

COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES

APPROPRIATIONS
COMMITTEE HEARING

STATE CAPITOL
HARRISBURG, PA

MAIN CAPITOL BUILDING
ROOM 140

MONDAY, FEBRUARY 10, 2014
10:01 A.M.

BUDGET HEARING
INDEPENDENT FISCAL OFFICE

BEFORE:

HONORABLE WILLIAM ADOLPH, MAJORITY CHAIRMAN
HONORABLE RYAN AUMENT
HONORABLE KAREN BOBACK
HONORABLE JIM CHRISTIANA
HONORABLE GARY DAY
HONORABLE BRIAN ELLIS
HONORABLE GARTH EVERETT
HONORABLE GLEN GRELL
HONORABLE SETH GROVE
HONORABLE ADAM HARRIS
HONORABLE TOM KILLION
HONORABLE DAVID MILLARD
HONORABLE MARK MUSTIO
HONORABLE DONNA OBERLANDER
HONORABLE BERNIE O'NEILL
HONORABLE MIKE PEIFER
HONORABLE SCOTT PETRI
HONORABLE JEFFREY PYLE
HONORABLE CURT SONNEY
HONORABLE JOSEPH MARKOSEK, DEMOCRATIC CHAIRMAN
HONORABLE MATTHEW BRADFORD
HONORABLE MICHELLE BROWNLEE
HONORABLE MIKE CARROLL
HONORABLE SCOTT CONKLIN

BEFORE (cont'd):

HONORABLE MADELEINE DEAN
HONORABLE DEB KULA
HONORABLE TIM MAHONEY
HONORABLE MICHAEL O'BRIEN
HONORABLE CHERELLE PARKER
HONORABLE JOHN SABATINA
HONORABLE STEVEN SANTARSIERO
HONORABLE JAKE WHEATLEY

ALSO IN ATTENDANCE:

HONORABLE KERRY BENNINGHOFF
HONORABLE GEORGE DUNBAR
HONORABLE MARGUERITE QUINN
HONORABLE MAUREE GINGRICH
HONORABLE JOE HACKETT
HONORABLE STEVE MENTZER
HONORABLE MARK GILLEN
HONORABLE TIM HENNESSEY
HONORABLE VANESSA LOWERY BROWN
HONORABLE STEVE SAMUELSON
HONORABLE PAM DELISSIO
HONORABLE EDDIE PASHINSKI
HONORABLE PHYLLIS MUNDY

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*Pennsylvania House of Representatives
Commonwealth of Pennsylvania*

COMMITTEE STAFF PRESENT:

DAVID DONLEY

MAJORITY EXECUTIVE DIRECTOR

RITCHIE LAFAVER

MAJORITY DEPUTY EXECUTIVE DIRECTOR

DAN CLARK

MAJORITY CHIEF COUNSEL

MIRIAM FOX

DEMOCRATIC EXECUTIVE DIRECTOR

BERYL KUHR

DEMOCRATIC CHIEF COUNSEL

I N D E X

TESTIFIERS

* * *

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DIRECTOR,	
INDEPENDENT FISCAL OFFICE.....	12

SUBMITTED WRITTEN TESTIMONY

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(See submitted written testimony and handouts online.)

P R O C E E D I N G S

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3 MAJORITY CHAIRMAN ADOLPH: Good morning,
4 everyone. I'd like to call to order House Appropriations
5 Budget Hearings for the fiscal year 2014/15. I want to
6 welcome everyone. Hard to believe that another year has
7 gone by. I'm looking forward to the testimony over the
8 next several weeks.

9 I just want to remind everyone, both the
10 Committee Members and testifiers and their staff and the
11 public that are present, if you could turn off your
12 iPhones, iPads, cell phones, whatever other electronic
13 devices that you may have. It would certainly help us go
14 on with the hearings.

15 We are going to just take a couple minutes right
16 now to introduce ourselves, give the Members an opportunity
17 for the viewers on PCN to know where the Members are from.
18 And my name is Bill Adolph. I'm the Republican Chair of
19 the Appropriations Committee. My district is the 165th
20 District in Delaware County.

21 Chairman Markosek.

22 MINORITY CHAIRMAN MARKOSEK: Thank you, Chairman.
23 And welcome, everybody. I am State Representative Joe
24 Markosek, 25th Legislative District. I live in Allegheny
25 County and represent parts of Allegheny County and

1 Westmoreland County. To my immediate right is our fine
2 Democratic Executive Director of the House Appropriations
3 Committee, Miriam Fox.

4 MAJORITY CHAIRMAN ADOLPH: Thank you. If we can
5 start with the Vice Chair of the Republican Committee.

6 REPRESENTATIVE PETRI: Yes, thank you,
7 Mr. Chairman. Scott Petri from Bucks County, 178th
8 District.

9 REPRESENTATIVE GRELL: Good morning. Glen Grell,
10 a Representative from Cumberland County, 87th District.

11 REPRESENTATIVE MILLARD: Good morning. David
12 Millard, Columbia County.

13 REPRESENTATIVE GROVE: Seth Grove, York County,
14 196th District.

15 REPRESENTATIVE SONNEY: Curt Sonney, 4th
16 District, Derry County.

17 REPRESENTATIVE PYLE: Good morning. Jeff Pyle,
18 60th District, Armstrong, Indiana, and soon to be Butler
19 Counties.

20 REPRESENTATIVE KILLION: Tom Killion, 168th
21 District, parts of Delaware and Chester Counties.

22 REPRESENTATIVE HARRIS: Adam Harris, 82nd
23 District, Juniata, Mifflin, Snyder.

24 REPRESENTATIVE EVERETT: Garth Everett, 84th,
25 Lycoming County.

1 REPRESENTATIVE MUSTIO: Good morning. Mark
2 Mustio, Allegheny County, communities surrounding the
3 airport, and Sewickley.

4 REPRESENTATIVE ELLIS: Brian Ellis, Butler
5 County, 11th District.

6 REPRESENTATIVE CHRISTIANA: Good morning. Jim
7 Christiana of Beaver County.

8 REPRESENTATIVE OBERLANDER: Representative Donna
9 Oberlander, Clarion and parts of Armstrong County.

10 REPRESENTATIVE BOBACK: Karen Boback, House
11 District 117, parts of Luzerne, Wyoming, and Columbia
12 Counties.

13 REPRESENTATIVE DEAN: Good morning. Madeleine
14 Dean, the 153rd in Montgomery County, Abington and Upper
15 Dublin Townships.

16 REPRESENTATIVE SANTARSIERO: Good morning. I'm
17 Steve Santarsiero. I represent the 31st District in Bucks
18 County.

19 REPRESENTATIVE BROWNLEE: Good morning. Michelle
20 Brownlee, Philadelphia County, 195th Legislative District.

21 REPRESENTATIVE CONKLIN: Good morning. I'm Scott
22 Conklin, 77th District, Centre County.

23 REPRESENTATIVE MAHONEY: Good morning. I'm Tim
24 Mahoney of Fayette County 51st District.

25 REPRESENTATIVE KULA: Good morning.

1 Representative Deb Kula from Fayette and Westmoreland
2 Counties, 52nd District.

3 REPRESENTATIVE CARROLL: Good morning. Mike
4 Carroll, Luzerne and Monroe Counties.

5 REPRESENTATIVE O'BRIEN: Good morning. Mike
6 O'Brien, 175th District, Philadelphia.

7 REPRESENTATIVE WHEATLEY: Good morning. Jake
8 Wheatley, 19th Legislative District, Allegheny County, City
9 of Pittsburgh.

10 REPRESENTATIVE PARKER: Cherelle Parker,
11 Philadelphia County, 200th Legislative District.

12 MAJORITY CHAIRMAN ADOLPH: Okay. Thank you. As
13 you all know, last week, the Governor presented his \$29.4
14 billion budget proposal. These hearings are the next stage
15 of our State's budget process as we bring in each State
16 Government agency to better understand the budget proposal
17 and peel back the many layers of the overall spending plan.

18 These hearings serve two purposes. First, they
19 will help the elected Members of the General Assembly
20 better understand the Governor's proposal and allow us to
21 appreciate how it will impact all of our districts and the
22 individuals we represent. With that better understanding,
23 we will then have a better idea if there are any changes we
24 will need to make to better meet the needs of the
25 constituents we represent.

1 The second purpose these hearings serve is that
2 they will allow the residents of Pennsylvania to gain
3 greater insight to the proposed State budget and appreciate
4 all the details and the technical points behind the \$29.4
5 billion spending proposal. I appreciate the live coverage
6 that we get from PCN.

7 I also wanted to let the viewers know that this
8 year we've provided a new opportunity for you to
9 participate in these hearings. This year, Pennsylvania
10 residents were able to submit questions about the State
11 budget to my office, to the House Republican Appropriations
12 website. This tool will be available throughout the
13 hearings, and I would encourage residents to visit the
14 website to see the full schedule of hearings and submit
15 questions. Today, we have about 100 questions and we will
16 be asking those questions periodically during the hearings.

