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COMMONWEALTH OF PENNSYLVANIA  
HOUSE OF REPRESENTATIVES  
APPROPRIATIONS COMMITTEE

MAIN CAPITOL  
ROOM 140  
HARRISBURG, PENNSYLVANIA

PUBLIC HEARING  
GLOBAL ECONOMY

TUESDAY, FEBRUARY 21, 2012  
9:32 A.M.

BEFORE:

- HONORABLE WILLIAM F. ADOLPH, JR.,  
Majority Chairman
- HONORABLE JOHN BEAR
- HONORABLE MARTIN CAUSER
- HONORABLE JIM CHRISTIANA
- HONORABLE GARY DAY
- HONORABLE GORDON DENLINGER
- HONORABLE BRIAN ELLIS
- HONORABLE MAUREE GINGRICH
- HONORABLE GLEN GRELL
- HONORABLE THOMAS KILLION
- HONORABLE DAVID MILLARD
- HONORABLE MARK MUSTIO
- HONORABLE BERNIE O'NEILL
- HONORABLE MICHAEL PEIFER
- HONORABLE SCOTT PERRY
- HONORABLE SCOTT PETRI
- HONORABLE TINA PICKETT

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1 BEFORE: (cont'd)

2 HONORABLE JEFFREY PYLE  
3 HONORABLE THOMAS QUIGLEY  
4 HONORABLE MARIO M. SCAVELLO  
5 HONORABLE CURT SONNEY  
6 HONORABLE JOSEPH MARKOSEK, Minority Chairman  
7 HONORABLE MATT BRADFORD  
8 HONORABLE MICHELLE BROWNLEE  
9 HONORABLE H. SCOTT CONKLIN  
10 HONORABLE PAUL COSTA  
11 HONORABLE DEBERAH KULA  
12 HONORABLE TIM MAHONEY  
13 HONORABLE MICHAEL O'BRIEN  
14 HONORABLE JOHN SABATINA  
15 HONORABLE STEVE SAMUELSON  
16 HONORABLE MATTHEW SMITH  
17 HONORABLE RONALD WATERS

18 ALSO PRESENT:

19 HONORABLE KERRY BENNINGHOFF  
20 HONORABLE JOHN EVANS  
21 HONORABLE RON MILLER  
22 HONORABLE BRENDAN BOYLE  
23 HONORABLE VANESSA LOWERY BROWN  
24 HONORABLE WILLIAM DEWEESE  
25 HONORABLE DAN FRANKEL

ED NOLAN, MAJORITY EXECUTIVE DIRECTOR  
MIRIAM FOX, MINORITY EXECUTIVE DIRECTOR  
DAN CLARK, COMMITTEE CHIEF COUNSEL

BRENDA J. PARDUN, RPR  
REPORTER - NOTARY PUBLIC

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1 P R O C E E D I N G S

2 CHAIRMAN ADOLPH: Good morning,  
3 everyone. I'd like to welcome everyone.

4 Today's the beginning of three weeks of  
5 budget hearings in the House of Representatives,  
6 obviously hosted by the House Appropriations  
7 Committee.

8 These hearings are designed to allow  
9 House members and our constituents the opportunity  
10 to gain a more detailed understanding of the  
11 governor's budget proposal and how it will impact  
12 state government and the residents of PA.

13 While the budget proposal encompasses  
14 both fiscal and policy items, we must remember our  
15 primary focus is to look at the fiscal aspects of  
16 this budget.

17 Our task over the course of the next  
18 three weeks is to look at this proposed spending  
19 plan and other related economic factors to make  
20 sure the final budget enacted by this legislature  
21 is one that is balanced, financially sustainable  
22 and one that meets the needs of PA residents given  
23 the available resources.

24 We must take on this task,  
25 understanding the current economic landscape is one

1 that is very different from the years past.  
2 PA, like many other states, this country is  
3 struggling to climb out of the financial hole  
4 created by the great recession, states who are very  
5 much insulated by the impact of this economic  
6 crisis due in large parts by the billions of  
7 dollars of federal stimulus funds handed down.  
8 Now, stimulus funds are history, and the states are  
9 forced to confront reality.

10           Fortunately here in PA, we started the  
11 process of bringing state spending in line with  
12 expected revenues last year. This has brought us  
13 closer to a more sustainable budget.

14           Despite the hard work of last year, we  
15 still find ourselves in a situation where state  
16 revenue is lower than expected. This should remind  
17 us all we are not out of the woods. We need to be  
18 innovative, and it is our responsibility, as the  
19 Appropriations Committee, to engage the departments  
20 that will come before us to find ways to be more  
21 productive with taxpayer dollars.

22           We should work to see what efficiencies  
23 can be gained and how new partnerships with the  
24 private sector can deliver state government  
25 services in the most cost effective manner.

1           In the end, these hearings will help us  
2 understand how we can mold this budget into a final  
3 spending plan that sets PA on a course of economic  
4 stability and prosperity.

5           I'd like to turn over now to Chairman  
6 Markosek for opening remarks.

7           REP. MARKOSEK: Thank you, Chairman  
8 Adolph.

9           And welcome everybody to the -- this  
10 year's version of our budget hearings.

11           As we all know, the governor has done  
12 his duty and proposed a state budget about a month  
13 ago now, and it's our job, over the next several  
14 weeks, to bring before us many of the folks who are  
15 part of the budget, who require spending from the  
16 budget, to come in front of us, tell us about what  
17 they do, justify what they do, answer the tough  
18 questions. And so that we, in the legislature, can  
19 sit down and put together a budget that is good for  
20 all Pennsylvanians.

21           As the Chairman mentioned, we do have  
22 tough times. That's nothing new. It's been that  
23 way now for a while. Last year, we saw a situation  
24 where we actually ended up with a lot more money on  
25 hand than was previously expected. We don't know

1 what will be this year. We see revenues coming in  
2 roughly about or slightly above where they were  
3 last year. Although, certainly not to the extent  
4 that those revenues have been expected to come.

5 It will be a tough budget, but we will  
6 work together. We, the Democrats, pledge to work  
7 with the Republicans, in a -- in as much of a  
8 bipartisan fashion as we can, to be part of the  
9 budget, to be part of the budget negotiations, and  
10 to move forward and represent all Pennsylvanians in  
11 the best way that we know how.

12 With that, Mr. Chairman, I appreciate  
13 the opening remarks. And I'll turn it back to you.

14 CHAIRMAN ADOLPH: Thank you, Chairman.

15 I would now like all the members of the  
16 committee as well as staff that are sitting at the  
17 tables to identify themselves, starting with my  
18 left.

19 DR. NOLAN: Ed Nolan, executive  
20 director, Appropriations Committee.

21 MR. CLARK: Dan Clark, chief counsel,  
22 Republican Appropriations Committee.

23 REP. KILLION: Tom Killion, Delaware  
24 and Chester Counties.

25 REP. CHRISTIANA: Jim Christiana,

1 Beaver County.

2 REP. PYLE: Jeff Pyle, Armstrong and  
3 Indiana Counties.

4 REP. SONNEY: Curt Sonney, Erie County.

5 REP. ELLIS: Brian Ellis, Butler  
6 County.

7 REP. CAUSER: Good Morning. Marty  
8 Causer, McKean, Potter, Cameron.

9 REP. BEAR: John Bear, Lancaster  
10 County.

11 REP. PEIFER: Good morning. Mike  
12 Peifer, Pike County.

13 REP. O'NEILL: Yeah, Bernie O'Neill,  
14 Bucks County.

15 REP. GRELL: Good morning. Glen Grell,  
16 Cumberland County.

17 REP. DAY: Gary Day, Lehigh and Berks  
18 County.

19 REP. MILLARD: Dave Millard, Columbia  
20 County.

21 REP. GINGRICH: Good morning. Mauree  
22 Gingrich from Lebanon County. Welcome.

23 REP. SCAVELLO: Good morning. Mario  
24 Scavello, Monroe County.

25 REP. DENLINGER: Good morning. Gordon



1 Denlinger from eastern Lancaster County.

2 REP. BOYLE: Brendan Boyle,  
3 Philadelphia and Montgomery Counties.

4 REP. MARKOSEK: Yeah. State  
5 Representative Joe Markosek, Allegheny,  
6 Westmoreland County.

7 MS. FOX: Miriam Fox, executive  
8 director, House Democratic Appropriations  
9 Committee.

10 REP. KULA: Deberah Kula, Fayette and  
11 Westmoreland Counties.

12 REP. SABATINA: John Sabatina,  
13 Philadelphia County.

14 REP. CONKLIN: Scott Conklin, Centre  
15 County.

16 REP. MAHONEY: Tim Mahoney, Fayette  
17 County.

18 REP. COSTA: Good morning, everybody.  
19 I'm Paul Costa from Allegheny County.

20 REP. O'BRIEN: Good morning. Mike  
21 O'Brien, Philadelphia.

22 REP. BROWNLEE: Good morning. Michelle  
23 Brownlee, Philadelphia.

24 CHAIRMAN ADOLPH: Okay. Thank you,  
25 members and staff.

1           I just want to go over some ground  
2 rules. I want all the members to understand that  
3 we'll try to get everybody's questions in, so keep  
4 in mind it's a large committee, and keep your  
5 questions short and precise. And I had would ask  
6 the testifiers to do the same.

7           Sometimes a follow-up question is  
8 necessary. I understand that. And for the most  
9 part, we will go along with that. However, if we  
10 get bogged down on one question, I might have to  
11 interject to try to move on.

12           We will come to a second round of  
13 questions, so keep that in mind. Keep your -- keep  
14 in mind that you have colleagues that are waiting.

15           For the Democrats, please get your --  
16 whoever wants to ask a question to Chairman  
17 Markosek, and for the Republicans, get them over  
18 here to Dr. Nolan, so we can go in some type of  
19 order. And I think we'll have a very successful  
20 budget hearing.

21           Putting things in perspective so the  
22 constituents out there know, that we don't even  
23 have light bulbs in these things this year. So I  
24 hope everybody can see in front of you. I went to  
25 turn the light on, and there's no light bulbs in

1 here, so there's cost cutting going on -- well,  
2 see, the Democrats have lights, so the Republicans  
3 do not have light bulbs here on our side.

4 So -- but our first testifier, ladies  
5 and gentlemen, is Alan Van Noord, chief investment  
6 officer of the PA state employees' retirement  
7 system.

8 We invited Mr Van Noord to come and  
9 provide us with his take on the economy. Mr. Van  
10 Noord has a very unique perspective, given his role  
11 as an investment officer who oversees over \$50  
12 billion worth of assets and makes investment  
13 decisions on how best to grow the value of the  
14 portfolio he manages.

15 It is imperative to remember that  
16 Mr. Van Noord is here to talk about -- not here to  
17 talk about the pension system, as we will hear from  
18 that group later on this week. However, Mr. Van  
19 Noord is here to share his perspective on the  
20 economy and how the economy is reacting to current  
21 economic circumstances before us.

22 I'd now like to welcome Mr. Alan Van  
23 Noord. Good morning.

24 MR. VAN NOORD: Thank you.

25 As was mentioned, my name is Alan Van

1 Noord. I am the chief investment officer for the  
2 PA Public School Employees' Retirement System.  
3 With me is Jeff Clay, our chief executive officer.  
4 Both Jeff and I will be back on Thursday for the  
5 budgetary hearings.

6 I was asked to give a global economic  
7 perspective, and what you have in front of you is  
8 the handout I would like to go over. This is  
9 typically the handout that the PSERS board would  
10 see. And Rep. Grell and Rep. Markosek are on that  
11 board.

12 But, basically, I start out with a  
13 market psychology, and it's a pendulum. It's  
14 Irrational despair and irrational exuberance,  
15 indicating undervalue and overvalue. And right  
16 now, it's sort of in the middle.

17 But some of the issues that we do talk  
18 about at each meeting, on the positive side, we are  
19 seeing leading economic indicator improving. This  
20 is very important for the equity market, because  
21 there's a very close correlation between the two.

22 We also are experiencing low interest  
23 rates, productivity is up with the corporations.  
24 Corporations also have strong profits. They have  
25 lots of cash, and with lot of cash you can do

1 mergers, acquisitions, and buy backs.

2           We have an extension of current tax  
3 rebates incentives -- rates, I should say, and we  
4 are seeing, in the aggregate, state revenues  
5 increasing.

6           However, there are a number of  
7 negatives out there, and we will address a number  
8 of these as the presentation goes on, but commodity  
9 price inflation is one. Sovereign debt issues. We  
10 are dealing with housing woes yet. Unemployment  
11 does remain high.

