

OFFICIAL REVENUE ESTIMATE

FISCAL YEAR 2022-23



JUNE
2022

INDEPENDENT FISCAL OFFICE

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INDEPENDENT FISCAL OFFICE

June 23, 2022

The Honorable Members of the Pennsylvania General Assembly:

The Independent Fiscal Office submits this official revenue estimate in accordance with Sections 604-B (a)(1) and 605-B (b.1) of the Administrative Code of 1929. This report provides revenue estimates for fiscal year (FY) 2021-22 and FY 2022-23, and supersedes the initial revenue estimate released on May 23, 2022.

This report contains estimates for unrestricted General Fund and Motor License Fund revenues that may be considered for appropriation in the General Appropriations Act. Estimates for the Lottery Fund represent net revenues after the deduction of certain expenses. Federal funds subject to General Fund appropriation are stated separately. A separate report that describes the methodologies used to produce the various revenue estimates included in this report will be posted to the office website.

Questions or comments regarding the contents of this report are welcome and can be submitted to contact@ifo.state.pa.us.

Sincerely,

A handwritten signature in blue ink that reads "Matthew J. Knittel".

Dr. Matthew J. Knittel
Director

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Economic Outlook

This section presents the economic forecast used to project General Fund, Lottery Fund and Motor License Fund revenues. The forecast assumes modest real economic growth and continued strong inflation relative to historical rates. It also assumes that the Federal Reserve (Fed) will continue to implement the higher interest rates and monetary tightening described in recent public statements. Officials have emphasized those actions are necessary to reduce inflation. The forecast does not assume that a recession occurs in calendar year (CY) 2022 or CY 2023. However, many analysts believe there is significant potential that the forecast could deteriorate rapidly based on high energy prices, volatile and declining equity markets and global events.

Pennsylvania Economic Forecast

Table 1.1 displays the forecast for the primary economic variables used for this revenue estimate. The forecast assumes that:

- Real GDP (real gross domestic product, excludes inflation) increases by 1.1% (2022) and 0.5% (2023).
- Wages and Salaries paid to Pennsylvania residents increases by 7.7% (2022) and 5.5% (2023) (excludes compensation earned by self-employed and independent contractors).
- Payroll Employment expands by 135,000 (2022, annual average) and 30,000 (2023) net jobs (excludes self-employed and independent contractors).
- The Philadelphia CPI-U (consumer price index, annual average) increases by 7.6% (2022) and 4.7% (2023).

	Annual Growth Rate or Change					
	2019	2020	2021	2022	2023	2024
Real GDP	1.7%	-4.5%	4.4%	1.1%	0.5%	1.3%
Wages-Salaries	4.4%	-0.3%	7.7%	7.7%	5.5%	4.1%
Net Payroll Jobs (000s)	56.1	-461.1	145.5	135.0	30.0	35.5
Philadelphia CPI-U	2.0%	0.9%	4.0%	7.6%	4.7%	2.8%

Note: Payroll jobs exclude self-employed and independent contractors.
 Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. All forecasts by IFO.

Forecasters are currently assessing various potential outcomes for the U.S. economy over the next two years due to highly unusual economic conditions and the impact of anticipated Fed policy actions. Most analysts believe that a “soft landing” will be very difficult for the Fed to achieve as it raises the federal funds rate while simultaneously reducing the money supply.¹ The economic forecast assumes the following Fed policy actions:

- At its last meeting, the Fed increased the federal funds rate by 75 basis points to a range of 1.50 to 1.75. It also signaled that rates could increase by a similar magnitude at the meetings in July and September. The forecast assumes that by December, the federal funds rate will be 2.75 to 3.00 and will have a significant impact on interest rates paid by consumers and businesses.
- The Fed announced that it will begin to “taper” its holding of U.S. Treasuries and mortgage-backed securities, which will reduce the money supply. Under the announced schedule, holdings may be reduced by a maximum of \$47.5 billion in June, which ramps up to \$95 billion in August and future months. If the Fed tapers by the maximum amount, then by the end of the year, its holdings will decline from \$8.90 trillion (June 15) to \$8.33 trillion, a \$578 billion reduction (-6.5%). The taper should also result in upward pressure on interest rates paid by consumers and businesses.

Nearly all analysts identify loose monetary policy as a significant factor that motivates historically high inflation. If the Fed implements both policy actions, it should reduce inflationary pressures, but will also restrain economic growth, both real and nominal. A primary transmission mechanism will be asset prices, which have been greatly inflated due to prolonged low interest rates and excessive money creation. The impact of the anticipated Fed policy actions is already evident in the stock and housing markets. Since the end of 2021, the S&P 500 Index has declined 22.9% (through June 17) while the 30-year conventional mortgage rate increased from 3.02% to 5.78%.

As noted, the economic forecast does not assume a recession. However, it does assume that rising interest rates, high energy prices and ongoing shortages imply that real economic growth will decelerate, and asset prices will contract further (stocks) or slow significantly (housing). For CY 2022 and CY 2023, most growth is inflationary, and real economic growth for the Pennsylvania economy ranges from 0.5% to 1.1%, notably slower than its recent historical average of 1.6% for non-recession years.

Table 1.2 displays the latest quarterly data for the state economy. The data show the following year-over-year (YOY) trends:

- Real GDP increased by 4.0% in 2021 Q4. The real GDP data are published with a considerable lag and the latest published data are for 2021 Q4.
- Wage and salary growth accelerated in the first half of CY 2022. That outcome reflects the tight labor market and labor force participation rates that have not reverted to pre-pandemic levels.
- The Philadelphia CPI-U grew at the fastest rate since 1981. Excluding the shelter component (mainly rents imputed to homeowners), the index grew 9.6% in April 2022 from the prior year.

¹ The term “soft landing” has not been defined. Some use the term to imply reducing inflation close to the 2% Fed target without causing a recession. This economic forecast could be described as “stagnation” characterized by minimal real economic growth, high inflation and equity market contraction.

- Data for 2022 Q2 show that payroll jobs increased by 193,300 from the prior year. The latest unemployment rate is 4.7% and the labor force participation rate is 61.6%. For May 2019, the unemployment rate was 4.3% and the labor force participation rate was 63.0%. The much lower participation rate implies that 135,000 fewer residents were either working or actively seeking work in 2022 Q2. Other data show that the worker contraction affects all age groups, but is relatively stronger for workers under age 35.²

Table 1.2
Recent Pennsylvania Economic Growth Rates or Change

	2021.1	2021.2	2021.3	2021.4	2022.1	2022.2
Real GDP	-1.3%	11.8%	3.7%	4.0%	--	--
Wages and Salaries	1.0%	12.6%	9.5%	8.0%	10.5%	10.0%
Philadelphia CPI-U						
All Items	1.0%	3.2%	4.6%	6.1%	7.3%	8.4%
All Items - Exclude Shelter	1.4%	4.6%	6.1%	7.4%	8.5%	9.6%
Change Payroll Jobs (000s)	-405.9	558.0	235.3	194.8	211.5	193.3
Unemployment Rate	7.3%	6.7%	6.1%	5.5%	5.1%	4.7%
Labor Force Participation Rate	61.9%	61.8%	61.3%	61.0%	61.1%	61.6%

Note: All growth rates are year over year. 2022 Q2 inflation rate based on April 2022 only. 2022 Wages and Salaries growth rates based on withholding revenues.

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

² See "Is the Student Loan Moratorium Affecting Employment?" (March 2022) at http://www.ifo.state.pa.us/download.cfm?file=Resources/Documents/RB_2022_03_Student_Loan.pdf.

