Pennsylvania Fiscal Outlook

FY 2026-27 TO FY 2031-32

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Today's Presentation

- Posted to IFO website at conclusion.
- PowerPoint contains some detail not found in report.
- For questions, please submit to contact box.
- If connection is lost, we will re-establish as soon as possible.

Executive Summary

Robust economics thru 2026 Q3

- S&P 500 +20% YOY
- US Consumer Spend +6%
- US Computer-Peripheral Equipment (AI) +70%
- Philly CPI-U +4.5%

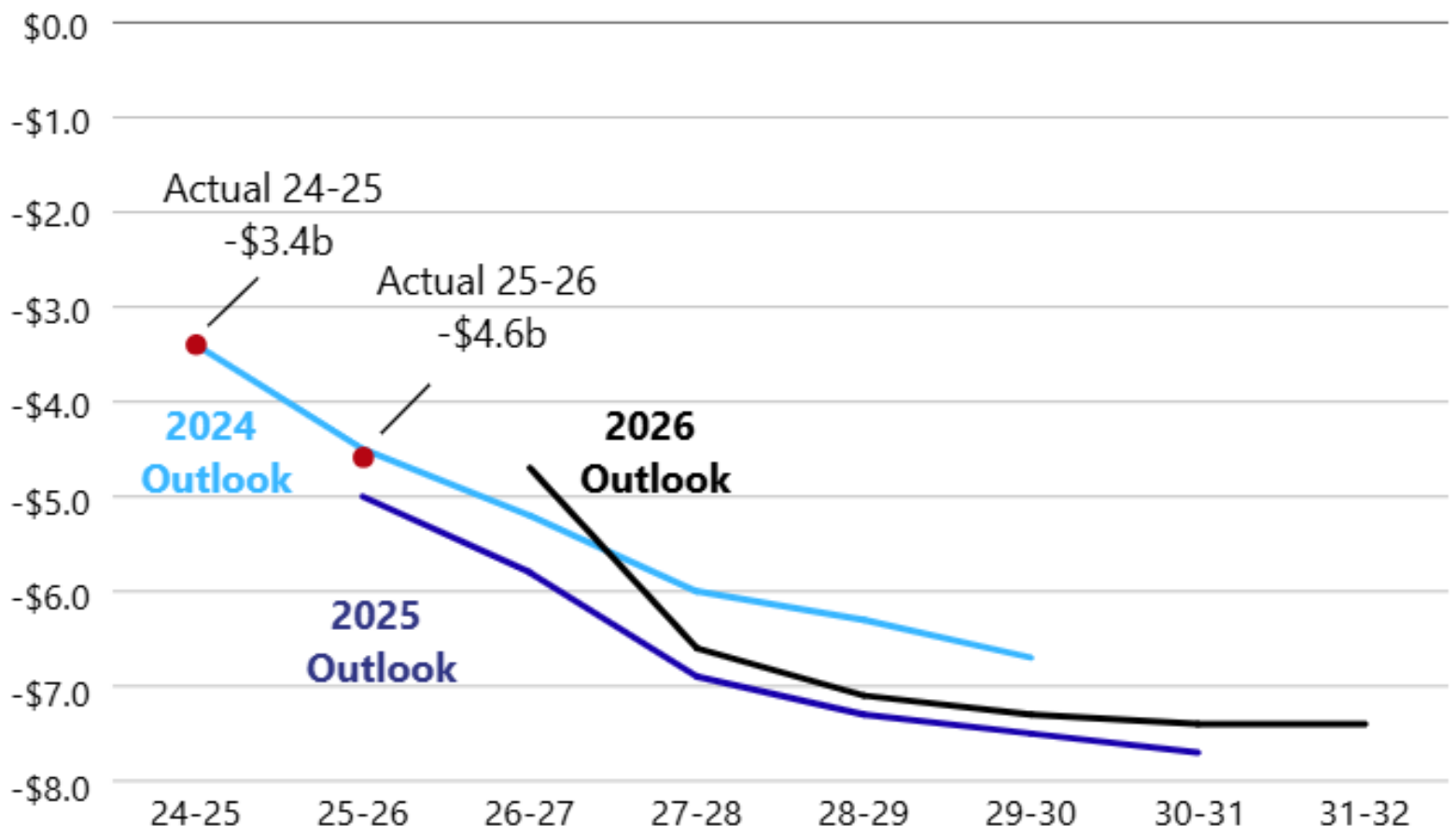
Strong revenues, but offset by higher spending/refunds

- Sales Tax +7% YOY
- CNIT +52%
- Inheritance +19%
- +$218m Fall Update
- +$565m adequacy funds

Little change to deficit outlook

- No permanent changes
- One-time measures largely depleted: $2.6b DHS cycle rolls, $1.3b transfers from other funds, residual Covid monies

Structural Deficits: Actuals and IFO Forecasts



Note: Billions of dollars.

