

ANALYSIS OF THE NEW JERSEY
FISCAL YEAR 1998 - 1999 BUDGET



ECONOMIC OVERVIEW AND
REVENUE ANALYSIS

PREPARED BY
OFFICE OF LEGISLATIVE SERVICES
NEW JERSEY LEGISLATURE
MARCH 1998

NEW JERSEY STATE LEGISLATURE

SENATE BUDGET AND APPROPRIATIONS COMMITTEE

Robert E. Littell (R), 24th District (Sussex and parts of Hunterdon and Morris), *Chairman*
Peter A. Inverso (R), 14th District (Parts of Mercer and Middlesex), *Vice Chairman*
Anthony R. Bucco (R), 25th District (Part of Morris)
Walter J. Kavanaugh (R), 16th District (Parts of Morris and Somerset)
Bernard F. Kenny, Jr. (D), 33rd District (Part of Hudson)
Joseph M. Kyrillos, Jr. (R), 13th District (Parts of Middlesex and Monmouth)
Wynona M. Lipman (D), 29th District (Parts of Essex and Union)

GENERAL ASSEMBLY APPROPRIATIONS COMMITTEE

Richard H. Bagger (R), 22nd District (Parts of Middlesex, Morris, Somerset and Union), *Chairman*
Leonard Lance (R), 23rd District (Warren and parts of Hunterdon and Mercer), *Vice Chairman*
Francis J. Blee (R), 2nd District (Part of Atlantic)
Joseph Charles, Jr. (D), 31st District (Part of Hudson)
Steve Corodemus (R), 11th District (Part of Monmouth)
Clare M. Farragher (R), 12th District (Part of Monmouth)
John C. Gibson (R), 1st District (Cape May and parts of Atlantic and Cumberland)
Guy R. Gregg (R), 24th District (Sussex and parts of Hunterdon and Morris)
John V. Kelly (R), 36th District (Parts of Bergen, Essex and Passaic)
Joseph R. Malone, III (R), 30th District (Parts of Burlington, Monmouth and Ocean)
William D. Payne (D), 29th District (Parts of Essex and Union)
Nellie Pou (D), 35th District (Part of Passaic)
Louis A. Romano (D), 33rd District (Part of Hudson)
Joseph Suliga (D), 20th District (Part of Union)
Bonnie Watson Coleman (D), 15th District (Part of Mercer)
Joel M. Weingarten (R), 21st District (Parts of Essex and Union)

OFFICE OF LEGISLATIVE SERVICES

Alan R. Kooney, *Legislative Budget and Finance Officer*
Allan Parry, *Assistant Legislative Budget and Finance Officer*

Glenn E. Moore, III, *Director, Central Staff*
David J. Rosen, *Section Chief, Revenue, Finance and Appropriations Section*

This report was prepared by the Revenue, Finance and Appropriations Section of the Office of Legislative Services under the direction of the Legislative Budget and Finance Officer. The primary authors were David J. Rosen, Maurice S. Shier, Martin Poethke and Catherine Z. Brennan, with additional contributions by Mary E. Forsberg and research assistance from Matthew Kirk.

Questions or comments may be directed to the OLS Revenue, Finance and Appropriations Section (Tel. 609 984-6798) or the Legislative Budget and Finance Office (Tel. 609 292-8030).

THE FY 1998 AND FY 1999 ECONOMIC OVERVIEW AND REVENUE ANALYSIS

Introduction

This analysis has been prepared by the Office of Legislative Services (OLS) to assist the Senate Budget and Appropriations Committee and the Assembly Appropriations Committee as they develop the FY 1999 general appropriations act. The OLS revenue estimates reflect a careful review of current State revenue collections, consideration of historical revenue collection patterns, and the examination of a variety of economic data and forecasts.

The analysis begins with an economic overview on page 2. The economic overview is divided into two sections: A Look Back at 1997 and A Look Ahead. On pages 10 and 11 the OLS presents a summary of year-to-date revenue collections for a selection of the major revenues. Actual revenue data are intrinsically significant and also serve as an economic indicator.

On pages 12 and 13, the OLS presents a summary of its FY 1998 and FY 1999 revenue estimates. This summary is followed by a more detailed discussion of selected revenue sources. The impact of the OLS's revenue estimates on the State budget surplus is discussed on page 24. Finally, a series of appendices provide additional detail and analysis.

Contents:

Economic Overview: A Look Back at 1997	2
Economic Overview: A Look Ahead	7
FY 1998 Year-To-Date Revenues	10
FY 1998 and FY 1999 Revenue Estimates	12
Discussion of Selected Revenue Sources	14
FY 1999 Surplus Analysis	24
Appendices:	
Detailed FY 1998 Revenue Estimates	A2
Detailed FY 1999 Revenue Estimates	A3
The Rainy Day Fund	A4
Public Utility Tax Revenue ...	A6

Economic Overview: A Look Back At 1997

A Look Back At 1997

The national and regional economies continued to grow at a remarkable pace throughout calendar year 1997. National output increased at the highest rate since 1988, unemployment declined to a 24-year low, and inflation fell to levels last seen three decades ago.¹ At 83 months, the current national expansion that began in 1991 is the third-longest period of uninterrupted growth on record, trailing only the 105 month expansion of the 1960's and the 93 month expansion of the 1980's.

The 1997 economy in New Jersey also experienced strong growth, out-performing neighboring states by most measures and narrowing the gap between State and national economies.

The Nation

Economic growth clearly exceeded expectations in 1997. The national real gross domestic product (GDP) increased by 3.8 percent for the year, a full percentage point above growth realized over the previous twelve months, and the strongest since 1988. Low inflation, high levels of employment, and favorable interest rates contributed to an economic environment conducive to strong consumption and investment by both firms and households.

Consumer spending (which increased by 3.3 percent in 1997, with spending on durable goods up by 5.6 percent) reflected strength in underlying fundamentals, including personal income, consumer confidence, and household net worth.

Personal income and salaries and wages continued to demonstrate strong growth in 1997, comparable to that which was realized in 1996. Personal income increased 5.8 percent, while wages and salaries increased 6.7 percent. Also, dividend, interest and rent earnings grew 5.5 percent for the year.

The optimism reflected in consumer spending, as measured by the Conference Board's Consumer Confidence Index, surged in 1997. As of December, the index, which measures consumers' appraisal of both their present situation, and their expectations for six months ahead, reached its highest level since mid-1967. Of particular note, the index indicated that 40.6 percent of consumers considered jobs to be "plentiful," the highest proportion in three decades.

"The economy continued to surprise observers with an impressive performance in 1997."

**Congressional Budget Office
January 1998**

Such sentiments were borne out by national employment data. Employment expanded by over 3.2 million in 1997 (compared to 2.5 million in 1996). Almost half (1.4 million or 44 percent) of all new jobs were concentrated in the services subsector², with an additional 513,000 or 16 percent of new jobs generated by the retail trade sector. Only federal government employment showed any decline over the last twelve months.

The unemployment rate, which fell to a 24-year low of 4.6 percent in November, averaged just under 5.0 percent for the year, down from an average of 5.4 percent in 1996. Moreover, the proportion of the population with jobs reached an all-time high of 64.1 percent during 1997.

¹ Congressional Budget Office, *The Economic Budget Outlook: Fiscal Years 1999-2008*, January 1998, p.1.

² Within the economy's service-producing sector, the services subsector includes employment in personal, business, health, legal, social and education (college and university) services; the hospitality and amusement and recreation industries (including casinos); and engineering and management.

Economic Overview: A Look Back At 1997

Despite record low unemployment, inflation, as measured by the consumer price index (CPI), remained remarkably subdued, at 1.7 percent, significantly lower than the rate of 3.3 percent that prevailed the year before. Although a tightening job market was reflected in a 3.9 percent increase in hourly wages in 1997, strong productivity growth and lower employee benefit costs, most notably in the area of health insurance, helped to keep labor market costs in check.

In previous years, the Federal Reserve Board (FED) has taken actions to reduce or increase the federal funds interest rates on short-term borrowing to fine-tune growth in the overall economy. In the first such action taken since January 1996, the FED raised its target federal funds rate by 25 basis points to 5.5 percent in March, 1997, as "a preemptive policy action that would head off any pick up of inflation."³

The bond market, as measured by Moody's Aaa corporate bond index, returned an average yield of 7.26 percent in 1997. This is slightly below the 1996 yield of 7.37 percent. Meanwhile, the average 1997 yield on the 30 year Treasury bond was 6.61 percent, its lowest level since 30 year bonds were reintroduced in 1977. The low Treasury yield has been attributed to diminished concerns about inflation, continued federal deficit reduction, and a "flight to quality" by foreign investors who perceive U.S. securities to be more attractive than foreign market assets.

Corporate profits continued to expand in 1997 for the sixth straight year, the third longest period of uninterrupted growth since World War II. Between the third quarter of

1996 and the third quarter of 1997, corporate profits grew by 12 percent.

High profitability in the corporate sector and forecasts of strong future earnings growth, have fueled a continued run-up in stock prices. The Dow Jones Industrial Stock Index broke 8100 in July, before settling at 7908.25 for the year (a 23 percent gain over 1996), while the Standard and Poor's 500 stock index ended the year at 970.43 (up 31 percent), marking the first time either index has risen more than 20 percent for three consecutive years. The volume of shares traded also continued to climb. Indeed, over the last five years, annual volume on both the NASDAQ and the New York Stock Exchange has at least doubled.

"These days you don't have bulls and bears, you have believers in the new era and people who don't think [the current investment landscape is] permanent."

**-- Wall Street Journal
January 2, 1998**

Overall, the combination of continued steady growth, stable inflation, low unemployment, and strong profits and stock prices has led most analysts to praise the state of the national economy. Indeed, some analysts have even speculated that the economy has entered some "new era." However, while noting that the current economy reflects the best performance in a generation, the President's Council of Economic Advisors cautions that any suggestions that "the old rules no longer apply" are probably unfounded.⁴

³ Minutes of the Federal Open Market Committee meeting of March 25, 1997, Federal Reserve Board.

⁴ *Economic Report of the President*, President's Council of Economic Advisors, February 1998, p. 62

Economic Overview: A Look Back At 1997

New Jersey

In 1997, New Jersey's economy experienced its best year since the current expansion began in 1993. The State benefitted from another year of strong growth in employment, income and retail sales, with no sign of inflation.