Federal and State Programs

In response to the COVID-19 pandemic, numerous programs injected significant funds into the state economy. **Table 1.3** displays amounts received in CY 2020 and CY 2021 and estimates of additional monies that will flow to Pennsylvania residents in CY 2022. During CY 2020 and CY 2021, Pennsylvania residents and businesses received nearly \$119 billion in support. Most support ended in CY 2021 as federal COVID relief declines to \$2.0 billion in CY 2022.

Most funds available in CY 2022 come from the emergency allotments for the Supplemental Nutrition Assistance Program (SNAP). This emergency funding provides all SNAP households the maximum monthly benefit based on size of household. A family of four receives a maximum monthly benefit of \$835. The amount for CY 2022 (\$1.5 billion) represents nine months (January through September) of expanded benefits. Rental and Homeowner Assistance allocated to the state in CY 2021 also remains available for use in CY 2022. Residual amounts of funding support from Economic Impact Payments (stimulus checks), expanded federal unemployment benefits and expanded child tax credits provides nearly \$400 million to Pennsylvania residents in CY 2022.

Table 1.3
Federal and State Pandemic Relief Programs

	2020	2021	2022	Total
Payments to Individuals or Businesses				
State Unemployment Compensation	\$5.2	\$0.8	\$0.0	\$6.0
Federal Pandemic Unemployment Comp (FPUC)	16.2	8.8	0.1	25.0
Pandemic Unemployment Assistance (PUA)	7.0	4.1	0.0	11.2
LWA and UC Extensions	3.1	3.2	0.0	6.3
SNAP Benefits	0.9	1.8	1.5	4.2
Economic Impact Payments	11.0	21.0	0.2	32.2
Expanded Child Tax Credits	--	3.4	0.1	3.5
Rental and Homeowner Assistance	--	2.0	0.0	2.0
Paycheck Protection Program (PPP)	<u>20.7</u>	<u>10.0</u>	<u>0.0</u>	<u>30.7</u>
Total	64.2	55.0	1.9	121.2
Other Federal Programs				
Direct State Support	\$5.9	\$20.2	\$0.1	\$26.2
Direct Local Support	2.6	8.2	0.1	10.9
Other Support	<u>6.9</u>	<u>3.0</u>	<u>0.0</u>	<u>9.8</u>
Total	15.3	31.4	0.1	46.9

Note: Figures in dollar billions. State support does not include federal funds associated with the temporary increase in the Federal Medical Assistance Percentage (FMAP) used to reimburse states for Medicaid program costs (effective January 1, 2020 until the termination of the national public health emergency declaration). Figures do not include savings associated with the federal student loan repayment moratorium in place from April 2020 through August 2022, with an estimated value of \$465 to \$750 million per month.

Payroll Employment Trends

In April 2020, Pennsylvania payroll employment (excludes self-employed and independent contractors) contracted by 1.1 million jobs relative to the prior year due to COVID-19 mitigation efforts and mandated business closures. By May 2021, the payroll job loss figure fell to 341,000 relative to May 2019. (See **Table 1.4.**) For May 2022, preliminary data show further improvement and a jobs reduction of 140,000 compared to 2019. For specific sectors, the latest data show that:

- The transportation and warehouse (+33,000) and professional service (e.g., legal, engineering, +23,000) sectors recorded significant job gains. Subsector data (not shown) reveal strong gains for warehousing and storage (+34,000) and couriers and messengers (+12,000).
- The administration-waste management and accommodations-food service sectors had the largest relative contractions.
- The nursing and residential care subsector (included with healthcare-social assistance) contracted by 30,000 payroll jobs (-14.6%) relative to May 2019 while the childcare subsector contracted by 3,000 (-7.0%).
- The government sector contracted by 30,000 payroll jobs (-4.2%). Notable contractions occurred for the local government-education (i.e., school districts, -9,000, -3.2%) and state government-education (i.e., public post-secondary institutions, -8,000, -14.3%) subsectors.

Table 1.4
Payroll Jobs Continue to Recover

	Change from 2019 (000s)		Growth from 2019	
	May 21	May 22	May 21	May 22
Total Payroll Employment	-341	-140	-5.6%	-2.3%
Construction	-8	-11	-3.1	-4.0
Manufacturing	-37	-13	-6.4	-2.3
Retail and Wholesale Trade	-35	-14	-4.3	-1.7
Transportation and Warehouse	5	33	1.6	11.0
Financial and Real Estate	-4	0	-1.1	0.0
Professional and Technical	7	23	2.1	6.5
Admin and Waste Management	-30	-28	-9.1	-8.7
Education (excludes local SD)	-14	-2	-5.9	-0.8
Healthcare-Social Assistance	-46	-40	-4.3	-3.8
Arts-Entertainment	-24	-5	-22.5	-4.5
Accommodation-Food Service	-91	-42	-18.6	-8.6
Other Services	-28	-16	-10.6	-6.1
All Government	-30	-30	-4.3	-4.2
All Other	-7	6	-2.8	2.3

Note: Data are not seasonally adjusted. Figures for May 2022 are preliminary. Excludes self-employed.

Source: U.S. Bureau of Labor Statistics, State and Metro Area Employment.

Income and Tax Revenues

Table 1.5 displays annual growth rates for personal income tax revenues (top portion) and fields reported on the Pennsylvania income tax return (bottom) for non-wage income. Withholding tax revenues reflect the growth of wages and salaries paid to payroll workers. For tax or calendar year 2021, withholding growth increased 8.5% from the prior year, and for 2022 (year not shown in table), the forecast projects further strong growth (8.0%). Taxpayers remit payments due on non-wage income such as dividends, capital gains and net business profits (excludes C corporations, but includes self-employed earnings) through estimated and final payments. Revenue data through May 2022 show that payments attributable to non-wage income received or generated in tax year 2021 surged 45% from the prior year. Final personal income tax return data are not available for two years, so the tax return growth rates displayed for tax years 2020 and 2021 are estimates. For tax year 2021, the forecast assumes that capital gains income grew by 85%, net business profits by 30% and dividends by 45%. These very strong growth rates are necessary to account for the revenues received through May 2022. Based on current and projected stock market trends, the revenue forecast assumes that capital gains contract by 50% for tax year 2022, which still exceeds the amount reported for tax year 2019 by nearly 20%. Largely due to inflation, net business profits are assumed to expand by 5% in 2022 while dividend income remains flat.

	Growth Rates by Tax Year					
	2016	2017	2018	2019	2020	2021
Tax Revenues						
Withholding	2.5%	4.0%	4.3%	4.3%	-1.0%	8.5%
Estimated + Final	-2.2	9.3	8.6	2.1	7.9	45.2
Tax Return Fields						
Capital Gains	-11.9	32.0	0.8	6.3	29.0	85.0
Dividends	-13.4	21.3	18.0	-1.0	-6.1	45.0
Net Business Profits	0.3	3.7	9.6	2.4	1.8	30.0
Interest	6.5	6.7	17.0	23.8	-15.7	-5.0
Total	-4.8	13.3	8.8	3.9	6.8	48.3

Note: Withholding growth rate controls for extra weekly deposit in 2020. Values for Tax Return Fields for 2020 and 2021 are estimates based on revenues.

The contraction of capital gains income is one factor that motivates the projected decline in Pennsylvania Cash Income. Cash Income includes all income received by state residents that can be spent or saved. It includes: wages, interest, dividends, capital gains, rents, royalties, pensions, Social Security, IRA disbursements, business and self-employment income and government transfers (e.g., unemployment and stimulus payments). The forecast projects that Cash Income will contract from \$767 billion in CY 2021 to \$728 billion in CY 2022, a reduction of \$39 billion (-5.0%). Despite strong wage growth (7.7%) and a material Social Security cost-of-living adjustment (5.9%), Cash Income contracts due to the lack of federal stimulus payments (-\$46 billion) and the projected decline in capital gains income.

