

Commonwealth of Pennsylvania



ECONOMIC & BUDGET OUTLOOK

FY 2017-18 to FY 2022-23

NOVEMBER 2017

Welcome

- ▶ **Matthew Knittel** | **Director, Independent Fiscal Office**
 - Balance Sheet, Demographic and Economic Outlook

- ▶ **Mark Ryan** | **Deputy Director, Independent Fiscal Office**
 - Revenue and Expenditure Detail, Revenue Package

- ▶ **Chaaron Pearson** | **The PEW Charitable Trusts**
 - Evaluation of State Economic Development Tax Incentives

Budget Emphasis: Cost Containment

- ▶ **State governments have used three methods.**
 - Efficiency Initiatives - Lean, TQM, Continuous Improvement.
 - Cost-Benefit Analysis - PEW Results First model.
 - Performance-Based Budgeting (PBB).
- ▶ **Act 48 of 2017: New PBB and tax credit review duties.**
 - IFO to develop PBB plans for all executive agencies.
 - Develop clear metrics to measure progress towards goals.
 - Submit plans to PBB Board for consideration and approval.
 - On the tax side: annual tax credit reviews.
 - Are they achieving their goals? How can they be improved?

Our Guest Speaker

▶ **Chaaron Pearson** | **The PEW Charitable Trusts**

▶ **Current Position: Senior Manager**

- Economic development tax incentives project.
- Ensure tax incentives are effective, accountable and fiscally sound.
- Work with states to develop and implement best practices.

▶ **Previous Experience and Education**

- Provided research and analysis on local and state public policy topics for the American Chamber of Commerce Executives.
- Planned and coordinated education for the government relations division and the Alliance for Regional Stewardship.
- Master's in public administration from George Mason University.

Projected General Fund Balance

	16-17	17-18	18-19	19-20	20-21	21-22	22-23
November 2016	-\$0.52	-\$1.75	-\$2.26	-\$2.60	-\$2.75	-\$2.98	--
November 2017 Baseline	-1.54	-0.68	-1.20	-2.01	-1.87	-1.86	-\$1.78
Plus: Revenue Package		2.30	0.22	0.14	0.09	0.08	0.07
Less: New SUT Transfer		--	--	--	--	--	-0.48
November 2017 Final	-1.54	1.62	-0.99	-1.87	-1.77	-1.78	-2.19
Two-Year Total		0.08					

Note: figures in dollar billions.

