Pennsylvania's Fiscal and Demographic Outlook

Presentation to the Lancaster Chamber of Commerce and Industry

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Independent Fiscal Office

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IFO

Independent Fiscal Office

- **Non-partisan fiscal and budgetary analysis.**
  - Began operations in September 2011.
  - Similar to the Congressional Budget Office.
  - Office does not make policy recommendations.

- **Primary duties:**
  - Revenue projections: May 1 and June 15.
  - Analyze fiscal impact of state employee wage contracts.
  - Coordinate actuarial analyses of pension legislation.
  - Numerous special studies on revenue or budget matters.
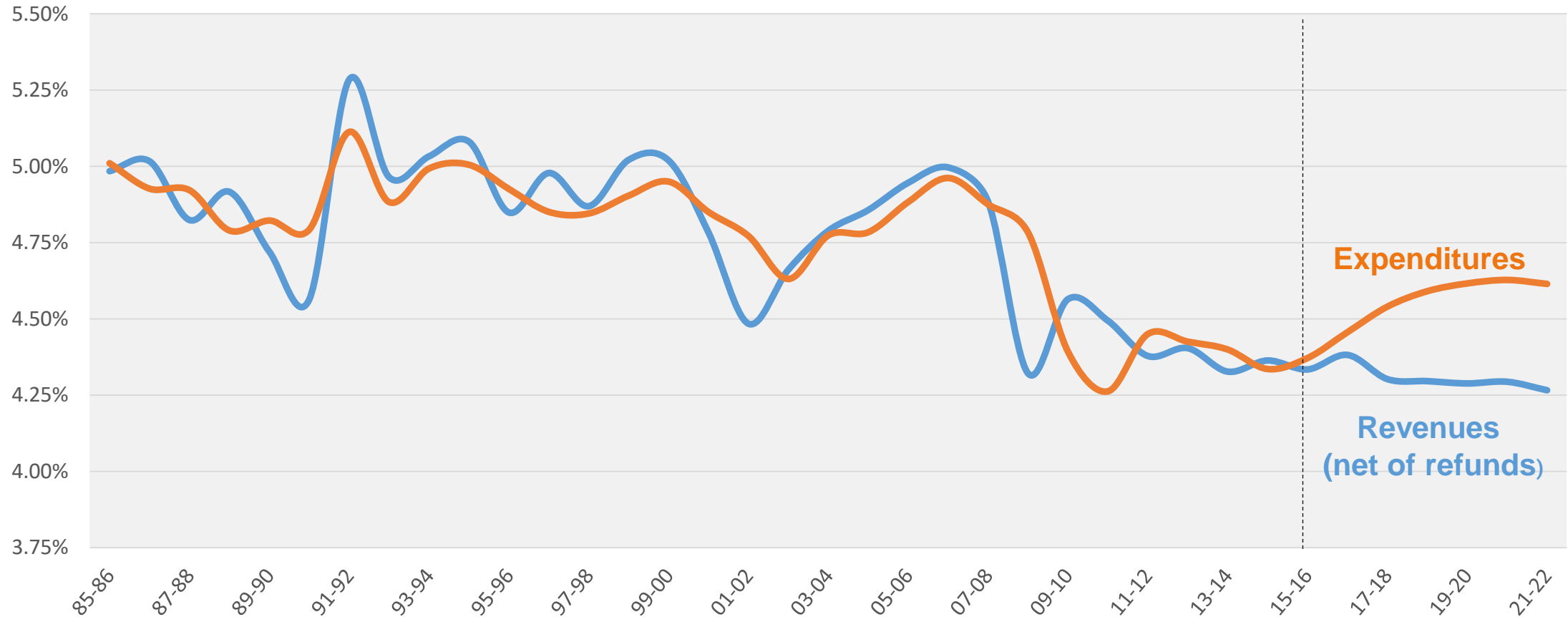 - Five-Year Economic and Budget Outlook.

Today's Presentation

▸ **PA's long-term structural imbalance.**
- Origins date to the 2008-2009 financial crisis.
- Persists even when PA economy returns to "normal" growth.

▸ **Demographic trends and budget implications.**
- Aging populace.
- Tax base erosion and expenditure cost-drivers.