12           We are dealing with political  
13 uncertainties, in particular Iran and what's  
14 happening right now with oil supplies.

15           De-leveraging and restructuring.  
16 De-leveraging means reducing your debt profile,  
17 going into an austerity mode. And we're seeing the  
18 consumer, both voluntarily and involuntarily, being  
19 delivered.

20           State and local budgets are under  
21 pressure in spite of rising revenues. The budget  
22 deficit at the national level is expected to be  
23 about \$1.3 trillion. We've seen a downgrade of  
24 U.S. debt securities this year. The debt ceiling  
25 was recently increased. We were at \$15.2 trillion.

1 They moved that up \$1.2 trillion.

2 We are experiencing a global economic  
3 slowdown. And we are experiencing a European bank  
4 uncertainty.

5 If you turn to the next page, a little  
6 background is necessary in looking at emerging  
7 markets versus developed market. First, in terms  
8 of population, developed markets represent about 15  
9 percent of the total population out there, with  
10 emerging markets representing 85 percent. The  
11 largest emerging markets out there would be China,  
12 India, and Indonesia. The developed markets are  
13 generally considered to be the U.S., Canada, many  
14 European countries, Australia, et cetera.

15 When we look at Gross Domestic Product,  
16 the United States is the largest, at about 19.7  
17 percent of total world-wide gross domestic product.  
18 The emerging markets, though, are really picking up  
19 a lot of speed. Right now, it's estimated that  
20 it's about 47.7 percent comes from emerging  
21 markets. The largest right now is China. China  
22 represents about 15 percent of total worldwide  
23 global domestic product. It's estimated that  
24 within five years China will surpass the U.S. and  
25 become the largest producer of goods and services.

1                   In terms of market cap, this is,  
2 basically, the markets of each individual country.  
3 And, basically, market capitalization means number  
4 of shares times the price. U.S. is the largest  
5 right now, at 42.8 percent. The other markets  
6 represent about 57.2 percent. This by way of a  
7 little bit of background.

8                   Now, on the next page is a chart which  
9 we do talk about, leverage along with the twin  
10 deficits. And there's been a lot written about  
11 Greece recently, but if you look at the other  
12 countries, in particular Ireland and Portugal,  
13 Spain, Italy, and Greece, there is a lot of debt  
14 relative to their gross domestic product.

15                   Greece just had a marathon session and  
16 they came through with some sort of negotiation  
17 that I'm not completely aware of this morning what  
18 the details are, but apparently they -- it's a very  
19 fluid situation, and I can tell you that the  
20 European markets are a little soft this morning so  
21 it wasn't the greatest thing. Everybody sort of  
22 anticipated that Greek would come with some sort of  
23 resolution.

24                   But this is a second time that the  
25 Greeks have received a bailout. This will be well

1 over a hundred thirty billion Euros, and it will be  
2 supplied by the IMF.

3 But you look at another country like  
4 Ireland, they have a hundred and eight percent of  
5 their sovereign debt, meaning their government debt  
6 relative to GDP. Portugal has a hundred and two  
7 percent. Spain, 70 percent. Italy, a hundred  
8 twenty-one percent. But Greece definitely stands  
9 out at a hundred sixty-three percent.

10 Then you look at the budget deficit  
11 relative to the GDP, which is the far column on the  
12 left. Ireland has a budget deficit relative to  
13 their GDP of 10.3 percent. You look at Greece  
14 right on the bottom, their budget deficit relative  
15 to their GDP is 8.9 percent.

16 Now, I can't help but notice also that  
17 the U.S. has a budget deficit right now of 10  
18 percent of their GDP, and the debt represents 100  
19 percent of real GDP. And this is the issue that  
20 we're talking about on the national level.

21 The budget deficit is estimated to be  
22 at \$1.3 trillion. We just raised the debt ceiling  
23 by \$1.2 trillion. So that means our new debt  
24 ceiling is at \$16.4 trillion.

25 Japan is sort of very unusual. They



1 have a hundred -- 200 percent of debt -- government  
2 debt relative to GDP, but most of that is financed  
3 internally.

4           On the next page, who really owns the  
5 debt, the sovereign debt? Most of the sovereign  
6 debt is owned by the banks. The problem you have  
7 here is the banks do not market the way they do it  
8 in the U.S. They keep it at par. So a Greek issue  
9 that's going to be marked down to 70 percent  
10 generally is hailed at a hundred percent on the  
11 books of the banks, and that's problematic in and  
12 of itself, because their central banking system has  
13 required that they increase their reserves. So in  
14 order to do that, they are curtailing lending in  
15 the European area.

16           Right now ECB, or the European Central  
17 Bank, is providing the necessary liquidity. In  
18 fact, they came out with about a 650 billion Euro  
19 loan to the banks at 1 percent. They, in turn, can  
20 loan it at 3 percent, so they are increasing their  
21 reserves through that mechanism.

22           Now, in the -- in the forth quarter, a  
23 number of the countries released their real GDP  
24 figures. And in the fourth quarter, the Euro zone  
25 did contract by three-tenths of 1 percent, or

1 annualized at a rate of 1.3 percent.

2           Specifically, we have five countries  
3 now that have two quarters of negative real GDP,  
4 which technically does put them into recession.  
5 They were Portugal, Belgium, Italy, the  
6 Netherlands, and Greece. And actually Greece's  
7 real GDP contracted by 18 percent in that  
8 particular quarter. So this is an ongoing problem  
9 that we continue to look at all the time.

10           On the next page, a positive is U.S.  
11 short-term interest rates. Chairman Bernanke has  
12 indicated that we're going to have low interest  
13 rates through 2014. This is very good news if  
14 you're a borrower, if you're looking to buy a house  
15 and you need a mortgage. It's bad news if you're a  
16 senior citizen looking to put money into a  
17 certificate of deposit.

18           It's good news if you're the state  
19 of -- or the Commonwealth of PA and you need to  
20 borrow money. A ten-year taxable right now is  
21 about 2.9 percent. A ten-year tax exempt can be  
22 floated at about 1.95 percent. Something to  
23 consider.

24           On the next page, corporations have a  
25 lot of cash on their balance sheet. And you can

1 see by this chart it keeps moving higher. They  
2 have approximately \$2 trillion. Now, a company  
3 that we're all very familiar with, Apple Computer,  
4 just reported that they have on their balance sheet  
5 \$97.2 billion in cash.

6           Corporations are holding cash for a lot  
7 of different reasons. Some of them that I do hear  
8 are, number one, this is cash in the aggregate.  
9 Some of this cash is overseas. They are not going  
10 bringing it over here because they would be taxed  
11 on it.

12           Number two, a lot of corporations do  
13 have excess capacity so they're not building new  
14 factories.

15           And number three, the chief executive  
16 officers are still very conservative. They have  
17 fresh memories of the 2008 financial crisis.

18           On the next page, what we are seeing is  
19 they are adding to their debt level, and it's sort  
20 of a conundrum right now. With cash positions as  
21 high as they are, why would they be adding to their  
22 debt? Well, take into consideration a company like  
23 Verizon, which now has a dividend yield of 5.3  
24 percent. They can go out into the debt market and  
25 borrow money at 3.5 percent. Interest is tax

1 deductible. Dividends are after tax. So they can  
2 actually do a pretty good arbitrage by buying back  
3 their stock and floating debt.

4 We're also seeing a lot of companies  
5 buying equipment because they have very, very  
6 favorable depreciation rates at the present time.  
7 So you can put equipment in, depreciate it to a  
8 hundred percent, and we're seeing companies do  
9 that.

10 We're also seeing companies borrowing  
11 U.S. dollars and invest internationally. What  
12 we're not seeing is a tremendous amount of increase  
13 in plant equipment, but we are beginning to see  
14 increases in employment.

15 On the next page, to understand  
16 inflation, I think, basically, you have to look at  
17 the composition. The last three quarters of last  
18 year, the CPI basically was unchanged, the Consumer  
19 Price Index. The Producer Price Index was actually  
20 down just a little bit.

21 But look at the composition of  
22 inflation in the U.S. "Other," at 47 percent,  
23 pertains primarily to wages and benefits. And  
24 what's happened to wages and benefits is they're  
25 just not going up. Thirty percent is derived from

1 rent, and the rent equivalent of your home is in  
2 there also. And home prices generally are not  
3 going up.

4 What we are seeing are increases in  
5 rental income. And we're also seeing a vacancy  
6 rate decrease.

7 Finally, food and energy, groceries are  
8 up. Crude oil is up. It's crossed over a hundred  
9 dollars a barrel. At service stations right now,  
10 it's about 3.70 for a gallon of unleaded gas.  
11 Offset to that is we've had a pretty good winter, a  
12 very mild winter, so that's been a pretty good  
13 offset.

14 But bottom line, inflation affects  
15 people differently. Every family's situation can  
16 be different. To compound it, if you do have a  
17 youngster that's going to higher education,  
18 generally you're seeing big increases there.

19 On the next page, year-over-year change  
20 in food prices. Anybody that's going to the  
21 grocery store realizes that food prices have moved  
22 up.

23 But from a global standpoint, we saw a  
24 lot of global unrest in Arab nations last year. A  
25 lot of that was attributed to inflationary factors.

1 Food prices dramatically going up. So this is  
2 something that's very, very important. And it  
3 affects people at different income levels.

4 On the next page, in employment-to-  
5 population ratio. We all have seen the employment  
6 statistics. We've seen employment move from 9.1  
7 percent in September of 2011 down to January's  
8 number 8.3 percent. We've seen the four-week  
9 moving average of unemployment claims move down  
10 from 420,000 to 366,000. Private sector is adding  
11 jobs. Public sector is actually reducing jobs,  
12 whether at the federal level, the states, or at the  
13 local level.

14 What this shows is back in January of  
15 2000, we had 82 percent of those in the 24-to-54  
16 age bracket actually working. What we're seeing  
17 right now is 75 percent of those in the 24-to-54  
18 age group working. This is the employment-to-  
19 population ratio.

20 We are seeing people that are dropping  
21 out of the system. We are seeing people that are  
22 taking part-time work rather than full-time work.  
23 We are seeing people that are unemployed.

24 To put this into perspective, we have,  
25 in Detroit, over 40 percent of those have been

1 unemployed for over fifty-two weeks. Same  
2 statistic for Atlanta. And in Philadelphia, the  
3 latest statistic I saw was 34 percent of those out  
4 of work have been out of work for fifty-two weeks  
5 or more.

6           On the next page is the employment cost  
7 index. You can see that it is positive, but it's  
8 very low. We've seen very low wage growth. And  
9 any offsets here have been offset by benefit  
10 increases that the employee has to pay. Then when  
11 you adjust it for inflation, you actually are  
12 pretty flat to probably down.

13           On the next page, the consumer is  
14 getting better. The consumer -- but the consumer  
15 still is behind on its bills. You look at this,  
16 this is as of 2011, still had \$96.8 billion in  
17 bills that were at least sixty days late. Seeing  
18 an improvement, but this is still a big problem.

19           On the next page, how are the consumers  
20 paying for the bills, we are seeing many, many  
21 consumers take out loans against their 401(k).  
22 This is sort of a new phenomena, and it's much  
23 different than past recessions, because past  
24 recessions you actually could -- you could actually  
25 get money out of your home equity loan. This time

1 around, with the house prices as weak as they are,  
2 you cannot tap your home equity loan anymore.

3           The other thing, the IRS has changed  
4 some of the regulations, in that you will not have  
5 a penalty if you pull money out of your 401(k) and  
6 use it for education expenses for your son or  
7 daughter. If you just use it for daily  
8 necessities, you do have a 10 percent penalty plus  
9 it's considered ordinary income. So we are seeing  
10 this.

11           We don't have the data yet for 2011,  
12 but I would imagine you'd see that move a little  
13 bit higher.

14           On the next page, the number of  
15 properties being foreclosed, it definitely is  
16 moving down. But we're still expecting about 2.75  
17 million units that are either three months  
18 delinquent or being foreclosed on this year. Lots  
19 of homeowners are under water.

20           And we have talked to a number of  
21 mortgage servicing people, and they tell us that  
22 people tend to walk when their loan-to-value equals  
23 about a hundred forty percent. And we are starting  
24 to see more and more people at that level.

