February 29, 2024 Policy Brief: Volume 24, Number 9

State general fund revenues fall short of last year's collections

Introduction: When Gov. Shapiro gave his budget address in early February, he laid out a long wish list of spending increases. While that makes great politics, it still has to be based on fiscal reality. And that reality is showing a weakened growth in general fund revenues.

Total general fund revenues

Pennsylvania's fiscal year (FY) runs from July 1 of one calendar year until June 30 of the next. The most recently completed fiscal year was 2022-23. In FY 2022-23, total general fund revenues came in at $44.92 billion. That represents a 6.7 percent decline from FY 2021-22, which reached an all-time high of $48.13 billion.

In FY 2019-20, the hardest hit year during the pandemic, general fund revenues fell 7.4 percent from the year before. Since then, each subsequent year's general fund collections exceeded $40 billion. Prior to the pandemic, FY 2013-14 through FY 2018-19, the total rose gradually to reach the then record high of $34.86 billion.

In response to the pandemic in FY 2019-20, federal government spending climbed sharply and the Federal Reserve pumped enormous amounts of money into the economy. As a result, inflation began to be an important factor as the prices of goods and services, along with personal and corporate incomes, began to rise, which, in turn, boosted Pennsylvania's total general fund revenues through sales and use, personal and corporate income taxes.

Total general fund revenues over the five-year period FY 2013-14 through FY 2018-19 climbed 21.9 percent. By comparison, from FY 2018-19 through FY 2022-23, the five-year growth picked up to 28.9 percent—seven percentage points faster.

The three major components of general fund revenues

The three largest areas of total general fund tax revenues are the personal income tax, the sales and use tax and the corporate net income tax. In FY 2022-23, personal income tax comprised 39 percent of total general fund revenues, the sales and use tax 31 percent and the corporate net income tax was nearly 14 percent.

Personal income tax collections were $17.63 billion, down 2.7 percent from the previous fiscal year ($18.13 billion). From FY 2013-14 through FY 2018-19, personal income tax collections rose from $11.4 billion to $14.1 billion (23.7 percent). However, from FY 2018-19 through FY 2022-23, the increase was 25 percent—1.3 percentage points higher. Thus, while last year's total was down from the previous year, the five-year growth was slightly stronger than previous five years, thanks to the powerful federal stimulus.

Sales and use tax revenue in FY 2022-23 was $14.02 billion and roughly the same as the previous fiscal year ($14.01 billion). Prior to the pandemic, the growth in this revenue was also slower than it was post-pandemic. From FY 2013-14 through FY 2018-19, the amounts collected increased by 21.6 percent, going from $9.1 billion to $11.1 billion. Then from FY 2018-19 through FY 2022-23, the growth rate picked up about 5 percentage points at 26.4 percent. Again, this rise was likely boosted by inflation as sales and use taxes are based on the price of the product or service.

As was documented in *Policy Brief Vol. 22, No. 31*, the corporate net income tax, once one of the highest in the country, has been reduced from 9.99 percent in 2022 to 8.99 percent in 2023, then to 8.49 percent in 2024 and is scheduled to drop by 0.5 percentage points annually until bottoming out at 4.99 percent in 2031.

The corporate net income tax, which was at a rate of 8.99 percent for the 2023 portion of the FY, realized $6.14 billion, up 15.4 percent from FY 2021-22's $5.3 billion when the rate was at 9.99 percent for the entire FY. Prior to the pandemic growth was brisk. From FY 2013-14 through FY 2018-19 the amount rose from $2.5 billion to $3.4 billion—a growth rate of 35.8 percent. However, from FY 2018-19 through FY 2022-23 the rate accelerated greatly to 81 percent.

For point of reference, the inflation rate for the Northeast U.S., as measured by the CPI-U, was 6.5 percent from 2013 through 2018 and quickened to 18.3 percent from 2018 through 2023. In each class of revenue mentioned above, collections exceed the growth in inflation.

However, for the first six months of FY 2023-24, July through December, revenue collections in these categories have slowed, possibly reflecting a slowdown in inflation. Total general fund revenues are just 0.74 percent ahead of the first six months of FY 2022-23. Both the sales and use tax collections (0.72 percent) and personal income tax collections (0.69 percent) are ahead of last FY's pace through the first six months. But the corporate net income tax collections are down slightly (0.70 percent, even though the rate is still 8.99 percent, before it reduces to 8.49 percent for the second half of the FY). While there are still six more (reporting) months remaining in the fiscal year and tax season is still a few months away, it appears that these collections will likely be flat at best.

State nonfarm job comparisons

The governor made the comment that, economically speaking, he's tired of losing to our neighbors, New Jersey, New York and Ohio. Looking at the annual average number of total nonfarm jobs in those states and comparing them to Pennsylvania from calendar 2013 through pre-pandemic calendar 2019, Pennsylvania's jobs grew 5.7 percent. Pennsylvania's neighboring states all posted higher growth rates during the same period: New Jersey (6.7 percent); New York (9.3 percent) and Ohio (6.2 percent). From 2019 through 2023, Pennsylvania's jobs increased by just 1.2 percent. This topped New York (-0.88 percent) and Ohio (0.55 percent) but not New Jersey (3.3 percent).

Clearly, Pennsylvania's neighboring states are not its biggest economic competitors. Since the pandemic, the nation's gross domestic product center has shifted from the Northeast states to those in the Southeast. Pennsylvania is likely losing jobs, and economic growth, to Georgia, North Carolina and South Carolina among others. From calendar 2013-2019, all three Southeast states had growth rates above 12 percent: Georgia (14.9 percent); North Carolina (12.9 percent) and South Carolina (15.2 percent). Then from calendar 2019 through 2023 the growth rates still far outpaced Pennsylvania: Georgia (6.1 percent); North Carolina (7.4 percent) and South Carolina (5.1 percent).

Conclusion

In spite of the higher spending aspirations from the governor's budget address, the growth to general fund revenues to pay for them has mostly cooled. For FY 2022-23, total general fund revenues were down from the previous FY, as were personal income tax collections. The sales and use tax revenue was flat as inflation has slowed somewhat. The only growth was in the smallest component, corporate net income tax collections. Through the first six months of the current FY, all are slightly ahead of FY 2022-23, except the corporate net income tax, it is slightly behind.

Paying for new programs with any accumulated surplus sounds promising. But once a program is begun, what happens when the surplus is drawn down? There is only a surplus because of the high tax collections post-pandemic, in large part due to the heavy infusion of federal government cash. But, as mentioned above, those collections have cooled and are unlikely to reach that immediate post-pandemic pace in the next few years.

Pennsylvania and neighboring Northeast states are trailing badly in the gains in economic activity to Southeast states. These northeastern states are historically unwelcoming to businesses through high taxes, regulatory controls, like the Regional Greenhouse Gas Initiative (RGGI), and are union strongholds.

Pennsylvania needs to be a more welcoming state for all business as has been done in high-growth southeastern states. Some obvious steps to take include Pennsylvania adopting Right-to-Work, ditching controls like RGGI and eliminating the right of teachers and transit workers to strike. But given the fealty to unions, that is unlikely to happen, and Pennsylvania will continue to lag states enjoying strong economic gains.

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