ANALYSIS OF THE NEW JERSEY

FISCAL YEAR 2001 - 2002 BUDGET

TAX AND REVENUE OUTLOOK

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

APRIL 2001

NEW JERSEY STATE LEGISLATURE

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THE FY 2001 AND FY 2002 TAX AND REVENUE OUTLOOK

Introduction

This report has been prepared by the Office of Legislative Services (OLS) to assist the Senate Budget and Appropriations Committee and the Assembly Budget Committee as they develop the FY 2002 appropriations act. The OLS revenue estimates reflect a careful review of current State revenue collections, historical revenue collection patterns, and a variety of economic data and forecasts.

The revenue outlook begins with a brief statement on the economy. For a more comprehensive economic overview and forecast for the State, the region and the nation, the appendix includes the annual economic report prepared by the New Jersey Council of Economic Advisors. The OLS would like to thank the Council for permitting the inclusion of their analysis in this report.

The report focuses on FY 2001 and FY 2002 revenues.

- Over the two fiscal years the OLS's revenue estimates are a total of $1.03 billion lower than the Executive's estimates.
- In FY 2001, the OLS's revenue estimates are $194 million below the Executive's.
- In FY 2002, the OLS's revenue estimates are $836 million below the Executive's.
- Revenues from the gross income tax account for about half of the difference between the OLS and the Executive.

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Economic Basis for the Revenue Outlook

The OLS Tax and Revenue Outlook reflects the economic forecast of the New Jersey Council of Economic Advisors -- continuing, but markedly slower growth for the national and State economies. The Council's projections for a number of key economic indicators (Figure 1) suggest what is often called a "soft landing" for the economy.

> *The New Jersey economy has been so good for so long that any slowing may feel like a shock, but our economy is fundamentally sound.*
> Council Chairman,
> Dr. Joseph J. Seneca

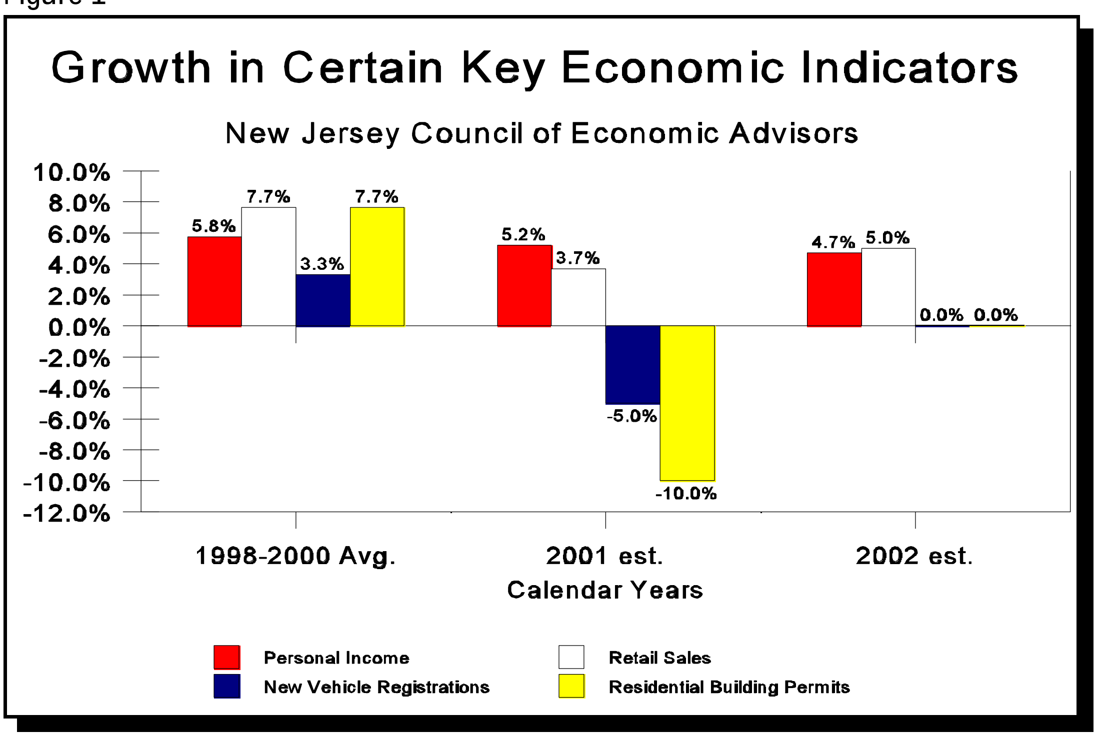
- Personal income grew by an average of 5.8% between 1998 and 2000, but growth is estimated to slow to 5.2% in 2001 and 4.7% in 2002.

- After an average growth in retail sales of 7.7% between 1998 and 2000, the Council anticipates weaker growth rates of 3.7% in 2001 and 5.0% in 2002.

- Following many years of growth, the Council anticipates residential building permits and new vehicle registrations will decline or remain flat.

The OLS revenue estimates assume slowing growth, but do not reflect or anticipate a recessionary economy. However, if economic growth were to turn negative, revenue estimates would need to be revised downward from the levels forecast in this report.

Figure 1



FY 2001 Collections Through February Follow Recent Annual Patterns

Revenue collections so far in FY 2001 mirror the pattern of the last several years. Compared to the same time last year, the gross income tax (GIT) is up about 20% through the end of February while other revenues are growing at a less robust rate. The sales tax, the State's second largest revenue, is up less than 6%. Significantly, two taxes are running negative. Corporation business tax revenues are nearly 10% below the same time last year and inheritance tax revenues are down by nearly 8%. All other major revenues are up by just under 4% through the first eight months of FY 2001.

The most noticeable trend in New Jersey State revenue collections is the rapidly growing importance of the GIT. As was discussed in this report last year, the GIT, which first took effect in FY 1977, accounted for about 35% of State revenues by the end of the 1990's. That percentage will increase to 39% in FY 2001 according to the Executive's revenue estimates.

- GIT revenue grew by more than 13% in each year since FY 1997, but growth in all other revenues exceeded 4% only once (Figure 2).

- For the four year period, the GIT has grown by a remarkable 72%, while all other revenues have grown by a total of about 16% (Figure 3).

- In FY 2001, GIT revenues are projected to increase by 15% over last year, while all other revenues are estimated to increase by just under 4%.

Certain individual revenues will be discussed in greater detail in the following pages as part of the OLS revenue estimates for FY 2001 and FY 2002. The appendix of this report contains a more detailed display of current year revenue collections through the end of February.

Figure 2

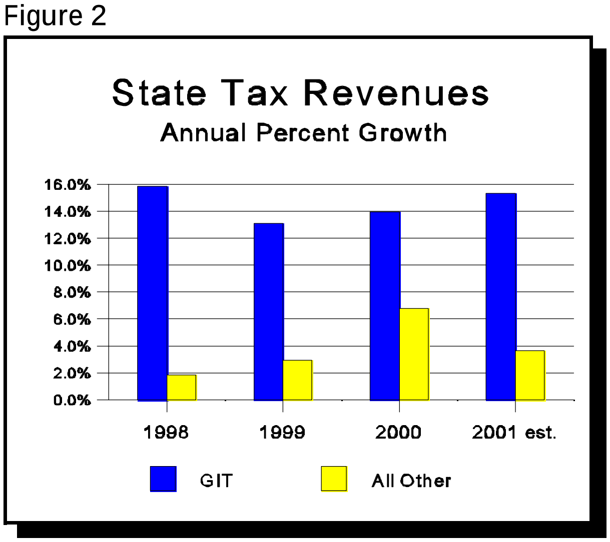
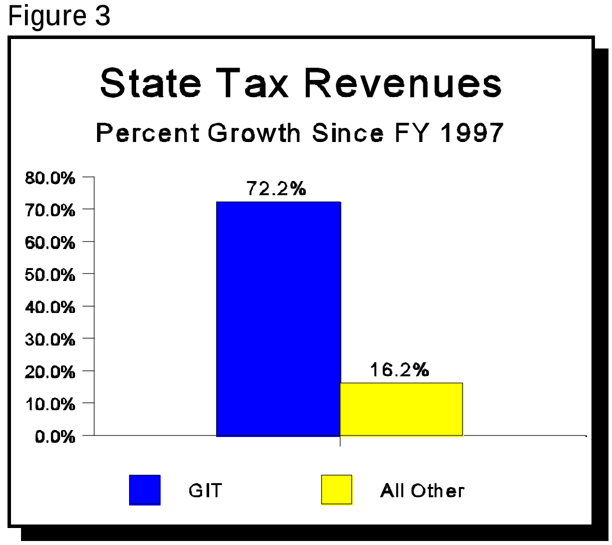


Figure 3



Fiscal Year 2001 Revenue Estimates

Figure 4 presents the FY 2001 revenue certification from the Appropriations Act (July 2000), the Executive's January revisions, and the OLS's forecast as contained in this report.

Figure 4
Fiscal Year 2001 Revenue Estimates
($ millions)

	Approp. Act (7/1/00)	Revised Executive (January)	Executive Changes	Office of Legislative Services (April)	Difference OLS vs. Revised Executive
Gross Income Tax	$7,738	$8,310	$572	$8,310	$0
Sales Tax	6,023	5,839	(184)	5,785	(54)
Corporation Business Tax	1,582	1,414	(168)	1,362	(52)
Inheritance Tax	575	575	0	480	(95)
Other Revenues	5,207	5,332	124	5,339	7
Grand Total, All Funds	$21,125	$21,469	$344	$21,276	($194)

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

FY 2001 Executive:

- In January the Executive revised estimates for all revenues upward by $344 million from the level certified in the FY 2001 Appropriations Act.
- The income tax estimate is up $572 million.
- The sales tax estimate is down $184 million.
- The corporation business tax estimate is down $168 million.
- The Executive did not change its estimate for the inheritance tax.
- Numerous other revenue adjustments yielded net increases of $124 million.

FY 2001 Office of Legislative Services:

- The OLS's revenue estimates are ***$194 million below*** the Executive's total.
- The OLS agrees with the Executive's FY 2001 income tax estimate.
- The OLS's sales tax estimate is down an additional $54 million.
- The OLS's corporation business tax estimate is down an additional $52 million.
- The largest difference is the OLS's $95 million lower amount for the inheritance tax.
- For many other revenue sources, The OLS is higher and lower by relatively small amounts, yielding a net difference of $7 million above the Executive's estimates.

