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State revenue continues to grow

Summary: The inflationary pressures of 2022 have benefited the Commonwealth of Pennsylvania's general fund revenues. Through October, all the major components of the general fund—the corporate net income tax, personal income tax and the sales and use tax—are trending higher than they were in calendar year 2021. However, a recent business survey indicates that the outlook for the next six months is not positive among executives as continued inflation will remain a challenge for the business community.

General fund revenues

Through October, total general fund revenues have reached $38.48 billion, roughly $5 billion ahead of calendar year 2021 when the amount through October came in at $33.95 billion. At this current pace, calendar year 2022 is projected to hit $46.17 billion, which would be nearly 4 percent higher than last year.

Calendar year 2021's $44.4 billion in total general fund revenue stands as the current high-water mark, aided in large part by the federal government's stimulus payments in the wake of the pandemic. The previous high was $35.6 billion in 2018. The projected 2022 amount of $46.17 billion, aided by an inflationary economy, will be nearly 30 percent higher than 2018. Over the 10 years before the pandemic, the range went from $26.7 billion (2010) to $35.2 billion (2019)—a growth rate of just 32 percent. Over the last three years, 2019 to projected 2022, the growth rate will be 31.1 percent.

While the inflationary economy has boosted revenues, it has also boosted costs as the prices of goods and services the state uses have also been affected.

General fund revenue components

The largest component is the personal income tax which represented 35.5 percent ($15.76 billion) of total general fund revenues in calendar year 2021. Once again, 2021's collection was the high-water mark coming in 12 percent ahead of pandemic-affected 2020. However, through October 2022, personal income tax collections sit at $16.3 billion and are likely to reach $18.5 billion by the end of the calendar year—13.5 percent greater than last calendar year.

In 2010, the amount of personal income tax collected was $10.1 billion and steadily grew until reaching $14.4 billion in 2019—growth of 42.2 percent over the 10-year period. In just three years, from 2019 to projected 2022, the growth rate is on pace to be 28.5 percent. This jump has likely been fueled by inflationary pressures that have pushed up wages.

Sales and use taxes are the second largest source of revenues for the general fund representing 30 percent of that total in 2021. The $13.4 billion collected in calendar 2021 was also the highest level achieved. Through October 2022 the amount collected is $11.9 billion—89 percent of 2021's total. With two months remaining, it will be on pace to reach $14.3 billion, about 6.4 percent greater than last year. As the sales and use tax is a percentage of a product's price, this growth is also largely due to the inflationary pressure in the economy.

From 2010 until 2019, the growth rate of the sales and use tax was 37 percent. In the three years since 2019, that growth rate is 27 percent. Due in part to stimulus payments in 2020, the sales and use tax increased over the 2019 level, one of the few general fund revenue streams to do so.

The final component is the corporate net income tax. This revenue stream brought in $4.45 billion through the first ten months of 2022 and is on pace to reach $5.34 billion. For calendar 2021, the state garnered $4.65 billion. The projected 2022 amount would be an increase of 14.6 percent over last year. Again, this is more a result of inflation increasing prices, or being blamed for price increases, that were passed onto consumers in the 2022 economy.

In calendar 2010, the corporate net income tax came in at $1.9 billion and had risen 79 percent over 10 years to reach $3.4 billion in 2019. At the projected amount of $5.34 billion, it would have increased another 20 percent in three years since 2019.

It is also worth noting that the state will begin reducing the rate on this tax from the current 9.99 percent to 8.99 percent in 2023 to 4.99 percent by 2031 (*Policy Brief, Vol. 22, No. 31*). It will be worth keeping track of how the business community reacts to this decrease and what the effect will be on state general fund revenues going forward.

Business climate survey

The Lincoln Institute of Public Opinion conducts a business climate survey every spring and fall, asking questions of business decision-makers. From the fall 2022 survey, the first question focused on the current state of the economy when the respondents were asked what their business' top challenge is. They were allowed to select more than one answer. The top vote-getter was inflation/rising costs, followed by current economic conditions and concern over future economic conditions.

When asked what steps that decision-maker would take in the next six months to deal with the inflationary economy, the top answer, again checking all that applied, was to increase their prices followed by increasing wages and or benefits for their employees. And, of course, this will continue to boost the general fund revenues mentioned above. The higher prices result in higher sales and use tax revenue and higher wages result in greater personal income tax collections. So, it is very likely the trend of rising general fund revenues will continue throughout calendar 2023.

Another question focused on employment by asking the respondents if their business had difficulty in finding enough qualified employees to fill open positions. The top two answers, garnering a total of 64.3 percent of the responses, were yes, with some difficulty (34.3 percent) and yes, with significant difficulty (30 percent). The same question was asked in the spring survey and the results were a bit higher with 65.5 percent claiming to have either some or significant difficulty finding enough qualified employees to fill open positions.

The implication of this question is that those people who are qualified are commanding higher wages and benefits in the job market as firms compete for their services, which, in turn, increases the amount of personal income taxes that they will pay to state coffers.

When asked about employment levels at their workplace, 51 percent of respondents claimed that their employment levels in the fall are the same as they were six months ago and about an equal percentage (51.7) also believe that they will remain the same six months from now. It is very likely this tight market for qualified employees will continue.

Respondents were also asked if Pennsylvania's fall business climate was better than it was in the spring. Only 20 percent of respondents claimed that they were, while 35 percent believed it to have gotten worse.

Looking ahead six months, only 23 percent believed that Pennsylvania's business climate will improve while 35 percent believe that it will get worse.

Conclusion

The national inflationary economy has benefitted the commonwealth's general fund tax coffers as prices for both goods and wages have been pushed up by levels not seen in decades. However, the danger is in thinking this economic situation will continue. Policymakers must resist the temptation to engage in spending sprees that cannot be sustained when the inevitable downturn happens. It is also worth remembering that the prices of goods and services used and purchased by commonwealth agencies have also gone up, so the increase in general fund revenues may not be the boon policymakers think it is. The jump in revenue may be needed to sustain real spending levels.

Pennsylvania must take action to make the state a more business-friendly location for not only new firms but existing firms as well. Embarking on reducing one of the nation's highest corporate net income tax rates is a good start.

But action needs to be taken with the labor climate. As we have written time and again, Pennsylvania cannot compete with Right-to-Work states in terms of economic growth. Eliminating the right of transit workers and public-school teachers to strike is another goal that should be achieved along with abolishing the prevailing wage law.

These are steps that would go a long way in reducing the cost of government, reduce the reliance on such high tax collections and make Pennsylvania more economically competitive nationally.

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