Figure 1.1 displays the projected contraction of Pennsylvania Cash Income and growth rates for non-motor vehicle sales and use tax (SUT) and motor vehicle SUT collections. Prior to CY 2020, there was a high degree of correlation between Cash Income and the two consumption series. For CY 2020, Cash Income surged due to federal stimulus (see Table 1.3), while the two SUT series decelerated or contracted due to mitigation efforts and business closures. Although income grew significantly, many residents used the federal payments to pay down debt or were reluctant to spend (e.g., unwillingness to travel). By contrast, Cash Income expanded again at a similar rate in CY 2021 (roughly 12%) but taxable spending surged, especially for motor vehicles. This was largely attributable to the third (and largest) economic impact payment received in March 2021 and a higher propensity to spend (i.e., less precautionary savings).

For CY 2022, the revenue forecast projects a slight contraction in motor vehicle SUT and typical growth for non-motor vehicle SUT, despite the decline in Cash Income. Additional detail is included in the next section of this report.

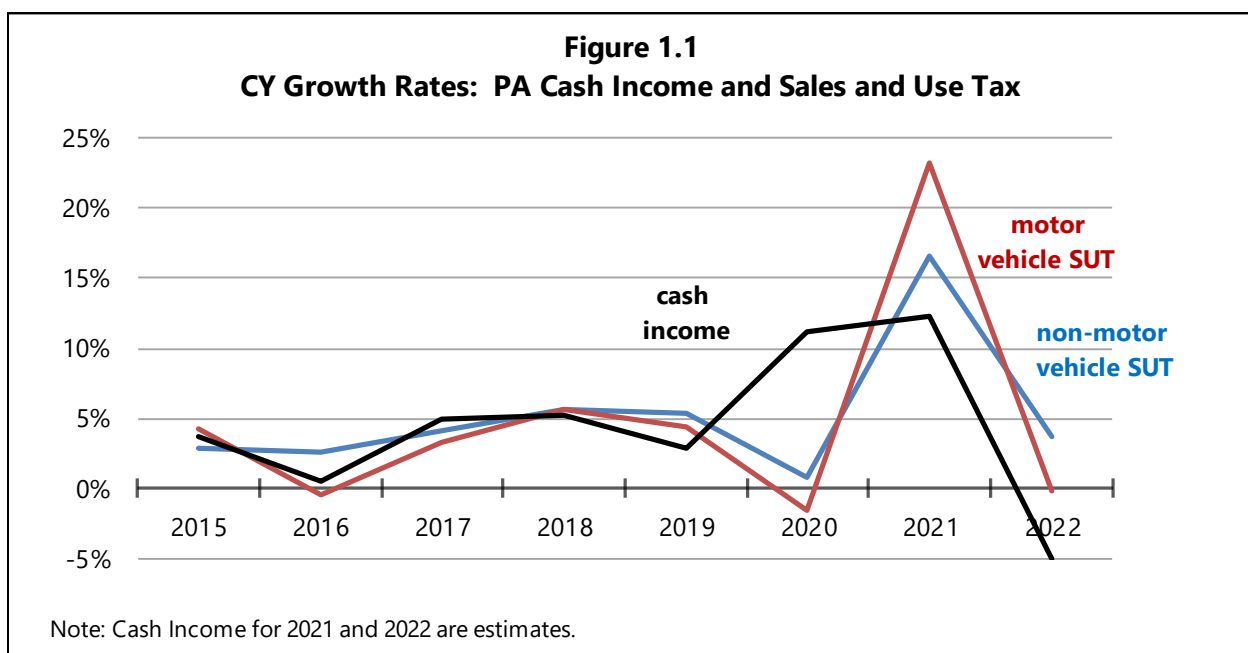


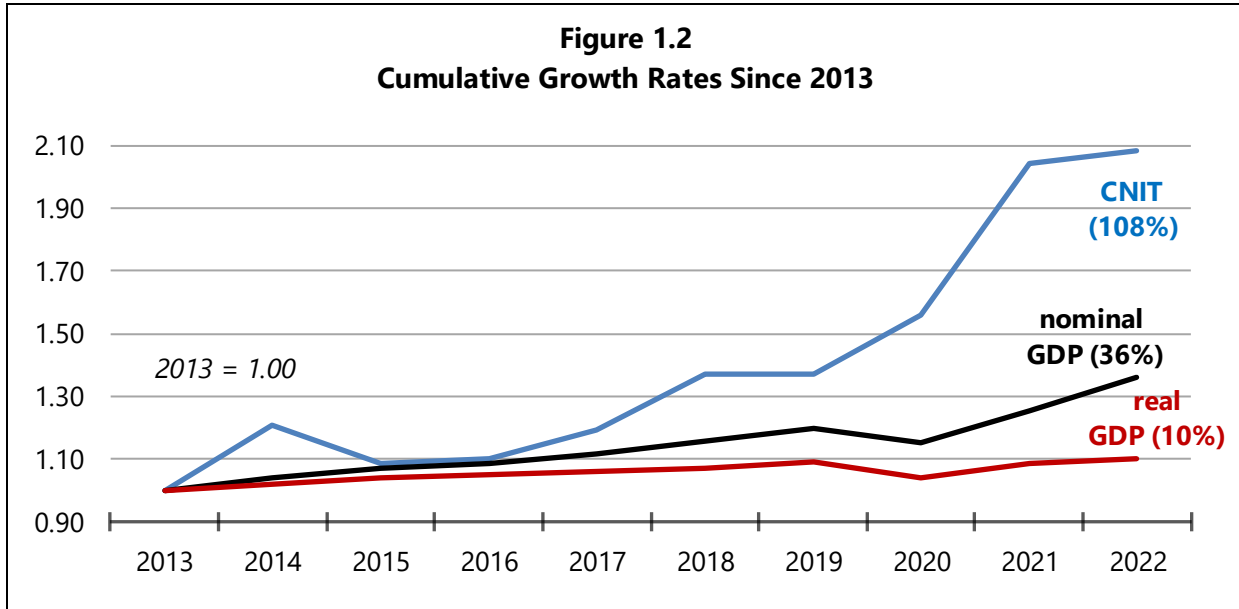
Figure 1.2 displays trends for corporate net income tax (CNIT) revenues and real and nominal Pennsylvania GDP, which reflects the overall growth rate of the state economy. The figure uses CNIT revenues because C corporation profits cannot be sourced accurately to specific states, and published data are not available. Corporate profits motivate trends in dividend income and indirectly motivate capital gains realizations. Both income sources impact consumer spending.

The figure illustrates the significant divergence between CNIT revenue growth and the state economy. The divergence is especially notable for CY 2020 and CY 2021. Because tax return data are not available, the factors that drive this outcome are not known with certainty, but it is likely that several factors motivate the very strong growth of CNIT revenues:

- Temporary inflation gains that will be eliminated as higher costs are reflected in the supply chain and existing inventories are eliminated. Recent trends suggest that consumers are less willing to absorb price increases that firms have pushed forward.
- A lag effect from higher labor costs that are now much higher due to a tight labor market.

- A material gain from reduced business travel and related expenses.
- Disproportionate purchases of durable goods and higher margin products. However, recent trends suggest that consumers are shifting towards products with lower profit margins.

