Testimony of Treasurer Bradley Abelow
Senate Budget and Appropriations Committee
May 22, 2006

Good morning Mr. Chairman and members of the Senate Budget and Appropriations Committee. I am pleased to return to this committee to update you on New Jersey's revenue picture for the current and next fiscal years. With me today from Treasury are Deputy Treasurers Carol O'Cleireacain and Robert Smartt, Chief of Staff Michellene Davis, Budget Director Charlene Holzbauer and Associate Deputy Treasurer Charles Chianese.

Approximately two weeks ago, the Office of Legislative Services and the Administration released some somber news about the State's revenue picture following a preliminary analysis of the April revenue collections. This collection period was viewed with much anticipation, as more than 40 percent of the Gross Income Tax and Corporation Business Tax revenues are received in the last quarter of the fiscal year. Moreover, the collection period provides an opportunity for us to update the assumptions which underlie revenue projections for the next fiscal year.

Now that all of the April envelopes have been opened, we see a complex and nuanced picture.

First, the good news. Taking into account lower than expected expenditures in the current fiscal year, the State will end FY 2006 with a larger surplus than we had anticipated in the Governor's Budget Message of March 21st.

Now, the rest. Revenue from two of our key sources – the Gross Income Tax and the Corporation Business Tax -- fell more than $300 million below our forecast. While not statistically significant in percentage terms, this change requires us to revise revenue projections for FY 2007, which results in a $441 million deficit. And, we now project that even with adoption of the spending cuts and revenue increases that we have proposed the State will still face an estimated budget gap of about $2 billion in FY 2008. This structural deficit is the result of the same pressures in the budget caused by the litany of deferrals, post-dated spending increases and court-mandated spending that created this year's problem.

Let me be clear about what this revenue shortfall means, and what it does not mean.

Clearly, the job of balancing the FY 2007 budget has become more difficult. Now more than ever we must take steps to ensure that the actions we take to close the deficit for FY 2007 do not further exacerbate the structural problem for FY 2008 and beyond. For that reason, we must put a premium on solutions which generate recurring savings and value.

It does not mean, however, that New Jersey's revenues--- or the state's economy that drives them -- are in peril. In fact, income tax revenue this year is growing at a 9.3 percent pace, and we're projecting roughly that kind of growth to continue in FY 2007.

The robust growth in this one revenue source underscores the "unforgiving arithmetic" of this budget. Even as our tax revenues are growing, the structural deficit is widening and easy solutions are scarcer.

To put it plainly, in the Governor's Budget Message on March 21st, we proposed a combination of spending cuts of $2.5 billion and revenue increases of $1.8 billion to close a structural deficit of $4.3 billion for FY 2007. Now, the State's April collections have opened a gap for next year of approximately $440 million. This gap will be closed by carrying forward a larger than anticipated surplus of $330 million from this fiscal year. We will close the rest of the gap with additional spending cuts.

Further, I want to go into some detail about FY 2006, summarizing how the April collections affect the current fiscal year and describe their influence on our revised projections for next year.

First, the FY 2006 revenues.

In the current year, we expect to collect $10.4 billion from the Gross Income Tax, which is $160 million short of the March 21st forecast. From today's vantage point, it appears that the baseline off which the FY 2006 target was set was an imperfect barometer for the longer term. Since actual collections are up by more than 9%, we believe that the FY2006 shortfall should be primarily attributed to estimation.

The Corporation Business Tax, which we projected to total $2.8 billion for FY 2006, has been revised down to $2.65 billion, or $155 million below the March forecast. April collections reflect both final results for tax year 2005 and the first estimated payments for tax year 2006. Final payments for 2005 were up strongly, consistent with extraordinarily strong corporate profits.

But, this first round of estimated payments for 2006 is weaker, which may reflect both the slower profits being forecast and the ability to offset profits fully with Net Operating Losses. As a result, we have reduced the revenue estimate.