On an average annual basis, New Jersey gained over 85,600 jobs during 1997, the largest annual posting since 1988.⁵ Moreover, by September, New Jersey had fully recovered the 262,000 jobs lost during the last recession. As noted by James W. Hughes and Joseph J. Seneca of the Edward J. Bloustein School of Planning and Public Policy at Rutgers, New Jersey's performance in this regard is remarkable considering that New York and Connecticut have regained just 59 and 65 percent of their recession job losses, respectively.⁶

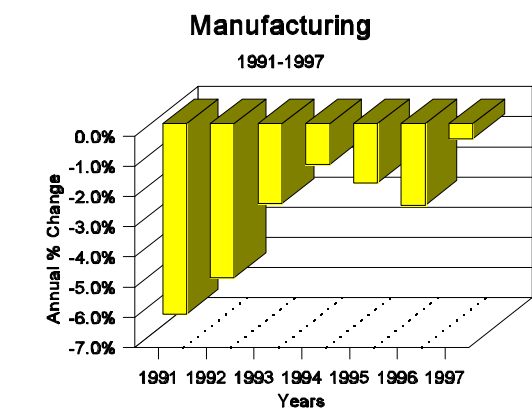
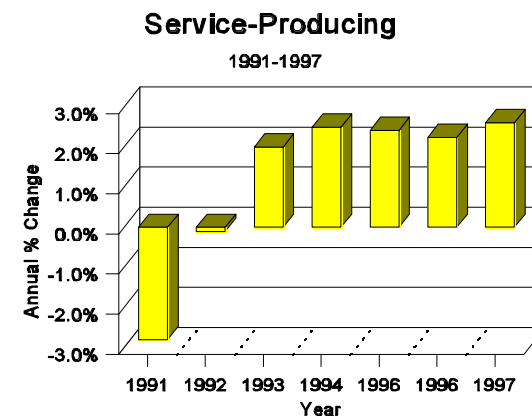
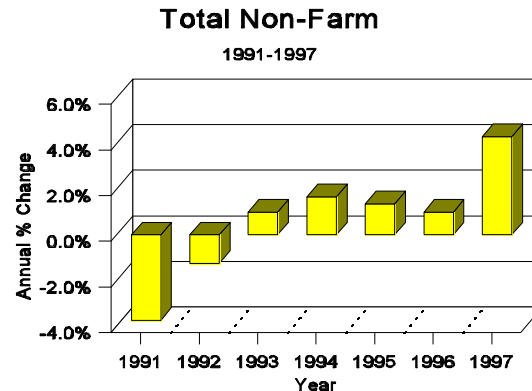
Total nonfarm employment expanded at an accelerated pace this year, growing at a rate of 2.4 percent (compared to 1.6 percent in 1996), setting a new record high of 3,799,300. In general, those sectors that saw growth in 1995 and 1996 grew more rapidly in 1997, while those sectors that declined in 1996, such as manufacturing, declined more slowly in 1997.

Specifically, within the service producing sector, the services subsector added more than 49,400 jobs in 1997 (4.4 percent growth) and remained the backbone of the New Jersey economy, currently employing over 30 percent of the State's workforce (up from 24 percent a decade ago). Business services again led with 24,500 jobs (9.4 percent growth). Meanwhile, the primary driver of growth within business services was the personnel

⁵ All State employment data reflect revised 1997 data released 2/5/98. Source: U.S. Department of Labor, Current Employment Statistics.

⁶ "Anatomy of a Business Cycle: The Final Report Card," *Rutgers Regional Report*, Number 15 (December 1997), J.W. Hughes and J.J. Seneca.

Figure 1
NJ Employment Growth
Annual Percent Change



Economic Overview: A Look Back At 1997

supply industry (11,900, 16 percent), which has grown by 77.5 percent since the recovery period began in 1993. Second to business services, retail trade added some 11,700 jobs in 1997, with almost half (44 percent) of the gain in retail occurring in eating and drinking establishments.

The New Jersey manufacturing sector, by contrast, continued to downsize in 1997, but at a much slower rate than in previous years. The employment reduction slowed to less than one percent with a loss of 1,400 jobs. In the prior year, the sector lost 13,200 jobs (2.7%). Manufacturing currently accounts for 13 percent of all jobs, compared to 19 percent just 10 years ago. The last time manufacturing employment increased was in 1984.

Within the remaining sectors, government employment remained flat, with decreases in federal employment (1,600; 2.3 percent) offset by relatively minor gains in total State and local government employment. (Figure 1 on page 4 shows how overall employment and specific labor market sectors performed as the State dropped into recession and then recovered.)

As employment growth accelerated, New Jersey's unemployment rate decreased by .8 percent points to 5.4 percent in 1997, the lowest level since 1990.

New Jersey personal income increased by an estimated 5.5 percent in the 1997, up from 4.7 percent in 1996. Income growth stemmed largely from increased employment as well as

gains in non-wage income, which was influenced by the recent federal capital gains tax cut. Continued growth in stock market values has provided investors with extraordinary gains in the past three years, most of which are taxable under the gross income tax.

Employees in New Jersey's financial services industry also benefitted from strong performances in the market through annual bonuses. According to a report by Bloomberg News, "Wall Street will pay record bonuses this year, with top traders, bankers and sales people seeing increases of as much as 50 percent" over 1996.⁷ Year end bonuses, which can account for 90 percent of financial services employees' total annual pay, will have a positive impact on New Jersey gross income tax revenues in FY 1998.

Fueled by income growth, retail sales grew by 7.3 percent in 1997, doubling the 1996 rate of 3.7 percent. When inflation is taken into account, adjusted retail sales in the Garden State increased 4.9 percent (see Figure 2 on page 6).

While retail sales are an important indicator of economic performance, they include items that have little direct impact on State revenues. Taxable sales, that portion of retail sales which does contribute to State revenues, are driven

SOME NEW JERSEYANS LEAVING FOR WARMER CLIMATES

According to reports published in the Fall of 1997, IRS data indicate New Jersey experienced a net loss of some 144,000 taxpaying families between 1992 and 1995, taking combined income of \$4.4 billion dollars with them. By tracking where people file their income tax returns, the IRS data suggest that New Jerseyans, many of whom are presumably retirees, relocated to states offering one or more of the following: warmer climates, lower tax burdens and land costs and less congestion -- primarily Arizona, Georgia, Florida, North Carolina, and Pennsylvania. The New Jersey Department of Commerce and Economic Development estimates that this net out-migration represents less than one percent of the State's \$2.9 trillion income base.

⁷ The Star Ledger, Newark Morning Ledger Company, October 14, 1997, p. 45.

Economic Overview: A Look Back At 1997

by two important components for which data are available -- housing and automobile sales.

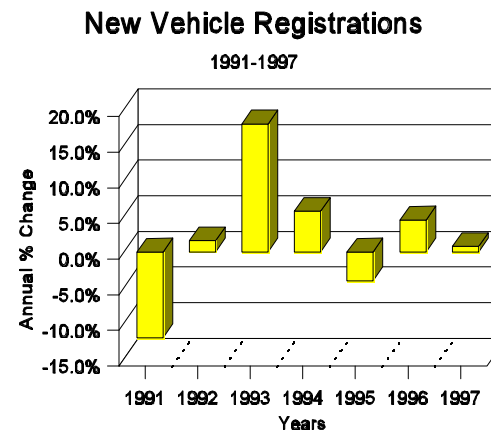
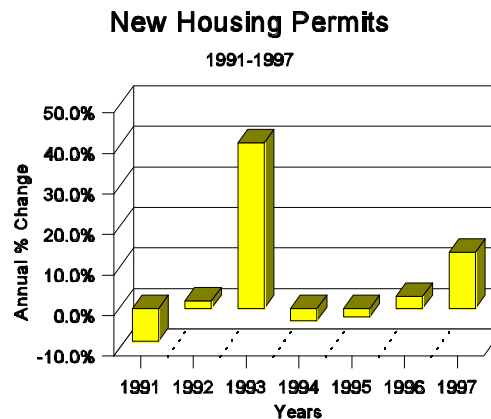
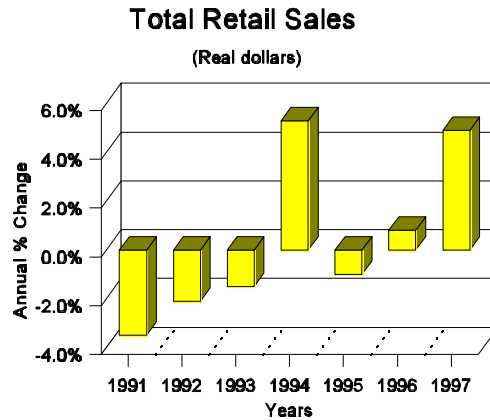
Home purchases provide a substantial boost to economic growth in New Jersey. New home production is a significant component of sales tax revenue for the State because all materials that are used to construct a home are taxable under New Jersey's sales and use tax. Existing home purchases also provide the State a significant economic benefit. Typically, furnishing a new home results in substantial taxable sales. Both the construction and the furnishing of a home generate employment and profits that feed into all three major State revenues (corporation business, sales and gross income taxes).

New housing starts in New Jersey, as measured by authorized permits, were up by almost 3,300 to approximately 27,500 in 1997. This 13.5 percent increase in new permits can be attributed to the same factors that have boosted home ownership to an all-time high nationally: income growth, low mortgage interest rates, and the increased availability of sub-prime mortgage loans, which relax the down payment constraints of traditional loans.

A second measurable component of taxable sales is new motor vehicle sales, which includes both cars and light trucks. In 1997, total new vehicle sales, as measured by new registrations, were up by less than one percentage point, from 531,963 in 1996 to 536,722 in 1997. In terms of taxable sales, however, this relatively low growth rate is misleading, since the average vehicle price has been increasing, particularly given the popularity of sport utility vehicles (SUV's). Indeed, although car registrations were down over last year, this decrease in new car sales was more than offset by an increase in the sales of light trucks, including SUV's.

Lastly, inflation for the New York/Northeastern New Jersey region was 1.8 percent, slightly above the national average, while the southern New Jersey/Philadelphia region's inflation rate was half a point lower at 1.3 percent.

Figure 2
NJ Sales Tax and Components
Annual Percentage Change



Economic Overview: A Look Ahead

A Look Ahead

The Nation

The national economic expansion is expected to continue, but moderate. Most analysts agree that the current trend of steady, moderate growth combined with low inflation and unemployment will continue through 1998 and into 1999. At 83 months, the current national expansion will enter its eighth year in May. It is already the third longest expansion since World War II. The average expansion in the post-War period is 50 months.

While most observers predict continued expansion in coming months, most are also less sanguine about the long-term prospects for the economy and have begun to sound cautionary warnings. In particular, forecasters note the economic turmoil in Asia, tight labor markets and historically high price-earnings ratios of U.S. stocks as the primary factors which could dampen future growth rates.

Such concerns were recently expressed by Federal Reserve Chairman Alan Greenspan who suggested that both investors and lenders may be underestimating the risks confronting the current expansion. Given his prediction that "events in the months ahead are not likely to unfold smoothly," Greenspan has noted that the FED's economic forecasts for the year ahead, which predict slower but continued growth, are particularly tentative.⁸

Similarly, the President's Council of Economic Advisors, the Congressional Budget Office, and a leading survey of economists, the Livingston Survey, all predict moderation of both supply- and demand-side indicators over the next 12-24 months. (See Figure 3.)