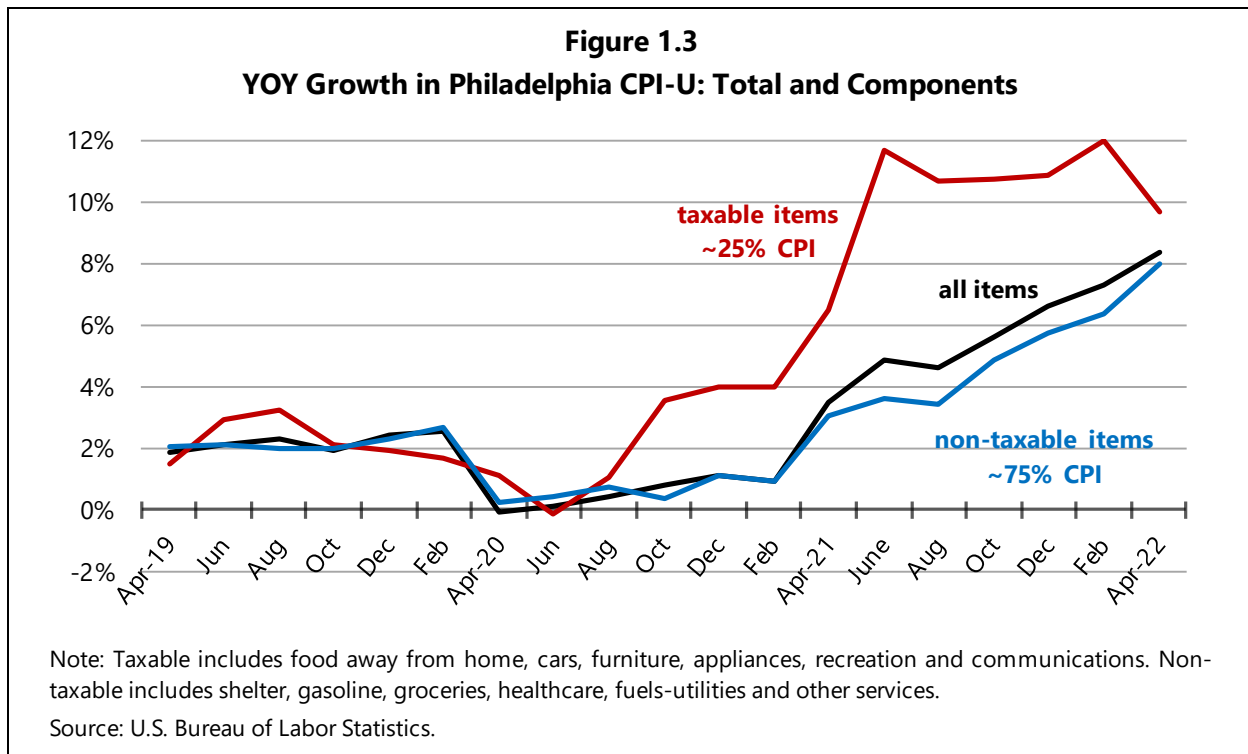
The economic forecast assumes that this divergence cannot be maintained. For CY 2022 and CY 2023, the forecast assumes a 2% expansion in corporate profits and then moderate contraction (-5%).



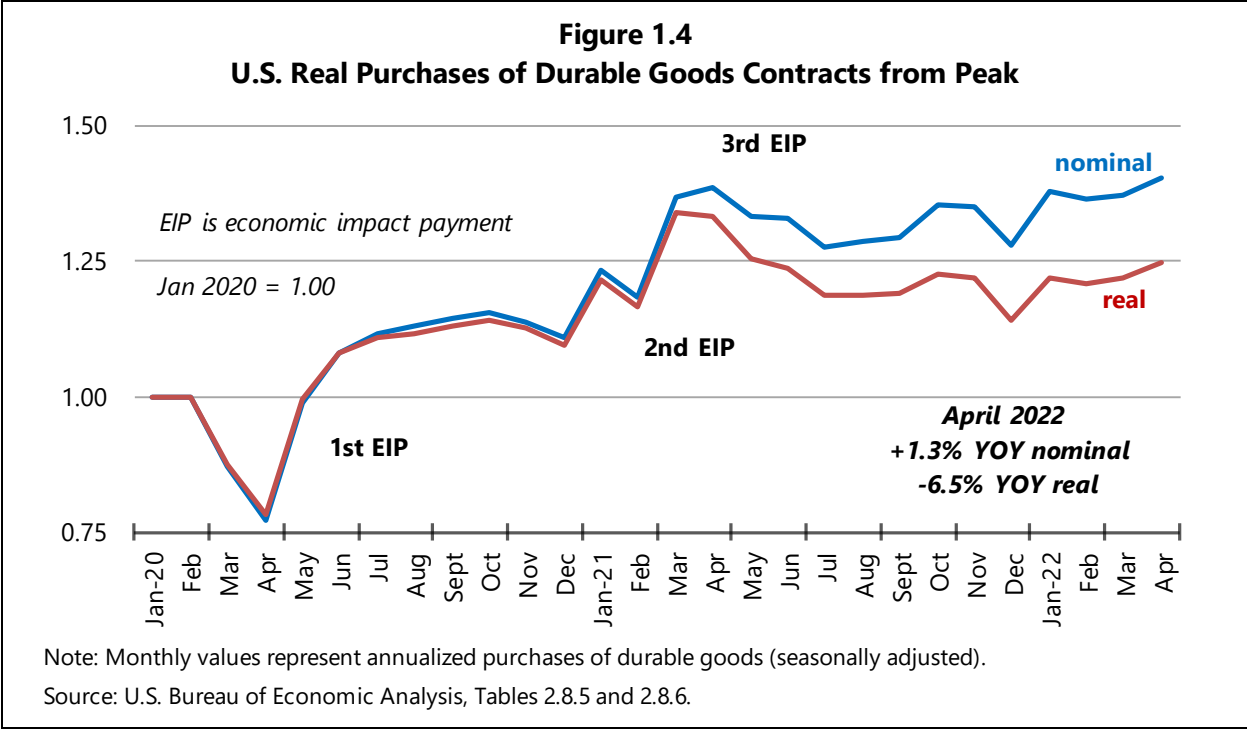
Inflation and Consumer Spending

The only published inflation metric for the state is the Philadelphia metro region consumer price index for all urban consumers (CPI-U). The latest reading for April 2022 shows YOY growth of 8.4% for the metro region. In addition to significant federal transfers, high inflation has also been a material factor that drives strong SUT collections. More specifically, prices for items subject to SUT have increased much faster than non-taxable goods and services.

Figure 1.3 displays annual growth rates for the Philadelphia CPI-U (all items), and estimated inflation rates for purchases subject to SUT and goods and services that are exempt. The figure illustrates the much higher inflation rate for taxable items such as vehicles, appliances, furniture and dining out compared to non-taxable items (e.g., shelter, groceries, clothing). The relative inflation rates provide an extra boost to SUT collections because relatively more income (i.e., a higher percentage) will flow to taxable purchases. Going forward, the forecast assumes these trends reverse, and inflation rates for non-taxable goods and services will be similar or exceed those for items subject to tax. This projected reversal will constrain SUT collections as a greater share of consumer income is used for purchases of non-taxable goods and services.



A related trend has been strong consumer spending and inflation for durable goods. **Figure 1.4** displays trends in nominal and real U.S. durable goods purchases (recent state-level data are not available). Relative to January 2020, nominal durable goods purchases for April 2021 surged by 39% and real purchases by 34%. The increase reflects the impact of federal transfer payments that were used for purchases such as vehicles, furniture and appliances. At that time, durable goods prices had increased modestly as the real and nominal growth rates were relatively close. By April 2022 (latest data), nominal purchases had increased slightly relative to the prior year (+1.3%) while real purchases declined (-6.5%). These trends suggest that consumers may be reverting to prior spending patterns. To the extent this trend continues, it will restrain the growth rate of SUT revenues.