▸ **Short-term revenue outlook.**
- FY 2016-17 revenue shortfall.
- Moderate growth rate projected for FY 2017-18.

Post-Recession Budgets

- **The 2008-2009 U.S. financial crisis significantly affected subsequent budgets.**
  - Federal ARRA funds cushioned the impact for several years.
  - Spending reductions / restraint for many program areas.

- **Since the recession, budgets have utilized short-term measures to achieve balance.**
  - Expenditures shifted to special funds.
  - Transfers of available monies from reserves or special funds.
  - One-time revenue measures.
  - Acceleration of revenue or deferrals of expenditures.

Long-Term Structural Imbalance

Note: Pennsylvania General Fund expenditures and revenues as a percentage of state GDP.
Source: Economic and Budget Outlook, Independent Fiscal Office, November 2016.

Demographic Trends

▶ **Subtle, yet crucial impact.**
- ▪ Hard to see in a single year.
- ▪ Determines work force, income sources and spending patterns.

▶ **PA is now in middle of a retirement wave.**
- ▪ First Boomers turned 65 in 2012.
- ▪ Will peak in approximately a decade.

▶ **Other factors contribute to state aging.**
- ▪ Life expectancies to accelerate after pause.
- ▪ Small migration into state for age 75+.

Three Demographic Waves

▶ **Baby Boomers: Born 1946 to 1964.**

- ▪ Retirements greatly reduce the potential labor force.
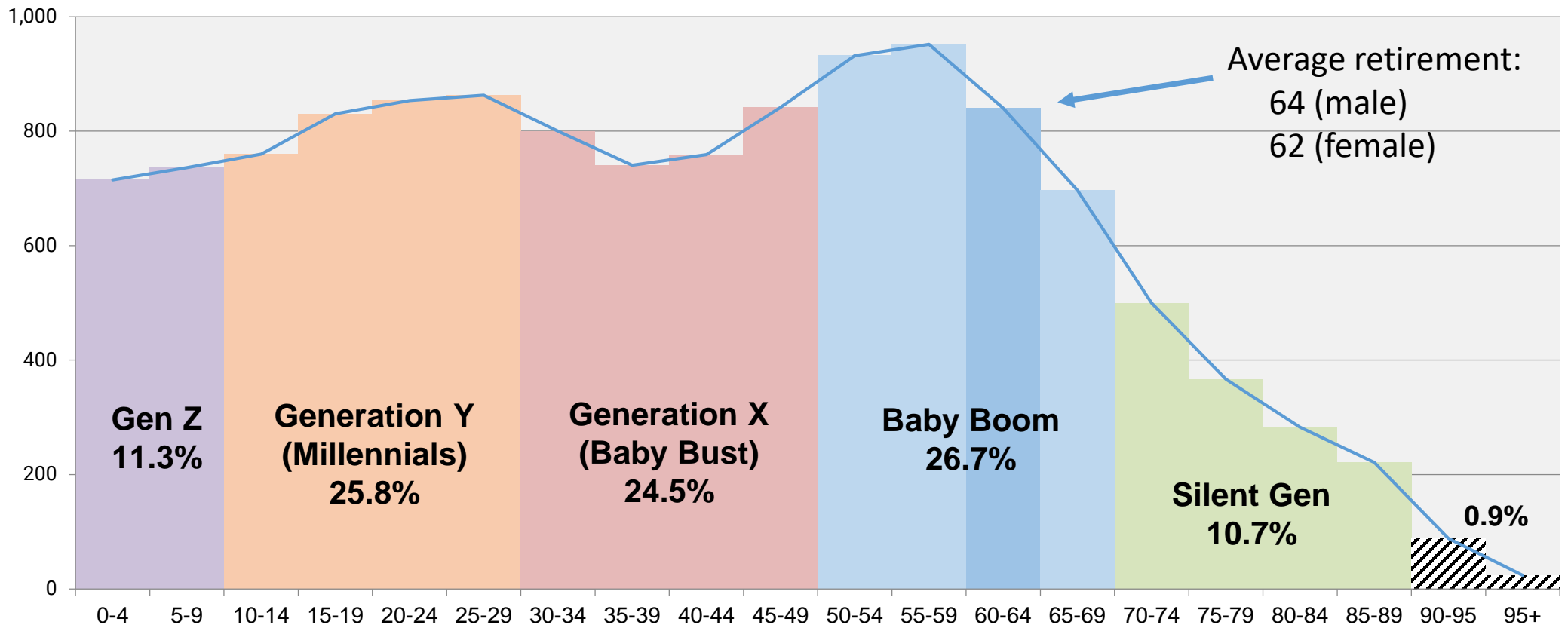- ▪ Reliance on savings, investment and gov't transfer income.

