

PENNSYLVANIA

FISCAL OUTLOOK



*The Society of Municipal Analysts
October 19, 2017*

The Independent Fiscal Office (IFO)

- ▶ **All states have a legislative fiscal office.**
 - Housed within legislature. Have governing boards.
 - The IFO is separate from the Executive and Legislature.
 - No governing board. Non-partisan vs. bi-partisan.
- ▶ **Primary duties:**
 - General Fund Revenue Estimates (May 1, June 15).
 - Five-year economic and budget outlook (November 15).
 - Pension and wage contract analysis.
 - Special studies at request of General Assembly.

A Quick Tour

▶ **Budget Status.**

- Where are we? How did we get here?

▶ **Demographic Outlook.**

- Suggests economic and budgetary challenges.

▶ **Economic Outlook.**

- Solid labor market, but consumption tepid.

▶ **Budget Outlook.**

- Revenue and expenditures. Pensions. Gaming.

General Fund Balance Sheet

	13-14	14-15	15-16	Growth Rates	
				14-15	15-16
Beginning Balance¹	\$547	\$84	\$257		
Current Year Revenues	28,607	30,593	30,902	6.9%	1.0%
Less: Refunds	<u>-1,105</u>	<u>-1,340</u>	<u>-1,250</u>	↑	
Net Revenue Available	27,502	29,253	29,652	<i>Escheats / Transfers</i>	
Less: Expenditures	-28,395	-29,153	-30,127	2.7%	3.3%
Plus: Lapses	427	91	221	↑	↑
Ending Balance	81	275	2	<i>Delay Payments</i>	
				<i>Medicaid Expansion</i>	
				<i>Eliminate PlanCon</i>	

Note: figures in dollar millions.

¹ Includes adjustments.

Source: Executive Budgets, various years.

General Fund Balance Sheet

	13-14	14-15	15-16	16-17	17-18
Beginning Balance¹	\$547	\$84	\$257	\$5	--
Current Year Revenues	28,607	30,593	30,902	31,670	\$32,491
Less: Refunds	<u>-1,105</u>	<u>-1,340</u>	<u>-1,250</u>	<u>-1,340</u>	<u>-1,280</u>
Net Revenue Available	27,502	29,253	29,652	30,330	31,211
Less: Expenditures ²	-28,395	-29,153	-30,127	-31,942	-31,996
Plus: Lapses ²	427	91	221	80	100
Ending Balance	81	275	2	-1,527	-685

Note: figures in dollar millions.
¹ Includes adjustments. Beginning balance omitted for FY 2017-18.
² Includes supplemental appropriations. For FY 2017-18, includes \$188 million moved to budgetary reserve and \$595 million in funding for higher education that has not been approved. Lapses for FY 2016-17 and FY 2017-18 are estimates.
Source: Executive Budgets, various years and IFO Official Revenue Estimate (June 2017).