⁸ *The New York Times*, February 25, 1998, page D-1.

Figure 3
United States Growth Predictions,
Selected Indicators
1998-1999

	President's Council of Economic Advisors	Congressional Budget Office	Livingston Survey of Economists
1998			
Real GDP	2.4%	2.7%	2.2%
Non Farm Employment	1.4%	n/a	n/a
Consumer Price Index	2.2%	2.2%	2.5%
Unemployment Rate	4.9%	4.8%	4.9%
1999			
Real GDP	2.0%	2.0%	2.2%
Non Farm Employment	1.1%	n/a	n/a
Consumer Price Index	2.2%	2.5%	2.6%
Unemployment Rate	5.1%	5.1%	5.0%

Source: *Economic Report of the President*, President's Council of Economic Advisors, February, 1998; *The Economic and Budget Outlook, Fiscal Years 1999-2000*, Congressional Budget Office, January 1998; *Livingston Survey*, Philadelphia Federal Reserve Bank, December 1997.

Nevertheless, an expansion simply does not die of old age or because it has continued for a long period of time, according to the President's Council of Economic Advisors. In its most recent report, the Council noted recent post-War expansions have ended because of rising inflation, financial imbalances or inventory overhangs. Accordingly, the absence of these conditions bodes well for the state of the economy in the short term.⁹

⁹ *Economic Report of the President*, President's Council of Economic Advisors, February 1998, page 87.

Economic Overview: A Look Ahead

New Jersey

Most economists predict New Jersey will continue to track the anticipated positive, albeit slower, performance of the nation. Figure 4 displays growth predictions by the New Jersey Council of Economic Advisors and the Executive. In its most recent annual report, the Council forecast growth in employment, personal income, and retail sales over the next two years.

Similarly, the Leading Index for New Jersey remained positive in December 1997, signaling that the State's economic expansion will continue through most of 1998. The index, which is constructed by the Federal Reserve Bank of Philadelphia, projects the growth of a state's current economic activity over the next nine months.

The New Jersey labor market is expected to expand by approximately 50,000 jobs in 1998, according to the New Jersey Council of Economic Advisors. The Council predicts most job growth to continue to be in five core industry groups: finance, entertainment/travel, health care, logistics and high technology.

The health care, pharmaceutical and communication technology industries are significant employers in New Jersey. AT&T, the State's largest employer, has recently announced the elimination of some 15,000 to 18,000 jobs nationwide in the year ahead, most of which will occur through early retirement and attrition programs. In addition, layoffs are anticipated as a result of the proposed merger of CoreStates Bank with First Union. The overall impact of these reductions, however, is expected to be mitigated by current labor market conditions.

Indeed, a number of economic observers are predicting an increasingly tight labor market. Small business owners are expressing concern over their inability to find enough qualified people to fill job openings. A survey by the New Jersey Chapter of the

Figure 4 New Jersey Growth Predictions, Selected Indicators 1998-1999		
	NJ Council of Economic Advisors	Executive
1998		
Non Farm Employment	1.4%	1.5%
Unemployment Rate	5.1%	4.4%
Pers. Income (Current \$)	4.8%	4.8%
Retail Sales (Current \$)	3.9%	N/A
1999		
Non Farm Employment	1.1%	0.9%
Unemployment Rate	5.3%	4.3%
Pers. Income (Current \$)	4.8%	4.7%
Retail Sales (Current \$)	4.8%	N/A

Source: *New Jersey Review and Economic Outlook for 1998-1999*, New Jersey Council of Economic Advisors, January 1998; and *Fiscal Year 1998 and 1999 Revenue Update*, Department of the Treasury, February 3, 1998.

National Federation of Independent Business recently concluded that "One of the biggest problems is the inability to find qualified people to hire. We've created a tremendous number of jobs.... We will only be able to hire people from someone else."¹⁰

Following a period of overbuilding in the 1980's, that produced a glut of commercial space, the current market for office space is at its lowest vacancy rates in 25 years. By the

¹⁰*The Star Ledger*, Newark Morning Ledger Company, January 30, 1998.

Economic Overview: A Look Ahead

end of 1997, New Jersey's office market (which is the fifth largest market nationally) reflected a vacancy rate of approximately 9 percent for "Class A" space, down from a historical rate of 12 percent.¹¹ In fact, some counties, such as Mercer (3.4 percent) and Somerset (3.9 percent) have nearly exhausted their available "Class A" space.¹² Of note, over a dozen office buildings are currently under construction in Central Jersey, most with all or a portion of the planned space already pre-leased. Predictably, the rental and sales prices of commercial real estate have been increasing as vacancy rates decline.

To some extent, New Jersey's economic growth has been attributable to the comparative advantage of its commercial real estate market. As prices increase and that advantage erodes, the State, according to some analysts, will have to rely on its other selling points to remain competitive within the region. These points include the State's highly trained labor force, good location, transportation infrastructure, and the availability of special financing and tax incentives for business relocation and job creation.

Most observers expect the Asian situation will have limited impact on the State's economy. The Federal Reserve Bank of New York estimates that just 8 percent of New Jersey's exports are sold to Asian markets, compared to 12 percent of all exports nationally. While most agree that it is too soon to measure the effect of the Asian fallout, it is likely that companies which are involved in infrastructure development, such as telecommunications and engineering projects, will face the greatest short term risks. Foster Wheeler, for example, a global

design, engineering, and construction firm with headquarters in Clinton, has about \$1 billion worth of projects scheduled in Southeast Asia.¹³ In contrast, the New Jersey pharmaceutical industry (which accounts for about 60,000 jobs in this State), is expected to be relatively unaffected by events in Asia, since demand for American pharmaceutical products tends to be fairly inelastic.¹⁴

Closer to home, a possible downturn in the U.S. stock market presents a more likely source of concern for the State. A sustained drop in stock prices could dampen consumer demand, since consumers would feel less wealthy if the value of their portfolios were to decline. Any decrease in consumption could, in turn, be expected to result in a slowdown in business expansions and hiring.

Although there are reasons to be cautious in the year ahead, the New Jersey Council of Economic Advisors has noted that New Jersey will "likely benefit more from regional developments in surrounding metropolitan areas than from the national expansion or international trade prospects."¹⁵ According to the Council, the State will benefit from, "the competitive strengths of the Mid-Atlantic region, [including] a well-educated labor force, technology resources, financial strength, and access to foreign markets." "Indeed, it has been at least a decade since the State's overall economic outlook was as favorable as is that for 1998."¹⁶

¹¹ *Sitar-Rutgers Regional Report*, Vol. 1, No. 1, J.W. Hughes and J.J. Seneca, editors, February 1998.

¹² *ibid.*

¹³ *The Record*, Bergen Record Corp., January 29, 1998.

¹⁴ *ibid.*

¹⁵ *New Jersey Review and Economic Outlook for 1998-1999*, Council of Economic Advisors, January 1998, p. 4.

¹⁶ *Sitar-Rutgers Regional Report*, Vol. 1, No. 1, J.W. Hughes and J.J. Seneca, editors, February 1998.

FY 1998 Year-To-Date Revenues

New Jersey's revenue collections have exceeded expectations throughout fiscal year 1998. As discussed in previous sections of this report, steady economic expansion, low inflation, continued job growth, a healthy corporate environment and heavy stock market activity have generated strong tax receipts.

Indeed, strong revenue growth is a national phenomenon, as reflected in the sudden evaporation of the federal budget deficit. At the state level, the National Conference of State Legislatures reported in January that revenues are running ahead of estimates in 30 states and matching estimates in 18 states.

Figure 5 on the following page displays FY 1998 year-to-date revenue collections for selected sources through the end of February compared to the same period in FY 1997. These 14 revenue sources account for about 80 percent of the State's annual budgeted revenues. The OLS monitors these revenues and provides periodic reports to the Senate Budget and Appropriations Committee and the Assembly Appropriations Committee.

The State is now nearly nine months into the fiscal year. The two largest tax revenues, the gross income tax (GIT) and the sales tax have shown robust growth rates throughout the fiscal year. Strong collections from employer withholding payments on employee income and quarterly estimated tax payments have driven the GIT to an 11.7 percent growth rate

so far this year, exceeding the Executive's revised year-end growth rate target of 10.7 percent. The 7.6 percent sales tax growth rate so far this year also exceeds the Executive's year-end growth rate target of 6.9 percent. Both taxes have seen revenue growth accelerate in January and February.

Midyear Cigarette Tax Increase Will Alter Collection Patterns

Effective January 1, 1998, the tax on a pack of cigarettes increased from 40 cents to 80 cents. In estimating the effect of this tax rate change the Executive and the OLS anticipated a drop in sales because of the increased price. The revised estimates for the remainder of FY 1998 assume a 14 percent decline in cigarette sales. While a doubling of tax revenue in the second half of the fiscal year would raise an additional \$110 million, the estimates only assume an additional \$77 million this fiscal year.

Current collections appear to be running below levels needed to achieve the Executive's revised year-end target. Given certain provisions of the cigarette tax law that affect the timing of tax payments during the transition to the new tax rate, it is too early to draw firm conclusions about revenues from this tax.

In addition to the largest tax revenues, the lottery, the motor fuels tax, the insurance premiums tax, the alcohol beverage excise tax, and the realty transfer tax are running ahead of the Executive's year-end growth targets.

Of the seven tax revenues running behind the Executive's year-end growth targets, most noteworthy are the corporation business tax (CBT) and the corporation tax on banks and financial institutions. The CBT has been affected by significantly higher tax refunds in recent months. After adjusting for higher refund payments, overall gross collections are running even with FY 1997. The corporation tax on banks and financial institutions also saw a sharp jump in refund payments, over \$20

million in February alone. That amount is more than in all the months between February and June last year.

Other tax revenues lagging behind growth rates needed to reach the Treasury's year end targets include motor vehicle fees, the transfer inheritance tax, the casino tax, and the petroleum products tax. Cigarette tax collections are a special case, discussed in the box on this page and again later in this report.

FY 1998 Year-To-Date Revenues

While the year-to-date collections are valuable data, revenue estimating is more complicated than simply taking the year-to-date growth rates and extending them to the end of the year. Changes in payment schedules, tax law, and the economy all affect the flow of collections.

Where appropriate, these considerations will be discussed in the context of particular revenues. Beginning on the following page, the OLS presents its FY 1998 and FY 1999 revenue estimates.

