

The Economic and Budget Outlook: FY 2012-13 to 2017-18

**Independent Fiscal Office
Commonwealth of Pennsylvania**



Today's Presentation



- Report posted to IFO website: www.ifo.state.pa.us.
- Demographic Outlook
 - New projections from Penn State Data Center.
- Economic Outlook
 - Latest projections from IHS Global Insight.
- Expenditure Outlook
 - Special focus on healthcare and pensions.
 - Guest speaker: Ms. Katharine Witgert (NASHP).
- Revenue Outlook
 - Where will growth come from?

Some Questions

- What implications do broad demographic trends have for revenues and expenditures?
- What is the likely path of the Pennsylvania economy over the next six years?
- Will future tax revenues be sufficient to fund the policy choices reflected in the FY 2012-13 budget?
- Are current tax and spending policies fiscally sustainable?

What is the Purpose?

- Establish a “neutral” baseline to assess decisions.
 - Uses a current services and current law baseline.

- Alert policymakers to long-term budget pressures.
 - Help to craft policy more effectively and efficiently.
 - Do not want to revisit decisions.

- Are budget controls necessary?
 - Performance-based measures: output & outcome.

Some Conventions

- Select a base year for comparison purposes.
 - Report uses FY 2012-13.
 - Assume base year policy is maintained all future years.
 - Provide same relative funding levels controlling for (1) inflation and (2) demographic growth.
 - Assume tax law does not change.

- Only two factors change.
 - Economic growth (GDP, wages, unemployment rates).
 - Demographics such as number of students, inmate population, the MA population and all residents.

Summary of Findings

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Revenues	28,510	28,745	29,515	30,536	31,452	32,337
Expenditures	<u>27,678</u>	<u>28,750</u>	<u>29,899</u>	<u>31,100</u>	<u>32,076</u>	<u>33,090</u>
Difference	832	-6	-384	-563	-624	-753
Less: Refunds	-1,300	-1,311	-1,346	-1,392	-1,434	-1,475
Net Difference	-468	-1,317	-1,730	-1,955	-2,058	-2,228

Differences exclude the carryover of any ending balances, lapses or transfers to the BSF.

Demographics

New Population Projections from Penn State Data Center based on 2010 Census

Demographic Outlook

Age Cohort	Number of Residents (000s)			Change	
	2000	2010	2020	2000-10	2010-20
0-9	1,555.7	1,483.2	1,545.2	-4.7%	4.2%
10-19	1,714.8	1,696.2	1,619.3	-1.1%	-4.5%
20-29	1,478.8	1,655.7	1,737.8	12.0%	5.0%
30-39	1,779.2	1,493.9	1,601.2	-16.0%	7.2%
40-49	1,905.3	1,807.1	1,490.7	-5.2%	-17.5%
50-59	1,416.4	1,863.7	1,738.8	31.6%	-6.7%
60-69	992.3	1,296.3	1,706.4	30.6%	31.6%
70-79	910.9	788.9	1,061.7	-13.4%	34.6%
80-89	527.6	513.9	475.5	-	-7.5%
90-94	-	81.4	99.7	-	22.5%
95+	-	22.2	52.9	-	139.0%
Total	12,281.1	12,702.4	13,129.4	3.4%	3.4%

Demographic Outlook



Pennsylvania Population by Decade and Age Cohort

Age Cohort	Number Residents (000s)			Decade Growth Rate		Share of Population		
	2000	2010	2020	2000-10	2010-20	2000	2010	2020
0-19	3,270	3,179	3,164	-2.8%	-0.5%	26.6%	25.0%	24.1%
20-64	7,091	7,563	7,486	6.7%	-1.0%	57.7%	59.5%	57.0%
65-84	1,681	1,653	2,140	-1.7%	29.4%	13.7%	13.0%	16.3%
85+	237	305	337	28.7%	10.5%	1.9%	2.4%	2.6%
Total	12,281	12,702	13,129	3.4%	3.4%	100%	100%	100%

