

Budget and Economic Update

**Greater Philadelphia Chamber of Commerce
February 12, 2015**

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Today's Presentation

➤ **What Is the Independent Fiscal Office?**

- Our role in the budget process.
- Other products and publications.

➤ **Tax Revenues and Budget Deficits.**

- Tax revenues through January 2015.
- Revisions to FY 2014-15 General Fund revenues.
- Implications for projected budget deficits.

➤ **Latest Economic Developments.**

- Gas prices. Consumer confidence. Low inflation.

The Independent Fiscal Office

- **Act 120 of 2010 Creates Independent Fiscal Office.**
 - Hiring starts September 2011. Currently 9 staff.
 - Similar to the Congressional Budget Office.
 - Revenue projections used for advisory purposes only.
- **Our Primary Duties:**
 - Annual Revenue Estimate: May 1 and June 15.
 - Economic and Budget Outlook: November 15.
 - Mid-Year Update: late January.
- **Office *Does Not* Make Policy Recommendations.**

Other Products and Releases

➤ **Two Regular Monthly Reports.**

- Monthly Economic Report.
- Monthly Revenue Trends Report.

➤ **Special Studies (at request of Gen. Assembly):**

- HB 1776 and SB 76 – Property Tax Reform.
- Medicaid Expansion.
- Film Tax Credits.
- Taxation of Natural Gas in Pennsylvania.
- Consolidation of York County School Districts.

Revenues and Deficits

Budget Timelines
Year-to-Date Performance
Revisions to General Fund Revenues

The Budget Timeline

- **I. Official General Fund Estimates Released.**
 - Independent Fiscal Office: May 1 and June 15.
 - Administration: end of June (certified estimate).

- **II. The Economic and Budget Outlook.**
 - Independent Fiscal Office: November 15.
 - Five-year projections, focus is on long-term trends.

- **III. The Mid-Year Updates.**
 - Administration (December) and Ind. Fiscal Office (January).

- **IV. The Governor's Executive Budget.**
 - Early February (March this year).

I. Official General Fund Revenue Estimates

Independent Fiscal Office and Department of Revenue (June 2014).

	FY 2014-15		
	IFO	DOR	Difference
General Fund - Total	\$29,957	\$30,181	-\$224
Corporate Net Income Tax	2,484	2,501	-17
Sales and Use Tax	9,463	9,477	-14
Personal Income Tax	12,027	12,033	-6
All Other Tax Revenue	4,949	5,097	-148
Non-Tax Revenue	1,034	1,072	-38

Dollar amounts are in millions.

II. The Economic and Budget Outlook

➤ **Large Structural Deficit Identified (Nov. 2014).**

- Not a surprise. A \$2.5 billion deficit by FY 2019-20.
- Key finding: deficit is structural.
- Deficit remains if growth returns to a “normal” level.

➤ **But, Focus Is on Short-Term Deficit.**

- FY 2014-15 + FY 2015-16: \$1.85 billion deficit.
- What permanent steps must be taken to address it?
- Some combination of spending cuts or tax increases.

Long-Term Structural Imbalance

General Fund Balance Sheet

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Beginning Balance	\$81	\$--	\$--	\$--	\$--	\$--
Available Revenue	28,700	29,023	29,897	30,836	31,794	32,835
State Expenditures	-29,027	-30,777	-32,079	-33,280	-34,358	-35,464
Current Year Balance	-327	-1,754	-2,182	-2,444	-2,564	-2,629
Lapses and Supplementals	<u>75</u>	<u>75</u>	<u>75</u>	<u>75</u>	<u>75</u>	<u>75</u>
Ending Balance	-171	-1,679	-2,107	-2,369	-2,489	-2,554

Note: millions of dollars.

\$1.85 billion deficit

What Drives Increase in the Deficit?