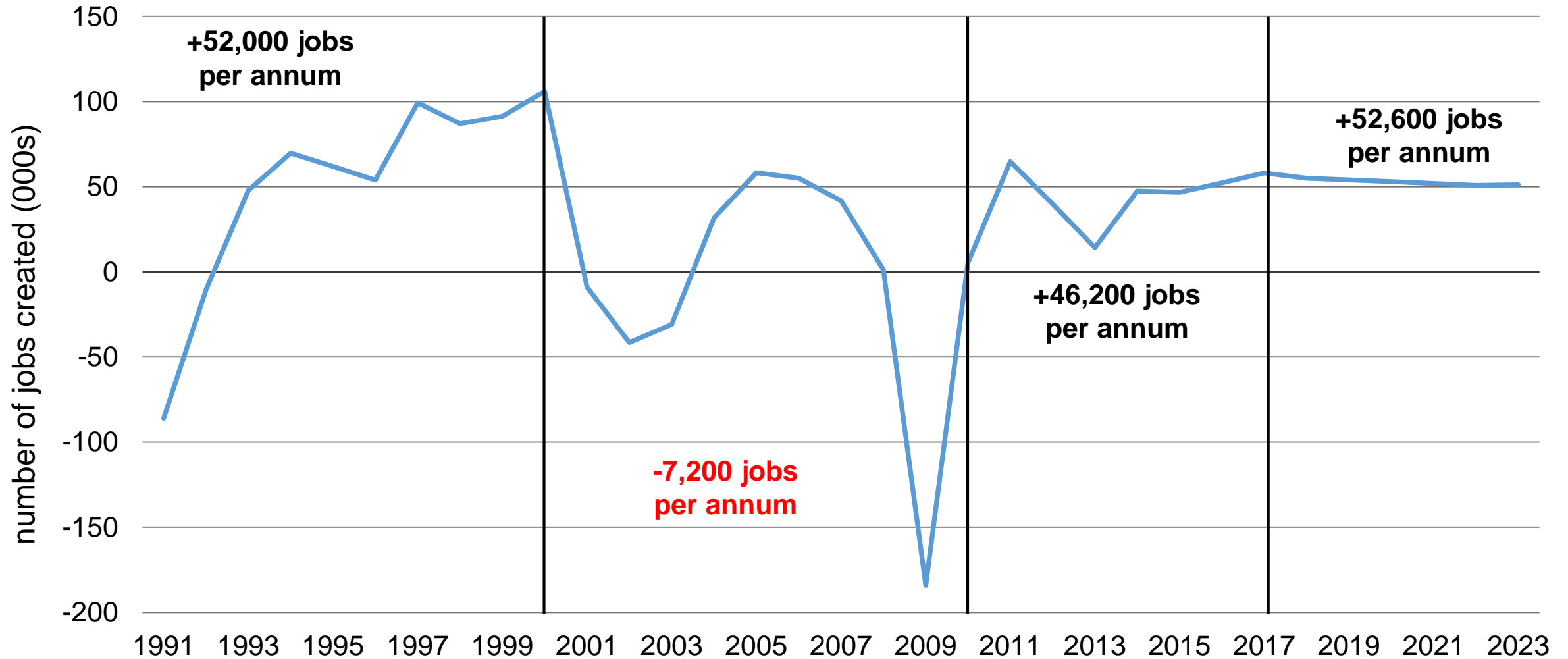
Main Budget Themes

- ▶ **Short-term relief, but long-term costs ramp up.**
 - Securitization of Tobacco Fund: ~\$95 million per annum.
 - PlanCon debt service phase-in. MLF funding shift begins.
- ▶ **Long-term revenue potential is limited.**
 - Continued modest growth of sales tax (+3.0%).
 - Other revenues declining (cigarette, -3.2%) or flat (GRT).
- ▶ **Cost containment efforts improve alignment.**
 - After FY 2017-18, revenues grow **~+3.2%**, expenditures **~+3.5%**.
 - Long-term growth rate gap lower than last year (**~0.5%**).

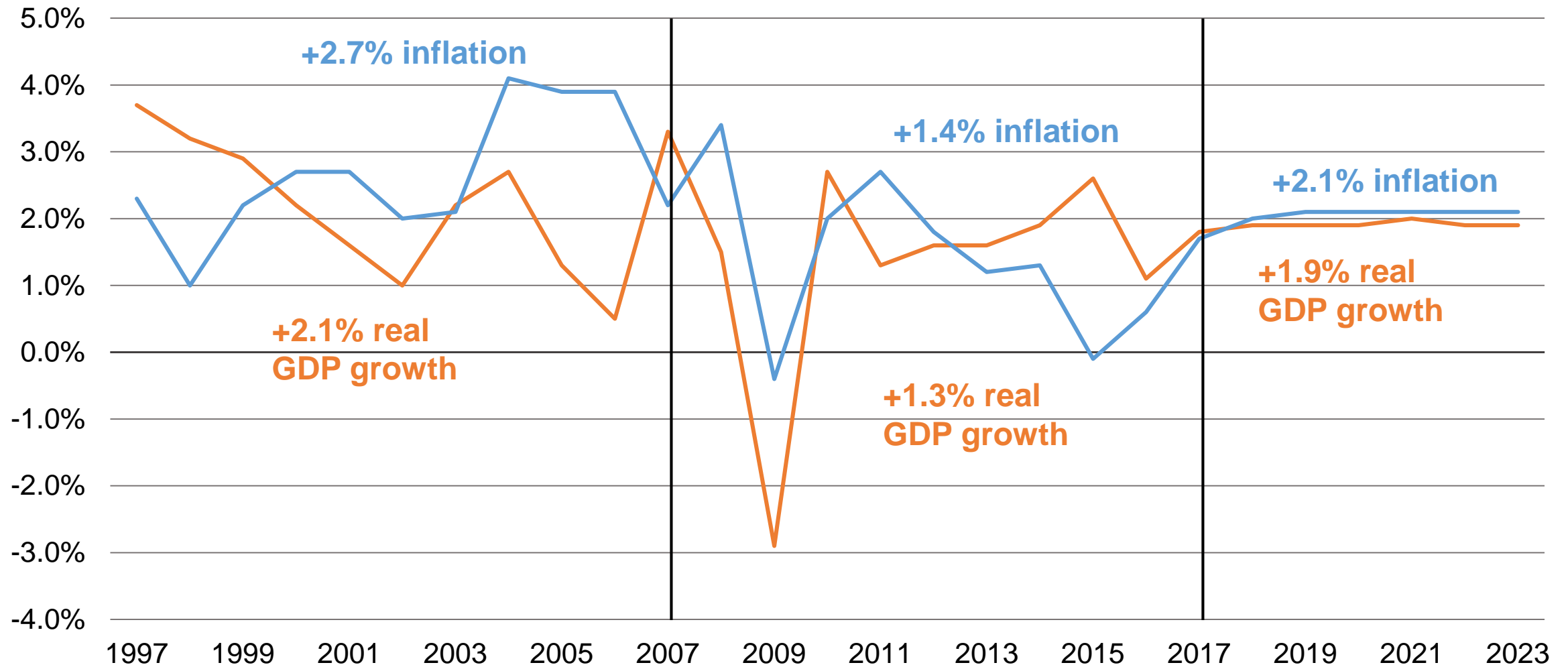
Some Important Caveats

- ▶ **Assume discretionary spending grows with inflation.**
 - Need not happen. Policymakers often elect to “flat fund.”
 - Who absorbs the higher costs? The service provider.
- ▶ **Economic projections are NOT a forecast.**
 - A controlled simulation. Outcomes under “normal” growth.
 - No booms or busts. No mild recession or slowdown.
- ▶ **What if a recession does occur?**
 - November WSJ poll: 15% probability in next year.
 - Odds imply recession more likely than not (54%) next 5 years.

