

INDEPENDENT FISCAL OFFICE

# BUDGET & ECONOMIC UPDATE

*Pennsylvania Institute of Certified Public Accountants  
June 7, 2017*

# Today's Presentation

## ▶ **Revenue Update for FY 2016-17.**

- Negative (base) revenue growth through May.
- Revenue shortfall approaches ~\$1.0 billion.

## ▶ **Economic Update.**

- Lots of jobs created, does not translate to spending.
- Weak spending yields minimal profits growth.

## ▶ **Budget Proposals and Tax Burden Rankings.**

- Deficit projections remain high (~\$2.5 - \$3.0 billion).
- PA state-local tax burden similar to U.S. average.

# Factors That Affect Revenue Shortfall

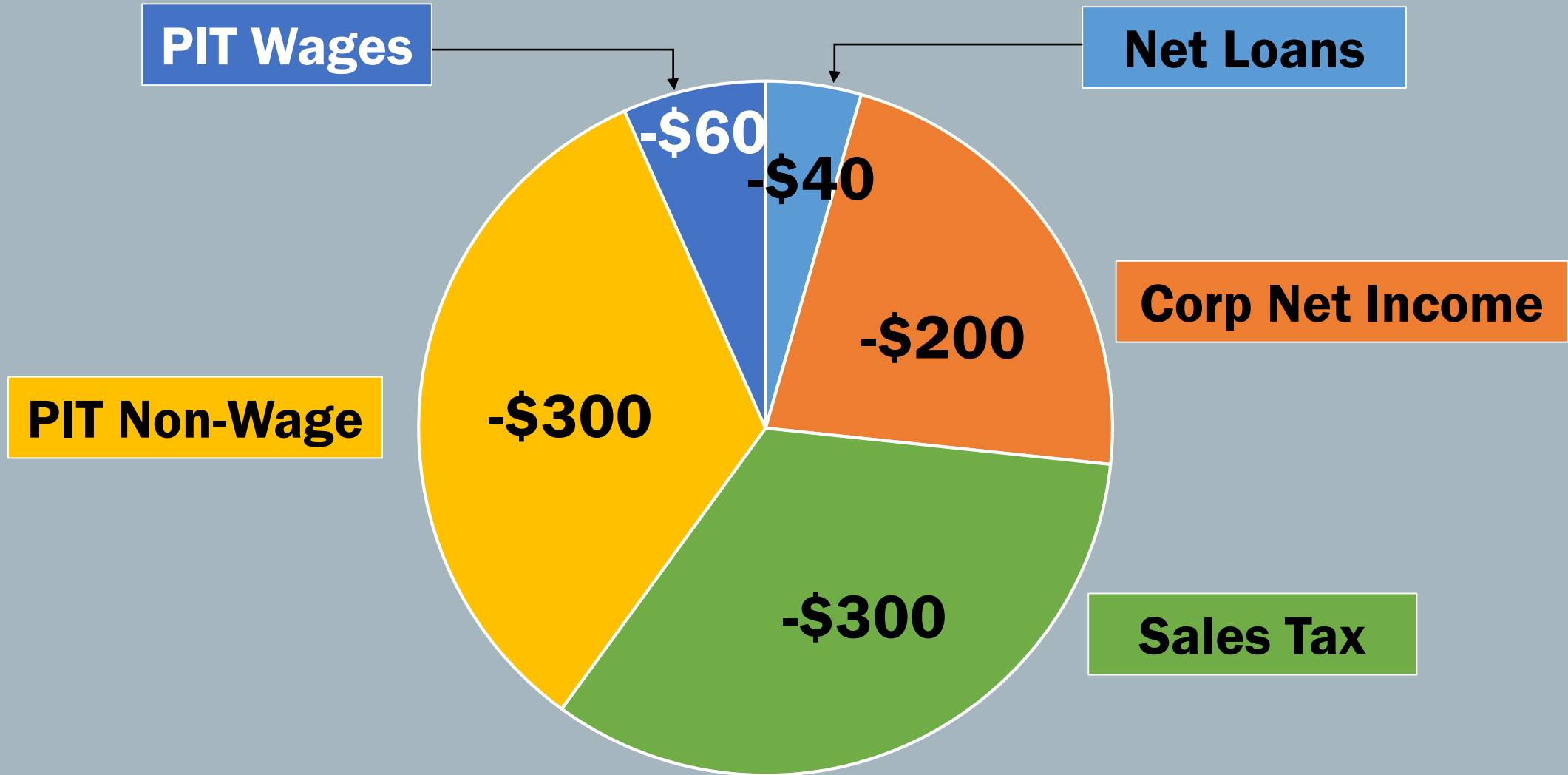
- ▶ **Taxable consumer spending is weak.**
  - Base sales tax growth is +0.7% Jan. to May 2017.
  - Much lower than income growth (~+3.0% to +3.5%).
- ▶ **Probable income shifting from 2016 into 2017.**
  - PA April final payments down from last year (-4%).
  - U.S. April final payments also down (-4%).
- ▶ **U.S. corporate profits decline in 2015 and 2016.**
  - Has not occurred outside recession for several decades.
  - Energy sector hit hard. Broad declines in 2016.