I caution all of us to treat the Corporation Tax revenue as particularly volatile and difficult to forecast. One reason is that the tax law has changed every year for at least the past five years, which makes it impossible to construct a baseline off which to forecast. In addition, businesses are increasingly organizing themselves in many different ways, and less often as the type of business reached by the New Jersey Corporation Business Tax.

As a result, we are experiencing a decline in the number of corporate tax filers.

The combined shortfalls in FY 2006 from the GIT and the CBT total $315 million, which are partially offset in this fiscal year by some refreshing strength in the performance of the Sales Tax. The Sales Tax is now $64 million above the March 21st estimate.

Sales tax collections based on sales through the third quarter of our fiscal year show a 4.1 percent rate of growth, somewhat above the historical trend.

The current year's revenue collections have seen some strong performance from other sources, most of which are historically difficult to predict. For example, while utility companies collect energy taxes throughout the year, more than half of those taxes were paid to the State on May 15.

The Transfer Inheritance Tax, the Insurance Premium Tax and the Realty Transfer Fee all helped to push the other revenues up by about $300 million, further offsetting weaker collections from the Income and Corporate Business taxes.

Additional good news can be found on the spending side of the budget. Through effective management of spending in the second half of this fiscal year, under-spending is almost triple our expectations expressed in the Governor's Budget Message and we will lapse those funds.

Taking all these changes into account, we now expect to end the year with a balance of $1.16 billion. You may recall that in March we estimated a year end balance of $824 million.

This higher than expected carry forward is of critical importance as we look to bring the FY 2007 budget back into balance.

Let me now look at the State's picture for FY 2007.

Our revised forecast for FY 2007 calls for the revenue from the GIT, where we continue to see strong growth, to increase over FY 2006 levels by 9.1 percent to $11.4 billion. However, despite strong growth this is $345 million lower than our March forecast.

Again, I caution us all to recognize that the income tax revenue is increasingly volatile, as a growing proportion of the tax is generated by a small number of taxpayers at the top of the income distribution. These taxpayers are highly mobile. In addition, their taxable income is less predictable, since much of it comes in the form of bonuses, investment returns, real estate, capital gains and business income, varying significantly from year to year.

The Governor's Budget Message had anticipated CBT collections of $2.46 billion for FY 2007, which we are revising downward by $184 million. These revenues remain subject to all of the uncertainty that I have already spoken about. In addition, the economy is facing continuing high energy prices, rising interest rates, and a return to a more normal profit outlook. In FY 2007, the decline in base CBT revenue is somewhat offset by our policy proposal to levy an additional surcharge on our corporate taxpayers.

With the stronger than expected Sales Tax collections in FY 2006, we now forecast FY 2007 revenues of $8.49 billion. This is $79 million above our March 21st target.

For FY 2007, the base growth is projected at 3.4 percent, which is the average growth experienced this decade. The sales tax remains our broadest and most stable source of revenue. Our forecast incorporates the expected impact of high energy prices, higher interest rates and the more expensive import costs that we are already starting to feel.

We now recognize that the new rates proposed in the budget will not be able to be implemented until October 1, and we have revised our estimates to take this into account.

Also on the revenue side, we revised upward energy tax receipts consistent with the strong FY 2006 performance. While in FY 2006 some improved revenues and restrained spending combine to offset the shortfalls in the major taxes, the FY 2007 problem remains formidable.

The situation we face now is largely the same as in March and this administration is applying the same logic to address this situation. We recognize the revenue shortfall of $441 million and some need for new spending – such as fuel costs – of about $100 million. We are in the fortunate position to be able to carry forward the $337 million larger surplus from FY 2006 to FY 2007. Also, we are proposing an additional $100 million reduction in State spending and a delay in the start of the Governor's Income Tax credit to January 1, 2007. Together these actions maintain balance in Governor Corzine's honest and responsible budget.

Mister Chairman, I want to reiterate that it was our hope that the budget picture would have improved significantly from the snapshot taken in March. Yet, while remaining strong, our revenues do not have the horsepower to keep up with the inherent growth in State spending. As a result, we now are proposing a package of $2.6 billion in spending reductions and the same $1.8 billion in increased revenues.

