

Commonwealth of Pennsylvania

ECONOMIC & BUDGET OUTLOOK

Fiscal Years 2019-20 to 2024-25

Independent Fiscal Office | November 2019



Welcome

Katherine Loughead | Tax Foundation

- Modernizing PA Tax Code as a Strategy for Growth

Matt Gardner | Institute for Taxation & Economic Policy

- Business Taxation and Sustainable Economic Development

Matthew Knittel | Independent Fiscal Office

- Pennsylvania demographic, economic and fiscal outlook
- *Questions for all presenters to be taken at end of session*

Economic Development and Business Taxation

30 states perform some form of annual tax credit review

- PA is one of 16 “leading” states (Pew, Aug 2019)

Since 2008, states make fundamental changes to business taxes

- 15 states reduce corporate net income rate (3 increase)
- 7 states have enacted mandatory combined reporting
- 19 reduce personal income tax rate on pass-throughs (9 increase)

Intense competition for increasingly mobile businesses

- Tax rates, exemptions, tax credits, loans, subsidies, grants, abatements

Guest Presentations

Guest presentations posted separately

Four Critical Assumptions

PA Labor force expands despite decline in 20-64 year olds

- Labor force participation rates must continue to increase

Moderate growth of personnel cost drivers after FY 19-20

- Personnel costs are 13% of state budget (excludes PSERS)

State economy operates at long-term potential | No recession

- Real GDP +1.8% | Wages-Salaries +3.9% | CPI-U +2.0%

No future use of one-time shifts, delays or new funding sources

Demographic Outlook

Outlook is unchanged – modest or no growth in state population

- 2016: +0.0% | 2017: +0.0% | 2018 +0.1%
- Birth rates continue to decline

Some change in migration patterns

- International in-migration declines | So does domestic out-migration
- Majority of in-migrants from border states

Continued dramatic change in age composition

- School Age and Working Age cohorts continue to contract
- Retirement wave continues | Begin to see dramatic increase in age 80+

PA Population Snapshots

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%	1.6%
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 Migration Snapshots

Age Group	Total 2018	State	Domestic 2017
0 to 19	28,921	New Jersey	13,821
20 to 24	-20,289	New York	11,179
25 to 39	12,014	Maryland	2,806
40 to 49	2,275	Texas	-5,980
50 to 59	-894	North Carolina	-6,064
60 to 69	-4,660	Virginia	-7,705
70 to 79	-1,706	Florida	-15,847
80 or older	<u>-188</u>	All Other	<u>-19,636</u>
Total	15,473	Total	-27,426

Source: U.S. Census Bureau. American Community Survey and U.S. Census Bureau, Population Estimates.

Economic Outlook

U.S. and PA year-over-year 2019 wage growth remains strong

- U.S. at +4.1% | PA at +4.5% (prelim)
- PA wage growth highest since 2007 | Lowest UE rate on record

PA labor market shows signs of slowing

- Minor deceleration of wage growth in 2019 Q3 (prelim)
- Net job gains down notably from last year (very prelim)

Other state fundamentals remain in good shape

- Home sales sluggish, but solid price gains
- Consumer debt picks up in first half of 2019 (+4.3%)

PA Economic Forecast

	Annual Growth Rates or Change					
	2016	2017	2018	2019	2020	2021
Real GDP	1.1%	1.7%	2.1%	1.9%	1.5%	1.7%
Wages and Salaries	1.3%	4.0%	4.0%	4.5%	3.6%	3.8%
Philadelphia CPI-U	0.6%	1.3%	1.3%	1.8%	1.5%	1.8%
Net Payroll Jobs (000s)	48.8	58.8	65.6	52.0	45.4	45.8

