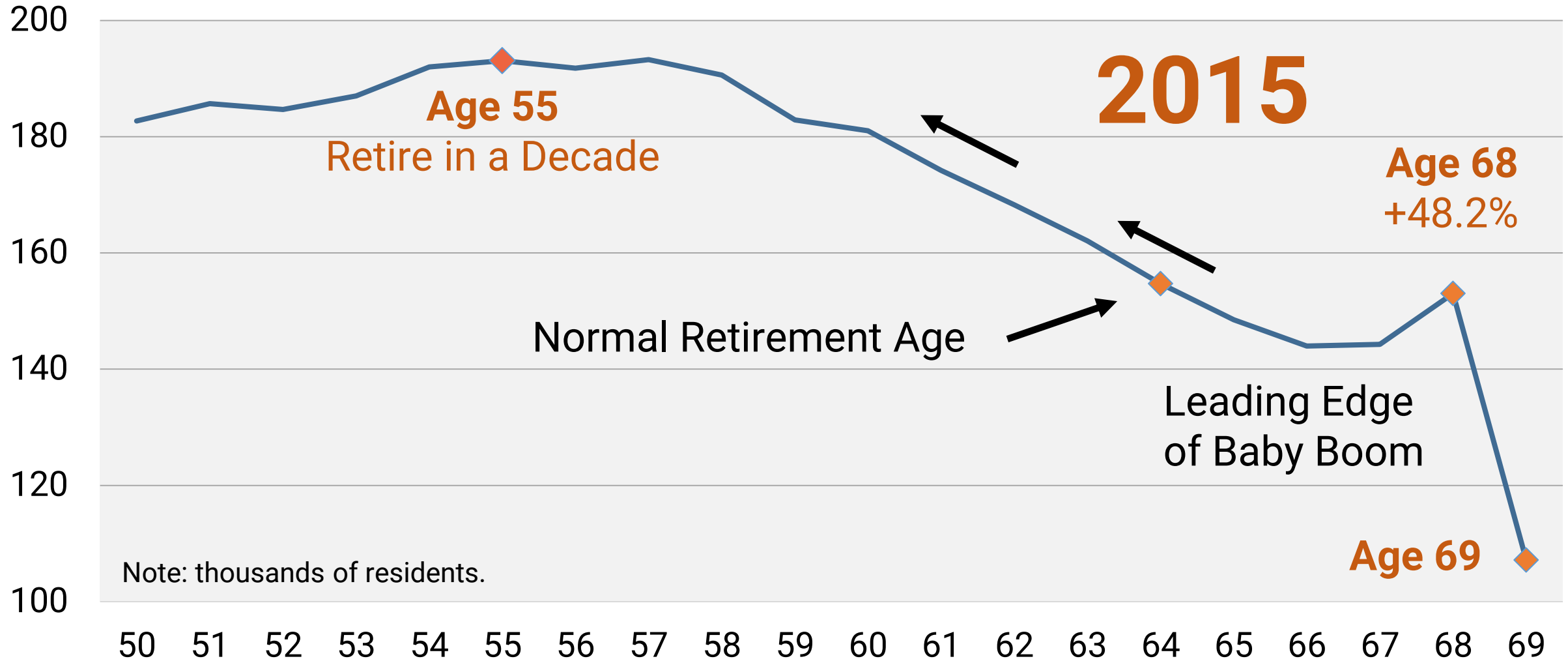
2005-10 0.4%  
 2010-15 0.1%

# PA Snapshot: 2015 to 2025

Age Cohort	Number of Residents (000s)			Gain or Loss (000s)		Avg. Annual Growth	
	2005	2015	2025	2005-15	2015-25	2005-15	2015-25
0-19		3,041	3,018		-23		-0.1%
20-39		3,257	3,432		175		0.5%
40-59		3,484	3,095		-389		-1.2%
60-79		2,404	3,019		615		2.3%
80+		<u>616</u>	<u>712</u>		<u>96</u>		<u>1.5%</u>
<b>Total</b>		<b>12,803</b>	<b>13,276</b>		<b>473</b>		<b>0.4%</b>

Note: thousands of residents.

# Residents Age 50 to 69: Retirement Wave



# Migration is Crucial to Growth

	2015-20	2020-30	2030-40	2015-40
<b>Start of Decade or Period</b>	<b>12,803</b>	<b>13,041</b>	<b>13,506</b>	<b>12,803</b>
Births less Deaths	72	57	-82	46
Net Domestic Migration	-30	-64	-66	-159
Net International Migration	<u>196</u>	<u>473</u>	<u>577</u>	<u>1,246</u>
<b>End of Decade or Period</b>	<b>13,041</b>	<b>13,506</b>	<b>13,935</b>	<b>13,935</b>

Note: thousands of residents.

# Regional Population Comparison

	Levels (000s) and Growth			Shares and Median Age		
	2010	2015	AAGR	< 20	65+	Median
Delaware	900	946	1.0%	24.3	17.0	40.0
Virginia	8,026	8,383	0.9	25.0	14.2	37.8
Maryland	5,788	6,006	0.7	25.0	14.1	38.4
New York	19,403	19,796	0.4	23.9	15.0	38.3
New Jersey	8,804	8,958	0.3	24.8	15.0	39.6
Ohio	11,541	11,613	0.1	25.3	15.9	39.3
Pennsylvania	12,712	12,803	0.1	23.8	17.0	40.7
West Virginia	1,854	1,844	-0.1	23.0	18.2	42.1
U.S.	309,347	321,419	0.8	25.6	14.9	37.8

Note: AAGR is average annual growth rate.