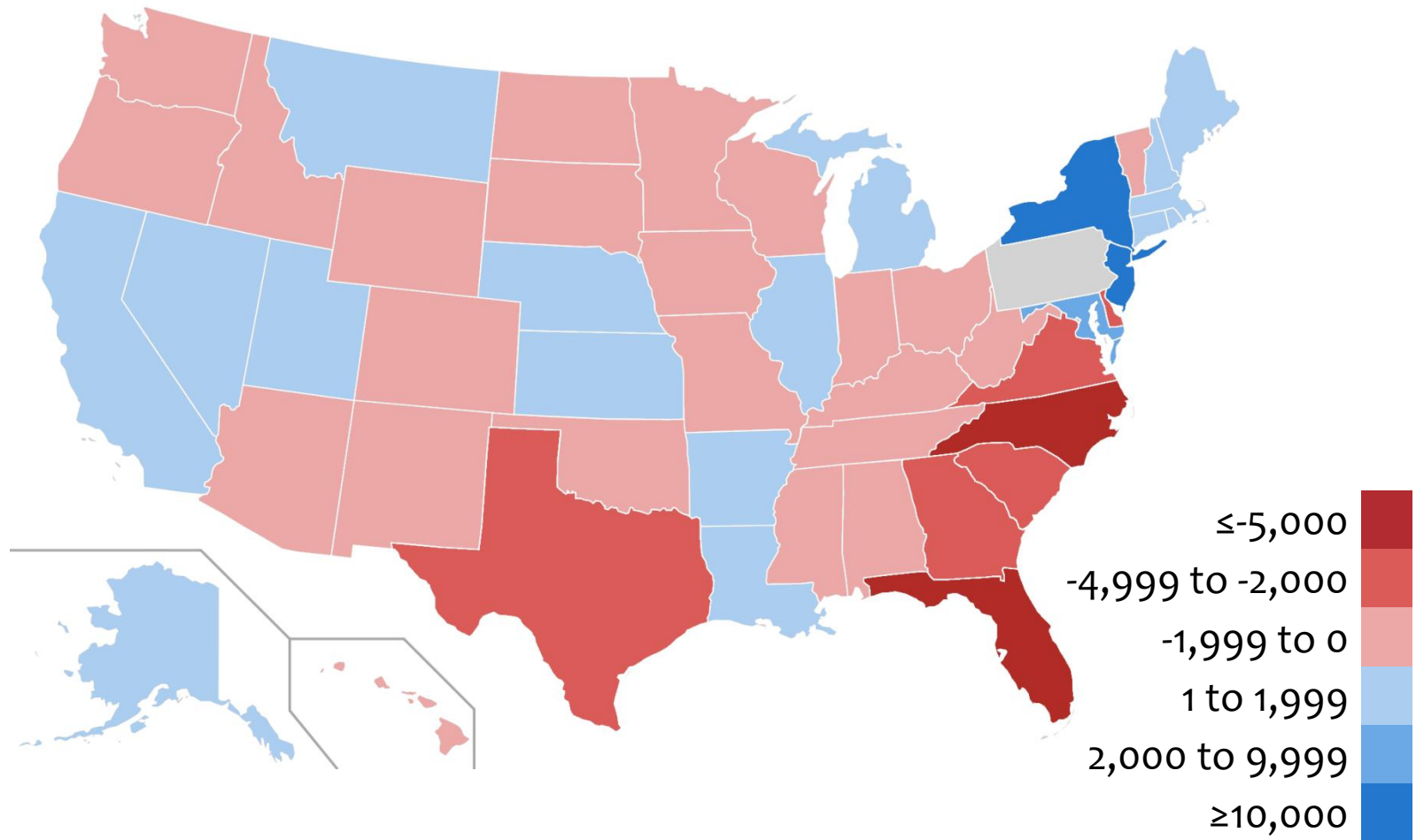
Demographic Outlook



Area/Age Cohort	Share of Population			Growth Rate	
	2000	2010	2020	2000-10	2010-20
<u>Pennsylvania</u>					
0-19	26.6%	25.0%	24.1%	-2.8%	-0.5%
20-64	57.7%	59.5%	57.0%	6.7%	-1.0%
65-84	13.7%	13.0%	16.3%	-1.7%	29.4%
85+	<u>1.9%</u>	<u>2.4%</u>	<u>2.6%</u>	<u>28.7%</u>	<u>10.5%</u>
Total	100.0%	100.0%	100.0%	3.4%	3.4%
<u>United States</u>					
0-19	28.5%	27.1%	26.6%	4.5%	7.8%
20-64	59.0%	59.9%	57.4%	11.6%	5.4%
65-84	10.9%	11.1%	14.1%	11.9%	39.8%
85+	<u>1.5%</u>	<u>1.9%</u>	<u>1.9%</u>	<u>33.9%</u>	<u>14.7%</u>
Total	100.0%	100.0%	100.0%	9.9%	10.0%

Demographics

Net Migration to Pennsylvania



Net Migration Data, 2006-2010



Age Cohort	Within U.S.	From Abroad	Include Abroad
0-17	6,725	10,268	16,993
18-19	9,912	2,845	12,757
20-24	-3,882	7,686	3,804
25-44	10,526	19,512	30,038
45-64	-1,447	7,757	6,310
65+	-1,988	2,632	644

Income Cohort	Within U.S.	From Abroad	Include Abroad
\$0 to \$9,999	19,423	24,839	44,262
\$10,000 to \$34,999	-2,121	10,390	8,269
\$35,000 to \$64,999	-1,553	4,307	2,754
\$65,000+	-1,387	2,798	1,411

Economics

**Forecast provided by IHS Global Insight as of
September 2012**

Economic Outlook

- Modest growth, very slow “recovery.”
 - Weakness in labor market.
 - Consumers still “unwinding.” Rebuilding home equity. Paying down debt. Much uncertainty.
 - Concern now shifts to student loan debt. PA second highest in nation at \$29,960 per student.

- Where will the unexpected growth come from?
 - **Consumers** – debt levels still high, employment unsure.
 - **Investment** – little incentive due to lack of demand.
 - **Government** – fiscal pressures at all levels.
 - **Exports** – major trading partners project weak growth (Europe, China, Japan, BRICs).

Economic Outlook



Annual Average Growth Rates for Select Economic Variables

	Pennsylvania		
	1992-01	2002-11	2012-18
Real GSP	2.2%	1.0%	1.9%
Personal Income	4.6%	3.7%	4.0%
Wages and Salaries	4.8%	3.0%	3.6%
CPI-U	2.5%	2.8%	1.7%
Payroll Employment	1.1%	0.0%	0.8%
UE Rate (average level)	5.7%	5.9%	6.4%

Economics



Year-to-Year Projected Growth Rates for Select Economic Variables

Pennsylvania	2012	2013	2014	2015	2016	2017	2018
Real GSP	1.7%	1.5%	2.2%	2.6%	2.0%	1.8%	1.7%
Personal Income	3.1%	3.6%	4.4%	4.2%	4.5%	3.9%	3.9%
Wages and Salaries	3.3%	3.6%	3.5%	3.9%	3.7%	3.5%	3.5%
CPI-U (PA-DE-NJ-MD)	2.1%	1.3%	1.7%	1.6%	1.8%	1.7%	1.8%
Payroll Employment	0.7%	1.1%	1.0%	1.0%	0.8%	0.6%	0.4%
Unemployment Rate	7.6%	7.2%	6.7%	6.3%	5.8%	5.6%	5.5%

Expenditures

Methodology

- Projections assume current policy/services are held constant.
- Projections use demographic trends to predict future growth of service populations (except DOC).
- When calculating average cost per recipient, data from Executive Budgets were used.
 - Once avg. cost was determined, various inflation factors were applied over forecast window.
- State pension contributions were backed out and forecasted separately.
 - Pensions added back to get total expenditures for each of the next five fiscal years.

Demographic Projections

- Reduction in residents **under age 20 (0.5 percent)** from 2010 to 2020.
 - Should help temper budget pressures for education and certain social assistance and programs (e.g., CHIP).
- Large increase in the **65-84 age cohort (29.4 percent)**.
 - Implies significant growth for general health care programs covered under Medical Assistance.
- Increase in the elderly **over age 85 (10.5 percent)** and **95 (139.0 percent)**.
 - Implies higher demand for long-term care services covered under Medical Assistance.

General Fund Expenditures

(\$ millions)



Agency	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Education	\$10,545	\$10,960	\$11,425	\$11,954	\$12,499	\$12,810	\$13,107
Public Welfare	\$10,550	\$10,585	\$10,959	\$11,385	\$11,836	\$12,314	\$12,796
Corrections	\$1,867	\$1,867	\$1,901	\$1,941	\$1,983	\$2,036	\$2,104
All Other	\$4,221	\$4,246	\$4,466	\$4,620	\$4,782	\$4,916	\$5,084
Total	\$27,184	\$27,658	\$28,750	\$29,899	\$31,100	\$32,076	\$33,090

Pension		\$1,163	\$1,651	\$2,159	\$2,685	\$2,950	\$3,178
Non-Pension		\$26,495	\$27,099	\$27,740	\$28,415	\$29,126	\$29,913
Total		\$27,658	\$28,750	\$29,899	\$31,100	\$32,076	\$33,090