17 As we dig into the details of this budget, we
18 need to appreciate the context of the budget as it was
19 constructed. This year's budget planning for the fiscal
20 year '14/'15 will unfold with a unique set of challenges.
21 Even before last week when the Governor presented his
22 budget, we had a substantial list of problems we needed to
23 consider. These problems included a significant increase
24 in required payments to our two State pension systems, the
25 implementation of the Affordable Care Act, and the \$220

1 million in additional mandates State spending obligations
2 to comply with the Federal mandates. One that we're all
3 familiar with is the \$325 million less in FMAP
4 reimbursements.

5 These issues alone could nearly consume all the
6 revenue growth and force more than \$1 billion increase in
7 State spending if we continued the same level of services.
8 That spending increase would not include the normal
9 inflation and contractual required spending growth across
10 the State Government. Needless to say, the challenges are
11 significant.

12 I hope that the Members of this Committee will
13 use these hearings for a genuine and sincere opportunity to
14 better understand this budget so that we can create a solid
15 roadmap. I hope that we can reserve judgment on the
16 initial proposal until we get a complete understanding of
17 this proposal. The strategies contained in this proposal
18 are one approach to constituting a budget. Before anyone
19 dismisses this budget, we should appreciate one important
20 factor, that there are no tax increases on the residents of
21 Pennsylvania, which is very important and something that I
22 know many of my constituents appreciate. I think that we
23 need to keep that in mind as we review this plan. We
24 should be cautious and understand that if there is an
25 outright dismissal of the strategies contained in this

1 budget, there are only a few other alternatives to think
2 about.

3 With that, I look forward to working with the
4 Members of this Committee to enact the fourth on-time
5 budget with no tax increases and a responsible but also a
6 very sustainable budget.

7 With that, I'm looking forward to my good friend
8 Chairman Markosek's comments.

9 MINORITY CHAIRMAN MARKOSEK: Thank you very much,
10 Chairman.

11 And I echo the Chairman's sentiments that this is
12 of course the beginning of a three-week period where we I
13 believe he used the term unpeel the budget and really get
14 into the nitty-gritty.

15 And I want to just say that we do look forward to
16 working with Chairman Adolf and his Committee and his
17 Members, his staff as well, and I might just say something
18 to the folks watching today, that we actually do respect
19 each other and get along. People might not think that's
20 true. We disagree on a lot of things and we quibble about
21 a lot of things, but at the end of the day, we have a great
22 respect for one another here, both Democrats and
23 Republicans, and I'm sure most elected officials feel that
24 way.

25 Since the Chairman mentioned the online

1 questioning, I would mention that the Democrats have a
2 website as well, HACD.net. That's House Appropriations
3 Committee Democrat.net, which folks can go online and more
4 than just ask questions, they can take a look at our
5 talking points and all of our various information that we
6 have on many, many different facets of the budget. So I
7 look forward to getting things started.

8 And, Chairman, with your permission, I'll just
9 ask the first question to get things started.

10 MAJORITY CHAIRMAN ADOLPH: Okay. Yes, we will.
11 For the viewers' information, our first testifier today is
12 Matthew Knittel. Mr. Knittel is the Director of the
13 Independent Fiscal Office. And good morning and welcome.

14 Before the Chairman asks the first question,
15 would you like an opening statement?

16 MR. KNITTEL: Yes. If I could do so, that'd be
17 nice.

18 MAJORITY CHAIRMAN ADOLPH: Okay. All right.
19 Thank you very much.

20 MR. KNITTEL: Well, good morning, and thank you,
21 Chairman Adolph, Chairman Markosek, and Members of the
22 Committee. I thank you for the opportunity to testify
23 before you today.

24 The Independent Fiscal Office or the IFO provided
25 some background materials to the Committee regarding the

1 office, the economy, and major General Fund revenue
2 sources. I will not review that material in the limited
3 time for opening remarks. Rather, I would like to
4 summarize the IFO's economic and revenue outlook for the
5 current and next fiscal year.

6 A core function of the IFO is the provision of
7 revenue estimates for consideration by the General
8 Assembly. Our next formal release will be on May 1st when
9 our preliminary revenue estimate will be completed. By
10 June 15th, the Office will release its official or final
11 estimate for FY '14/'15. Although the Office will not
12 provide a formal estimate until May 1st, I would like to
13 take this opportunity to outline our current thinking about
14 the revenue outlook and the state of the economy.

15 Turning to the revenue outlook for the current
16 fiscal year, the IFO recently released a midyear update of
17 its revenue estimate for the current fiscal year and
18 concluded that a \$150 million reduction was warranted to
19 the revenue estimate. For comparison, our revised estimate
20 is roughly \$112 million below that certified by the
21 Governor, and that figure did not change in the recent
22 Executive Budget. The IFO's reduction was based on two
23 factors. First, at the midpoint of the fiscal year, the
24 growth rates for the General Fund and its major revenue
25 sources were below our expectations. Second, for the

1 remainder of the fiscal year, it is unlikely that the
2 growth will reach the levels necessary to meet the IFO's
3 original estimate.

4 Although we have reduced our estimate, it still
5 relies on stronger growth in the second half of the fiscal
6 year. Factors that likely had a negative impact on
7 economic growth in tax revenues in 2013 such as the
8 expiration of the Federal payroll tax cut and the Federal
9 budget sequester should largely be absorbed at this point.
10 However, recent wage growth and consumer spending do not
11 appear to be strong enough to meet our original estimate.

12 For the first half of the fiscal year, General
13 Fund revenues only grew by 0.5 percent. The projected
14 second-half growth rate necessary to meet our revised
15 estimate is 1.8 percent for a total growth of the fiscal
16 year of 1.2 percent. The projected January through June
17 growth rates for major General Fund revenue sources are
18 follows: For corporate net income, 1.7 percent versus 1.3
19 percent in the first half; for sales and use taxes, 3.9
20 percent versus 2.3 percent in the first half; and for
21 personal income tax withholding, 3.6 percent versus 2.2
22 percent in the first half. So these differentials
23 underscore the fact that our reduced revenue estimates
24 still require a higher level of economic activity in the
25 second half of the fiscal year compared to the first.

1 Unlike last year, we do not expect strong growth
2 in the final payment for personal income taxes this April.
3 April 2013 revenues were artificially inflated because
4 taxpayers accelerated the receipt or recognition of certain
5 income at the end of 2012 to avoid Federal tax increases
6 that took effect in 2013. When we remove this behavioral
7 effect, we expect annual personal income tax payments in
8 the spring of 2014 to return to a more normal pattern or
9 more normal level. Therefore, our estimate anticipates a
10 three percent reduction in the April and annual payment.

11 Turning to the outlook for 2014, the economic
12 outlook, the economic data released at the end of 2013
13 suggests that conditions are favorable to facilitate
14 stronger growth in the U.S. economy in 2014. Businesses
15 have cash balances available to spend for hiring.
16 Households are in better financial shape as they continue
17 to pay down debt, especially credit card debt and mortgage
18 debt. There have been gains in the stock market. There
19 have been gains in the housing market that may bolster
20 consumer confidence and give rise to a wealth effect that
21 would facilitate more consumer spending. However, recent
22 revenue data suggests that these conditions have not yet
23 translated into higher spending levels.

24 We believe that the key to tax revenue growth in
25 2014 will be the labor market. Wages are highly correlated

1 with overall economic growth, personal income, and sales
2 and use tax revenues. An increase in consumer spending is
3 not sustainable without growth in wages. For 2013, wage
4 growth was very modest due to low inflation and significant
5 slack in the labor market, which reduces worker leverage.
6 In order for workers to realize wage gains, the slack must
7 be removed from the labor market. Hiring must increase for
8 an extended period of time before that can occur.

9 For 2014, the IFO projects Pennsylvania wage
10 growth of 3.6 percent compared to 2.6 percent for 2013.
11 That growth rate can be decomposed into two parts: One
12 percent growth due to new jobs. We anticipate 57,000 new
13 jobs for 2014; the second part, 2.6 percent for wage
14 inflation or pay raises to current workers, for a sum of
15 3.6 percent. And improvement in the labor market would
16 support stronger sales and use tax and employer withholding
17 collections.

18 Turning to the outlook for FY '14 for revenues,
19 stable Federal tax policy and the resolution of Federal
20 budget issues remove some of the sources of uncertainty
21 that have affected the economic and revenue outlooks for
22 recent years. The IFO's preliminary outlook for FY '14/'15
23 General Fund revenues indicates a growth rate of roughly
24 3.0 percent over the current year. That base growth rate
25 does not include any additional revenues that might be

1 received due to the expansion of small games of chance to
2 bars, restaurants, and taverns; proposed legislative
3 changes to reduce the holding period for unclaimed property
4 or to transfer monies from the Oil and Gas Lease Fund; and
5 new revenues due to slots or table game fees from new
6 casino openings. If we include small games of chance in
7 our revenue estimate, then our projected growth rate would
8 then increased to roughly 3.3 percent for next fiscal year.