25           In many states, you can still live in



1 your house for six hundred and seven hundred days  
2 without paying a mortgage. And that is also  
3 another source of income that consumers can use to  
4 pay down debt or buy goods and services. But I do  
5 not believe that we are out of the woods yet with  
6 housing. I think we're going to see lower housing  
7 prices this year yet.

8 We are seeing a shift from owning to  
9 renting. And if you look at this chart, the blue  
10 would be home ownership, the red would be the  
11 renters. And, basically, the left-hand side would  
12 be the home ownership. The right-hand side would  
13 be the percent of renters.

14 Back in 1980, we had 66 percent of the  
15 households out there own their own home, 34 percent  
16 of them rented. We saw a bottom back in 1995, with  
17 home ownership at 64 percent and rentals at 36  
18 percent.

19 We saw a peak, and pretty much  
20 coincidental with a run-up in home prices in 2004,  
21 with home ownership representing 69 percent of  
22 total units, with rents at 31 percent. And right  
23 now, that has come back down to about 66 percent  
24 home ownership, 34 percent rental income.

25 We are seeing a sharp increase in

1 rental rates, where we're seeing increases in new  
2 housing. It happens to be in multi-family.

3 I will say, though, that conditions are  
4 ripe for a turnaround in housing. The number of  
5 household formations being -- has increased  
6 significantly over the last couple of years.

7 Number two, when you look at the price  
8 of the house, it is substantially cheaper than it  
9 was once, and if you look at the interest rates,  
10 they're very, very low. So it is ripe for a  
11 turnaround.

12 On the next page, monetary policy  
13 worldwide has been very, very accommodative.  
14 Central banks have lowered interest rates. They've  
15 repurchased fixed income securities, but it's  
16 fiscal policy that is very, very tight at the  
17 present time.

18 We're seeing the federal government --  
19 their stimulus programs have sort of exhausted, and  
20 you bring forward things, and now we're into a sort  
21 of a drag. We're starting to see austerity  
22 programs pop up in Europe in particular. And in  
23 the latest debt negotiation with Greece, the  
24 Germans really demanded a lot of austerity from the  
25 Greeks. So anybody that's looking to get a loan

1 from the International Monetary authority is going  
2 to be under pressure to increase austerity  
3 measures.

4 On the next page, mentioned before  
5 that, from a labor standpoint, the federal  
6 government, the states in the aggregate and locals  
7 are reducing their employment. And we do not  
8 expect federal governments to be a stimulus going  
9 forward. Rather, they're going to be a drag.

10 On page nineteen, this is sort of a  
11 different chart, and it needs a lot of  
12 explanation. If we consider each vertical bar and  
13 look at it in 2007, prior to the recession, and  
14 then look at it at the bottom in terms of the  
15 trough, this would be a percentage increase off of  
16 the trough. The -- the chart is a little bit  
17 outdated because it's as of the third quarter of  
18 2011 -- we haven't received the fourth quarter  
19 statistics yet -- but what you can see is only  
20 high-end consumer retail is back to where it was  
21 prior to the start of the recession. The rest of  
22 these items are much below where they were.

23 This is a much, much different recovery  
24 than we've ever seen before. Typically, you'd see  
25 every one of these vertical bars towards the top,

1 rather than where they are right now.

2           Finally, on the last page, I do think  
3 we're into a new normal. I think we're looking at  
4 real GDP this year of 2 percent. We're looking at  
5 inflation of about 2 percent. And we're looking  
6 for ten-year treasuries to trade in the area of 2  
7 percent to 3 percent.

8           There are some concerns that I have.  
9 2012 is starting out much like it did in 2011. We  
10 had pretty strong economic growth the last part of  
11 2010. The markets basically peaked in March, April  
12 of 2011 and trailed down in the second and third  
13 quarter. We saw employment actually bottom in  
14 March, and then it picked up till it hit a high  
15 again in September of 9.1 percent.

16           The market thus far has been very  
17 strong. We've had six good weeks. Two weeks have  
18 been relatively flat, the last two weeks. But I  
19 think, looking into -- forward, looking at 2013,  
20 there are two things out there that I think we have  
21 to be aware of.

22           Number one is the expiration of the  
23 Bush tax cuts, which means about \$240 billion. And  
24 we are going to be starting spending cuts.

25           I already mentioned that Europe, I

1 believe, is in a recession. China, the very large  
2 economic power out there, has experienced a policy-  
3 induced slowdown, but I don't think that that's  
4 going to a big consideration because they are going  
5 to change leadership come this fall, and I think  
6 they're going to do everything they can to prop up  
7 that economy.

8 So this concludes my remarks. Thank  
9 you.

10 CHAIRMAN ADOLPH: Thank you, Mr. Van  
11 Noord, for your presentation.

12 I have a very quick question that maybe  
13 you can help explain it to me regarding the payroll  
14 tax cut that we hear so much about. This is  
15 actually the percentage of the Social Security  
16 contribution rate that employees have been paying.  
17 Is that correct?

18 MR. VAN NOORD: That's correct.

19 CHAIRMAN ADOLPH: Okay. And so there's  
20 X amount of dollars now no longer going into the  
21 Social Security fund. Is that correct?

22 MR. VAN NOORD: That's correct.

23 CHAIRMAN ADOLPH: Okay. On a macro  
24 level, what do you think they're thinking of with  
25 that? I was always under the impression, the last

1 couple years, that our Social Security fund was  
2 kind of underfunded, and I know previous  
3 administrations have been trying to figure out a  
4 way to get this stabilized, so when we get to 2024,  
5 that folks will have Social Security to look  
6 forward to. And I'm trying to think of this  
7 philosophy where the -- it's better off not to  
8 contribute into this fund for the economy.

9 MR. VAN NOORD: The intent of the  
10 payroll tax is to try and prod the consumer to  
11 spend more. Theoretically, and only theoretically,  
12 if the consumer spends more will it spur the  
13 economy to higher levels. If the consumer decides  
14 to save or the consumer decides to pay down debt,  
15 it does nothing to increase the -- the rate of  
16 economic growth.

17 And you are absolutely correct, you're  
18 borrowing from Peter to pay Paul. And at some  
19 point in time, you have to pay the piper.

20 CHAIRMAN ADOLPH: It's kind of  
21 interesting, you know, during this entire debate --  
22 and the debate's been going on for about a year now  
23 in Washington -- I'm trying to keep this on a macro  
24 level -- and when you talk to so many of our  
25 constituents, you know, whether they are retired or

1 approaching retirement age, you know, they're  
2 always concerned about Social Security.

3 And it seems like to me, that during  
4 this debate, no one's talking about where this  
5 payroll tax cut, which in my opinion is just a  
6 decrease in the defined benefit program, is  
7 hurting. And that subject never comes up. And I  
8 know you, that deals with the pension plans, would  
9 have a perspective on this.

10 MR. VAN NOORD: It sounds vaguely  
11 familiar to what we've experienced here in  
12 PA with the pension system. And it sounds vaguely  
13 familiar to the resolution that the House and  
14 Senate came to in 2010, but, yes, if you underfund,  
15 whether it's a Social Security system or a pension  
16 system, for an extended period of time, you have to  
17 put more money into it at a later point in time,  
18 so, in essence, it is sort of like kicking the can  
19 down the road.

20 CHAIRMAN ADOLPH: Okay. Thank you.  
21 Chair Markosek.

22 REP. MARKOSEK: Thank you, Chairman  
23 Adolph.

24 A couple of housekeeping things here,  
25 first. Rep. Bradford from Montgomery County is

1 with us. Rep. Matt Smith from Allegheny County and  
2 Rep. Ron Waters from Philadelphia County are also  
3 present.

4 I really -- I've heard the presentation  
5 before, as you know, as you mentioned being on the  
6 PSERS board, and it is very good information to  
7 hear.

8 And I think, if we can just assume, for  
9 a second -- and I know that's maybe a bad word to  
10 use around economists -- but that we don't have a  
11 major crisis in Europe of either economic or  
12 political crisis with Iran or, you know, worldwide,  
13 how is the economy perking along as we move  
14 forward? You know, assuming that anything major  
15 doesn't happen, do you predict that the economy is  
16 getting better? To what extent? Are we kind of  
17 holding our own? Are we getting slightly better?

18 It seems like more people are working,  
19 although certainly nowhere near what we'd like to  
20 see there.

21 And just would like your thoughts on  
22 all of that.

23 MR. VAN NOORD: If you look at the  
24 economic growth in the United States last year, the  
25 first quarter of last year, we were up four-tenths



1 of one percent. We increased each quarter until  
2 the fourth quarter, we actually were up 2.8  
3 percent.

4                   However, 1.9 percent of that actually  
5 came from inventory building, and at some point in  
6 time, people will draw down on that inventory. I  
7 personally think that we are into what's called a  
8 new normal, in that we will have slow economic  
9 growth for several years yet. We will be dealing  
10 with some subdued inflationary pressures, under 2  
11 percent, and we will be dealing with low interest  
12 rates.

13                   The economy definitely has the look and  
14 feel like it is getting better. The leading  
15 economic indicators out there would verify that.  
16 The stock market itself has been doing quite well.  
17 Remember we bottomed in October. The four quarter  
18 was strong. The first quarter thus far is pretty  
19 strong. But there still are major concerns out  
20 there.

21                   REP. MARKOSEK: The interest rates  
22 currently that we see have really been pretty much  
23 next to zero for many of the bonds and borrowing.  
24 And you just mentioned that, you know, some  
25 analysts and economists had indicated that they

1 would remain pretty much the same through 2014, I  
2 believe you said. Am I correct in that?

3 MR. VAN NOORD: Correct. The best  
4 economist out there right now is Chairman Bernanke  
5 of the federal reserve system. And the chairman  
6 has indicated that the economy is not strong. It's  
7 weak. We have to do everything we can to support  
8 it. So he has indicated that interest rates will  
9 stay low for -- until 2014. We are talking about a  
10 couple years yet.

11 REP. MARKOSEK: Okay. Thank you.

12 CHAIRMAN ADOLPH: Thank you, Chairman.

13 I'd like to acknowledge the presence of  
14 Rep. Quigley of Montgomery County, Rep. Bear of  
15 Lancaster County, and Rep. Mustio of Allegheny  
16 County.

17 At this time I'd like to acknowledge  
18 Rep. Dave Millard for questions.

19 REP. MILLARD: Thank you,  
20 Mr. Chairman.

21 Mr. Van Noord, excuse my back here,  
22 but, two questions for you, and I'm going to, in an  
23 effort to save time here, ask both of them, and ask  
24 you to expand upon your answers.

25 First of all, slide seven of your

1 presentation states that corporations continue to  
2 cling to their cash. And then slide eight follows  
3 this up with a statement that corporations are also  
4 adding to their debt. Now, these two statements  
5 contradict each other. And can you explain why  
6 cash reserves and debt levels of corporations are  
7 rising simultaneously?

8           And the second question, I guess, you  
9 know, our air waves and the print media are all  
10 flush with economists and forecasters reporting  
11 that corporations are flush with cash, and your  
12 slide seven indicates that at a level of about 2.1  
13 trillion, and you mentioned also that the national  
14 debt deficit is 1.3 trillion.

15           A lot of articles all over the places,  
16 again going back to these two slides, that  
17 businesses are flush with cash, and I guess the big  
18 question is why they're not spending it in  
19 investing in production or hiring back workers.  
20 And, you know, given your experience, can you give  
21 us some insight with regards to these two  
22 concerns?

23           Thank you.

24           MR. VAN NOORD: I think that's a very,  
25 very good question. And each corporation is going

1 to have a different reason why they would want to  
2 have their own particular cash position on hand.  
3 So it's difficult to go corporation by  
4 corporation.

5           But I think that there are a couple  
6 reasons. Number one, when you look at the cash  
7 position, it's cash in the aggregate, so it  
8 includes foreign subsidiaries. A lot of the  
9 corporations are not moving their cash from their  
10 foreign subsidiaries to home corporation levels  
11 because of a tax that they would have to pay. If  
12 that tax was not there, I'm sure you'd see a lot of  
13 them move their cash from foreign subsidiaries to  
14 their home corporation.

15           Number two, I think that there still is  
16 a lot of excess capacity, so a lot of the  
17 corporations are not doing big, big, big projects.

18           I also should mention that the  
19 reciprocal of adding to the debt would indicate  
20 that the cash positions have moved up. So that  
21 would be another reason.