Nov 2024 Outlook
accurate for 24-25 and 25-26 deficits

Nov 2025 Outlook
off by $0.4 billion for 25-26

Nov 2026 Outlook
improves by ~$1.1 billion due to stock market, AI boom, +$230m tariff windfall

Higher 26-27 spend permanent; same for revenue?

Pennsylvania Economic and Demographic Forecasts

Economics	Annual Growth Rate 2026	2027	2028	2029	2030
Real GDP	1.8%	1.8%	1.8%	1.8%	1.8%
Wages and Salaries	4.1%	4.0%	4.0%	4.0%	4.0%
Philadelphia CPI-U	4.2%	3.0%	2.2%	2.2%	2.2%
Cash Income	4.6%	3.8%	4.0%	4.0%	4.0%

Demographics	Annual Change (000s) 2026	2027	2028	2029	2030
Age 0-19	-22	-21	-26	-23	-22
Age 20-64	-31	-21	-19	-21	-18
Age 65-79	44	5	10	10	4
Age 80+	11	42	32	28	27
Total	**2**	**6**	**-4**	**-6**	**-9**

Note: All growth rates are year-over-year.
Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics and U.S. Census Bureau. Forecasts by IFO.

Assumes reversion to "normal" growth

No recession; but 2027 flat stock market and corporate profits

Inflation target attained by 2028

Age 20-64 group contraction continues

Oldest Baby Boomers turn 80 in 2027

FY 2026-27 Revenues Through October

	Dollar Amount	IFO Estimate	Variance	Compare to Prior FY $ Change	Compare to Prior FY Growth
General Fund	**$15,284**	**$14,714**	**$571**	**$1,761**	**13.0%**
Corporate Net Income	1,630	1,225	**405**	558	**52.1**
Sales – Non-Motor	5,065	4,961	**104**	343	**7.3**
Sales – Motor	502	487	15	12	2.4
PIT – Withholding	4,744	4,716	28	151	3.3
PIT – Other	1,236	1,182	55	92	8.1
Inheritance	714	627	**88**	113	**18.7**
All Other Tax	704	747	-42	-17	-2.4
All Non-Tax	688	770	-82	510	**285.3**

Note: Millions of dollars.

GF includes $580m non-tax transfers; +9% growth without

CNIT $230m windfall from tax on tariff refunds; similar to other states

If excluded, YOY growth rate is +31%

Sales tax driven by stock market and taxable business spending

General Fund Revenue Outlook

Amount ($ billions)	26-27	27-28	31-32
Corporate Net Income	$5.18	$4.80	$4.07
Personal Income	$21.08	$21.74	$25.62
All Sales Tax	$16.11	$16.53	$18.20
Inheritance	$2.01	$1.98	$2.35
Gross Receipts	$1.57	$1.63	$2.01
All Other	$4.86	$4.21	$4.59
Total	**$50.81**	**$50.89**	**$56.84**

Growth Rate	26-27	27-28	AAGR
Corporate Net Income	4.1%	-7.2%	-4.1%
Personal Income	5.2%	3.1%	4.2%
All Sales Tax	4.0%	2.6%	2.4%
Inheritance	**8.7%**	-1.5%	4.4%
Gross Receipts	**13.5%**	3.7%	5.4%
All Other	-6.2%	-13.4%	2.2%
Total	**3.8%**	**0.2%**	**2.8%**

CNIT rate: 7.49% (2026) to 4.99% (2031)