# Domestic Migration: 2014-15 IRS Data

		Inflow to PA	Outflow from PA	Change	
New Jersey	Net Inflows also from RI, CT, MS	20,147	15,610	4,537	
New York		20,049	14,750	5,299	
Maryland		9,371	8,542	829	
West Virginia		2,268	2,194	74	
Virginia		5,546	6,742	-1,196	
Ohio		5,405	6,484	-1,079	
Delaware		4,262	5,547	-1,285	
Florida		9,671	18,180	-8,509	
California		5,230	7,113	-1,883	
Texas		7,013	8,509	-1,496	
North Carolina	FY 2012-13	-21,578	4,484	6,775	-2,291
All Other	FY 2013-14	-26,482	<u>31,722</u>	<u>41,156</u>	<u>-9,434</u>
<b>Total</b>		<b>125,168</b>	<b>141,602</b>	<b>-16,434</b>	

# Economic Outlook

Projections by IFO

U.S. Bureau of Labor Statistics  
U.S. Bureau of Economic Analysis

# Long-Term PA Economic Forecast

Economic Metric	Average Annual Growth Rates		
	2004-10	2010-16	2016-22
Real GDP	0.8%	1.6%	1.9%
Wages and Salaries	2.8%	3.3%	3.9%
Philadelphia CPI-U	2.5%	1.2%	2.1%
Payroll Job Gains (000s)	-3.8	43.3	47.5



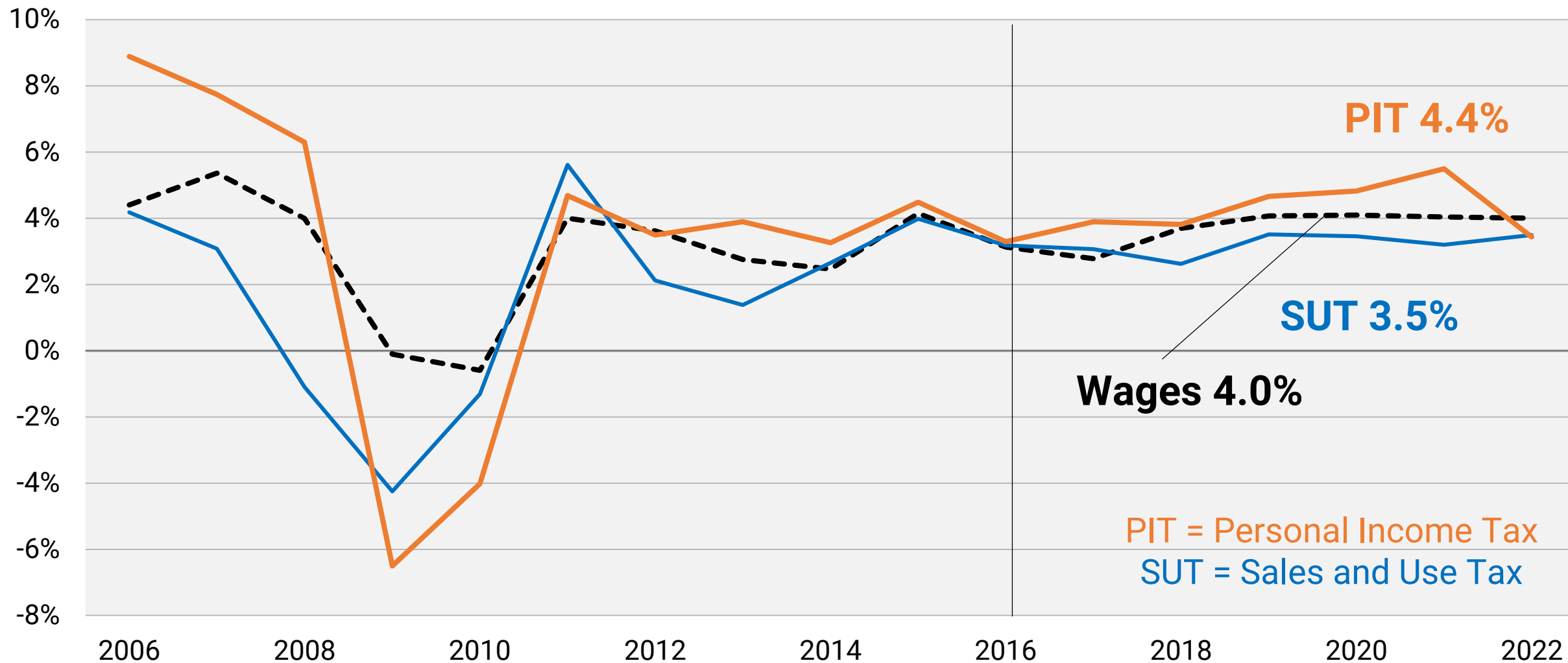
# PA Annual Growth Rates

	2013	2014	2015	2016	2017	2018	2019
Real GDP	1.2%	2.3%	1.7%	1.7%			
Wages and Salaries	1.8%	3.9%	4.0%	2.7%			
Average Wage	1.6%	3.1%	3.1%	1.9%			
Philadelphia CPI-U	1.2%	1.3%	-0.1%	0.6%			
Job Gains (000s)	14.7	47.6	48.6	44.3			