Figure 5 Selected Year-To-Date Revenue Comparison Through the End of February 1998 vs. 1997 (\$ millions)				
Revenue Source	FY 1997 Actual Year-To-Date	FY 1998 Actual Year-To-Date	FY 1998 Actual % Growth	FY 1998 Year-End Executive % Growth
Income Tax *	\$2,885.1	\$3,221.2	11.7%	10.7%
Sales Tax *	2,568.9	2,765.0	7.6%	6.9%
Corporation Tax	617.0	579.6	(6.1)%	2.2%
Lottery	411.1	430.0	4.6%	0.8%
Motor Fuels *	278.9	282.1	1.2%	0.5%
Motor Vehicle Fees	267.4	264.2	(1.2)%	(0.9)%
Casino	202.5	207.6	2.5%	4.8%
Transfer Inheritance	197.2	220.6	11.9%	14.9%
Insurance Premiums	99.0	100.1	1.1%	(3.8)%
Cigarette	164.0	178.1	8.6%	32.3%
Petroleum Products *	116.6	115.3	(1.2)%	2.6%
Alcohol Excise *	42.2	41.2	(2.3)%	(8.0)%
Corp. Banks & Financial	37.0	4.6	(87.6)%	(33.1)%
Realty Transfer *	32.2	38.3	19.2%	13.7%

Sources: Year-To-Date revenues are from Treasury monthly reports. The Executive year-end percentage growth target is based on the January revised revenues for FY 1998 contained in the proposed FY 1999 budget.

* Revenues represent seven months of cash collections. All others represent eight months of cash collections.

FY 1998 and FY 1999 Revenue Estimates

Figures 6 and 7 compare components of the Executive and the OLS revenue estimates for FY 1998 and FY 1999. (For greater detail, refer to pages A2 and A3 in the appendix). Comparison of columns 1 and 2 of Figure 6 shows the Executive increased its overall estimate of FY 1998 revenues by a net \$610 million between the appropriations act certification last June and the Executive's FY 1999 budget submission this February.

This \$610 million upward adjustment consisted of a \$304 million upward revision in gross income tax collections, a \$170 million upward revision in sales tax collections, a \$33 million upward revision in corporation business tax collections, a \$46 million total increase in

other major tax revenues. A series of upward and downward revisions produce a net increase in miscellaneous revenues of \$66 million. The \$46 million net change in other major taxes includes a \$77 million upward revision in cigarette tax receipts attributable to the 40 cent per pack tax increase that took effect on January 1, 1998.

The OLS estimates for FY 1998, listed in the fourth column of Figure 6, total \$5 million more than the revised Executive estimates. The largest single difference is for the income tax, where the OLS is estimating \$20 million more than the Executive.

Figure 6 Fiscal Year 1998 Revenue Estimates (\$ millions)					
	Approp. Act (7/1/97)	February Revised Executive	Executive Changes	Office of Legislative Services	Difference OLS vs. Revised Executive
Gross Income Tax	\$5,036	\$5,340	\$304	\$5,360	\$20
Sales Tax	4,550	4,720	170	4,735	15
Corporation Business Tax	1,282	1,315	33	1,300	(15)
Other Major Taxes	2,154	2,200	46	2,189	(11)
Misc. Taxes, Fees, Revenues	1,931	1,997	66	1,997	0
Interfund Transfers	922	916	(6)	916	0
Other Funds	387	383	(4)	379	(4)
Grand Total, All Funds	\$16,262	\$16,871	\$610	\$16,877	\$5

See Appendix for additional detail. Numbers may not add due to rounding.

FY 1998 and FY 1999 Revenue Estimates

The Executive anticipates \$17.582 billion in FY 1999, as shown in Figure 7. This is a \$711 million (4.2%) increase over its FY 1998 estimates. The OLS is projecting \$17.444 billion in FY 1999, an increase of \$567 million (3.4%) from a slightly higher estimated FY 1998 base. **The OLS total revenue projection for FY 1999 is \$138 million less than the Executive estimate.**

The Executive anticipates strong growth in the gross income tax (GIT). GIT collections in FY 1999 are anticipated to increase by \$520 million (9.7%) over FY 1998. The sales tax is anticipated to increase by \$208 million (4.4%) over FY 1998 and the corporation business tax (CBT) is anticipated to increase by \$116 million

(8.8%), due in part to the effects of the change in public utility taxation enacted in 1997.

The largest difference between the OLS and the Executive estimates is for the GIT, where the OLS is estimating \$60 million less than the Executive.

Over the two fiscal years, the OLS projects State revenues will be \$133 million less than the amount estimated in the Executive budget submission.

A discussion of the sales tax, the gross income tax, and other selected tax revenues follows Figure 7.

Figure 7 Fiscal Year 1999 Revenue Estimates (\$ millions)					
	Executive	% Change 98 to 99	Office of Legislative Services	% Change 98 to 99	Diff. OLS vs. Exec.
Gross Income Tax	\$5,860	9.7%	\$5,800	8.2%	(\$60)
Sales Tax	4,928	4.4%	4,945	4.4%	17
Corporation Business Tax	1,431	8.8%	1,410	8.5%	(21)
Other Major Taxes	2,225	1.1%	2,204	0.1%	(21)
Misc. Taxes, Fees, Revenues	1,791	(10.3)%	1,791	(10.3)%	0
Interfund Transfers	919	0.2%	909	(0.8)%	(10)
Other Funds	429	11.9%	386	2.2%	(43)
Grand Total, All Funds	\$17,582	4.2%	\$17,444	3.4%	(\$138)

See Appendix for additional detail. Numbers may not add due to rounding.

Discussion of Selected Revenue Sources

Sales Tax

The Executive estimates the sales tax will produce \$4.720 billion in FY 1998 and \$4.928 billion in FY 1999. The OLS estimates sales tax collections of \$4.735 billion in FY 1998, \$15 million more than the Executive, and \$4.945 billion in FY 1999, \$17 million more than the Executive. The differences between the OLS and the Executive are small, based largely on current collections data, not on a different view of economic activity.

According to the Executive, underlying base growth in the sales tax will be about 6.9 percent in FY 1998 and then moderate to 4.9

percent in FY 1999, as shown in Figure 8. The FY 1999 underlying growth rate is adjusted for the \$25 million anticipated loss from the Governor's proposal to remove the sales tax on intrastate phone calls between regional calling areas.

The higher growth rate in FY 1998 is based on high growth in current collections, while the lower rate in FY 1999 assumes a return to recent average growth patterns. Figure 9 on the next page displays underlying growth in the sales tax from FY 1991 through FY 1999, after adjusting for tax rate and base changes. The average growth over the last five fiscal years has been about 5.0 percent.

Figure 8 Sales Tax, FY 1998 and FY 1999 (\$ millions)				
	FY 1998		FY 1999	
	Executive	OLS	Executive	OLS
Sales Tax Total (Budget)	\$4,720.0	\$4,735.0	\$4,928.0	\$4,945.0
<i>Percent Growth (Budget)</i>	<i>6.9%</i>	<i>7.2%</i>	<i>4.4%</i>	<i>4.4%</i>
Proposed Tax Change*			\$25.0	\$25.0
Sales Tax (Underlying)	\$4,720.0	\$4,735.0	\$4,953.0	\$4,969.0
<i>Percent Growth (Underlying)</i>	<i>6.9%</i>	<i>7.2%</i>	<i>4.9%</i>	<i>4.9%</i>
* The Governor has proposed the elimination of the sales tax on phone calls between regional calling areas. Figures from the Department of the Treasury.				

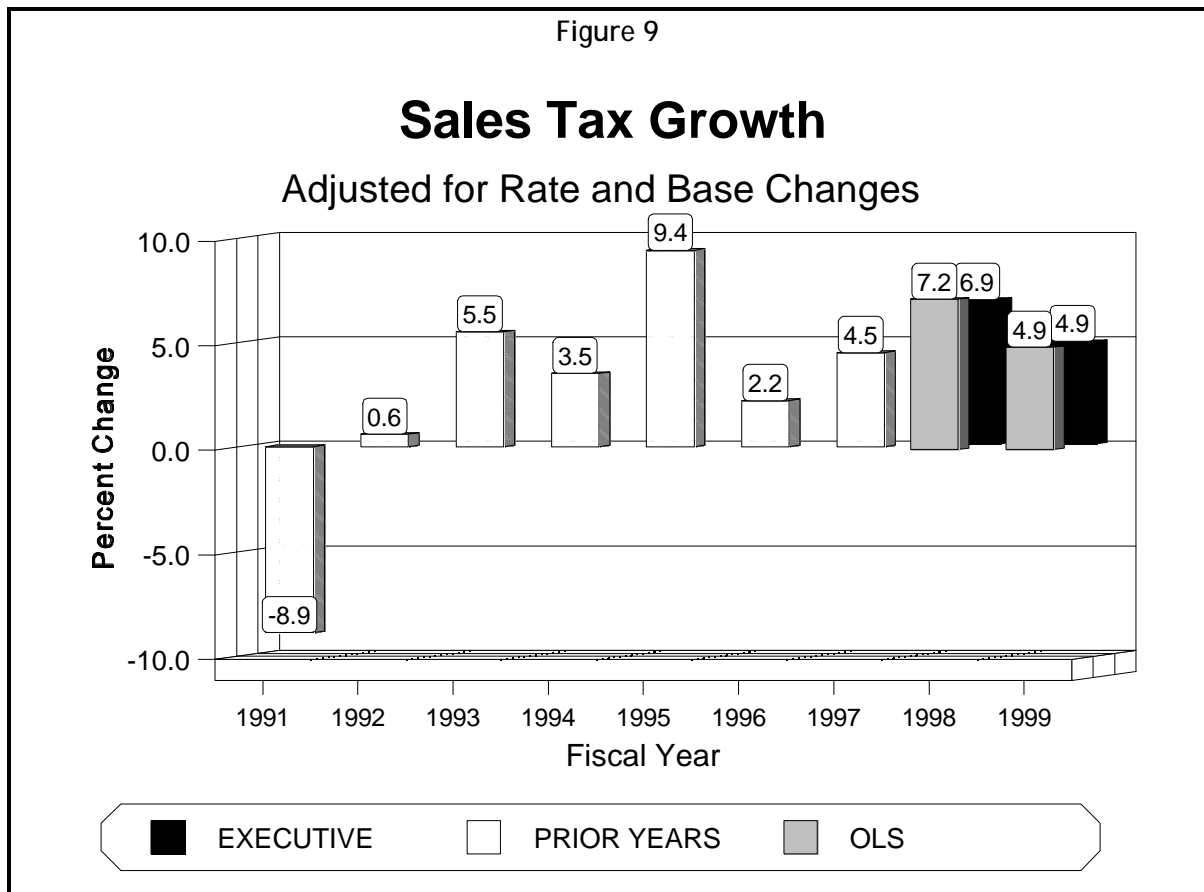
Discussion of Selected Revenue Sources

The OLS generally agrees with the Executive's assessment of sales tax revenues. The current sales tax growth rate, as discussed on pages 10 and 11, is 7.6 percent through the end of February. This represents seven months of sales activity through the end of January, because collections lag sales by one month. If the 7.6 percent growth rate continues over the remaining five months of sales tax collections, the State will end the year with \$4.751 billion, \$31 million more than the Executive is estimating and \$16 million more than the OLS is estimating for FY 1998.