Assumes Solid Job Creation



Assumes Normal Growth and Inflation



Demographic Outlook

Projections from the Pennsylvania State Data Center

Adjustments by IFO for 2017

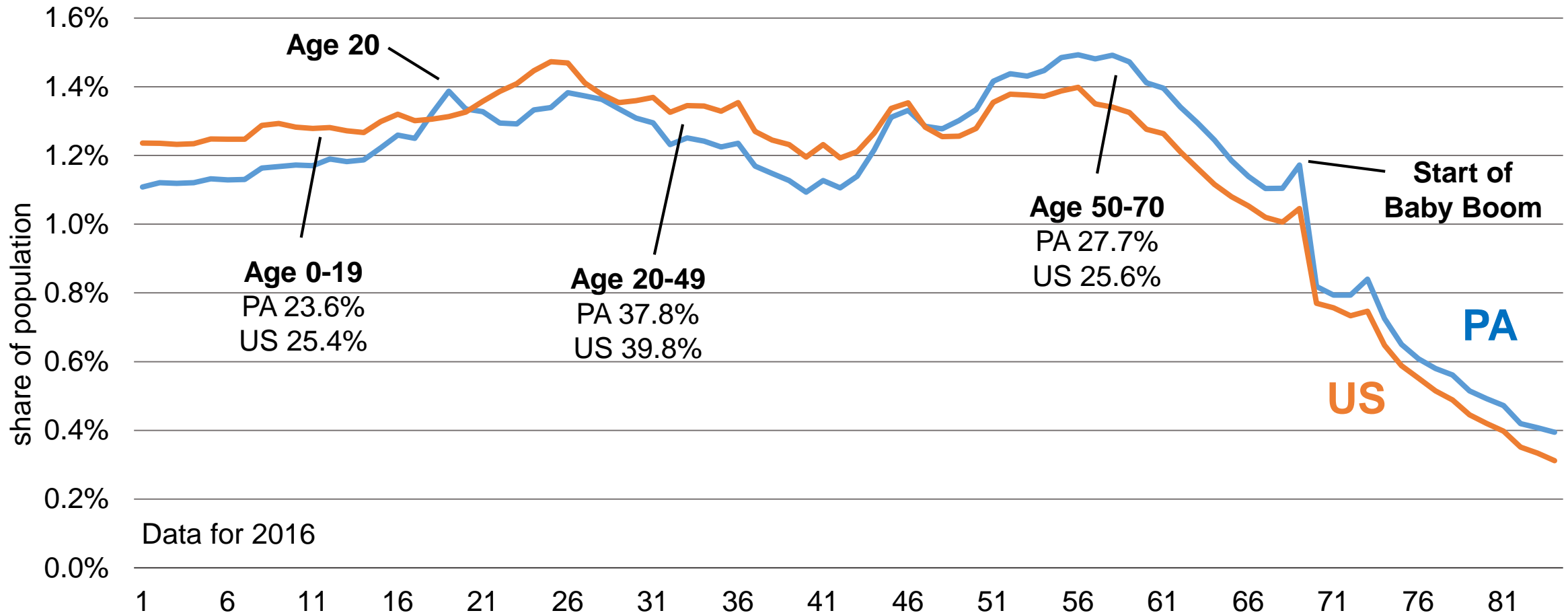
Source: U.S. Census Bureau



Three Demographic Trends

- ▶ **Unexpected contraction of PA population in 2016.**
 - Birth rates continue to fall.
 - Strong domestic migration out of state (but data very preliminary).
- ▶ **Retirement surge has important implications.**
 - “Churning” reduces growth of total wages paid.
 - Possible contraction of labor force. But participation rates increase.
- ▶ **No signs of “brain drain” or strong elderly inflow.**
 - Recent data suggest a small net inflow of 18-24 age group.
 - Elderly continue to move to warmer weather locations.

U.S. and PA Population Distributions



Recent PA Demographic Trends

	2012	2013	2014	2015	2016	Total
Births	142	142	142	141	141	708
Deaths	<u>-126</u>	<u>-131</u>	<u>-127</u>	<u>-131</u>	<u>-133</u>	<u>-646</u>
Natural Growth	17	11	16	11	8	62
Domestic Migrate	-17	-31	-35	-45	-46	-175
Int'l Migrate	<u>29</u>	<u>30</u>	<u>34</u>	<u>35</u>	<u>35</u>	<u>162</u>
Net Migration	12	-1	-2	-10	-11	-12
Total Population	12,772	12,781	12,791	12,792	12,784	
Change	28	9	9	1	-8	40

Note: thousands of residents. Detail does not sum to total due to unallocated amounts.

PA Snapshot: 2015 to 2025

Age Cohort	Number Residents (000s)			Gain or Loss (000s)		Avg. Annual Growth	
	2015	2020	2025	2015-20	2020-25	2015-20	2020-25
0 - 19	3,039	3,023	2,981	-16	-42	-0.1%	-0.3%
20 - 64	7,573	7,472	7,407	-102	-65	-0.3%	-0.2%
65 - 79	1,563	1,827	2,111	264	284	3.2%	2.9%
80+	<u>617</u>	<u>635</u>	<u>710</u>	<u>18</u>	<u>75</u>	<u>0.6%</u>	<u>2.2%</u>
Total	12,792	12,957	13,209	165	252	0.3%	0.4%

Note: thousands of residents.

Domestic Migration: Average 2011-15

Age	Inflow to PA	Outflow from PA	Net Migration
0-19	63,951	58,059	5,892
20-24	36,960	41,305	-4,345
25-30	33,019	37,106	-4,087
30-39	37,441	36,618	823
40-49	20,645	23,054	-2,409
50-59	17,077	19,009	-1,932
60-69	10,800	16,665	-5,865
70+	<u>9,405</u>	<u>12,695</u>	<u>-3,290</u>
Total	229,298	244,511	-15,213

Domestic Migration: College Age

Age	Inflow to PA	Outflow from PA	Net Migration
18	17,417	10,129	7,288
19	9,484	9,522	-38
20	7,944	6,682	1,262
21	6,156	5,974	182
22	8,365	9,997	-1,632
23	8,222	10,446	-2,224
24	<u>6,273</u>	<u>8,206</u>	<u>-1,933</u>
Total	63,861	60,956	2,905

Note: figures are annual averages for the time period 2011 to 2015.