# PA Annual Growth Rates

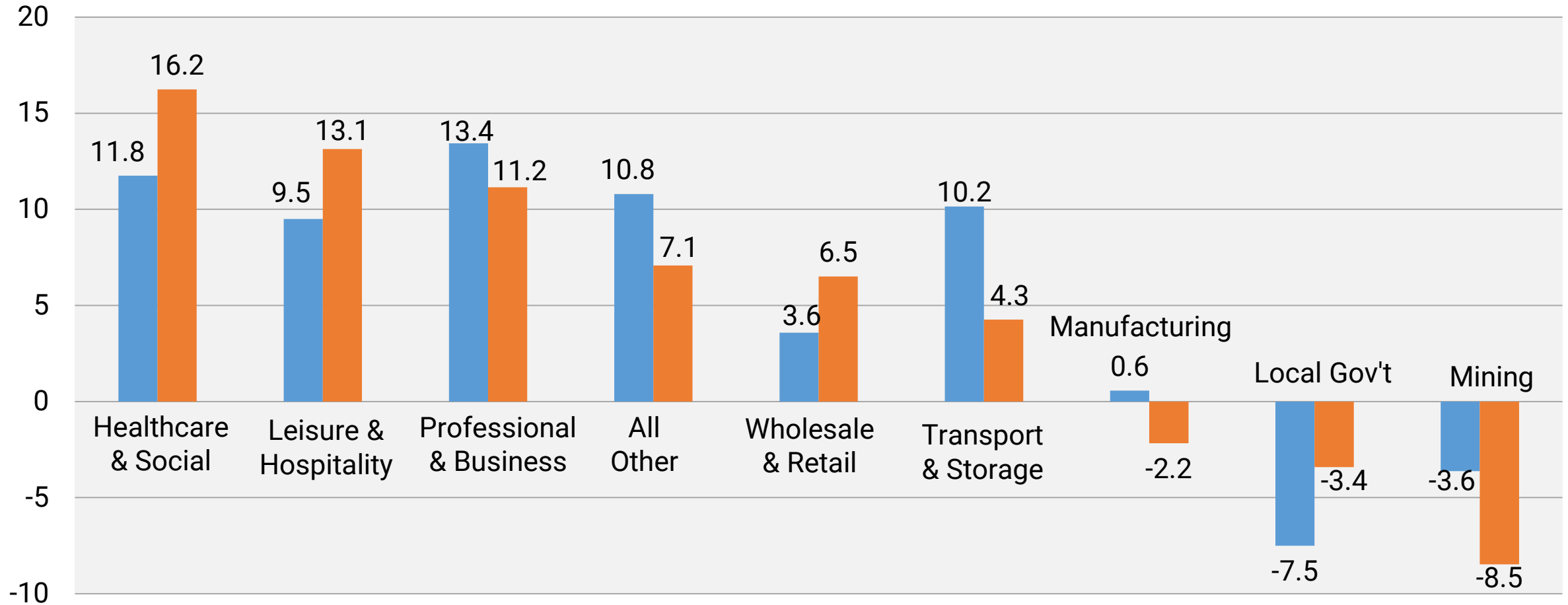
	2013	2014	2015	2016	2017	2018	2019
Real GDP				1.7%	2.0%	2.0%	2.0%
Wages and Salaries				<b>2.7%</b>	3.3%	4.0%	4.1%
Average Wage				1.9%	2.5%	3.2%	3.3%
Philadelphia CPI-U				0.6%	1.5%	2.1%	2.2%
Job Gains (000s)				<b>44.3</b>	50.0	48.9	47.8

# Growth Rate: Wages, PIT and SUT



# Service Sector Drives Job Gains (000s)

■ 2015 ■ 2016



# Long Run Growth Rate Discrepancy

Average Growth Rates | FY 2017-18 to FY 2021-22

<u>Revenue</u>	<u>Growth</u>
Pers. Income	4.6%
Corporate Net	4.3%
Sales-Use	3.4%
All Other	2.7%
Cigarette	<u>-3.4%</u>
<b>TOTAL</b>	<b>3.6%</b>