However, this pace is not expected to continue. The OLS notes that the growth rate in the first five months of the year was 6.1 percent while revenues attributable to

important December and January sales jumped to an 11.2 percent growth rate. The OLS assumes sales tax growth will return to a more moderate 6.7 percent over the last five months of FY 1998. In February, the Treasury projected 6.8 percent growth for the last five months. Yet, actual collections through February exceed the Treasury's revised target by \$15 million. Given the strong recent collections, sales tax revenue need only grow by 5.9 percent over the last five months to reach the Treasury's current target.

Both the Executive and the OLS assume sales tax growth in FY 1999 will return to the average growth level in the previous five years, or about 4.9 percent.



Discussion of Selected Revenue Sources

Income Tax

Upward revisions appear to be the norm for federal income tax and state income tax revenues nationwide. The Congressional Budget Office recently reported additional upward revisions in revenues, particularly for the income tax, and it is now projecting the federal fiscal year will end with the first budget surplus since 1969. The National Conference of State Legislatures reported in January that revenue collections in 30 states are exceeding budgeted targets, in large part due to strong income tax collections. In fact, those states without an income tax are among the 18 states that are only matching their revenue targets.

The Executive has revised its estimates of income tax collections upward to \$5.340

billion in FY 1998, an increase of \$304 million above the amount certified in June for the FY 1998 Appropriations Act. After adjusting for the impact of the second year of the property tax deduction and an OLS estimate of the one-time effect of the change in the federal tax rate on capital gains enacted in 1997, the Executive's underlying growth rate for the GIT is about 10.8 percent in FY 1998, as shown in Figure 10.

The Executive anticipates \$5.860 billion in GIT collections in FY 1999, \$520 million (9.7%) more than in FY 1998. After adjusting for the next step in the property tax deduction and the absence of the capital gains one-time impact, the OLS estimates the Executive's underlying growth rate at about 11.7 percent in FY 1999, an increase from the Executive's underlying growth in FY 1998.

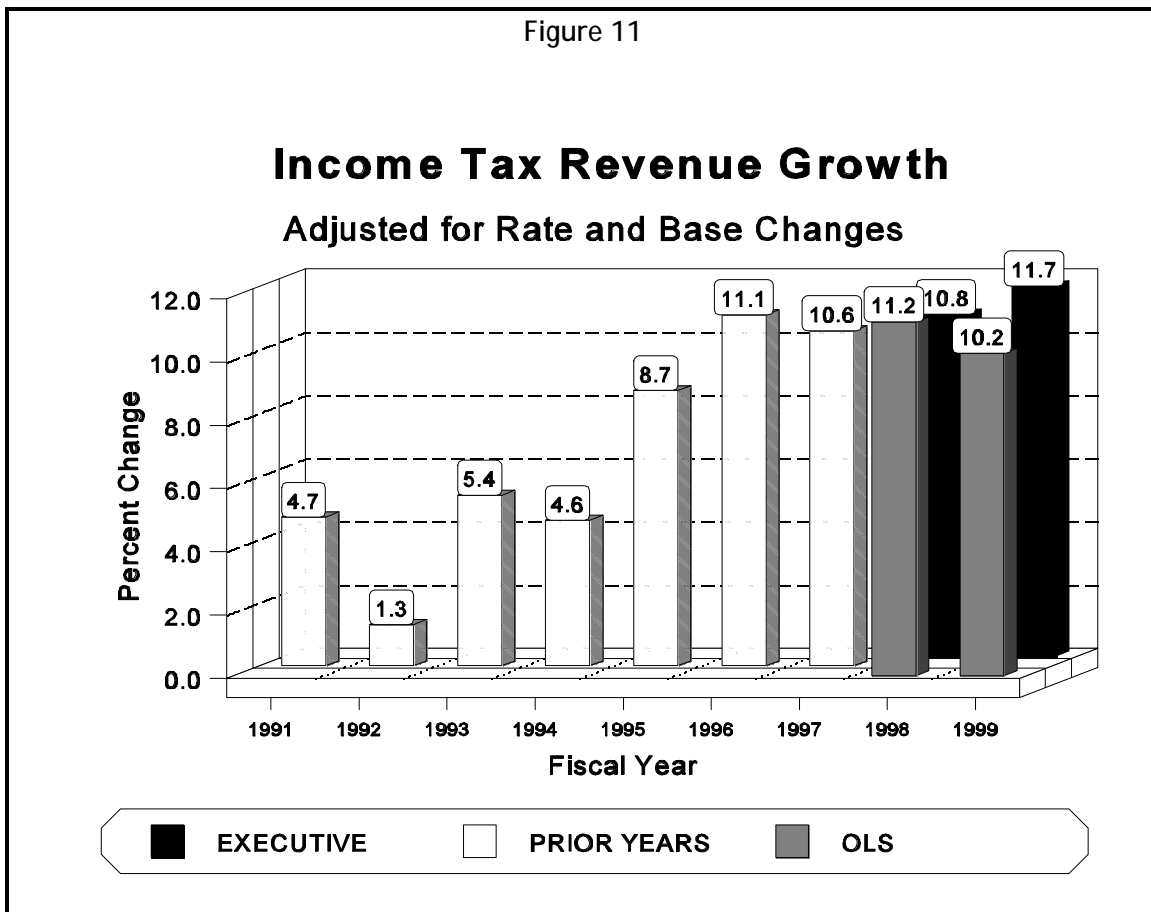
Figure 10 Income Tax, FY 1998 and FY 1999 (\$ millions)				
	FY 1998		FY 1999	
	Executive	OLS	Executive	OLS
Income Tax Total (Budget)	\$5,340.0	\$5,360.0	\$5,860.0	\$5,800.0
<i>Percent Growth (Budget)</i>	<i>10.7%</i>	<i>11.1%</i>	<i>9.7%</i>	<i>8.2%</i>
Property Tax Deduction*	\$167.0	\$167.0	\$234.0	\$234.0
OLS Est. Federal Capital Gains Tax Change One Time Impact**	(\$50.0)	(\$50.0)	\$0.0	\$0.0
Income Tax (Underlying)	\$5,457.0	\$5,477.0	\$6,094.0	\$6,034.0
<i>Percent Growth (Underlying)</i>	<i>10.8%</i>	<i>11.2%</i>	<i>11.7%</i>	<i>10.2%</i>
* Executive Budget estimates.				
** Based on an estimate of about \$800 million in gains at an average marginal tax rate of 6%.				

Discussion of Selected Revenue Sources

The Executive's underlying growth estimates are in line with recent experience. As is shown in Figure 11, underlying growth in the gross income tax was about 11.1 percent in FY 1996 and about 10.6 percent in FY 1997.

The OLS agrees with the Executive's assessment that income tax revenues will exceed the original estimates in FY 1998 by a significant amount. Monthly collections of tax withholding from employee wages have grown by nearly 11 percent so far this year, exceeding both the Executive's and OLS's cash flow estimates. Quarterly estimated payments in the December and January period were 22 percent ahead of the same period a year ago (which

itself grew by 29% over the prior year). Figure 12 on the next page displays actual income tax collections growth in FY 1998 over FY 1997 for each month. Actual collections have been running well ahead of Treasury's and OLS's targets all year. This extraordinary strength indicates there should be strong final tax payments in April. Indeed, the OLS, with the benefit of an additional month or two of data than the Executive, estimates the GIT will receive \$5.360 billion in FY 1998, \$20 million more than the Executive. The OLS estimate, after adjusting for tax changes, reflects a slightly higher underlying growth rate of 11.2 percent.



Discussion of Selected Revenue Sources

A number of factors have affected the strong growth in the GIT in FY 1998. As noted in the economic analysis on pages 4 and 5, New Jersey gained over 85,000 jobs during 1997, the largest increase since 1988, and New Jersey personal income grew by 5.5 percent last year, up from 4.7 percent in 1996. In particular, income is growing most rapidly in the highest tax brackets, driving tax collections up rapidly because of the progressive rate structure. For example, the 50 percent growth in bonuses for employees of the financial sector noted on page 5, is mostly taxable at a rate of 6.37 percent and has a significantly larger State tax revenue impact than income growth at a lower marginal tax rate such as 1.4 percent.

In addition to solid growth in employment and wages, the impact of the extraordinary gains in stock values and market activity has been widely viewed as a leading cause of the strong increase in income tax collections in New Jersey and the nation. According to the latest State data, capital gains income grew by over 44 percent in tax year 1995, the first year of the three year market boom (largely affecting FY 1996). Tax year 1996 gains likely grew at a similar rate. Following federal changes in the capital gains tax rate in 1997, tax year 1997 gains could accelerate further. Capital gains income is also concentrated in the highest tax brackets and produces significant tax revenues.

The change in the federal tax rate on capital gains was anticipated to increase annual levels of capital gain realizations. It also was anticipated that the rate change would encourage realization of gains that had been held for a long period of time, resulting in a

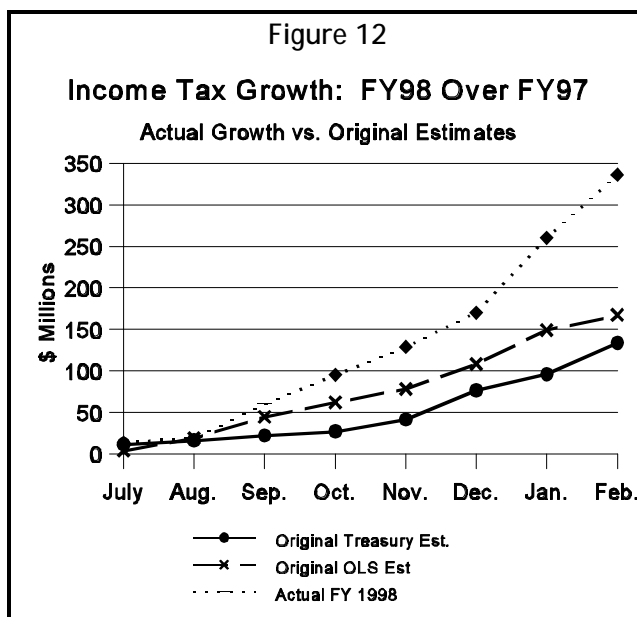
one-time surge in realizations and tax revenues. Federal tax analysts had estimated at least a 30 percent jump in capital gains income due to the change in federal capital gains taxes alone, half of which may be a one time surge in the first year and the rest being a permanent increase.

Based on these reports, the OLS is estimating that capital gains in tax year 1997 could grow by perhaps \$4 billion, generating over \$200 million in new tax revenue.