▶ **Generation X or Baby Bust: Born 1965 to 1984.**

- ▪ Unusual exits from labor force.
- ▪ Changing attitude towards home ownership and mortgage debt?

▶ **Generation Y or Millennials: Born 1985 to 2004.**

- ▪ Wave of college-age students: more student loan debt.
- ▪ Does debt restrain growth by delaying home purchases, marriage and child bearing?

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2015 Pennsylvania Population Distribution

Average retirement:
64 (male)
62 (female)

Gen Z
11.3%

Generation Y
(Millennials)
25.8%

Generation X
(Baby Bust)
24.5%

Baby Boom
26.7%

Silent Gen
10.7%

0.9%

Note: thousands of residents.
Source: Pennsylvania State Data Center.

Change Over Next Decade

Age Group	Residents (000s)		Decade Change	
	2015	2025	Number	Percent
0 to 19	3,041	3,018	-23	-0.8%
20 to 64	7,581	7,401	-181	-2.4%
65 to 74	1,197	1,589	392	32.8%
75 to 84	649	903	254	39.1%
85+	334	365	32	9.5%
Total	**12,803**	**13,276**	**473**	**3.7%**

Source: U.S. Census Bureau and Pennsylvania State Data Center.

Labor Force Participation

Year	All Groups	Labor Force Participation Rate by Age			
		25-44	45-54	55-64	65+
2001	65.0%	85.2%	83.6%	60.8%	12.0%
2006	64.4%	84.3%	82.2%	64.8%	14.4%
2011	63.2%	82.9%	80.1%	64.1%	16.1%
2016	63.3%	84.0%	82.5%	65.8%	20.1%
Excludes Disabled					25.5%
Change 2001-2016		**-1.2%**	**-1.1%**	**+5.0%**	**+8.1%**

Note: The labor force participation rate (LFPR) is the share of the age group that is part of the labor force. The labor force includes all individuals actively working or seeking work.
Source: PA Department of Labor and Industry, Center for Workforce Information and Analysis.

Regional Population Comparison

	Levels (000s) and Growth			Shares and Median Age		
	2010	**2015**	**AAGR**	**< 20**	**65+**	**Median**
Delaware	900	946	1.0%	24.3	17.0	40.0
Virginia	8,026	8,383	0.9	25.0	14.2	37.8
Maryland	5,788	6,006	0.7	25.0	14.1	38.4
New York	19,403	19,796	0.4	23.9	15.0	38.3
New Jersey	8,804	8,958	0.3	24.8	15.0	39.6
Ohio	11,541	11,613	0.1	25.3	15.9	39.3
Pennsylvania	12,712	12,803	0.1	23.8	17.0	40.7
West Virginia	1,854	1,844	-0.1	23.0	18.2	42.1
U.S.	309,347	321,419	0.8	25.6	14.9	37.8