Growth Rate

Pension			41.9%	30.8%	24.4%	9.9%	7.7%
Non-Pension			2.3%	2.4%	2.4%	2.5%	2.7%
Total			3.9%	4.0%	4.0%	3.1%	3.2%

Department of Education



(\$ millions)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Inflation – CPI-U	3.3%	2.1%	1.3%	1.7%	1.6%	1.8%	1.7%
K-12 Public & Non-Public	-0.5%	-0.4%	-0.4%	-0.4%	-0.4%	-0.3%	-0.3%
Higher Education	0.2%	0.4%	0.4%	0.5%	0.4%	0.5%	0.5%
PSERS/SERS	601	858	1,222	1,605	1,999	2,130	2,256
Basic Education Subsidy	7,082	7,137	7,200	7,296	7,398	7,519	7,633
Higher Education	1,150	1,150	1,170	1,196	1,219	1,247	1,275
Employee Social	555	544	549	557	564	574	582
All Other	1,158	1,273	1,284	1,301	1,319	1,341	1,361
Total	10,54	10,960	11,425	11,954	12,499	12,810	13,107
Growth Rate	0.9%	3.9%	4.2%	4.6%	4.6%	2.5%	2.3%
% GF Spending	38.8%	39.6%	39.7%	40.0%	40.2%	39.9%	39.6%

Trends

- Decline in under 20 age cohort affects enrollment.
- Substantial growth in PSERS obligations.
- Higher Education funding increasing by 2% per annum.

Department of Public Welfare



(\$ millions)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Inflation – Healthcare	1.9%	2.1%	2.7%	2.9%	3.0%	3.0%	3.0%
PA Population	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
MA Population	1.7%	1.9%	0.9%	0.9%	0.9%	0.9%	0.9%
SERS	31	68	97	127	158	191	215
Medical Assistance	4,857	4,952	5,134	5,335	5,545	5,766	5,995
Long Term Care	966	1,016	1,067	1,121	1,184	1,249	1,318
Intellectual Disability	2,030	2,019	2,080	2,148	2,220	2,295	2,372
All Other	2,666	2,530	2,581	2,654	2,729	2,813	2,896
Total	10,550	10,585	10,95	11,385	11,836	12,314	12,796
Growth Rate	20.2%	0.3%	3.5%	3.9%	4.0%	4.0%	3.9%
% GF Spending	38.8%	38.2%	38.1%	38.1%	38.1%	38.4%	38.7%

Trends

- Increasing enrollment in MA population.
- PPACA effect on Pennsylvania’s MA program.
- Escalating health care costs.

Department of Public Welfare

Other Funds (\$ millions)

FY 2012-13

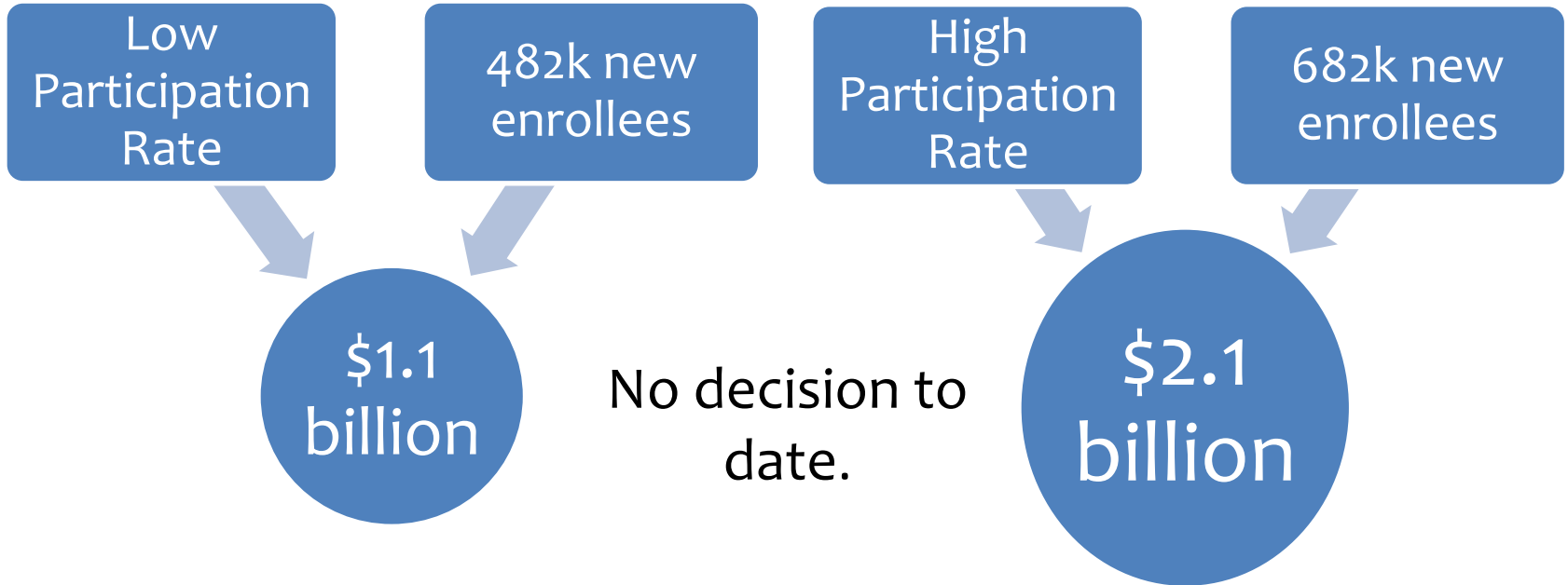
Miscellaneous	22
Tobacco	252
Lottery	309
Managed Care GRT	628
Assessments*	1,240
Total	2,450

*The Statewide Hospital Assessment and the Philadelphia Hospital Assessment need reauthorization in FY 2013-14.

Impact of Patient Protection and Affordable Care Act (PPACA)



- Provision allows states to expand their MA program.
 - Individuals with incomes up to 133% federal poverty line (FPL).
 - 2014-16 federal government picks up 100% of costs.
 - Phase-down process through 2019, 90% fed/10% state.



Department of Corrections



(\$ millions)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Inflation – CPI-U	2.1%	1.3%	1.7%	1.6%	1.8%	1.7%	1.8%
Inmate Population	-0.5%	-1.6%	-1.8%	-2.1%	-1.9%	-1.6%	0.0%
SERS	82	120	166	212	258	305	341
All Other	1,78	1,747	1,735	1,730	1,726	1,731	1,762
Total	1,86	1,867	1,901	1,941	1,983	2,036	2,104
Growth Rate	12.3%	0.0%	1.8%	2.1%	2.2%	2.6%	3.3%
% GF Spending	6.6%	6.9%	6.8%	6.6%	6.5%	6.4%	6.3%

Trends

- If JRI initiative is successful, DOC will realize significant savings.
- Rising inmate health care costs could apply budget pressure.
- New wage contracts can influence expenditures.