9 Thank you very much and I would be happy to
10 answer any questions that you might have.

11 MAJORITY CHAIRMAN ADOLPH: Thank you,
12 Mr. Knittel.

13 Chairman Markosek.

14 MINORITY CHAIRMAN MARKOSEK: Yes, thank you,
15 Chairman.

16 Good morning. And just maybe reiterate because
17 you covered some of this stuff that I had in mind to ask.
18 The Governor's budget for next year, and let me just run
19 down some of these things, assumes that we will end the
20 current fiscal year on target as far as revenue growth. At
21 the midway point you estimated that the State would end the
22 fiscal year \$112 million below the estimate. Now, you had
23 mentioned that obviously there are some things that may or
24 may not happen as we move forward that we can't predict,
25 and understanding that the two largest collection months

1 are coming up, March and April I believe---

2 MR. KNITTEL: Right.

3 MINORITY CHAIRMAN MARKOSEK: ---if I'm not
4 mistaken, does your forecast indicate that we will end the
5 year below the estimate?

6 MR. KNITTEL: We believe that it's more likely
7 than not that we will end up below the official revenue
8 estimate. However, as you noted, we still have a few large
9 months ahead of us, March and April. Our take on the very
10 important final payment in April is that it will be
11 relatively weak due to that behavioral effect, the higher
12 capital gains tax rates, things where individuals pulled
13 monies forward. So I know that's a bit of a difference
14 between us and the Administration regarding that April
15 final payment.

16 MINORITY CHAIRMAN MARKOSEK: Okay. I think you
17 had indicated roughly about a percentage difference. The
18 budget for the next fiscal year is based on more than a
19 four percent growth where you had predicted about three
20 percent. And when we're talking about a \$29 billion
21 General Fund budget, one percent can be a fairly big number
22 and create a lot of problems for us, for the Commonwealth,
23 relative to our putting a budget together. And I guess
24 just really the bottom line is do your forecasts still
25 indicate that the three percent is even realistic?

1 MR. KNITTEL: Currently, between us and the
2 Administration, if you remove some of these items such as
3 the proposals for unclaimed property, the transfer from the
4 Oil and Gas Lease Fund, and the new slots and table games
5 fees, the \$75 million, the growth rate in the Executive
6 Budget is roughly 3.9 percent. That would compare to a
7 growth rate for the IFO of roughly 3.3 percent, so about a
8 0.6 percent differential. That would translate into
9 roughly \$375 million between the two fiscal years. And I
10 would attribute that to a more optimistic economic outlook
11 on the part of the Administration, that they think the
12 labor market will improve a bit more and in particular
13 withholding tax revenues will be stronger.

14 MINORITY CHAIRMAN MARKOSEK: Okay. But you also
15 indicated there that they're using some one-time budget gap
16 fillers, so to speak, to make up that difference, that one
17 percent difference.

18 MR. KNITTEL: There are some items that would not
19 be repeated in future years, yes.

20 MINORITY CHAIRMAN MARKOSEK: Okay. Thank you
21 very much.

22 Thank you, Mr. Chairman.

23 MR. KNITTEL: Thank you.

24 MAJORITY CHAIRMAN ADOLPH: Thank you very much.

25 Mr. Knittel, on your projection that you do not

1 feel that the March or April of 2014 will be similar to
2 March or April of 2013, and you state that because the
3 taxpayers paid a larger fourth-quarter estimate than they
4 did the year before and you don't see that coming because
5 there was fear of a capital gains tax at the Federal level.
6 Now, the PIT in Pennsylvania, whether it's capital gains or
7 wages, there has been no change in the rate of tax. And
8 the stock market in 2013 did quite well, and if those folks
9 that dabble in the stock market did well and they paid what
10 is considered the safe harbor estimated tax payments,
11 meaning that they paid what they owed the year before,
12 isn't it possible that they still may owe some substantial
13 tax with Pennsylvania in March or April?

14 MR. KNITTEL: That is possible. As you note, the
15 S&P 500, I believe, was up 25 percent on the year-over-year
16 basis, so very strong growth. One item that is of concern
17 is that the quarterly payment in January was very weak, and
18 that's usually a precursor to the final payment that we'll
19 receive in April.

20 MAJORITY CHAIRMAN ADOLPH: Right. Yes. I think
21 it also has to do with the safe harbor payment more than
22 anything else, and only time will tell. That's for sure.
23 I'm optimistic that hopefully the Pennsylvania residents
24 did very well in the stock market and we'll see the tax in
25 March or April.

1 I was very interested in your November 2013
2 forecast regarding the demographics of Pennsylvania, and it
3 really is pretty shocking if people take a look at that.
4 The under-19 population in Pennsylvania will decline by 1.8
5 percent. The working-age population, age 20 to 64, will
6 see no growth. And the 65-and-older population in
7 Pennsylvania will increase by 29.2 percent. That's pretty
8 staggering. I guess my first question to you is that are
9 people retiring at age 65 in 2013/14 like they did 10 years
10 ago?

11 MR. KNITTEL: The data that we are seeing -- and
12 I would defer to the Bureau of Labor Statistics. They
13 publish labor force participation rate. It actually
14 suggests that the older individuals, more of them are
15 working and they may still be making up losses in the stock
16 market or pension funds for prior years, but that
17 participation rate is actually increasing.

18 MAJORITY CHAIRMAN ADOLPH: Okay. What we're
19 seeing in an our budget and what we're seeing nationwide in
20 many State budgets, and I can take a look at my own family,
21 that the aging population you see about 90 percent of all
22 your healthcare come in your last two years. And people
23 are living longer now and obviously those folks that are
24 retired do not pay taxes on their pensions or their Social
25 Security in the State of Pennsylvania, but a lot of times

1 the health costs that we're experiencing and we're going to
2 see it when the Department of Welfare Secretary appears to
3 us. But it is staggering that the population of 65 and
4 over is almost increasing at 30 percent and everything else
5 is stagnant. So I think it does affect our revenues.

6 MR. KNITTEL: Oh, absolutely. It will restrain
7 them moving forward.

8 MAJORITY CHAIRMAN ADOLPH: Okay. Thank you very
9 much.

10 The next question will be by Representative
11 Parker.

12 REPRESENTATIVE PARKER: Thank you, Mr. Chair, and
13 welcome, Director Knittel.

14 I guess I want to pick up where we left off last
15 year during our hearings as it relates to the issue of
16 student loan debt. Last year, I had asked about trends in
17 student loan debt and sort of where Pennsylvania fell
18 compared to the other States. You gave us a shocking
19 answer. Well, at least it was shocking to me, and that was
20 that Pennsylvania ranked second in the Nation in our
21 Pennsylvania graduates having the highest average loan
22 debt. And last year, the number you gave us was \$29,959.
23 Now, some of our State-related institutions, Temple
24 University, Lincoln University, personally familiar with
25 those, they rolled out some incentives to encourage

1 graduation in four years to reduce student loan debt. Tell
2 me, how are we faring now?

3 MR. KNITTEL: To my knowledge things haven't
4 largely changed that much since last year. I would need to
5 confirm that. Pennsylvania is still in the top of student
6 loan debt whether you measure it in terms of per capita
7 basis or in terms of income. We rank somewhere between
8 second and seventh generally. There are a few surveys out
9 there. So over the past year since we last talked, that
10 largely has not changed. What we're finding in
11 Pennsylvania and much like the rest of the U.S. is mortgage
12 debt, credit card debt continues to decline. They're
13 paying that up. The one type of debt that continues to
14 increase is student loan debt.

15 REPRESENTATIVE PARKER: Okay. Thank you. And,
16 Director Knittel, if in fact any new and/or current data is
17 found, can you please forward that to Chairmen Adolph and
18 Markosek?

19 My second question I want to go back to the
20 demographic issue that Chairman Adolph mentioned earlier.
21 In you're five-year economic outlook you note that we could
22 see a slower growth in the PIT along with the sales and use
23 taxes due to the demographic shifts, little or no growth in
24 the working population and increase in the senior
25 population. Well, given that the PIT and SUT are two of

1 our Commonwealth's three major revenue sources, would you
2 be of the opinion that we should start exploring other
3 sources of revenue not based on wages and/or consumer
4 spending? And is that something that we've looked at
5 comparing to what other States are doing in that area? I
6 was looking at the data. I think about 41 percent of our
7 revenue comes from the personal income tax and about 31
8 percent of revenue comes from the sales and use tax.

9 MR. KNITTEL: Yes, that's correct. Going
10 forward, the demographics do suggest that the revenue
11 growth will be restrained. In particular, the lack of
12 growth in the labor force, it will be stagnant over the
13 next decade, so less job creation, lower wage growth. As
14 well, elderly residents have different spending patterns.
15 They tend to spend on nontaxable items such as healthcare
16 and prescription drugs, less on taxable items, new cars,
17 furniture, things of that nature. So we do expect
18 restrained revenue growth from these broad demographic
19 trends. They will place pressures on the budget. We have
20 identified a structural deficit under current law going
21 forward. Really the only way to relieve a structural
22 deficit is either to raise more revenues or cut spending.

23 REPRESENTATIVE PARKER: Thank you, Mr. Director.
24 Thank you, Mr. Chair.

25 MAJORITY CHAIRMAN ADOLPH: Thank you. I'd just

1 like to acknowledge the presence of Representative Peifer
2 and also Representative George Dunbar.