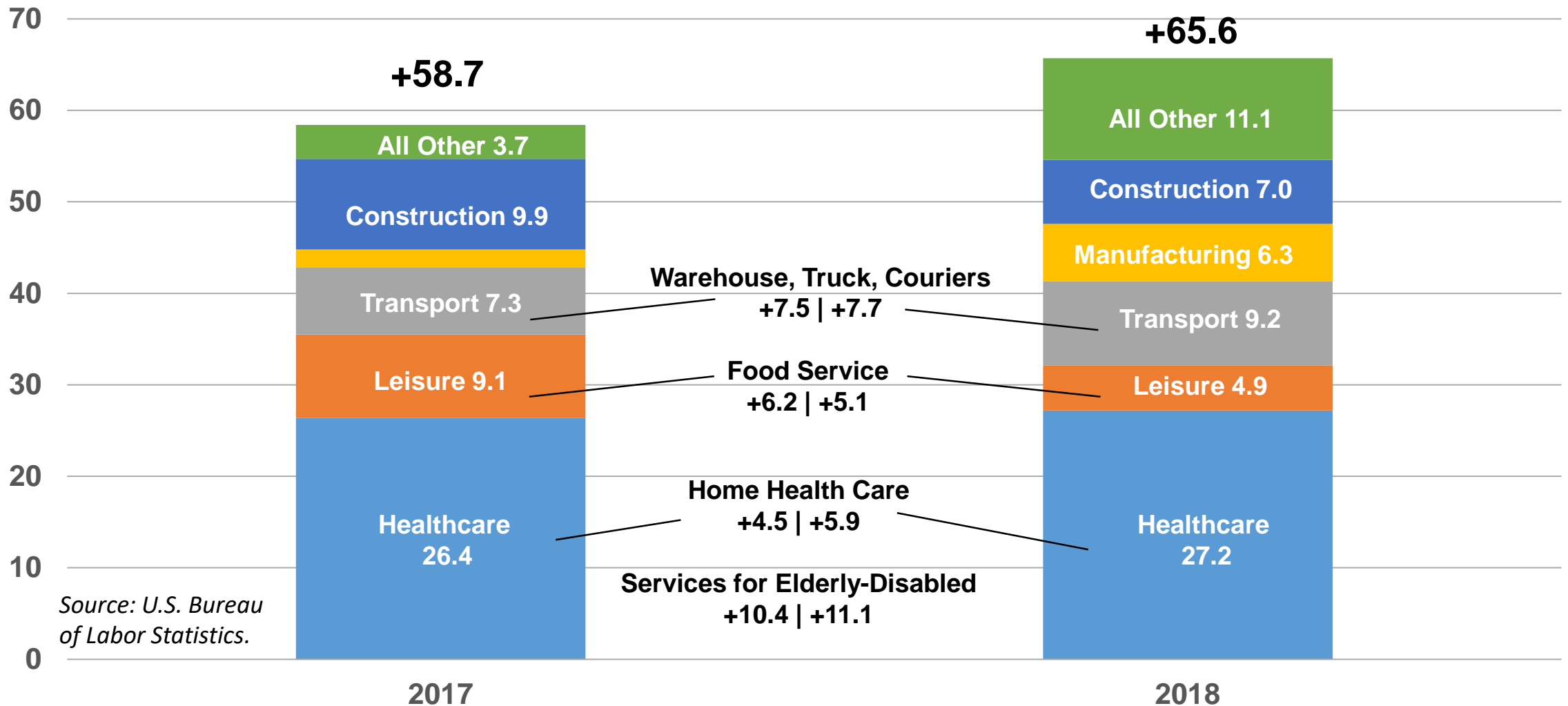
Source: Historical data from the U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.

PA Real Time Economic Indicators

Quarterly Data	Year-Over-Year Growth Rate or Change				
	2018.3	2018.4	2019.1	2019.2	2019.3
Real GDP	2.0%	2.6%	3.2%	---	---
Total Wage Growth	4.3%	3.2%	4.5%	5.0%	4.8%
Job Gains (000s, ann rate)	65.0	56.7	45.4	49.5	37.2
Monthly Data	May	June	July	Aug	Sept
Zillow PA Home Sales	2.1%	-7.7%	2.1%	-3.5%	---
Zillow PA Median Price	4.9%	5.8%	6.7%	6.8%	---
# PA Refinancings	-0.7%	60.0%	43.0%	107.0%	88.0%