22           But I hear from some corporations that  
23 the chief executive officer generally has not been  
24 there more than, you know, two, three, four years.  
25 There's been a lot of turnover in that executive

1 office. And they just basically want to be  
2 conservative. They're listening to the financial  
3 officer that went through a financial crisis in  
4 2008, in which he did not have liquidity, and he  
5 wants to have as much liquidity as possible out  
6 there to pay bills. And he's listening to the  
7 marketing person who says, you know, I'm seeing  
8 business increase. But they still want to be very,  
9 very conservative.

10           There are also tax reasons why a  
11 corporation might want to add to its debt level.  
12 And I mentioned Verizon as an example. Their  
13 common stock yields 5.3 percent. They can go into  
14 the market and loan money at 3.5 percent. The  
15 interest payable is tax deductible whereas the  
16 dividend payment is an after-tax expense. So  
17 they're -- you can create a nice arbitrage with a  
18 high-yield stock.

19           The other thing is, the depreciation  
20 rules are such that basically you can write off all  
21 your equipment in one year, so you might want to  
22 consider using debt for that.

23           But it is one of these questions that  
24 remains on everybody's mind, why all the cash? Why  
25 does Apple need to have \$97.8 billion on hand?

1                   So, interesting question. Very, very  
2 good question.

3                   REP. MILLARD: Thank you.

4                   CHAIRMAN ADOLPH: Thank you.

5                   Rep. O'Brien.

6                   REP. O'BRIEN: Thank you,

7 Mr. Chairman.

8                   Thanks to Rep. Millard's line of  
9 question, my question's going to be rather  
10 truncated. And I am just taken back that there's  
11 \$2 trillion liquid. And I'm absolutely taken back  
12 that Apple has \$97.8 billion in reserve, cash.  
13 Cash.

14                   Now, it's my understanding that Apple  
15 does most of their manufacturing in foreign  
16 markets; correct?

17                   MR. VAN NOORD: I don't know what the  
18 exact percentage is, but I would have to assume  
19 that, yes.

20                   REP. O'BRIEN: So, my truncated  
21 question, on the government policy side of the  
22 equation, what would the Commonwealth of  
23 PA have to do to stimulate that manufacturing?  
24 What would be sound government policy to bring  
25 those jobs home?

1 MR. VAN NOORD: Well, I think that's a  
2 very, very difficult question for me to answer.  
3 The Commonwealth does not have monetary authority,  
4 so it cannot print money. It has to create  
5 incentives that might bring that money back, but  
6 what specifics are out there, I think that's a  
7 question reserved more for the fiscal agency and  
8 for the revenue commission.

9 REP. O'BRIEN: Take a stab.

10 MR. VAN NOORD: I can't answer the  
11 question.

12 REP. O'BRIEN: Thank you very much.

13 CHAIRMAN ADOLPH: Thank you.

14 Rep. Gordon Denlinger.

15 REP. DENLINGER: Thank you,

16 Mr. Chairman.

17 And thank you for your testimony,  
18 Mr. Van Noord.

19 One question, kind of relates to Rep.  
20 O'Brien's question that he just asked. In your  
21 discussion about the growth -- or the stagnation of  
22 wages, in fact, some declines, even considering  
23 benefits and so forth, it sparks some curiosity  
24 with me over rates of wage and thinking about sort  
25 of that trilateral comparative between Europe, the

1 North American economy, and Asia, China, which is,  
2 of course, coming online here in a powerful way.  
3 We know we're going through a time when the Chinese  
4 economy is expanding, growing, and Chinese  
5 employees are going to expect higher wages and a  
6 better style of life.

7 I'm wondering where are we in the  
8 continuum of seeing, I guess, the wage comparative  
9 between the North American economy and China  
10 starting to balance out in such a way that  
11 companies like Apple or whoever else might, you  
12 know, relook at those economics and say, you know,  
13 it makes a lot more sense to bring those  
14 manufacturing jobs back home, less people  
15 transferring them out.

16 I'm just wondering, are we, you know --  
17 within the next five year, are we going to see  
18 enough equalization that we might start to see the  
19 reverse of that outsourcing of jobs?

20 MR. VAN NOORD: Very, very good  
21 question.

22 I do not have specifics in terms of  
23 numbers in terms of what the actual wage rates are  
24 between the different countries. It's my  
25 understanding, however, when talking with corporate



1 leaders, that more of them are considering moving  
2 manufacturing capacity back in the United States.  
3 We've seen that particularly with the automotive  
4 industry, where a lot of the European companies  
5 have moved production over here, based on, you  
6 know, a whole host of factors, including currency  
7 valuations.

8           So there definitely is a trend to move  
9 more and more jobs here, as we become more and more  
10 competitive. And I think that is a trend that will  
11 continue going forward.

12           REP. DENLINGER: That's positive.

13           One other quick question, if I may, and  
14 it relates to our role as policy makers here. You  
15 mentioned some things that are, frankly, concerning  
16 long-term trends, move toward more renting as  
17 opposed to home ownership. People tapping into  
18 their retirement savings on a more significant way,  
19 potentially for college education or whatever else,  
20 maybe to get by. Bad decision, long term. Just a  
21 number of things, you know, less people in the job  
22 market, as your slide indicated, less productive  
23 employment going on.

24           Of those major negative long-term  
25 trends, which one or two do you think we, as policy

1 makers, would be best, most wise to attack or go  
2 after? Is it the home ownership issue longer  
3 term? Is it the tapping into retirements? Where  
4 do you think the big bar is in terms of our policy  
5 directions in the future?

6 MR. VAN NOORD: Again, those are very,  
7 very good and thought-provoking questions. Home  
8 ownership has always been sort of like the  
9 cornerstone of a family's balance sheet, and once  
10 you stop that decline, I think the consumer is  
11 going to have confidence. And once the consumer  
12 has his confidence back, I think that you'll see  
13 increases in spending patterns and you'll see  
14 growth in the economy. So whatever could be done  
15 to help on the home front.

16 Now, quite frankly, PA never went  
17 through the rapid increases like a state -- like  
18 California or Florida. So the fall has not been as  
19 intense as it has been in California or in  
20 Florida. It is my understanding that there still  
21 are about 25,000 homes in PA that are being  
22 foreclosed or in the process of being foreclosed,  
23 but that's a small number compared to a state like  
24 Florida, which is experiencing probably 500,000  
25 homes being foreclosed on.

1                   But I think that home ownership has  
2 always been the cornerstone of a family's wealth,  
3 and once they feel like their wealth is increasing,  
4 they're going to be more confident about spending.

5                   REP. DENLINGER: Very good. Thank  
6 you.

7                   Thank you, Mr. Chairman.

8                   CHAIRMAN ADOLPH: Thank you.

9                   Rep. Matt Smith.

10                  REP. SMITH: Thank you, Mr. Chairman.

11                  Thank you, Mr. Van Noord, for your  
12 testimony today.

13                  Just a few questions as it relates to  
14 the various contraction and austerity measures that  
15 you detail both in this country and in other  
16 countries. And I'm just wondering, what is your  
17 opinion on sort of the general contraction at the  
18 federal government level as it relates to GDP  
19 growth or GDP decrease in growth? Is there a  
20 connection there between the austerity and  
21 contraction measures and GDP growth?

22                  MR. VAN NOORD: The one chart that I  
23 did have would indicate that the federal government  
24 is going to be a drag on real GDP growth. So there  
25 is a very good connection between austerity

1 programs.

2           You know, you can look to Greece as now  
3 being the example. They have gone through five  
4 years of contraction. And every time they get a  
5 loan from the International Monetary Fund, they are  
6 required to go through another austerity program.  
7 Once you keep pulling back like that, it does  
8 present sort of like this stone that's rolling  
9 downhill. And now in the latest quarter, the Greek  
10 GDP contracted at 18 percent, so that's a very  
11 large number. And yet, in the most recent budget  
12 or loan negotiations, it is my understanding that  
13 the Germans have decided that the Greeks need more  
14 austerity.

15           It's one of the issues you run into  
16 when you have seventeen nations that have shared  
17 the common currency, and you have some nations that  
18 are very good export nation, like Germany, but then  
19 you have a nation like Greece, which basically  
20 doesn't have an export economy. It's another  
21 problem when you have an European Union, which  
22 includes twenty-seven countries. So you have  
23 twenty-seven countries in a European Union. You've  
24 got seventeen countries in a Euro base.

25           REP. SMITH: It's sort of taking that

1 example, and in some ways you can almost look at  
2 the independent EU countries as independent states  
3 of the larger EU, Greece being one of them, Italy,  
4 et cetera, et cetera.

5 And so that sort of brings me to my  
6 next question as it relates to the states here at  
7 home.

8 Isn't the same thing basically  
9 applicable to the states, where there's state  
10 contraction and austerity measures, that there  
11 would be sort of a drag in the state's economy? So  
12 that if a state drastically reduces spending and  
13 expenditures and that causes a net results in loss  
14 of jobs, particularly on the public sector side,  
15 that that would then be a drag on that particular  
16 state's economy.

17 MR. VAN NOORD: That would be correct.

18 REP. SMITH: You had mentioned earlier  
19 one thing that I thought was interesting, that your  
20 forecast and the chairman -- Chairman Bernanke's  
21 forecast on future interest rates is that for the  
22 foreseeable future they would be, obviously, very  
23 low, and that that would, obviously, be bad for  
24 savers, good for borrowers.

25 Can you elaborate on -- you know, the

1 timing of borrowing I think is something that gets  
2 lost in the shuffle in our debate on debt -- and  
3 whether, in your opinion, it makes sense for -- if  
4 there is a need to borrow, that that borrowing  
5 occur within this window where we're going to have  
6 drastically reduced interest rates?

7 MR. VAN NOORD: I mentioned, in  
8 particular, where the Commonwealth right now should  
9 be able to borrow money. I mention that only in  
10 the context of having another arrow or -- in your  
11 quiver in case you might need to do something along  
12 that line.

13 And when you can borrow at 1.95 percent  
14 for ten years tax exempt or 2.9 percent on PA  
15 taxable issue, it is something that you at least  
16 should have in the back of your mind.

17 Whether you decide as a group to issue  
18 more debt, you know, that is an Appropriation  
19 Committee decision. And I can't recommend.

20 REP. SMITH: Sure. What is -- where  
21 does PA fit in right now in terms of its debt  
22 rating to other states?

23 MR. VAN NOORD: PA right now is a AA.  
24 There are three groups: Moody's, S and P, and  
25 Fitch. And all of them have AA plus or minus. So

1 it's a AA.

2 REP. SMITH: Which is -- where does  
3 that fit in among other states and on the scale  
4 of --

5 MR. VAN NOORD: AAA is the best rating,  
6 so it's a notch below that. And I honestly don't  
7 know what all the other fifty states, I can't give  
8 you that. But I can easily get you that  
9 information if you would like that.

10 REP. SMITH: That would be great.

11 MR. VAN NOORD: Sure.

12 REP. SMITH: You can certainly direct  
13 it through Chairman Adolph and Chairman Markosek.  
14 I appreciate that.

15 MR. VAN NOORD: Sure.

16 REP. SMITH: Just one final question.

17 You had mentioned the debate in  
18 Washington on the extension of the payroll tax cuts  
19 and extension of unemployment compensation  
20 insurance.

21 In your opinion, what would be more  
22 stimulative to the economy? That combination of  
23 immediate payroll tax cuts, where the individuals  
24 are saving more money through their biweekly  
25 paycheck and/or they're continuing to receive those

1 unemployment benefits, versus the stimulative  
2 effect of something like the Bush tax cuts, that  
3 you've mentioned are set to expire in 2013, I think  
4 you had mentioned to the tune of 240 billion a year  
5 as a cost to the federal government? What would be  
6 more stimulative as a short-term jolt to the  
7 economy?

8 MR. VAN NOORD: In general, economists  
9 feel that unemployment -- actually, you would get  
10 probably a factor of 1 to 1.2 stimulative effect to  
11 the economy. Basically, if you're on unemployment,  
12 you are going to spend a hundred percent of what  
13 you get. A payroll tax, in order for it to work,  
14 you need to spend it. But a lot of people, I  
15 think, are going to save it, or they're going to  
16 pay down debt with it. If the latter two occur,  
17 you really do not stimulate the economy.

18 REP. SMITH: And how about with respect  
19 to the Bush tax cuts, because the thing that  
20 worries me there is, that something similar to what  
21 Rep. O'Brien asked about is -- is corporate --  
22 corporations are sitting on cash reserves. Is that  
23 a possibility with those particular tax cuts for  
24 those making over \$200,000 that, like the payroll  
25 tax cut example you mentioned, that that money will



1 not actually be spent, it will actually be saved or  
2 put into some form of a restricted access account?