3 The next question will be by Representative Scott
4 Petri.

5 REPRESENTATIVE PETRI: Thank you, Mr. Chairman,
6 and thank you for being here again this year.

7 I have a two-part question. The first, you
8 mentioned in your testimony uncertainties, and I've read
9 and I'm sure many of the Members have read articles about
10 how corporations have more cash than any point in time in
11 recent history, that things are about to move and explode
12 but yet we're lagging and lagging, both State and
13 Federally. So I'm wondering have you seen any reliable
14 information or surveys about this business uncertainty, and
15 if so, is it Pennsylvania only? Is it something that we as
16 a Legislature have done, aren't doing, or is it more
17 national? And if so, can you tie it to any policies of the
18 Federal Government or uncertainties in that -- so that's
19 part one.

20 Part two is if you have any information on what
21 you anticipate the PA TABOR rates to be for one-, two-, and
22 three-year increases, understanding that our joint
23 responsibility is to pass a budget that is not only on time
24 and balanced, but reflects where we think we're going in
25 one to two years? So your comments on that would be

1 helpful. Thank you.

2 MR. KNITTEL: Sure. Sure. I agree with your
3 note on the business cash holdings liquid investments.
4 They do have a very large holding, more than at any other
5 time previously, and the Federal Reserve tracks those
6 amounts. So they do have a large amount of liquid holdings
7 that are available to be spent for hiring for investment
8 purposes.

9 What we think is happening, and as you had noted,
10 the economy continues to underperform below expectations
11 both for Pennsylvania and for the U.S. We keep expecting
12 jobs growth and we don't get that. One of the reasons we
13 think that's happening is we've talked about deleveraging
14 or paying down debt. We thought that would reach a bottom
15 and people would stop paying down the debt and therefore
16 would have more money to spend. The most recent data don't
17 support that. It shows that they continue to pay down
18 their debt. They are continuing to pay down credit cards,
19 mortgage debt. The only debt that is rising is student
20 loan debt. So they're still in that leveraging process and
21 that's restraining the spending, and businesses are seeing
22 that, and they are not investing. So they're kind of in a
23 holding pattern.

24 I would also agree that there is uncertainty at
25 the Federal level. We always have the debate over debt

1 ceilings. Some of it has been removed from the tax policy,
2 so it's always good to remove that uncertainty from a
3 business perspective. We think that, going forward, things
4 will improve, the consumer spending will pick up, the
5 deleveraging will stop, some of the uncertainty will be
6 removed. They're working on the Federal budget sequester
7 right now trying to come to a bipartisan agreement, so
8 that's a good sign.

9 Regarding the TABOR rates, I'm not sure what
10 average inflation rate one would use, what years that would
11 be based on. The inflation rates that we're seeing
12 recently are on the order of 1.5 percent. The demographic
13 growth, you can see in our report, average demographic
14 growth of about 0.4 percent, so depending on the average
15 one uses, the years you use, that rate might range from 1.7
16 to 2.2, somewhere in that ballpark.

17 MAJORITY CHAIRMAN ADOLPH: Thank you. I'd also
18 like to acknowledge the presence of Representative Pam
19 DeLissio.

20 The next question will be by Representative
21 Santarsiero.

22 REPRESENTATIVE SANTARSIERO: Thank you,
23 Mr. Chairman. And, Mr. Knittel, welcome back.

24 MR. KNITTEL: Thank you.

25 REPRESENTATIVE SANTARSIERO: I'd like to focus

1 this morning on job and economic growth in Pennsylvania. I
2 noticed in your testimony you talked about in addition to
3 57,000 jobs in Pennsylvania in 2013, can you give us a
4 sense of how that job growth broke out in terms of private
5 versus public sector and then within the private sector,
6 what sectors of the economy we saw those numbers being
7 added?

8 MR. KNITTEL: Sure. Most of the great majority
9 of it would be in the private sector, and two sectors stand
10 out much like they've done over the past three or four
11 years. That would be healthcare and professional business
12 services. They're clearly the ones that are adding the
13 jobs, the great majority of the jobs. The public sector
14 jobs I believe are largely flat both at the Federal and
15 State levels.

16 REPRESENTATIVE SANTARSIERO: Okay. And when you
17 talk about professional business services, what is that?
18 Can you give us a little bit more specifics of what that
19 means?

20 MR. KNITTEL: Sure, a catchall, engineering,
21 architecture, accountants, lawyers.

22 REPRESENTATIVE SANTARSIERO: Okay. And
23 healthcare, what is that range?

24 MR. KNITTEL: Any home care, hospitals, doctors,
25 dentists.

1 REPRESENTATIVE SANTARSIERO: Okay. Okay. Within
2 that grouping, any greater emphasis, say, on home care
3 versus, say, doctors or do you have that breakdown?

4 MR. KNITTEL: That I'd have to check on. I'm not
5 familiar with the granular detail.

6 REPRESENTATIVE SANTARSIERO: Okay. If you could,
7 if you could get that back to us at some point, that would
8 be helpful.

9 MR. KNITTEL: Sure.

10 REPRESENTATIVE SANTARSIERO: The 57,000 number,
11 how does that compare -- well, let me ask on a percentage
12 basis. What is that? What kind of growth is that?

13 MR. KNITTEL: That's one percent growth---

14 REPRESENTATIVE SANTARSIERO: One percent.

15 MR. KNITTEL: ---in jobs.

16 REPRESENTATIVE SANTARSIERO: Okay. And how does
17 that compare to the national growth rate in jobs?

18 MR. KNITTEL: That would be somewhat lower than
19 the national growth rate. Relative to the prerecession
20 high, both the U.S. and Pennsylvania right now through the
21 fourth quarter of 2013, they have both shed about one
22 percent of their jobs.

23 REPRESENTATIVE SANTARSIERO: Okay.

24 MR. KNITTEL: So Pennsylvania is still short
25 about 50,000 jobs from the prerecession high.

1 REPRESENTATIVE SANTARSIERO: Okay.

2 MR. KNITTEL: The U.S. is short about 1.2
3 million.

4 REPRESENTATIVE SANTARSIERO: Right.

5 MR. KNITTEL: The recession in Pennsylvania was
6 not as severe and so we're not getting the uptick that the
7 U.S. is getting.

8 REPRESENTATIVE SANTARSIERO: Right. So I guess
9 that's why my next question is really comparing apples to
10 apples. Where are we in terms of that growth, just
11 focusing on the growth rate in 2013 versus nationwide?

12 MR. KNITTEL: The growth rate in Pennsylvania, it
13 was slightly under that in 2013 compared to the nationwide
14 growth rate.

15 REPRESENTATIVE SANTARSIERO: Where are we with
16 respect to our neighboring States, New Jersey, New York?

17 MR. KNITTEL: That I'd have to check on. I'm not
18 sure.

19 REPRESENTATIVE SANTARSIERO: If you could, yes.
20 And just if you could include the Northeast as a snapshot
21 on that, that would be helpful as well.

22 Turning to economic growth, and I think the
23 phrase we use at the State level is gross state product,
24 where are we with economic growth in 2013?

25 MR. KNITTEL: I believe we were at 1.2 or 1.3

1 percent. It's in the packet here. I'd have to check on
2 that.

3 REPRESENTATIVE SANTARSIERO: Okay. And I just
4 don't recall the number for gross domestic product in 2013.
5 Do we know where that was? Do you know that offhand?

6 MR. KNITTEL: That was also in the low one or
7 mid-one range. I'd have to check on that as well.

8 REPRESENTATIVE SANTARSIERO: Okay. And I guess
9 I'd have the same question, if you could follow up, in
10 terms of comparing gross state product between Pennsylvania
11 and the other States in the Northeast. That would be
12 helpful as well.

13 Last question I have has to do with the point
14 that Chairman Adolph raised earlier about our senior
15 population, and you talked about the increase in growth in
16 the senior population. Certainly, one of the reasons for
17 that would be the demographic trends in terms of birth rate
18 over the last 60, 70 years and where we are today. Are
19 there other factors that you're aware of that contribute to
20 such a significant increase in the senior population in
21 Pennsylvania?

22 MR. KNITTEL: No, not that I'm aware of, and we
23 do have the Baby Boom generation that's a large population
24 wave that's entering retirement, so that's really the
25 driving factor.

1 REPRESENTATIVE SANTARSIERO: Okay. Do you have,
2 in comparing the other States, would you be able to provide
3 us with the demographic breakdown of the projected growth
4 rates of those other States as well?

5 MR. KNITTEL: Sure. I can say based on the
6 latest data, Pennsylvania is the fourth-oldest State in the
7 Nation following Florida, Maine, and West Virginia.

8 REPRESENTATIVE SANTARSIERO: Yes, and I think
9 most of us are probably aware of that distinction and it's
10 trying to get our arms around why that is that I ask those
11 questions.

12 MR. KNITTEL: Sure.

13 REPRESENTATIVE SANTARSIERO: Okay. Thank you
14 very much.

15 MR. KNITTEL: Absolutely.

16 MAJORITY CHAIRMAN ADOLPH: Thank you.

17 Representative Donna Oberlander.

18 REPRESENTATIVE OBERLANDER: Thank you, Chairman.
19 Thank you, Director, for being here.

20 You stated in your testimony that stable Federal
21 tax policy and resolution of Federal budget issues will
22 make this less uncertain, but I want to bring it back to
23 last year when the Federal Government removed the payroll
24 tax cut and immediately in January there was a two percent
25 increase to everyone's taxes. Do you see anything like

1 that on the horizon, and if so, can you talk about what
2 might happen in terms of impact on revenue collections for
3 the Commonwealth?