Note: AAGR is average annual growth rate.
Source: U.S. Census Bureau

U.S. Life Expectancy Increases

At Birth

At Age 65

2000 to 2010
+1.5 years

2015-30
+1.1 years
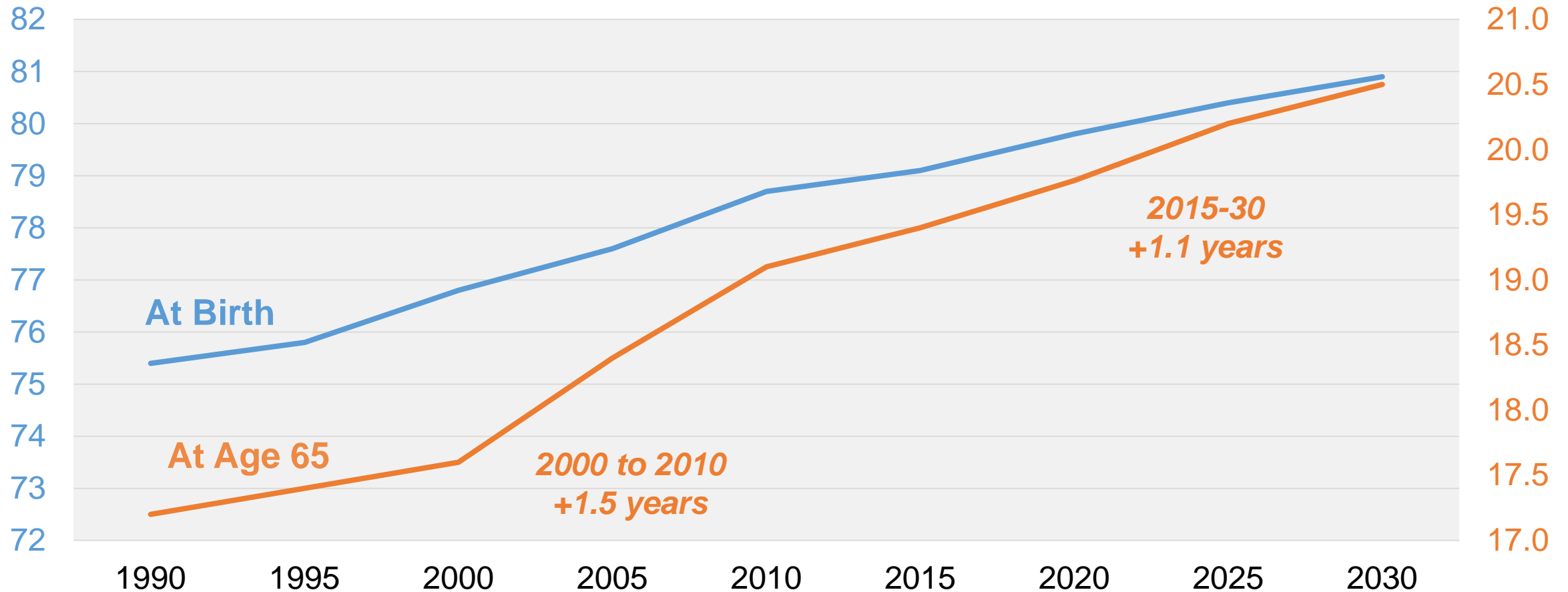
Sources: Centers for Disease Control and Prevention and U.S. Social Security Administration.

Components of PA Population Change

	2012	2013	2014	2015	2016
Total Change	**27,561**	**9,484**	**9,227**	**1,339**	**-7,677**
Natural Increase	16,606	11,070	15,624	10,746	7,844
Domestic Migration	-17,463	-31,138	-35,353	-45,064	-45,565
International Migration	29,193	29,791	33,818	34,910	34,678

Other contracting states in 2016: Connecticut, Illinois, Mississippi, New York, West Virginia and Wyoming.

Note: Amounts do not sum to total, excludes undefined residual.
Source: U.S. Census Bureau.

Domestic Migration: 2014-15 IRS Data

		Inflow to PA	Outflow from PA	Change
New Jersey		20,147	15,610	4,537
New York	Net Inflows also from RI, CT, MS	20,049	14,750	5,299
Maryland		9,371	8,542	829
West Virginia		2,268	2,194	74
Virginia		5,546	6,742	-1,196
Ohio		5,405	6,484	-1,079
Delaware		4,262	5,547	-1,285
Florida		9,671	18,180	-8,509
California		5,230	7,113	-1,883
Texas		7,013	8,509	-1,496
North Carolina		4,484	6,775	-2,291
All Other	FY 2012-13 -21,578	31,722	41,156	-9,434
Total	FY 2013-14 -26,482	**125,168**	**141,602**	**-16,434**

PA Population Change by Age

Age Group	Domestic Migration to/from PA			
	Inflow	Outflow	Share	Net
Under 18	38,253	43,028	1.7%	-4,775
18 to 29	95,886	104,409	5.0%	-8,523
30 to 44	50,064	56,791	2.5%	-6,727
45 to 59	26,156	30,037	1.1%	-3,881
60 to 74	15,434	22,874	1.1%	-7,440
75 and older	6,890	5,748	0.6%	+1,142
Net Change			**2.0%**	**-30,204**

Note: Net change differs from previous slide due to different data source. Share is percentage outflow.
Source: U.S. Census Bureau, 2015 American Community Survey, 1-year estimates.

