

The Commonwealth's Budget Outlook: FY 2016-17 and Beyond

presented to the

Greater Pittsburgh Nonprofit Partnership

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The Independent Fiscal Office

- **Office Began Operations September 2011.**
 - Similar to the Congressional Budget Office.
 - Non-partisan analysis. No governing board.
- **Our Primary Duties:**
 - General Fund Revenue Estimate: May 1 & Jun. 15.
 - Five-Year Economic and Budget Outlook: Nov. 15.
 - Special studies at request of General Assembly.
- **Office Makes NO Policy Recommendations.**

FY 2016-17 Budget Outlook

Origins of Current Budget Challenge Can be Traced
to the 2008-2009 Financial Crisis

Recent Budgets Have Been Balanced Using
Various Short-Term Measures

Underlying Fundamentals Suggest Significant
Disparity Between Revenues and Expenditures

Post-Recession Budgets

- **The widespread 2008-2009 U.S. financial crisis significantly affected subsequent budgets.**
 - Federal ARRA funds cushioned the impact for several years.
 - Spending reductions/restraint for many program areas.
 - Recession hit pension funds, contributing to funding issues.
- **Recent budgets have utilized a succession of short-term measures.**
 - Shifts to the Lottery, Tobacco Settlement and Oil and Gas Lease funds.
 - Transfers of available monies from special funds.
 - Acceleration of revenue or deferrals of expenditures.
 - “Snap-back” as one-time measures expire.

Recent Short-Term Measures

- **About \$1.6 billion of short-term measures used in FY 2014-15 ultimately affect the current year.**
 - Fund transfers and escheat changes (\$700 million in FY 2014-15).
 - Payment delays and greater utilization of special funds (\$900 million in FY 2014-15).
- **Additional short-term measures were adopted for use in FY 2015-16.**
 - Deferred county child welfare and school social security payments (\$260 million) and refinanced reimbursements for school construction (\$300 million).
 - Shifted funding for PHEAA grants off-budget (\$39 million).
 - Transferred available balances from special funds (\$47 million).

IFO January Report

FY 2016-17 Preliminary Balance Sheet

Beginning Balance	---
Current Year Revenues	\$31,525
Less Refund Reserve	-1,370
Less State Expenditures	-32,065
Lapses	50
	=====
Ending Balance	-1,860

Note: dollar amounts are in millions.

Highlights of January Report

- **FY 2016-17 expenditure growth of \$1,884 million.**
 - One-time expenditure deferrals expire.
 - Use of special funds scaled back.
 - Mandatory expenditure categories (e.g., pensions, debt service, human services and corrections) constitute as much as 80 to 90 percent of the increase.

- **Revenue growth of only \$603 million.**
 - Certain prior year transfers do not recur.
 - Escheat collections return to a “normal” level.
 - Elimination of the capital stock and franchise tax.
 - Technical considerations affect timing of revenues.

Changes Since January Report

FY 2015-16 Appropriation Changes in Act 1A

Basic Education Subsidy	\$50
Medical Assistance Programs	-153
PHEAA Grants	- 39
Other (various increases/decreases)	<u>-8</u>
Total	-150

Note: dollar amounts are in millions. Compared to estimates in the January 2016 IFO report, which was based primarily on Act 10A of 2015.

- **Impact of changes on FY 2016-17 is unclear.**
 - Sustainability of reductions to Medical Assistance.
 - Commitment of additional resources from PHEAA to maintain grants.

Changes Since January Report

- **FY 2016-17 revenue estimate increased by \$61 million in the May 3rd release.**
 - Corporate net income tax increased by \$101 million and non-tax sources increased by \$51 million.
 - Personal income tax decreased by \$113 million.
 - Other sources, including sales tax, increased by \$22 million.
- **The next revenue update will be on June 15th.**
 - More recent data on corporate profits suggest weakness.
 - Wage/salary withholding collections have underperformed.
 - Sales tax collections have been strong in recent months.
 - The jobs forecast is important to the revenue estimate.