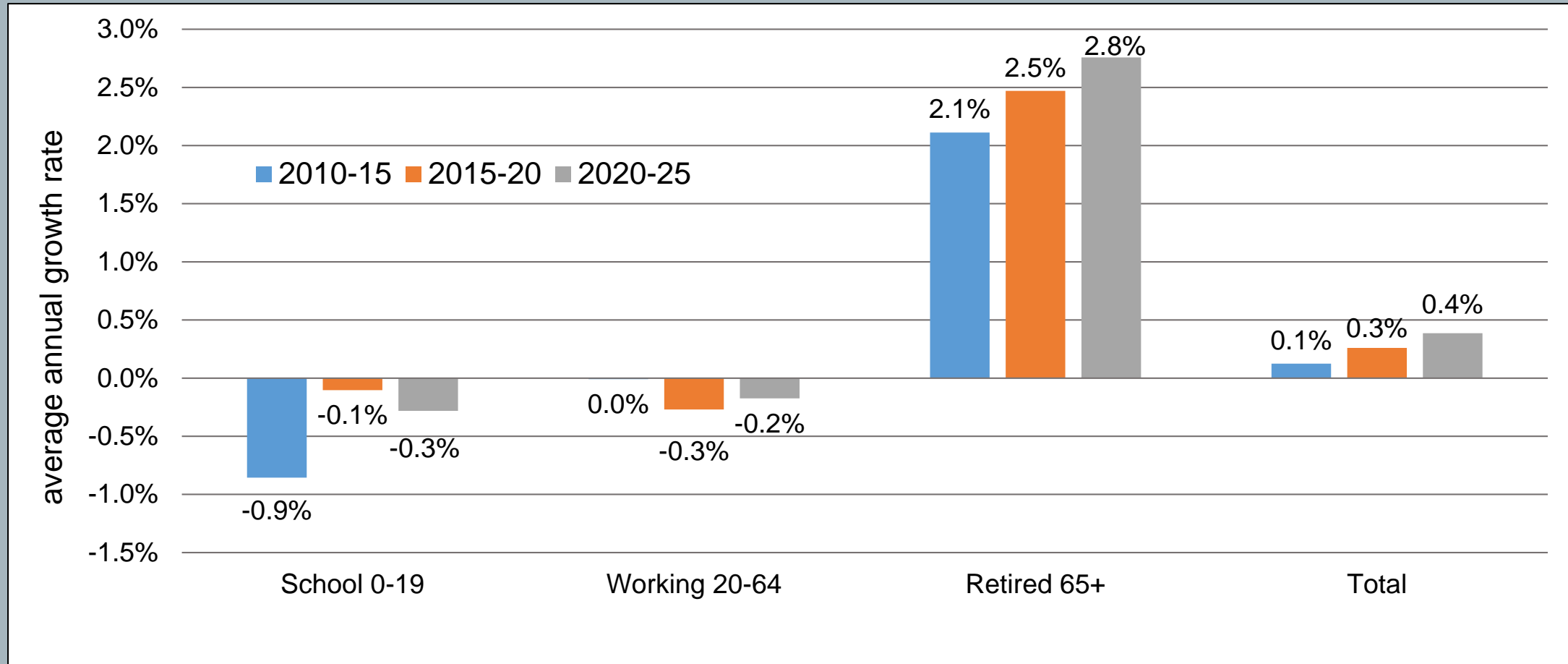
Budget Status

- ▶ **Unresolved issues for FY 2017-18.**
 - Roughly \$600m in higher education funding.
 - Cash flow constraints: Nov. thru March (up to ~\$1.7b).
 - Size of current year deficit still an estimate.
- ▶ **How to address the gaps in both years.**
 - Borrow to fill FY 2016-17 deficit? Tobacco Fund and liquor.
 - FY 2017-18: severance tax, transfers, net operating losses.
- ▶ **Revenue options are limited.**
 - Limited potential in further gaming expansion.
 - How quickly can it be implemented?

Demographics: Short- and Long-Term Issues

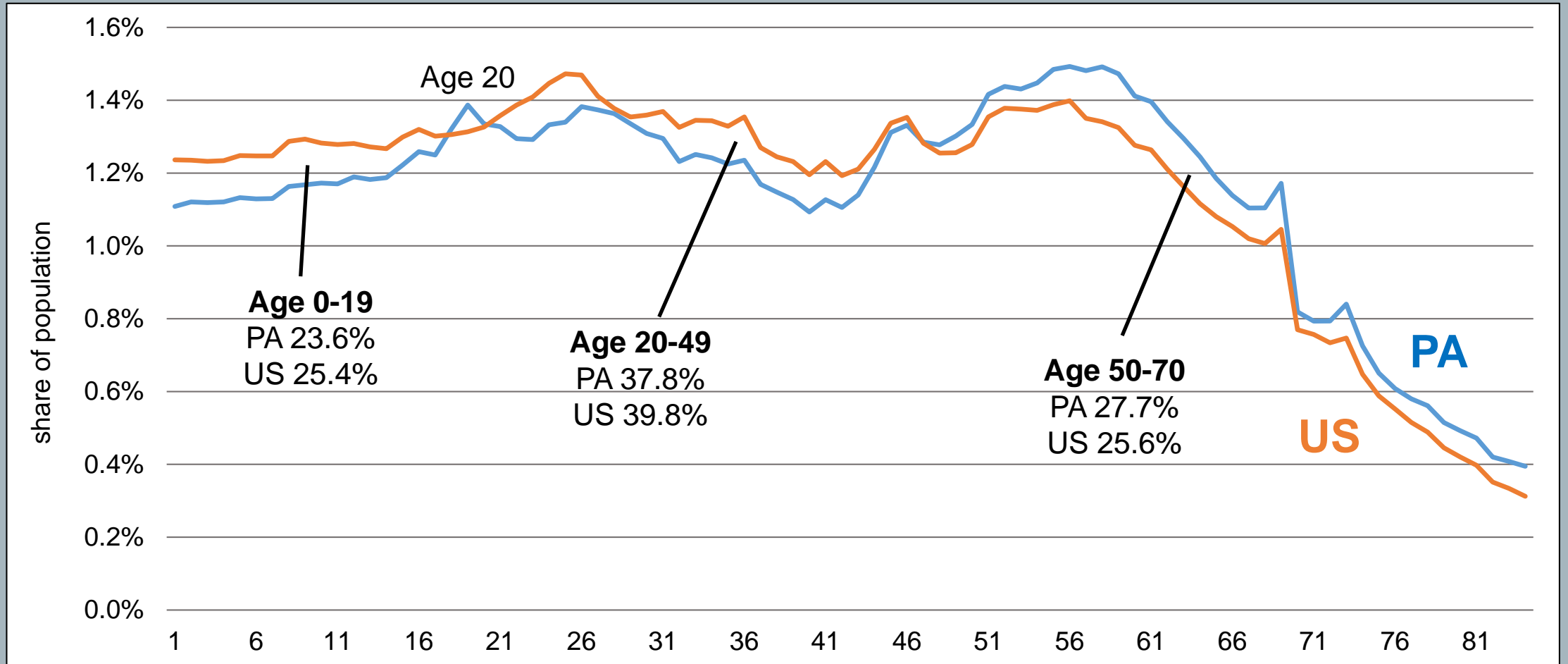
- ▶ **Near Term: <5 Years.**
 - Retirement wave accelerates.
 - Baby Boom more pronounced in PA than US.
- ▶ **Mid-Term: 5 - 10 Years.**
 - Labor force may contract.
 - Tax burden falls on smaller cohort.
- ▶ **Long-Term: 10+ Years.**
 - Deaths exceed births.
 - Heavily dependent on international migration.