Persistent Tax Base Erosion

‣ **Personal Income Tax.**

  ▪ Wage income less important. Larger share of income not subject to tax: Social Security, Pensions, IRAs.

  ▪ Age 65+ reports 21% of income on federal tax returns, much of it nontaxable.

‣ **Sales and Use Tax.**

  ▪ Elderly buy fewer durable goods that are taxable. Significant purchases of healthcare and medications.

  ▪ Broader long-term shift in consumption. Services comprise a greater share of spending.

Long-Term Tax Base Erosion
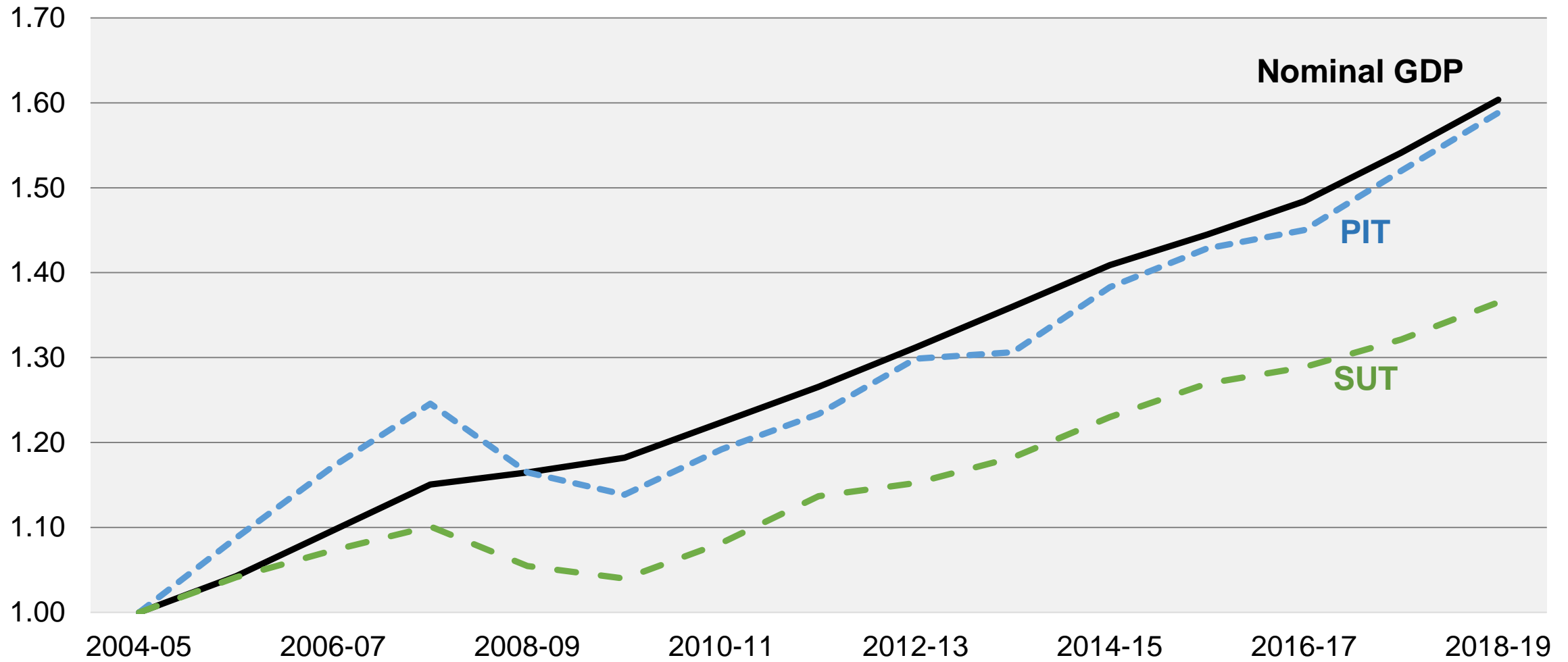
Federal Tax Return Shares by Age

	Age Cohort			
	18-34	**35-54**	**55-64**	**65+**
Salaries & Wages	91.4%	78.3%	59.1%	17.6%
Capital Income	2.2%	7.2%	12.0%	20.1%
Business Income	4.2%	9.7%	10.4%	6.4%
Retirement Income	1.3%	4.6%	18.5%	55.2%
All Other	0.8%	0.2%	0.0%	0.8%

Note: U.S. returns, tax year 2014. Includes non-taxable social security, interest and pension income.
Source: Internal Revenue Service.