4 MR. KNITTEL: Sure. As you noted, in January 1st
5 of last year, the two percent payroll tax cut expired and
6 raised the Social Security tax for wage earners. Going
7 forward, I'm not aware of any similar type of scheduled tax
8 increase, but of course that would be dependent on what
9 Congress will do.

10 REPRESENTATIVE OBERLANDER: Thank you. It
11 certainly did have a big impact on our 2013 sales tax for
12 the first quarter, and hopefully, we won't see anything
13 like that again.

14 Thank you.

15 MAJORITY CHAIRMAN ADOLPH: Thank you.

16 Representative Jake Wheatley.

17 REPRESENTATIVE WHEATLEY: Thank you,
18 Mr. Chairman. Good morning again, Director.

19 I want to follow up on the line of questioning
20 that my colleague before me kind of started. And today
21 there was a report that came out that talks about the
22 recovery after six years of this economic recession that we
23 had, and they talk about the fact that -- and actually to
24 get it right I want to read the line and then I want to get
25 your feedback on it as it relates to Pennsylvania. It

1 says, "this fragile recovery after six years of severe
2 economic shock results from policies that choose fiscal
3 austerity over job creation and investment and growth, a
4 choice made again" -- it goes on to talk about the choices
5 of Federal Government.

6 But I want to talk about it as it relates to us
7 because one of the things that stuck out to me in your
8 presentation you talked about in order for us to really
9 start to maximize and grow our economy, we have to invest
10 in the wages, a sustained, continual investment and growth
11 of wages that will impact our economy the best. So one,
12 respond to that statement around the choices of austerity
13 and its implications to our economy from policy positions,
14 because we're policymakers so these choices have real
15 ramifications. So I would like to get your feedback on
16 that first.

17 MR. KNITTEL: It is, as you noted, a policy
18 choice, so I cannot comment on whether it's appropriate or
19 inappropriate to have fiscal austerity, to restrain
20 spending growth. I can say that generally more spending
21 would generally increase economic output. I would also
22 note that, as I noted in my testimony, the wage growth is
23 really the underpinning of the Pennsylvania economy. In
24 order to get the revenues to come in, we do need additional
25 wage growth to drive the personal income tax collections

1 and to drive the sales and use tax collections. And that
2 currently has not picked up as we had hoped.

3 REPRESENTATIVE WHEATLEY: So, again, I'm a
4 policymaker so I understand what you're saying and I don't
5 want to put you in the cross arrows of anyone. You're
6 independent. You're supposed to be very balanced. Do you
7 have suggestions for us looking around at other States?
8 Again, I read some things that talked about other States
9 having surpluses and having the choice now of if they're
10 going to give their citizens some tax return break or
11 they're going to invest more in their economics. We on the
12 other hand have a deficit. So can you suggest to us how,
13 from a policy perspective, we might have gotten here and
14 what we can learn from getting here, going forward doing
15 something differently?

16 MR. KNITTEL: I cannot make policy
17 recommendations or suggestions. I can say in order to
18 enhance economic growth, there are several important
19 factors. Certainly the tax structure is an important
20 factor. Educated workforce is an important factor for
21 businesses, where they choose to locate; infrastructure,
22 another important factor. So these are things that
23 businesses are looking towards and they consider in their
24 location decisions. And again we need the additional
25 hiring growth in Pennsylvania, much like any other State,

1 to get the economy growing.

2 REPRESENTATIVE WHEATLEY: And, Mr. Chairman, I'm
3 going to end with this. I want to make sure I have it
4 right, what you said, the investment in educated workforce,
5 the investment in infrastructure, and the tax structure
6 makes a difference in how business in our economy can
7 respond positively and grow?

8 MR. KNITTEL: I think those three items are all
9 important in the business decision on where they locate and
10 what they choose to do going forward regarding hiring.

11 REPRESENTATIVE WHEATLEY: Okay. Thank you.
12 Thank you, Mr. Chairman.

13 MAJORITY CHAIRMAN ADOLPH: Thank you.

14 Representative Grell.

15 REPRESENTATIVE GRELL: Thanks, Mr. Chairman.
16 Thank you, Director Knittel, and thanks for your excellent
17 testimony and the work of yourself and your office. I
18 think your work is very, very helpful to us throughout this
19 process.

20 I just wanted to ask to what extent your office
21 analyzes or follows the Commonwealth's bond ratings, and if
22 so, can you give us any thoughts on the direction of those
23 bond ratings or the risk factors associated with those bond
24 ratings and whether we're seeing positive or negative
25 movement in the factors that were included in some of the

1 bond reports from last summer?

2 MR. KNITTEL: We do not track them closely and
3 haven't been asked to do any analysis on them. I know
4 recently in the fall there was a minor downgrade, I
5 believe. I forget which rating agency, but we have not
6 followed that issue closely.

7 REPRESENTATIVE GRELL: Thank you, Mr. Chairman.

8 MAJORITY CHAIRMAN ADOLPH: Thank you.

9 Representative Dean.

10 REPRESENTATIVE DEAN: Thank you, Mr. Chairman.

11 Good morning, Director Knittel. Nice to see you again.

12 MR. KNITTEL: Thank you.

13 REPRESENTATIVE DEAN: Since we're here talking
14 about appropriations, I want to say to you also thank you
15 for your work and the work of your office. And I noted I
16 think that the Governor is suggesting an appropriation for
17 your office that continues what it was last year, \$1.675
18 million I believe. Is that sufficient? What are your
19 needs? How are things going?

20 MR. KNITTEL: Yes, I would characterize it as
21 sufficient for our needs. We currently have nine staff.
22 We hope to hire one or two more staff going forward and
23 that \$1.675 million should be sufficient once we get fully
24 staffed.

25 REPRESENTATIVE DEAN: Terrific. And now to your

1 testimony, you said that the revenues, your projection is
2 \$112 million less for this fiscal year than what was
3 projected before. What drives that number? What informs
4 that number?

5 MR. KNITTEL: Well, there are two items that
6 mainly inform it. One is the revenues we've seen through
7 January. They clearly have fallen below our expectations.
8 I know they're running roughly \$40 million below the
9 Administration's expectations. So there's that element.
10 The second element is economic growth has just been revised
11 down for the second half of the fiscal year. So those two
12 items combined led us to reduce our estimate by \$150
13 million.

14 REPRESENTATIVE DEAN: And if you break it into
15 the revenue portion of that, the reduction, what are some
16 of the shortfalls, in what areas?

17 MR. KNITTEL: There are two items that clearly
18 stand out, sales and use tax very much weaker than we had
19 expected, also personal income tax withholding, much
20 weaker, not as weak but weaker than we had expected.

21 REPRESENTATIVE DEAN: Okay. And on the jobs
22 issue, you projected a 57,000 job gain this year. What did
23 we gain last year?

24 MR. KNITTEL: The current number, and I stress
25 that it's still preliminary at this point, is 25,000.

1 REPRESENTATIVE DEAN: Okay. And that's for '13?

2 MR. KNITTEL: That's for '13.

3 REPRESENTATIVE DEAN: And for '12?

4 MR. KNITTEL: That number I'd have to check. I
5 do not recall what the gain was in '12.

6 REPRESENTATIVE DEAN: Okay. And in any of them,
7 maybe we'll just choose the 57,000, what percentage of that
8 is public and what is private?

9 MR. KNITTEL: Nearly all of it is private.

10 REPRESENTATIVE DEAN: All private.

11 MR. KNITTEL: I'd have to check on the exact
12 percentage.

13 REPRESENTATIVE DEAN: So no gains, in fact,
14 probably we're shedding jobs still in the public sector?

15 MR. KNITTEL: I think in the overall it's roughly
16 flat but I'd have to confirm that.

17 REPRESENTATIVE DEAN: Okay. And a final
18 question, in a response to one of the questions you spoke
19 of a structural deficit number. Can you explain what that
20 means and do you have such a number projected?

21 MR. KNITTEL: Yes. So a structural deficit is
22 the deficit that remains after the economy returns to a
23 normal level of output, normal growth rate. So the deficit
24 is not due to economic conditions; it's really due to
25 policy choices. In our five-year outlook report that we

1 put out in November, we did identify a structural deficit.
2 It was \$840 million for next fiscal year and then it grew
3 to about \$2 billion five years after.

4 If you look at the underlying detail that's
5 driving that, what you find is that revenues only grow by
6 2.8 percent but spending grows by 3.9 percent, and nearly
7 all of the additional spending growth is driven by
8 pensions. We found that they were growing by 19 percent on
9 average over the next five years.