Pensions

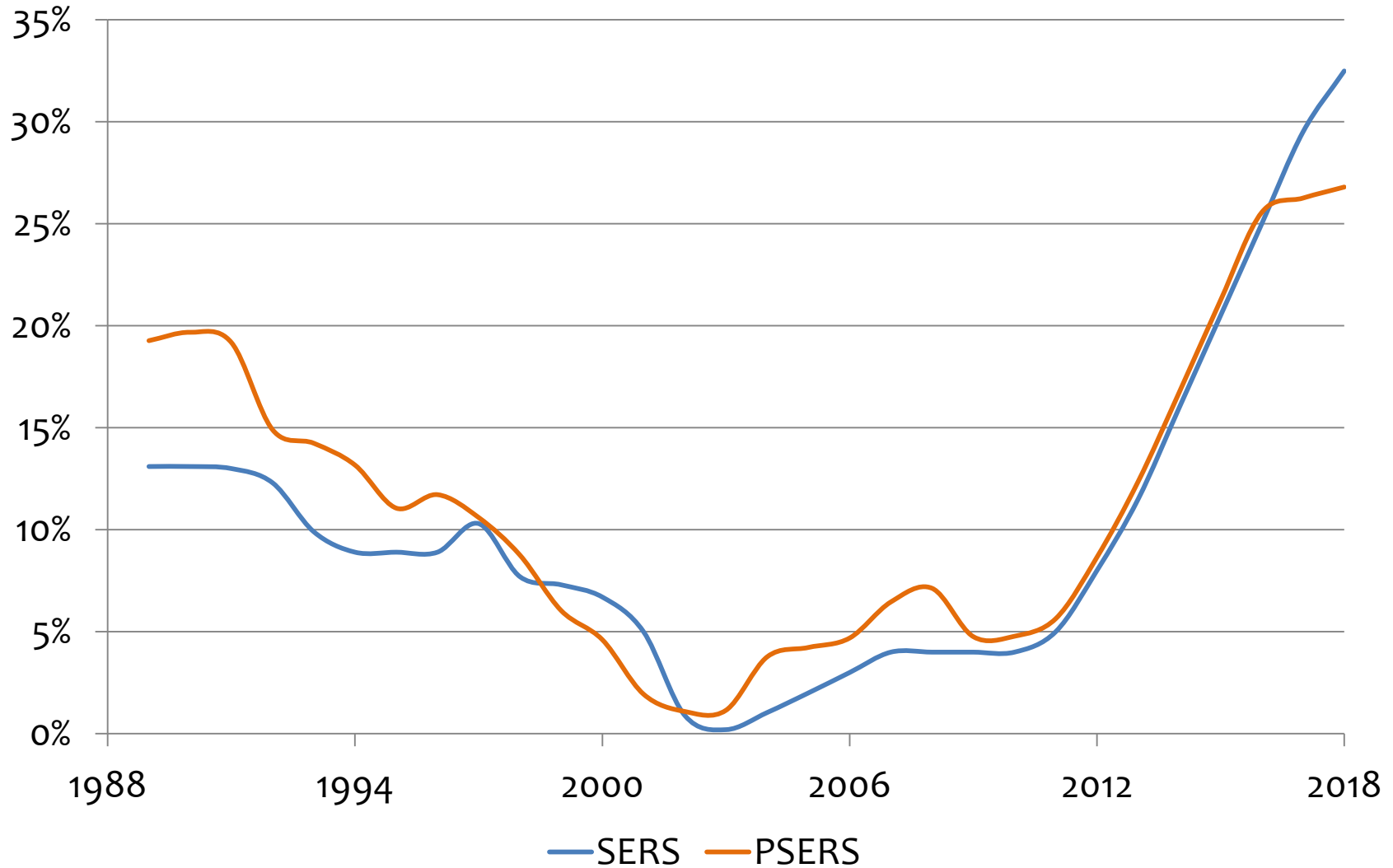
Pensions

Scope and Methodology

- Pensions paid from General Fund Appropriations.
- SERS: FY 2012-13 base year; growth based on employer rates and underlying agency growth.
- PSERS: System with an estimate of the state share.

Pensions

Employer Contribution Rates: 30 Years (FYE 1989-2018)