# Actual FYTD Revenues Through May

	May 2017	Dollar Change	Annual Growth	Base Change	Base Growth <sup>1</sup>
<b>Total General Fund</b>	<b>\$28,405</b>	<b>\$564</b>	<b>2.0%</b>	<b>-\$84</b>	<b>-0.3%</b>
Corporate Net Income	2,130	-181	-7.8	-154	-6.7
Capital Stock	34	-114	n.a.	0	n.a.
Gross Receipts	1,208	-86	-6.7	-74	-5.7
Sales – Non-Motor	7,765	111	1.4	72	0.9
Sales – Motor Vehicle	1,247	24	2.0	24	2.0
PIT – Wages	8,862	295	3.4	291	3.4
PIT – Non-Wage	2,582	-98	-3.7	-107	-4.0
All Tobacco	1,216	386	46.5	-51	-6.1
Inheritance	855	3	0.4	3	0.4
Realty Transfer	424	-3	-0.7	10	2.3
All Non-Tax	2,084	228	12.3	-98	-5.3

Note: Dollar amounts are in millions. PIT is personal income tax.  
<sup>1</sup> Base growth rate controls for (1) changes in tax law, (2) an extra withholding day last fiscal year and (3) one-time transfers.

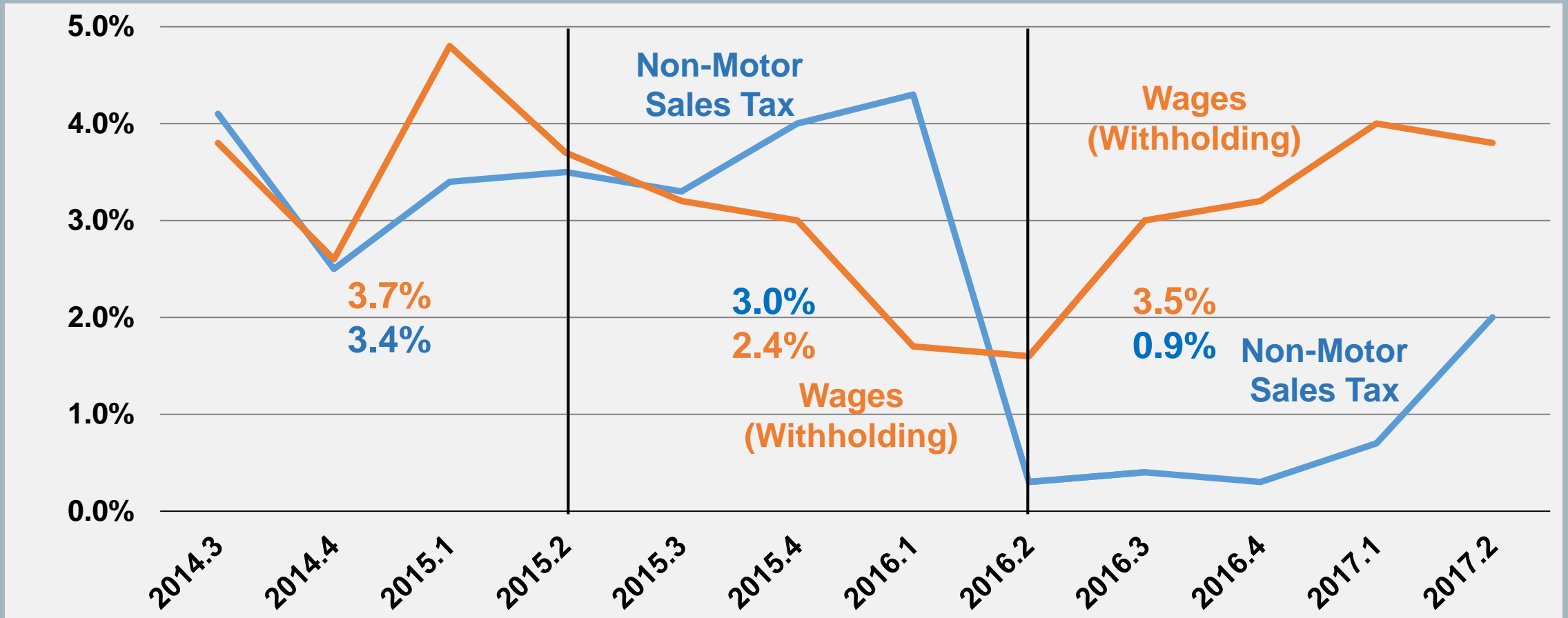
# FY 16-17 IFO Revenue Shortfall = $-\$900\text{m}$