3 MR. VAN NOORD: I think that the  
4 important thing right now is confidence. And the  
5 two items I mentioned, the Bush tax cut along with  
6 the spending cuts, are both policy decisions.  
7 Policy decisions can be changed at any point in  
8 time. But how do you have confidence that it's not  
9 going to change or that it will change next year?  
10 You don't know for certain if you're going to be  
11 paying a higher tax rate, the same tax rate, or  
12 something lower. It's -- there's going to be a lot  
13 of debate on those items this year.

14 So I think if corporations had more  
15 confidence in the tax policies at the federal  
16 level, I think they would be more free to invest  
17 their cash because they can think more long term.  
18 One year from now, things could be entirely  
19 different than where they are.

20 REP. SMITH: And just one final  
21 question, Mr. Chairman.

22 Do you -- do you think that -- correct  
23 me if I'm wrong -- but one of the things I'm taking  
24 away from your testimony is that we sort of have to  
25 move on two sort of mutually exclusive tracks, one

1 of which is short-term stimulus, short-term dollars  
2 into the market, creating demand, and the other  
3 track is a longer term, a five-, ten-, fifteen-year  
4 plan that provides some certainty with respect to  
5 tax rates, with respect to reducing the debt and  
6 that sort of thing, and moving on those two tracks,  
7 I think is difficult, but that seems to be what  
8 you're saying, that there's a need for a short-term  
9 jolt, but, also, at the same time, a need for a  
10 longer term certainty to hopefully remove some of  
11 that cash from the corporate balance sheets.

12 MR. VAN NOORD: That would be correct.  
13 The positive thing right now is, I don't think  
14 there are many economists or any economists out  
15 there that are looking for contraction in our Gross  
16 Domestic Product this year or next year. It's --  
17 but it's basically very, very slow growth, and  
18 that's much different than any other recovery that  
19 we've had in the past. And I think it's going to  
20 be -- it's going to take time for us to get back to  
21 a normalized growth rate.

22 REP. SMITH: Thank you, Mr. Chairman.

23 CHAIRMAN ADOLPH: Thank you.

24 I'd like to acknowledge the presence of  
25 Rep. Ron Miller of York County, chairman of the

1 Labor Committee. Thank you for joining us.

2 Rep. Brian Ellis has the next question.

3 REP. ELLIS: Thank you very much,  
4 Mr. Chairman.

5 Mr. Van Noord, thank you very much for  
6 coming in today.

7 At the very beginning of your  
8 presentation, you started touching on the  
9 geopolitical factors that enter into the market  
10 psychology, specifically with Iran. Were you  
11 referring to gas prices at that point?

12 MR. VAN NOORD: Yes. There's a lot of  
13 tension right now. And the European Union has put  
14 sanctions out there. They're curtailing their  
15 purchases from Iran in the tune of 600,000 barrels  
16 a day. We're hearing that Lloyd's of London has  
17 stopped insuring tankers in that particular area.  
18 So there's a lot of tension right now, and we've  
19 seen that reflected in gasoline prices.

20 Higher gasoline prices do act as a  
21 tax. So the higher the gasoline price is going,  
22 and, basically, it's become an evening news item.  
23 Every night they talk about where gasoline is and  
24 where people project it's going to go.

25 REP. ELLIS: I guess, specifically,

1 what I'm asking, you know, four years ago, when the  
2 Obama administration took over, gas was a little  
3 under 1.80 a gallon. Now we're looking at it going  
4 upwards of 4 and beyond.

5 At that point -- when -- is there a  
6 trigger point where gas prices are so high that  
7 this slow growth trend could be reversed, where  
8 folks will say, like, Oh, my gosh, it's \$4 a  
9 gallon, I'm not spending it on anything because  
10 I need to do that? Is there a trigger point in  
11 your mind where PA's economy is really going to  
12 suffer because of the gas price specifically?

13 MR. VAN NOORD: There definitely has to  
14 be a trigger point in which that takes place. With  
15 each individual, it's going to be little bit  
16 different. I can't give a good feel. But what I  
17 can tell you, that gasoline is like a tax. You  
18 have X number of dollars in personal disposal  
19 income. If you see a reduction in that, that means  
20 you can't spend it some other place. So if you  
21 have increases in fuel cost, definitely you have to  
22 readjust your balance.

23 Now, fortunately, we, in PA, have  
24 experienced a relatively mild winter, so that is a  
25 nice offset. But higher gasoline prices definitely

1 are a concern that I have.

2 REP. ELLIS: Okay. I appreciate that.

3 If I can just touch on one other area,  
4 if you can help me understand a little better. On  
5 slide thirteen, you list it as behind on the  
6 bills. How does that affect the economy in PA, the  
7 fact that, you know, nationwide, \$96.8 billion is  
8 sixty days late on mortgages and other bills? How  
9 does that translate and affect us? And what can we  
10 do to try to curb that in PA? And I guess also, is  
11 PA one of the worst states? Are we in the middle?  
12 Or do you have any information along those lines?

13 MR. VAN NOORD: I'm sorry. I do not  
14 have specific information. It's very possible the  
15 next two groups will have very, very specific  
16 information. It's my understanding that we were  
17 going to go from the global, the macro, to the  
18 micro. So very likely they would have very  
19 specific information.

20 But if you're sixty days behind,  
21 generally, you're going to start, you know, working  
22 with a bank or working with a work-out group to  
23 bring your payments up to where they should be.  
24 You're not going to be granted extensions on your  
25 credit. So any time you pull back on credit, you

1 are going to impact the economy.

2 Now, fortunately, this is going in the  
3 right direction, but, you know, it's still not  
4 where it should be or where it was prior to the  
5 start of the financial crisis that we had in 2008.

6 REP. ELLIS: But, overall, you think  
7 we're going to continue on that number going down.

8 MR. VAN NOORD: Yes.

9 REP. ELLIS: Okay. Thank you very  
10 much.

11 CHAIRMAN ADOLPH: Thank you,  
12 Representative.

13 Next question is Rep. Mauree Gingrich.

14 REP. GINGRICH: Thank you,  
15 Mr. Chairman.

16 Thank you, Mr. Van Noord. I think your  
17 presentation was excellent and obviously has  
18 generated a lot of discussion and a lot on the  
19 corporate level, which was important, and thank you  
20 for answering all those.

21 I'm inclined to ask a little bit more  
22 about what's going on with the 401(k) plans, and  
23 I'll tell you why and share your thoughts with me.

24 We -- we have an escalating older  
25 population here in PA. And, of course, we know

1 there's a price to longevity. When we look at  
2 people accessing their 401(k) plans, which, in the  
3 private sector is their retirement plan in this  
4 particular time and framework, people are living  
5 longer. This, I guess, is going to require them to  
6 work longer as well, if you're going to be  
7 borrowing against the 401(k) and having an  
8 opportunity now to do it, in some cases, without  
9 penalty, I would assume that, with most students  
10 wanting to go on to higher education and areas that  
11 are accessible to these funds, we may see more of  
12 that.

13 I'm looking at this bar graph, and it's  
14 a significant increase.

15 What is your thought, long term, on  
16 that piece of the economy? Aside from everything  
17 that's going on -- economy at large and  
18 corporations and their decisions and building  
19 jobs -- access to the 401(k)s in the numbers we're  
20 looking at on the chart, do you see that  
21 continuing? And do you agree with me on that  
22 having a significant impact?

23 MR. VAN NOORD: I would agree with you  
24 that it does have a significant impact. You  
25 mentioned the senior citizen out there. With CD

1 rates where they're at right now, the senior  
2 citizen is really being harmed greatly. It affects  
3 his current income level.

4           When we see increases in drawdowns from  
5 the 401(k), that's very disturbing, which means --  
6 it means you're not saving enough for retirement.  
7 And if you're not saving enough for retirement, you  
8 can't retire. So, therefore, you're in the work  
9 force longer, and that affects unemployment.

10           The statistics we're seeing right now  
11 in terms of cash balances or balances in a 401(k)  
12 are very disturbing. I mean, they're under  
13 \$50,000. And when you have \$50,000 in a 401(k),  
14 and you're looking for a fixed income investment,  
15 you're just -- you're just not able to live the  
16 lifestyle that you had once hoped you would live.

17           So it is a very alarming statistics.  
18 The statistics I showed in there were for the year  
19 ending December 31 of 2010. Every indication we've  
20 seen is that 2011 will be very, very similar, and  
21 it will be higher.

22           I would hope at some point in time that  
23 would reverse, but, you know, you are right on in  
24 the statement that you made.

25           REP. GINGRICH: I'm concerned about



1 that cycle, because it's a cycle that you just  
2 described. Can't retire because you can't afford  
3 to retire, have to keep the jobs, so the jobs are  
4 not available, and, ultimately, we end up with a  
5 very poor elderly population, which comes back, of  
6 course, on the government as we make our policies  
7 decisions and how we're going to care for those  
8 people.

9 So I really appreciate you having that  
10 chart in there along with all the other good  
11 information.

12 Thank you, Mr. Van Noord.

13 MR. VAN NOORD: You're welcome.

14 CHAIRMAN ADOLPH: Thank you,  
15 Representative.

16 Seeing no other questions, I want you  
17 thank you, Mr. Van Noord, for a very interesting  
18 and informative presentation and looking forward to  
19 be working with you during this budget process.

20 MR. VAN NOORD: Thank you. We do thank  
21 you for the opportunity to be here. We consider  
22 ourselves a resource for you. If there's ever  
23 anything that we can do, please call. And we look  
24 forward to seeing you on Thursday.

25 CHAIRMAN ADOLPH: Thank you.

1                   For the members' knowledge, the next  
2                   hearing will start immediately at 11 o'clock.

3                   Thank you.

4                   (Whereupon, the hearing concluded  
5                   at 10:44 a.m.)

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## REPORTER'S CERTIFICATE

I HEREBY CERTIFY that I was present upon the hearing of the above-entitled matter and there reported stenographically the proceedings had and the testimony produced; and I further certify that the foregoing is a true and correct transcript of my said stenographic notes.

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BRENDA J. PARDUN, RPR  
Court Reporter  
Notary Public

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COMMONWEALTH OF PENNSYLVANIA  
HOUSE OF REPRESENTATIVES  
APPROPRIATIONS COMMITTEE

MAIN CAPITOL  
ROOM 140  
HARRISBURG, PENNSYLVANIA

PUBLIC HEARING  
INDEPENDENT FISCAL OFFICE

TUESDAY, FEBRUARY 21, 2012  
11:02 A.M.

BEFORE:

- HONORABLE WILLIAM F. ADOLPH, JR.,  
Majority Chairman
- HONORABLE JOHN BEAR
- HONORABLE MARTIN CAUSER
- HONORABLE JIM CHRISTIANA
- HONORABLE GARY DAY
- HONORABLE GORDON DENLINGER
- HONORABLE BRIAN ELLIS
- HONORABLE MAUREE GINGRICH
- HONORABLE GLEN GRELL
- HONORABLE THOMAS KILLION
- HONORABLE DAVID MILLARD
- HONORABLE MARK MUSTIO
- HONORABLE BERNIE O'NEILL
- HONORABLE MICHAEL PEIFER
- HONORABLE SCOTT PERRY
- HONORABLE SCOTT PETRI
- HONORABLE TINA PICKETT

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1 BEFORE: (cont'd)

2 HONORABLE JEFFREY PYLE  
3 HONORABLE THOMAS QUIGLEY  
4 HONORABLE MARIO M. SCAVELLO  
5 HONORABLE CURT SONNEY  
6 HONORABLE JOSEPH MARKOSEK, Minority Chairman  
7 HONORABLE MATT BRADFORD  
8 HONORABLE MICHELLE BROWNLEE  
9 HONORABLE H. SCOTT CONKLIN  
10 HONORABLE PAUL COSTA  
11 HONORABLE DEBERAH KULA  
12 HONORABLE TIM MAHONEY  
13 HONORABLE MICHAEL O'BRIEN  
14 HONORABLE JOHN SABATINA  
15 HONORABLE STEVE SAMUELSON  
16 HONORABLE MATTHEW SMITH  
17 HONORABLE RONALD WATERS

18 ALSO PRESENT:

19 HONORABLE KERRY BENNINGHOFF  
20 HONORABLE JOHN EVANS  
21 HONORABLE RON MILLER  
22 HONORABLE BRENDAN BOYLE  
23 HONORABLE VANESSA LOWERY BROWN  
24 HONORABLE WILLIAM DEWEESE  
25 HONORABLE DAN FRANKEL

ED NOLAN, MAJORITY EXECUTIVE DIRECTOR  
MIRIAM FOX, MINORITY EXECUTIVE DIRECTOR  
DAN CLARK, COMMITTEE CHIEF COUNSEL

BRENDA J. PARDUN, RPR  
REPORTER - NOTARY PUBLIC

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P R O C E E D I N G S

CHAIRMAN ADOLPH: Thank you.