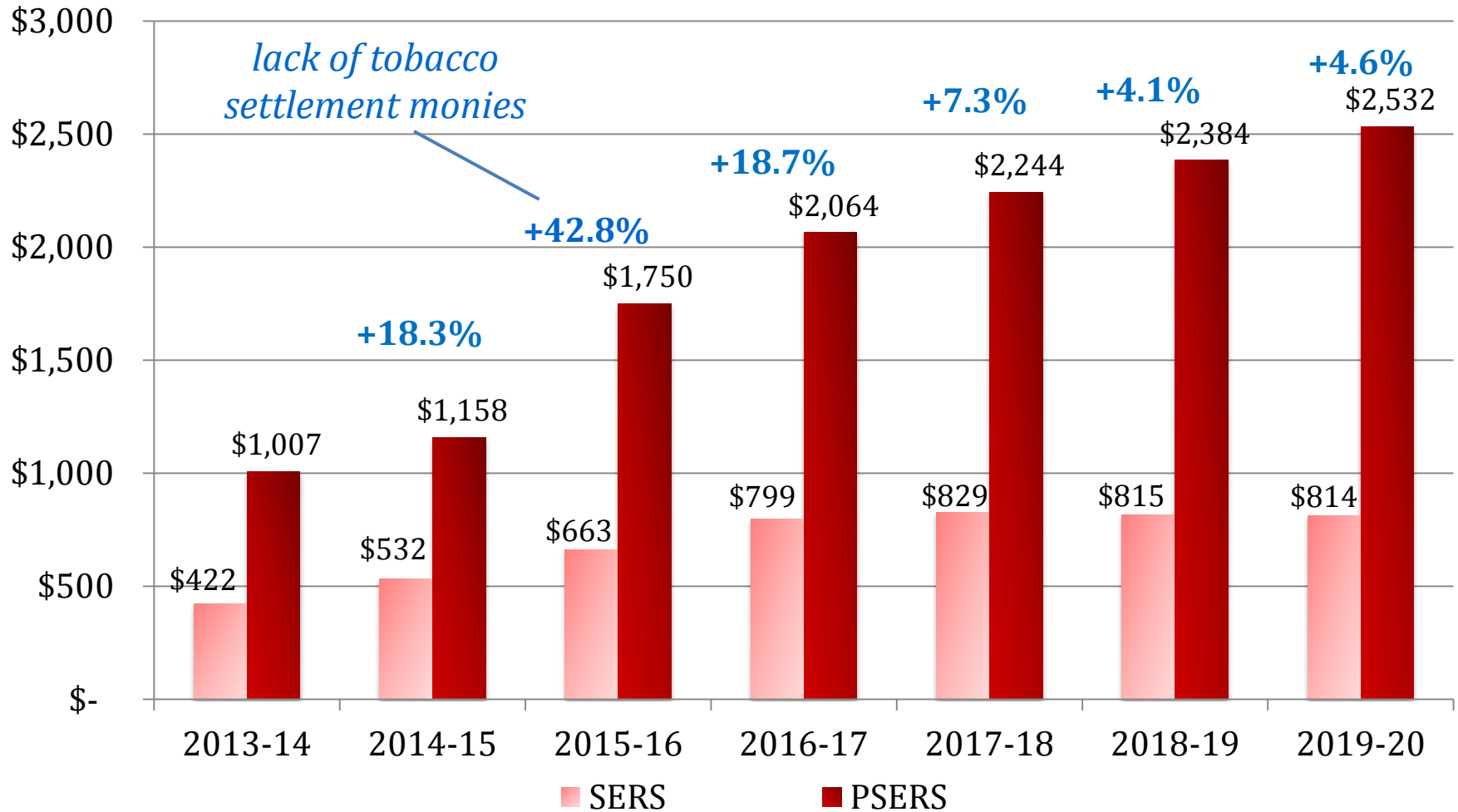
- **Non-Recurring Savings, Shifts and Revenues.**
 - Used in FY 2014-15. Not available next fiscal year.
- **Pension Contributions: SERS and PSERS.**
 - SERS up \$131 million (25%) in FY 2015-16.
 - PSERS up \$592 million (51%, state share only).
- **More Subtle: Rapidly Aging Population.**
 - Age 65 and older **expands by 14.9%** through 2020.
 - Under age 65 **contracts by -0.7%** through 2020.

