

INDEPENDENT FISCAL OFFICE

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Chairman Adolph, Chairman Markosek and members of the Appropriations Committee, thank you for the opportunity to testify before you today. For my opening remarks, I would like to very briefly discuss the outlook for the Pennsylvania economy and General Fund revenues.

2015 Economic Outlook

Looking forward to the rest of the calendar year, we are optimistic regarding the economic outlook. Recent economic data reveal several positive trends:

- For 2014, the Pennsylvania economy generated an average increase of 41,800 jobs, up from 16,600 in 2013. For 2015, we project employment growth of 48,700 jobs.
- Total wages are also accelerating slightly. For 2014, total wages grew by 3.2 percent, compared to 1.9 percent in 2013. For 2015, we project wage growth of 3.6 percent.
- Low gasoline prices imply that consumers are saving money in fuel costs. Some of those savings free up funds for other purchases. It also produces low inflation and boosts consumer confidence because it implies real wage gains. Since the recession, many wage earners have not realized real gains in their level of income; they have only kept pace with inflation.
- The debt level of Pennsylvania consumers remains relatively low. For 2014, total consumer debt was lower than 2007.

The primary risk to the economy is weakness overseas. Analysts expect energy prices to remain subdued, which should provide a tailwind to the state and national economies.

FY 2014-15 General Fund Revenues

For our mid-year revenue update released in January, the IFO increased its General Fund revenue estimate for FY 2014-15 by \$250 million, and the revised amount is now

roughly equal to the official certification made last July. Several factors motivated the upward adjustment to revenues:

- An unexpected inheritance tax windfall of \$100 million.
- Very strong growth in corporate payments. Corporate net income tax revenues are up 12.8 percent through February. It is unclear what is driving this trend as the national data show that U.S. domestic profits of non-financial corporations increased by only 1.1 percent through the third quarter of 2014.
- Gains in sales and use taxes. Some of the gains are due to the unexpected drop in gasoline prices, which was not anticipated by economic forecasting firms.

Despite much colder temperatures to start the year, sales tax revenues in January and February increased by 4.2 percent over the prior year. Motor vehicle collections were especially strong, growing by 11.2 percent. Once spring weather takes hold, we expect that warmer weather and low gasoline prices will release some pent up demand and further motivate economic growth.

FY 2015-16 General Fund Revenues

Our preliminary estimate for next fiscal year is a General Fund revenue growth rate of 1.3 percent. By comparison, the Administration projects a growth rate of 1.5 percent prior to any revenue changes due to proposals. Three factors will restrain revenue growth next fiscal year:

- A \$380 million reduction in non-tax revenues due to one-time revenues received in the current fiscal year related to a change in escheats (\$150 million) and several transfers into the General Fund (\$227 million).
- The continued phase out of the capital stock and franchise tax (roughly -\$100 million).
- A reduction in inheritance tax collections due to the \$100 million windfall received in the current fiscal year.

Absent these technical factors, we expect that the economy will motivate moderate revenue growth that ranges from 3 to 4 percent for most revenue sources. Continued jobs growth, modest energy prices and retrenched consumers may provide some upside to projected revenues. Our preliminary revenue estimate for next fiscal year will be released on May 1.

Thank you. I would be happy to answer any questions that you might have.