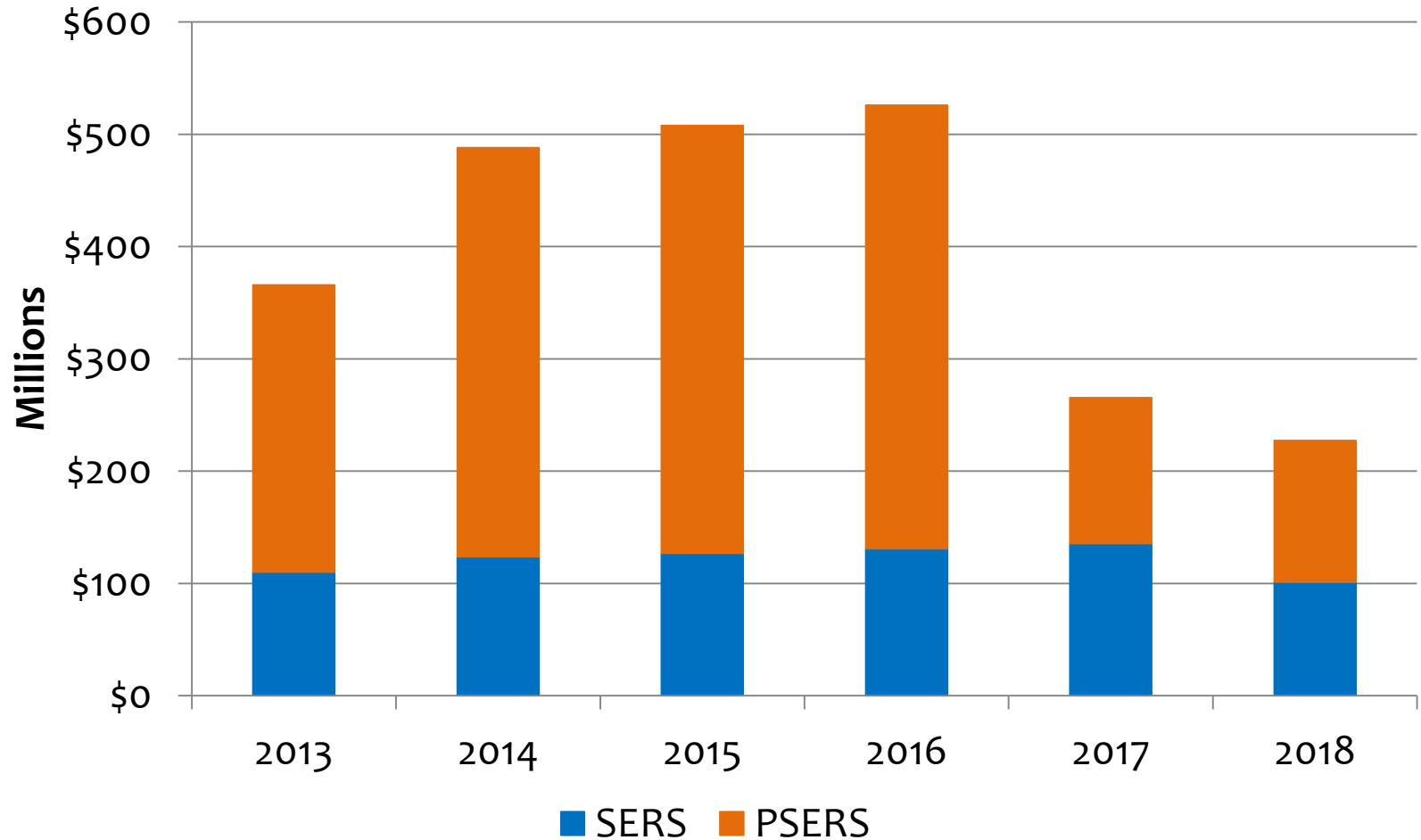
Pensions

Total Contributions from General Fund Appropriations by FY (\$ Millions)

	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
SERS	307	431	558	689	824	926
PSERS	856	1,220	1,601	1,996	2,126	2,252
Total	1,163	1,651	2,159	2,685	2,950	3,178

Pensions

Annual Increase in SERS & PSERS Employer Contributions from Appropriations (FYE 2013-2018)



Pensions

Caveats

- Additional \$220 million in appropriations by FY 2017-18 if the non-appropriated sources do not grow in line with pension costs.
- Out-year PSERS rates could be higher if investment returns do not match the 7.5% earnings assumption.

Revenues

Revenues



General Fund Revenues: Percent Growth (FYE 2013-18)

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Corporate Net Income	15.0%	-4.4%	0.7%	3.1%	2.9%	2.3%
Personal Income	3.6%	2.8%	4.5%	4.2%	3.8%	3.7%
Sales & Use	3.4%	2.3%	4.0%	3.5%	2.8%	2.5%
All Other	-2.6%	-3.0%	-2.5%	2.0%	1.5%	1.7%
<hr/>						
Total	3.0%	0.8%	2.7%	3.5%	3.0%	2.8%

Overview of Revenue Projections

- Intended to display revenue trends; primary value is in long-term growth rates, rather than point estimates.
- Methodology for long-term estimates differ from methodology used to estimate revenues for the budget.

FY 2012-13 Overview – General Fund Total

- No changes from our June estimate.
- Too early to draw any conclusions about any overage or shortfall for the year.
- External events (e.g., federal tax policy & global economy) will play significant role.

FY 2012-13 Overview – Highlights

- 3% overall revenue growth; includes \$308 million reduction from phase-out of CSFT.
- Specific discussion of the three largest revenue sources (PIT, SUT & CNIT).
- Comparison of current growth rates to predicted growth rates.

FY 2012-13: Personal Income Tax

- 2.7% growth in withholding through September (vs. 2.8% FY prediction).
- Strong withholding in October because of the calendar, due date fell in November last year & October this year.
- Expect strong growth in annual payments; pull-forward of dividends and gains.

Revenues

FY 2012-13: Sales and Use Tax

- 2.4% growth through October (vs. 3.4% FY prediction).
- Expiration of federal payroll tax cut or other federal tax increases could reduce disposable income and reduce sales tax revenues.

FY 2012-13: Corporate Net Income Tax

- 32.1% growth through October (vs. 15% FY prediction).
- Growth over depressed levels in the last half of 2011.
- Growth will moderate after the first of the year, but fiscal year results will be strong.

FY 2013-14: Overview

- 0.8% growth rate heavily influenced by technical factors.
- Should not be viewed as a point estimate for the year. Our May 1 estimate will reflect a thorough evaluation of short-term models and the latest data.

Revenues

FY 2013-2014: Overview (continued)

- \$300 million reduction in CSFT from phase-out.
- CNI declines; reversion to reflect underlying profits.
- PIT annuals decline; result of 2013 revenue advanced to 2012.