Fiscal Year 2002 Revenue Estimates

Figure 5 presents the Executive's FY 2002 revenue estimates and the OLS's forecast as contained in this report.

Figure 5
Fiscal Year 2002 Revenue Estimates
($ millions)

	Executive	% Change 01 to 02	Office of Legislative Services	% Change 01 to 02	Difference OLS vs. Exec.
Gross Income Tax	$8,916	7.3%	$8,435	1.5%	($481)
Sales Tax	6,247	7.0%	6,130	6.0%	(117)
Corporation Business Tax	1,548	9.5%	1,399	2.7%	(149)
Inheritance Tax	575	0.0%	480	0.0%	(95)
Other Revenues	5,588	4.8%	5,594	4.8%	6
Grand Total, All Funds	$22,874	6.5%	$22,038	3.6%	($836)

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

FY 2002 Executive:

- The Executive expects total revenues to grow by $1.4 billion, or 6.5% over FY 2001.
- Income tax revenues increase by $606 million, or 7.3%.
- Sales tax revenues increase by $408 million, or 7.0%.
- Corporation business tax revenues increase by $134 million, or 9.5%.
- The Executive is holding its inheritance tax estimate flat from the FY 2001 level.
- All other revenues increase by $256 million, or 4.8%, due largely to increased transfers from the Unclaimed Personal Property Trust Fund ($51 mil.) and movement of the Tobacco Settlement Fund "on budget" ($140 mil.).

FY 2002 Office of Legislative Services:

- The OLS's revenue estimates are *$836 million below* the Executive's total. Revenues are expected to grow by only $762 million, or 3.6% over FY 2001.
- The OLS believes the income tax will grow by $125 million, or 1.5%, $481 million lower than the Executive's estimate.
- The OLS's sales tax estimate is $117 million lower than the Executive.
- The OLS's corporation business tax estimate is $149 million below the Executive's estimate.
- The OLS's inheritance tax estimate is $95 million below the Executive's estimate.
- For many other revenue sources, the OLS is higher and lower by relatively small amounts, yielding a net difference of $6 million above the Executive's estimates.

Budgetary Impact of the OLS Revenue Estimates

For the current and upcoming fiscal years, the OLS's revenue estimates are a total of $1.03 billion lower than the Executive's estimates. This difference amounts to about 2.3% of the $44.3 billion total revenues over the two year period. However, the difference constitutes 4.5% of the revenues anticipated to be available to support the FY 2002 budget.

As part of its analysis, the OLS typically recalculates the State's year-end budgeted balance based solely on the revenue forecast difference between the Executive and the OLS. Figure 6 assumes that the spending plan and tax law changes in the FY 2002 Executive budget will be followed. However, any calculation of the actual balance must take into account numerous spending decisions as well as anticipated revenue. Decisions on these and other matters will be made by the Executive, both budget committees and the full Legislature over the next three months.

Figure 6
OLS Adjusted FY 2002
Year-End Balance

Executive Estimate	$1,000,000,000
OLS Revenue Adjustment	($1,030,000,000)
OLS Adjusted Balance	($30,000,000)

As is shown in Figure 6, the Executive estimates an FY 2002 year-end balance of $1.0 billion. All other things being equal, the lower OLS revenue estimates would produce a negative year-end balance of $30 million, $1.03 billion less than the Executive.

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 balances from this analysis of State revenues.

Projections of the State's year-end balance are a frozen image of 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. Historically, spending is adjusted and new revenue measures are instituted during the fiscal year when such actions are necessary to maintain an adequate balance.

For a review of State surpluses during the last 20 years, please see the additional discussion in the appendix.

Gross Income Tax

The gross income tax (GIT) now accounts for nearly 40% of budgeted State revenues. As was noted on page 3, GIT revenues have grown by 72% since FY 1997, more than four times faster than all other budgeted State revenues. Fully two-thirds of State revenue growth during the last four years has come from the GIT.

Figure 7

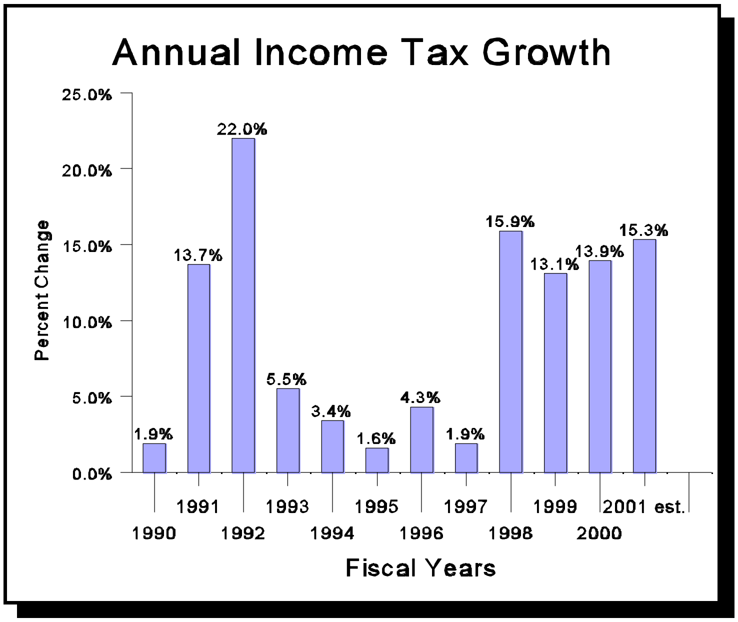


Figure 7 displays annual growth rates for the GIT from FY 1990 through the estimate for FY 2001.

- The high growth rates in FY 1991 and FY 1992 were due primarily to the increase in tax rates in 1991, which affected both fiscal years.
- Fiscal years 1993 and 1994 were marked by slow income and job growth.
- From FY 1995 through FY 1997, a phased-in reduction in tax rates held down revenue growth, masking the impact of an improving economy
- Fiscal years 1998 to 2001 reflect strong income and job growth and the absence of major tax changes.

The Growing Importance of Capital Gains

The most significant reason for the extraordinary growth in GIT revenues is the concentration of wealth and income in upper income tax brackets. According to the most recent data, the top 12% of taxpayers account for 72% of income taxes paid. Nearly all the reported New Jersey income growth in the last decade comes from upper income brackets.

Capital gains income is the fastest growing component of the GIT. Between 1994 and 1998, net gains grew by an average of 35% per year. By contrast, all other kinds of income grew by about 8% per year.

The importance of growth in capital gains is amplified by a combination of the State's graduated tax rate structure and the concentration of such income among taxpayers in the highest brackets. As a result, most capital gains income (over 80%) is taxed at the top rate of 6.37%, well above the average tax rate of about 2.6%.

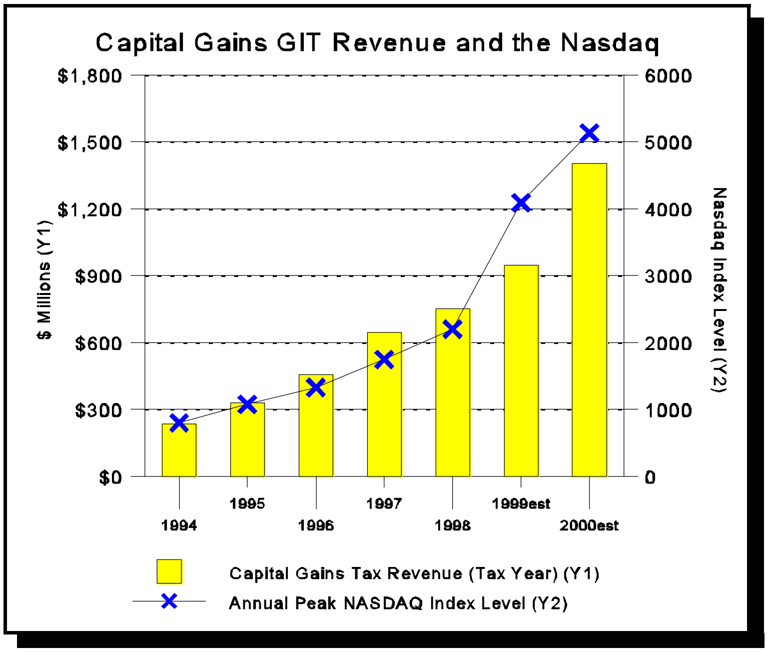
What are Capital Gains?

Capital gains are income from the sale or exchange of any property. For most taxpayers, the sale of property consists primarily of the sale of real estate or of financial assets such as stocks. In recent years stock sales have come to predominate, as stock ownership, either directly or through mutual funds, has expanded substantially. At the same time, recent tax law changes have excluded the gains from most home sales from taxation.

Gross Income Tax (continued)

The OLS estimates that GIT revenue from capital gains has grown from about $235 million in 1994 to approximately $1.4 billion in the year 2000[1]. Capital gains account for about 17% of GIT revenue in FY 2001. This portion of income tax revenue has grown to almost the same level as total revenue collections from the corporation business tax. *If capital gains GIT revenue were separate from the income tax, it would be New Jersey's fourth largest State tax revenue.*

Figure 8



Rapid capital gains income growth has been driven by the stock market boom of the late 1990's. Major stock indices grew by double digit rates during the latter half of the decade, peaking in the first quarter of 2000. The Nasdaq composite index grew by a record 86% in 1999 alone. Moreover, from 1998 to 2000, the number of shares sold on the Nasdaq has doubled. Figure 8 compares the sharp growth in the Nasdaq index with the sharp growth in New Jersey's capital gains tax revenue. While the causal link between these two variables is more complex, the correlation is nevertheless compelling.

Capital Gains in Other Guises

The capital gains data do not represent the entire impact of stock-driven income growth. The increasing use of stock options as a form of employee compensation and the impact of stock values on profits from partnerships, S-corporations and other small businesses which are taxed under the gross income tax are substantial. Unfortunately, State and federal income statistics do not track income sources such as stock options[2]. Employers withhold on income from stock options, but the withholding data do not distinguish between regular wage income and stock option income. Accordingly, the impact of the recent stock market boom on the New Jersey GIT is larger than it appears when only considering income labeled as capital gains.

The sharp annual growth in the State's income tax revenue between FY 1997 and FY 2000 owes much to the stock market boom. Moreover, FY 2001 received an *extra* surge of revenue as trading volume jumped in the face of falling stock prices during calendar year 2000. On the other hand, FY 2002 revenue growth will suffer from the after-effects of the recent sharp stock market decline and the FY 2001 capital gains surge.