Economic Outlook

Projections by IFO

U.S. Bureau of Labor Statistics

U.S. Bureau of Economic Analysis



The Economic Outlook

- ▶ **PA economy shows solid growth through 2017 Q3.**
 - Pace of annual jobs creation is +65,000 jobs.
 - Wages growing by ~+3.8%. Inflation is modest (~+1.4%).
- ▶ **Other economic fundamentals are sound.**
 - Consumers still cautious about debt, except student loans.
 - Housing values up 4.4%. Corporate profits appear to rebound.
- ▶ **Federal tax reform may have material impact.**
 - Large tax cuts for corporate and pass-through business income.
 - 100% full expensing for 2018 may delay business purchases.

PA Economic Growth Rates

	2013	2014	2015	2016	2017	2018	2019
Real GDP	1.6%	1.9%	2.6%	1.1%	1.8%	1.9%	1.9%
Wages and Salaries	1.8%	3.9%	4.1%	1.3%	3.8%	3.8%	3.9%
Philadelphia CPI-U	1.2%	1.3%	-0.1%	0.6%	1.7%	2.0%	2.1%
Job Gains (000s)	14.3	47.4	46.7	52.2	58.1	55.0	54.0

Final

Preliminary

Forecast

Three Sectors Produce All Job Gains

Thousands of annual job gains

	1997	2007	2017
Healthcare and Social	17.8	17.3	24.0
Professional Service	28.6	20.3	15.9
Leisure-Hospitality	9.6	8.1	15.4
Transportation-Storage	2.4	5.3	7.3
Construction	9.9	1.0	5.6
All Other Services	11.7	-0.7	4.7
All Government	2.3	-0.1	-3.0
Wholesale-Retail	13.6	2.0	-5.0
Manufacturing	3.4	-11.5	-6.8
Total Net Job Gains	99.3	41.7	58.1

Revenue Impact of Two Recessions

	Mild Recession			Forecast
	2000-01	2001-02	2002-03	
Personal Income	6.0%	-4.7%	-0.5%	4.3%
Sales and Use	2.6%	1.2%	3.1%	3.0%
Corporate Net Income	-13.8%	-11.5%	-1.5%	3.7%
Total Tax Revenue	1.4%	-2.6%	1.9%	3.3%
	Severe Recession			Forecast
	2007-08	2008-09	2009-10	
Personal Income	6.3%	-6.5%	-2.3%	4.3%
Sales and Use	-1.1%	-4.2%	-1.3%	3.0%
Corporate Net Income	-3.0%	-18.1%	-9.5%	3.7%
Total Tax Revenue	2.3%	-7.3%	-1.5%	3.3%

Note: FY 2002-03 growth rate controls for cigarette tax increase.

Fiscal Outlook

Long-Term Structural Imbalance

General Fund Balance Sheet

	16-17	17-18	18-19	19-20	20-21	21-22	22-23
Beginning Balance	\$5	-\$1,538	--	--	--	--	--
Available Revenue	30,320	33,358	\$32,403	\$33,340	\$34,518	\$35,538	\$36,242
State Expenditures	<u>-31,942</u>	<u>-31,951</u>	<u>-33,516</u>	<u>-35,330</u>	<u>-36,417</u>	<u>-37,447</u>	<u>-38,556</u>
Current Year Balance	-1,622	1,407	-1,113	-1,990	-1,899	-1,909	-2,314
Adjustment for Lapses	<u>79</u>	<u>210</u>	<u>125</u>	<u>125</u>	<u>125</u>	<u>125</u>	<u>125</u>
Prelim Ending Balance	-1,538	79	-988	-1,865	-1,774	-1,784	-2,189

Note: figures in dollar millions.

Cost-to-Carry Reconciliation

Fiscal Year 2018-19

Ending Balance	-\$988
Adjust for non-mandatory spending increases	
Basic education funding	163
Special education funding	31
Post-secondary education	27
Other education	43
Certain DHS and State Police expenditures	62
Employee wage, healthcare and various non-personnel costs ¹	<u>63</u>
Subtotal	389
Ending Balance with Cost-to-Carry Only	-599