**0.5% Differential**

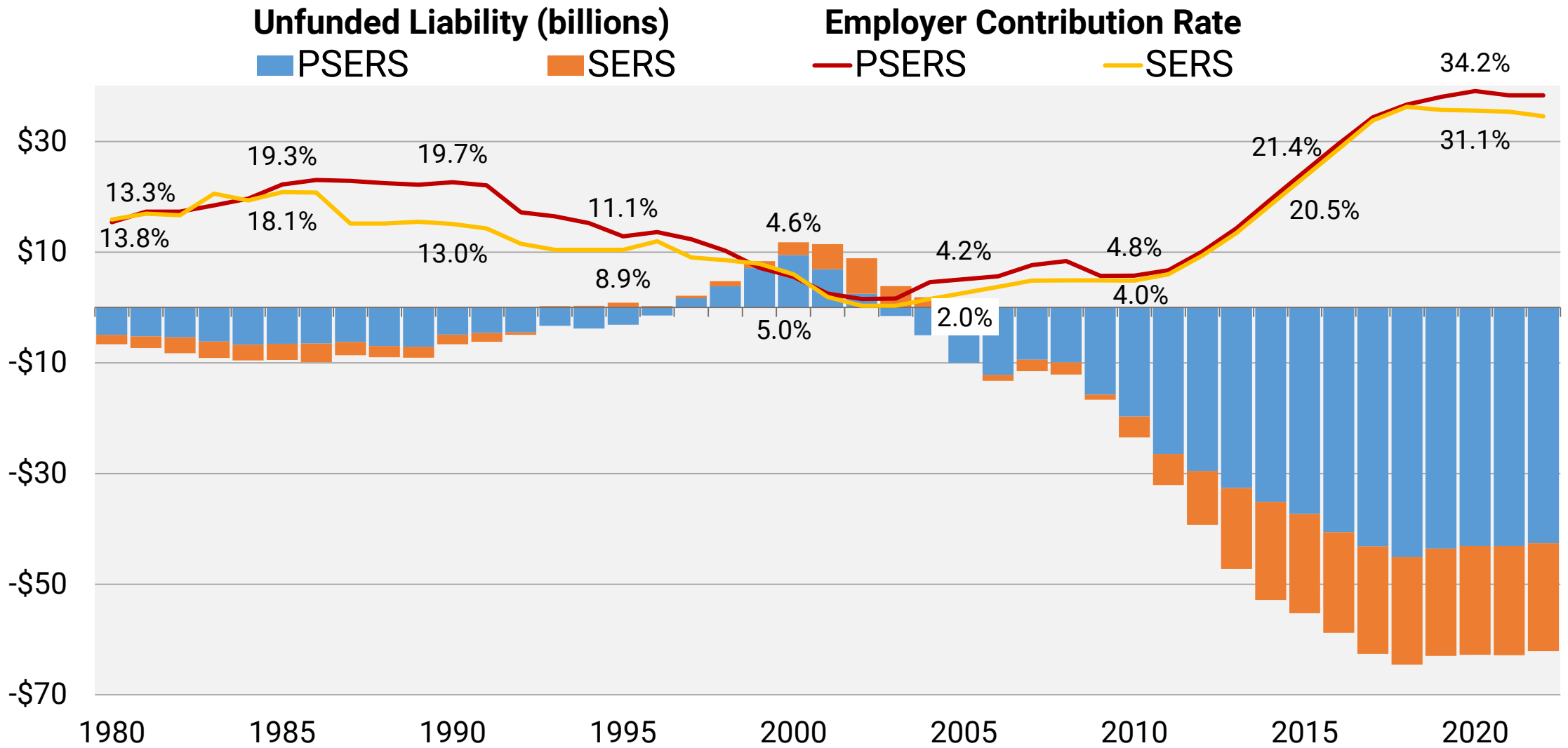
+\$175 million per annum

+\$65 million MLF shift

+\$240 million deficit growth

<u>Agency</u>	<u>Growth</u>
DHS	5.1%
Debt	4.5%
Other	3.5%
Education	3.3%
Corrections	<u>3.2%</u>
<b>TOTAL</b>	<b>4.1%</b>

# Pensions



# Our Guest Speaker

## ▶ **Dr. Don Boyd | Director of Fiscal Studies**

- Rockefeller Institute of Government

## ▶ **Background**

- Ph.D. in economics from Rensselaer Polytechnical Institute
- Over three decades experience analyzing state/local fiscal issues.  
Previous positions:
  - State Budget Crisis Task Force, Executive Director
  - New York State, Director of Economic and Revenue Analysis
  - New York State, Assembly Ways and Means Committee, Director

# Fiscal Outlook Overview

- ▶ **Expenditures: current policy / current services.**
  - FY 2016-17 appropriations serve as the base for extrapolation.
  - Out-year projections are adjusted for the appropriate inflation factor and growth in service populations.
  - Adjustments for expenditures not reflected in the base year.
- ▶ **Special fund forecasts and General Fund impact.**
- ▶ **Revenues: current law with IFO economic and demographic assumptions.**
  - Base revenue growth adjusted for policy changes.



# General Fund Expenditure Extrapolators

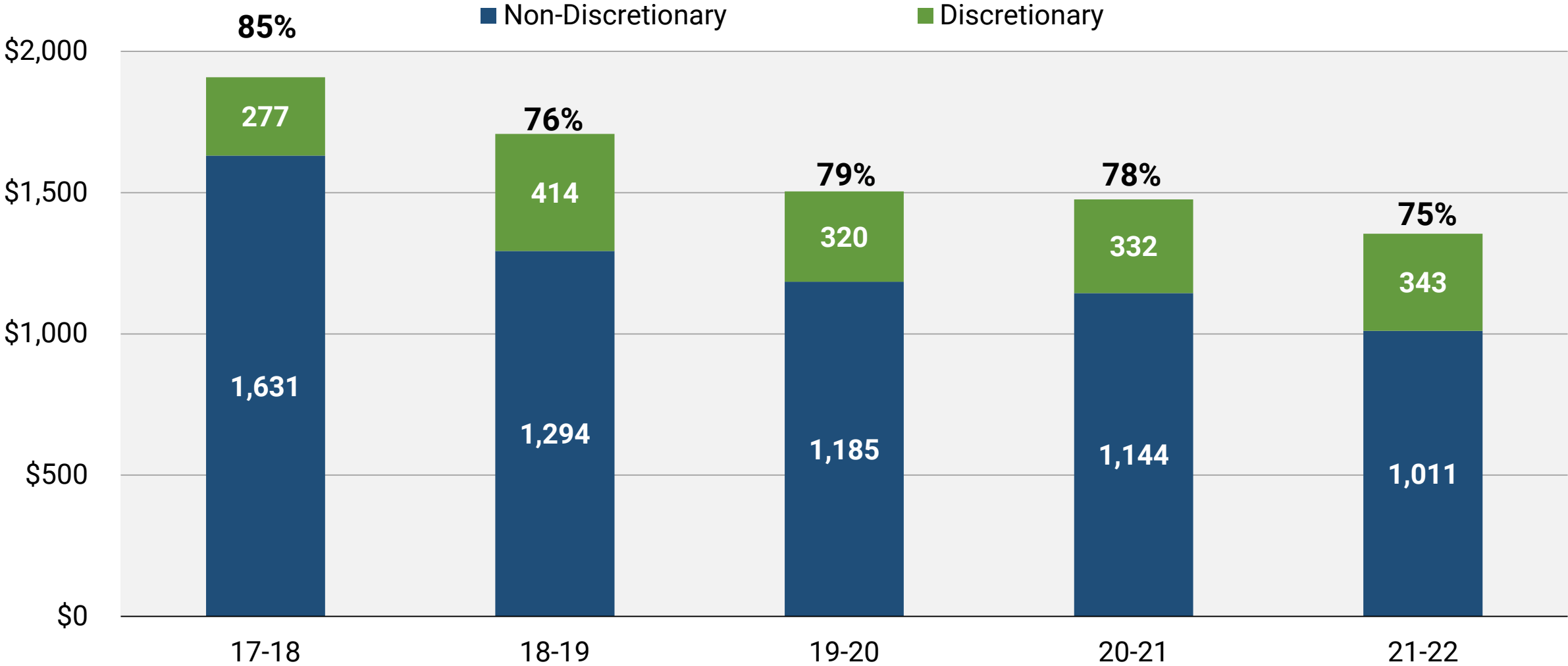
	17-18	18-19	19-20	20-21	21-22
<b>Demographic Groups</b>					
Age 5 to 14	-0.3%	-0.3%	-0.3%	-0.4%	-0.4%
Age 20 to 24	0.1	0.4	0.7	1.0	1.3
Age 20 to 64	-0.3	-0.3	-0.3	-0.2	-0.2
Age 65 and Older	2.8	2.8	2.8	2.7	2.7
All Residents	0.4	0.4	0.4	0.4	0.4
<b>Personnel Expenses</b>					
Wages	3.0	4.0	3.5	3.5	3.5
Pensions - SERS	7.5	-1.5	-0.3	-0.7	-2.1
Retiree Healthcare	5.0	5.2	5.3	5.3	5.3
Healthcare Benefits	3.3	3.7	3.7	3.7	3.7
Non-Personnel Expenses	1.8	2.2	2.2	2.2	2.2