Pennsylvania Economic Outlook

	2013	2014	2015	2016	2017
Real GDP	0.7%	1.5%	2.0%	2.0%	2.2%
Wages and Salaries	1.8%	4.0%	3.4%	3.7%	4.2%
Consumer Prices	1.2%	1.3%	-0.1%	1.0%	1.6%
Job Gains (000s)	14.7	47.6	48.6	52.4	50.6

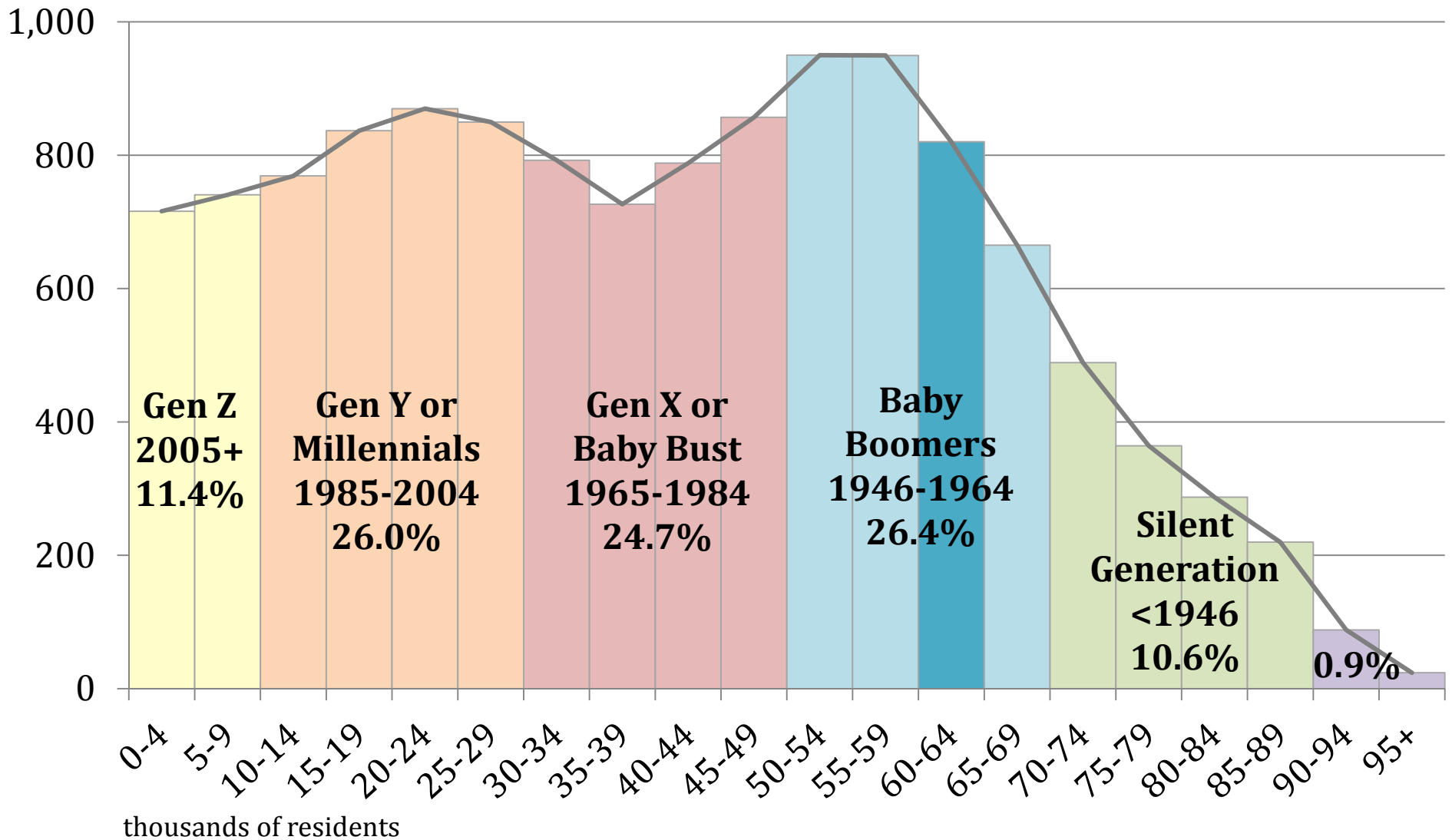
Average annual growth rates. Values are forecasts for entire year.