The next hearing will be with the Independent Fiscal Office. It's my pleasure to introduce Matthew Knittel, the director of the Independent Fiscal Office as well as Mark Ryan, the deputy director, and Jennifer Boger, senior budget analyst.

Good morning.

By way of background for the members, the Independent Fiscal Office was created by Act 120 of 2010. The Independent Fiscal Office was created to provide a nonpartisan fiscal analysis of economic, revenue, and budget issues to assist the general assembly and the governor.

The 2011-2012 budget made an appropriation of \$1.9 million to this office. The director was hired on September 19th, 2011, and there are currently three employees. The office expects to be fully staffed by this fall, with total a total of ten to eleven employees.

The major mandatory obligations of this office are, number one, publish a five-year outlook; number two, convene a revenue conference; and, number three, produce an initial revenue

1 estimate by May 1st of each fiscal year and produce  
2 an official estimate by June 15th of each fiscal  
3 year.

4 Thank you. And without further ado,  
5 Mr. Director, the time's yours.

6 DIRECTOR KNITTEL: Thank you.

7 Chairman Adolph, Chairman Markosek, and  
8 members of the committee, thank you for the  
9 opportunity to testify before you today.

10 The Independent Fiscal Office was  
11 created to provide revenue projections for the  
12 annual budget process and impartial fiscal analysis  
13 of economic, revenue, and budgetary issues. The  
14 office seeks to provide the public and the general  
15 assembly with information that can be used to  
16 evaluate the potential fiscal and economic  
17 implication of policy decisions.

18 Within that role, the office might  
19 estimate the economic or fiscal impact of a  
20 proposed policy, but will not recommend, support,  
21 or oppose any specific proposal.

22 For all analysis, the office will  
23 explain the methodology used as well as any  
24 assumptions or research that are incorporated  
25 therein.



1 I'd like to direct my brief comment  
2 towards three issues: the current status of the  
3 office, the economic outlook for 2012, and the  
4 revenue outlook for the rest of the fiscal year.

5 Turning to the office status, I started  
6 in my capacity as director of the Independent  
7 Fiscal Office on September 19. Two additional  
8 staff joined in November and December so that the  
9 office currently employs three individuals.

10 We anticipate hiring two more staff  
11 during the next few weeks. And we expect that the  
12 office will be fully staffed by the end of the  
13 fall, at which point the office will have ten to  
14 eleven individuals.

15 For FY '12-'13, the executive budget  
16 proposed an appropriation of 1.805 million. And  
17 after taking into account expected operating costs  
18 and miscellaneous, one-time expenditures, we do  
19 anticipate that that appropriation will be  
20 sufficient to fund the office for the current  
21 fiscal -- the next fiscal year once we're fully  
22 staffed.

23 Since its establishment a little more  
24 than four months ago, the office has published a  
25 five-year outlook report, convened a revenue

1 conference, and established an office website, and  
2 we view those achievements as basic templates for  
3 future activity, and we will expand upon those  
4 efforts once the office is fully staffed and  
5 acquired the necessary data and statistical  
6 packages to perform more rigorous analysis.

7           Turning to the economic outlook, the  
8 table submitted with this testimony details  
9 selected series from the economic forecast provided  
10 by IHS Global Insight for January 2012. That  
11 forecast was used for the recent release of the  
12 executive budget.

13           The 2012 forecast has weakened since  
14 the official estimate for the current fiscal year  
15 was released last June. The weaker economics  
16 explain much of the decline in expected revenues  
17 for the year.

18           For both the U.S. and PA, real output  
19 and employment were revised down for most years,  
20 while unemployment rates were revised up.

21           The January economic forecast calls for  
22 modest real growth for the Commonwealth for 2012 of  
23 1.6 percent and modest real growth in nominal wage  
24 income of 3.5 percent. The projected unemployment  
25 rate remains at 7.9 percent for the year, and

1 average unemployment -- average employment levels  
2 increased by 66,000 jobs.

3 The forecast also suggests that the  
4 housing market bottomed out in 2011, as existing  
5 home sales and new homes sales increase in 2012.

6 Overall, we believe that the economic  
7 forecast is plausible but leans slightly  
8 pessimistic. Some very recent economic reports  
9 suggest that growth could be a bit more robust than  
10 the current forecast.

11 At the revenue conference the office  
12 hosted last month, several presenters commented on  
13 the improving outlook for states. The presentation  
14 by the National Conference of State Legislatures  
15 show that the state revenue collections are now  
16 generally in line with projections. Another  
17 presentation from the Philadelphia Federal Reserve  
18 show that leading economic indicators for the  
19 Commonwealth are positive, suggesting a guardedly  
20 optimistic outlook.

21 We believe that if the labor market  
22 continues to improve, then it will bolster consumer  
23 confidence and imply additional spending, hiring,  
24 and investment.

25 Turning to the year-to-date revenues,

1 through January, year-to-date general fund tax  
2 revenues have fallen short of the levels projected  
3 at the time the budget was enacted, by \$497  
4 million, approximately 3.5 percent. However, they  
5 have shown a modest increase year over year of \$326  
6 million, approximately 2.4 percent.

7           Looking forward to the remainder of the  
8 fiscal year, we expect a modest final payment for  
9 April personal income taxes; continued growth in  
10 sale taxes, especially motor vehicle taxes, which  
11 have shown strong growth for the first half of the  
12 fiscal year; a weak final payment for corporations;  
13 and realty transfer tax payments that slowly  
14 reflect an improving housing market.

15           Overall, we do not anticipate a spring  
16 surprise similar to the one that occurred last year  
17 when we had a surge in personal income and  
18 corporate income tax final payments; however, we do  
19 anticipate that revenues will reflect an economy  
20 that is gradually gaining strength.

21           We also anticipate significant  
22 head winds from the scheduled expiration of many  
23 federal tax provisions in 2013. The expiring  
24 provisions include the payroll tax cut; reduced  
25 capital gains and dividend tax rates; lower tax

1 rate brackets; higher child tax credits; the  
2 reinstatement of limitations on the itemized  
3 deductions and personal exemption phaseout, known  
4 as PEP and Pease; and the elimination of all  
5 federal bonus depreciation and higher Section 179  
6 expensing thresholds.

7 Automatic spending cuts are also  
8 scheduled to occur. If current law remains  
9 unchanged, these actions will have a significant  
10 impact on the disposable income of Commonwealth  
11 residents and general fund tax revenues. The  
12 office is currently working to quantify that impact  
13 as part of its preliminary revenue estimate on May  
14 1st.

15 Thank you. And I'd be happy to answer  
16 any questions that you might have.

17 CHAIRMAN ADOLPH: Thank you.

18 I have just a couple short, little  
19 questions regarding the Independent Fiscal Office  
20 itself. Where are you located?

21 DIRECTOR KNITTEL: We're currently  
22 located in the North Office Building, on the first  
23 floor.

24 CHAIRMAN ADOLPH: North Office  
25 Building.

1                   DIRECTOR KNITTEL: And we're scheduled  
2 to move next week to the Rachel Carson Building, on  
3 the second floor.

4                   CHAIRMAN ADOLPH: Okay. And we had  
5 appropriated \$1.9 million to your office for the  
6 current fiscal year, and based upon -- we're  
7 looking at the entire Independent Fiscal Office  
8 right now?

9                   DIRECTOR KNITTEL: That's correct.

10                  CHAIRMAN ADOLPH: You three folks?  
11 Okay. The \$1.9 million, I'm sure, is not being  
12 divided among you three; is that correct?

13                  DIRECTOR KNITTEL: That is correct.

14                  CHAIRMAN ADOLPH: That's correct.  
15 Okay.

16                  So we should have some excess money  
17 left over in the Independent Fiscal Office come  
18 June 30th?

19                  DIRECTOR KNITTEL: That's correct. We  
20 do have some large, one-time expenditures coming up  
21 for our office furniture, computers,  
22 infrastructure, but we do anticipate there'll be  
23 moneys left over.

24                  CHAIRMAN ADOLPH: Okay. And I'm  
25 looking forward to your first report to the general

1 assembly.

2 Chairman Markosek.

3 REP. MARKOSEK: Thank you, Chairman.

4 Just the question that you asked,  
5 Chairman, was one of the best ones I've heard here  
6 since we've been doing these: Where are you  
7 located.

8 Your fiscal report is due in May?

9 DIRECTOR KNITTEL: That's correct. May  
10 1st.

11 REP. MARKOSEK: Okay. What do you --  
12 what do you base that on, and -- how do you get  
13 your information, I guess, is a better way to ask  
14 that question. You have -- I think I know the  
15 answer, but perhaps for the -- just some general  
16 information here, what kind of consultants do you  
17 use or don't use? And where else do you get your  
18 information from?

19 DIRECTOR KNITTEL: Yeah. Our main data  
20 will be of two varieties. One will be nonpublic  
21 data. This would be tax data, that the office is  
22 currently work with revenue department to secure,  
23 that we will be using for purposes of projections  
24 and for scoring out proposed changes to tax  
25 policy. The other ones are publicly available,

1 things that would be on the Bureau of Labor  
2 Statistics BEA websites, things of that nature,  
3 that we'll be using to -- constructing the models  
4 and projecting revenues forward.

5 REP. MARKOSEK: Has the revenue  
6 department been cooperative?

7 DIRECTOR KNITTEL: Yes. So far we've  
8 met several times with the revenue department,  
9 three or four times, and we've had good discussions  
10 with them and are making good progress.

11 REP. MARKOSEK: Okay. They're going to  
12 be in this afternoon, any questions that you have  
13 for us to ask them?

14 DIRECTOR KNITTEL: Not immediately, no.

15 REP. MARKOSEK: All right.

16 Thank you, Mr. Chairman.

17 CHAIRMAN ADOLPH: Thank you, Chairman.  
18 Rep. Gordon Denlinger.

19 REP. DENLINGER: Thank you,  
20 Mr. Chairman.

21 Thank you for your testimony.

22 Two questions that are somewhat  
23 unrelated, but as we're getting to know you and  
24 you'll be a key part to this whole budget process,  
25 first, could you give us -- we're not the Senate



1 side so we don't do the whole approval process --  
2 could you give us a brief kind of biographical  
3 snapshot of your professional background?

4 And I'm going to go ahead and give the  
5 second question right away. You touched on the  
6 subject of the bonus depreciation issue. We're  
7 obviously very interested in that from a policy  
8 standpoint. It effectively ended, I guess, at the  
9 end of 2011. Do you have a metric that you can  
10 share with us on what the impact to PA tax  
11 collections and revenue will be as we're now  
12 getting into this next cycle?

13 DIRECTOR KNITTEL: Um-hum. Sure.

14 Responding to your first question, I  
15 receive my masters and doctorate from Michigan  
16 State University. Shortly thereafter, I worked for  
17 four years at the Michigan Department of Treasury,  
18 which doubles as their revenue department. In  
19 1998, I accepted a position with the U.S. treasury  
20 department, where I was an analyst mainly for  
21 corporate income taxes and business taxes  
22 generally. And I worked there until 2011.

23 I have also taught at George Washington  
24 and Johns Hopkins Universities periodically.

25 Regarding your second question on bonus

1 depreciation, yes, our office is tracking that very  
2 closely, and moving forward, it does make a big  
3 difference how one characterizes what's occurring  
4 in this fiscal year, because if a lot of the  
5 shortfall is due to bonus depreciation, those  
6 revenues will be made up in the next three to four  
7 years. However, if it is really a shortfall in  
8 profits, then we won't make those moneys up.

9           Looking at the provision, we do think,  
10 generally, that the bonus provision has contributed  
11 to the shortfall this fiscal year. We cannot  
12 exactly quantify that until we get the tax return  
13 data in; however, we do think it was a bit more  
14 than the official revenue estimate.

15           REP. DENLINGER: Are you hearing any  
16 indications from your sources that the Obama  
17 administration's considering a re-up of that  
18 provision?