Financial and Consumer Data

Table 1.6 concludes the section with recent data from national financial markets, Pennsylvania home values and rents and per capita consumer debt. The table shows YOY growth rates, while the final column displays the cumulative growth rate from 2019 Q2 (pre-pandemic) to 2022 Q2.³ The data reveal the following trends:

- The average S&P 500 Index is down (-2.4%) in 2022 Q2, but up 40% from 2019 Q2. Since December 31, 2021, the Index is down 22.9% (through June 17, not shown).
- The rate for a conventional 30-year mortgage has increased dramatically since the start of the year. The current rate is 5.78%.
- Pennsylvania existing home values (all homes, not only sales) increased by 14.5% from last year and 35.3% since 2019 Q1.
- Average rents are up significantly in all metro areas.
- Auto loans recorded strong growth for the latest four quarters. The data also reveal recent strong growth in credit card debt.

Mortgage refinancing trends are not shown in Table 1.6, but they will impact consumer spending. Due to very low interest rates, many homeowners refinanced mortgages in CY 2020 and CY 2021. For CY 2021, Freddie Mac estimates that the average Philadelphia homeowner that refinanced saved \$2,715 per annum. For the U.S., Freddie Mac estimates that \$248 billion in existing equity was cashed out in CY 2021. If the

³ If data are not available for 2022 Q2, then the cumulative growth rate is from 2019 Q1 to 2022 Q1.

Pennsylvania share is 4%, then homeowners cashed out roughly \$10 billion of home equity through refinancings.⁴ Due to rising interest rates, refinancing should fall dramatically and the cash-out equity income received in CY 2021 will not recur. Similar to other trends discussed in this section, that outcome should constrain SUT revenue growth.

Table 1.6
Financial, Housing and Debt Trends

	Year-Over-Year Growth Rate					2019.2 to 2022.2
	2021.2	2021.3	2021.4	2022.1	2022.2	
Financials						
S&P 500 Index	42.8%	32.4%	30.1%	19.2%	-2.4%	39.7%
30-Year Mortgage Rate	3.0	3.0	3.1	4.7	5.8	--
Housing						
PA Home Price Index	16.5	14.8	13.4	14.5	--	35.3
Rent - Philadelphia	4.0	7.8	10.8	11.9	11.3	17.9
Rent - Pittsburgh	3.9	7.0	8.3	8.5	10.1	17.7
Rent - Harrisburg	10.1	13.3	13.7	14.2	11.7	24.1
Rent - Scranton	11.3	15.1	12.9	12.7	14.0	31.2
PA Per Capita Consumer Debt						
Auto Loan	12.7	9.9	8.9	7.4	--	17.0
Credit Card	-6.2	-2.8	3.1	8.9	--	-5.5
Primary Mortgage	4.2	6.3	6.4	4.4	--	14.2

Note: Primary mortgage includes closed-end home equity loans. S&P 500 for 2022.2 uses value through June 17. Rent growth rates for 2022.2 use April and May. Home Price Index is purchase only. Mortgage rate from end of quarter. If 2022 Q2 data are not available, cumulative growth rate is from 2019.1 to 2022.1.

Source: Wall Street Journal, Freddie Mac, Federal Housing Finance Agency, Zillow and NY Federal Reserve Bank.

⁴ See <https://www.freddiemac.com/research/pdf/202204-Note-Refinancing-04.pdf>.

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Official Revenue Estimate

This section provides revised revenue estimates for FY 2021-22 and official estimates for FY 2022-23 for the General Fund, Motor License Fund, Lottery Fund and federal funds subject to appropriation. The subsequent pages provide detail on the projected levels and growth rates for those funds. For the purpose of this revenue estimate, all projections are made on a “current law” basis and exclude any statutory changes or administrative actions proposed in the *2022-23 Executive Budget*.

The General Fund

The Independent Fiscal Office (IFO) released its official FY 2021-22 General Fund revenue estimate of \$41.91 billion in June 2021. Since then, revenues in almost every category have dramatically outperformed expectations. Based on very strong revenue collections through May 2022, the revised estimate for FY 2021-22 is \$48.15 billion, \$6.24 billion above the IFO’s official estimate. (See **Table 2.1.**) Significant revisions to the FY 2021-22 forecast include:

- Corporate net income tax (CNIT) collections are expected to exceed the IFO’s official estimate by \$1.54 billion. The revision is largely attributable to: (1) higher prices that have been pushed forward to consumers, (2) corporate savings due to reductions in business expenses (e.g., travel, remote working) and (3) shifts in consumer purchases to higher margin products.
- The revised sales and use tax (SUT) estimate is \$1.46 billion higher than the IFO’s official estimate, primarily due to strength in non-motor vehicle collections (\$1.30 billion). The upward revision reflects SUT growth of 9.8% (adjusted) and is driven by strong wage gains, the continued moratorium on federal student loan repayments, delayed spending of federal stimulus payments and inflation rates that are much higher than anticipated.
- The updated personal income tax (PIT) estimate exceeds the IFO’s official estimate by \$2.63 billion, an increase of 20.8% (adjusted for one-time transfers, additional due dates and COVID-related delayed due dates) over the prior fiscal year. The revision is attributable to strong wage growth (TY 2021 and TY 2022) driven by a tight labor market and inflation, and unprecedented increases in capital gains and net business profits (TY 2021).
- Inheritance tax collections continue to outperform expectations, likely attributable to a strong stock market and elevated home values. As a result, the updated estimate exceeds the IFO’s revised official estimate by \$265 million, an increase of 16.8% over the prior fiscal year.

For FY 2022-23, the official estimate is \$42.32 billion, a reduction of \$5.83 billion from the current fiscal year. (See **Table 2.2.**) Federal funds totaling \$3.84 billion and transferred to the General Fund during FY 2021-22 do not recur in FY 2022-23. Excluding that one-time transfer and a new transfer to the Public Transportation Trust Fund (PTTF), the initial estimate declines by \$1.48 billion (-3.3%) compared to FY 2021-22.

Table 2.1
Adjustment to Revenue Estimate for FY 2021-22

	June 2021 Estimate		June 2022 Estimate		Dollar Change
	Amount	Growth	Amount	Growth	
Total General Fund	\$41,915	3.8%	\$48,154	19.2%	\$6,239
Total Tax Revenue	37,357	-4.7	43,529	11.1	6,172
Total Corporation Taxes	5,721	-9.7	7,316	15.5	1,595
Corporate Net Income	3,766	-14.9	5,303	19.9	1,537
Gross Receipts	1,047	5.8	1,028	3.8	-19
Utility Property	41	1.0	40	-1.3	-1
Insurance Premiums	432	-4.4	494	9.3	62
Financial Institutions	435	2.8	451	6.6	16
Total Consumption Taxes	13,910	-3.2	15,401	7.2	1,491
Sales and Use	12,459	-2.9	13,918	8.4	1,459
Non-Motor	10,781	-1.9	12,078	9.9	1,297
Motor	1,677	-9.2	1,840	-0.4	163
Cigarette	874	-9.4	880	-8.7	6
Other Tobacco Products	139	2.7	150	11.4	11
Malt Beverage	24	1.0	23	-2.9	-1
Liquor	416	-0.1	430	3.5	14
Total Other Taxes	17,726	-4.0	20,813	12.7	3,087
Personal Income	15,518	-4.7	18,149	11.5	2,631
Withholding	11,436	5.5	12,034	11.0	598
Quarterly	2,252	-12.0	2,779	8.6	527
Annual	1,830	-36.6	3,336	15.6	1,506
Realty Transfer	683	6.6	837	30.7	154
Inheritance	1,307	-2.9	1,572	16.8	265
Gaming	262	8.3	315	30.3	53
Minor and Repealed	-43	-13.2	-60	-57.8	-17
Total Non-Tax Revenue	4,558	276.0	4,625	281.4	67
State Store Fund Transfers	185	0.0	185	0.0	0
Licenses and Fees	169	-9.6	168	-10.4	-1
Treasury	12	28.0	16	68.6	4
Escheats	233	-0.7	265	12.9	32
Other Miscellaneous	3,896	--	3,930	--	34
Fines, Penalties & Interest	63	-1.8	62	-3.8	-1

Note: Figures in dollar millions. Due to rounding, detail may not sum to total. Growth rates based on the unrounded amounts.