[1] The capital gains revenue estimates are based on OLS assumptions about marginal tax rates, annual data from the *Statistics of Income* and consultations with the Treasury's Office of Revenue and Economic Analysis.

[2] The California Legislative Analyst's Office indicates that stock options may account for perhaps 10% of that state's total income tax revenue, about half the size of capital gains.

Gross Income Tax (continued)

FY 2001 Estimate

The OLS concurs with the Executive's estimate that the gross income tax will raise $8.31 billion in FY 2001. This level is reasonable given recent annual growth patterns and consistent with actual collections data reported through the end of February this year.

On a cash basis, the GIT is running about 20% ahead of last year through the first eight months of the fiscal year. Even after a technical adjustment for a difference in the withholding payment pattern this year, GIT revenues are about 18% ahead of the same time last year. The year-end growth rate necessary to reach the $8.31 billion target is 15.3% and the OLS believes this is in the likely range.

Pushing this year's strong growth is another remarkable year on Wall Street. While the major stock indices declined by significant percentages during the year 2000, the *volume* of transactions was up sharply. The combination of high volume and a large pool of *previously unrealized gains from the 1990's market boom*, suggest capital gains realizations soared last year.

The Division of Taxation's Office of Revenue and Economic Analysis anticipates that net (capital) gains grew by about 50% in 2000 and the OLS agrees that such strong growth is plausible. Supporting evidence of this growth comes from the GIT's estimated quarterly tax payments. Taxpayers who have large capital gains or other non-wage income, are likely to make large estimated quarterly tax payments in September and January and large final tax payments in April. So far the quarterly payments are up 31% in FY 2001, nearly twice the growth rate recorded during the previous four fiscal years.

GIT Components

In analyzing the GIT, it is helpful to break up the revenue stream into four basic components:

1. **Withholding collections** are paid throughout the year by employees through their employers as a deduction from each paycheck, bonuses and some stock options;
2. **Estimated quarterly payments** generally are paid in the months of September, January, April, and June by taxpayers with significant non-wage income;
3. **Final year-end payments** are the familiar payments made by April 15th each tax filing season. As with estimated payments, taxpayers who must make large final tax payments generally have significant sources of non-wage income;
4. **Refund payments** are paid by the State, largely in the spring and summer, to taxpayers whose April 15 tax filings show payments exceeding their tax liability.

Accordingly, this spring the Executive and the OLS anticipate strong growth in *final year-end payments* for tax year 2000. However, substantial moderation from the remarkable growth in *quarterly payments* and some moderation from the robust growth in *withholding* collections is also expected for the remainder of the fiscal year. Figure 9 on the next page summarizes the FY 2001 estimate, indicating the estimated 50% growth in revenue from capital gains income, the approximately 10% growth in revenue from non-capital gains income, and the resulting net overall growth rate for FY 2001 of 15.3%.

Gross Income Tax (continued)

Figure 9
Gross Income Tax Revenue Estimates
$ Billions

	FY 2001 Executive and OLS		FY 2002			
			Executive		OLS	
Category	Amount	Growth	Amount	Growth	Amount	Growth
Capital Gains[3]	$1.400	50.0%	$1.450	3.5%	$1.045	(25.0)%
All Other Income	$6.910	10.3%	$7.466	8.0%	$7.390	7.0%
Total	$8.310	15.3%	$8.916	7.3%	$8.435	1.5%

FY 2002 Estimate

The Executive is anticipating $8.916 billion in FY 2002, or 7.3% growth over FY 2001 (Figure 9). *The OLS is estimating total GIT revenue will grow by only 1.5% to $8.435 billion, $481 million below the Executive's estimate.*

The non-capital gains portion of the GIT represents more than 80% of total collections, but only $76 million, or less than one-sixth of the difference between the Executive and the OLS estimates. The Executive expects GIT revenue from income other than capital gains will grow by 8% in FY 2002, following estimated 10% growth in FY 2001. The OLS estimates slightly lower growth for these GIT revenues of 7%. The lower growth assumption anticipates slower employment growth, reduced bonuses, and reduced income from stock options.

However, following the estimated 50% jump in capital gains realizations in FY 2001, the OLS believes there will be a significant decline in GIT revenue from capital gains realizations in FY 2002. The OLS estimate assumes that the value of *unrealized* capital gains is substantially lower today than it was a year ago.

- In the tax year 2000 capital gains surge, investors "cashed in" significant portions of existing unrealized gains by *selling* assets.
- The recent dramatic erosion of stock values has reduced the unrealized gains associated with assets that were *not sold* in 2000.

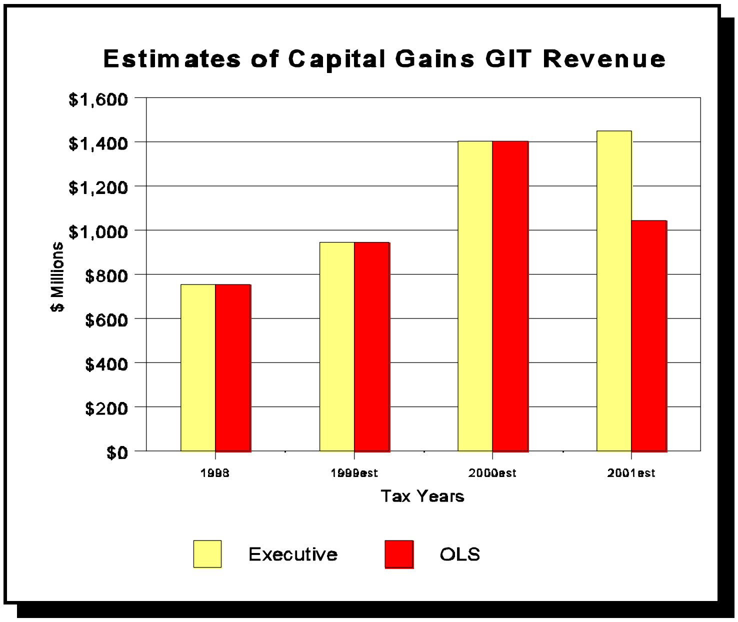
While the Executive is expecting still further growth in revenue from the income tax on capital gains (up 3.5%), the OLS is expecting a decline toward previous levels of revenue from this source. Stock values have fallen back to levels seen in 1998 and 1999, but volume is higher than in those years. Accordingly, the OLS anticipates the level of capital gains should fall back toward, but still exceed, the levels of 1998 and 1999 (Figure 10, page 11). The OLS estimates $1.045 billion in revenue from GIT capital gains in FY 2002 (down 25%), or $405 million less than the Executive's estimate.

Despite this forecast of a decline in capital gains realizations in FY 2002, the OLS still expects tax revenue from capital gains income to record the second highest level in the State's history.

3 Tax year 2000 capital gains impact FY 2001 tax revenues.
Tax year 2001 capital gains impact FY 2002 tax revenues.

Gross Income Tax (continued)

Figure 10



- Capital gains income has become increasingly dominated by stocks and financial assets[4].

While various analysts are exploring the linkage between stock market behavior and revenue forecasts, no consensus model has emerged. The Congressional Budget Office (CBO), in figures published in January, estimated flat capital gains realizations in 2001 and declines of up to 5% in each of the following five years. However, the CBO's estimates are strongly tied to estimates of growth in gross domestic product and may not account for sudden short-term fluctuations. For the most recent complete year (FY 1999), CBO underestimated federal capital gains realizations by $55 billion, an 11% error. Similar miscalculations have occurred since the mid-1980's.

What are Other Analysts Expecting to Happen to Capital Gains Income?

As was discussed in the previous section, the Executive is estimating continued growth in capital gains realizations for FY 2002, while the OLS is predicting a decline toward prior levels. The growing importance of this form of income as a source of tax revenue has focused the attention of state and federal revenue forecasters. Unfortunately, capital gains income is highly volatile from year to year for two particular reasons:

- Unlike wage income, which grows from year to year off of a relatively stable employment base, capital gains income begins each year at $0. Each year's gains come from new, distinct transactions rather than from an established base of ongoing activity.

Underestimating the impact of rapidly growing capital gains income has been one aspect of the frequent need to upwardly revise federal budget surplus figures. However, capital gains revenue accounts for only between 10% and 12% of federal income tax receipts, as compared to an estimated 17% of GIT revenue in New Jersey in FY 2001. New Jersey relies more on capital gains income than the federal government because New Jersey taxpayers have higher incomes than the nation as a whole and because New Jersey's gross income tax does not have a reduced tax rate for capital gains. Accordingly, an error in the estimate of capital gains has a greater proportional budget impact on New Jersey than on the federal budget.

[4] The Congressional Budget Office indicates that in the 1980's stocks accounted for over 40% of reported federal capital gains and that this proportion has undoubtedly risen during the 1990's. Data from California indicate that over 75% of that state's capital gains income is stock related.

Gross Income Tax (continued)

In contrast to the CBO, economists at the Pennsylvania-based firm *Economy.com* are projecting sharp declines in capital gains nationwide. Due specifically to the declining value of stocks, Mark M. Zandi and Mark McMullen estimate a 33% decline in U.S. capital gains realizations in tax year 2001.

For some states with wealthier populations the *Economy.com* forecast projects even more severe declines. In tax year 2001, the firm estimates a potential 45% decline in both New York and Connecticut, a 59% decline in California, and *a 63% decline for New Jersey.*

> *It is unlikely that government policy makers are prepared for what will be a significant deceleration in tax revenue growth.*
>
> Mark M. Zandi
> Mark McMullen
> *Economy.com*

The CBO's models have had significant forecasting errors in the past, while the new *Economy.com* analysis is persuasive but as yet unproven over time. In this widely divergent context, several states with significant levels of capital gains and similar economic and demographic profiles to New Jersey have recently made revenue forecasts for the coming year. The New York State Department of the Budget's (DOB) capital gains forecasting model is based on analytical work done by CBO officials. Accordingly, the DOB is forecasting a 0.4% decline in capital gains in 2001. However, the DOB warns that "the significant drop in stock prices observed in 2000 and the uncertainty as to how investors will behave in 2001, pose significant risks" to the budget forecast.