While difficult, the problems facing us are far from insurmountable. We look forward to a continued partnership with the Legislature over the next several weeks as we finalize and enact a truly balanced budget for FY 2007.

At this point, I would like to proceed with testimony on the State Treasury Department budget.

As you know, the Treasury Department plays a major role in developing the annual budget for the State of New Jersey, and this task alone has dominated my first five months in this office. But the breadth of the department stretches far wider than keeping track of New Jersey's revenue and spending.

As Treasurer, I oversee multiple divisions that perform a wide variety of functions:

- collecting the State's revenues and enforcing our tax laws;

- investing the State's money appropriately and prudently;
- managing hundreds of State properties and facilities;
- procuring public contracts;
- handling purchasing issues for all of state government, as well as for counties and municipalities;
- serving as custodian of one of the largest public employee retirement systems in the United States; and
- preparing and monitoring the State's budget.

While we do many complex things, we are guided by four simple principles:

1. Conduct the public's business with the highest level of integrity;
2. Operate with the greatest degree of economy and efficiency;
3. Strive for operational excellence and continual improvement; and
4. Provide the greatest possible degree of openness and transparency.

Ethical behavior is at the heart of everything we do. Governor Corzine has stressed that the people we serve have the right to expect that we in State government do things the right and ethical way.

We have already taken several steps to heighten the need for and awareness of ethics rules in our department and we plan to do more. We intend to lead through example and by continually reinforcing our expectations. We are reinvigorating training to ensure that our people fully understand those expectations as well as the rules that govern our behavior.

Treasury employees will be required to certify annually that they possess a copy of the department's Code of Ethics, understand its provisions, have not violated them and do not know of any violation of them. Finally, we recognize that despite our best efforts we can only ensure compliance through a rigorous program of auditing and monitoring. To that end, we have entered into an unprecedented agreement with the Inspector General under which two assistant IGs will work full-time within Treasury to help us monitor and audit performance in this regard.

We hope and expect that members of the public, as well as government and Treasury employees will alert the Inspectors General to ethical and other problems they see around them.

Consistent with out principle of operating with the greatest degree of economy and efficiency, we are working hard to do more with less.

Four years ago Treasury had 3,764 employees. In January, when Governor Corzine took office, that figure stood at 3,710. In March, Treasury's workforce was 3,691. The only significant area of employment growth is in Taxation's enforcement and compliance functions.

Under the proposed budget plan, the combination of attrition and layoffs of unclassified employees, we will reduce our workforce by 122 employees, saving about $5 million by the end of FY 2007. Additionally, our department plans to reduce overtime by 25 percent by the end of FY 2007.

Our goal, throughout Treasury is to improve and increase the delivery of services to the public and our other constituencies while finding ways to reduce our costs. When we reduce our bottom line, it often means that we reduce the space necessary to do our jobs.

That's been our experience in Treasury's Division of Property Management and Construction.

Treasury oversees approximately 330 leases and 40 State-owned buildings.

Through re-negotiating some 35 leases, consolidating facilities and redeploying surplus furniture, we will save taxpayers -- or avoid the cost of -- $4.2 million in the coming and subsequent fiscal years.

The DPMC is the Treasury agency responsible for the sale of State assets.

I would like to take a moment to discuss this daunting challenge in some detail.

When I initially appeared before this committee, I discussed the Administration's view about asset sales. I see two simple rules on this. One, proceeds of a one-time sale of State assets should only be used for capital purposes and not to support State expenses. Any such funds should be set aside for capital purposes. Two, it is not always realistic to achieve a specific revenue target for asset sales within a defined fiscal year.

The sale of the former North Princeton Development Center to Montgomery Township provides a case in point. While the NPDC's sale was recently just approved by the State Senate, this one transaction has already been about ten years in the making.

Despite the complex challenges of asset sales, I do believe that such transactions, when carefully planned and managed, can provide funds to help meet the State's pressing capital needs.