Long-Term Budget Trends

Changing Demographics Impact Longer-Term Outlook
Working Age Population Projected to Decline
Wave of Retirements Next Decade

All Demographic Projections from the Penn State Data
Center; Reflects U.S. Census Estimates for 2015

2015 Snapshot by Generation

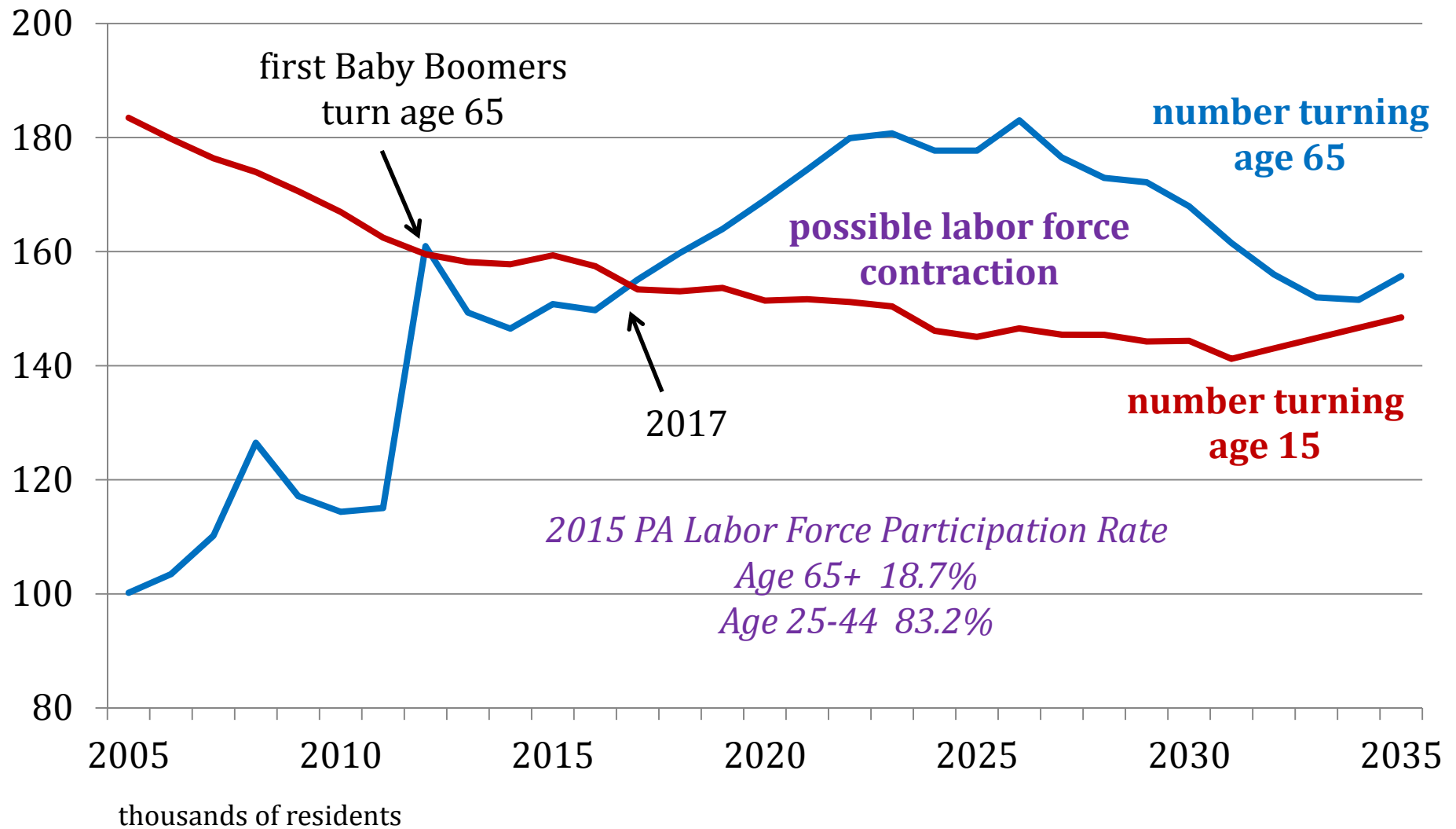


Population Change by Age Group

Age	Population Gain or Loss		Average Annual Growth	
	2005-15	2015-25	2005-15	2015-25
0-19	-164	-14	-0.5%	0.0%
20-39	116	139	0.4%	0.4%
40-59	-77	-438	-0.2%	-1.3%
60-79	439	663	2.1%	2.5%
80+	<u>39</u>	<u>86</u>	<u>0.6%</u>	<u>1.3%</u>
Total	353	436	0.3%	0.3%