10 REPRESENTATIVE DEAN: Do you mind backing up and
11 doing those numbers again? I'm sorry I missed them.

12 MR. KNITTEL: Sure.

13 REPRESENTATIVE DEAN: What drives that?

14 MR. KNITTEL: We have the revenue growth growing
15 by I believe 2.9 percent per annum and the spending growth
16 was at 3.8 percent per annum and the pensions, a little
17 more than 19 percent. If pensions had grown the same as
18 the rest of the budget, the spending, there would be no
19 structural deficit.

20 REPRESENTATIVE DEAN: And I think also wouldn't
21 it be true that if revenues had grown, if we didn't have
22 this economic sort of anemia, we also would be overcoming
23 this structural deficit?

24 MR. KNITTEL: In theory, but in theory that
25 projection is returning the revenue growth to a normal

1 historical average, so again, it's when the economy is
2 operating at full capacity, at full employment.

3 REPRESENTATIVE DEAN: Yes, but I think as
4 policymakers up here we also see just the significant tax
5 cuts that have been put in place in the last three or four
6 years, and that to me seems to be driving down revenues,
7 which is making our spending harder and making our growth
8 more anemic, all of these things contributing.

9 So again, I thank you very much for your fine
10 work and the work of your department.

11 MR. KNITTEL: Thank you.

12 MAJORITY CHAIRMAN ADOLPH: Thank you.

13 Representative Boback.

14 REPRESENTATIVE BOBACK: Thank you, Mr. Chairman.
15 Director Knittel.

16 MR. KNITTEL: Good morning.

17 REPRESENTATIVE BOBACK: Essentially, all of the
18 gross receipts tax collections are received in March,
19 correct?

20 MR. KNITTEL: That's correct, yes.

21 REPRESENTATIVE BOBACK: The deregulation of the
22 electric industry has significantly impacted the way this
23 tax is paid and the cash flow of the revenue is received by
24 our Commonwealth. My question to you is are you
25 anticipating any major shortfall or surplus in the tax

1 collections for the gross receipts tax?

2 MR. KNITTEL: Yes. As you noted, due to the
3 deregulation and consumers switching their providers, we
4 did have some unusual patterns in gross receipts tax over
5 the last few years. For this spring we think there'll be
6 less of that and we have relatively flat growth. We think
7 a lot of that has largely played out having to deal with
8 the safe harbor payments and giving these odd patterns to
9 gross receipts, surpluses or shortfalls. So we don't
10 anticipate a major surplus or shortfall.

11 REPRESENTATIVE BOBACK: Thank you.

12 MAJORITY CHAIRMAN ADOLPH: Thank you.

13 Representative Carroll.

14 REPRESENTATIVE CARROLL: Thank you, Mr. Chairman.
15 Director Knittel, thank you so much for being here today.

16 I'm going to change gears a little bit to a
17 subject that I haven't heard discussed this morning, and
18 that is revenue projections related to gambling, whether
19 it's small games of chance, the lottery, tables and slots.
20 Can you characterize for me what the outlook is going
21 forward for our tax revenues related to gambling in those
22 various categories?

23 MR. KNITTEL: Sure. Let me start with the
24 lottery. The Office had recently issued a lottery report
25 about two weeks ago where we looked at historical trends

1 and we looked at challenges going forward. And very
2 recently, the lottery has done quite well. The sales have
3 been very strong I think over the last three years, about
4 6.5 percent. For the first half of this fiscal year I
5 believe sales are up 5.1 percent year-over-year. Instant
6 ticket sales in particular have been a real standout, very
7 strong growth, more than 9 percent over the last few years.

8 We talked about in the report that there are some
9 concerns because the demands for the services provided by
10 the lottery funds we think will grow very quickly because
11 they go to elderly residents. We do think there's movement
12 for the lottery to further expand. We refer to that as the
13 penetration rate, so there could be some additional growth
14 there.

15 However, that will be increasingly harder to
16 attain. The market is getting increasingly saturated with
17 alternatives for gaming. Now, we have small games of
18 chance that will be expanded and Keno as well. So we do
19 anticipate it will get increasingly difficult to generate
20 growth rates both for lottery, Keno, and small games of
21 chance going forward as the market becomes more saturated.

22 REPRESENTATIVE CARROLL: Can I assume table games
23 fall into that same category with respect to growth rates?

24 MR. KNITTEL: And slots, yes, so that would be
25 all.

1 REPRESENTATIVE CARROLL: And you reference the
2 potential expansion to Keno. Does the Keno expansion in
3 any way negatively affect the growth rates for these other
4 categories?

5 MR. KNITTEL: I would think there would be some
6 shifting of sales from lottery products or small games of
7 chance over to Keno if it were enacted. How much is
8 unclear but they are clearly substitutes for one another,
9 so I would expect some sales shift.

10 REPRESENTATIVE CARROLL: It just seems to me that
11 we would be unrealistic if we just assume a level of growth
12 in all of these various categories related to gambling
13 without some expectation that there's going to have to be
14 some limit relative to the amount of money that's available
15 with respect to all of these various programs. Do any of
16 your revenue estimates going forward show any kind of a
17 decline in growth or even a reduction in growth, a decline
18 in revenue, I should say, relative to this universe of
19 gambling options that exist?

20 MR. KNITTEL: In the short-term, no. And we
21 haven't done long-term projections. We haven't tried to
22 estimate the impact of Keno or even small games of chance
23 at this point, so we have not done so. In the short-term,
24 we do think the lottery sales will continue to be robust.

25 REPRESENTATIVE CARROLL: And then, finally, the

1 effect of the expansion of table games and slot machines in
2 neighboring States and their effect on Pennsylvania casinos
3 and therefore our tax revenues that are generated by slots
4 and table games, going forward, do your revenue projections
5 contemplate the effect of other States' expansion of
6 gambling in the world of casinos and their impact on our
7 revenues?

8 MR. KNITTEL: We have not built that in, but your
9 point is well taken. Recent casino openings in Ohio and
10 Maryland are competition for the Pennsylvania casinos and
11 would restrain growth.

12 REPRESENTATIVE CARROLL: Not to mention New
13 Jersey's online gaming activity as well?

14 MR. KNITTEL: Absolutely.

15 REPRESENTATIVE CARROLL: All right. I'd be
16 interested to know. I'm not sure, I'll have to take a
17 closer look at what the expectation of the Independent
18 Fiscal Office is with respect to these sorts of projections
19 because it seems to me that folks in this building are
20 increasingly relying on revenues from these sorts of
21 programs. And if we are going to use all of these programs
22 as a substitute for tax revenues, we better get a pretty
23 good handle on what the expectations really are because the
24 default position that a lot of folks have around here is
25 let's just do another game and the revenue that'll be

1 generated, it will solve our problem instead of the usual
2 traditional sources of revenue for programs that are
3 worthy. So, going forward, I think it's important for the
4 Independent Fiscal Office and for all of us to have a keen
5 understanding of what the expected revenues are from these
6 various types of gaming.

7 MAJORITY CHAIRMAN ADOLPH: Thank you.

8 Representative Grove.

9 REPRESENTATIVE GROVE: Thank you, Director
10 Knittel, appreciate it.

11 In your kind of slideshow handout you have, sales
12 and use tax collections, you did a projection year-to-year
13 growth between New Jersey, Massachusetts, New York, Ohio,
14 North Carolina, Pennsylvania, Maryland, and Virginia. Out
15 of that list, we're third from the bottom. We're in the
16 positives, has Maryland at -.1 percent, Virginia -2.9
17 percent. The rest of the States we've seen a major growth
18 ranging from 3.3 percent to 8.6 percent. PA is at 2.3
19 percent. Have you analyzed why we've seen those States
20 have a huge jump surrounding us comparably to Pennsylvania?

21 MR. KNITTEL: We have not but I would agree with
22 you. We found it odd that we would be quite different than
23 the surrounding States. Again, we were anticipating some
24 gains here. We have the stock market is up, the housing
25 market, and it does not appear to have translated in

1 Pennsylvania.

2 REPRESENTATIVE GROVE: In one of your notes later
3 you mentioned the fear of that is because, what, 30 to 40
4 percent of sales tax collections are derived from
5 businesses, from corporations. Are we seeing corporations
6 and businesses spending more money in those States where in
7 Pennsylvania it's holding onto it?

8 MR. KNITTEL: That's possible, but unfortunately,
9 there are no data that we can point to to confirm that.

10 REPRESENTATIVE GROVE: Okay. Maybe another
11 aspect is expanded sales tax base. I know Maryland, while
12 its -.1 percent, does have sales tax on clothing versus
13 Pennsylvania. Could that play a role in that as well?

14 MR. KNITTEL: That could be a likely candidate,
15 the broader sales tax base picking up some additional
16 growth.

17 REPRESENTATIVE GROVE: All right. Have you
18 looked at this in relation to the personal income tax? I
19 know that's a little more difficult as we have a flat rate
20 versus other States who have more progressive rate. Have
21 we seen that in income tax also or is it just unique to
22 sales tax?

23 MR. KNITTEL: We did not make the comparison for
24 personal income tax. We just did it for sales.

25 REPRESENTATIVE GROVE: Okay. And one other

1 question, obviously, we are continuing the capital stock
2 franchise tax elimination through this budget. Part of
3 your testimony brought in that. At least within here I saw
4 a line item that it'll be easier to calculate moving
5 forward as it's a shrinking amount. Have we looked at
6 alternative taxes like other States? I know some States
7 employ an alternative minimum tax plus a CNI. Have you
8 done a comparison with other States if that's completely
9 phased out, where we are comparable to other States?