Table 2.2
General Fund Revenue Estimate for FY 2022-23

	Estimated 2021-22		Projected 2022-23	
	Amount	Growth	Amount	Growth
Total General Fund	\$48,154	19.2%	\$42,324	-12.1%
Total Tax Revenue	43,529	11.1	41,560	-4.5
Total Corporation Taxes	7,316	15.5	7,012	-4.2
Corporate Net Income	5,303	19.9	4,982	-6.1
Gross Receipts	1,028	3.8	1,045	1.6
Utility Property	40	-1.3	40	1.5
Insurance Premiums	494	9.3	484	-2.0
Financial Institutions	451	6.6	461	2.2
Total Consumption Taxes	15,401	7.2	14,563	-5.4
Sales and Use	13,918	8.4	13,086	-6.0
Non-Motor	12,078	9.9	11,721	-3.0
Motor	1,840	-0.4	1,365	-25.8
Cigarette	880	-8.7	845	-4.0
Other Tobacco Products	150	11.4	164	9.0
Malt Beverage	23	-2.9	24	4.0
Liquor	430	3.5	445	3.4
Total Other Taxes	20,813	12.7	19,986	-4.0
Personal Income	18,149	11.5	17,494	-3.6
Withholding	12,034	11.0	12,823	6.6
Quarterly	2,779	8.6	2,489	-10.4
Annual	3,336	15.6	2,182	-34.6
Realty Transfer	837	30.7	781	-6.6
Inheritance	1,572	16.8	1,415	-10.0
Gaming	315	30.3	353	12.2
Minor and Repealed	-60	-57.8	-58	3.7
Total Non-Tax Revenue	4,625	281.4	764	-83.5
State Store Fund Transfers	185	0.0	185	0.0
Licenses and Fees	168	-10.4	158	-5.8
Treasury	16	68.6	16	2.5
Escheats	265	12.9	258	-2.5
Other Miscellaneous	3,930	--	84	-97.9
Fines, Penalties & Interest	62	-3.8	63	2.8

Note: Figures in dollar millions. Due to rounding, detail may not sum to total. Growth rates based on the unrounded amounts.

The text that follows provides a brief description of the factors that motivate trends across revenue sources for FY 2021-22 and FY 2022-23.

Corporate Net Income

The revised CNIT estimate for FY 2021-22 is \$5.30 billion. The estimate reflects an increase of \$1.54 billion from the IFO's official estimate and is \$880 million (+28.6% after adjusting for COVID-related delayed tax due dates) over the prior fiscal year. The revision is driven by three factors: (1) higher prices that have been pushed forward to consumers, (2) corporate savings due to reductions in business expenses (e.g., less business travel) and (3) shifts in consumer purchases to higher margin products.

For FY 2022-23, the preliminary estimate is \$4.98 billion, a decline of 6.1% from FY 2021-22. The forecast assumes that corporate profits will contract by 5.2% in CY 2023 due to the lack of federal stimulus, growth of labor compensation costs and a shift of consumer spending to products that have lower profit margins.

Sales and Use

The revised SUT estimate for FY 2021-22 is \$13.92 billion. This estimate reflects an increase of \$1.46 billion from the IFO's official estimate and is 9.8% above revenues from the prior fiscal year (after adjusting for a due date shift). SUT collections in the current fiscal year have been boosted by strong wage gains, the moratorium on federal student loan payments, delayed spending of federal stimulus payments and inflation rates that are much higher than anticipated. As a result, non-motor vehicle revenues are projected to increase by 11.6% (adjusted) from the prior fiscal year. E-commerce sales have begun to slow during the fiscal year, as consumers revert to normal spending patterns (more spending on non-taxable services, less spending on taxable goods). Motor vehicle SUT is expected to decline 0.4% to \$1.84 billion in FY 2021-22, an increase of \$163 million from the IFO's official estimate.

SUT collections are expected to decline 2.3% (adjusted) for FY 2022-23, as inflation moderates, the Federal Reserve raises interest rates and reduces bond holdings (money supply tightens), wage growth fails to keep pace with higher prices (including fuel), the elimination of wealth effects from strong stock market and housing gains and consumers partially revert to historical spending patterns (more services, less goods). For FY 2022-23, the forecast projects that non-motor vehicle revenues will decrease by \$358 million (-3.0%), and motor vehicle revenues will increase 2.0%, after adjusting for a new transfer to the PTTF (\$511 million).

Personal Income

The revised PIT estimate for FY 2021-22 is \$18.14 billion, which is \$2.63 billion higher than the IFO's official estimate, an increase of 20.8% over the prior fiscal year (after adjustments for COVID-related delayed due dates, extra due dates and one-time transfers). The upward revision is the result of two main factors: (1) very strong April final payments (+\$1.33 billion above the official monthly estimate) largely due to unusual strength in TY 2021 capital gains (85% estimated growth) and business income (30% estimated growth) and (2) wage growth (real and inflationary). These factors add a net of \$598 million to withholding and \$2.03 billion to non-withheld revenues.

For FY 2022-23, the forecast projects \$17.49 billion in PIT collections, a decline of 3.6%. Withholding is expected to increase by 6.6%, while non-withheld revenues fall by 23.6%. As noted in the prior section, the forecast assumes that capital gains income contracts by 50% for TY 2022.

Cigarette

Sales of cigarettes were significantly impacted in FY 2020-21, likely due to an increase in stress-related smoking during the pandemic and increased opportunities to smoke for those working from home. Consumption appears to have largely returned to normal in FY 2021-22, as revised collections are expected to decline 8.7% and are only \$6 million above the IFO's official estimate. For FY 2022-23, collections are projected to decline \$35 million (-4.0%) consistent with historical patterns. Consistent with prior years, collections are reduced by \$115 million for debt service related to the Tobacco Settlement Bonds.

Realty Transfer

The revised realty transfer tax estimate for FY 2021-22 is \$837 million, an increase of \$154 million from the IFO's official estimate and up 30.7% from the prior fiscal year. The revision is largely driven by increased home prices due to limited supply, pent-up demand and historically low mortgage rates. For FY 2022-23, sales are expected to decline and prices moderate due to rising interest rates. As a result, the official realty transfer tax estimate for FY 2022-23 falls to \$781 million, a decline of 6.6% from the current year.

Inheritance

Inheritance tax collections continue to outperform expectations, largely attributable to a strong stock market and elevated home values. As a result, the revised estimate for FY 2021-22 exceeds the IFO's official estimate by \$265 million, an increase of 16.8% over the prior fiscal year. Moving forward, more muted increases in home values due to rising interest rates and smaller gains in the stock market (the S&P 500 Index increased by almost 30% in CY 2021 but is down roughly 22.9% through June 17) are expected to reduce inheritance tax collections by 10.0% for FY 2022-23.