Past, Present and Future Trends



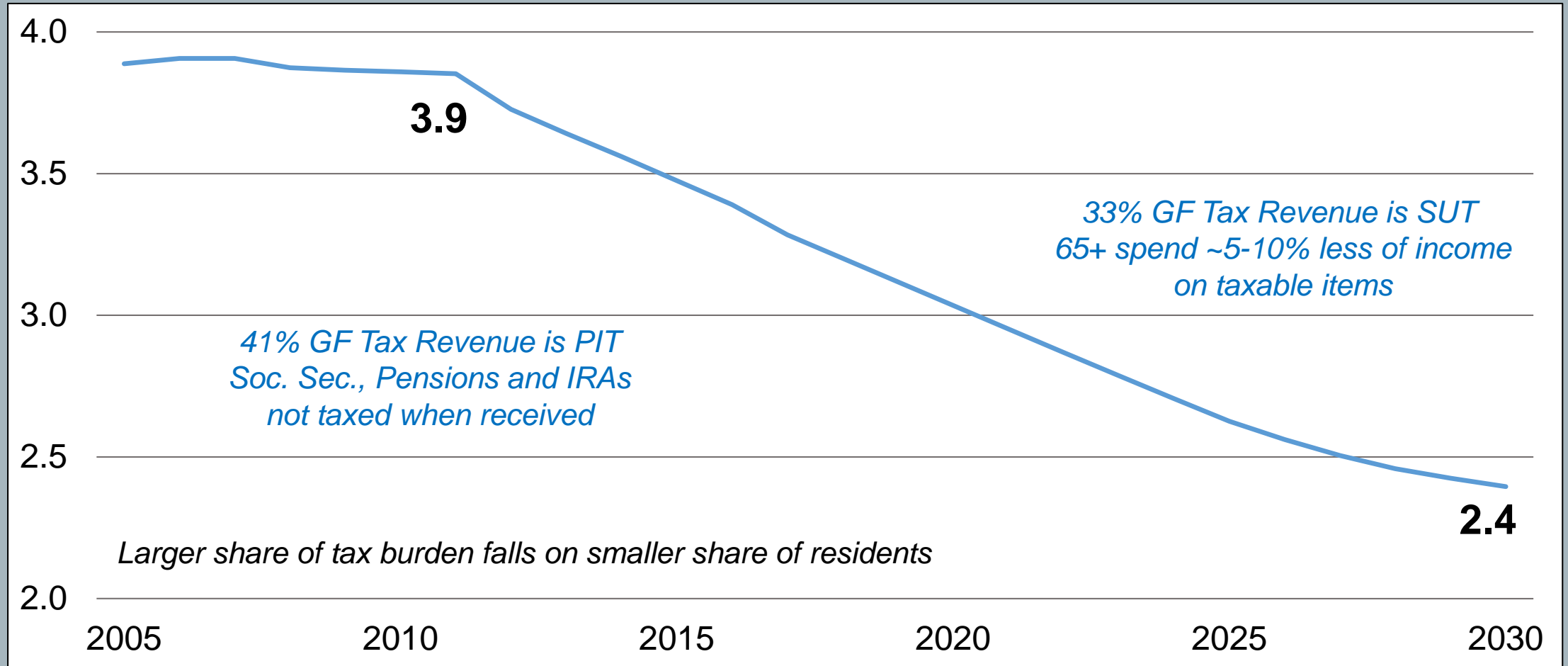
Source: Pennsylvania State Data Center with adjustments by the IFO.

U.S. and PA Population Distributions



Source: U.S. Census Bureau.

PA Ratio: Working Age / Retirees-Elderly



Note: Ratio is equal to residents age 20-64 to those age 65 and older. PIT is personal income tax. SUT is sales-use tax.

Source: U.S. Census Bureau and Pennsylvania State Data Center with adjustments and calculations by the IFO.

Components of PA Population Change

	Estimate	Projections		
	2010-15	2015-20	2020-25	2025-30
Start of Period	12,712	12,792	12,957	13,209
Births less Deaths	69	69	45	13
Net Migration	18	97	207	247
No Category	<u>-8</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>
End of Period	12,792	12,957	13,209	13,470

	Estimate	Projections		
	2010-15	2015-20	2020-25	2025-30
Age 0 to 19	-133	-16	-42	-12
Age 20 to 64	-3	-102	-65	0
Age 65 to 79	219	264	284	121
Age 80 or more	<u>-3</u>	<u>18</u>	<u>75</u>	<u>151</u>
All Age Groups	80	165	252	260

Note: thousands of residents. Net migration includes domestic and international.
Source: U.S. Census Bureau, Pennsylvania State Data Center and IFO.