10 MR. KNITTEL: In terms of tax burden or tax
11 structure?

12 REPRESENTATIVE GROVE: Yes.

13 MR. KNITTEL: We have not. We do put out a so-
14 called tax burden report every year where we do rank the
15 States by various personal income, corporate income. Our
16 ranking has been falling slowly but we haven't examined it
17 in a prospective basis going forward.

18 REPRESENTATIVE GROVE: Okay. Thank you.

19 Thank you, Mr. Chairman.

20 MAJORITY CHAIRMAN ADOLPH: Thank you.

21 Representative Christiana.

22 REPRESENTATIVE CHRISTIANA: Thank you,
23 Mr. Chairman. Good morning, Director.

24 I just want to shift gears to a different topic.
25 Just last week I think the Congressional Budget Office

1 released a pretty extensive report about the economy, and a
2 significant section of that was dealing with the Affordable
3 Care Act and the impact on the economy and the labor force.
4 I hate to put you on the spot because you may not have read
5 the document or have been aware of it, but can you talk
6 about the impacts of the labor force as it relates to the
7 Affordable Care Act? And what they were talking about as
8 to a reduction of work hours to employees.

9 MR. KNITTEL: I'm familiar with it, and as you
10 noted, they did increase their estimate of the reduction in
11 the labor force due to the Affordable Care Act, much of
12 that due to working fewer hours to make sure the healthcare
13 coverage, they maintained the subsidization. So much of it
14 was due to that, but it was characterized as a reduction in
15 the labor force.

16 REPRESENTATIVE CHRISTIANA: And for a broader
17 question specific to Pennsylvania, can you talk about, you
18 mentioned some of the opportunities in the economy as it
19 relates to the stock market growth, housing growth, but my
20 concern is that's also offset by the rising cost of
21 healthcare and the fact that more and more companies see
22 the percentage of their budgets being taken up by
23 healthcare costs. Can you talk about looking to the future
24 with the uncertainty of the Affordable Care Act?

25 Will health care costs, and since it is such a

1 significant part of our economy, I mean, nearing 17, 18
2 percent of GDP, can you talk about the uncertainty as it
3 relates to healthcare and whether or not you believe that
4 will offset some of the opportunities in the economy?

5 MR. KNITTEL: I would agree it is a major concern
6 for a business, the healthcare cost, since they comprise
7 such a large component of the labor costs for them. I
8 would also say that uncertainty, regardless of its origin,
9 whether it's healthcare or tax law, is generally a bad
10 thing. It generally restrains economic growth, and anytime
11 we can clear up the uncertainty, it's to the benefit.

12 REPRESENTATIVE CHRISTIANA: Well, I appreciate
13 the insight and you being here today.

14 And thank you, Mr. Chairman.

15 MAJORITY CHAIRMAN ADOLPH: Thank you.

16 Representative Mahoney.

17 REPRESENTATIVE MAHONEY: Thank you, Mr. Chairman.
18 Thank you for being here today.

19 Throughout the State, there are people hurting
20 for property taxes, and I see you did some reports on
21 elimination of property taxes and studies on House Bill 76
22 and Senate Bill 76. Can you relate to if any of these
23 things that you've done would fit in for us as a
24 legislature to pursue?

25 MR. KNITTEL: Well, the analysis we undertook was

1 a specific proposal to eliminate the school operating taxes
2 and replace them with sales and use and personal income, so
3 it was a very targeted, specific analysis, but we haven't
4 done anything more broadly to make suggestions regarding
5 options for property tax relief.

6 REPRESENTATIVE MAHONEY: The report you did with
7 Michigan, what was that report about?

8 MR. KNITTEL: So that request was an analysis for
9 Michigan. In 1994 Michigan instituted what was known as
10 Proposal A where they eliminated all local school operating
11 taxes and replaced it with a higher sales and use tax,
12 higher tobacco taxes, and a statewide levy property tax.

13 REPRESENTATIVE MAHONEY: So that's like House
14 Bill 76, Senate Bill 76?

15 MR. KNITTEL: It was similar.

16 REPRESENTATIVE MAHONEY: And how did that work in
17 Michigan? Do you know?

18 MR. KNITTEL: I would say it depends on who you
19 talk to.

20 REPRESENTATIVE MAHONEY: Well, I'm telling you if
21 you talk to somebody that owns property and that they're 65
22 or older, it's important.

23 MR. KNITTEL: I would say it's still in effect
24 today. It likely has restrained the growth of the property
25 taxes, not completely. They have begun to creep up again.

1 It has restrained growth in spending on education. I think
2 if you talk to individuals there, they would largely
3 characterize it as having been successful in its original
4 goals.

5 REPRESENTATIVE MAHONEY: All right. Thank you
6 very much.

7 MAJORITY CHAIRMAN ADOLPH: Thank you.

8 We'll now start our second round of the
9 questioning with Representative Santarsiero.

10 REPRESENTATIVE SANTARSIERO: I know you're
11 probably excited to be part of the bonus round here. I
12 just have a couple of follow-up questions, first, to the
13 ones that my colleague, Representative Dean, was asking
14 before. When you talked about that structural deficit and
15 you identified the pension, let me ask about the tax cuts,
16 the corporate tax cuts that this Administration has enacted
17 in the last three years which, through this fiscal year,
18 total \$1.2 billion. If they go through as proposed for the
19 next fiscal year, I think the total by the end of these
20 four years would be \$2.1 billion. How has that impacted
21 the structural deficit going forward? Have you done that
22 analysis?

23 MR. KNITTEL: We have not broken that out
24 separately, but I mean it's all built into our estimates.

25 REPRESENTATIVE SANTARSIERO: If you could provide

1 that information to us to see how that has impacted the
2 structural deficit going forward for the State, I think
3 that would be very helpful.

4 Second question is following up on Representative
5 Christiana, who was talking about healthcare costs, and it
6 reminded me of a discussion we had at some length last year
7 with a number of the witnesses who came in front of us, and
8 that is have you done an analysis on what job growth would
9 be in Pennsylvania had the Governor expanded Medicaid under
10 the Affordable Care Act and had we gotten that \$39 billion
11 or so in Federal aid over the next eight years, as some of
12 the other States near us have done?

13 MR. KNITTEL: We did not do an analysis of the
14 impact on jobs growth. Last spring, my office did put out
15 a report on the budget impact from Medicaid expansion but
16 in that report we did not touch on the impact on the labor
17 market.

18 REPRESENTATIVE SANTARSIERO: Okay. Can you get
19 that information or is that an analysis you'd have to
20 undertake?

21 MR. KNITTEL: We could not do that. We don't
22 have the models to make that estimate.

23 REPRESENTATIVE SANTARSIERO: Okay. Thank you
24 very much.

25 MAJORITY CHAIRMAN ADOLPH: Thank you.

1 Representative Boback.

2 REPRESENTATIVE BOBACK: Thank you.

3 And this is more or less a follow-up to the last
4 question. Do you have any studies on job growth in other
5 States that are near us or where was, I guess, the big
6 switch to more jobs in neighboring States? And we talk
7 about the gas companies and the gas industries hiring in
8 Pennsylvania, but there's got to be more than that in other
9 States. You mentioned the private sector. Who is hiring?
10 When I talk to manufacturers, because we had been the prime
11 manufacturing State way back when, but many of them have
12 told me that technology now is taking over. For 10
13 employees, they might have a machine that's run by one. So
14 have you done any studies? Where can we go with this to
15 create more jobs in the private sector?

16 MR. KNITTEL: Yes, we have not undertaken any
17 studies to that effect about what could be done to
18 encourage more job creation. As you note, both for
19 Pennsylvania and the U.S., 1/3 of the job losses since the
20 prerecession peak have been in manufacturing so
21 Pennsylvania as much like the U.S. in that regard. And
22 much like the U.S., nearly half the job gains are in the
23 healthcare sector. So the healthcare sectors, the
24 professional business sectors, leisure and hospitality are
25 the ones that are growing most quickly.

1 REPRESENTATIVE BOBACK: So healthcare sectors,
2 are you talking about professionals, doctors, nurses,
3 dentists, and dental assistants, et cetera?

4 MR. KNITTEL: Yes.

5 REPRESENTATIVE BOBACK: And then with tourism and
6 housing or---

7 MR. KNITTEL: Tourism I can't comment on. For
8 construction---

9 REPRESENTATIVE BOBACK: Construction?

10 MR. KNITTEL: ---Pennsylvania is a little
11 different than the U.S. Thirteen percent of the job losses
12 were due to construction in Pennsylvania. For the U.S. it
13 was 1/3 of the job losses, so that reflects the more severe
14 housing bust for the U.S. than for Pennsylvania.

15 REPRESENTATIVE BOBACK: Okay. So we're saying
16 healthcare and construction, they would be key in the
17 private industry to create more jobs?