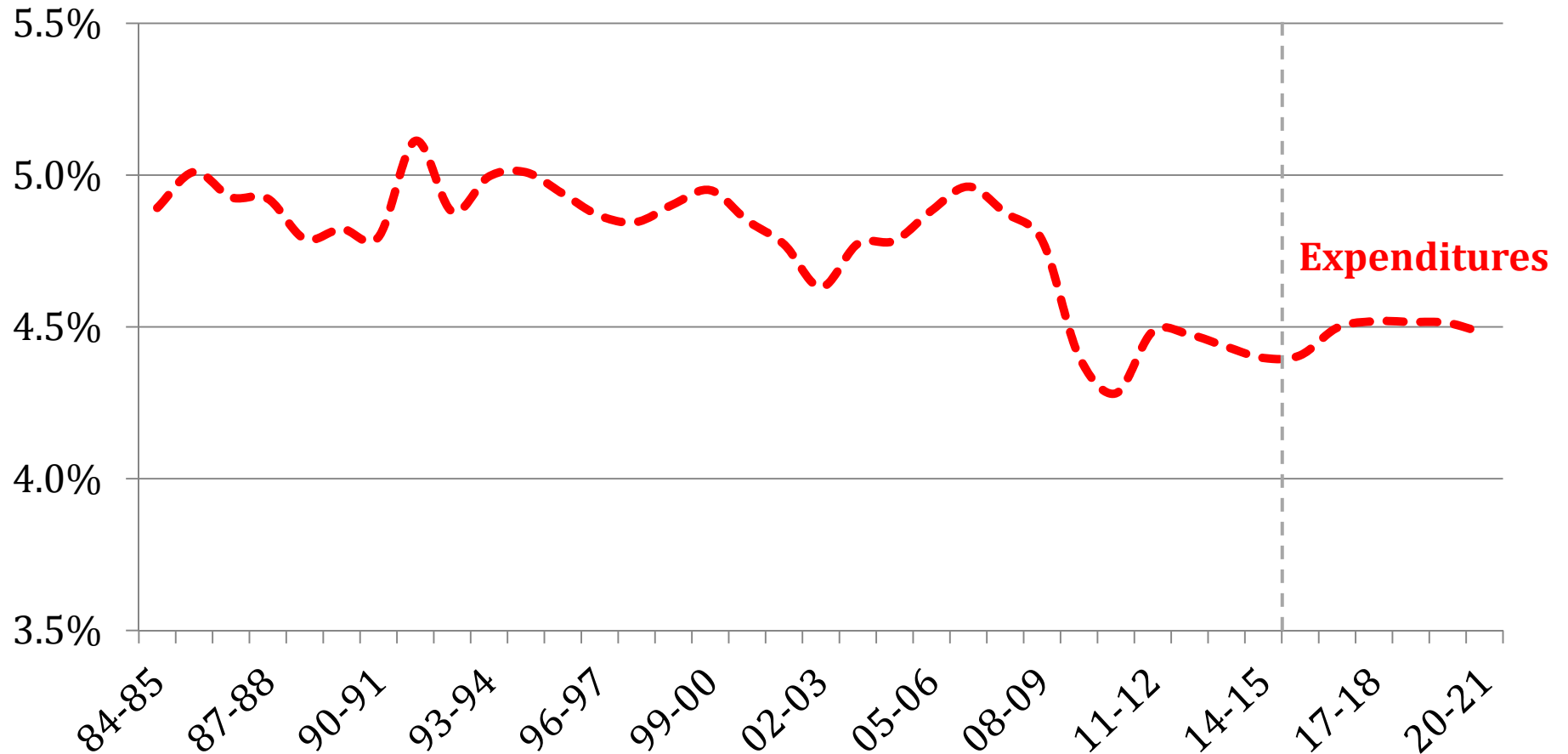
thousands of residents

PA Labor Force May Contract



Long-Term Expenditure Trends

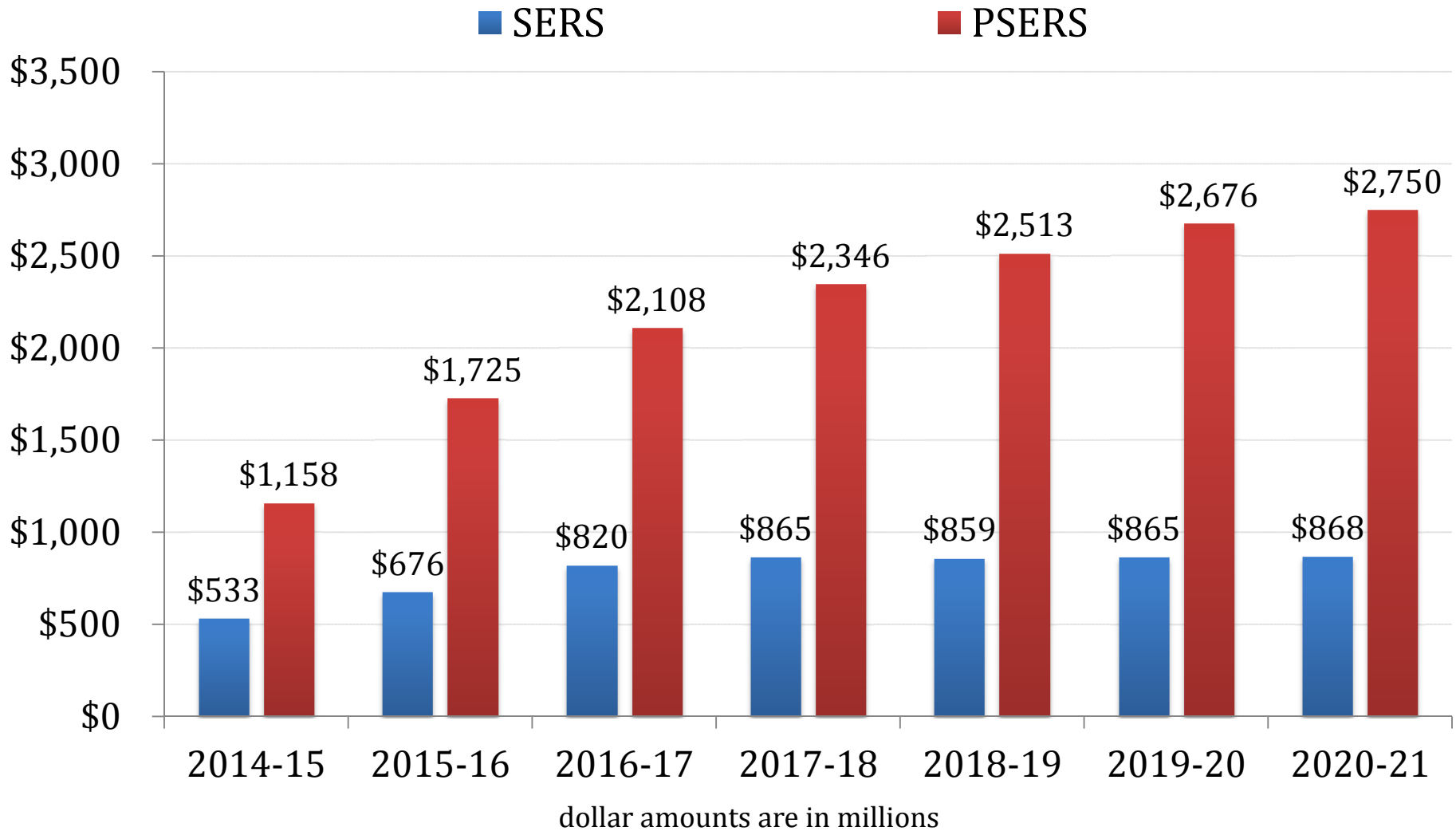