Assuming only 25 percent of that amount is a one-time tax revenue increase, then the FY 1998 income tax collections include some \$50 million in one-time collections. This amount is reflected in OLS's calculation of underlying GIT growth rates, as displayed in Figures 10 and 11. For a further discussion of the stock market

boom and State revenues, please see the discussion on page 19.

Given consensus forecasts of moderating employment and income growth rates in calendar years 1998 and 1999 (please see pages 8 and 9), the OLS does not assume an increase in the underlying growth rate of GIT collections going into FY 1999. Rather, the OLS assumes that underlying growth in GIT collections will remain strong, but moderate to about 10.2 percent. As a result, the OLS is projecting collections of \$5.800 billion in FY 1999, \$60 million less than the Executive.



Discussion of Selected Revenue Sources

The State Budget and the Stock Market "Deja Vu All Over Again"

As discussed in this report last year, the performance of the stock markets has been remarkable for several years. The major stock index values have increased by over 80 percent since the end of 1994. This stock value growth affects income tax, corporation tax, and inheritance tax collections directly, and sales tax collections indirectly, as increased wealth generates increased sales of goods and services. In addition, growth in the value of stocks translates into large gains in the State's pension fund investments and concomitant reductions in General Fund appropriations.

Part of the impact of the stock boom on State income tax revenues appears as capital gains income. Last year the OLS speculated that a 25 percent increase in capital gains in 1995 and an additional 25 percent increase in 1996 could generate a total of \$3.0 billion in increased taxable capital gains over those two years, resulting in \$160 million to \$190 million in additional income tax receipts. Since then the Treasury's Office of Tax Analysis has reported capital gains grew from \$3.7 billion in 1994 to \$5.3 billion in 1995, an increase of \$1.6 billion (45%), as displayed in Figure 13. California recently reported 1996 capital gains growth of 60 percent. If gains in New Jersey grew by 50 percent in 1996, then the two year total increase in capital gains in New Jersey could have been almost \$5.9 billion, not the \$3.0 billion estimated last year, resulting in \$325 million to \$375 million in additional income tax receipts in FY 1996 and FY 1997 combined.

Strong growth in 1997 stock values and activity (market sales volume grew by over

20 percent, due in part to changes in the federal capital gains tax) suggests strong tax receipts will continue. If New Jersey saw 50 percent growth in 1997, then the total, *cumulative increase* in taxable capital gains since 1994 would reach \$14.2 billion, as shown in Figure 13. Such an increase in taxable income would have generated between \$780 million and \$905 million in higher income tax receipts since 1994.

Figure 13
Capital Gains Income
(\$ Billions)

Tax Year	Total Amount	Amount Over 1994
1994	\$3.7	
1995	\$5.3	\$1.6
1996 est.	\$8.0	\$4.3
1997 est.	\$12.0	\$8.3
Cumulative Increase		\$14.2

The impact of the stock market boom on income tax revenues is more extensive than capital gains growth alone. Stock market gains also affect dividend income, which grew by over 13 percent in 1995. In addition, tax analysts have recently pointed out that stock options are an increasingly common benefit offered by corporations to their employees. Stock options are not treated as capital gains, but rather as regular income for tax purposes. While State tax figures do not specifically track stock options, such options provide an additional boost to taxable income in New Jersey.

Discussion of Selected Revenue Sources

Other Tax Revenues

In addition to the gross income tax and the sales tax, the OLS estimates differ from the Executive's on 10 other revenue sources in FY 1998 and 11 other revenue sources in FY 1999. For some of these revenues the OLS is higher and for some the OLS is lower than the Executive. Overall, the OLS totals for these revenues are \$30 million below the Executive in FY 1998 and \$95 million below the Executive in FY 1999, as displayed in Figure 14 and Figure 15.

The OLS estimates for most of these revenues are based largely on an analysis of actual cash collections through the first eight months of FY 1998. Historically, actual collections have proven to be a reliable indicator of year-end revenue collections. Figures 14 and 15 display

the revenue differences from the largest positive difference to the largest negative difference between the OLS and the Executive in each year.

The largest positive difference in both FY 1998 and FY 1999 is for the motor fuels tax. As displayed in Figure 5 on page 11, current FY 1998 collections for the motor fuels tax are running 1.2 percent ahead of last year at the same time, but after adjusting for fluctuations in the motor fuels use tax component of this revenue, actual growth in this revenue has been running between 2.0 and 3.5 percent in recent months. The OLS anticipates continued steady growth at a higher rate than the 0.5 percent rate suggested by the Executive's FY 1998 target. The OLS also anticipates steady growth in FY 1999.

	FY 1998 Executive	FY 1998 OLS	Difference
Motor Fuels Tax	\$467.2	\$480.0	\$12.8
Insurance Premiums	270.0	275.0	5.0
Realty Transfer	59.0	62.0	3.0
Alcoholic Beverage Excise	70.0	73.0	3.0
Gubernatorial Elections Fund	1.5	1.0	(0.5)
Casino Revenue Fund	325.5	322.0	(3.5)
Petroleum Products Gr. Rec.	199.5	195.0	(4.5)
Transfer Inheritance Tax	360.0	350.0	(10.0)
Corporation Business Tax	1,315.1	1,300.0	(15.1)
Corporation Business - Banks and Financial Institutions	60.0	40.0	(20.0)
FY 1998 Net Difference			(\$29.8)

Discussion of Selected Revenue Sources

Current collections trends in FY 1998 for the realty transfer tax and the alcoholic beverage tax also suggest some additional strength, which is reflected in the OLS's slightly higher estimates for both fiscal years.

The OLS is estimating lower collections than the Executive for six revenues in FY 1998 and seven revenues in FY 1999. The largest differences are for the corporation business tax (CBT), the corporation tax on banks and financial institutions (CBT B&F), and the Casino Revenue Fund.

The OLS is estimating \$1.300 billion in CBT collections in FY 1998 and \$1.410 billion in FY 1999, \$15 million and \$21 million less than the Executive in each year respectively. The CBT,

as shown in Figure 5 on page 11, is running 6 percent below last year through the end of February, while the Executive is forecasting 2 percent growth for the entire year. Some of the apparent discrepancy between current collection rates and the Executive's growth assumption can be explained by accelerated refund payments. Through eight months of FY 1998, CBT refund payments have reached \$121 million as compared to \$84 million at the same time last year, a 45 percent increase. The Division of Taxation anticipates overall refund payments to exceed last year, but some of the higher level of refunds is an acceleration of payments that otherwise would still be paid in the coming months. Net collections should improve somewhat over the last four months of the fiscal year.

Figure 15
Other Fiscal Year 1999 Revenue Estimates
For Which the Executive and the Office of Legislative Services Differ
(\$ millions)

	FY 1999 Executive	FY 1999 OLS	Difference
Motor Fuels Tax	\$478.2	\$495.0	\$16.8
Insurance Premium	280.0	285.0	5.0
Realty Transfer	60.0	63.0	3.0
Alcoholic Beverage Excise	70.0	73.0	3.0
Gubernatorial Elections Fund	1.5	1.0	(0.5)
Petroleum Products Gr. Rec.	209.5	200.0	(9.5)
Transfer Inheritance Tax	380.0	370.0	(10.0)
State Lottery Fund	680.0	670.0	(10.0)
Corporation Business Tax	1,431.0	1,410.0	(21.0)
Corporation Business - Banks and Financial Institutions	79.0	50.0	(29.0)
Casino Revenue Fund	372.7	330.0	(42.7)
FY 1999 Net Difference			(\$94.9)

Discussion of Selected Revenue Sources

Nevertheless, the OLS is assuming lower collections than the Executive for two reasons. First, gross collections thus far are only even with FY 1997, but not growing, after adjusting for the higher level of refund payments. Second, FY 1997 benefited from an accounting procedure (the reversal of accrued refund payments) that resulted in an additional \$57 million in receipts. The reversal in FY 1998 will be only \$18 million, significantly less than last year. This net \$39 million difference will result in relatively lower CBT receipts in FY 1998 than FY 1997.

The OLS is estimating \$40 million in CBT B&F collections in FY 1998 and \$50 million in FY 1999, \$20 million and \$29 million less than the Executive in each year respectively. The Executive in February already reduced its estimate for FY 1998 from \$100 million to \$60 million based on actual collections through the end of December. Since then, collections have dropped further due to over \$20 million of refunds paid in February. February refund payments alone exceed total refunds paid out last year between February and June. The OLS does not have information that additional large refunds are due in the remainder of the year, and, therefore, assumes collections will increase over the last four months of the year. The OLS assumes this tax, which has a history of large year to year fluctuations, will improve next year, at least because of a lower level of refund payments.

The OLS is estimating Casino Revenue Fund collections of \$322 million in FY 1998, \$4

million below the Executive, and \$330 million in FY 1999, \$43 million below the Executive. Current FY 1998 collections growth is only 2.5 percent, slightly below the Executive's target, so the OLS is making a small downward adjustment. Moreover, in FY 1999 the Executive's estimate reflects growth of nearly 15 percent in this revenue source, based on the assumption that a tax increase may be enacted by the Legislature. However, no specific tax increase proposal has been presented by the Executive. While the OLS generally assumes in its annual revenue analysis that all tax changes proposed by the Executive will be adopted, the OLS cannot adopt the Executive's FY 1999 estimate because no specific proposal has been made. The OLS's estimate anticipates 2.5 percent growth over FY 1998, matching growth in FY 1998.

A minor downward adjustment in both years involves the Gubernatorial Elections Fund, which is based on taxpayer designations on State income tax returns each year. The Fund has not received \$1.5 million since FY 1988 and in recent years it has collected about \$1.0 million annually, so the OLS is estimating \$1.0 million for FY 1998 and FY 1999. Current collection trends also suggest somewhat lower growth in the petroleum products gross receipts tax and the transfer inheritance tax. Accordingly, the OLS is estimating lower collections in both years than the Executive. The OLS also is assuming somewhat slower growth than the Executive in the State lottery fund for FY 1999.

Discussion of Selected Revenue Sources

Cigarette Tax Revenue

The revenue estimates for FY 1998 and FY 1999 assume a drop in cigarette sales of about 14 percent following the January 1998 doubling of the cigarette tax rate. Tax collections have been weak since the rate increase went into effect. However, due to statutory lags in tax payments, making accurate estimates is difficult at this time. The OLS, for the time being, is accepting the Executive's FY 1998 and FY 1999 revenue estimates for the cigarette tax.

Pursuant to P.L.1997, c.264, the first \$150 million in cigarette tax revenue is dedicated to the Health Care Subsidy Fund (HCSF) and the next \$50 million is dedicated to the School Construction and Renovation Fund, beginning in FY 1999. The FY 1999 Budget expectation of \$269 million does not include the \$150 million for the HCSF, which is maintained "off budget." In fact, the Executive anticipates that a total of \$419 million (\$269 + \$150) will be collected under this tax. If actual revenues are larger or smaller than this expectation, the impact will be felt in the General Fund, not the two dedicated funds. The dedicated funds would not be threatened unless cigarette sales fell off by an additional 50 percent or

more. It should be noted that the \$50 million dedicated to the School Construction and Renovation Fund is included in the \$269 million of anticipated "on budget" cigarette tax revenue and by a \$50 million appropriation.