Non-Recurring Savings, Shifts and Revenues

Delay payments to managed care organizations	\$394
Transfer tobacco settlement investments to PSERS	<u>\$225</u>
Total Savings	\$619
Funding Shifts (to Lottery and Tobacco Funds)	\$332
Transfers into General Fund (from special funds)	\$322
Inheritance tax windfall and other	<u>\$250</u>
Total Revenues	\$572
TOTAL NON-RECURRING	\$1,523

Note: millions of dollars.

Growth in Pension Contributions



Note: millions of dollars.

III. The Mid-Year Updates

➤ **Administration - December 3, 2014.**

- Revenues up ~+\$200 million through November.
- But, negative hits later this fiscal year (e.g., casino fees).
- Some unexpectedly large cost drivers next fiscal year.
- DHS +\$910 million (+8%); DOC +\$215 million (+10%).

➤ **Independent Fiscal Office - January 28, 2015.**

- Revenues up ~+\$400 million through January.
- Add +\$250 million to General Fund revenue estimate.
- Still lose some fees and transfers later this fiscal year.
- Unanticipated factors drive revenue gains.

General Fund Tax Revenues

FY 2014-15 (through January)

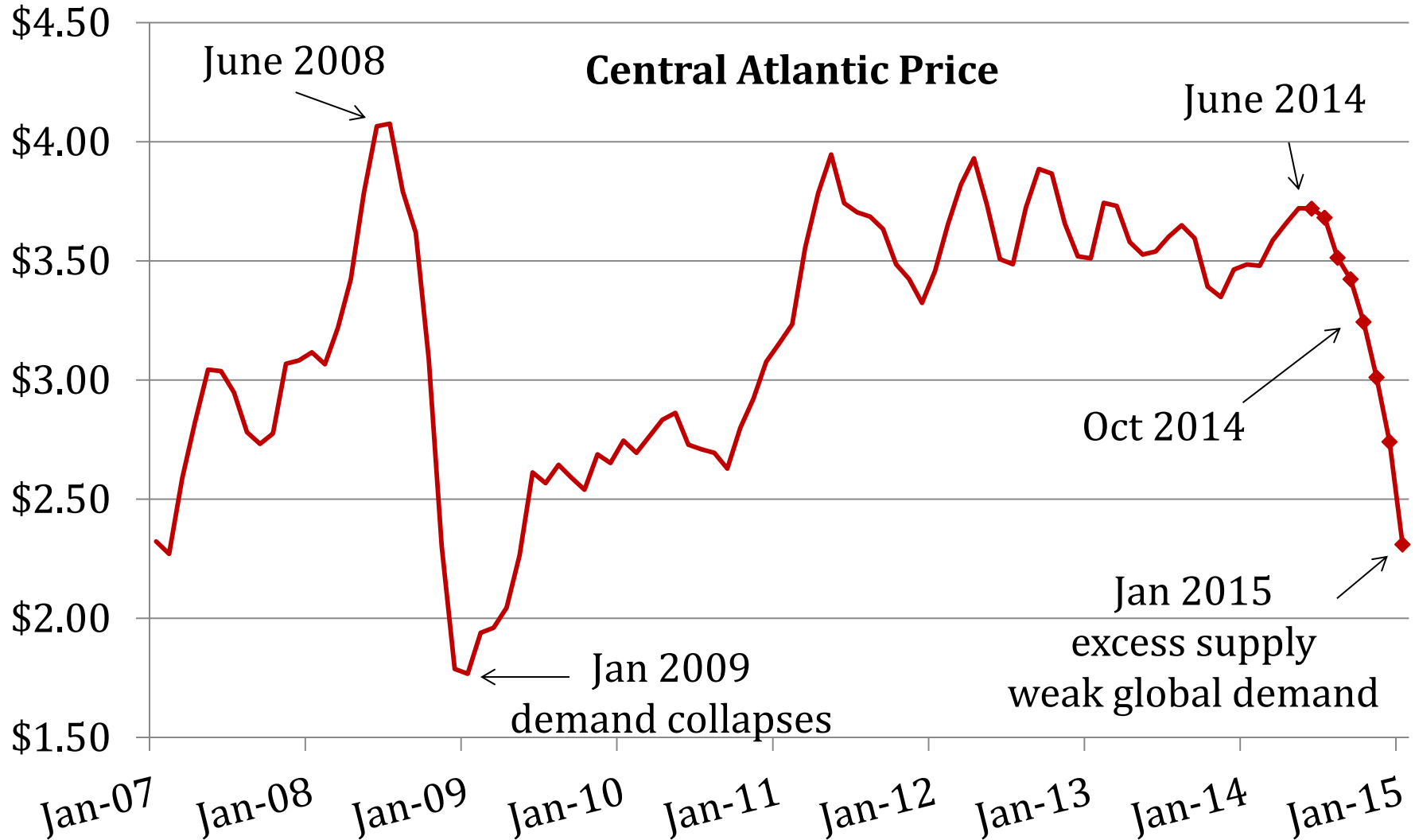
Revenue Source	Actual	Estimate	Difference
General Fund - Total	\$15,698	\$15,280	\$418
Corporate Net Income	1,348	1,164	184 ← <i>sustainable?</i>
Sales and Use	5,647	5,578	69 ← <i>gas prices and confidence</i>
Personal Income	6,322	6,327	-5
Other Tax Revenue	1,902	1,758	144 ← <i>+\$100 m inheritance</i>
Non-Tax Revenue	478	454	24