*Note: Dollar amounts are in millions.*

# Income Does Not Translate to Spending

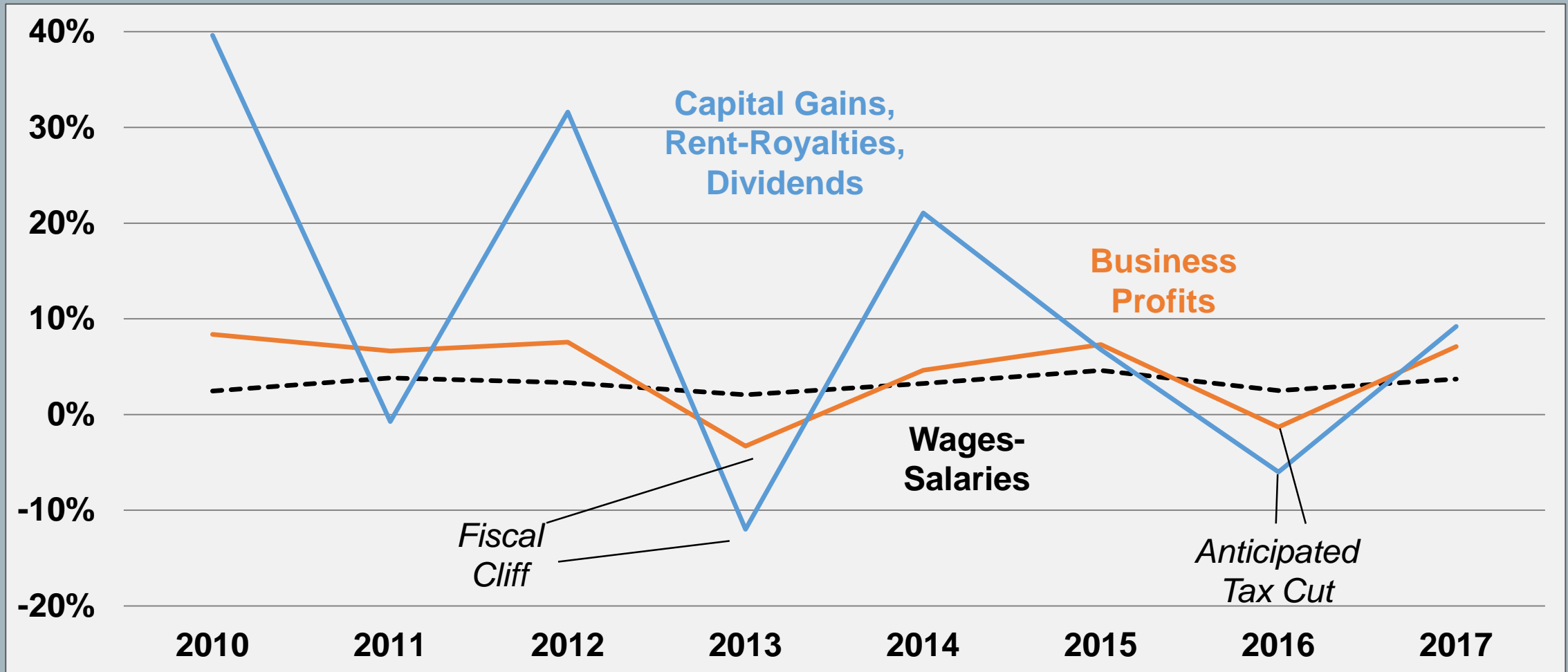
## Year-Over-Year Growth Rates



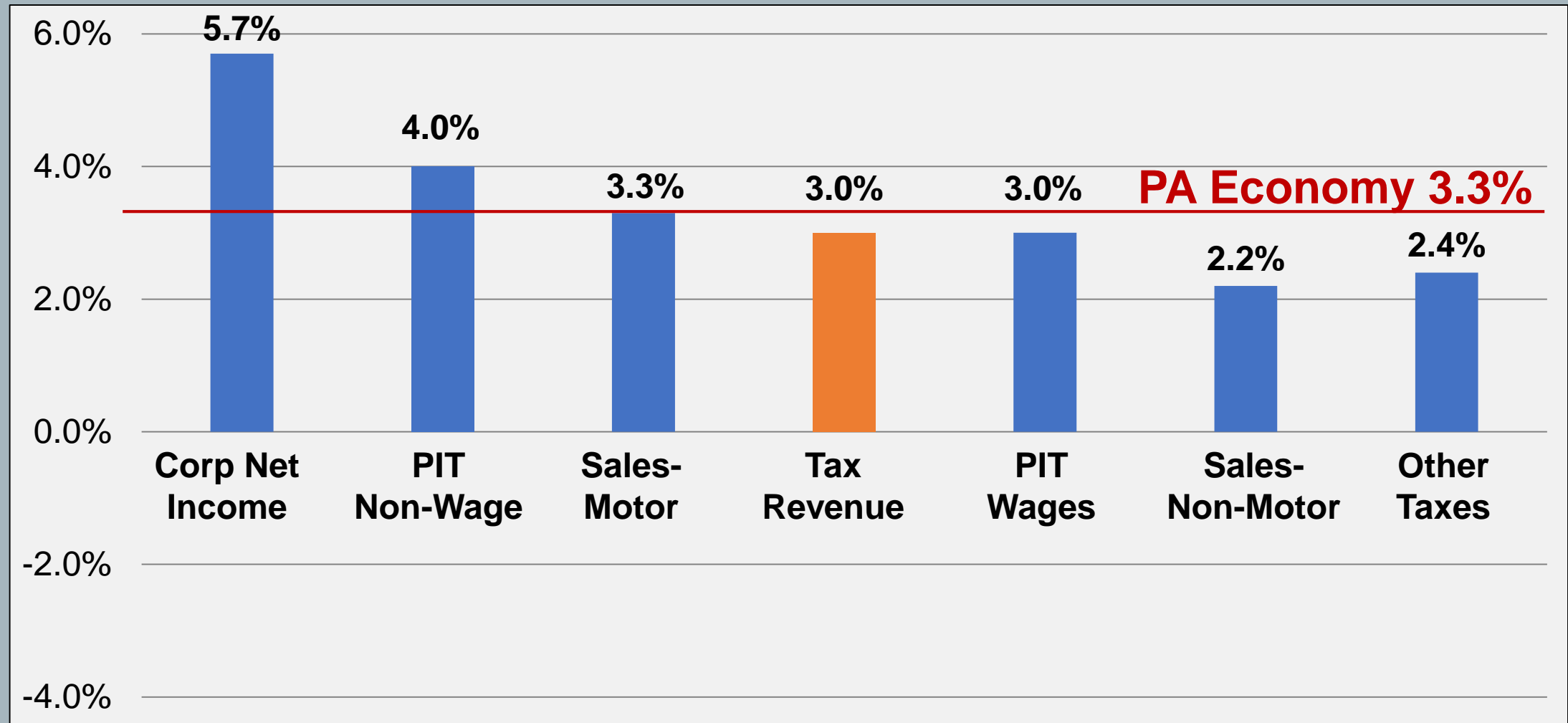
Note: Sales tax growth rate controls for tax law changes and transfers. Data are lagged one month to coincide with withholding. Withholding growth rate controls for any extra deposit days in quarter.