Hedge: flat corporate profits and stock market in 2027; then 4% to 5% growth

Sales tax moderation: wealth effects and modest business spend contraction

Gross Receipts: +15% electric price increase 2026; no reversion

AAGR is average annual growth rate 27-28 thru 31-32

General Fund Expenditure Outlook

Amount ($ billions)	26-27	27-28	31-32
Human Services	$19.06	$22.00	$25.29
PDE - PreK to 12	$18.89	$19.81	$21.56
All State Personnel	$6.05	$6.46	$6.98
Debt Service	$1.42	$1.45	$1.81
All Other	$5.43	$5.56	$5.92
Total Expenditures	**$50.85**	**$55.28**	**$61.56**

Growth Rates	26-27	27-28	AAGR
Human Services	5.5%	**15.4%**	3.5%
PDE - PreK to 12	5.1%	**4.9%**	2.1%
All State Personnel	-0.4%	**6.8%**	2.0%
Debt Service	**8.2%**	1.9%	5.8%
All Other	-2.9%	2.4%	1.6%
Total Expenditures	**3.7%**	**8.7%**	**2.7%**

Note: DHS, PDE and All Other exclude state personnel costs. Fall Update increase of +$207m to DHS not included in FY 26-27 but included in future years.

DHS 27-28 growth: reversion to 12 monthly payments (+$1.3 billion)