Note: Dollar amounts are in millions. Estimates are from Independent Fiscal Office.

Economic Developments

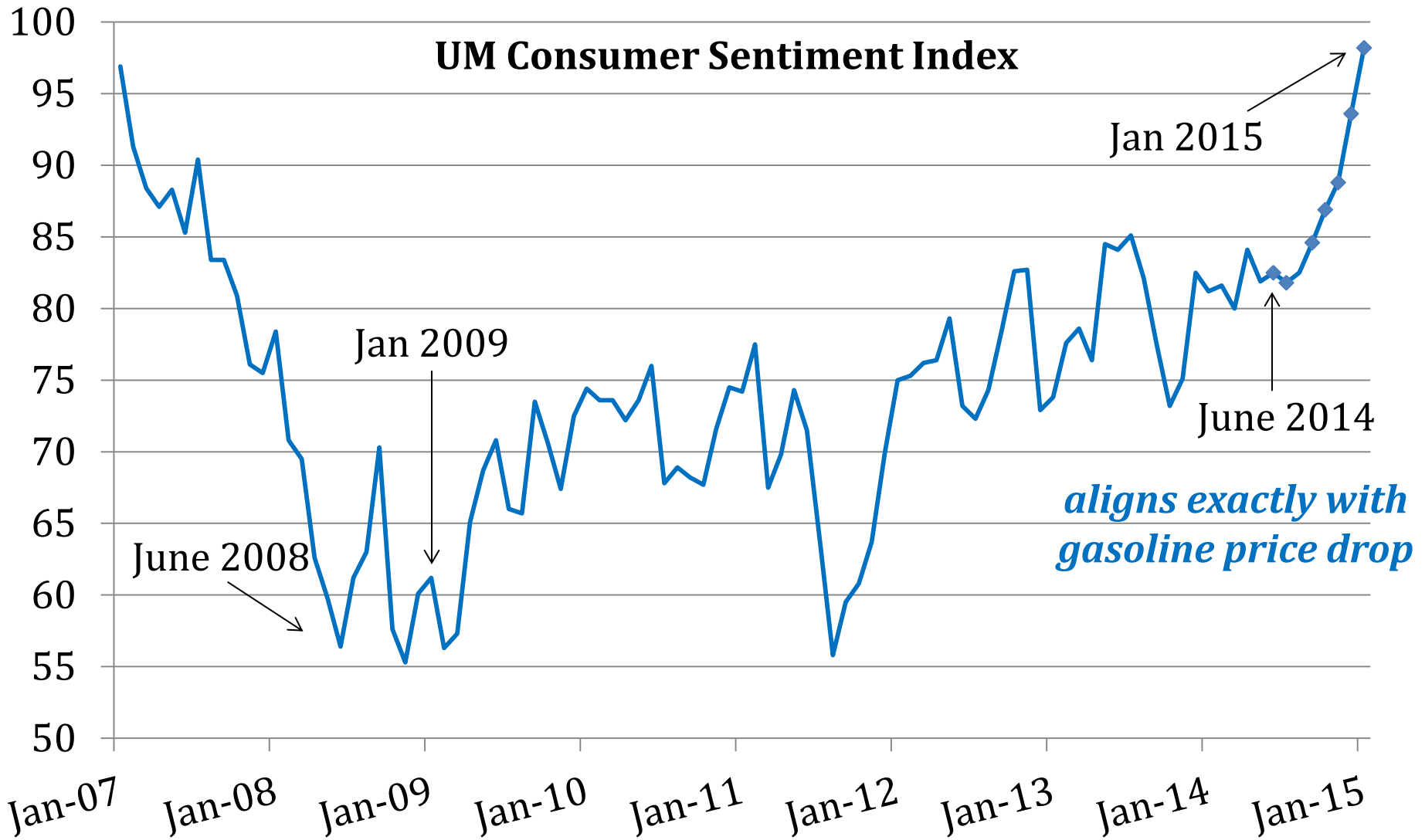
Gas Prices Collapse
Consumer Confidence Surges
Low Inflation Anticipated