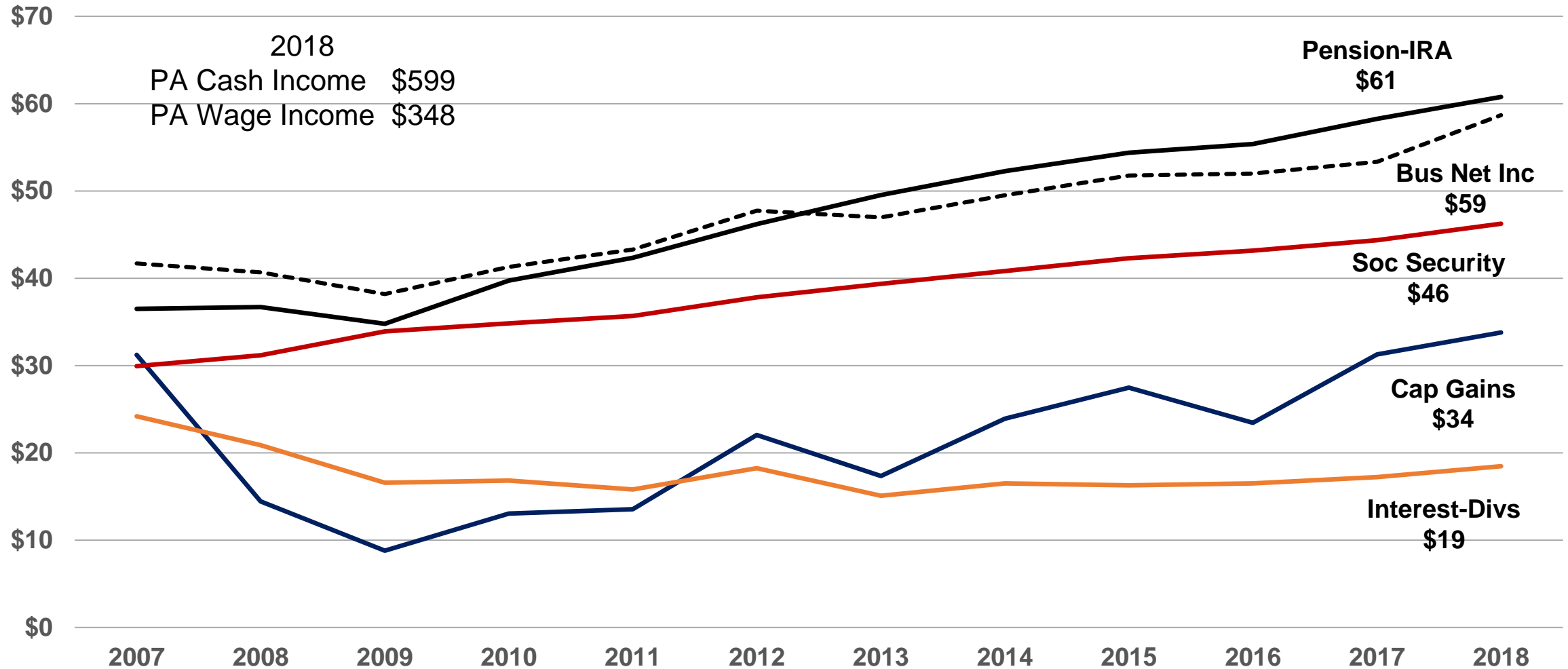
Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Housing data from Zillow. Refinancings from MBA.

Net PA Payroll Job Gains (000s)



Source: U.S. Bureau of Labor Statistics.

Paths of PA Cash Income Sources (\$ billions)



Revenue and Expenditure Outlooks

Revenues above IFO estimate by \$230 million through October

- Adding \$200m to official estimate
- Strength in sales-use, escheats and personal income non-withheld

Request for \$779 million in supplementals for FY 19-20

- DHS \$642m | Criminal Justice \$90m | PDE \$47m
- IFO assumes \$279m additional DHS supplemental

One-time measures impact FY 20-21 expenditures (\$811m)

- Managed care shift (+\$216m) | JUA Transfer (\$200m)
- Return of PlanCon costs to General Fund (+\$198m)

Revenues Through October

	Dollar Amount	Versus Estimate	Actual Growth	Adjusted Growth
Total General Fund	\$10,377	\$230	3.5%	5.2%
Corporate Net - Finals	299	58	20.4%	
Corporate Net – Estimated	610	16	-2.2%	
Sales - Non-Motor	3,320	-49	1.9%	5.4%
Sales - Motor Vehicle	550	12	4.9%	
PIT Withholding	3,472	7	2.8%	4.6%
PIT Non-Withheld	814	93	16.2%	
Non-Tax (Escheats)	124	55	19.1%	
All Other	1,189	38	-0.4%	

Big Three Drive Nearly All Revenue Gains

	Dollar Change (\$ millions)					AAGR
	20-21	21-22	22-23	23-24	24-25	
Corporate Income	\$122	\$156	\$185	\$215	\$230	4.8%
Sales and Use	404	351	-102	374	383	2.3%
Personal Income	725	542	699	675	713	4.2%
All Other	<u>34</u>	<u>50</u>	<u>83</u>	<u>116</u>	<u>96</u>	<u>1.2%</u>
Total Change	1,286	1,098	865	1,379	1,423	3.2%
New SUT Transfer	---	---	<u>477</u>	<u>491</u>	<u>505</u>	n.a.
Adjusted Amount	1,286	1,098	1,342	1,870	1,928	3.4%

Note: AAGR is average annual growth rate.