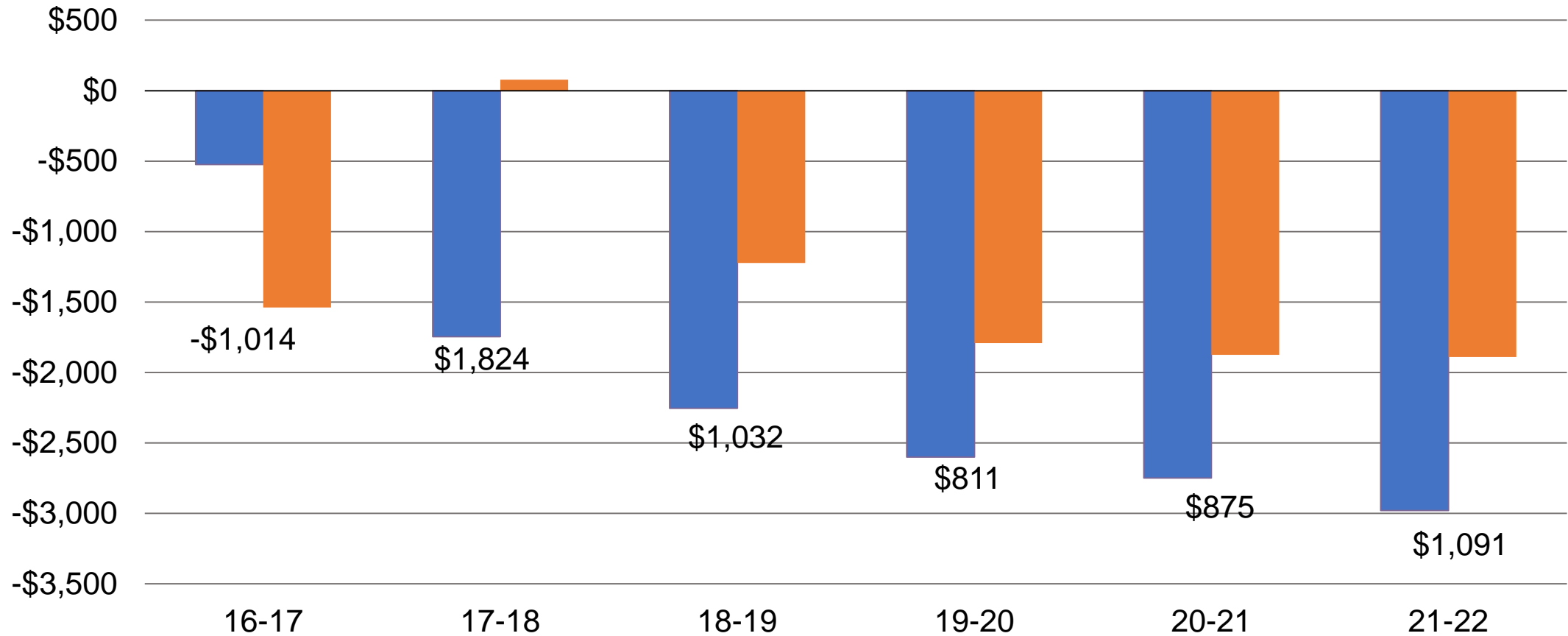
Note: figures in dollar millions.

¹ Excludes costs for mandatory line items.

Improved Ending Balances

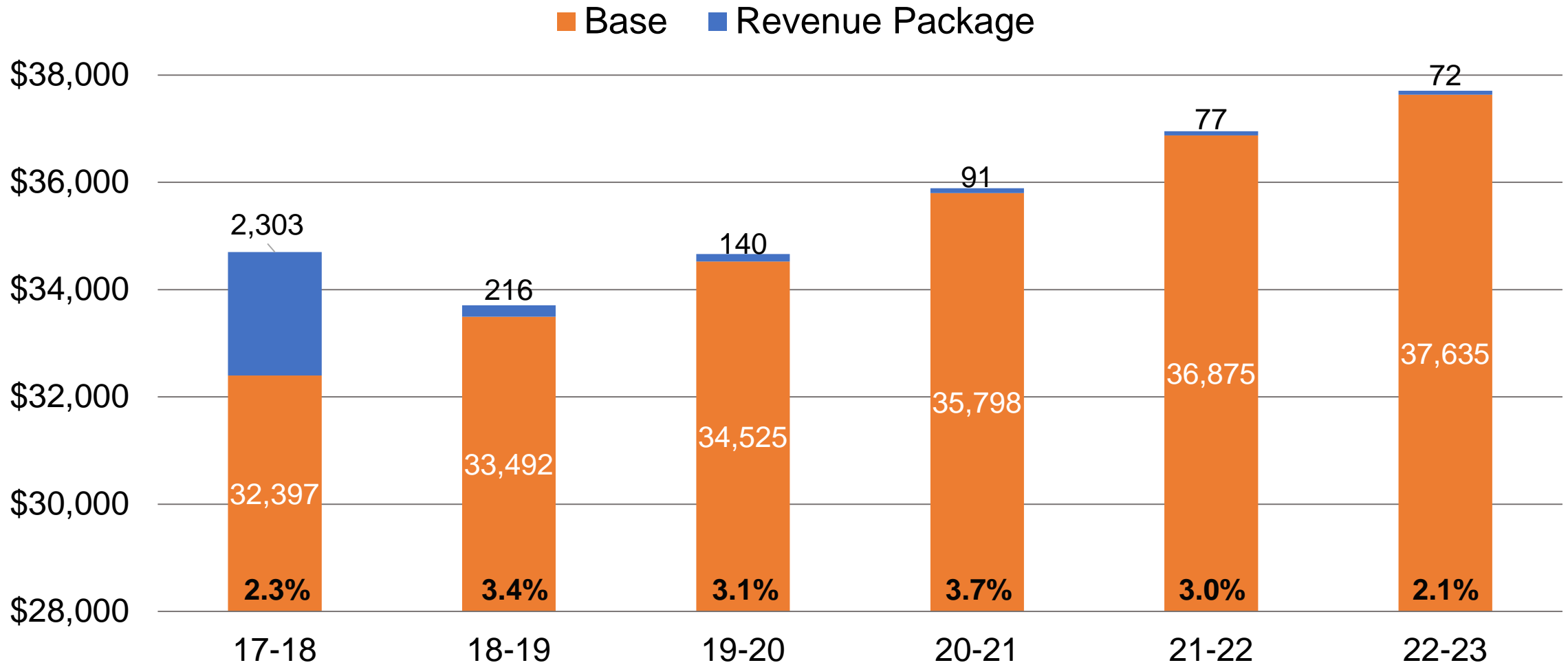
\$1 Billion Improvement in General Fund Ending Balances

■ Nov 2016 ■ Nov 2017



Note: figures in dollar millions.