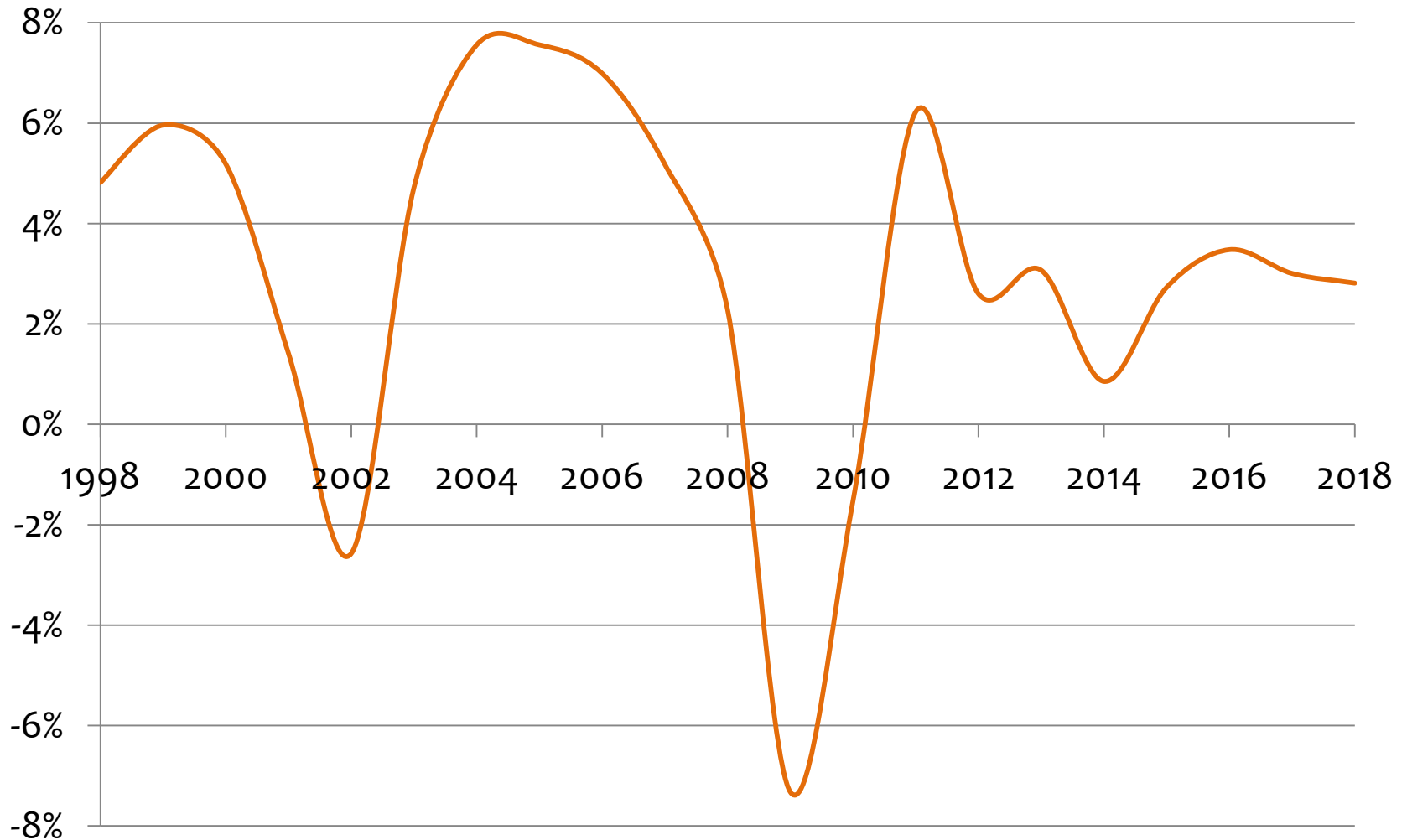
Revenues

FY 2014-15 through FY 2017-18: Overview

- 3.0% average annual growth rate.
- Long-term growth limited by demographics and economics.

Revenues

Tax Revenue Growth Rates – Percent (FYE 1998-2018)

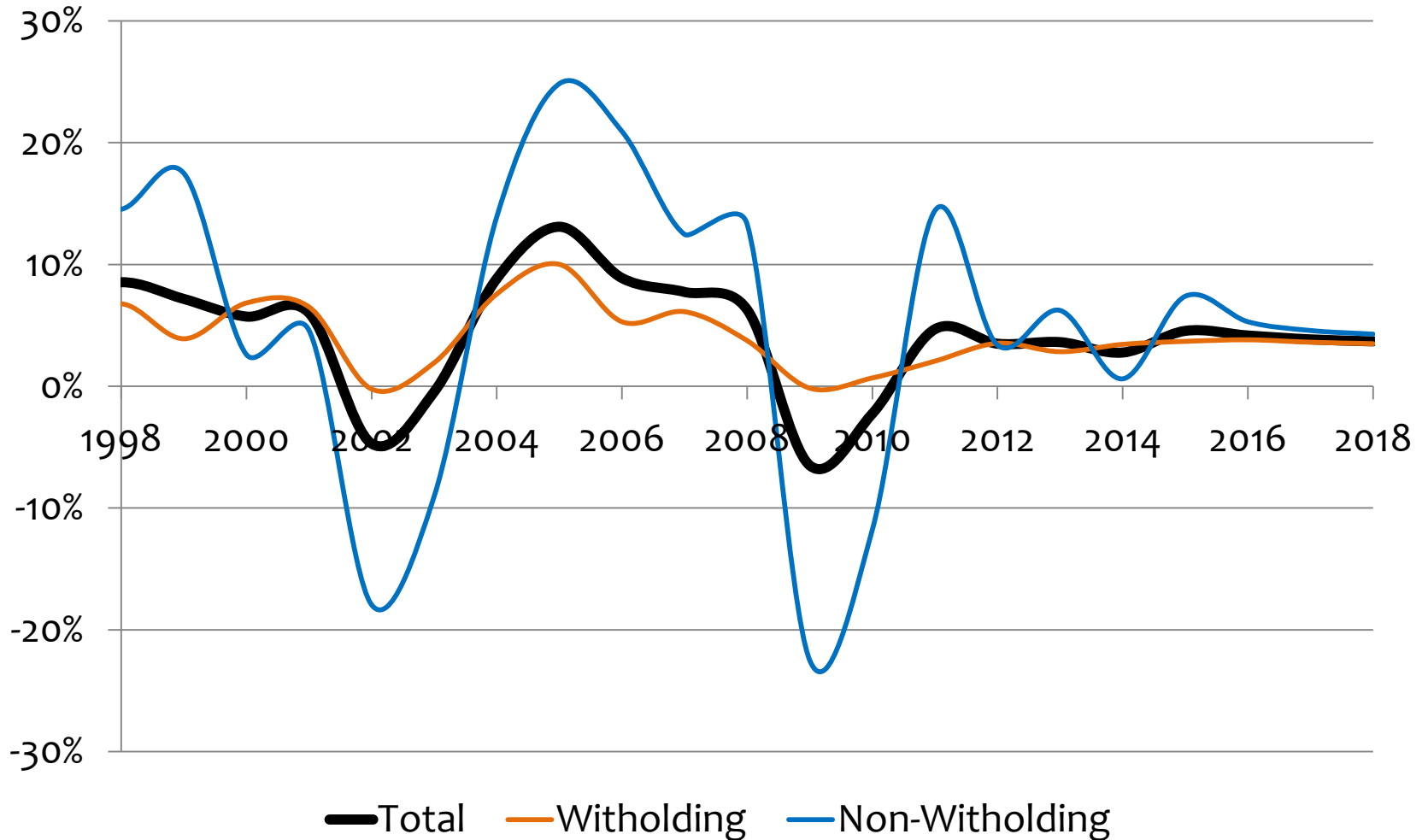


Major Demographic Trends Affecting the Forecast

- Working age cohort (age 20 to 64) declines by 1% from 2010 to 2020.
- The 65 and over population increases by 27% from 2010 to 2020.