19           DIRECTOR KNITTEL: I have heard talk  
20 about it. At the federal level, of course, we do  
21 have 50 percent bonus depreciation for 2012. How  
22 it will turn out, I'm unsure.

23           REP. DENLINGER: Thank you.

24           Thank you, Mr. Chairman.

25           CHAIRMAN ADOLPH: Thank you.

1                   Rep. Mario Scavello.

2                   REP. SCAVELLO: Thank you,  
3 Mr. Chairman.

4                   And thank you for your testimony.

5                   The first question that I had, when the  
6 chairman asked where you're located, you know, in  
7 the Irvis Building, all the judicial moved out and  
8 moved across the street. There's plenty of room up  
9 there. Is there any inquiries about possibly  
10 coming in-house and saving taxpayer dollars, rather  
11 than renting? Was that a possibility? Did you  
12 talk to anyone about that?

13                  DIRECTOR KNITTEL: We're not paying --  
14 in the Rachel Carson Building, we won't be paying  
15 rent.

16                  REP. SCAVELLO: You won't be paying  
17 rent?

18                  DIRECTOR KNITTEL: That's correct.

19                  REP. SCAVELLO: What is your projection  
20 for -- for revenue for this -- this coming year, in  
21 dollars? What would you project added dollars to  
22 the state budget?

23                  DIRECTOR KNITTEL: The official  
24 projection right now is a shortfall of about \$719  
25 million, and our take on the economic assumptions,

1 we're a bit more optimistic moving forward. We do  
2 think there's some reports that have come out that  
3 suggest a bit more of an optimistic outlook. And,  
4 in fact, if you look at the global insight forecast  
5 for February versus the one that was used in  
6 January for the budget, things have gotten a little  
7 better.

8 So we do think that the shortfall will  
9 be somewhat less than \$719 million.

10 REP. SCAVELLO: Okay. In our  
11 projection for 2012-2013, what could we estimate in  
12 increased revenue? Do you have an idea?

13 DIRECTOR KNITTEL: We haven't looked at  
14 that year yet. We'll do that for our May 1st  
15 release.

16 REP. SCAVELLO: Because for the  
17 governor's budget, his spending numbers, we'd like  
18 to see what the revenues would be to offset that.

19 I think -- I would have loved to have  
20 your office for the past eight years, would have  
21 been great for us. Unfortunately, you weren't here  
22 then.

23 But thank you very much, and I wish you  
24 the best.

25 DIRECTOR KNITTEL: Thank you.

1 CHAIRMAN ADOLPH: Thank you.

2 Rep. O'Brien.

3 REP. O'BRIEN: Thank you,  
4 Mr. Chairman.

5 Welcome.

6 DIRECTOR KNITTEL: Thank you.

7 REP. O'BRIEN: As you know, your office  
8 had a bit of a rocky birth.

9 DIRECTOR KNITTEL: I've learned that,  
10 yes.

11 REP. O'BRIEN: Little bit of a rocky  
12 birth. But I have to say, the three of you are --  
13 come with good reputations and good regard.

14 But on the flip side, it has been said  
15 that your office is tasked to do what the four  
16 appropriation staffs have done over the years. So  
17 let's take a moment and be prospective.

18 Where do you see your office in five  
19 years, doing what? What will be your asset to the  
20 Commonwealth five years down the road?

21 DIRECTOR KNITTEL: Long term, the way I  
22 view the office, again, very broadly, as an  
23 information provider. And I would fall back on the  
24 federal model, where I view the office as combining  
25 the duties of the joint committee on taxation and

1 the congressional budget office. So anything that  
2 has to do with economic or fiscal or budgetary  
3 issues, that our office would be able to provide an  
4 analysis of that, both to the general assembly and  
5 to the public.

6 And we will also have access to data  
7 that are not currently available to the caucuses,  
8 in particular tax data, to do those analyses.

9 REP. O'BRIEN: Thank you.

10 Thank you, Mr. Chairman.

11 CHAIRMAN ADOLPH: Thank you,  
12 Representative.

13 Rep. Mauree Gingrich.

14 REP. GINGRICH: Thank you,  
15 Mr. Chairman.

16 Welcome aboard.

17 DIRECTOR KNITTEL: Thank you.

18 REP. GINGRICH: You're going to find it  
19 an interesting ride with all of us, I'm sure.

20 We talked a little bit just now about  
21 your projections. I don't expect you to be a  
22 soothsayer, but part of your job, of course, is the  
23 revenue projections.

24 This morning, before this session, we  
25 talked a lot about the global economy in general

1 and the factors there. So there's a differential,  
2 obviously, in what you stated again this morning,  
3 and I read before, the numbers that you project  
4 versus what the governor shared with us in his  
5 budget proposal.

6           So we're all kind of curious about  
7 where that difference lies. For one thing, whether  
8 this is the governor's floor, and, you know, an  
9 expectation. As you said, things can get better,  
10 but things don't necessarily have to get better.

11           DIRECTOR KNITTEL: True

12           REP. GINGRICH: There's a flip side to  
13 that.

14           On the heels of what we discussed this  
15 morning, and my filling up my tank on the way to  
16 Harrisburg today, and everything I've heard this  
17 past week from all the pundits on the news and our  
18 projections for gasoline prices, how do you  
19 anticipate things like that, and maybe even just  
20 specifically the impact of gasoline cost, which is  
21 a major driver in the economy at every level,  
22 individually and on the business side? How  
23 confident are you or can you continue to be -- tell  
24 me how you're going to do this without firm  
25 numbers. Or we just have to wait until you get

1 those firm numbers? We've got to make decisions  
2 posthaste here.

3 DIRECTOR KNITTEL: Yeah. Absolutely.

4 REP. GINGRICH: Thanks.

5 DIRECTOR KNITTEL: Sure.

6 Regarding what we assume in all the  
7 models that we're going to construct, of course  
8 we'll be using the input from global insight,  
9 the -- our economics providers, which is the same  
10 as the Office of the Budget, the same as the  
11 revenue department. So what their assumptions will  
12 be about the price of gas or disposable income or  
13 wage income will be fed into our models. And we  
14 will be checking them closely to make sure they  
15 look reasonable and plausible and to make sure that  
16 they're lining up with what we're observing in the  
17 receipts. And if they don't line up with what we  
18 see in the receipts, then, of course, you want to  
19 make some adjustment, a technical adjustment, to  
20 your models, to adjust the output of it. So we'll  
21 be watching those closely.

22 And as you noted, certainly gasoline,  
23 the rising price of gasoline, is a major concern  
24 moving forward, taking less -- having -- consumers  
25 have less disposable income.



1                   But broadly speaking, we do think that  
2 the consumer outlook is very important. The  
3 expectations, the sentiment appears to be  
4 improving. We do hope that we'll get some more  
5 wealth effects moving forward, both from the stock  
6 market and from improving house prices, and that  
7 will lead to more spending. We do think that  
8 businesses are ready to expand, and they have the  
9 liquidity to do so.

10                   REP. GINGRICH: Thanks.

11                   We talked this morning about confidence  
12 in major industries, too, and how they're holding  
13 on to an awful lot of their cash, and one of the  
14 reasons it stuck with me is they have fresh  
15 memories of what happened just a couple years ago.  
16 So does the consumer.

17                   And when the gas -- just, for instance,  
18 when the gasoline prices go up, that's going to  
19 alter how many times I go to the store to buy and  
20 how many decision we make per vacations. And all  
21 of those wonderful things that we were projecting  
22 will continue to increase on the sales tax and  
23 consumer side. So, I think we're all paying close  
24 attention.

25                   Thanks.

1                   CHAIRMAN ADOLPH: Thank you,  
2 Representative.

3                   Rep. Paul Costa.

4                   REP. COSTA: Thank you, Mr. Chairman.  
5                   And thank you all for testifying here  
6 today.

7                   I'm just curious, May 1st your first  
8 report comes out. What happens if there's a  
9 disparity between the four caucuses and your  
10 group? Whose numbers do we follow?

11                  DIRECTOR KNITTEL: We do hope to meet  
12 with the caucuses on a regular basis and to share  
13 information about what we're seeing, and there's a  
14 lot of expertise out there, and we want to take  
15 that into consideration.

16                  I would anticipate that numbers would  
17 differ, both between us and the caucuses, the  
18 numbers that they're carrying, as well as the  
19 Office of the Budget. And we view that not as a  
20 bad thing, because then you can work through the  
21 numbers and the differences and understand what's  
22 driving them. Is it technical assumptions? Is it  
23 economic assumptions? Are there behavioral  
24 parameters therein?

25                  So I would anticipate that the numbers

1 would be somewhat different, but as long as you can  
2 pin them down to the reasons, reasonable people can  
3 be looking at the same sets of figures and come up  
4 with somewhat different numbers.

5 REP. COSTA: But there's no hierarchy  
6 you would have to work it out. You don't have the  
7 authority over the caucuses or vice versa?

8 DIRECTOR KNITTEL: No. We'll publish  
9 our numbers on May 1st and again on June 15th. And  
10 what the governor signs off on, our numbers can be  
11 used or they need not be used.

12 REP. COSTA: So the governor has the  
13 last say.

14 DIRECTOR KNITTEL: Yes.

15 REP. COSTA: Okay.

16 Thank you, very much.

17 CHAIRMAN ADOLPH: Thank you.

18 Rep. Gary Day.

19 REP. DAY: Thank you.

20 Thank you for being here today.

21 My questions are along the lines of  
22 revenue forecasting as well. Can you explain --  
23 I'll ask you the questions and then you can  
24 answer.

25 Can you explain the methods for the

1 forecasting? You mentioned in your comments just  
2 now that you intend to use the same data input or  
3 variables in your forecasting.

4           The other specific question I want to  
5 ask is, do you see in the future using a different  
6 set of variables or data than we have been using or  
7 that -- that maybe each of the caucuses would be  
8 using different data than you?

9           DIRECTOR KNITTEL: That's certainly  
10 possible. Again, I think there's some value to all  
11 parties using the same underlying economic  
12 assumptions, as long as they're plausible and  
13 reasonable, because there's going to be a lot of  
14 differences, even holding those assumptions  
15 constant moving forward. Again, there's technical  
16 parameters or behavioral assumptions that would be  
17 built into the estimates. And if you add different  
18 economic forecasts in there as well, then the  
19 numbers, it's hard to compare them, to make an  
20 apples-to-apples comparison.

21           However, again, we will be looking at  
22 our economics provider very closely, making sure  
23 that things look reasonable. We have had some  
24 questions with them. They've been very responsive  
25 to this point.

1           Regarding the models, there's a number  
2 of different models one could use moving forward  
3 for these projections. You can use a simple time  
4 series model, you can use a structural equation  
5 model, some extrapolations procedures. So there's  
6 a lot of room for differences, depending on the  
7 model one chooses and the explanatory variables  
8 used with them.

9           REP. DAY: Have you explored -- you  
10 mentioned time series. That was kind of -- my next  
11 question is, judgmental, consensus, or time -- you  
12 know, what methods -- have you seen that the  
13 caucuses have used time series or -- and, you know,  
14 whatever information you have about what current  
15 methods are used and what which ones you're willing  
16 to explore.

17           DIRECTOR KNITTEL: Yeah. I'm not sure  
18 what methodology the caucuses use right now. Of  
19 course, the revenue department puts out their  
20 methodology guide. We have looked at that.

21           My experience has been, for very short-  
22 run forecast, maybe one or two years out, that time  
23 series models do very well. They performed -- it's  
24 hard to beat them.

25           REP. DAY: And the last question is,

1 could you explain a revenue conference that's one  
2 of things that you have to do, and could you just,  
3 for my education, what is written, and also if you  
4 plan to expand on what -- whatever you think it is,  
5 and whatever you think it will be?

6 DIRECTOR KNITTEL: Absolutely. So this  
7 past year, in January, we hosted our first revenue  
8 estimating conference, and we -- in addition to our  
9 office there were four other groups making  
10 presentations. And the idea was to get a general  
11 sense of the outlook of the -- the economic outlook  
12 for the U.S. and the Commonwealth and see what the  
13 revenue trends were like moving forward, to  
14 exchanges ideas. And we do hope to expand on that  
15 moving forward, and -- but, again, it would be  
16 hosted in January. By statute, we have to host it  
17 by January 31st.

18 REP. DAY: Thank you for your answers.

19 And thank you, Mr. Chairman.

20 CHAIRMAN ADOLPH: Thank you.

21 Rep. Matt Bradford.

22 REP. BRADFORD: Thank you, Chairman.

23 I just had a question in follow-up on  
24 the question of capital -- of bonus depreciation,  
25 the accelerated depreciation.