Economics: Job Gains, But Modest Growth

- ▶ **Long-term downshift in economic growth.**
 - More service sector jobs; labor intensive.
 - Jobs growth appears strong for 2017; same trends.
- ▶ **Continued low inflation has mixed effects.**
 - Margins get squeezed. Hard to pass on costs.
 - Real wage gains. Does not translate into spending.
- ▶ **Healthcare-Soc. Service dominates job gains.**
 - About two-thirds of these gains for elderly-disabled.
 - Food Service and Professional Services strong too.

Long-Term PA Macro Economic Trends

	Dot Com Boom/Bust 1996-02	Housing Boom 2002-07	Housing Bust 2007-11	Tepid Recovery 2011-17
Real GDP	2.4%	2.0%	0.6%	1.8%
Wages-Salaries	4.7%	4.3%	1.6%	3.3%
Avg. Job Gains (000s)	55.5	31.2	-28.2	42.8
Philadelphia CPI-U	2.1%	3.2%	1.9%	1.1%
Avg. Wage Growth	3.7%	3.8%	2.1%	2.5%
Avg. Real Wage Growth	1.5%	0.5%	0.2%	1.4%

Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics.

Service Sector Drives Job Gains

	Employment (000s)		Change (000s)	
	2007	2017	Number	Percent
Manufacturing	659	552	-107	-16.2%
Local Government	490	449	-41	-8.3%
Wholesale-Retail	891	849	-42	-4.7%
All Other Sectors	1,699	1,705	6	0.3%
Professional Services	312	357	45	14.6%
Leisure-Hospitality	500	572	72	14.4%
Administration-Management	394	452	58	14.7%
Healthcare-Social Service	<u>855</u>	<u>1,007</u>	<u>153</u>	<u>17.8%</u>
Total	5,799	5,943	144	2.5%

Source: U.S. Bureau of Labor Statistics. 2017 is an estimate by IFO based on preliminary data through August.

Recent PA Growth Rates

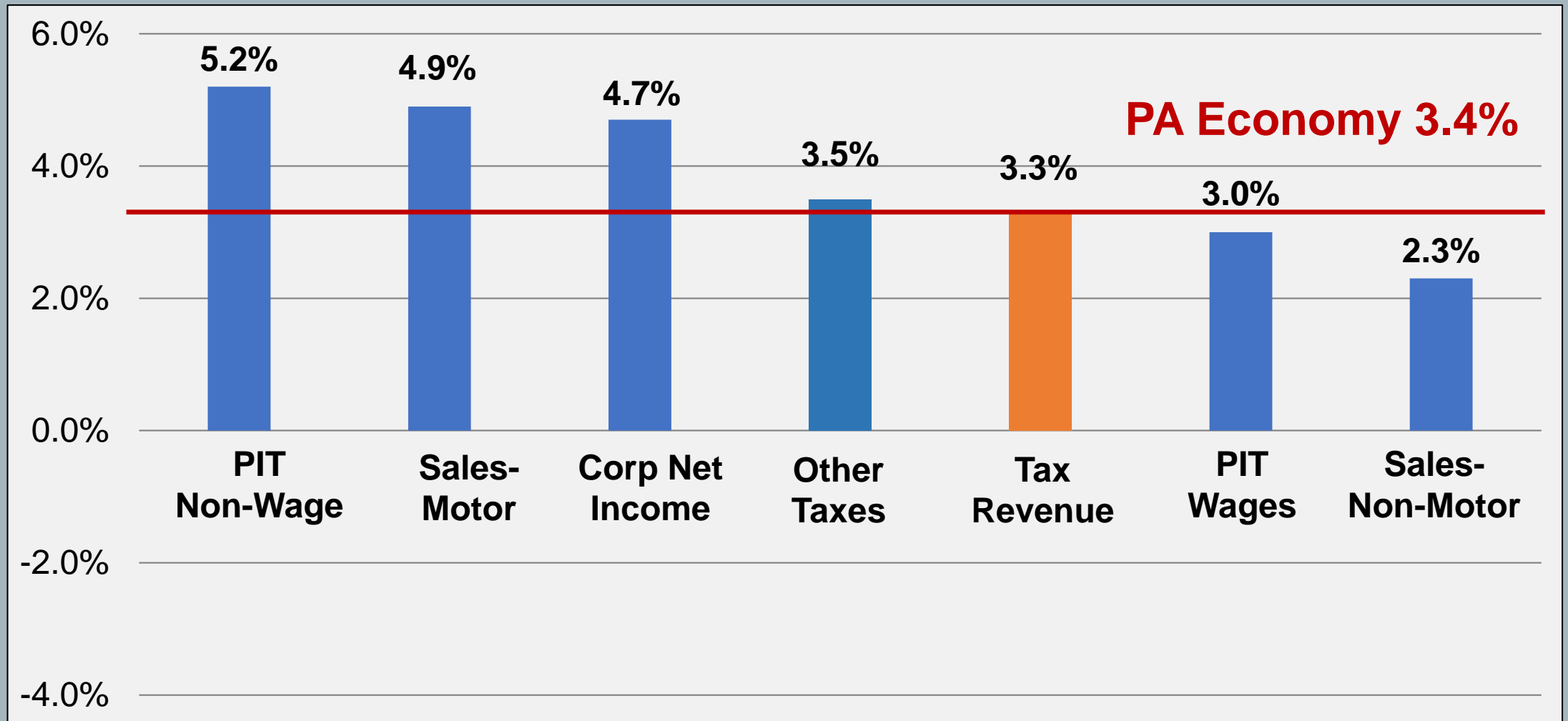
	Growth Rate or Change				
	2013	2014	2015	2016	2017
Real GDP	1.6%	1.9%	2.6%	1.1%	1.9%
Wages and Salaries	1.8%	3.9%	4.1%	1.3%	3.8%
Net Job Gains (000s)	14.3	47.4	46.7	52.2	63.4
Healthcare-Social Service	6.5	14.3	11.2	23.7	27.1
Leisure-Hospitality	8.0	5.1	7.5	13.1	16.2
Transportation-Storage	2.7	7.4	11.2	9.0	7.6
All Government	-11.9	-9.4	-6.5	0.0	-3.3
All Other Sectors	8.9	29.9	23.3	6.3	15.8
Philadelphia CPI-U	1.2%	1.3%	-0.1%	0.6%	1.7%
Social Security COLA	1.7%	1.5%	1.7%	0.0%	0.3%

Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Net job gains for 2017 is annual pace through August 2017.

Revenues & Expenditures

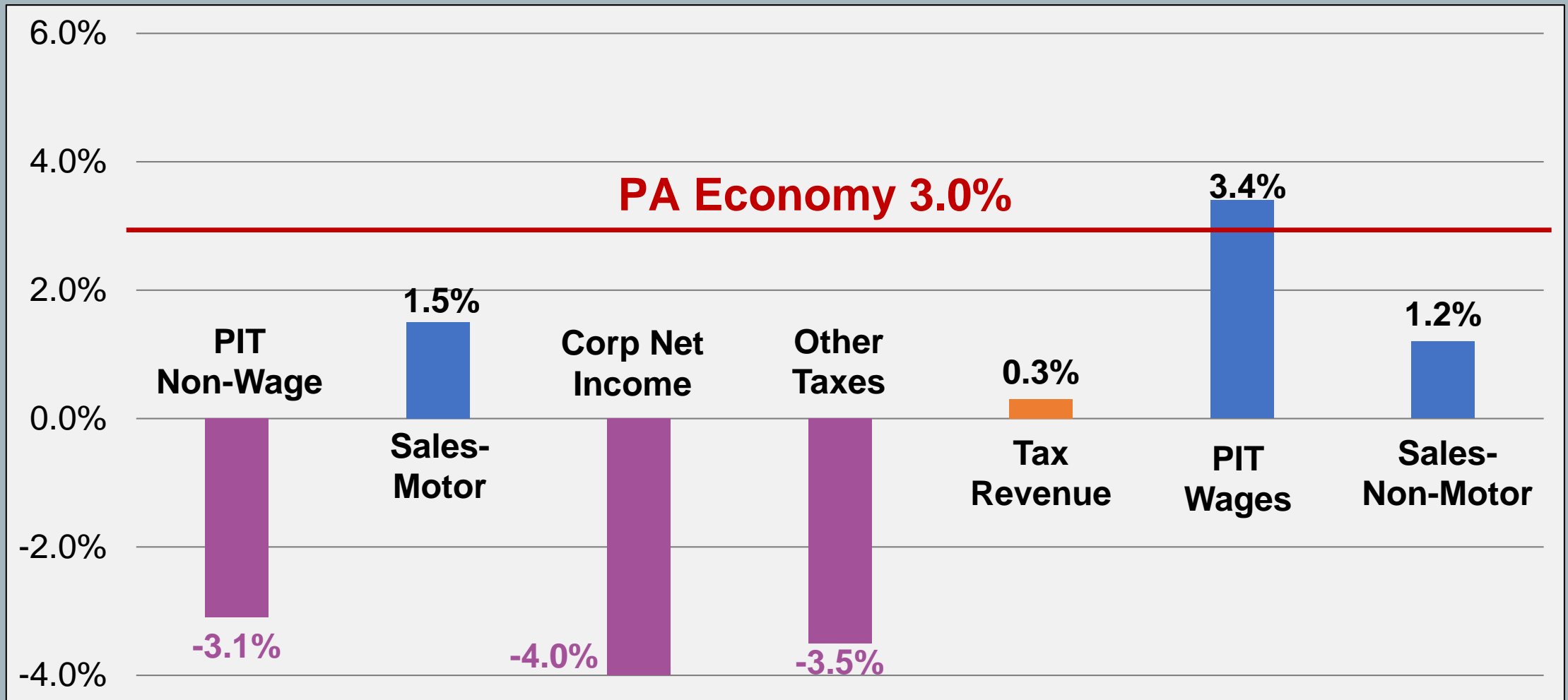
- ▶ **FY 2016-17: revenues collapse.**
 - Across the board weakness. IFO overpredicts by \$850m.
 - Revenues nearly flat if tax law changes excluded.
- ▶ **FY 2017-18: revenue forecast holding up so far.**
 - But forecast assumes federal tax cut.
 - Uncertainty could impact collections (again).
- ▶ **Healthcare and Pensions drive spending growth.**
 - SERS employer contribution rate projected to fall.
 - State share of Medicaid expansion increases to 5-6%.