Expenditures as a Share of State GDP



IFO Expenditure Projections

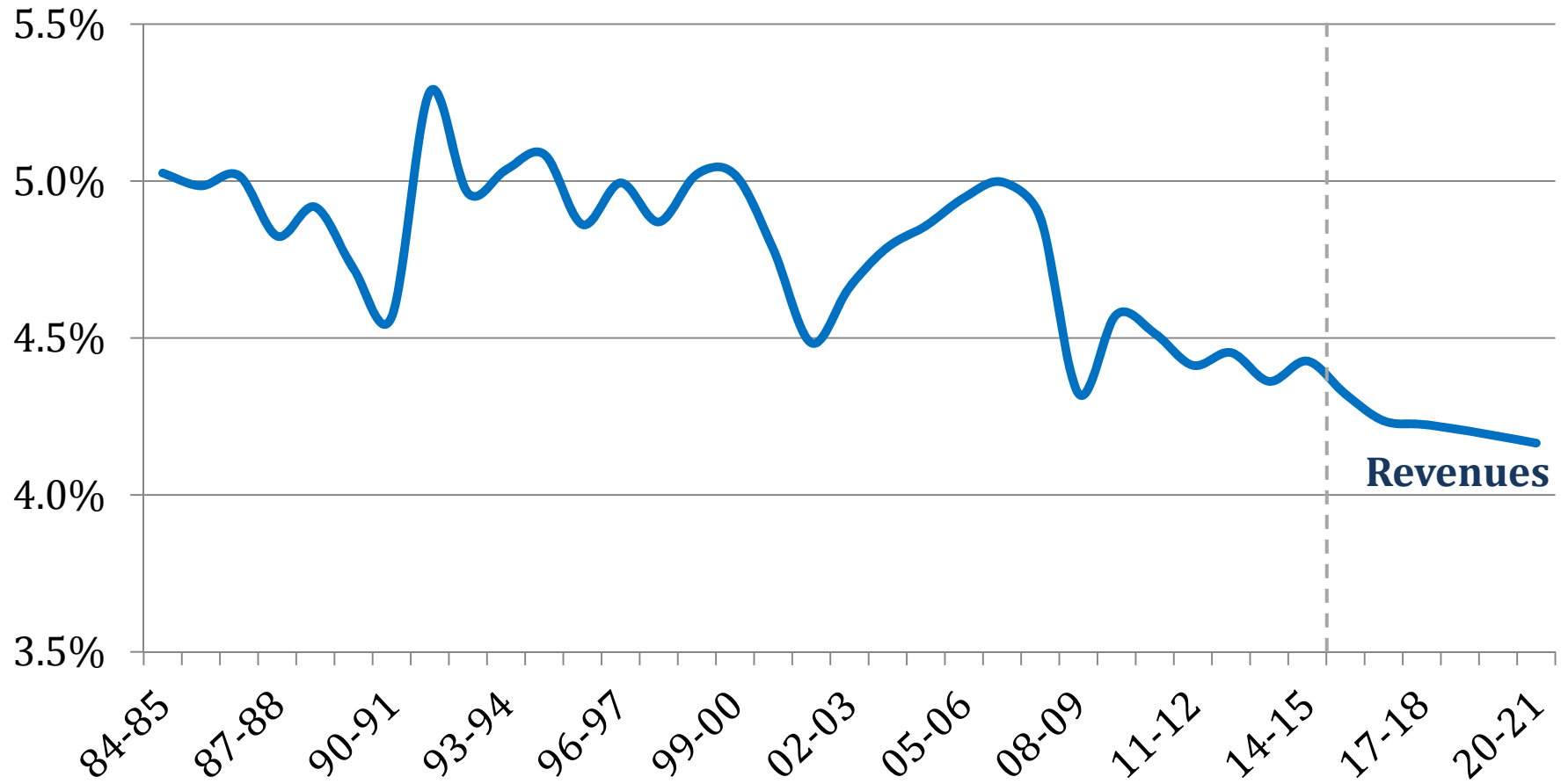
	General Expenditures	Older Resident Healthcare
(1) Demographics	0.3%	2.5%
(2) General Inflation	2.0%	2.0%
(3) Healthcare Premium	<u>n.a.</u>	<u>1.5%</u>
TOTAL ANNUAL FACTOR	2.3%	6.0%
Five-Year Cumulative Growth	12.0%	33.8%