1                   My understanding is that the federal  
2 law, obviously at the federal level, said -- or  
3 basically allowed the states to opt-in, and  
4 Pennsylvania chose or elected to opt in to that.  
5 How did that exactly work?

6                   DIRECTOR KNITTEL: My understanding is  
7 that with the -- it was a technical interpretation,  
8 and with the hundred percent, the interpretation  
9 was that PA could conform to the federal  
10 provision.

11                  REP. BRADFORD: Okay. So that was the  
12 secretary of Revenue and the governor's decision,  
13 basically, to elect into that?

14                  DIRECTOR KNITTEL: I'm not sure whose  
15 ultimate decision it was, but my understanding, it  
16 was a technical interpretation.

17                  REP. BRADFORD: What was the cost of  
18 that tax expenditure to the Commonwealth? I know  
19 you said it was higher than what was budgeted, but  
20 do we have any idea what the final cost of that  
21 corporate tax cut was?

22                  DIRECTOR KNITTEL: For conforming to  
23 the 100 bonus?

24                  REP. BRADFORD: Yes.

25                  DIRECTOR KNITTEL: Again, let me

1 emphasize we don't have the tax data yet to exactly  
2 quantify that, but using some extrapolation from  
3 existing data, we think it might be roughly 300 to  
4 350 million in total. Again, most of those moneys  
5 will be made up in the next three to four years.

6 REP. BRADFORD: And what was the -- do  
7 you recollect what was the budgeted amount? Was it  
8 like 200 million was what the governor expected the  
9 cost of that tax break?

10 DIRECTOR KNITTEL: I believe 200 was  
11 the official, the original estimate. Correct.

12 REP. BRADFORD: Okay.

13 Similar -- similar issue, I was  
14 wondering about, one of your projection for modest  
15 wage growth was 3.5 percent.

16 DIRECTOR KNITTEL: Correct.

17 REP. BRADFORD: One of the things  
18 that's coming up a lot now is the issue of wage and  
19 equality, and as we're talking about wage growth is  
20 who's actually seeing more dollars in their bank,  
21 who's seeing more dollars in their payroll. We're  
22 seeing -- and the numbers earlier indicated that  
23 corporations are seeing high bankrolls and are  
24 sitting on that cash, and we're seeing modest wage  
25 growth.



1           Even among that wage growth, have you  
2 started to look at who's going to see that growth?  
3 Is it the bottom? The top? Who's seeing the wage  
4 growth in terms of our earners? Is it being evenly  
5 distributed?

6           DIRECTOR KNITTEL: We haven't looked at  
7 that issue yet. What we do see in the data, and,  
8 again, the jobs data, payroll, employment numbers,  
9 where most of the gains and the jobs are coming are  
10 in the service sector. And those are generally a  
11 bit lower paying than other jobs, say, in the  
12 manufacturing sector. Although manufacturing is  
13 also showing some gains moving forward, but,  
14 disproportionately, the gains are in the service  
15 sector, and that's just a trend of past job gains.

16          REP. BRADFORD: So the actual  
17 employment gains are in the service sector?

18          DIRECTOR KNITTEL: Most of them.

19          REP. BRADFORD: Are we actually seeing  
20 wage increases, though, at all levels in all  
21 sectors, or are we seeing it --

22          DIRECTOR KNITTEL: That, we haven't  
23 examined yet, whether it's being -- there's an even  
24 distribution over all professions and income  
25 distributions, whether they're all gaining in a

1 similar fashion, I'm not sure.

2 REP. BRADFORD: Thank you, Chairman.  
3 Thank you for the questions.

4 CHAIRMAN ADOLPH: Thank you.

5 I believe that's the last question on  
6 the first round. And second round, we'll start  
7 with Rep. Mario Scavello.

8 REP. SCAVELLO: Thank you,  
9 Mr. Chairman.

10 I want to go back to bonus  
11 depreciation. I know that the governor had  
12 estimated 200 million in the first year. And that  
13 350 you mentioned is over the life, correct, in  
14 which we get that back?

15 DIRECTOR KNITTEL: Yeah. The 350 would  
16 be what we call a liability effect.

17 REP. SCAVELLO: Exactly. And, you  
18 know, I was receiving e-mails all last year that  
19 that number was like 750, 800 million, in that  
20 area, and I knew that those numbers weren't  
21 accurate. So it's money that we're going to get  
22 back anyway, so 200 that first year was accurate,  
23 that budget number was accurate.

24 DIRECTOR KNITTEL: My understanding was  
25 that there was 70 million in last fiscal year and a

1 hundred thirty in this fiscal year, so --

2 REP. SCAVELLO: Okay. Thank you.

3 CHAIRMAN ADOLPH: Thank you.

4 Mr. Director, I guess my question would  
5 be, regarding the gross receipts tax, something  
6 specifically in the governor's budget that caught  
7 many of our eyes. He calls for about a 30 percent  
8 increase in the growth receipts collection for the  
9 fiscal year '12-'13, which is about a 30 percent  
10 increase. The last several years the gross  
11 receipts tax has declined about -- maybe 15  
12 percent, 16 percent. Your thoughts?

13 DIRECTOR KNITTEL: Yeah. We did meet  
14 with revenue department on Friday of last week  
15 and -- excuse me, the previous Friday, and we were  
16 talking through that issue with them. And they  
17 walked us through their reasoning for the large  
18 increase. And it does appear to be that there's  
19 some timing issues going on, some safe harbor  
20 issues as well as customers switching providers.

21 And, clearly, when you look at the tax  
22 data, there is a decline in the remittances, mainly  
23 by telecom firms. So it does look a little strong  
24 to us, and we're looking at it a bit more closely  
25 and working with the revenue department to see if

1 that will hold up.

2 CHAIRMAN ADOLPH: Can you explain to  
3 the committee members as well as the viewers out  
4 there exactly what the gross receipts tax is?

5 DIRECTOR KNITTEL: It's just a levy on  
6 telecom and electric utility providers to -- of 59  
7 mills or 50 mills on the annual value of the  
8 production.

9 CHAIRMAN ADOLPH: Thank you for that  
10 explanation.

11 Next question is Rep. Matt Smith.

12 REP. SMITH: Thank you, Mr. Chairman.

13 Thank you for your testimony today.

14 Just a quick question on the timing as  
15 it relates to your office's revenue estimates.

16 It's my understanding that on May 1st, annually,  
17 you'll submit sort of a preliminary initial review  
18 of the revenue estimate for the upcoming fiscal  
19 year. Is that correct?

20 DIRECTOR KNITTEL: That's correct.

21 REP. SMITH: And then on June 15th  
22 every year you'll submit what is the official  
23 revenue estimate from your office. Is that  
24 correct?

25 DIRECTOR KNITTEL: That's correct.

1                   REP. SMITH: Is there a material  
2 difference, in your estimation, between what you're  
3 able to submit on May 1st versus June 15th, and if  
4 so, what is the difference?

5                   DIRECTOR KNITTEL: There shouldn't be  
6 too much difference in terms of the economic data  
7 that are fed into our models. We'll only have one  
8 more month of data. It really won't change things  
9 too much.

10                   What could be a bit different are some  
11 of the tax payments that come in. In particular,  
12 we've been told that we could take the June 15th  
13 final -- excuse me, estimated payment for  
14 corporations into consideration. So that could  
15 move things a bit.

16                   REP. SMITH: So the June 15th estimate  
17 would obviously be the -- I don't want to  
18 overstate, but the much more accurate view of what  
19 the revenue intake will be for the coming fiscal  
20 year.

21                   DIRECTOR KNITTEL: Yes. But I wouldn't  
22 think things change too much between the May 1st  
23 and the June 15th.

24                   REP. SMITH: Okay.

25                   Thank you, Mr. Chairman.

1                   CHAIRMAN ADOLPH: Thank you.

2                   Rep. Gary day.

3                   REP. DAY: One more question about  
4 projections.

5                   Is there a measure of accuracy of  
6 projections, like percent error or something like  
7 that that you plan to use to monitor your own  
8 performance?

9                   DIRECTOR KNITTEL: Most definitely.  
10 We'll be tracking those, much like the  
11 congressional budget office does. They have a  
12 methodology to track their forecast accuracy.

13                  REP. DAY: What is that called? What  
14 do you call that?

15                  DIRECTOR KNITTEL: I'm not sure the  
16 official term they give to it.

17                  REP. DAY: Okay.

18                  Do you plan to publish that measure for  
19 your own office? The governor's going to give you,  
20 in his budget, right, the governor and the four  
21 caucuses. Is there a way that you can publish the  
22 error difference on the estimates for everyone?

23                  DIRECTOR KNITTEL: Sure. If there's  
24 interest in that, we'd be happy to do so. That's  
25 easily done.

1 REP. DAY: Thank you very much.

2 Thank you, Mr. Chairman.

3 CHAIRMAN ADOLPH: Thank you for that,  
4 Representative.

5 Seems to be all the questions for  
6 today.

7 I have one final question. I know  
8 everybody that was on this committee last year and  
9 was in this general assembly remembers the debate  
10 that was going on regarding the amount of surplus  
11 versus -- that was left over from last year.

12 Have you had an opportunity to analyze  
13 last year's revenues over expenses, and could  
14 you -- could you explain that to the members of  
15 this committee briefly.

16 DIRECTOR KNITTEL: We haven't had a  
17 chance to look at it too closely. I do know,  
18 looking at the pattern of payments, there was some  
19 very unusually large payments that one wouldn't  
20 have expected last year, both on the corporate and  
21 the individual side. They looked very usual.

22 CHAIRMAN ADOLPH: If I may, I would  
23 appreciate if you could go into further detail for  
24 this committee, because, you know, obviously, it's  
25 a reaction that legislators will have that, you

1 know, coming out of the recession, and all of a  
2 sudden you have one good month, that to react in a  
3 way that, hey, happy days are here again.

4           And I think we can learn from just last  
5 year that you still have to be very careful in this  
6 fragile economy. And, I know, Rep. Smith, and I  
7 would agree him, you know, the longer you go  
8 towards the end of the fiscal year, you get a  
9 better look at the revenue because you actually  
10 know what came in, instead of projecting it. And I  
11 can understand that.

12           But sometimes, current revenue is not  
13 always what's going to be in next month and -- or  
14 six months forthcoming, and I would look -- I'd  
15 like, in your reports to us, I'd like you to  
16 discuss that a little bit.

17           DIRECTOR KNITTEL: Sure

18           CHAIRMAN ADOLPH: And then, finally,  
19 how does PA's economy compare to the surrounding  
20 states, if not nationwide? If you could comment on  
21 that a little bit for us. Thank you.

22           DIRECTOR KNITTEL: Sure. Be happy to.

23           Oh, right now?

24           CHAIRMAN ADOLPH: Right now. Right  
25 now.



1                   DIRECTOR KNITTEL: I do think the PA  
2 economy has been performing well and outperforming  
3 many of the surrounding states, and, certainly, if  
4 you look across the nation, has been doing much  
5 better than a number of states, and there are  
6 various factors for that, both on the demographic  
7 makeup and, of course, with the certain industries  
8 that are experiencing very significant growth,  
9 mining being one of them. But there's a number of  
10 factors that are helping the Commonwealth moving  
11 forward.

12                   And I would anticipate, much like when  
13 we went down into the recession, PA didn't suffer  
14 as much as some others, coming out of it, we might  
15 not have the growth that some of the others  
16 experience for the same reasons.

17                   CHAIRMAN ADOLPH: Okay.

18                   At this time, I'd like to acknowledge  
19 the presence of Rep. Scott Petri of Buck County,  
20 who joined us earlier today.

21                   Any other questions of any members?

22                   Seeing none, hearing none, I'd like to  
23 thank the Independent Fiscal Office for your first  
24 appearance at testifying before the House  
25 Appropriations Committee. I appreciate your

1 insight and looking forward to working with you.

2 For the members understanding, our next  
3 presentation will be at 1:30 p.m.

4 Thank you.

5 (Whereupon, the hearing concluded  
6 at 11:38 a.m.)

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## REPORTER'S CERTIFICATE

I HEREBY CERTIFY that I was present upon the hearing of the above-entitled matter and there reported stenographically the proceedings had and the testimony produced; and I further certify that the foregoing is a true and correct transcript of my said stenographic notes.

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BRENDA J. PARDUN, RPR  
Court Reporter  
Notary Public