# Income Shift From 2016 to 2017

Annual Growth Rates, Income Reported on PA Tax Return



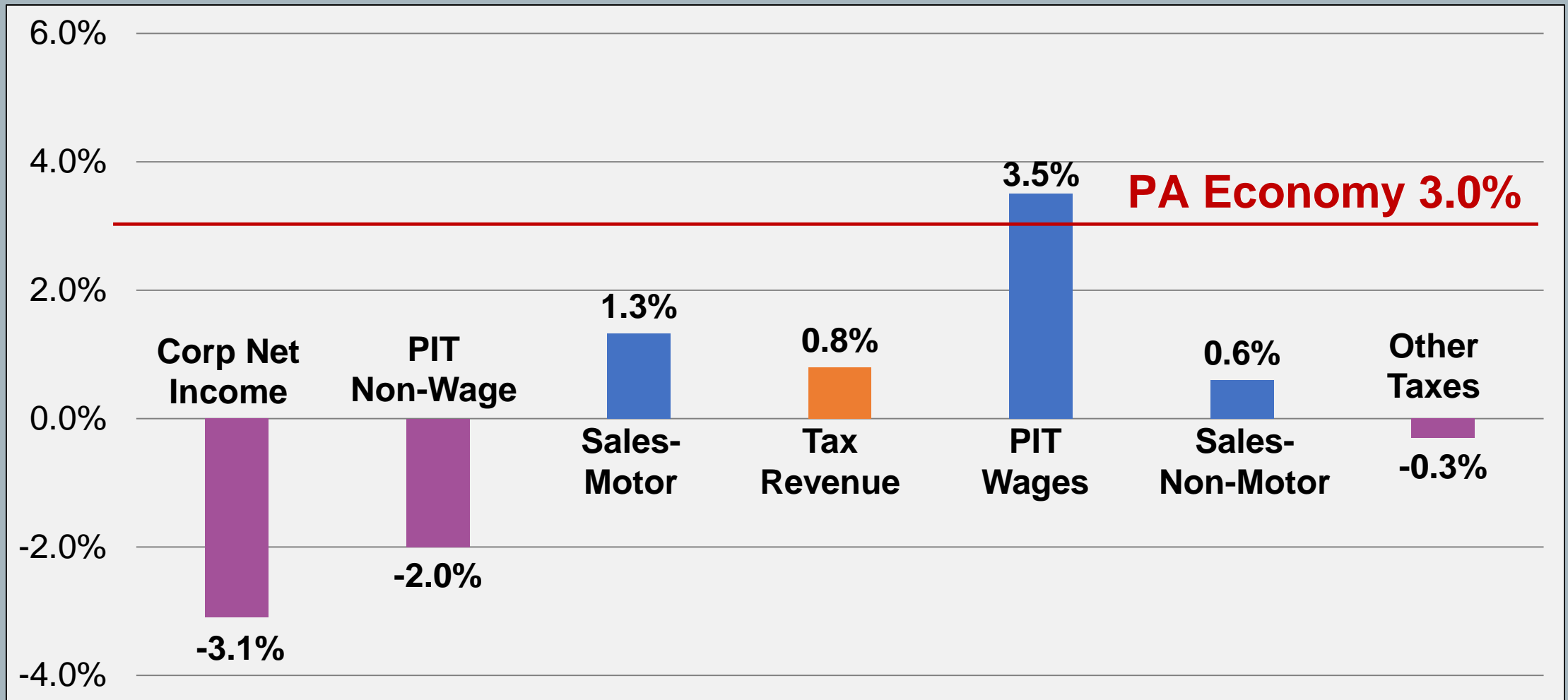
# 5-Year Average Annual Revenue Growth



Note: Tax revenue excludes non-tax, cigarette and CSFT. Excludes tax amnesty monies and SUT changes.