Revenues

Personal Income: Percent Change (FYE 1998-2018)



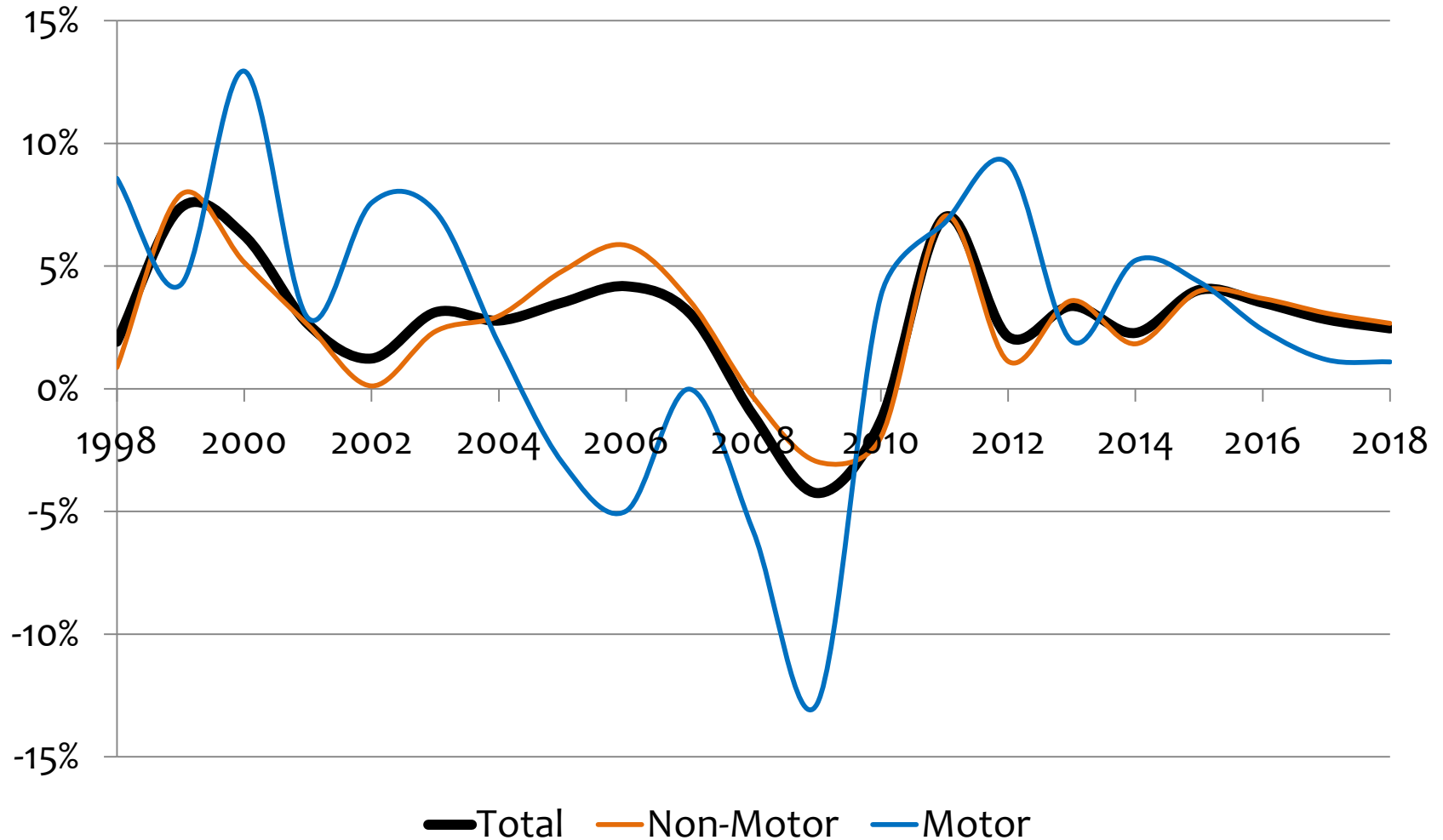
Revenues

FY 2014-15 through FY 2017-18: Personal Income Tax

- 4.1% average annual growth rate (3.7% withholding).
- Assumes increasing labor force participation rate.

Revenues

Sales and Use: Percent Change (FYE 1998-2018)



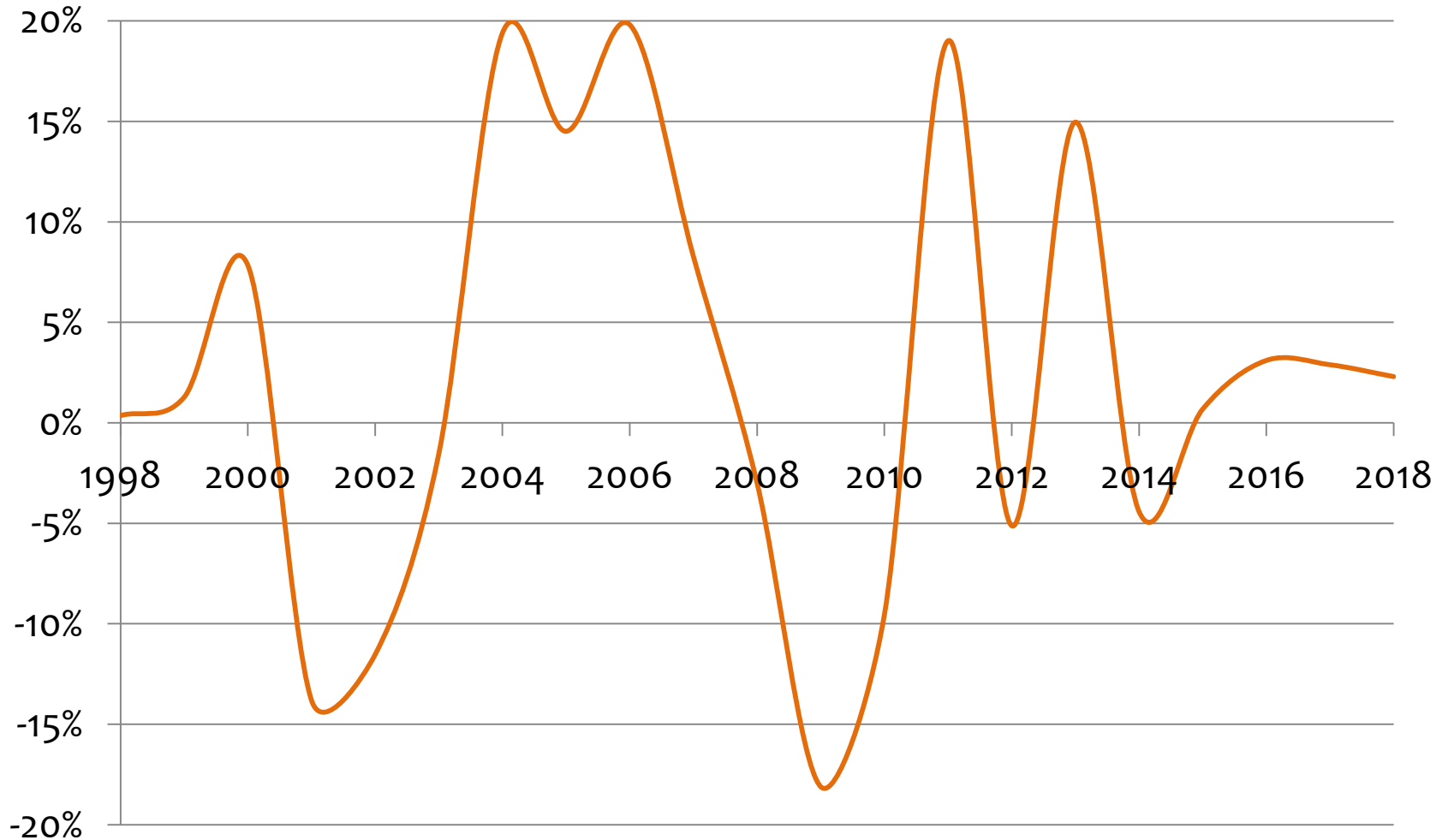
Revenues

FY 2014-15 through FY 2017-18: Sales and Use Tax

- 3.2% average annual growth rate.
- An aging population, student loan debt and growing internet sales will constrain the growth of the tax base.