Average Annual Growth: FYE 2011 to 2016



Note: Tax revenue excludes non-tax, cigarette and CSFT. PA Economy is average annual growth rate of nominal GDP.

FY 2016-17 Tax Revenue Growth



Note: Tax revenue excludes non-tax, cigarette and CSFT. Excludes tax amnesty monies and SUT changes. PIT wage and tax revenue growth control for extra deposit day in prior fiscal year. PA Economy is nominal GDP growth rate.

No Surprises Yet for FY 2017-18 Q1

	Results from Q1		Dollar Difference	
	Amount	Growth	Last Year	Estimate
All General Fund	\$6,933	4.8%	\$319	\$25
Corporate Net Income	587	11.0%	58	37
Sales and Use	2,591	3.9%	97	-22
Personal Income	2,837	3.8%	105	-14
Cigarette	309	10.6%	30	-6
Inheritance	234	4.5%	10	9
All Other Tax	313	5.6%	17	5
All Non-Tax	62	4.7%	3	16

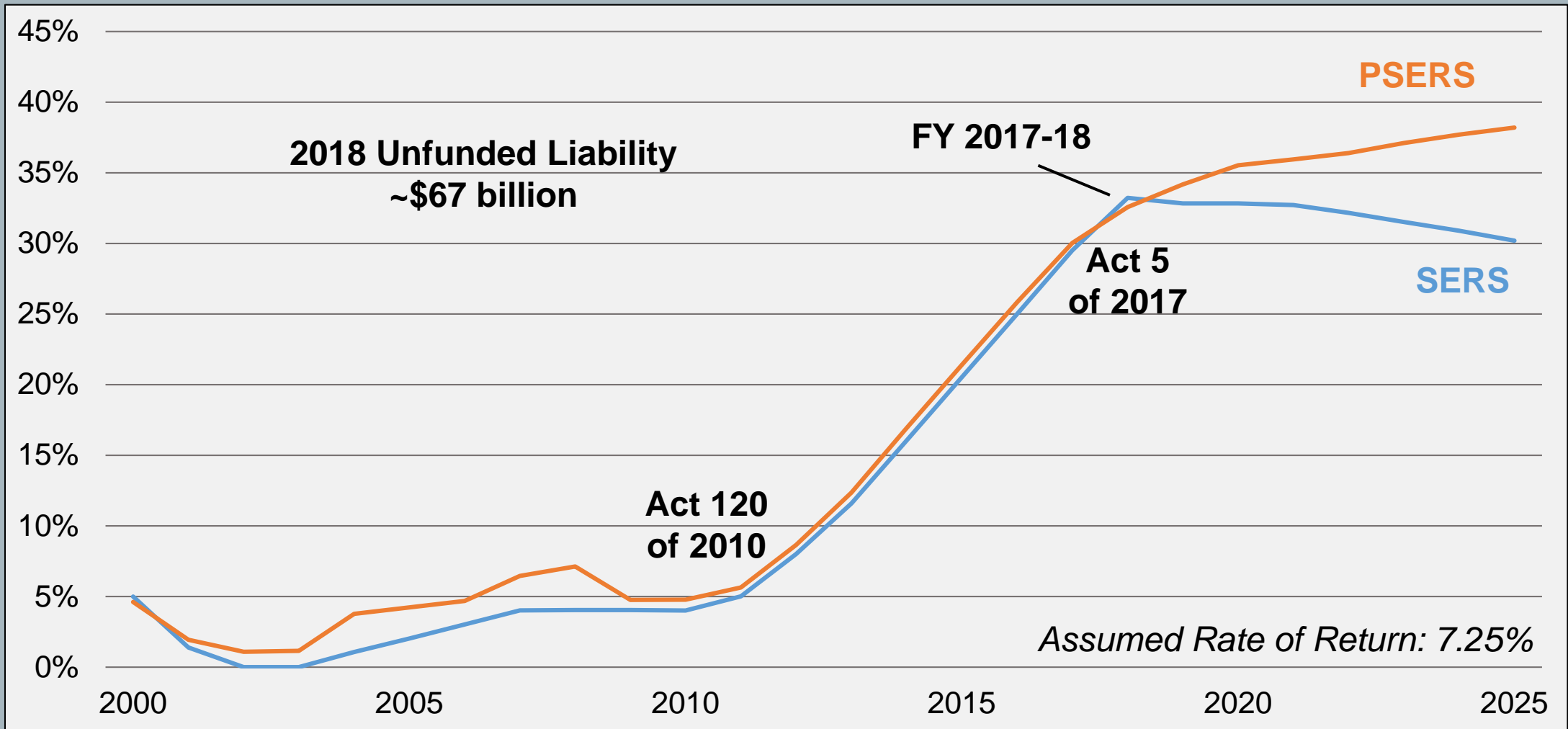
Note: millions of dollars. Estimate is from the IFO Official Estimate released in June 2017.