Monthly Average Gas Price



Source: U.S. Energy Information Administration.

Consumer Sentiment Surges



Savings from Gas Price Drop

- **Average Gasoline Price Decline Year-Over-Year:**
 - Average Price Decline: Jul to Dec 2014 **-7.0%**.
 - Average Price Decline: Jan to Jun 2015 **-37.7%**.
 - *Assumes prices do not change from latest value.*
- **Savings Are Significant for FY 2014-15.**
 - PA Consumers ~ \$3.0 to \$3.5 billion.
 - PA Businesses ~ \$1.5 to \$2.0 billion (less clear).
- **Forecast Assumes Continuation to FY 2015-16.**
 - OPEC maintains output. But, pullback in U.S. shale drilling.
 - Weak global demand: EU and China.

Potential Tax Revenue Impact

➤ **Consumers: Direct Sales and Use Tax Impact.**

- Jul to Dec 2014: +\$10 to \$15 million.
- Jan to Jun 2015: +\$45 to \$60 million.
- Assumes roughly two-thirds of savings spent.

➤ **Consumers: Indirect Effects as Well.**

- Low gasoline prices improve consumer confidence.
- More inclined to spend disposable income.
- More inclined to borrow.

➤ **Businesses: Lower Costs Increase Net Profits.**

Low Inflation for 2015

➤ Latest Forecast Calls for Low Inflation in 2015.

- Consumer Price Index (CPI) for Philadelphia metro region.
- Due to low gasoline prices. Low utility prices too.
- Also, strong dollar makes imports cheaper.

➤ Why Does This Matter?