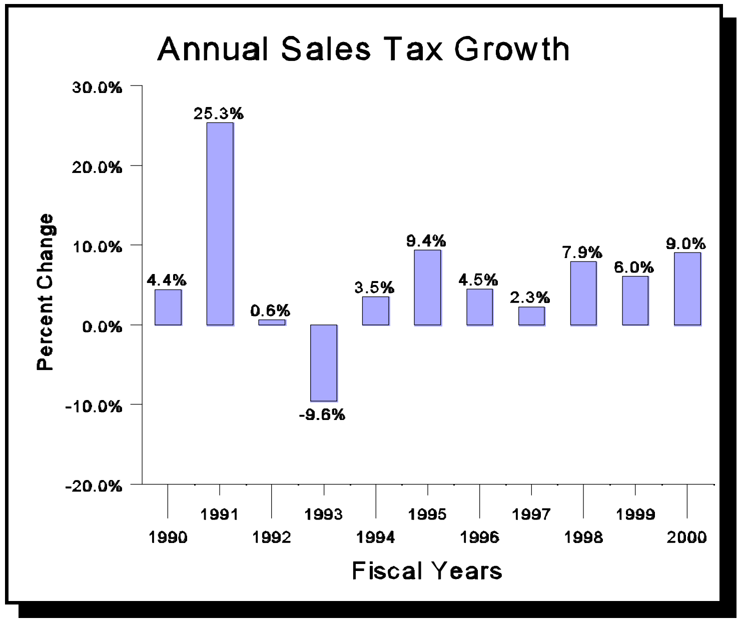
In California, a state with more detailed data on capital gains and stock options than most states, the Executive is currently forecasting a 10% decline in capital gains and stock option income for 2001. In February, the Legislative Analyst's Office released its forecast of a 15% decline in these income sources.

Connecticut's Executive does not specifically forecast capital gains separate from other non-wage (or non-withheld) income, but it is expecting non-withheld income to show 0% growth in FY 2002. The Connecticut General Assembly's Office of Fiscal Analysis, relying in part on the *Economy.com* analysis, reported in March that it is estimating a 4% decline in non-withheld income, due largely to an assumed 25% decline in capital gains income.

Sales Tax

The sales tax accounts for more than a quarter of budgeted revenues. Figure 11 displays the annual growth rates for this tax between fiscal years 1990 and 2000. The two years in which the sales tax rate changed are clearly visible in the figure. In FY 1991, the Legislature increased the tax rate from 6% to 7%, and expanded the base of the tax. Accordingly, revenues increased by 25% that year. Two years later, the Legislature reduced the tax rate to 6%, and revenues declined by almost 10%. Excluding the two tax change years, the average growth in the sales tax during the 1990's was nearly 5%.

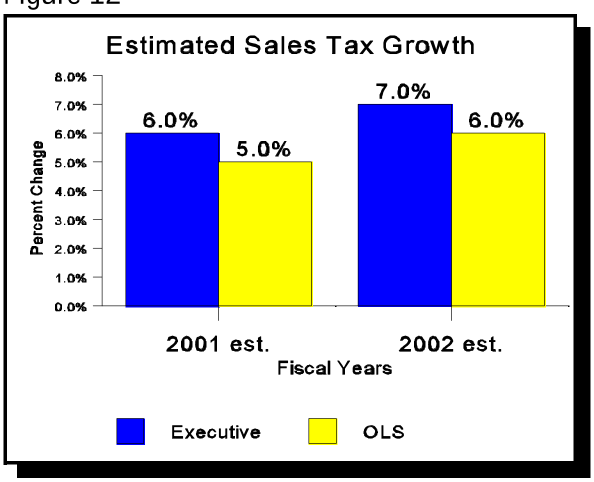
Figure 11



FY 2001

Cash receipts for the sales tax through the first seven months of the fiscal year are running 5.7% ahead of the same period last year. Monthly collection patterns for this normally steady tax have been unusually volatile. Three months have reported growth of 12% or better, while three other months have reported growth of 2% or less. However, a trend of slowing growth appears visible since last year's strong 9% growth. The first quarter of FY 2001 grew by 7.1% and the four months since then have grown by only 4.6% over last year.

Figure 12



The Executive anticipates the sales tax will collect $5.839 billion this year, or 6% growth over last year (Figure 12). To reach that target, the sales tax growth rate would have to accelerate from the growth rates seen in the last four months. The OLS anticipates the recent slowing in the growth rate will not be immediately reversed and that the sales tax will collect $5.785 billion in FY 2001, or 5% growth over last year.

FY 2002

As was noted earlier in this report, the New Jersey Council of Economic Advisors is projecting slower growth rates for many key economic variables. The Executive anticipates sales tax growth will accelerate slightly in FY 2002. The estimate of $6.247 billion assumes 7% growth for the year. Based on the prevailing view of positive but slow economic growth, the OLS is more cautious in projecting sales tax revenue growth for FY 2002. The OLS estimates this tax will collect $6.130 billion, or 6% above the current year. While slightly less than the Executive's growth rate, the OLS rate still assumes some acceleration from FY 2001 levels, and overall growth higher than the 10-year average rate of about 5% growth.

Corporation Business Tax

The corporation business tax (CBT) is the State's third largest tax revenue, after the gross income tax and the sales tax. In FY 2000 this revenue accounted for just over 7% of total State budgeted revenues.

In FY 2001 the Executive is estimating collections of $1.414 billion, a 2.6% decline from the previous year (Figure 13). However, the "base" CBT collections are actually expected to decline by nearly 6.9%. Total CBT collections will be augmented by a $62 million on-budget payment from energy-related corporations that was not received last year.

The OLS is estimating somewhat lower CBT collections in FY 2001. Including the $62 million from energy-related corporations, the OLS estimates the CBT collections should reach $1.362 billion in FY 2001, 6.2% below last year. The CBT base is estimated to decline by 10.5% to $1.300 billion this year.

CBT payments are off significantly in FY 2001. The tax is down 9.5% through the first eight months of the fiscal year. Each of the last five months have been lower than the same months last year. In particular, the important December quarterly payment fell by a startling 22% from the prior year's level. Given the declining collections and the ongoing reports of weakening corporate earnings, the OLS is more cautious in its FY 2001 estimate.

In FY 2002 the Executive is estimating $1.548 billion, a 9.5% increase over FY 2001. After adjusting for $35 million in energy-related corporate payments and $64 million (net) from certain tax law changes, the Executive is estimating base CBT growth of 7.2%. The tax law change component consists of two parts:

- a $36 million assumed loss from the passage of P.L. 2001, c.23, which is the first year cost of the phased-in elimination of the tax on subchapter S-corporations.
- a $100 million assumed gain from pending legislation that would minimize the use of certain tax advantages by limited liability corporations.

Given projections of weak corporate earnings in calendar year 2001, the OLS is forecasting no growth in the base CBT collections for FY 2002. Instead, the OLS estimates flat CBT payments and it assumes the energy-related collections and the tax law changes will occur. If the limited liability corporation bill is not enacted, the OLS revenue estimates would be $100 million less than in the current analysis.

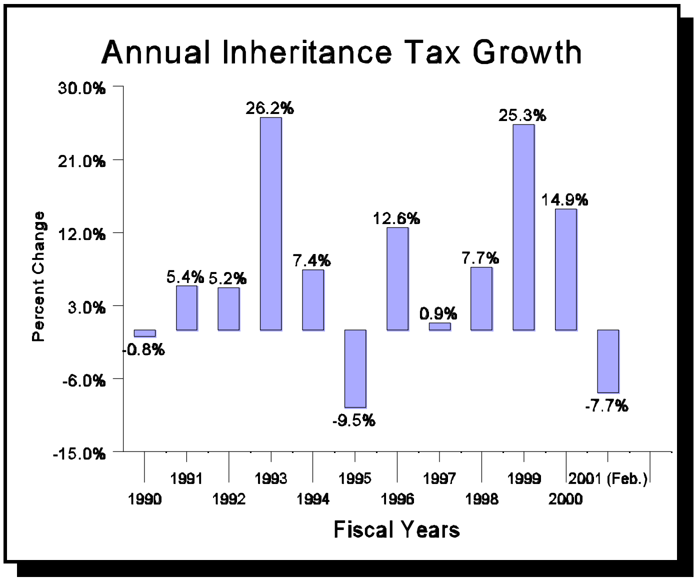
Figure 13
Corporation Business Tax Revenue Estimates
$ Millions

	FY 2001				FY 2002			
	Executive		OLS		Executive		OLS	
Category	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth
CBT Base	$1,352	(6.9)%	$1,300	(10.5)%	$1,449	7.2%	$1,300	0.0%
Energy	$62		$62		$35		$35	
Tax Changes	$0		$0		$64		$64	
Total	$1,414	(2.6)%	$1,362	(6.2)%	$1,548	9.5%	$1,399	2.7%

The Inheritance Tax

The strong collections growth occurring in the inheritance tax the last several years appears to be over. Revenue from this tax grew by 8% in FY 1998, by 25% in FY 1999, and by 15% in FY 2000 (Figure 14). In stark contrast, FY 2001 collections through the end of February are *down* by 7.7% compared to the same period last year.

Figure 14



The Executive is estimating the inheritance tax will raise $575 million in FY 2001, 18.3% above the FY 2000 level. This estimate is unchanged from the amount certified in the FY 2001 Appropriations Act last July. For FY 2002 the Executive is keeping this revenue flat and estimating $575 million.

Given the consistently weak performance of the inheritance tax so far this year, the OLS believes it is unlikely that the inheritance tax will suddenly reverse course and rise strongly over the last 4 months of the fiscal year. Based on the current collection pattern of approximately $40 million per month, the OLS is estimating that the inheritance tax will raise only $480 million by the end of the year, $95 million below the Executive's estimate. For FY 2002 the OLS is estimating stability in this revenue source and is holding at $480 million.

The reasons for the strong growth in this tax revenue in the years prior to FY 2001 are not entirely clear. The most likely explanation is the 1990's boom in stock values. As the assets of estates have risen, so have the taxes paid by those estates. The decline in growth in FY 2001 may reflect the deterioration of stock market values over the last 12 months. There are indications that federal estate tax collections are showing a similar pattern.

The inheritance tax consists of two very different parts. One part is the transfer inheritance tax, which is applied to the transfer to certain beneficiaries of all personal property and New Jersey real property having an aggregate value of $500 or more. The second part is the estate tax, which absorbs the value of any federal estate tax credit remaining after transfer inheritance taxes have been paid. For more information on the New Jersey inheritance taxes and the potential impact of a repeal of the federal estate tax, please see an additional discussion in the appendix.

The Remaining Revenue Differences

The remaining differences between the OLS and the Executive are relatively minor and involve small differences based largely on current revenue growth patterns. Overall these differences are not fiscally significant. The first two tables in the appendix display all the revenue differences in greater detail.