Source: Demographic projections from the Pennsylvania State Data Center. Other forecasts by IFO.

# Non-Discretionary Expenditures

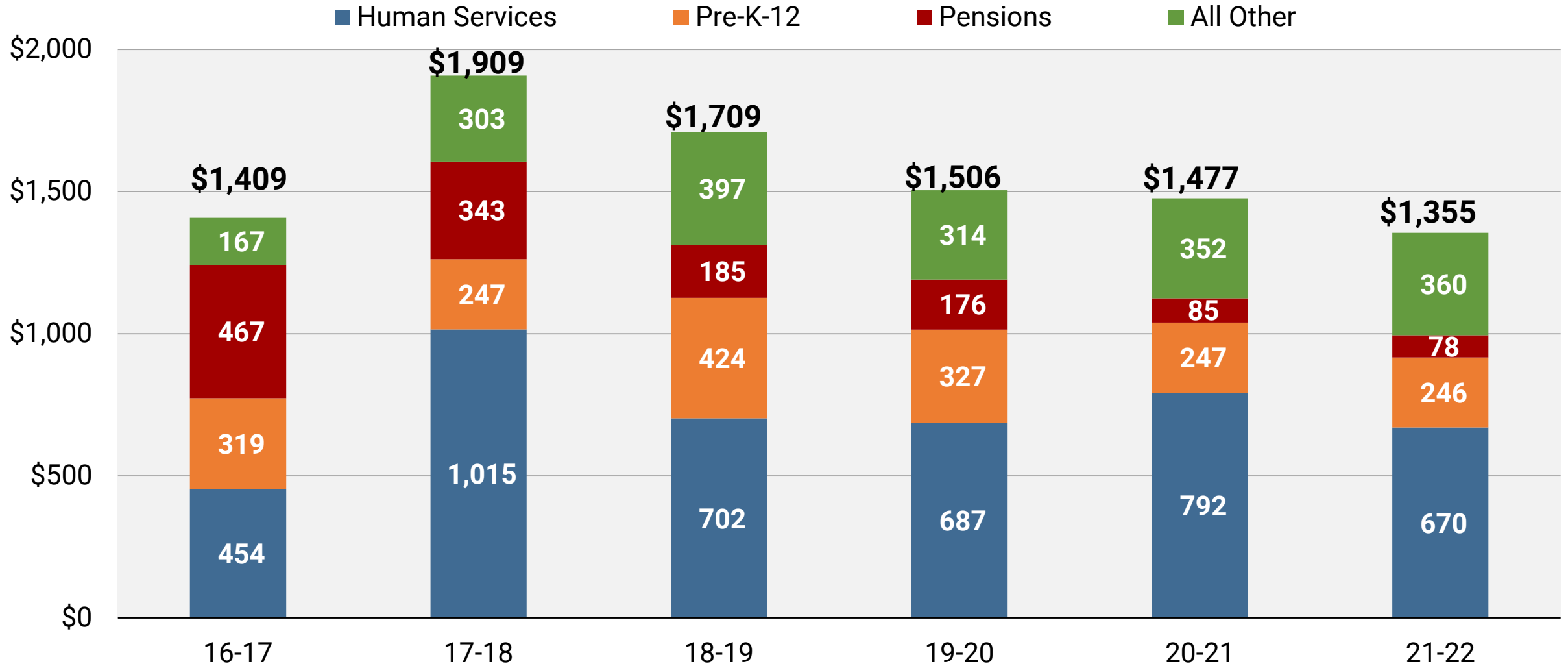
- ▶ **Non-discretionary expenditures are mandated by federal law, constitutionally required or not easily changed.**
  - Includes the cost-to-carry (mandatory spending) and additional expenditures over which policymakers exercise limited control.
  - Includes human services, public safety, debt service, statutory funding shifts, pensions and employee compensation.
- ▶ **Remaining expenditures classified as discretionary.**
  - Includes agency operations and the basic and special education subsidies.

# Discretionary vs. Non-Discretionary



Note: figures in dollar millions.

# Contributions to Expenditure Growth



Note: figures in dollar millions.