18 MR. KNITTEL: Yes. Going forward, we would
19 expect job gains in both of those sectors.

20 REPRESENTATIVE BOBACK: Thank you very much.

21 MAJORITY CHAIRMAN ADOLPH: Thank you.

22 Representative Dean.

23 REPRESENTATIVE DEAN: Thank you.

24 Just sort of a global understanding, as I was
25 looking over the Governor's budget proposal, there's an

1 awful lot of the upcoming budget that will be based on
2 nonrepeating funds, unsustained funds, somewhere in the
3 area of about \$1.2 million. To give you some examples of
4 what I'm thinking about, the escheat time frame, shortening
5 the time frame for escheats, that's going to get us
6 something right away but it will not be sustained; the one-
7 month payment delay to the managed care organizations; the
8 leasing of forest lands for additional drilling.

9 I would add to that I know that lottery and
10 gambling and those kinds of games will continue, but the
11 dependence upon these kinds -- if they're not one time,
12 they are either in the area of gambling/lottery. I worry
13 about that as a source of our spending, as a source of our
14 collection of revenues and then a source of our spending.
15 Can you say anything about the health of an economy that
16 does rely upon such things, you know, \$1.2 billion worth of
17 unsustained stuff and then add on that gambling, lottery,
18 et cetera?

19 MR. KNITTEL: Well, to your point, as you note,
20 some of the revenues in the current budget are one time,
21 much like the escheat proposal, the transfer from the Oil
22 and Gas Lease Fund. If one looks at the underlying detail,
23 the spend number is up about \$1 billion in the budget year.
24 If you look at the underlying detail, the General Fund, the
25 normal recurring General Fund revenues are also up by

1 roughly \$1 billion. They have 3.9 percent growth. If you
2 took out the small games of chance, it would be again
3 roughly \$1 billion, 3.5 percent growth.

4 So if one ignores all of the interactions with
5 the beginning balances and the lapse funds, if one believes
6 that the revenues will grow by 3.9 percent, it would be
7 enough to support the \$1 billion in spending. But we have
8 a difference with that. We do not think it will be 3.9
9 percent.

10 REPRESENTATIVE DEAN: For me to be a little
11 clearer on that, I'm talking about this one-time spending.
12 And so when we come about next year and the year after, how
13 do we sustain a budget of this size when we continue to do
14 tax cuts? I can't see this as a healthy path toward
15 collection of revenues and spending.

16 MR. KNITTEL: And I would refer to again our
17 five-year outlook report where it is true that there is a
18 structural deficit going forward. So it can't continue on
19 that path. A policy choice must be made to raise revenues
20 or cut spending.

21 REPRESENTATIVE DEAN: Yes. And that's my concern
22 that maybe this is the year that we face these questions.
23 Thanks very much for your information.

24 MAJORITY CHAIRMAN ADOLPH: Thank you.
25 Representative Grove.

1 REPRESENTATIVE GROVE: Thank you, Mr. Chairman.

2 You stated earlier, one of the comments you made
3 was if we didn't have the, basically, increases in our
4 pension system, we wouldn't have a structural deficit in
5 our budget, correct?

6 MR. KNITTEL: That's correct.

7 REPRESENTATIVE GROVE: So that is the driving
8 factor. So if we take care of that issue, we take care of
9 our structural deficit leading to why we should be doing
10 pension reform.

11 I also want to hit on the capital stock and
12 franchise tax a little bit. 2003 we had a 7.24 millage
13 rate. We're down to .89. Over that time frame we've seen
14 a decrease in revenue of the capital stock and franchise
15 tax of \$594 million. At that same time we've seen growth
16 in the corporate net income tax of \$894 million and
17 personal income tax increases of over \$3.9 billion. Would
18 it follow to reason that we're changing the business
19 climate and that reduction in the capital stock and
20 franchise tax has led to an increase of corporate net
21 income tax as well as personal income tax through
22 businesses hiring more people and wanting to come to
23 Pennsylvania and stay and create jobs here in Pennsylvania?

24 MR. KNITTEL: In theory I say, yes, it can only
25 make the business climate more attractive by reducing the

1 tax burden. To prove that statistically would be very
2 difficult, though.

3 REPRESENTATIVE GROVE: Okay. Thank you.

4 Thank you, Mr. Chairman.

5 MAJORITY CHAIRMAN ADOLPH: Chairman Markosek.

6 MINORITY CHAIRMAN MARKOSEK: Thank you. Just one
7 thought relative to the last speaker's question, what we
8 have is a debt problem. This is really relative to the
9 pension. It's not a pension problem. It's a debt problem.
10 And some of the solutions that we've seen out there just
11 increase that debt and increase that structural debt. Is
12 that correct?

13 MR. KNITTEL: In the near term some of the
14 proposals would do so. In fact, they would increase in the
15 near term the unfunded liability.

16 MINORITY CHAIRMAN MARKOSEK: Right. So I just
17 want folks to just keep that in mind when we look at that
18 issue and that's coming. We have those folks scheduled I
19 believe next week. So our issues with that are a debt
20 problem, not necessarily a pension problem.

21 Thank you, Chairman.

22 MAJORITY CHAIRMAN ADOLPH: Thank you.

23 Mr. Knittel, on the online sales tax, the remote
24 sales tax, could you discuss with the Committee a little
25 bit about whether you think we are collecting our fair

1 share of sales tax on these internet sales? Do you have a
2 figure in mind that is probably escaping us as a result of
3 this? And do you have any suggestions how we could improve
4 our collections on these remote sales?

5 MR. KNITTEL: Yes. I believe the latest annual
6 number is roughly \$42 million in remote seller collections
7 through the sales and use tax. Is that a little higher?
8 Maybe closer to \$45 million perhaps.

9 MAJORITY CHAIRMAN ADOLPH: Is that a year?

10 MR. KNITTEL: That's an annual number, yes. We
11 do think the sales tax collections maybe were not where
12 they could have been this last holiday season, and there's
13 no doubt there's some leakage there that even though we
14 have the remote seller collections, that some still
15 escapes. We have not tried to put a number on that. There
16 would really have to be a Federal legislation in order to
17 address that issue.

18 MAJORITY CHAIRMAN ADOLPH: I understand that.
19 And that doesn't seem to be forthcoming.

20 MR. KNITTEL: Not in the near term.

21 MAJORITY CHAIRMAN ADOLPH: Yes. Yes. There's
22 been an awful lot of discussion today regarding reducing
23 business taxes and how that improves the job creation. I
24 think there are an awful lot of things that go into job
25 creation other than just reducing business taxes, and that

1 is obviously an educated job force, number one.

2 And I think we've been very fortunate here in
3 Pennsylvania with the new natural gas industry. And you
4 mentioned that we here in Pennsylvania, even though we went
5 through the recession, we were not hit as deeply as some
6 other States as a result of having the natural gas industry
7 coming to Pennsylvania almost at the same time as people
8 were suffering with the recession. Is there any truth to
9 that statement that I just mentioned?

10 MR. KNITTEL: Yes. Clearly, at the start of the
11 recession, roughly about 2007 or 2008, is when we started
12 to see large job gains in the natural resources and mining
13 sector. So without those, the recession clearly would have
14 been worse.

15 MAJORITY CHAIRMAN ADOLPH: And one thing that we
16 always debate here in the General Assembly is tax credits
17 as far as job creation is concerned. Any thoughts
18 regarding tax credits for any particular industry? Do they
19 create jobs, giving an industry a tax credit?

20 MR. KNITTEL: I would have to defer on that. We
21 haven't studied that issue on whether it's an effective way
22 to encourage job creation.

23 MAJORITY CHAIRMAN ADOLPH: Okay. Well, I would
24 appreciate anything that your office could do with that
25 because that always seems to be an issue that we in the

1 General Assembly face. Obviously, the film tax industry
2 comes into mind and there's some legislation that's been
3 introduced that they would like to uncap it and there's an
4 awful lot of us that feel that this would be a great
5 opportunity for jobs here in Pennsylvania and increase
6 revenues. But there are some other thoughts to that, that
7 they don't bring back the tax revenue that is lost as a
8 result of the tax credits, so anything that your office
9 could help us with that because I'm sure that's going to be
10 part of the debate as well.

11 Just for the Members' information, we're going to
12 delay the afternoon session hearings for about a half an
13 hour. We didn't realize when we scheduled the one o'clock
14 hearing this afternoon that at the same time we were going
15 to have a new Member of the General Assembly sworn in, and
16 I've been asked by a few of the Members of the Committee
17 that they would like to be present for that swearing in.
18 We're going to start the afternoon session at 1:30. You
19 can adjust your schedules and your phone calls and that
20 type of stuff that you need to do. We'll come back here at
21 1:30.

22 Mr. Knittel, I want to thank you for testifying
23 before us today and also for the outstanding job that you
24 and your staff have been doing for the Commonwealth of
25 Pennsylvania over the last couple years.

1 MR. KNITTEL: Thank you. It's our pleasure.

2 MAJORITY CHAIRMAN ADOLPH: Okay. Thank you very
3 much.

4 We'll come back at 1:30. Thank you.

5

6 (The hearing concluded at 11:19 a.m.)

1 I hereby certify that the foregoing proceedings
2 are a true and accurate transcription produced from audio
3 on the said proceedings and that this is a correct
4 transcript of the same.

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