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Appendix Contents:

Detailed Fiscal Year 2001 Revenue Estimates

$ Millions

Revenue Source	Approp. Act	Executive Revised	OLS	Diff: OLS - Executive
Major Taxes:				
Sales Tax	$6,023.0	$5,839.0	$5,785.0	($54.0)
Corporation Business Tax	1,582.0	1,413.7	1,361.7	(52.0)
Corporation Business Tax Base	*1,582.0*	*1,352.0*	*1,300.0*	*(52.0)*
Corporation Business Tax Energy Contribution	*0.0*	*61.7*	*61.7*	*0.0*
Motor Fuels	515.0	525.0	520.0	(5.0)
Motor Vehicle Fees	406.3	398.3	385.0	(13.3)
Inheritance Taxes	575.0	575.0	480.0	(95.0)
Insurance Premiums	300.0	300.0	300.0	0.0
Cigarette	199.0	215.0	220.0	5.0
Petroleum Products Gross Receipts	217.0	217.0	215.0	(2.0)
Corporation Business - Banks and Financial	40.0	49.0	70.0	21.0
Alcoholic Beverage Excise	80.0	80.0	80.0	0.0
Realty Transfer	80.0	83.0	85.0	2.0
Savings Institutions	14.0	14.0	14.0	0.0
Tobacco Products Wholesale	12.0	15.0	15.0	0.0
Public Utilities Excise	8.7	8.7	8.7	0.0
Subtotal, Major Taxes	$10,052.0	$9,732.7	$9,539.4	($193.3)
Misc. Taxes, Fees and Revenues				
Public Utility Taxes (State retention)	$68.4	$68.4	$68.4	$0.0
Transitional Energy Facility Assessments	147.1	216.0	216.0	0.0
Medicaid Uncomp. Care Reimbursement	448.3	423.0	423.0	0.0
MTF Revenue Fund	46.0	40.0	40.0	0.0
Good Driver Program	67.7	62.4	62.4	0.0
Motor Vehicle Inspection Fund	70.2	74.0	74.0	0.0
Investment Earnings	26.6	41.5	41.5	0.0
Other	970.0	962.3	962.3	0.0
Subtotal, Misc. Revenues	$1,844.4	$1,887.5	$1,887.5	$0.0
Interfund Transfers				
State Lottery Fund	$713.0	$713.0	$713.0	$0.0
Tobacco Settlement Fund	144.2	153.2	153.2	0.0
Unclaimed Personal Property Trust Fund	46.0	81.0	81.0	0.0
Other	175.8	176.6	176.6	0.0
Subtotal, Interfund Transfers	$1,079.0	$1,123.8	$1,123.8	$0.0
TOTAL GENERAL FUND	$12,975.4	$12,744.0	$12,550.7	($193.3)
Property Tax Relief Fund (Income Tax)	$7,738.0	$8,310.0	$8,310.0	0.0
Casino Revenue Fund	352.4	352.3	352.3	0.0
Casino Control Fund	58.1	61.5	61.5	0.0
Gubernatorial Elections Fund	1.5	1.5	1.0	(0.5)
GRAND TOTAL, ALL FUNDS	$21,125.4	$21,469.3	$21,275.6	($193.8)

Detailed Fiscal Year 2002 Revenue Estimates
$ Millions

Revenue Source	Executive	% Change	OLS	% Change	Diff: OLS - Executive
Major Taxes:					
Sales Tax	$6,247.0	7.0%	$6,130.0	6.0%	($117.0)
Corporation Business Tax	1,548.0	9.5%	1,399.0	2.7%	(149.0)
Corporation Business Tax Base	*1,449.0*	*7.2%*	*1,300.0*	*0.0%*	*(149.0)*
Corporation Business Tax Energy Contribution	*35.0*		*35.0*		*0.0*
Corporation Business Tax, Tax Changes	*64.0*		*64.0*		*0.0*
Motor Fuels	541.0	3.0%	530.0	1.9%	(11.0)
Motor Vehicle Fees	398.8	0.2%	385.0	0.0%	(13.8)
Inheritance Taxes	575.0	0.0%	480.0	0.0%	(95.0)
Insurance Premiums	300.0	0.0%	300.0	0.0%	0.0
Cigarette	200.0	(7.0)%	210.0	(4.5)%	10.0
Petroleum Products Gross Receipts	220.0	1.4%	220.0	2.3%	0.0
Corporation Business - Banks and Financial	49.0	0.0%	70.0	0.0%	21.0
Alcoholic Beverage Excise	80.0	0.0%	80.0	0.0%	0.0
Realty Transfer	85.0	2.4%	85.0	0.0%	0.0
Savings Institutions	14.0	0.0%	14.0	0.0%	0.0
Tobacco Products Wholesale	15.0	0.0%	15.0	0.0%	0.0
Public Utilities Excise	8.7	0.0%	8.7	0.0%	0.0
Subtotal, Major Taxes	$10,281.5	5.6%	$9,926.7	4.1%	($354.8)
Misc. Taxes, Fees and Revenues					
Public Utility Taxes (State retention)	$68.4	0.0%	$68.4	0.0%	$0.0
Transitional Energy Facilities Assessment	176.1	(18.5)%	176.1	(18.5)%	0.0
Medicaid Uncomp. Care Reimbursement	416.16	(1.6)%	416.16	(1.6)%	0.0
MTF Revenue Fund	40.0	0.0%	40.0	0.0%	0.0
Good Driver Program	62.4	0.0%	62.4	0.0%	0.0
Motor Vehicle Inspection Fund	74.10	0.1%	74.10	0.1%	0.0
Investment Earnings	44.2	6.6%	44.2	6.6%	0.0
Other	1,016.2	5.6%	1,016.2	5.6%	0.0
Subtotal, Misc. Revenues	$1,897.4	0.5%	$1,897.4	0.5%	$0.0
Interfund Transfers					
State Lottery Fund	$715.0	0.3%	$715.0	0.3%	$0.0
Tobacco Settlement Fund	293.4	91.5%	293.4	91.5%	0.0
Unclaimed Personal Property Trust Fund	132.0	63.0%	132.0	63.0%	0.0
Other	209.7	18.8%	209.7	18.8%	0.0
Subtotal, Interfund Transfers	$1,350.2	20.1%	$1,350.2	20.1%	$0.0
TOTAL GENERAL FUND	$13,529.1	6.2%	$13,174.3	5.0%	($354.8)
Property Tax Relief Fund (Income Tax)	8,916.0	7.3%	8,435.0	1.5%	(481.0)
Casino Revenue Fund	368.1	4.5%	368.1	4.5%	0.0
Casino Control Fund	59.7	(2.9)%	59.7	2.8%	0.0
Gubernatorial Elections Fund	1.5	0.0%	1.0	0.0%	(0.5)
GRAND TOTAL, ALL FUNDS	$22,874.4	6.5%	$22,038.1	3.6%	($836.3)

FY 2001 Year-To-Date
Selected Revenue Comparison
Through the End of February 2001 vs. 2000
($ millions)

Revenue Source	FY 2000 Actual Year-To-Date	FY 2001 Actual Year-To-Date	FY 2001 Actual Year-To-Date % Growth	FY 2001 Year-End Treasury % Growth Target
Gross Income Tax	$3,885.2	$4,681.5	20.5%	15.3%
Sales Tax *	3,184.8	3,366.7	5.7%	6.0%
Corporation Business Tax	680.7	616.1	(9.5)%	(6.9)%
Lottery	438.1	447.7	2.2%	(1.0)%
Motor Fuels *	298.9	304.6	1.9%	3.7%
Motor Vehicle Fees	247.0	250.4	1.3%	4.0%
Casino	221.5	225.7	1.9%	3.5%
Inheritance Taxes	343.9	317.5	(7.7)%	18.3%
Insurance Premiums	101.0	112.7	11.6%	11.6%
Cigarette (Budgeted)	107.2	101.3	(5.5)%	(7.4)%
*Cigarette (Total)***	*262.2*	*256.3*	(2.3)%	*(4.4)%*
Petroleum Products *	124.9	128.5	2.9%	3.9%
Alcohol Excise *	42.9	43.7	1.8%	2.4%
CBT -- Banks & Financials	12.0	30.7	156.7%	46.3%
Realty Transfer *	46.5	50.6	8.9%	6.8%

Sources: Year-To-Date revenues are from Treasury monthly cash reports. The Executive year-end percentage growth target is based on the January revised revenues for FY 2001 contained in the proposed FY 2002 budget.
** Revenues represent seven months of cash collections. All others represent eight months of cash collections.*
*** Cigarette (Total) includes $155 million deposited directly into the off-budget Health Care Subsidy Fund in both FY 2000 and FY 2001.*

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The State Budget Surplus in Perspective

The Executive budget proposes an FY 2002 year-end surplus of $1.0 billion. While this amount is the largest *proposed* closing balance in the State's history, $1.0 billion surpluses have become relatively common in recent years. The Executive anticipates that FY 2001 will end with a $1.3 billion surplus, which would be the fifth year in a row with a surplus greater than $1.0 billion.

Comparing surplus amounts to budget expenditures helps put the dollar amounts in context. The anticipated $1.3 billion surplus in FY 2001 is equal to about 5.9% of anticipated expenditures. *The projected $1.0 billion surplus for FY 2002 is equal to about 4.3% of the Executive's spending proposal.*

Figure A displays New Jersey's annual surplus as a percentage of total expenditures since FY 1983. The figure also displays an annual national average for all states through FY 2001 compiled by the National Association of State Budget Officers (NASBO). The average New Jersey State surplus percentage between FY 1983 and FY 2000 (the most recent completed year) is 6.7%, while the national average for all states is 4.8%.

New Jersey's surplus as a percentage of budget expenditures exceeded 11.0% twice during the 1980's. Indeed, each year from FY 1984 through FY 1988 the State's surplus exceeded 7.0%, well above the national averages compiled by NASBO. However, as the State's economy entered recession at the end of the decade, the surplus percentage dropped suddenly and steeply. By FY 1990 the surplus was less than 2.0% of State expenditures, falling briefly below the national average.

As the economy began to expand, New Jersey's State budget surplus percentage recovered. New Jersey's surplus exceeded 5.0% of budgeted expenditures in each year between FY 1992 and FY 2000, peaking at just over 8.0% in FY 1994. Since FY 1995 New Jersey's surplus as a percentage of State expenditures has generally been equal to or slightly below the national average. However, if FY 2002 were to end the year at the proposed $1.0 billion surplus, the 4.3% level would be the lowest actual percentage since FY 1991.