Revenue Growth Rates: Historical vs Projected

	14-15 to 19-20			19-20 to 24-25		
	Change	AAGR	Adjust	Change	AAGR	Adjust
General Fund Tax	\$5,539	3.5%	3.2%	\$6,013	3.2%	3.4%
Corporate Net	650	4.2%		909	4.8%	
NMV Sales	1,879	4.2%	3.3%	1,289	2.4%	3.1%
MV Sales	222	3.1%		120	1.5%	
Personal Income	2,529	3.9%		3,353	4.2%	
All Tobacco	156	3.2%		-220	-4.4%	
All Other	103	0.5%		562	2.5%	

Note: Millions of dollars. AAGR is average annual growth rate. Adjusted growth rates control for (1) new revenues from internet sales from FY19-20, (2) adds back a one-time SUT transfer in FY 19-20 and (3) adds back the new SUT transfer in FY 24-25.

Change in Expenditures by Agency

	Dollar Change (\$ millions)					AAGR
	20-21	21-22	22-23	23-24	24-25	
Human Services	\$1,113	\$528	\$571	\$586	\$602	4.6%
Education	556	322	337	335	331	2.5%
Criminal Justice	77	72	93	69	60	2.6%
Treasury	61	47	38	63	25	3.7%
All Other	<u>169</u>	<u>128</u>	<u>168</u>	<u>118</u>	<u>274</u>	<u>4.7%</u>
Total Spending	1,975	1,097	1,207	1,170	1,292	3.6%
<i>Growth Rate</i>	5.5%	3.0%	3.2%	3.0%	3.2%	

Note: millions of dollars. AAGR is average annual growth rate from FY 19-20 to FY 24-25. FY 19-20 includes \$779 supplemental.

General Fund Program Spend vs Revenues

	14-15	15-16	16-17	17-18	18-19	19-20	AAGR
State Funds	\$29.15	\$30.13	\$31.94	\$31.95	\$33.40	\$34.00	3.1%
Requested Supplemental	---	---	---	---	---	0.78	n.a.
Anticipated Supplemental	---	---	---	---	---	0.28	n.a.
Restricted + Augment	<u>3.58</u>	<u>3.57</u>	<u>3.70</u>	<u>4.12</u>	<u>5.21</u>	<u>4.73</u>	<u>5.7%</u>
Total General Fund	32.74	33.70	35.65	36.07	38.62	39.78	4.0%
Special Fund Offsets	0.93	0.68	0.66	0.61	0.71	0.75	-4.4%
New Revenue Transfers	---	---	<u>0.11</u>	<u>0.15</u>	<u>0.21</u>	<u>0.53</u>	<u>n.a.</u>
Adjusted Expenditures	33.67	34.38	36.41	36.84	39.53	41.06	4.0%
Net Revenues	29.25	29.65	30.32	33.23	33.55	34.45	3.3%

Note: billions of dollars. Special Funds includes Lottery, Tobacco Settlement, Oil and Gas Lease, ESF and Recycling Funds.

General Fund Financial Statement

	19-20	20-21	21-22	22-23	23-24	24-25
Current Year Revenues	\$35.72	\$37.00	\$38.10	\$38.97	\$40.35	\$41.77
Less: Refunds	<u>-1.27</u>	<u>-1.30</u>	<u>-1.34</u>	<u>-1.37</u>	<u>-1.40</u>	<u>-1.44</u>
Net Revenues	34.45	35.70	36.77	37.60	38.94	40.32
State Expenditures	-34.78	-36.75	-37.85	-39.06	-40.22	-41.52
Assumed Supplemental	-0.28					
Plus: Prior Year Lapses	<u>0.20</u>	<u>0.13</u>	<u>0.13</u>	<u>0.13</u>	<u>0.13</u>	<u>0.13</u>
Prelim Ending Balance	-0.41	-0.93	-0.96	-1.33	-1.16	-1.06
		<i>assumes no one-time shifts</i>		<i>new SUT transfer</i>		
Note: billions of dollars. Includes a requested \$779 supplemental for FY 19-20.						

Summary and Outlook

Structural deficit lower than last year's report

- Roughly \$500 million lower by final year
- Pick up from FY 18-19 revenue gains (sales, corporate net income)

Economy outperforms forecast, especially wage growth

- Had assumed +4.0% | Actual is ~+4.5%
- Translates to gains for personal income and sales taxes

What do we assume going forward?

- Is a 4.0% UE rate normal? | Will inflation/interest rates increase?
- Implications for safety net programs, healthcare, pension returns