Recently the *Federal Funds Information for States* (FFIS) estimated the impact of an increase in federal cigarette taxes on state tax revenue. Proposals by the White House and Congress to increase federal cigarette taxes by more than \$1.00 per pack would significantly reduce sales and tax revenues. Likewise, a significant price increase by manufacturers resulting from a national tobacco settlement also would reduce sales. FFIS estimated that a nationwide 50 cent increase in the price of a pack of cigarettes will result in a 10 percent drop in tax revenue in New Jersey. That translates into over \$40 million in lost cigarette tax revenue for each 50 cent increase. This raises the prospect of reduced revenue to the State's General Fund. However, New Jersey's two dedicated funds should continue to receive the anticipated amounts so long as the price of a pack of cigarettes does not increase by more than \$2.50.

FY 1999 Surplus Analysis

Each year the OLS recalculates the State's year-end budgeted surplus based solely on the revenue estimates contained in this report. Figure 16 assumes that the spending plan, tax law changes, additional fees and accounting adjustments proposed for FY 1998 and FY 1999 in the FY 1999 Executive budget will be followed. However, any calculation of actual surplus must take into account spending (appropriation) decisions and accounting adjustments, as well as anticipated revenue. For example, *since* the release of the Budget, the Department of Education has proposed increasing school aid by over \$35 million. This amount is not reflected in the surplus calculation below, because it was not part of the original Executive budget proposal. Decisions on these and other matters will be made by the Executive, both appropriations committees and the full Legislature over the next three months.

As is shown in Figure 16, the Executive estimates an FY 1999 year-end surplus of \$650 million. The lower OLS revenue estimates would produce a surplus of \$517 million, \$133 million less than the Executive.

Figure 16 Adjusted FY 1999 Year-End Combined Surplus (\$ millions)	
Executive Estimate	\$650.0
OLS Revenue Adjustment	(\$133.0)
OLS Adjusted Surplus	\$517.0

Because this analysis does not address possible changes to appropriations, Executive spending patterns or other non-tax revenues, it is premature to draw conclusions about actual year-end surpluses from this analysis of State revenues.

The annual estimates of the State's surplus are point in time estimates chasing a moving target. Because of the large number of changes that occur in both spending and revenues throughout any fiscal year, the surplus changes significantly between the enactment of the annual appropriations act and the end of the fiscal year and a review by State auditors. Figure 17 below displays the surplus amount based on the annual appropriations act passed by the Legislature and signed by the Governor each June. The figure also displays the final surplus amount at the end of each fiscal year. The differences between the appropriations act amount and the final amount each year are significant, and in recent years has increased significantly during the year. Accordingly, the OLS urges caution in drawing conclusions about the FY 1999 year-end surplus.

Figure 17 Fiscal Year Combined Surplus Since FY 1990 (\$ millions)		
Fiscal Year	Approp. Act	Final
1990	\$426.2	\$162.1
1991	\$322.2	\$370.6
1992	\$513.6	\$836.2
1993	\$141.5	\$1,150.8
1994	\$411.0	\$1,264.6
1995	\$455.5	\$950.2
1996	\$549.2	\$880.0
1997	\$550.1	\$1,108.0
1998*	\$550.0	\$1,021.0

Source: Annual New Jersey State Budgets.
* FY 1998 Final amount is the Executive's estimate as of February 1998.

Appendix Contents:

Page

A2.....	Detailed Fiscal Year 1998 Revenue Estimates
A3.....	Detailed Fiscal Year 1999 Revenue Estimates
A4.....	The Rainy Day Fund
A6.....	Public Utility Tax Revenue

Detailed Fiscal Year 1998 Revenue Estimates				
Fiscal Year 1998 (\$ millions)	Approp. Act	Executive Revised	OLS	Diff: OLS - Executive
Major Taxes:				
Sales Tax	\$4,550.0	\$4,720.0	\$4,735.0	\$15.0
Corporation Business Tax	1,282.0	1,315.1	1,300.0	(15.1)
Motor Fuels	470.0	467.2	480.0	12.8
Motor Vehicle Fees	419.0	357.8	357.8	0.0
Transfer Inheritance	305.0	360.0	350.0	(10.0)
Insurance Premiums	261.0	270.0	275.0	5.0
Cigarette	243.0	320.0	320.0	0.0
Petroleum Products Gross Receipts	198.0	199.5	195.0	(4.5)
Corporation Business - Banks and Financial	100.0	60.0	40.0	(20.0)
Alcoholic Beverage Excise	75.0	70.0	73.0	3.0
Realty Transfer	51.0	59.0	62.0	3.0
Savings Institutions	18.0	18.0	18.0	0.0
Tobacco Products Wholesale	7.0	11.0	11.0	0.0
Public Utilities Excise	7.0	7.0	7.0	0.0
Subtotal, Major Taxes	\$7,986.0	\$8,234.6	\$8,223.8	(\$10.8)
Misc. Taxes, Fees and Revenues				
Public Utility Taxes (State retention)	\$38.4	\$39.2	\$39.2	\$0.0
Transitional Energy Facility Assessments	361.0	346.0	346.0	0.0
Medicaid Uncomp. Care Reimbursement	400.1	418.6	418.6	0.0
MTF Revenue Fund	54.1	58.0	58.0	0.0
Good Driver Program	123.0	120.0	120.0	0.0
Motor Vehicle Inspection Fund		64.4	64.4	0.0
Investment Earnings	8.0	15.0	15.0	0.0
Other	946.1	936.0	936.0	0.0
Subtotal, Misc. Revenues	\$1,930.7	\$1,997.2	\$1,997.2	\$0.0
Interfund Transfers				
State Lottery Fund	\$670.0	\$655.0	\$655.0	\$0.0
State Disability Benefit Fund	24.8	24.8	24.8	0.0
Other	227.3	236.5	236.5	0.0
Subtotal, Interfund Transfers	\$922.1	\$916.3	\$916.3	\$0.0
TOTAL GENERAL FUND	\$10,838.8	\$11,148.1	\$11,137.3	(\$10.8)
Property Tax Relief Fund (Income Tax)				
Gross Income Tax	\$5,236.0	\$5,507.0	\$5,527.0	\$20.0
Property Tax Deduction	-200.0	-167.0	-167.0	0.0
Subtotal, Property Tax Relief Fund	\$5,036.0	\$5,340.0	\$5,360.0	\$20.0
Casino Revenue Fund	330.7	325.5	322.0	(3.5)
Casino Control Fund	54.8	56.3	56.3	0.0
Gubernatorial Elections Fund	1.5	1.5	1.0	(0.5)
GRAND TOTAL, ALL FUNDS	\$16,261.8	\$16,871.4	\$16,876.6	\$5.2

Detailed Fiscal Year 1999 Revenue Estimates					
Fiscal Year 1999 (\$ millions)	Executive	% Change	OLS	% Change	Diff: OLS - Executive
Major Taxes:					
Sales Tax	\$4,928.0	4.4%	\$4,945.0	4.4%	\$17.0
Corporation Business Tax	1,431.0	8.8%	1,410.0	8.5%	(21.0)
Motor Fuels	478.2	2.4%	495.0	3.1%	16.8
Motor Vehicle Fees	360.8	0.8%	360.8	0.8%	0.0
Transfer Inheritance	380.0	5.6%	370.0	5.7%	(10.0)
Insurance Premiums	280.0	3.7%	285.0	3.6%	5.0
Cigarette	269.0	(15.9)%	269.0	(15.9)%	0.0
Petroleum Products Gross Receipts	209.5	5.0%	200.0	2.6%	(9.5)
Corporation Business - Banks and Financial	79.0	31.7%	50.0	25.0%	(29.0)
Alcoholic Beverage Excise	70.0	0.0%	73.0	0.0%	3.0
Realty Transfer	60.0	1.7%	63.0	1.6%	3.0
Savings Institutions	18.0	0.0%	18.0	0.0%	0.0
Tobacco Products Wholesale	13.0	18.2%	13.0	18.2%	0.0
Public Utilities Excise	7.0	0.0%	7.0	0.0%	0.0
Subtotal, Major Taxes	\$8,583.5	4.2%	\$8,558.8	4.1%	(\$24.7)
Misc. Taxes, Fees and Revenues					
Public Utility Taxes (State retention)	\$60.6	54.6%	\$60.6	54.6%	\$0.0
Transitional Energy Facilities Assessment	282.0	(18.5)%	282.0	(18.5)%	0.0
Medicaid Uncomp. Care Reimbursement	409.0	(2.3)%	409.0	(2.3)%	0.0
MTF Revenue Fund	51.5	(11.2)%	51.5	(11.2)%	0.0
Good Driver Program	96.3	(19.8)%	96.3	(19.8)%	0.0
Motor Vehicle Inspection Fund	64.4	0.0%	64.4	0.0%	0.0
Investment Earnings	15.0	0.0%	15.0	0.0%	0.0
Other	812.2	(13.2)%	812.2	(13.2)%	0.0
Subtotal, Misc. Revenues	\$1,791.0	(10.3)%	\$1,791.0	(10.3)%	\$0.0
Interfund Transfers					
State Lottery Fund	\$680.0	3.8%	\$670.0	2.3%	(\$10.0)
State Disability Benefit Fund	25.2	1.6%	25.2	1.6%	0.0
Other	213.4	(9.8)%	213.4	(9.8)%	0.0
Subtotal, Interfund Transfers	\$918.6	0.2%	\$908.6	-0.8%	(\$10.0)
TOTAL GENERAL FUND	\$11,293.1	1.3%	\$11,258.4	1.1%	(\$34.7)
Property Tax Relief Fund (Income Tax)					
Gross Income Tax (base)	\$6,094.0	10.7%	\$6,034.0	9.2%	(\$60.0)
Property Tax Deduction	(234.0)	40.1%	(234.0)	40.1%	0.0
Subtotal, Property Tax Relief Fund	\$5,860.0	9.7%	\$5,800.0	8.2%	(\$60.0)
Casino Revenue Fund	372.7	14.5%	330.0	2.5%	(42.7)
Casino Control Fund	54.8	(2.8)%	54.8	(2.8)%	0.0
Gubernatorial Elections Fund	1.5	0.0%	1.0	0.0%	(0.5)
GRAND TOTAL, ALL FUNDS	\$17,582.0	4.2%	\$17,444.2	3.4%	(\$137.9)