# FY 2016-17 Tax Revenue Growth



Note: Tax revenue excludes non-tax, cigarette and CSFT. Excludes tax amnesty monies and SUT changes. PIT wage and tax revenue growth control for extra deposit day in prior fiscal year.

# Recent PA Economic Trends

- ▶ **Strong job gains through 2017 Q1.**
  - Very strong gains in healthcare sector.
  - Manufacturing, mining and retail sector contract.
- ▶ **Total income growth is moderate.**
  - Wage growth slightly weaker than expected, but decent.
  - Business profits continue to lag.
- ▶ **Limited borrowing by PA consumers.**
  - Mortgage debt falls in first quarter.
  - Increases to credit card, auto and student loans.

# Recent Economic Trends

	2016.2	2016.3	2016.4	2017.1	2017.2
PA Real GDP	0.9%	1.7%	1.4%	n.a.	n.a.
PA Wages-Salaries	2.8%	4.0%	2.8%	3.2%	3.5%
PA Job Gains (000s)	41.3	52.8	61.2	68.9	n.a.
Philly CPI-U	0.4%	0.4%	1.5%	2.1%	1.1%
PA Home Price Index	3.0%	3.8%	3.7%	3.6%	n.a.
Mid-Atlantic Gasoline	-15.1%	-13.0%	6.1%	25.8%	9.4%
U.S. Domestic Profits	-7.7%	0.3%	8.0%	-0.6%	n.a.
S&P 500	-1.3%	6.7%	6.4%	19.3%	15.6%

Note: All growth rates are year-over-year. Wage growth for 2017 Q1 and Q2 is an estimate by IFO based on withholding tax revenues. Corporate domestic profits exclude the Federal Reserve. Home price index represents increase in average market value of existing homes.

Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Energy Information Admin., Federal Housing Finance Agency.

# Change in Payroll Employment (000s)

	2014	2015	2016	2017
Mining	1.7	-3.8	-9.0	-3.2
Construction	4.8	6.5	3.7	6.5
Manufacturing	3.0	0.0	-9.3	-7.1
Wholesale-Retail	2.8	1.0	-2.7	-3.7
Transportation-Storage	7.4	11.2	9.0	8.4
Professional Services	13.3	18.0	14.4	10.7
Healthcare-Social	14.3	11.2	23.7	29.4
Leisure-Hospitality	5.1	7.5	13.1	11.2
Local Government	-7.3	-6.8	-0.9	0.3
State-Federal Government	-2.0	0.3	0.9	-1.5
All Other Sectors	<u>4.3</u>	<u>1.5</u>	<u>9.3</u>	<u>12.0</u>
<b>Annual Job Gains</b>	<b>47.4</b>	<b>46.7</b>	<b>52.2</b>	<b>63.0</b>

Note: Professional Services includes the Management and Administrative sectors. Data for 2017 represent the annualized pace through April.  
Source: U.S. Bureau of Labor Statistics.

# Mortgage Debt Falls – Other Debt Increases

	Annual Growth in PA Per Capita Debt					
	2012	2013	2014	2015	2016	2017.1
Auto Loans (10%)	6.6%	1.6%	8.3%	8.6%	5.2%	6.0%
Credit Card (7%)	-1.8%	-2.2%	0.0%	5.2%	3.5%	4.3%
All Mortgage (66%)	-1.7%	-4.1%	1.3%	0.1%	2.0%	-0.8%
Student Loan (14%)	7.5%	6.9%	5.1%	2.5%	7.2%	7.2%
All Other Debt (3%)	<u>-2.2%</u>	<u>-15.8%</u>	<u>8.0%</u>	<u>8.3%</u>	<u>-2.3%</u>	<u>-6.7%</u>
<b>Total Consumer Debt</b>	<b>-0.1%</b>	<b>-2.6%</b>	<b>2.5%</b>	<b>1.8%</b>	<b>3.0%</b>	<b>1.1%</b>

Note: Percentages in parentheses represent share of total debt. Per capita debt levels for all PA consumers with a credit report. Includes family members of such consumers.  
 Source: Federal Reserve Board of New York, Quarterly Report on Household Debt and Credit.