Other Revenue Sources

Other revenue sources that have a notable impact on General Fund revenue trends for FY 2021-22 and FY 2022-23 include:

- The revised gaming estimate for FY 2021-22 is \$315 million, an increase of \$73 million over the prior fiscal year due primarily to increases in sports wagering and iGaming. The forecast for FY 2022-23 of \$353 million reflects the opening of two category 4 casinos and assumes that table games tax revenues remain in the General Fund.
- The revised escheats estimate of \$265 million is \$32 million above the IFO's official estimate, due to higher than anticipated deposits of unclaimed property. For FY 2022-23, escheats collections are projected to decline to \$258 million.
- The FY 2022-23 estimate assumes that \$185 million will be available for transfer from the State Stores Fund to the General Fund.

The Motor License Fund

The Motor License Fund (MLF) primarily includes various taxes levied on a per gallon basis and revenue from licenses and registration fees. Based on actual revenue collections through May 2022 and projections for the remainder of the fiscal year, the revised estimate for FY 2021-22 is \$2.89 billion, an increase of 2.2% from the prior year and \$53 million above the IFO's official estimate.

The MLF collections are expected to be flat (-0.1%) for FY 2022-23. That result is driven by three factors:

- Consumption of gasoline has rebounded but remains below pre-pandemic levels due to changes in driver behavior (largely more telecommuting) and increased vehicle fuel efficiency.
- Increases for most fees levied under Title 75 (the Vehicle Code) are tied to the rate of inflation, with adjustments occurring in calendar years ending in an odd number. Therefore, there is no inflation adjustment for FY 2022-23. Without a fee increase, fee revenues are historically flat.
- The oil company franchise tax (OFT) rate is calculated annually based on the average wholesale price (AWP) of gasoline and diesel fuel in the prior calendar year. Beginning with CY 2017 and thereafter, the minimum AWP is \$2.99 per gallon. For the 12-month period ending September 30, 2021, the Pennsylvania Department of Revenue determined the actual AWP to be \$1.92 per gallon. Therefore, the AWP used to calculate the 2022 OFT rate remains at the statutory minimum of \$2.99 per gallon (no increase in the rate).

Table 2.3
Motor License Fund Summary

	Estimated 2021-22		Projected 2022-23	
	Amount	Growth	Amount	Growth
Total Motor License Fund	\$2,887	2.2%	\$2,884	-0.1%
Liquid Fuels Taxes	1,750	5.7	1,764	0.8
Oil Company Franchise	954	5.4	962	0.9
Act 89 OCFT - Liquid Fuels	500	5.9	502	0.5
Act 89 OCFT - Fuels	146	1.5	150	2.1
Other Liquid Fuels Taxes	150	11.1	150	0.0
Motor Licenses and Fees	1,129	-2.0	1,111	-1.6
Vehicle Registration & Titling	807	-5.6	816	1.2
Registration Other States - IRP	176	1.6	176	0.0
Operator's Licenses	89	11.2	72	-20.0
Other Licenses and Fees	57	30.5	47	--
Other Motor Receipts	8	--	9	13.6
Vehicle Fines Clearing Acct	1	-92.1	2	155.6
Treasury	5	5.5	5	-7.7
Transportation	1	10.1	2	14.3
General Services	1	81.1	1	-16.7

Note: Figures in dollar millions. Due to rounding, detail may not sum to total. Growth rates based on the unrounded amounts.

The Lottery Fund

Similar to other consumer purchases, Lottery sales were impacted by the COVID-19 pandemic. **Figure 2.1** displays year-over-year growth rates for January 2020 through June 2022 (projected) for those games that were primarily impacted (Instants, Numbers and iLottery). While sales of most Lottery games declined due to business closures and other mitigation efforts in the early months of the pandemic, iLottery sales climbed dramatically due to the availability of online play. From May 2020 to April 2021, Instants, Numbers and iLottery all displayed very strong year-over-year growth, likely due to federal COVID relief payments to individuals, as spikes in growth rates directly correlate with the distribution of stimulus payments. As a result, the FY 2021-22 growth rates for Instants, Numbers and iLottery were largely negative following an unusually strong FY 2020-21.

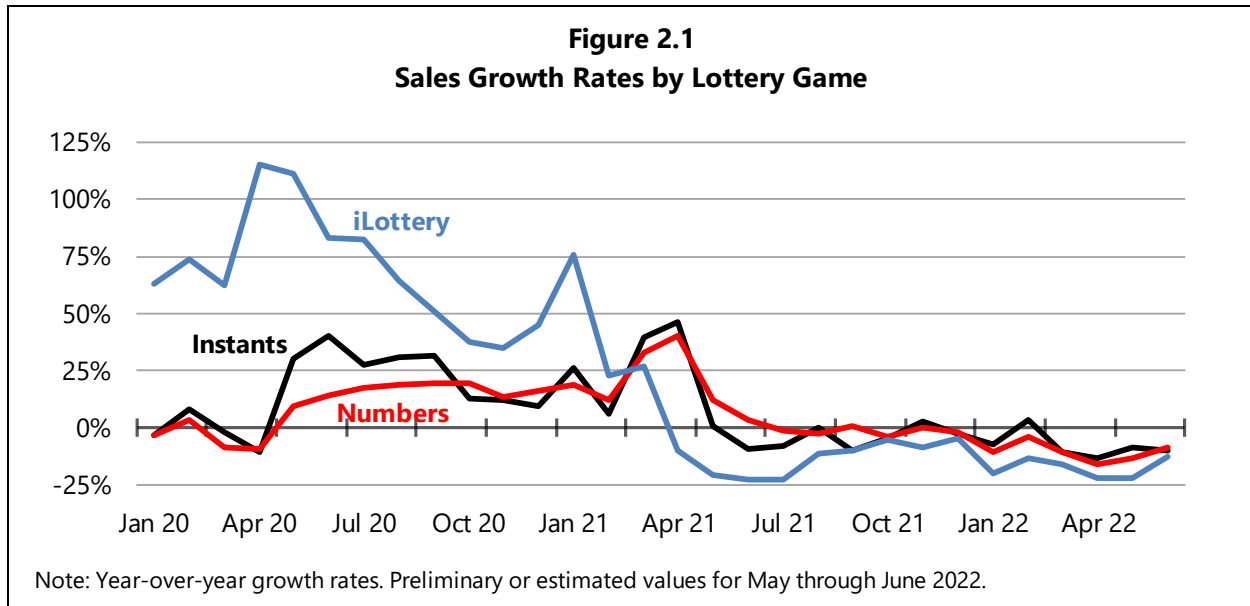


Table 2.4 displays historical sales and the average annual growth rate by category of Lottery game for FY 2014-15 to FY 2018-19, as well as actual collections for pandemic impacted years of FY 2019-20, FY 2020-21 and FY 2021-22 (estimated). After average growth of 4.5% per annum for the four-year period prior to the pandemic, sales of Instants increased 18.0% in FY 2020-21 and are projected to decline 6.2% for the current year. Numbers games grew 18.2% in FY 2020-21 and are projected to decline 6.2% for the current year. Multistate Lotto games, which rely heavily on large jackpots to drive sales, benefited from an increase in the number of jackpots in FY 2020-21 (42.3%) and are projected to decline in FY 2021-22 (-0.9%).

Due to the limited history of iLottery, it is displayed separately in Table 2.4. Revenues in this category saw significant growth for FY 2019-20 (92.8%) and FY 2020-21 (23.5%), largely due to increased demand for games that offered online play during the pandemic. For FY 2021-22, revenues are projected to decline 14.6% as some players shift back to in-person games.