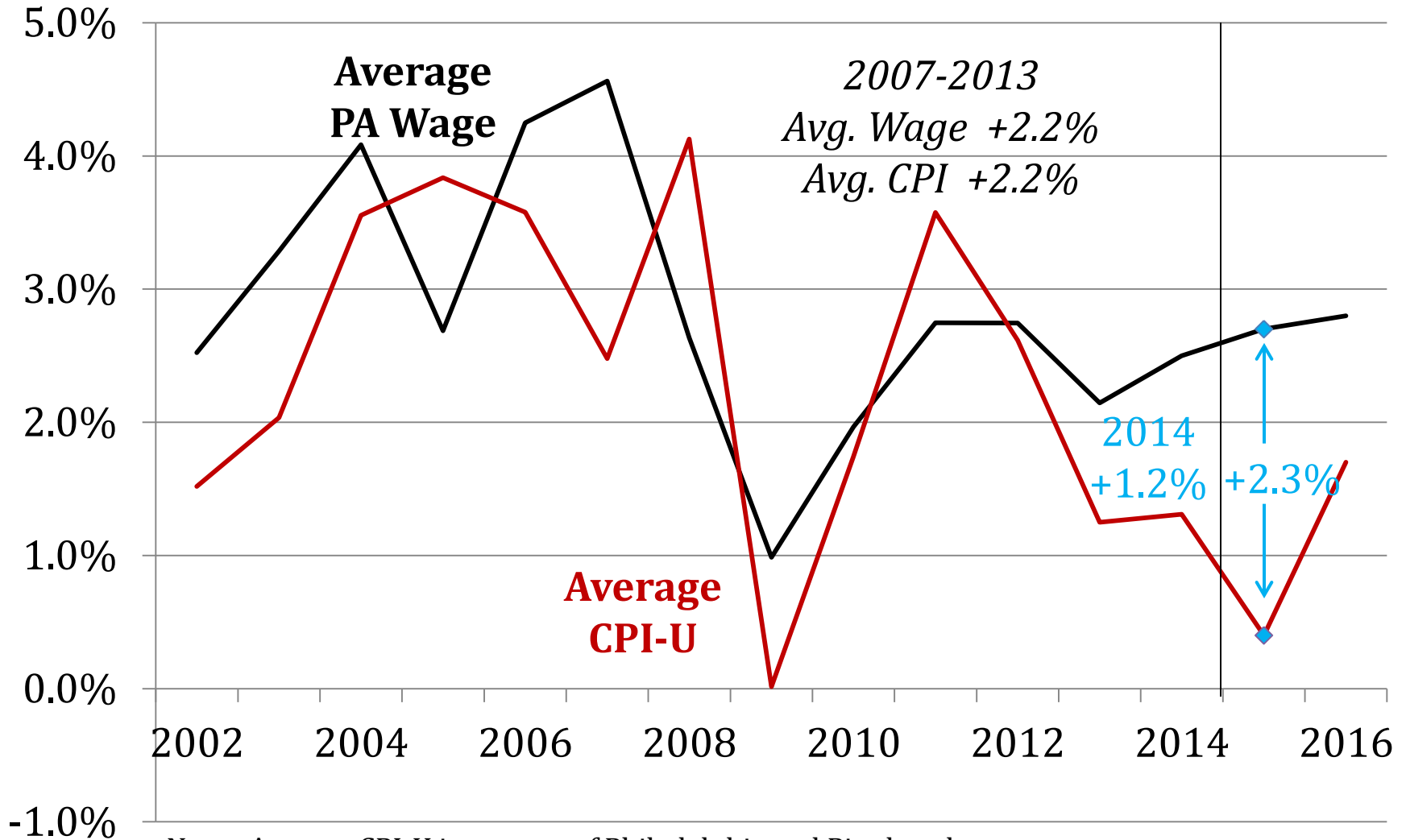
- Tax revenues include inflation: (1) higher prices (sales) and (2) higher wages (personal income).
- Could further bolster consumer confidence if wage growth holds up.

Gas Prices Drive Low Inflation

	CY 2013	CY 2014	Dec-13 to Dec-14	CPI Weight
All Items – Philadelphia CPI-U	1.2%	1.3%	0.6%	100.0%
Food and Beverage	1.3%	2.0%	3.6%	13.8%
Housing				
Shelter	1.4%	2.3%	2.2%	35.1%
Fuels and Utility	-0.7%	0.1%	-3.1%	6.0%
Furnishings	-2.2%	-2.9%	-1.9%	4.1%
Transportation				
Car, Public Transit, Other	2.8%	0.6%	2.0%	9.5%
Gasoline	-3.8%	-2.7%	-21.5%	4.5%
Medical Care	2.2%	2.5%	3.5%	7.1%
All Other	2.3%	1.8%	2.7%	19.8%
All Items Less Energy	1.6%	1.7%	2.0%	

Source: U.S. Bureau of Labor Statistics. CPI-U weight represents 2011 and 2012.

Average Wage Growth vs. Inflation



Note: Average CPI-U is average of Philadelphia and Pittsburgh metro areas.

Wrap Up

- **Budget Picture Is a Moving Target.**
 - Revenues can change quickly due to unanticipated factors.
 - Biggest revenue months are still ahead (March and April).
- **Low Energy Prices a Large, Positive Windfall.**
 - Gasoline and Natural Gas. Will they remain low?
 - Will wage growth hold up with low inflation?
- **Permanent Changes Required to Balance Budget.**
 - Will require difficult policy choices.
 - Make all changes up front, or over several years?

Questions/Discussion

Presentation to be
Posted at IFO website
www.ifo.state.pa.us