Personal Income Tax Base Erosion 2004-2016

Category (Status)	2004	2010	2016
Wage (taxable)	60.1%	56.9%	55.9%
Capital (taxable)	10.3%	9.9%	10.6%
Business (taxable)	11.2%	10.5%	10.9%
Retirement (not taxable)	13.2%	15.0%	16.7%
Maintenance (not taxable)	3.9%	6.0%	4.3%

Note: shares of Pennsylvania "Current Income" as described by the IFO in the methodology to its official revenue estimate..
Source: Historical data from the IRS, U.S. Census Bureau, Social Security Administration and the U.S. Department of Labor.

Sales Tax Base Erosion 1998-2015

	1998-2015	1998-2007	2008-2010	2011-2015
PA Nominal GDP	3.9%	4.6%	2.1%	3.5%
Personal Consumption Expenditures	4.0%	5.2%	2.0%	2.9%
Goods (durable and nondurable)	3.3%	4.4%	1.3%	2.3%
Services (excluding healthcare)	4.2%	5.5%	2.6%	3.0%
Healthcare	5.0%	6.0%	3.8%	3.6%

Note: average annual growth rates.
Source: U.S. Bureau of Economic Analysis, Pennsylvania Personal Consumption Expenditures.

# Consumer Expenditures Decline After Age 65

Item	25-34	35-44	45-54	55-64	65+
Total	**$54,128**	**$67,410**	**$74,967**	**$64,344**	**$46,573**
Food (home and away)	6,784	7,828	8,286	7,276	5,382
Housing	20,530	26,375	23,748	20,725	17,821
Apparel and Services	1,842	2,300	2,344	1,970	1,258
Transportation	9,424	9,883	12,234	10,200	6,554
Healthcare	2,740	3,947	4,582	4,973	5,886
Entertainment	2,410	3,115	3,438	3,001	2,360

Note: Average annual expenditures by household based on age of the respondent.
Source: U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, Northeast Region, 2014-2015.

Impact of Demographics and Inflation

	Hypothetical Program	Older Resident Healthcare
(1) Demographics (Service Population)	0.3%	2.5%
(2) General Inflation	2.0%	2.0%
(3) Healthcare Premium	<u>n.a.</u>	<u>1.5%</u>
Total Annual Budget Growth	**2.3%**	**6.0%**
Five-Year Cumulative Growth	12.0%	33.8%