Revenues

Corporate Net Income: Percent Change (FYE 1998-2018)



Revenues

FY 2014-15 through FY 2017-18: Corporate Net Income Tax

- 2.2% average annual growth rate.
- Profit rates are forecasted to exhibit relatively little growth.

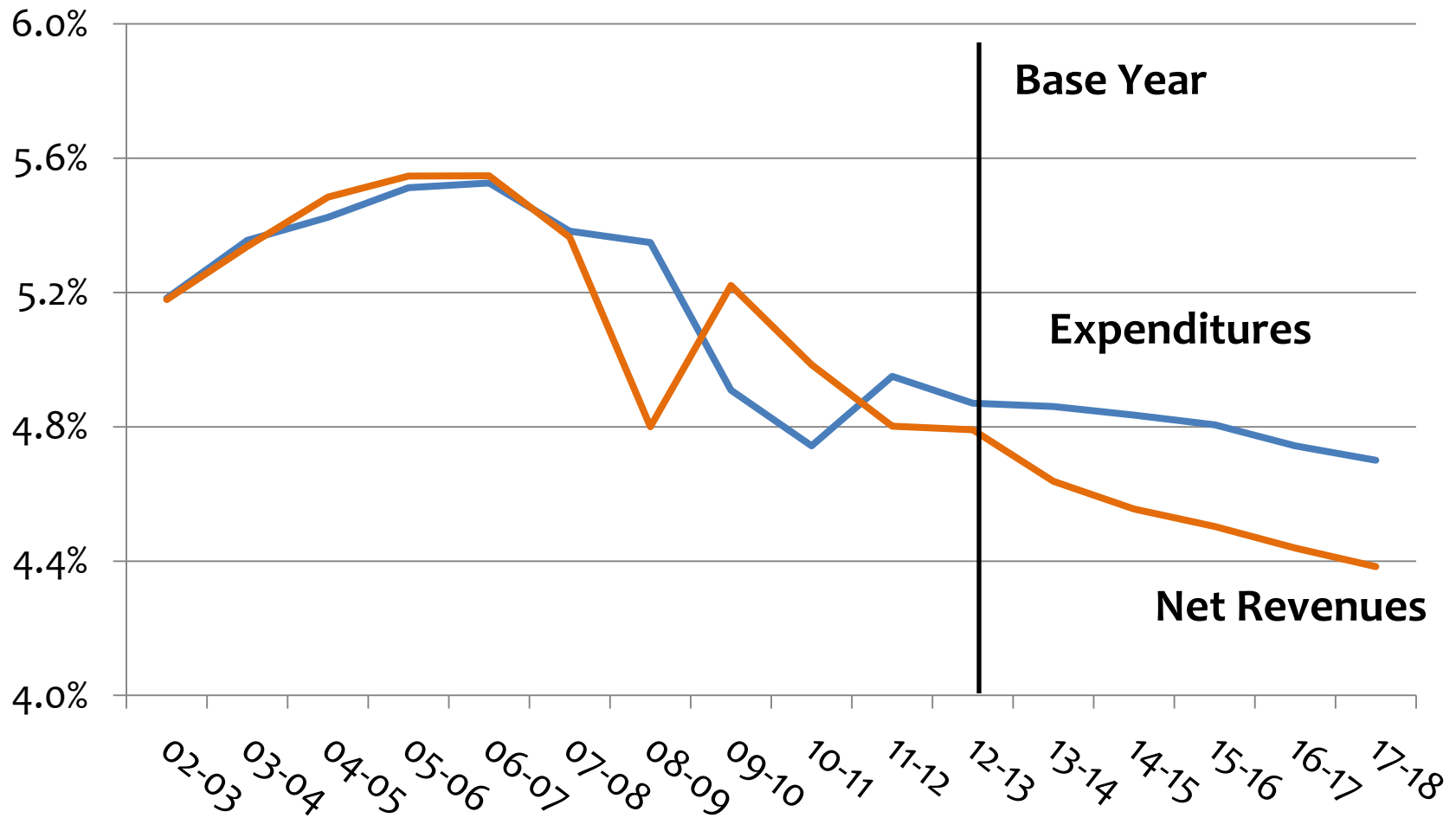
Summary of Findings

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Revenues	28,510	28,745	29,515	30,536	31,452	32,337
Expenditures	<u>27,678</u>	<u>28,750</u>	<u>29,899</u>	<u>31,100</u>	<u>32,076</u>	<u>33,090</u>
Difference	832	-6	-384	-563	-624	-753
Less: Refunds	-1,300	-1,311	-1,346	-1,392	-1,434	-1,475
Net Difference	-468	-1,317	-1,730	-1,955	-2,058	-2,228

Differences exclude the carryover of any ending balances, lapses or transfers to the BSF.

Summary of Findings

Net Revenues and Expenditures as % of State Personal Income



Summary of Findings

➤ Revenues

- Weak labor market. Slow wage growth.
- Tax base erosion: sales and use, cigarettes, gaming?
- Federal tax policy: income, payroll and capital income tax increases. Lower disposable income.
- Little “wealth effect” from housing and stock market.

➤ Expenditures

- Mandated employer pension contributions.
- Demographics: elderly cohort grows, especially very old.
- “Moderate” healthcare inflation (3.0% per annum) still outpaces revenues (2.6% per annum).

Summary of Findings

- Some potential outcomes not included in forecast.

- **Revenues**
 - Asia and Eurozone growth: could be much worse.
 - Housing market: faster recovery?
 - Improved business climate?

- **Expenditures**
 - All funding cuts made for FY 2012-13 not restored.
 - Medical Assistance expansion?
 - Department of Corrections savings from JRI.
 - Higher healthcare inflation.

Report available at www.ifo.state.pa.us.