As such, I look forward to working with the Legislature to identify appropriate properties for disposition, with the proceeds set aside for high-priority capital projects approved by the Capital Budgeting and Planning Commission.

As a first step, I will direct that our entire property inventory be posted on the state website so that this information is readily and transparently available to legislators, local officials, environmental and land use advocates, and prospective purchasers.

I will ask that the State House Commission review the inventory and, in consultation with local officials and interested parties, decide which properties can and should be sold.

As Treasury moves to open up and expedite the asset sales process, I ask that the Legislature take a single step to support our mutual goals.

I will request budget language – to be followed by the enactment of legislation – to give the State House Commission authority to approve asset sales without the need for any further review by the Legislature or the Governor.

Throughout the Treasury Department our focus is on creating efficiencies that can be extended throughout State government. By doing this we improve our operations and create a system of best practices that delivers real savings to New Jersey's taxpayers.

These efforts are already underway in areas where we have core competencies and expertise.

Treasury is providing human resources, fiscal, IT and telecom services for the Department of Public Advocate and other state agencies that do not have the critical mass to perform these functions independently.

As the operator of the State's Central Motor Pool, Treasury is currently conducting the recall of 614 passenger cars, which will generate hundreds of thousands of dollars from auctions and save an additional $850,000 in lower fuel consumption and maintenance costs.

Treasury also plays a key role in state-wide energy costs management, administering the consolidated energy purchasing program that has saved $26.1 million since its inception earlier this decade.

Pursuant to an executive order, we have launched a major initiative that will reduce energy consumption across State government.

We are increasing our use of technology and encouraging our various constituencies to make use of technology to improve services and create efficiencies.

- Almost 2 million tax returns, about half of our total, were filed electronically in this year's tax period.

- Electronic business registration and other related activities have led to a 45 percent increase in filings in the past four years, while we have reduced staff in our commercial recording unit.

- We have launched electronic bidding to the vendor community through our eBid system and we have replaced our Bidders Mailing List with a new eRFP Notification Service.

While I am pleased that the state has used new technologies to make the contracting process more transparent, I am deeply concerned that state government has not moved with the same speed and efficiency to tear down the old barriers that have restricted access to public contracting opportunities.

As Treasurer, one of my highest priorities will be to work, under the leadership of Governor Corzine, and in close cooperation with Office of Economic Growth Chief Gary Rose, to make business diversity a cornerstone of the state's economic development strategy.

As you know, New Jersey took a leadership role last year by becoming the first state in the country to mandate by law divestment of public funds from foreign companies with equity ties to the Sudan. I am pleased to announce that we expect soon to be fully divested from the necessary holdings, two years ahead of the legally mandated schedule.

We are pleased with the recent performance of our investment portfolio, now with a market value of $75.3 billion. In the first nine months of the current fiscal year, we are ahead our performance benchmarks for each of our four major portfolios with the overall pension fund return at an estimated 10.49% versus 9.14% for our benchmark.

We are moving ahead with our effort to diversify our portfolio, which is critically important to mitigate the State's risk and enhance returns in support of the pension funds.

As you know, the performance of the pension portfolio figures prominently in the State's ability to meet the payout obligations of the pension system. The State recently received the bad news that the actuarially-determined unfunded liability for the combined systems grew from $12 billion in 2004 to $18 billion in 2005. This growth in the unfunded liability results from several factors, but fundamentally the State has failed to contribute to the pension system at a rate consistent with the growth in liabilities.

While we think that it is appropriate to fully fund the contribution at this time, clearly we cannot do so given the current budget condition. However, we think it is essential that we not continue to make the situation worse, and that is why the Governor has proposed that we contribute $1.3 billion in FY 2007.

Mr. Chairman and members of the committee, thank you for giving me the time to present an updated revenue and budget picture for the State and to talk about some of the accomplishments and objectives for the Treasury Departments as we prepare for the next fiscal year.

I welcome questions from you and members of the committee. I realize that there is not time to deal with all of the questions you have so I invite you to contact me or visit my office at any time to discuss specific issues or concerns that you may have. Thank you.