SNAP error rate is 6%-8% first two years (+$230m), then <6%

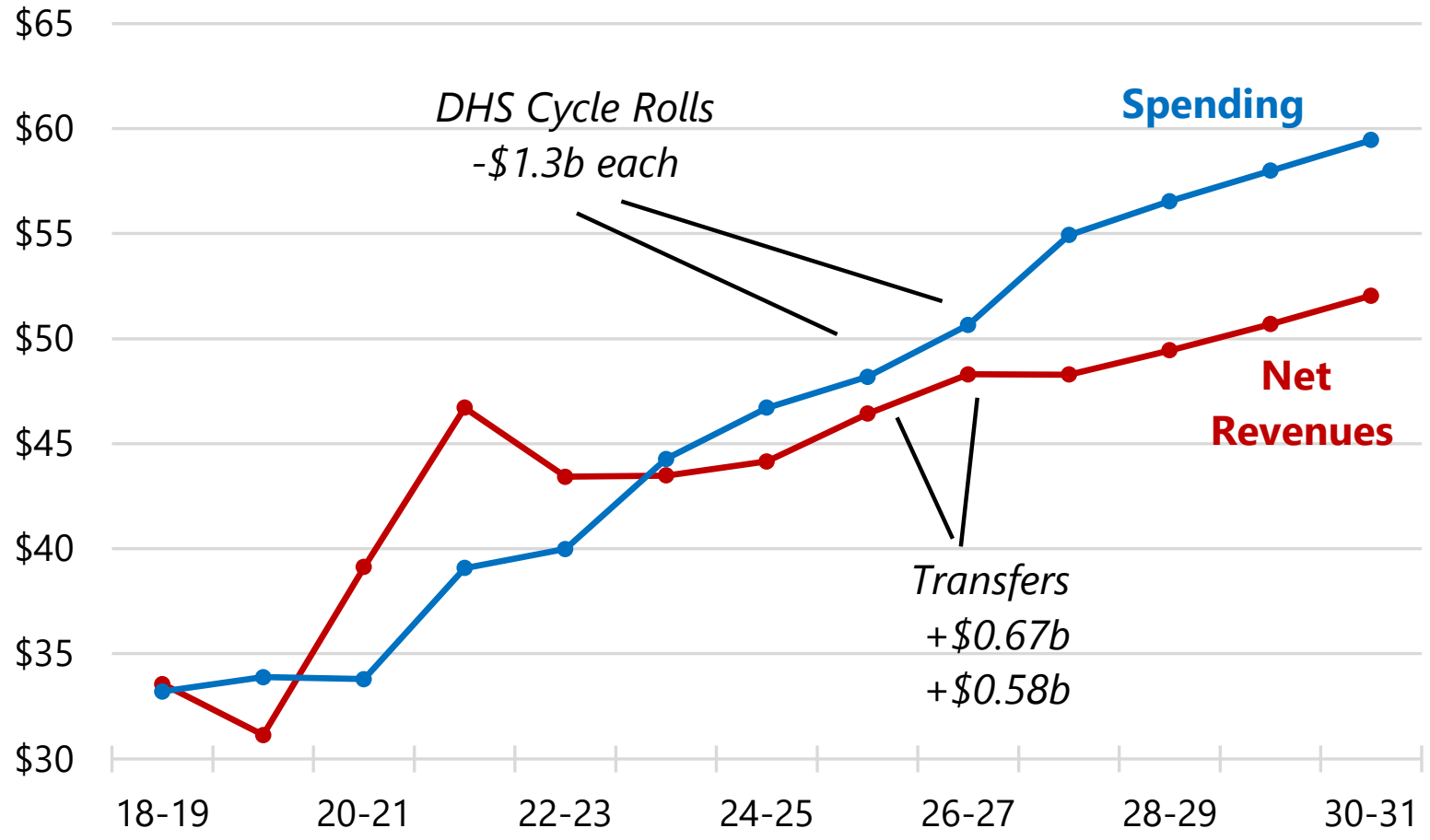
+$207m to DHS Fall Update

27-28 PreK-12 includes +$400m adequacy spend; inflation thereafter

State Personnel: 27-28 bump from retiree healthcare (+65%); then declining pension contributions

Higher Education flatlined

Spending and Revenues: Historical Trends



Note: Billions of dollars.

Temporary measures suppress spending, enhance revenues

Prior budgets also benefit from unusually large lapses (Covid funds)

One-time measures and Covid funds largely depleted

General Fund Financial Statement

	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32
Gross Revenues	$46.41	$48.93	$50.81	$50.89	$52.14	$53.50	$54.95	$56.84
Less Refunds	-2.25	-2.49	-2.50	-2.60	-2.70	-2.80	-2.90	-3.00
Net Revenues	44.16	46.43	48.31	48.29	49.44	50.70	52.05	53.84
Expenditures	-47.82	-49.03	-50.85	-55.28	-56.89	-58.34	-59.81	-61.56
Plus: Prior Year Lapses	1.12	0.84	0.19	0.35	0.35	0.35	0.35	0.35
Current Year Deficit	**-2.55**	**-1.76**	**-2.35**	**-6.65**	**-7.10**	**-7.29**	**-7.41**	**-7.37**
Less Temporary Support	0.87	2.79	2.35	--	--	--	--	--
Structural Deficit	**-3.41**	**-4.55**	**-4.70**	**-6.65**	**-7.10**	**-7.29**	**-7.41**	**-7.37**
Ending Balances								
General Fund	$4.16	$2.46	$0.11	$0.00	$0.00	$0.00	$0.00	$0.00
Rainy Day Fund	7.47	7.76	8.11	--	--	--	--	--

Note: Billions of dollars. FY 26-27 prior year lapses deducts $218 million higher spending from Fall Update.

Change to Structural Deficit Outlook

	Actual 24-25	Actual 25-26	Budget 26-27	Forecast 27-28	28-29	29-30	30-31	31-32
November 2025 Outlook	**-$3.41**	**-$4.98**	**-$5.84**	**-$6.90**	**-$7.27**	**-$7.53**	**-$7.66**	**--**
Net Revenue Impact	--	0.48	1.40	1.16	1.08	1.01	0.97	--
Spending Impact	--	-0.05	-0.26	-0.91	-0.91	-0.78	-0.73	--
November 2026 Outlook	**-3.41**	**-4.55**	**-4.70**	**-6.65**	**-7.10**	**-7.29**	**-7.41**	**-$7.37**
Deficit Change	--	0.43	1.14	0.25	0.17	0.23	0.25	--

Note: Billions of dollars.

- FY 26-27 revenue gains largely assumed permanent except tariff windfall ($230m)
- Spending jump in 27-28: adequacy funds +$400m, annualized 2027 DHS rate increases +$172m

Three Executive Budget Recommendations

Administrative Code Section 604B (b) (2)

- The IFO may "provide an analysis of the executive budget, including budgetary projections, economic outlook and economic impact. The budget analysis may include performance recommendations to secure greater efficiency and economy."

Motivation

- State Constitution: budget must include (1) a balanced operating budget for the ensuing fiscal year setting forth in detail proposed expenditures and estimated revenues from all sources (including proposed new revenues required to bring the budget into balance) and (2) a financial plan for the next succeeding five fiscal years.
- General Fund surplus depleted and most large temporary measures have been used; permanent policy changes now required if Rainy Day Fund is maintained.