Pension Contributions and Unfunded Liabilities

Sources: Actuarial valuations for PSERS and SERS, various years.
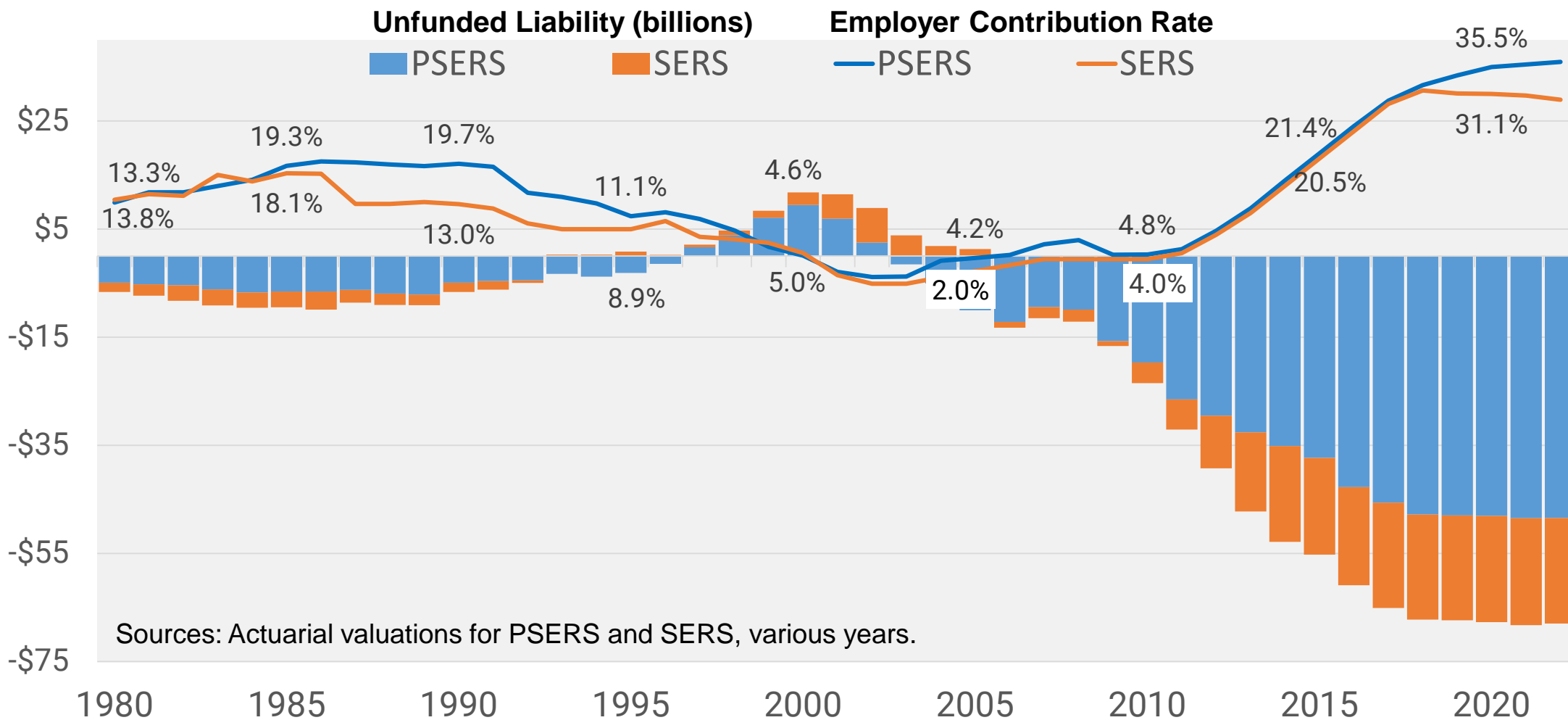
Pensions Share of GF Expenditures
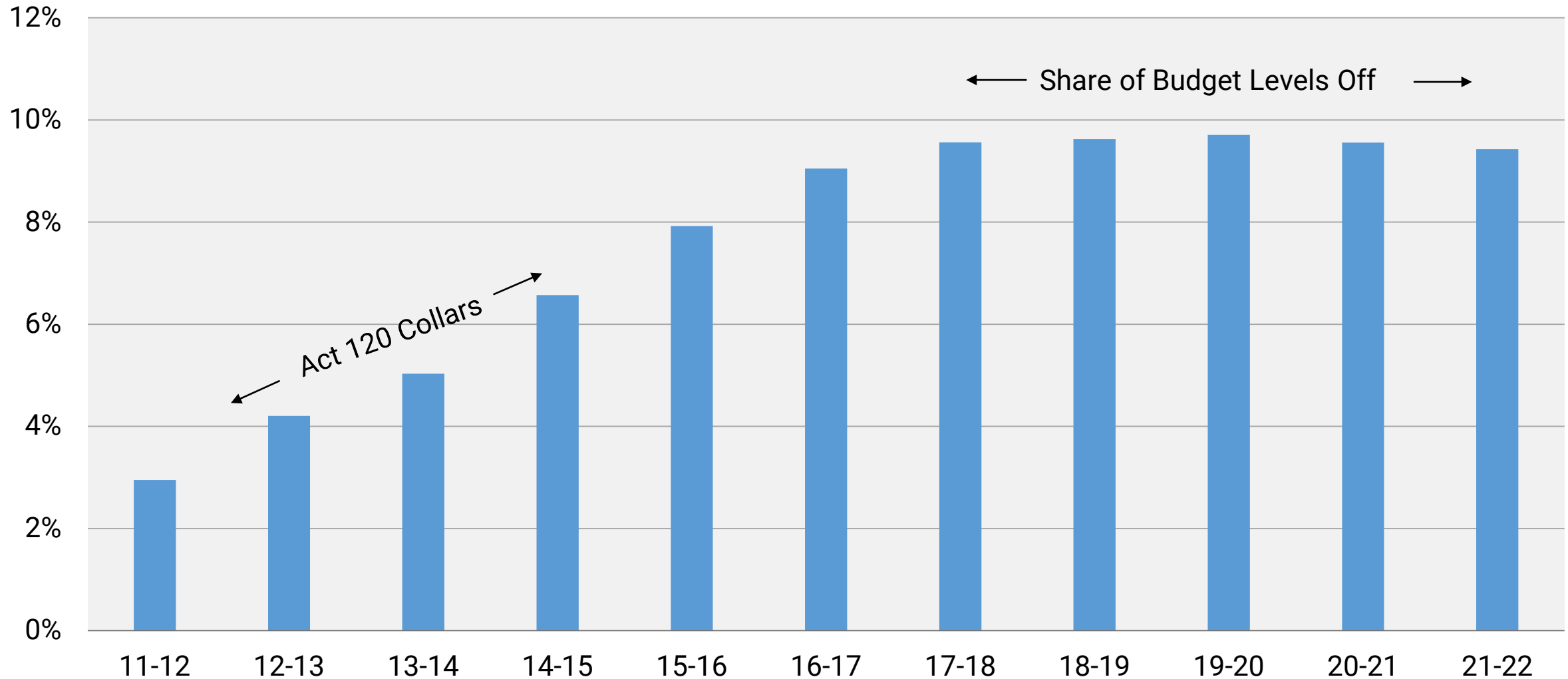
$1.1 Billion Revenue Shortfall for FY 16-17