Expenditures Nearly Flat for FY 2017-18

	Annual Growth Rate			Contribution to Growth		
	15-16	16-17	17-18	15-16	16-17	17-18
Human Services	1.2%	7.5%	-2.1%	0.4%	2.8%	-0.8%
Education	-0.2%	3.4%	2.3%	-0.1%	1.2%	0.8%
Criminal Justice	2.8%	4.8%	-5.9%	0.2%	0.3%	-0.4%
Debt	2.8%	-1.4%	0.8%	0.1%	-0.1%	0.0%
PSERS	48.5%	20.1%	9.7%	1.9%	1.1%	0.6%
SERS	24.8%	19.0%	8.3%	0.5%	0.4%	0.2%
All Other	<u>3.2%</u>	<u>2.2%</u>	<u>-2.5%</u>	<u>0.3%</u>	<u>0.2%</u>	<u>-0.2%</u>
General Fund	3.3%	6.0%	0.2%	3.3%	6.0%	0.2%

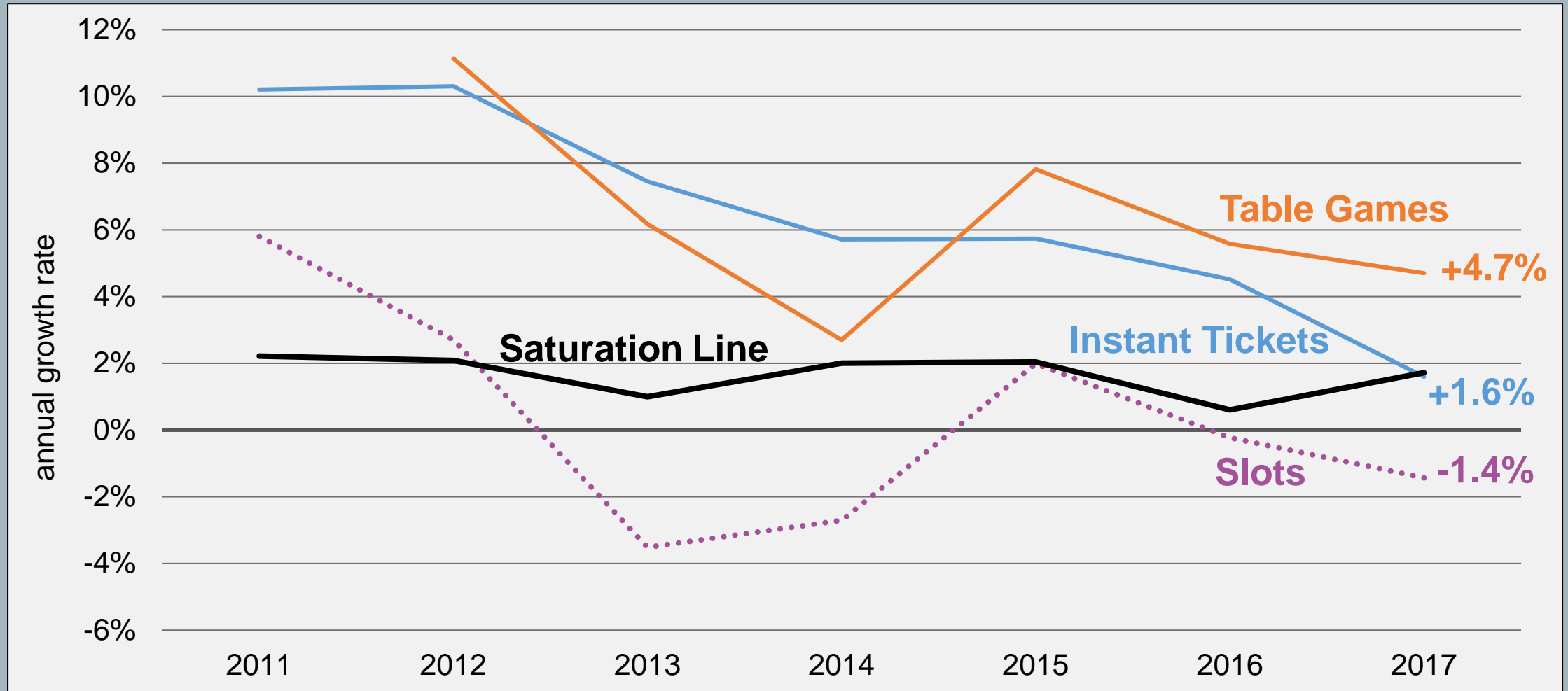
Source: Executive Budgets, various years and IFO five-year outlook reports. Includes \$595 million for higher education funding.