Growth in Pension Contributions



Long-Term Revenue Trends

Revenues as a Share of State GDP



Revenue Impacts

➤ Sales and Use Tax.

- Elderly buy fewer durable goods that are taxable.
- Significant purchases of healthcare and medications.
- Growth in services outpacing growth in goods.

➤ Personal Income Tax.

- Wage income becomes less important over time. Larger share of income not subject to tax.
- Age 65+ reports nearly 20% of income on federal tax returns. Non-taxable income: Social Security, Pensions, IRAs.

Consumer Spending by Age Cohort

	Allocation of Spending by Age Group					
	25-34	35-44	45-54	55-64	65-74	75+
Generally Taxable	25.1%	23.6%	23.7%	22.4%	21.7%	15.2%
Dining Out	6.4	6.3	6.0	5.3	5.5	3.9
Alcohol and Tobacco	1.9	1.5	1.8	1.8	1.6	0.9
Cell Phones	2.4	2.3	2.2	1.9	1.5	0.9
Home Furnishings	3.3	3.2	3.3	3.7	3.7	2.5
Car Purchase / Repairs	11.2	10.3	10.4	9.7	9.4	7.0
Generally Non-Taxable	62.0%	63.4%	61.4%	64.6%	66.2%	73.1%
Housing	39.9	39.3	36.1	36.7	35.3	37.3
Food At Home	8.4	8.7	8.5	8.5	8.4	8.4
Healthcare	5.5	6.7	7.5	9.5	12.5	15.4
Gasoline	5.9	5.8	5.6	5.5	4.9	3.6
Cash Contributions	2.3	2.8	3.7	4.4	5.1	8.4
All Other	12.9%	13.0%	15.0%	13.0%	12.1%	11.7%

Source: U.S. Bureau of Labor Statistics, Consumer Expenditure Survey.