Table 2.4
Historical Lottery Sales by Category

	14-15	18-19	AAGR	19-20		20-21		21-22	
	Amt.	Amt.		Amt.	Growth	Amt.	Growth	Amt.	Growth
Instant Tickets	\$2,592	\$3,093	4.5%	\$3,306	6.9%	\$3,902	18.0%	\$3,660	-6.2%
Numbers	597	575	-0.9	576	0.2	681	18.2	639	-6.2
In-State Lotto	233	272	4.0	254	-6.6	271	6.7	261	-3.6
Multistate Lotto	376	507	7.7	270	-46.8	384	42.3	380	-0.9
Raffle and Other	<u>18</u>	<u>57</u>	<u>34.1</u>	<u>64</u>	<u>12.3</u>	<u>65</u>	<u>1.9</u>	<u>66</u>	<u>1.2</u>
Sub-Total	3,815	4,503	4.2	4,469	-0.8	5,302	18.6	5,006	-5.6
iLottery	<u>0</u>	<u>381</u>	<u>--</u>	<u>735</u>	<u>92.8</u>	<u>908</u>	<u>23.5</u>	<u>776</u>	<u>-14.6</u>
Grand Total	3,815	4,885	6.4	5,205	6.6	6,211	19.3	5,782	-6.9

Note: Figures in dollar millions. AAGR is average annual growth rate from FY 14-15 to FY 18-19. Instant Tickets includes Scratch Offs and Fast Play. Other includes Keno and Xpress Sports.

The final revenue estimate projects that Lottery Fund net revenues will decline by \$30 million (-1.5%) for FY 2021-22 and grow by \$11 million (0.6%) for FY 2022-23. (See **Table 2.5**.) The first result is driven in part by (1) the presence of the Gaming Fund transfer in FY 2021-22 following no transfer in FY 2020-21 and (2) a decline in gross ticket sales for FY 2021-22 (explained above).⁵

For FY 2022-23, Lottery ticket sales are expected to revert to growth rates slightly below historical patterns, a result of less discretionary income (more spent on food, utilities, housing and transportation) as inflation outpaces wage growth.

- Instant ticket sales, which includes Fast Play, are projected to increase 3.3% as they remain popular with consumers.
- Sales of iLottery are expected to rise 3.7% after negative growth in FY 2021-22.
- Multistate Lotto sales are projected to return to a more typical average annual growth rate of 2.5%.
- Numbers games are expected to remain flat due to players' preference for newer lottery games.

⁵ In response to the COVID-19 pandemic, Property Tax/Rent Rebate payments that would have been disbursed in FY 2020-21 were accelerated into FY 2019-20.

**Table 2.5
Lottery Fund Summary**

	Estimated 2021-22		Projected 2022-23	
	Amount	Growth	Amount	Growth
<u>Total Lottery Fund</u>	\$1,977	-1.5%	\$1,988	0.6%
Gross Ticket Sales	5,782	-6.9	5,951	2.9
Field Paid Prizes & Commissions	-3,920	-6.8	-4,052	3.4
Miscellaneous Revenues	115	--	89	-22.1
<u>Gross Ticket Sales Detail</u>	5,782	-6.9	5,951	2.9
Instant Tickets	3,660	-6.2	3,781	3.3
Multistate Lotto Games	380	-0.9	390	2.5
In-State Lotto	261	-3.6	269	3.0
Numbers Games	639	-6.2	639	0.0
iLottery	776	-14.6	804	3.7
Raffle and Other	66	1.2	68	2.7
<u>Miscellaneous Revenues Detail</u>	115	--	89	-22.1
Gaming Fund Transfers	114	--	89	-22.2
Other Miscellaneous Revenue	0	-21.2	0	6.7

Note: Figures in dollar millions. Due to rounding, detail may not sum to total. Growth rates based on the unrounded amounts. Instant Tickets includes Scratch Offs and Fast Play. Other includes Keno and Xpress Sports.

Federal Funds

Federal funds appropriations confer authority to spend money that the federal government may provide, and state agencies request annual spending authority as part of the budget process. A federal funds appropriation does not guarantee funding at any particular level. In fact, the actual funds received and disbursed may be considerably less than the appropriated amounts. Agencies typically request authority to spend all federal funds anticipated for a given fiscal year. In response to the COVID-19 pandemic, Congress enacted additional funding for state agencies that will affect federal funding levels.

The IFO reviewed Request for Appropriation of Federal Funds (RAFF) forms and reports provided by the Office of the Budget for base federal appropriations as well as for additional federal funds authorized in response to the COVID-19 pandemic.

For FY 2021-22, agencies request \$34.4 billion in federal General Fund appropriations. (See Table 2.6.) Executive authorizations and non-General Fund requests for appropriations are not included. The departments of Human Services (DHS), Education (PDE) and Health comprise roughly 94% of the General Fund federal spending authority requested by the Commonwealth in FY 2021-22. The Department of Human Services requested \$29.0 billion, PDE \$2.6 billion and Health \$574 million. The administration projects that agencies will require \$37.1 billion in base General Fund federal spending authority for FY 2022-23.

In addition to the funds detailed in Table 2.6, the state was allocated \$3.9 billion in federal Coronavirus Relief Funds (CRF) under the CARES Act to offset expenditures incurred by state and local agencies to address the COVID-19 public health emergency. Of this amount, \$1.5 billion was used to offset General

Fund expenditures in FY 2020-21 for the Department of Criminal Justice (\$1.3 billion), Pennsylvania State Police (\$226 million), Department of Human Services (\$30 million) and Department of Health (\$14 million).

Federal funds related to a temporary increase in the Federal Medical Assistance Percentage (FMAP) used to calculate federal reimbursements for Medicaid programs offset additional Department of Human Services program costs. The enhanced FMAP remains in effect until the termination of the national public health emergency declaration and is currently expected through September 2022. Enhanced FMAP funds offset \$1.7 billion in DHS Medical Assistance program costs in FY 2020-21 and \$2.5 billion in FY 2021-22. The extension of the enhanced FMAP into the first quarter of FY 2022-23 is expected to provide an additional \$0.9 billion in federal COVID relief in the budget year.

**Table 2.6
Federal Funds Summary**

	2020-21	Available 2021-22		Projected 2022-23	
	Amount	Amount	Growth	Amount	Growth
Total Federal Funds	\$30,633	\$34,429	12.4%	\$37,120	7.8%
Human Services	25,104	28,984	15.5	31,059	7.2
Education	2,648	2,634	-0.5	2,871	9.0
Health	580	574	-1.0	576	0.3
Labor & Industry	519	525	1.3	460	-12.4
Drug & Alcohol	314	303	-3.6	308	1.8
DCED	254	276	8.6	431	55.9
Military & Veterans Affairs	203	212	4.7	247	16.6
Transportation	199	206	3.5	246	19.8
Executive Offices	205	202	-1.4	205	1.6
DEP	130	138	5.9	324	135.4
Aging	105	105	0.2	105	0.0
Agriculture	98	99	0.5	97	-2.1
DCNR	41	50	22.1	76	53.4
PEMA	23	37	62.0	37	0.0
State	30	18	-40.0	12	-34.1
All Other	181	67	-63.0	66	-1.8

Note: Figures in dollar millions.

Under the federal American Rescue Plan Act, Pennsylvania has been allocated an additional \$7.3 billion in general aid for eligible expenses incurred through CY 2024. Similar to the CARES Act, the federal funds are available for a wide range of uses in response to the health and economic impacts of the COVID-19 pandemic, including support to households and businesses, replacing lost revenue and support for government operations affected by the pandemic. In FY 2021-22, \$3.8 billion of this amount was transferred to the General Fund as revenue loss replacement. An additional \$1.3 billion was appropriated for pandemic response programs, including funds for long-term living facilities and hospital and healthcare workforce assistance.