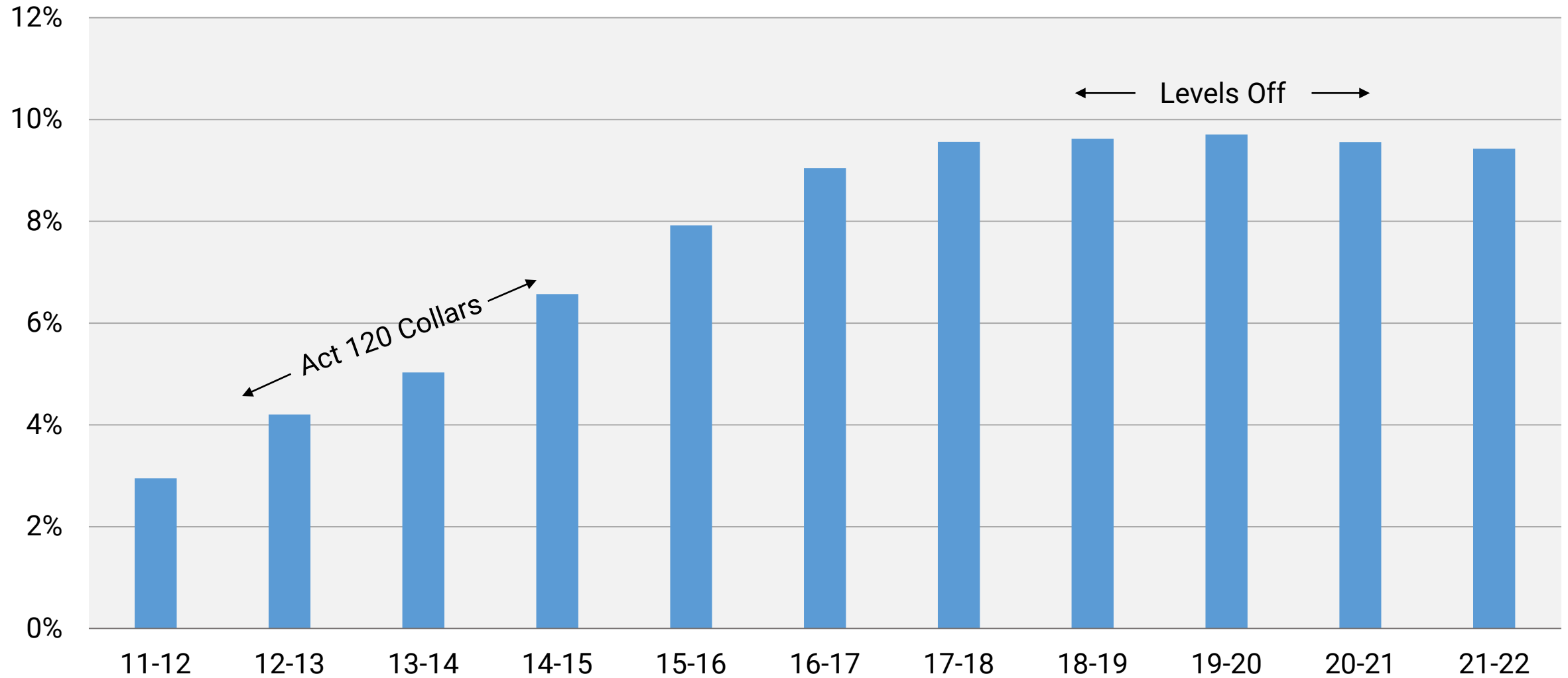
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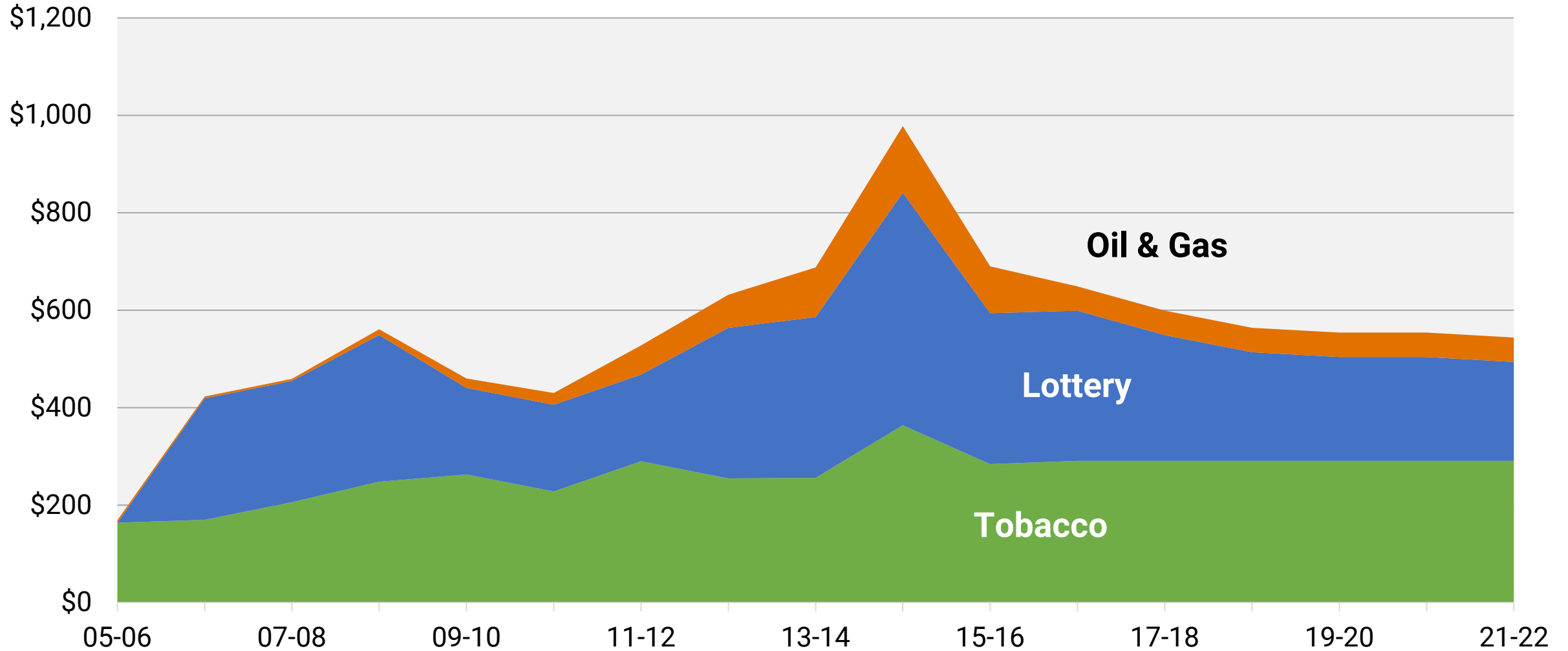
# Growth in Human Services Expenditures