# U.S. Corporate Profits Decline - Again

	Annual Growth Rate			
	2013	2014	2015	2016
<b>U.S. Domestic Corp Profits</b>	<b>2.4%</b>	<b>6.1%</b>	<b>-2.6%</b>	<b>-1.5%</b>
Financials	-14.1	7.7	4.2	3.1
Non-Financials	7.4	4.3	-4.5	-3.7
Manufacturing	8.6	4.7	-8.2	-7.2
Petroleum-Coal	-4.6	16.1	-87.1	loss
Other Manufacturers	10.5	3.3	2.9	-2.1
Wholesale & Retail	2.7	5.8	4.6	-3.1
Transportation & Information	14.0	0.5	6.4	4.3
All Other Sectors	7.1	4.4	-11.5	-4.3%

*Source: U.S. Bureau of Economic Analysis, NIPA Table 6.16D. Financials excludes Federal Reserve. Includes C and S corporations.*

# Budget Update

- ▶ **Consensus: potential deficit of ~\$2.5 - \$3.0 billion for FY 2016-17 and FY 2017-18.**
  - But, figures are now dated.
  - General Assembly / Governor have discretion over funding.
- ▶ **Executive Budget uses three methods to address.**
  - Revenue proposals. Loans/enhancements. Efficiency gains.
  - Unclear what will be enacted.
- ▶ **Severance tax and minimum wage increase.**
  - Gas prices recently recover. Will it last?
  - Minimum wage: higher incomes vs. lower employment.

# The Outlook in February 2017

	2015-16	2016-17	2017-18	Growth
<b>Beginning Balance</b>	<b>\$275</b>	<b>\$2</b>	<b>-\$936</b>	
Revenue Available	29,855	30,994	31,309	+1.0%
Expenditures	30,127	31,931	33,410	+4.6%
<b>Ending Balance</b>	<b>\$2</b>	<b>-\$936</b>	<b>-\$3,037</b>	

Note: Dollar amounts are in millions.  
Source: FY 2017-18 Executive Budget presentation, Feb. 7, 2017. Excludes all policy initiatives.



# Proposed Deficit Reduction

	2-Year Impact
Revenue Package	\$1,006
Revenue Enhancements	304
Loans or Leasebacks	335
Gaming Expansion	250
Reduce Tax Credits	100
Consolidation/Closures/Complement	351
2016-17 DHS Savings	165
Pupil Transport Savings & U. Penn Appropriation	82
Miscellaneous Efficiency Savings	<u>451</u>
<b>Total Change to Balance Sheet</b>	<b>\$3,043</b>

Note: Dollar amounts are in millions. Source: FY 2017-18 Executive Budget and Feb. 7, 2017 budget presentation.

# Impact of Revenue Proposals

	Fiscal Years				
	17-18	18-19	19-20	20-21	21-22
Corporate Net Income	\$18	\$178	\$63	-\$241	-\$521
Severance Tax	349	712	755	931	1,152
Insurance Premiums	142	164	172	182	191
Sales and Use	<u>435</u>	<u>500</u>	<u>526</u>	<u>554</u>	<u>573</u>
<b>Total</b>	<b>\$944</b>	<b>\$1,554</b>	<b>\$1,516</b>	<b>\$1,426</b>	<b>\$1,395</b>

Note: Dollar amounts are in millions. Corporate net income includes combined reporting, rate reduction and NOL threshold. Sales tax includes taxation of custom programming and certain business storage services.  
 Source: *Analysis of Revenue Proposals, IFO, April 2017.*

# Natural Gas Production and Prices

	2014	2015	2016	2017	2018
PA Natural Gas Production	4,071	4,597	5,092	5,198	5,437
Growth Rate	31.2%	12.9%	10.8%	2.1%	4.6%
Average Annual Prices					
Henry Hub	\$4.46	\$2.70	\$2.57	\$3.42	\$3.43
PA Regional Hub	\$3.14	\$1.43	\$1.53	\$2.44	\$2.62
		17-18	18-19	19-20	20-21
Tax on Market Value		\$574	\$952	\$1,017	\$1,216
Less Impact Fee		<u>\$225</u>	<u>\$240</u>	<u>\$262</u>	<u>\$285</u>
Net Tax Revenues		\$349	\$712	\$755	\$931

Note: Production is billion cubic feet. Dollar amounts are in millions. PA regional hub is weighted average of Leidy and Dominion South trading hubs.  
 Source: Analysis of Revenue Proposals, IFO, April 2017.