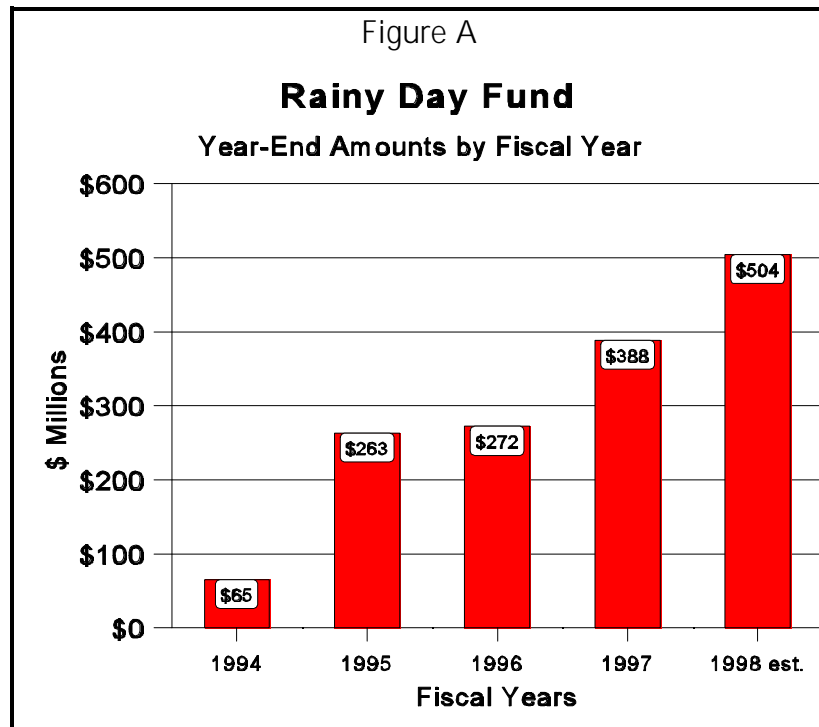
The Rainy Day Fund

Whenever actual General Fund Revenues exceed the Governor's certified estimates, one-half of the windfall must be deposited in the Surplus Revenue Fund, also known as the Rainy Day Fund. Unexpected revenue growth in recent years has produced such windfalls and the required deposits have been made. Figure A displays the year-end amounts in the Rainy Day Fund as listed in the State's Comprehensive Annual Financial Reports for FY 1994 through FY 1997. The amount in the table for FY 1998 is the estimate contained in the Governor's Recommended Budget. The amount in the fund has increased from \$65 million in FY 1994 to an estimated \$504 million four years later.

It is important to realize that the Rainy Day Fund counts as part of the overall budget surplus. The amount in the Rainy Day Fund at the end of one fiscal year is rolled over and included as a portion of the anticipated State budget surplus for the following year. As is indicated in Figure B, the Governor's budget anticipates a FY 1999 year-end surplus of \$650 million, of which \$504 million, or 77.5 percent, is in the Rainy Day Fund. Since the uses of the Rainy Day Fund are restricted, having a large percentage of the projected State budget surplus consist of Rainy Day Fund balances raises issues of budgetary flexibility.

Until the balance in the Rainy Day Fund reaches 5 percent of the combined General Fund and Property Tax Relief Fund revenues (for FY 1999 approximately \$850 million), the Rainy Day Fund Statute provides two circumstances under which the resources in the Rainy Day Fund may be used. The Governor may use monies from the fund

upon declaration of an "emergency," with notification to and approval by the Joint Budget Oversight Committee. Alternatively, the Rainy Day Fund can be tapped if revenues fall below expectations. If the Governor certifies that anticipated revenues in the General Fund are less than those certified upon approval of the annual appropriations act, or if the Legislature determines that an appropriation from the Rainy Day Fund is more prudent than a tax



increase to offset anticipated revenue declines in the General Fund, the Legislature is authorized to make appropriations from the Rainy Day Fund.

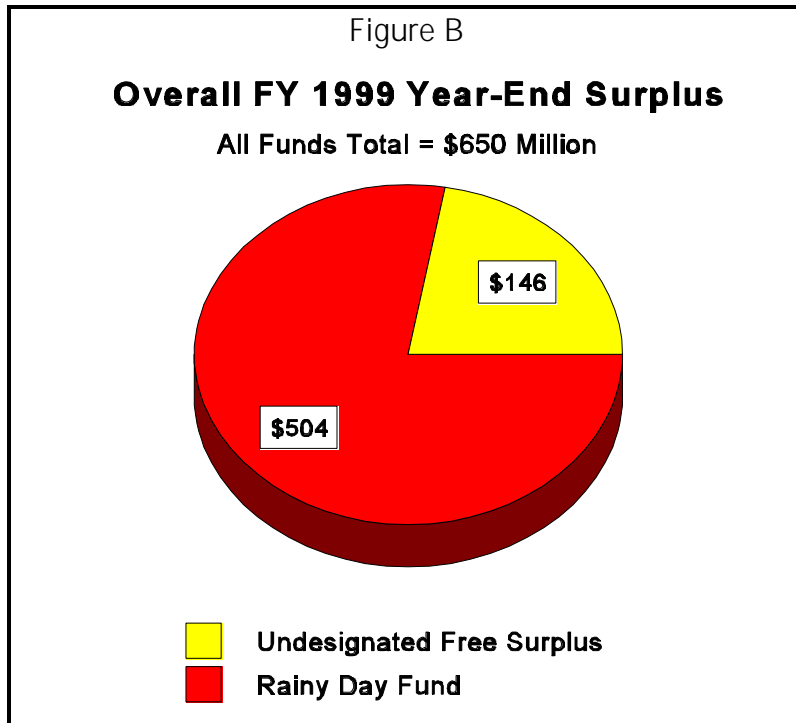
While the statutory requirements for withdrawals from the fund are relatively stringent, it should be noted that under several previous budget acts, statutory restrictions upon a number of special funds have been suspended and non-conforming fund withdrawals authorized during the fiscal year. Such action has not been proposed for the Rainy Day Fund, but given the relatively small size of the undesignated free balance

forecast in the FY 1999 budget proposal, the issue may arise in the future.

To provide a context for this discussion, the OLS surveyed the experience of other states with rainy day funds. All but five states have some form of surplus revenue or budget stabilization fund. There are a variety of mechanisms for using money in these funds: simple appropriation (10 funds), appropriation by supermajority (9 funds), executive transfer (10 funds), and triggered or formulaic distribution (7 funds). In addition,

supermajority to access the fund balances.

Three Midwestern states that were contacted identified a strong commitment to the integrity of their funds. Minnesota has a statutory fund with a balance equal to the cap stipulated in its establishing provisions (5%). It has been accessed for cash flow, but never for expenditures. Minnesota's fund is available to the executive to cover projected budget deficits. Michigan has a very large fund, at about 14 percent of General Fund revenues. The legislative research staff pointed to the highly cyclical nature of Michigan's economy and the use of the fund to pay one time costs such as litigation settlements as the reason for its size. Iowa uses two different funds. One fund addresses budget imbalances while the other is intended for onetime emergency expenditures. Neither fund has been utilized since their establishment, and each has achieved its maximum value of 5 percent.



some funds incorporate more than one of the processes listed above.

Several states with substantial balances in Rainy Day Funds were contacted to discuss their experiences. Of states in the region, Pennsylvania and Delaware have 3 percent and 5 percent of General Fund revenues, respectively, in budget stabilization funds. Both funds are over ten years old. Delaware's fund is constitutionally mandated and has never been accessed, while Pennsylvania's fund is statutory and has been tapped, although not recently. Both funds require a

different intent in creating multiple funds, but each set generally follows the divisions used by Iowa, with one fund to address budget shortfalls, and another to pay one time expenditures. Florida follows this structure with its Budget Stabilization Fund and Working Capital Fund. These funds receive automatic deposits, but are each capped at 5 percent, and all funds deposited thereafter must be returned to state taxpayers.

Public Utility Tax Revenue

P.L.1997, c.162 repealed the 1940 State tax system of franchise and gross receipts taxes imposed on regulated gas and electric utilities and telecommunications utilities operating in New Jersey, effective on January 1, 1998. Energy utilities are now subject to the sales and use tax, the corporation business tax and the transitional energy facility assessment tax, a temporary tax which phases out over five years. Telecommunications utilities became subject to the corporation business tax under this act. These utilities have been collecting and remitting sales and use taxes since 1990. Water and sewer utilities were unaffected by the law change and continue to pay taxes as they did previously.

The revenues anticipated by the Executive from the replacement taxes in FY 1998 and FY 1999 are shown in Figure C on the next page. Total revenues for FY 1998 as shown are approximately \$2 million higher than the total taxes paid by the same sources in the prior fiscal year.

P.L. 1997, c. 167 replaced the complex aid distribution formulae that were contained in the franchise and gross receipts statutes and provides a new system for the distribution of State aid to municipalities. In FY 1998, \$740 million from the taxes listed in Figure C shall be deposited in the Energy Tax Receipts

Property Tax Relief Fund and distributed to municipalities according to the new formula. The amount deposited in this fund will be \$745 million in FY 1999, \$750 million in fiscal years 2000 and 2001 and \$755 million in each subsequent fiscal year.

From a budgeting perspective, the tax revenues deposited into the Energy Tax Receipts Property Tax Relief Fund are "off-budget" and therefore *not* included in either the revenues anticipated or the amount of State aid appropriated in the annual appropriations act. Figure C indicates how the Administration plans to allocate the anticipated revenues between on- and off-budget accounts. For instance, in FY 1998 all of the \$468 million anticipated from the sales and use tax from these taxpayers will be placed in the off-budget account. Of the \$256 million in anticipated corporation business tax revenues, \$251 million will be in the off-budget account and the remaining \$5 million will be included in the on-budget CBT total. If actual collections are higher or lower than anticipated in any year the impact will be felt in the on-budget accounts, because the statute effectively ensures that the required amounts will be deposited in the Energy Tax Receipts Property Tax Relief Fund.

Figure C			
Public Utility Tax Revenue Fiscal Years 1998 and 1999 (\$ Millions)			
Estimated Revenue FY 1998			
Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		\$468	\$468
Corporation Business Tax	\$5	\$251	\$256
Transitional Energy Facilities Assessment (TEFA)	\$346		\$346
Franchise and Gross Receipts Tax Water and Sewer Utilities	\$39	\$21	\$60
Public Utility Excise Tax Water and Sewer Utilities	\$7		\$7
Total	\$397	\$740	\$1,137
Estimated Revenue FY 1999			
Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		\$539	\$539
Corporation Business Tax	\$81	\$206	\$287
Transitional Energy Facilities Assessment (TEFA)	\$282		\$282
Franchise and Gross Receipts Tax Water and Sewer Utilities	\$60		\$60
Public Utility Excise Tax Water and Sewer Utilities	\$7		\$7
Total	\$430	\$745	\$1,175
Source: Department of Treasury, February 18, 1998.			