Figure A

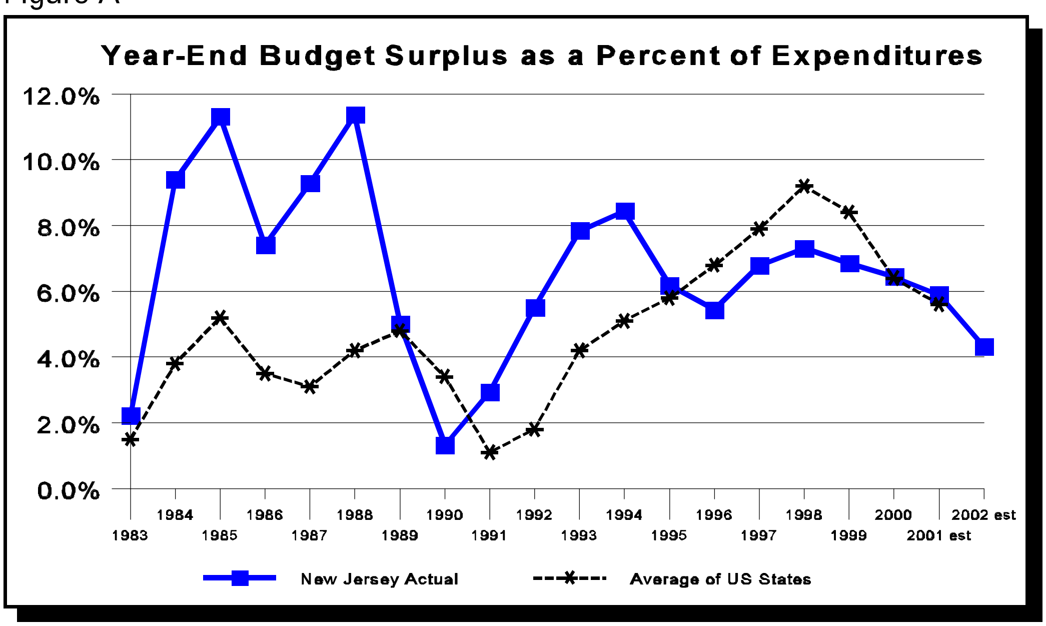

Figure B
State Budget Surpluses
$ Millions

FY	Proposed	Actual End
1983	$30.0	$139.3
1984	$55.7	$645.8
1985	$96.1	$891.2
1986	$255.7	$640.9
1987	$254.5	$882.6
1988	$287.2	$1,203.0
1989	$317.3	$595.8
1990	$412.0	$162.1
1991	$397.0	$370.6
1992	$671.0	$836.2
1993	$270.6	$1,149.6
1994	$146.7	$1,264.6
1995	$453.5	$950.3
1996	$500.0	$882.2
1997	$550.0	$1,106.4
1998	$550.0	$1,256.7
1999	$650.0	$1,268.0
2000	$750.0	$1,284.6
2001	$850.0	*Est $1,279.0*
2002	$1,000.0	

Surplus includes amounts from the General Fund, Property Tax Relief Fund, Casino Revenue Fund, Casino Control Fund, Gubernatorial Elections Fund and the Surplus Revenue Fund (ie., the "Rainy Day" Fund).

Surplus May Change Significantly During the Fiscal Year

Surpluses may increase or decrease from the original Executive proposal for a variety of intended and unintended reasons. Figure B displays 20 years of proposed and actual year-end budget surpluses. In many years the actual year-end surplus exceeded the original proposal, sometimes by significant amounts. In other years, such as during the State and national economic recession at the beginning of the 1990's, the actual surplus fell short of the Executive's original plan. Surplus may vary from the initial proposal during a fiscal year because of revenues lagging or exceeding forecasts, upward or downward adjustments to spending, the incorporation of new revenues, or a statutory reduction in existing taxes.

In certain years, extraordinary actions were undertaken late in the fiscal year to produce large year-end surpluses. While by no means a comprehensive list, the following items indicate the kind of actions which have been undertaken in the last decade.

- The State has acquired one-time revenues from the sale of assets to the New Jersey Turnpike Authority and the acceleration of public utility payments.
- Scheduled debt service expenditures have been avoided during several fiscal years through refinancing of prior bond obligations.
- Additional one-time federal revenues were realized from expanded and retroactive claims for Medicaid Uncompensated Care Reimbursement for services at psychiatric hospitals.
- A State tax amnesty was undertaken to increase the one-time collection of previously uncollectible and unknown State tax liabilities.
- Several dedicated fund balances have been transferred to the State General Fund as year-end revenue sources.
- Pension liabilities have been restructured so as to avoid or reduce State employer pension contributions.

New Jersey Inheritance Taxes

Distribution of Inheritance Tax Collections
$ Millions

	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01*
Collections								
Transfer	$221.6	$202.9	$217.3	$203.3	$244.6	$256.4	$282.3	$173.5
Estate	$90.2	$78.5	$90.9	$155.6	$97.8	$170.7	$208.5	$144.4
Total	$311.8	$281.4	$308.2	$318.8	$342.4	$427.1	$490.8	$318.0
% of Total								
Transfer	71.1%	72.1%	70.5%	63.8%	71.4%	60.0%	57.5%	54.6%
Estate	28.9%	27.9%	29.5%	36.2%	28.6%	40.0%	42.5%	45.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

** FY01 amounts are through the end of February, 2001.*

Overview:

New Jersey imposes two types of inheritance taxes: the **transfer inheritance tax** and the **estate tax**. The transfer inheritance tax is imposed on certain *beneficiaries* for the receipt of assets from a New Jersey resident decedent. The amount of the tax depends upon the value of the assets transferred and the beneficiary's relationship to the decedent. In addition to the tax on beneficiaries, New Jersey also imposes an estate tax in an amount equal to the credit *allowed* under the federal estate tax for any State death taxes paid.

According to the National Conference of State Legislatures (NCSL), nationwide state inheritance taxes (including inheritance, estate and gift taxes) collectively provided one percent of state tax collections in 1997. Not surprisingly, the data indicate that states with the highest collections per capita, including Connecticut ($69.37), Pennsylvania ($51.21), New York ($49.03), Delaware ($43.38), and New Jersey ($38.92), also are the states which rank highest in per capita income. Moreover, the amount of revenue collected from the various inheritance taxes is greatest in those states which, like New Jersey, impose *both* an inheritance tax and an estate or pick-up tax.

Transfer Inheritance Tax

Under the transfer inheritance tax, the rate of taxation is determined by the value of the property transferred and the relationship of the decedent to the beneficiary. Pursuant to N.J.S.A.54:34-2, the relationship of the parties, and the corresponding rates of taxation, are defined according to "class" where: "Class A" beneficiaries (spouses and other immediate family members) and "Class B" beneficiaries (churches, hospitals, religious and charitable organizations) are exempt from taxation; "Class C" beneficiaries (the sibling of a decedent, or the spouse or widow/er of a child of a decedent) are taxed at a rate of 11 to 16 percent depending on the amount transferred, with the first $25,000 exempt; and "Class D" beneficiaries (all others--i.e. distant relatives and all non-relatives) are taxed at a rate of 15 to 16 percent depending on the amount transferred, with no tax on bequests under $500.[1]

[1]Exemptions from the transfer inheritance tax include: all transfers having an aggregate value under $500; life insurance proceeds paid to a named beneficiary; charitable transfers to certain types of institutions, transfers for public purposes made to the State or to any political subdivision; Federal civil service retirement benefits payable to

According to the Division of Taxation, most beneficiaries taxed under the two taxable classes, "Class C" and "Class D," pay the tax at the lowest applicable tax rates, equal to 11 and 15 percent, respectively.

The New Jersey Estate Tax

In addition to the transfer inheritance tax, New Jersey, like all other states, also imposes an estate tax. The New Jersey estate tax is also known as a "sponge tax" or "pick-up tax" because it absorbs the value of any allowable federal estate credit. In effect, the State inheritance tax credit shifts revenue to the State without increasing the aggregate tax burden imposed on an estate. New Jersey's estate tax law is designed to equal the allowable federal credit amount and automatically adjusts liability up to the maximum federal credit. For an explanation of how the New Jersey estate tax is calculated see page A10.

Inheritance Tax Collections

As discussed on page 15, annual inheritance tax collections are somewhat variable, since the amount of revenue depends upon the number of wealthy residents who die in a given year, the magnitude of their wealth, and the degree to which individuals undertake estate tax planning. Based on FY01 certified revenues, the "inheritance tax" ranks as New Jersey's fourth largest tax revenue source (following the gross income tax, sales tax, and corporation business tax).

As reported by the Department of the Treasury, total inheritance tax revenues reflect collections from both the transfer inheritance tax and the estate or "pick-up" tax. While historically, revenues from the transfer inheritance tax have comprised the overwhelming majority of all inheritance taxes collected, the proportion of total revenues attributable to the estate tax has grown dramatically in recent years. In the mid-1980's, practically all inheritance tax revenues were derived from the transfer inheritance tax. Over the last decade, however, the share of total revenues attributable to the estate tax has been steadily increasing following changes made to the federal tax code in 1986. As indicated in the table on the page A8, currently, the estate tax is approaching parity with transfer inheritance tax revenues.

Impact of Federal Estate Tax Repeal

Given the relative significance of inheritance tax revenues to overall revenues, and the growing importance of the New Jersey estate tax to total inheritance tax collections, a repeal or phase out of the federal estate tax, as contained within President Bush's tax plan (which calls for full repeal by 2009), can be expected to have a measurable impact on New Jersey revenue collections.

With a full repeal of the federal estate tax, New Jersey would forego the full value of its estate tax, since without a federal estate tax there is no allowable federal credit amount to be "picked-up." At the same time, however, the State would see a slight gain in transfer inheritance tax revenues in that some transfers to "Class C" and "Class D" beneficiaries would be increased by the elimination of a federal estate tax. Hence, if a full repeal had been in effect during State FY00, New Jersey would have lost $208.5 million in estate tax revenues, but would have experienced a modest increase in the transfer inheritance tax.

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a beneficiary other than the estate; government annuities paid to survivors of military retirees; and certain qualified employment annuities paid to a surviving spouse.