- ▶ **Healthcare inflation and growth in the 60+ population.**
- ▶ **Federal programs require additional state funds.**
  - Medicare Part B premiums for individuals also eligible for Medicaid.
  - Medicare Part D prescription drug clawbacks.
  - Federal share of Medicaid expansion phases down from 100% to 90%.
- ▶ **Lottery Fund cannot sustain current support for DHS.**
- ▶ **Replacement of one-time receipts in FY 2016-17.**
- ▶ **Does not include potential supplemental expenditures.**

# Pensions Share of GF Expenditures



# Special Funds that Support the GF



Note: figures in dollar millions.

11/15/2016

# Lottery Fund Balance Sheet

	15-16	16-17	17-18	18-19
Beg. Balance	\$15	\$26	\$41	\$12
P/Y Reserve	75	75	0	0
Net Ticket Sales	1,877	1,847	1,903	1,941
Aging	-531	-574	-592	-611
Revenue	-843	-846	-894	-911
Transportation	-182	-179	-188	-197
Human Services	-310	-308	-258	-223
C/Y Reserve	-75	0	0	0
Ending Balance	26	41	12	11

Note: figures in dollar millions.

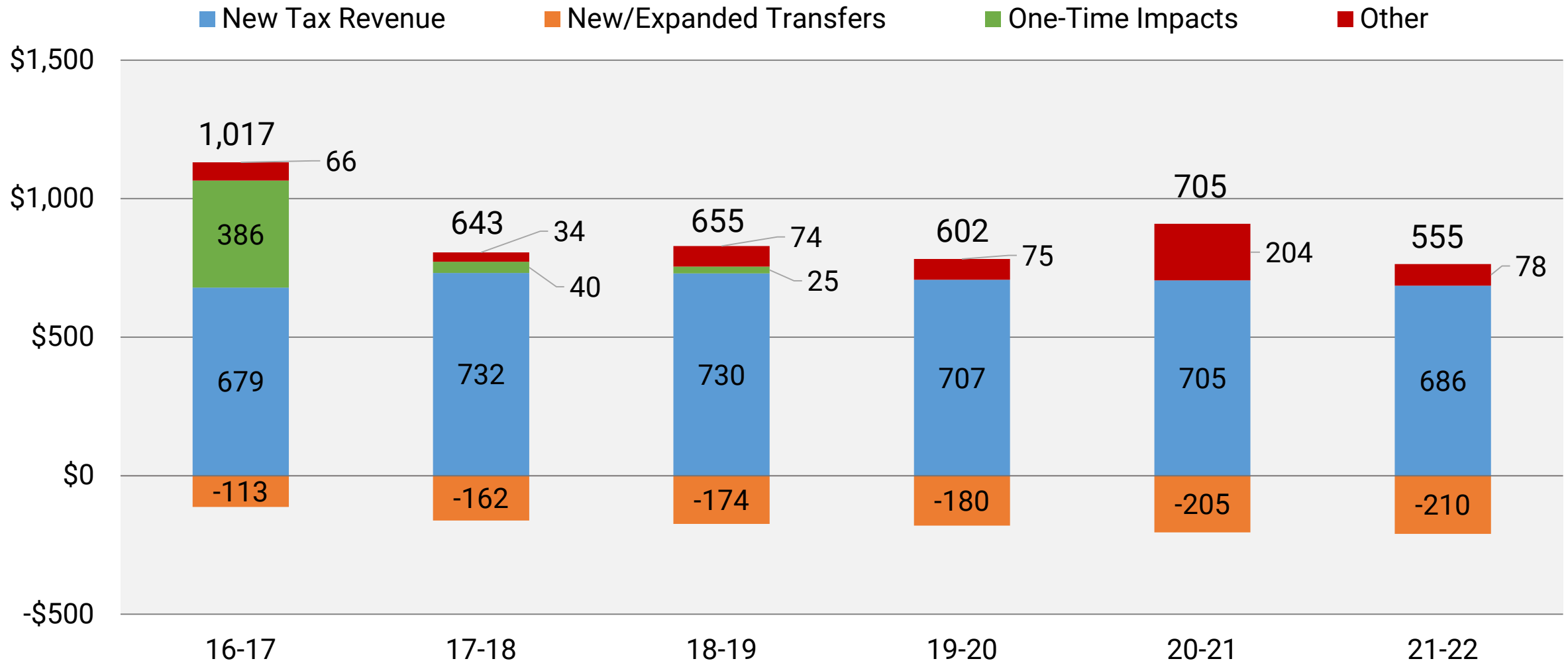


# Revenues – Base Growth Rates

	16-17	17-18	18-19	19-20	20-21	21-22
Tax Revenue	2.8%	3.2%	3.6%	3.8%	3.7%	3.7%
CNI	3.4	3.2	3.9	3.6	3.8	4.7
SUT	2.5	3.3	3.5	3.4	3.3	3.5
PIT	4.2	4.1	4.6	4.8	4.6	4.3
Other Tax	-0.5	0.8	1.0	1.6	1.7	1.9

Note: Base growth rates exclude the revenue impact of recent tax law changes that affect the tax base, various transfers and tax credits, as well as temporary revenues attributable to tax amnesty.