Pensions: Employer Contribution Rates



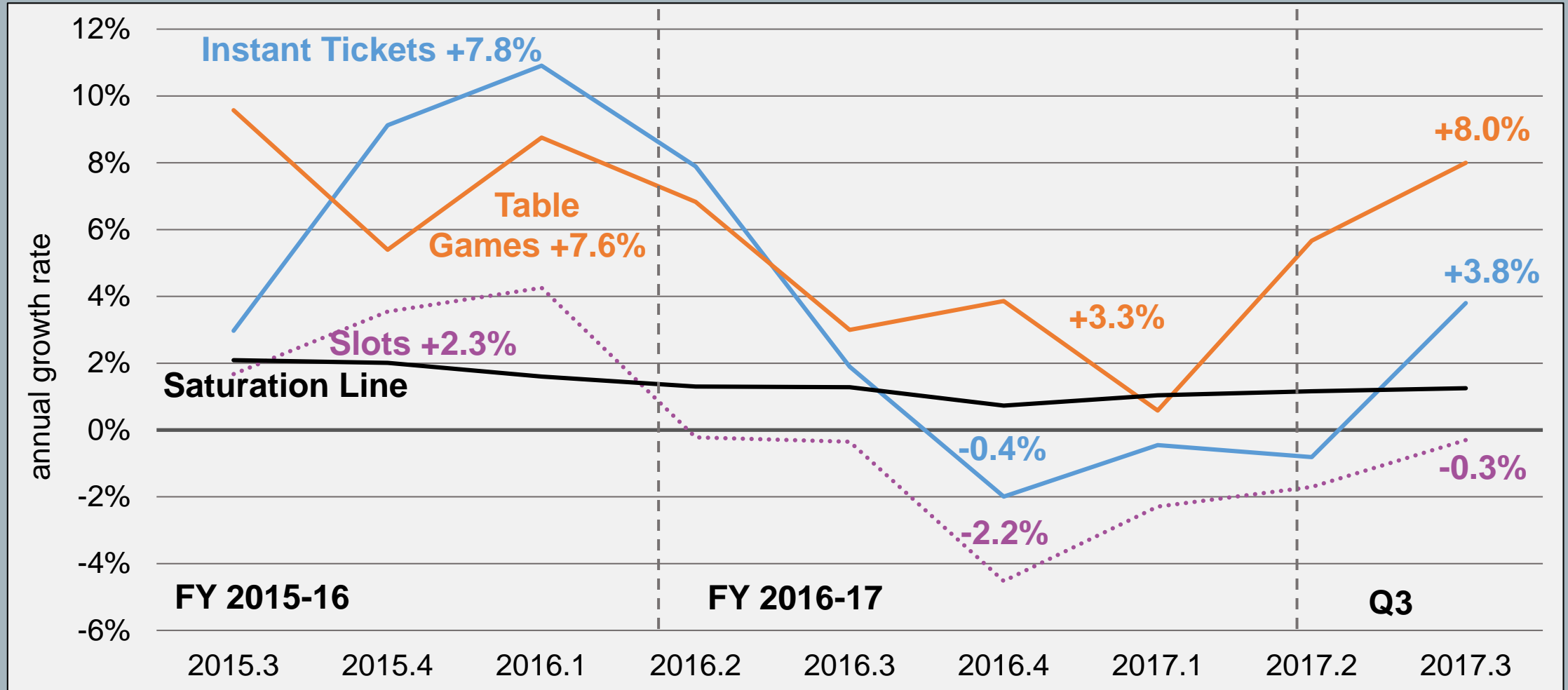
Source: Consolidated Annual Financial Reports and Actuarial Valuations for SERS and PSERS, various years.

Gaming Revenue Growth Decelerates



Note: Saturation line growth rate equal to population growth plus one-half wage growth (assumes elasticity of gaming relative to income = 0.5). Table games growth rate uses the tax base to control for a tax rate change.

Recent Gaming Revenue Trends



Note: Saturation line growth rate equal to population growth plus one-half wage growth (assumes elasticity of gaming relative to income = 0.5). Table games growth rate uses the tax base to control for a tax rate change.

Moving Forward

- ▶ **Will FY 2017-18 deficit carry forward to future?**
 - Permanent vs. temporary revenues.
 - Federal tax cut should boost state revenues.
- ▶ **Current revenue sources have limited upside.**
 - Sales tax will continue to lag economic growth.
 - Flat rate structure cushions economic booms and busts.
- ▶ **Potential savings from mergers.**
 - Dept. of Corrections and Probation and Parole.
 - DHS, Aging, Health, Drug and Alcohol.