Estate Tax Example:

To understand the effect of a repeal of the federal estate tax would have on states, and on New Jersey in particular, it is useful to understand how the estate or "pick-up" tax works. Consider the following example of a $1.0 million estate of a New Jersey resident decedent left to one beneficiary who is a direct lineal (eg., daughter or son):

1. Calculate allowable federal credit as follows:

- Value of Estate = $1,000,000

- Taxable federal amount = $325,000
  Based on federal exemption for TY2000 of $675,000. ($1,000,000 - $675,000).

- Federal Tax liability = $108,000
  Based on federal estate tax rate of 30% ($325,000 x 0.3), and otherwise unadjusted.

- Maximum federal credit allowed under the federal tax code for State taxes paid against federal taxable amount = 3%

  Maximum allowable federal credit amount = $9,750. *($325,000 x .03)*

- Federal Estate Tax owed: $98,250
  Deduct the allowable federal credit from federal tax liability to determine federal liability ($108,000 - $9,750)

2. Calculate N.J. Estate Tax

- Determine *allowable* federal credit amount (see above): $9,750.

- State transfer inheritance taxes: $0
  No transfer inheritance tax due in this case because beneficiary is a member of an exempt class under State tax law.

- New Jersey estate or "pick-up" tax = $9,750.
  Deduct from the allowable federal credit amount, any State taxes paid. ($9,750 - $0).

- Summary: Net impact on estate from N.J. estate tax = $0; Liability is shifted from federal to State Treasury.

Public Utility Tax Revenue

Fiscal Year 2002 will be the fifth year under the revised system of public utility, energy and telecommunications taxation. 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 (CBT) and the transitional energy facility assessment tax, a temporary tax which phases out over five years. Telecommunications utilities became subject to the CBT 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.

Figure 1 below displays public utility revenues between FY 1991 and FY 2002. The revenues are divided into two categories: *Municipal Use*, which is generally "off budget" and *State Use*, which is generally "on budget." Collections through FY 1997 were under the old public utility tax system. The State Use portions in FY 1992 to FY 1994 included large scheduled prepayments from large utilities pursuant to statutory changes at that time. Since FY 1998 taxes have been collected under the current law.

Figures 2 through 6 display the actual and anticipated revenues from the replacement taxes between FY 1998 and FY 2002 in greater detail. The figures were prepared by the Department of Treasury.

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 G were credited to the Energy Tax Receipts Property Tax Relief Fund and distributed to municipalities according to the new formula. The amount credited to this fund was $745 million in FY 1999, $750 million in fiscal year 2000, and will be $750 million 2001 and $755 million in 2002.

From a budgeting perspective, the tax revenues credited to the Energy Tax Receipts Property Tax Relief Fund are considered "off budget" and therefore not included in either the anticipated revenues or the amount of State aid appropriated in the annual appropriations act.

Figure 1

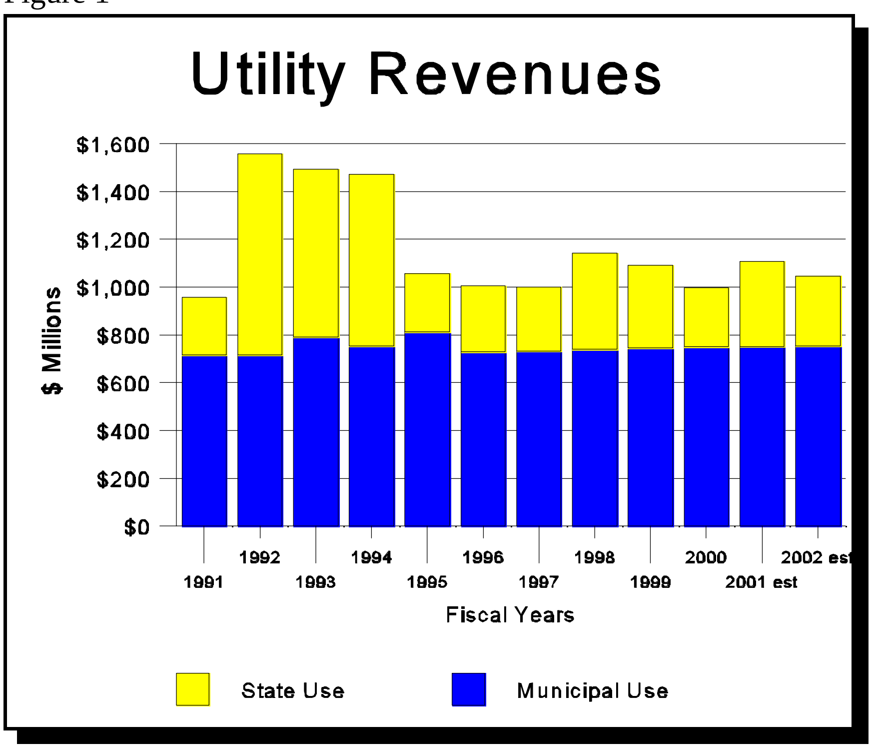

Figure 2
Actual Public Utility Tax Revenue Fiscal Year 1998
($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax	$6.7	$510.2	$516.9
Corporation Business Tax	$3.9	$229.8	$233.7
Transitional Energy Facilities Assessment (TEFA)	$314.9		$314.9
Franchise and Gross Receipts Tax Water and Sewer Utilities	$68.4		$68.4
Public Utility Excise Tax Water and Sewer Utilities	$9.2		$9.2
Total	$403.1	$740.0	$1,143.1

Source: Department of Treasury, February 1999.

Figure 3
Actual Public Utility Tax Revenue Fiscal Year 1999
($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		$528.2	$528.2
Corporation Business Tax	$37.4	$216.8	$254.2
Transitional Energy Facilities Assessment (TEFA)	$228.0		$228.0
Customer Specific Tax	$2.5		$2.5
Franchise and Gross Receipts Tax Water and Sewer Utilities	$68.7		$68.7
Public Utility Excise Tax Water and Sewer Utilities	$8.9		$8.9
Total	$345.5	$745.0	$1,090.5

Source: Department of Treasury, January 2000.

Figure 4
Actual Public Utility Tax Revenue Fiscal Year 2000
($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		$540.3	$540.3
Corporation Business Tax		$155.6	$155.6
Transitional Energy Facilities Assessment (TEFA)	$164.0	$54.1	$218.1
Customer Specific Tax	$2.6		$2.6
Franchise and Gross Receipts Tax Water and Sewer Utilities	$71.2		$71.2
Public Utility Excise Tax Water and Sewer Utilities	$9.1		$9.1
Total	$246.9	$750.0	$996.9

Source: Department of Treasury, March 2001.

Figure 5
Anticipated Public Utility Tax Revenue Fiscal Year 2001
($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		$574.8	$574.8
Corporation Business Tax	$61.7	$175.2	$236.9
Transitional Energy Facilities Assessment (TEFA)	$216.0		$216.0
Customer Specific Tax	$2.3		$2.3
Franchise and Gross Receipts Tax Water and Sewer Utilities	$68.4		$68.4
Public Utility Excise Tax Water and Sewer Utilities	$8.7		$8.7
Total	$357.1	$750.0	$1,107.1

Source: Department of Treasury, March 2001.

Figure 5
Anticipated Public Utility Tax Revenue Fiscal Year 2002
($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		$597.4	$597.4
Corporation Business Tax	$35.0	$117.7	$152.7
Transitional Energy Facilities Assessment (TEFA)	$176.1	$39.9	$216.0
Customer Specific Tax	$2.1		$2.1
Franchise and Gross Receipts Tax Water and Sewer Utilities	$68.4		$68.4
Public Utility Excise Tax Water and Sewer Utilities	$8.7		$8.7
Total	$290.3	$755.0	$1,045.3

Source: Department of Treasury, March 2001.

New Jersey Review and Economic Outlook for 2001-2002

State of New Jersey
Council of Economic Advisors
January 2001

The Office of Legislative Services would like to thank the Council for permitting the reproduction of its annual economic report in the following appendix pages of the FY 2001-2002 Revenue Analysis.

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NEW JERSEY REVIEW & ECONOMIC OUTLOOK FOR 2001-2002

Forecast Summary: ***"The New Jersey economy has been so good for so long that any slowing may feel like a shock, but our economy is fundamentally sound"***

Joseph J. Seneca,Chairman, Council of Economic Advisors

NJ Summary:

As the national expansion slows, the New Jersey economy also will experience slower growth for 2001 and 2002.

Problem areas for the State include tight markets for skilled labor, continuing inflationary pressures (including rising fuel and home prices), low vacancy rates (offices) and softening retail spending.

Supporting continuing growth are substantial backlogs of non-residential construction including public construction projects, a diversified portfolio of vibrant growth industries (clusters), continued economic gains in the adjacent New York metropolitan area, and decreased reliance on manufacturing.

Summary: New Jersey Forecast (% Chg)

	2001	2002
Gross State Product (Current $)	**4.8%**	**5.0%**
Personal Income (Current $)	**5.2%**	**4.7%**
Retail Sales (Current $)	**3.7%**	**5.0%**
Consumer Price Index (All Urban)	**2.5%**	**2.5%**
Total Non-Ag Employment	**1.1%**	**1.2%**

The U.S Outlook:

The new-year begins with widespread evidence of an economic slowdown along with increasing cost pressures. The consumer, still experiencing employer wage restraint and a stock market correction, is buying fewer new cars, fewer new and existing homes and spending at a slower rate at retail stores. Meanwhile households are facing rising prices triggered by volatile energy and food prices.

Businesses continue to face tight labor markets across the nation and rising labor costs, especially for employee health benefits. Over the past three years the strongest contributor to growth has been business investment with 13-15% increases. The near term outlook indicates less stimulus from business investment, which is expected to grow at rates about 50% slower than previously.

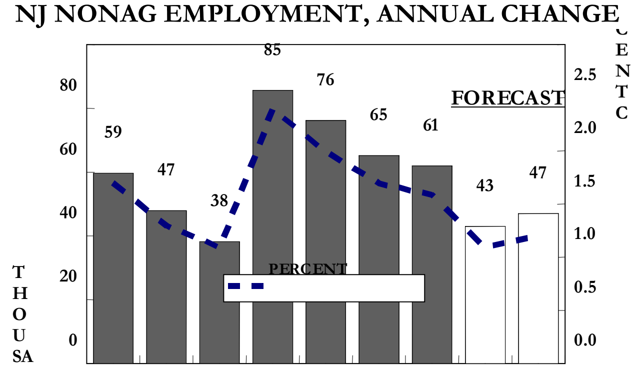
At the moment indications are that the U.S. slowdown will not be severe or prolonged. Government policy is key to this point of view. Mounting Federal budget surpluses are available to finance a tax cut and/or countercyclical spending to supplement consumer expenditures. The current fiscal year Federal budget surplus is estimated at over $180 billion.