# Lifetime Effective Tax Rates – Natural Gas

	Statutory Tax Rate	Effective Tax Rate at Wellhead
Arkansas	5.0%	3.6%
Louisiana	13.9 cents/mcf	4.0%
Ohio	2.5 cents/mcf	1.3%
Oklahoma	7.0%	4.6%
Texas	7.5%	3.5%
West Virginia	5.0%	5.0%
Pennsylvania	n.a.	9.0%
Current Impact Fee	n.a.	1.4%
Proposed Severance Tax	6.5%	7.6%

Note: Analysis assumes prices range from \$2.60 to \$3.50 per mcf. Post production costs assumed to be 87 cents per mcf in 2018 and increase with inflation. PA proposed severance tax disallows deduction for post-production costs. *Source: Analysis of Revenue Proposals, IFO, April 2017.*

# Minimum Wage Impact on PA Employment

Increase Minimum Wage to \$12 per Hour (thousands of workers)

Hourly Wage	Number Affected	Higher Wage	Employment Reduction	Percent Reduction
\$7.25 to \$8.99	396	360	-36	-8.9%
\$9.00 to \$9.99	274	263	-11	-4.0%
\$10.00 to \$10.99	437	430	-7	-1.7%
\$11.00 to \$11.99	<u>235</u>	<u>235</u>	<u>0</u>	<u>0.0%</u>
<b>Total Affected</b>	<b>1,342</b>	<b>1,288</b>	<b>-54</b>	<b>-4.0%</b>

Source: Analysis of Revenue Proposals, IFO, April 2017.

# Minimum Wage Increase Trade Offs

- ▶ **Roughly 1.3 million workers receive higher wages.**
  - Total net gain = \$3.6 billion; average gain = \$2,770.
  - Roughly 54,000 reduced employment opportunities.
- ▶ **Other potential impacts:**
  - DHS estimates a \$232 million reduction for Medical Assistance.
  - Higher employer payroll taxes of \$265 million.
  - Less employee turnover? Higher worker efficiency?
- ▶ **Policy could increase size of PA economy.**
  - Essentially, it is an income transfer to lower-wage workers.
  - Those workers spend all income, and even borrow against it.

# State Tax Burden Rankings

Ratio: State-Local Taxes / State Personal Income

	NY	NJ	MD	OH	PA	VA
Personal Income	1	21	3	18	19	13
Sales-Use	22	39	42	16	40	44
Property	7	2	27	26	20	21
<b>All Taxes</b>	<b>1</b>	<b>7</b>	<b>9</b>	<b>20</b>	<b>21</b>	<b>38</b>

Note: excludes severance taxes.

Source: U.S. Census Bureau and Internal Revenue Service. Computations by the IFO. See "State and Local Taxes: A Comparison Across States," May 2017.

# Tax Burden Ratios: PA vs. U.S. Average

Ratio: State-Local Taxes / State Personal Income

	PA	U.S.	Difference
Personal Income	2.69%	2.47%	+0.22%
Sales-Use	1.96%	2.62%	-0.66%
Property	2.96%	3.16%	-0.20%
All Other	<u>2.83%</u>	<u>2.18%</u>	<u>+0.65%</u>
<b>All Taxes</b>	<b>10.44%</b>	<b>10.43%</b>	<b>+0.01%</b>

Note: excludes severance taxes.

Source: U.S. Census Bureau and Internal Revenue Service. Computations by the IFO. See "State and Local Taxes: A Comparison Across States," May 2017.



# Questions/Discussion



Presentation to be  
Posted at IFO website  
[www.ifo.state.pa.us](http://www.ifo.state.pa.us)