Revenue Summary

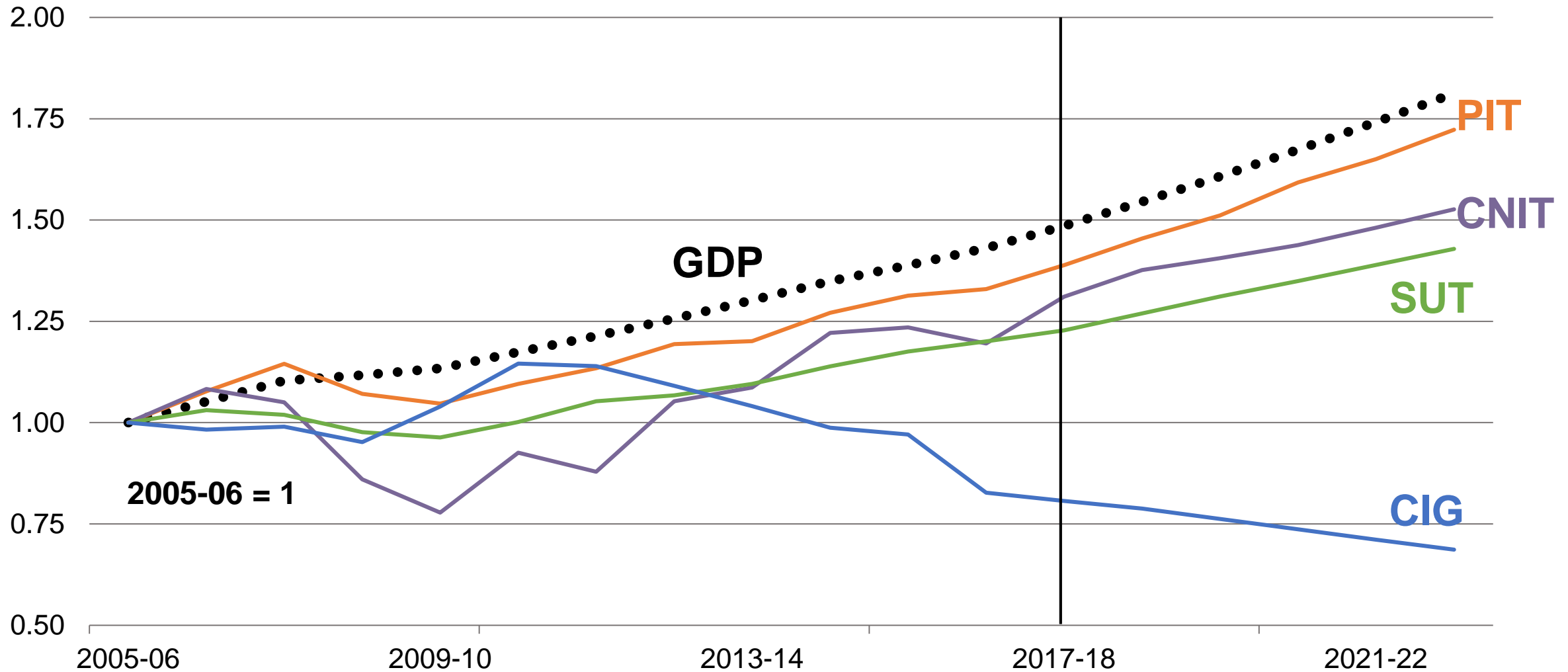


Note: figures in dollar millions.