Composition of Income on Federal Tax Return

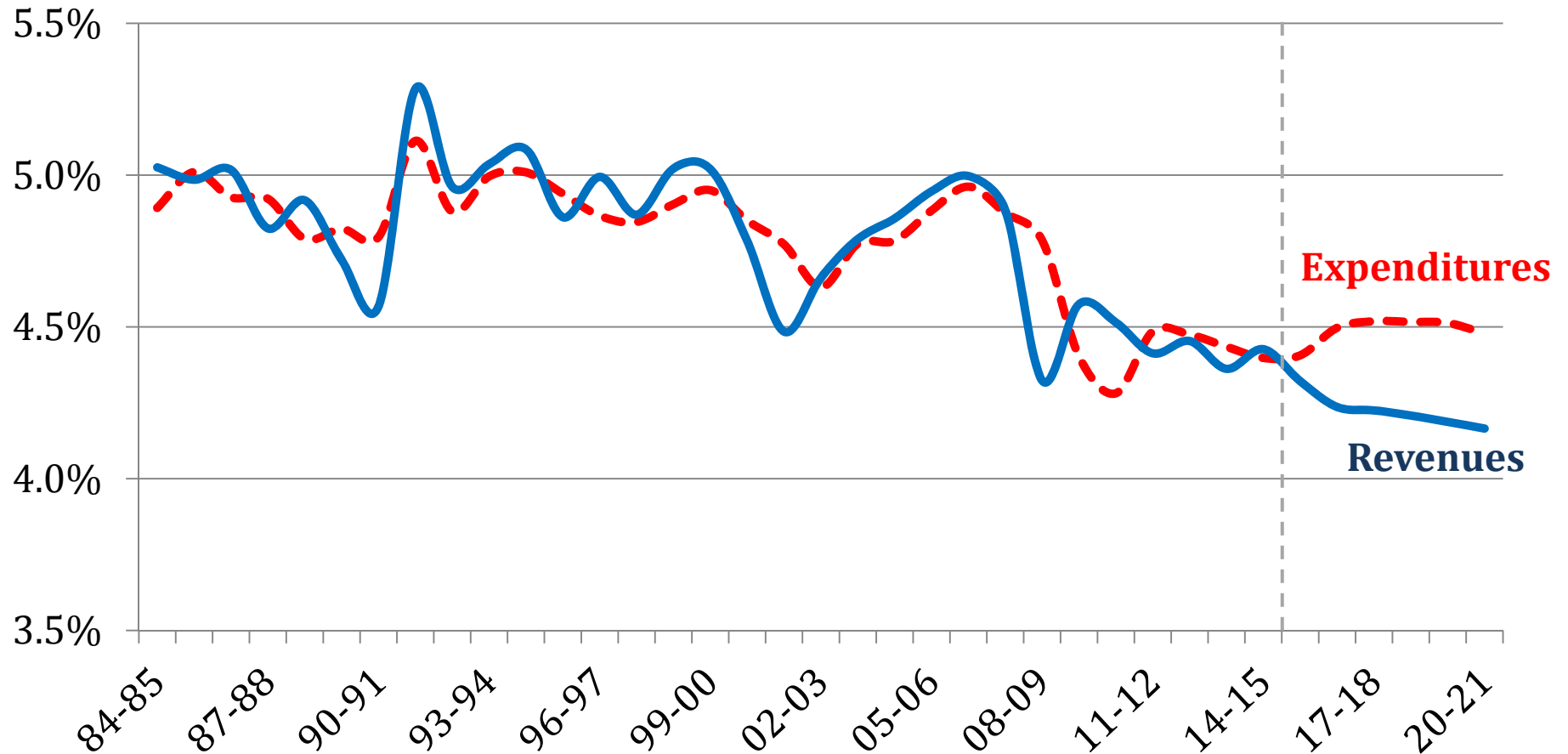
By Income Type and Age Cohort

	<u>Age Cohort</u>			
	18-34	35-54	55-64	65+
Salaries & Wages	91.5%	79.5%	60.7%	18.1%
Capital Income	1.8	5.9	9.9	18.0
Business Income	4.3	9.7	10.2	6.2
Retirement Income	1.4	4.7	19.2	57.0
All Other	1.0	0.1	0.1	0.6

Note: U.S. returns, tax year 2013. Includes non-taxable social security, interest and pension income.
Source: Internal Revenue Service.

Long-Term Budget Trends

Revenues and Expenditures as a Share of State GDP



Thank You

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