# Adjustments to Base Revenues



Note: figures in dollar millions.

11/15/2016



# Long-Term Structural Imbalance

## General Fund Balance Sheet

	15-16	16-17	17-18	18-19	19-20	20-21	21-22
Beginning Balance	\$257	\$2	--	--	--	--	--
Available Revenue	29,652	30,936	\$31,596	\$32,796	\$33,954	\$35,283	\$36,406
State Expenditures	<u>-30,127</u>	<u>-31,535</u>	<u>-33,443</u>	<u>-35,151</u>	<u>-36,655</u>	<u>-38,131</u>	<u>-39,486</u>
Current Year Balance	-476	-599	-1,846	-2,355	-2,701	-2,849	-3,080
Adjustment for Lapses	<u>221</u>	<u>75</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
<b>Preliminary Ending Balance</b>	<b>2</b>	<b>-524</b>	<b>-1,746</b>	<b>-2,255</b>	<b>-2,601</b>	<b>-2,749</b>	<b>-2,980</b>

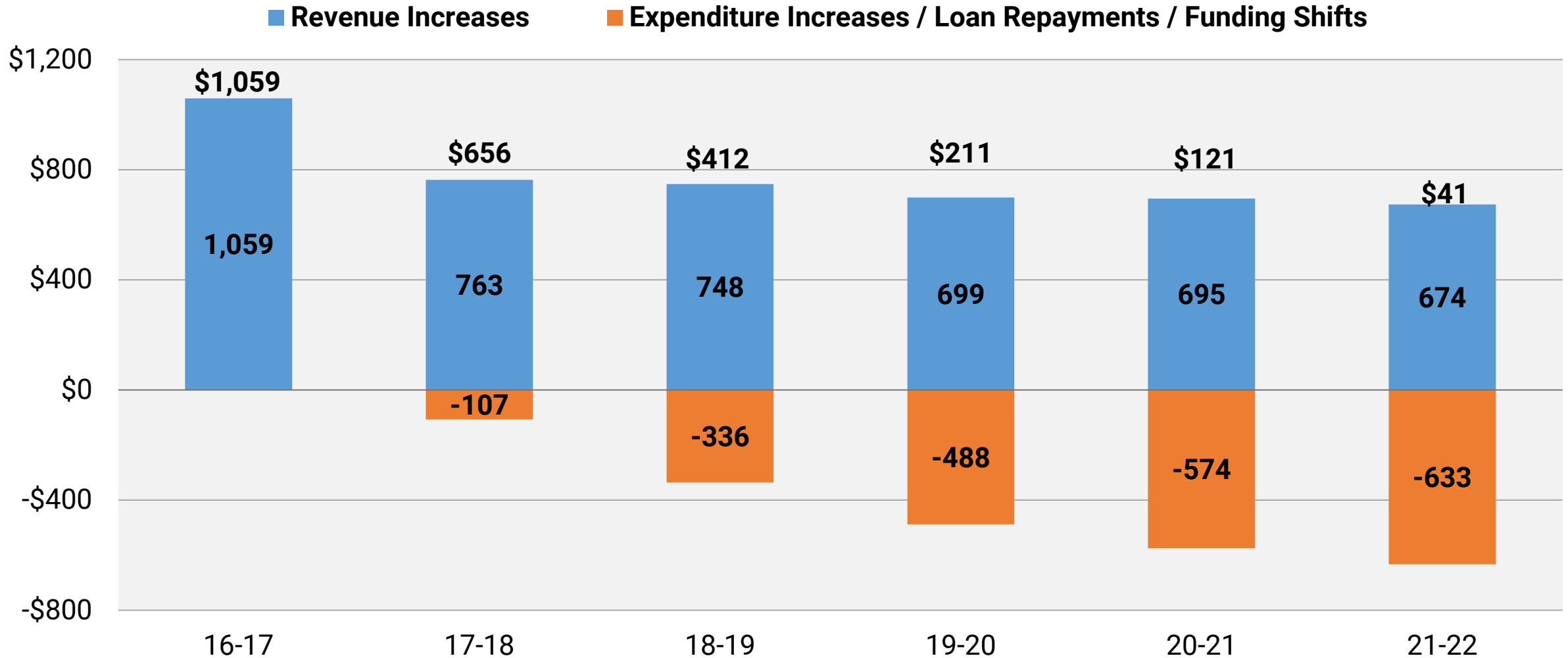
Note: figures in dollar millions.

# Balance Sheet Comparison

	15-16	16-17	17-18	18-19	19-20	20-21
Net Revenue & Lapses	\$276	\$806	\$303	\$331	\$308	\$418
Expenditures	54	530	130	-201	-282	-537
<b>Change in Deficit</b>	<b>320</b>	<b>1,336</b>	<b>434</b>	<b>131</b>	<b>26</b>	<b>-120</b>

Notes: figures in dollar millions. Represents change between January 2016 and November 2016 reports. A negative figure indicates an increase in the projected deficit.

# Impact of Recent Policy Changes



Note: figures in dollar millions.

11/15/2016

# Long-Term Outlook Summary

- ▶ **Main elements driving the structural imbalance are unchanged.**
  - Demographic trends affect revenues and expenditures.
  - Slow tax base erosion and modest revenue growth.
  - Non-discretionary spending continues to drive expenditure growth.
- ▶ **Recent policy changes reduced the short-term deficit, but the long-term imbalance remains.**