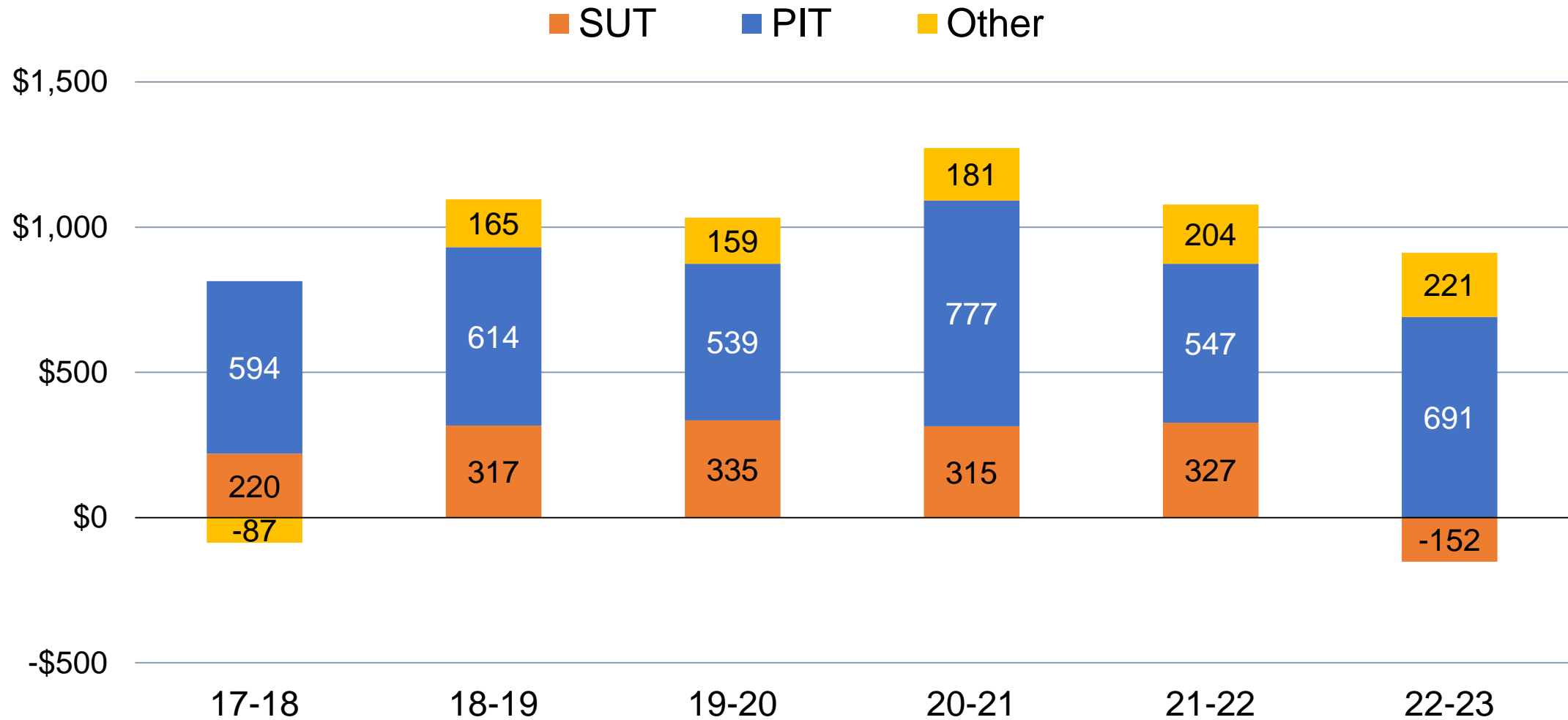
November 16, 2017



Long-Term Tax Base Erosion



Contributions to Base Revenue Growth



Note: figures in dollar millions.

New Revenues

	17-18	18-19	19-20	20-21	21-22
Tobacco Fund Securitization	\$1,500	--	--	--	--
Fund Transfers	500	--	--	--	--
Gaming Expansion	103	\$68	\$43	\$23	\$23
NOL Case and Statutory Change	207	104	56	24	8
Other Changes	<u>-8</u>	<u>44</u>	<u>41</u>	<u>44</u>	<u>46</u>
Total	2,303	216	140	91	77

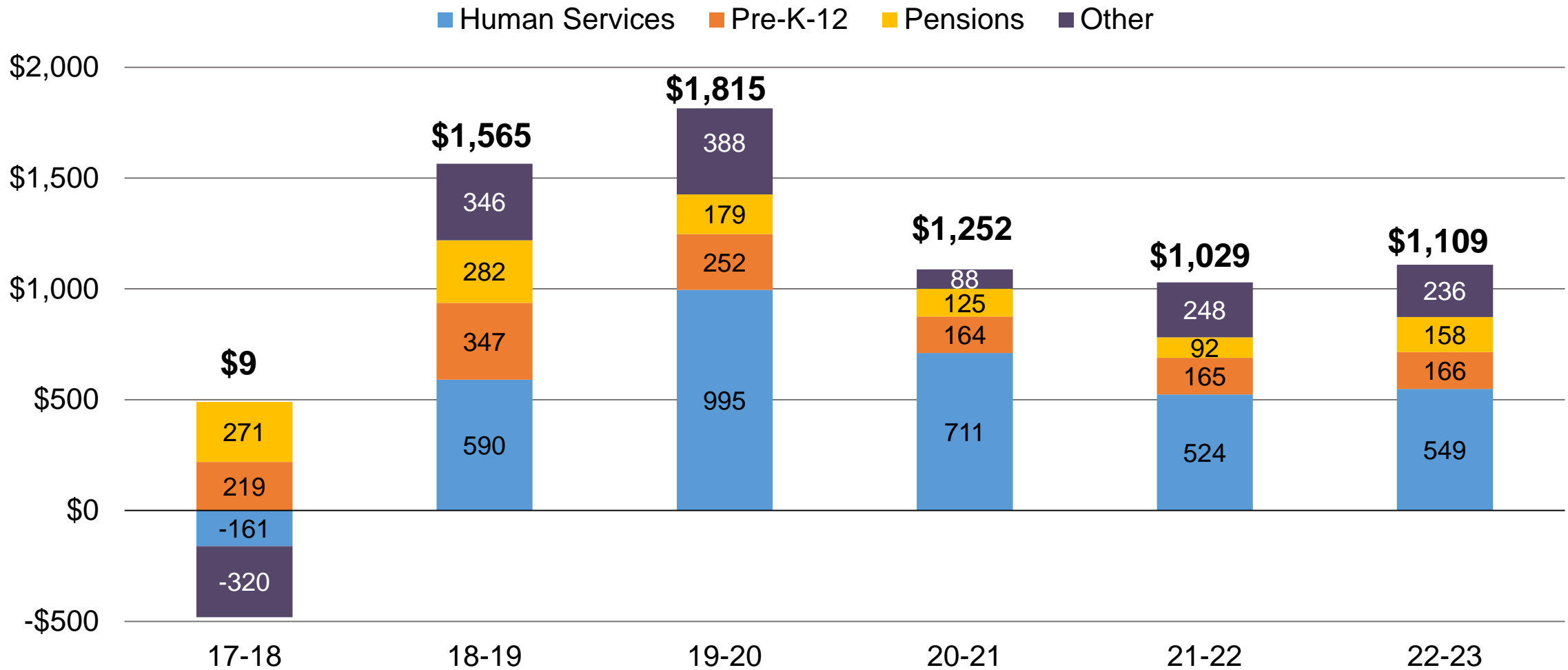
Notes: figures in dollar millions.