1 Maintain Rainy Day Fund for Unanticipated Shortfalls

Rainy Day Funds Used to Balance Prior Budgets

Budget Release	Forecast Year 24-25	25-26	26-27	27-28	28-29	29-30	30-31	Total
Feb 2024	-$0.4	$0.0	$3.0	$2.7	$2.2	--	--	$7.5
Feb 2025	-$0.3	$1.6	$2.4	$1.9	$1.2	$0.7	--	$7.4
Feb 2026	--	--	$4.6	$2.2	$1.1	$0.0	-$0.2	$7.7

Note: Billions of dollars. Negative amount indicates that RDF received a net transfer.
Source: Executive Budget, various years.

- PA is only state to use entire RDF to balance long-term budget
- Some states used a portion in the budget year only to balance budget
- Pew Charitable Trusts: leaders should be cautious about using RDFs to close structural imbalances

2 Use a Current Services Approach for Mandatory Spending

Growth Rates for Department of Human Services Spending

Budget	23-24	24-25	25-26	26-27	27-28	28-29	29-30
Feb 2023	16.5%	3.4%	3.1%	2.3%	2.5%	--	--
Feb 2024	13.3%	6.3%	3.8%	2.5%	2.4%	2.4%	--
Feb 2025	12.8%	6.4%	10.2%	1.7%	1.5%	1.5%	1.5%
Feb 2026	12.8%	5.9%	7.7%	6.6%	1.1%	0.9%	0.8%

Note: Budget Year shaded blue. Long-term projections shaded peach. Actual growth rates as of budget release are unshaded.

- Current Services baseline includes inflation and demographic adjustments to maintain real value of per capita services
- Used by US Congressional Budget Office and other states; best budgeting practice
- Pew Charitable Trusts: current services generates realistic spending forecasts

3 Provide Alternatives to Uncertain Revenue Estimates

Recent Executive Budget Revenue Proposals	
Skill Games	+$2.0 billion per annum
Combined Reporting	+$1.1 billion per annum
Recreational Marijuana Fees	+$660 million (first year)

Source: FY 2026-27 Executive Budget.

Factors that create uncertainty and variability:

- Limited or no data: number of skill games, average gross terminal revenue
- Implementation and ramp up: regulations, administration, enforcement, legal challenges
- Consumer, business and taxpayer response: expand small games of chance (tavern games, Act 90-2013): $156m estimate, $1m actual

Simulation: 0.5 PPT Rate Increase for 2026

Tax Source	Static Estimate	Adjustments: Behavior	Adjustments: Multiplier	Net Estimate
Personal Income	$3,090	-$110	-$90	$2,890
Sales and Use	$1,450	-$100	-$50	$1,300

Tax Incidence		Personal Income: Amount	Personal Income: Share	Sales and Use: Amount	Sales and Use: Share
$0	$50k	$233	9%	$243	23%
$50k	$100k	522	19	270	25
$100k	$200k	700	26	270	25
$200k	$500k	577	21	173	16
$500k	$1,000k	247	9	54	5
$1,000k	or more	467	17	70	7
Total		**$2,746**	**100%**	**$1,079**	**100%**

Note: Millions of dollars. Behavior is how individuals/businesses react to tax increase (e.g., price elasticities) and reduced compliance. Multiplier is direct, indirect and induced effects due to tax increase, informed by IMPLAN model.

Recommendation: Include PIT or SUT rate increase estimate as fallback option

Known with certainty and enacted rapidly

5% PIT and 17% SUT paid by non-residents

5% Discretionary Spend Sequester: $270 to $310 million per annum

CNIT Rate Freeze: $300 to $350 million per annum

Common Questions Regarding Fiscal Outlook

Can we “grow out of” deficits?

No, because (1) the state economy is already operating above capacity, (2) the demographic forecast is flat with a contracting working age cohort, (3) PA has a rapidly aging population and (4) reduced federal support.

Can you sum up all annual deficits after the current year to get a grand total?

No. Unless they are financed with savings, the deficits cannot occur and are hypothetical.

The IFO always projects deficits, but budgets get balanced. What is different now?

FY 25-26 actual deficit $4.6 billion. Previously: Securitize TSF Bonds (2018, $1.5 billion); large Covid windfalls ($30 billion direct state aid, $135 billion in stimulus). One-time transfers and delays/shifts have been largely used up. General Fund surplus exhausted.

Questions?
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