▶ **No "base" revenue growth from the prior year.**
- Base sales and use tax growth was only +1.2%.
- Growth mainly from legislated tax and revenue changes.

▶ **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.

Recent PA Economic Trends

▸ **Strong job gains through May 2017.**
  - 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.

PA Economic Forecast

	2013	2014	2015	2016	2017	2018
Real Gross Dom. Product	1.6%	1.9%	2.6%	1.1%	1.8%	1.9%
Philadelphia CPI-U	1.2%	1.3%	-0.1%	0.6%	2.0%	2.0%
Pittsburgh CPI-U	1.3%	1.3%	0.7%	1.6%	2.0%	2.0%
Wages and Salaries	1.8%	3.9%	4.0%	2.8%	3.7%	3.8%
Employment Gains (000s)	14.3	47.4	46.7	52.2	54.4	52.5

Note: Data represent calendar years.
Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics.

Change in Payroll Employment

	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	4.3	1.5	9.3	12.0
Annual Job Gains	**47.4**	**46.7**	**52.2**	**63.0**

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.

FY 2017-18 Revenue Forecast

- **Projected $32.5 billion in General Fund receipts before refunds.**
  - Based on current law and policies. Does not take into account any statutory changes being considered by the General Assembly.
  - Increase of $821 million (2.6%) over the prior fiscal year.
  - Reflects a shift in business profits and capital gains from tax year 2016 to 2017 in anticipation of lower federal tax rates in 2017.

- **Underlying growth rate is 3.7% with adjustments for various technical factors.**
  - Special fund transfers of $231 million in FY 2016-17 do not recur.
  - Tax amnesty produced $100 million of one-time revenue in FY 2016-17 and reduces collections by $10 million in FY 2017-18.
  - Other adjustments: CSFT elimination ($25 million), new tax credits taking effect ($20 million) and one-time settlements ($18 million).

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Wrap Up

- **Demographic trends play a significant role in the long-term structural imbalance.**
  - Gradual tax base erosion driven by an aging populace.
  - Expenditures, driven by non-discretionary spending, increase faster than the revenue base.

- **Annual policy changes address the imbalance in the short-term, but the long-term imbalance persists.**
  - Annual budget shortfalls have been addressed by various short-term measures.
  - Reliance on short-term measures does not alter the fundamental long-term trend.

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Thank You!

Presentation to be posted on the IFO website
www.ifo.state.pa

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