Gaming Expansion Detail

	17-18	18-19	19-20	20-21	21-22	22-23
iGaming	\$42.0	\$26.6	\$29.4	\$8.7	\$8.9	\$10.7
Category 4 (Mini) Casinos	40.0	12.1	7.5	7.7	7.9	8.1
Loan Repayment	12.0	24.1	--	--	--	--
All Other	<u>9.2</u>	<u>5.7</u>	<u>6.2</u>	<u>6.2</u>	<u>6.3</u>	<u>6.4</u>
Total	103.2	68.4	43.1	22.7	23.1	25.2

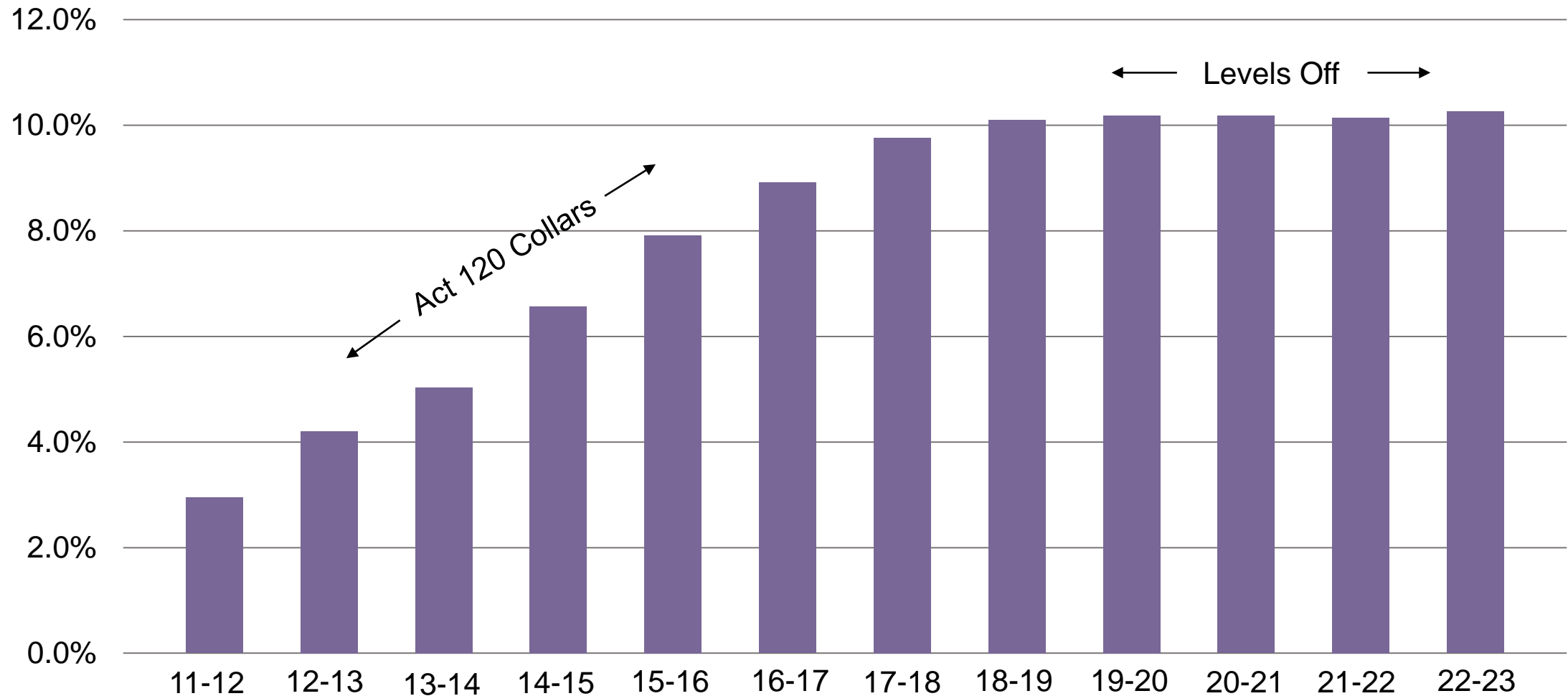
Notes: figures in dollar millions. All other includes category 3 licenses, fantasy contests, VGTs, and patron of amenities.

Contributions to Expenditure Growth



Note: figures in dollar millions. Human Services category excludes pension and other personnel costs. Non-pension personnel costs are included in "other."

Pensions Share of GF Expenditures



Lottery Fund Balance Sheet

	17-18	18-19	19-20	20-21
Beginning Balance	-\$19	--	--	--
Net Revenue	<u>1,802</u>	<u>\$1,780</u>	<u>\$1,811</u>	<u>\$1,842</u>
Funds Available	1,783	1,780	1,811	1,842
Aging	534	556	579	603
Human Services	308	308	308	308
Revenue	840	835	846	856
Transportation	<u>179</u>	<u>184</u>	<u>190</u>	<u>196</u>
Total Expenditures	1,861	1,883	1,923	1,963
New legislation and policy initiatives	14	63	46	54
Ending Balance	-64	-40	-66	-67

Note: figures in dollar millions.

Tobacco Settlement Fund Balance Sheet

	17-18	18-19	19-20	20-21
Beginning Balance	\$123	\$110	\$73	\$18
Total Revenues	<u>350</u>	<u>350</u>	<u>350</u>	<u>350</u>
Funds Available	473	460	423	368
DCED	3	--	--	--
Health	63	63	63	63
Human Services	297	297	247	197
Commonwealth Financing Authority	<u>0</u>	<u>27</u>	<u>95</u>	<u>95</u>
Total Expenditures	363	387	405	355
Ending Balance	110	73	18	13

Note: figures in dollar millions.

Revenues and Expenditures Share of GDP