A healthy economy has also left state & local governments with the means to increase spending. Meanwhile, the Fed has begun to ease monetary policy, using lowered interest rates to help prolong the expansion.

Employment

Total nonfarm employment increased by 61,000 (1.6%) in 2000 to a record 3.9 million payroll jobs. This was the fourth consecutive year that New Jersey job growth exceeded 60,000. Slowing national and State economies will decrease the State's job growth to the 1% to 1.2% range in 2001 and 2002, closer to the 20-year trend growth rate of about 45,000 jobs per year. The average job increase will be about 43,000 in 2001, and 47,000 in 2002.

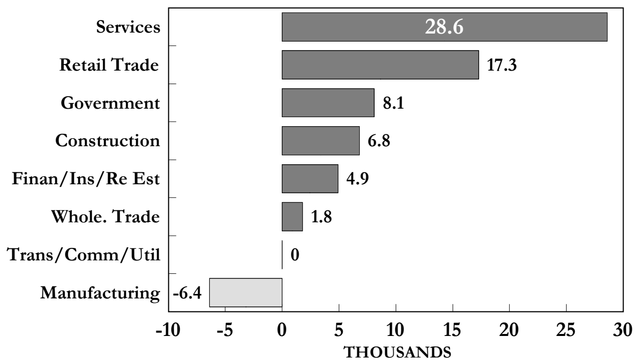
NJ NONAG EMPLOYMENT, ANNUAL CHANGE



This job forecast will be sufficient to absorb trend-level labor force growth, leaving the unemployment rate in the 4% range in the forecast years, the lowest level since the late 1980's and in line with the national average. Labor markets will remain especially tight in the emerging technology industries in the State where the shortage of high-skilled workers has been cited time and again by New Jersey business leaders as the primary constraint to business growth.

The services industries continued to lead in employment growth, with an average of 28,600 jobs added in 2000.

NJ EMPLOYMENT GROWTH x INDUSTRY, 1999-00
(11-month average, year-to-year change)



Retail trade was second with an employment gain of 17,300, followed by an increase of 8,100 government jobs, many of which were temporary federal government hires for the April 2000 Decennial Census.

Two industries; the engineering/consulting/research industry and computer and data processing services accounted for almost 10,000 of the 28,600 gain in the services sector. These industries are part of the Council's **information technology** and **research** "industry growth clusters".

Industry Clusters…

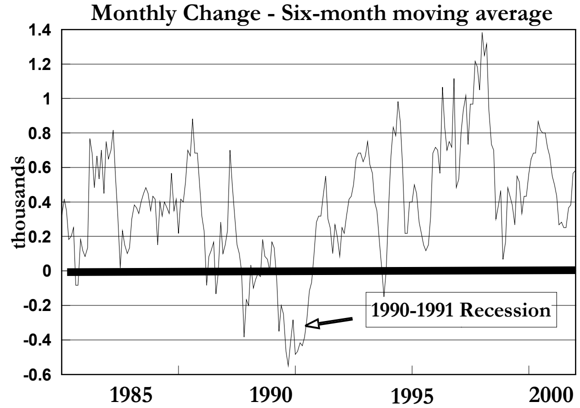
New Jersey's recent job growth has been concentrated in well-defined business clusters of economic activity - information technology (IT), R&D, pharmaceuticals, finance/insurance, logistics, and entertainment.

Clusters are groups of geographically concentrated industries including suppliers, providers of specialized infrastructure, producers of complementary products and/or companies linked by similar labor skills, technology or other common inputs.

These "growth" clusters added jobs at a 2.3% annual rate during the current expansion compared to a 1.3% rate for non-cluster industries. As the economy slows, the growth clusters are expected to continue adding jobs to offset declines in cyclically sensitive industries.

The personnel supply industry, a cyclically sensitive area in the sense that temporary help is most vulnerable in a downturn, continued to be one of the high growth industries in 2000, adding over 6,000 jobs (6.2%). Nationally, the most recent six-month average of employment change in this sector dropped below zero for the first time since the 1990-91 recession. The chart below indicates a slowdown in temporary help in NJ, but the level of new hiring remains positive.

N.J. Personnel Supply Employment
Monthly Change - Six-month moving average



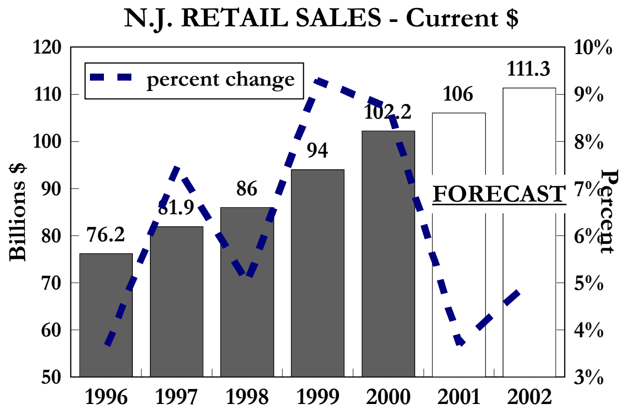
Income, Inflation and Consumer Spending

Personal incomes in New Jersey grew by 5.8% in 2000. Income gains were boosted by non-wage income such as investment returns and bonuses and continued job growth, especially in above average wage sectors.

However, inflation took a larger bite out of household income with the CPI rising 3.1% in 2000, due largely to energy price increases. Less energy, the CPI price increase was 2.4%, still below the average rate of inflation for the 1990's (2.7%). Despite recent increases in home prices, the outlook is for inflation remaining at 2.5% for the next two years.

Healthy income growth ignited a 16% increase in new vehicle registrations in 2000, an all-time record! For the year, the State added over 675 thousand new vehicles - 1 new vehicle parked in front of every 5 houses.

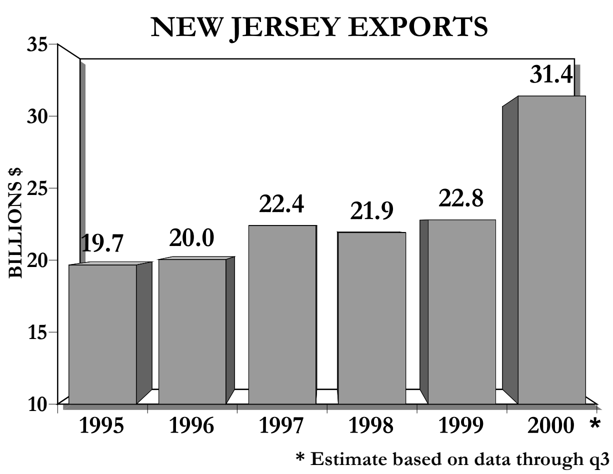
In another case of deja vu all over again, retail sales estimates have been revised upward. Apparently defying the limits of income growth, retail sales will post an increase in excess of 8% in 2000 following a 9% increase in 1999. Final sales (including e-sales) are expected to total $102 billion for 2000, up from $94 billion in the previous year. However, e-retail sales have not as yet had a significant impact on traditional retailers. National figures show rapid growth in e-sales, but these account for less than 1% of total retail sales.



With slower growth on the horizon and consumer sentiment on the decline, total sales will more closely parallel income growth for the next two years. Similarly, vehicle registrations will decline from current record levels.

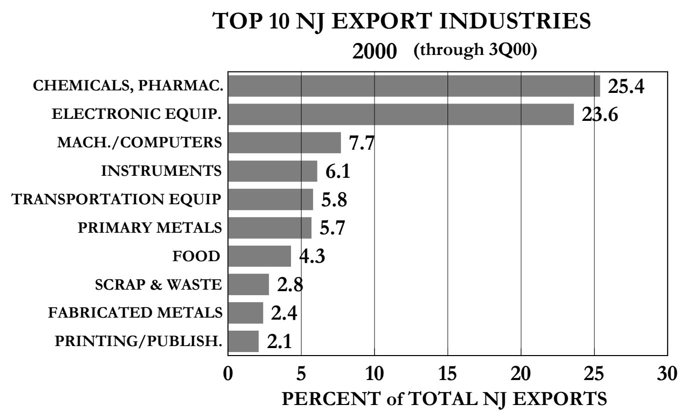
Global Trade

U.S. companies continued to expand their global presence during the past year and now account for 30% of world output (up from 26% in 1992) . The largest (Dow Jones) companies now derive almost 40% of their revenues from overseas sources (up from 35% in 1988).



New Jersey-based companies fully participated in the global marketplace in 2000, posting a 38% increase in exports. NJ exports easily bested the 14% increase in national exports and topped export growth among all industrial states.

Almost all New Jersey manufactured product categories experienced export gains. Among the largest export categories, chemicals (incl. pharmaceuticals), the number one State export, expanded by 20%, food exports grew by 29%, primary metals trade increased 60% and industrial machinery (computer equip) increased by 29%. But, the largest dollar increase in export trade was electronic equipment (including telecommunications equipment). Electronic goods in 2000 doubled exports from last year and now rank a close second behind chemical export trade.



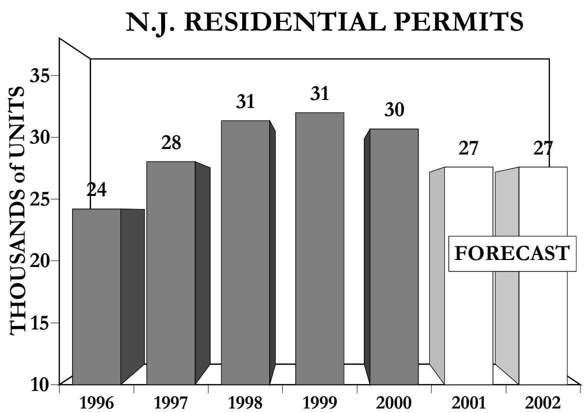
By region, trade with the European Union and the Far East both posted gains of 50%. Exports to NAFTA (Canada and Mexico) grew by 30%, trade with the volatile Middle-East was flat, while trade with the Mercosur region (South America) fell by 47%.

For next year, gains in exports will be far more modest based on recent downward revisions for global growth. However, even modest increases in foreign markets provide another economic cushion for New Jersey companies facing slower domestic/local markets.

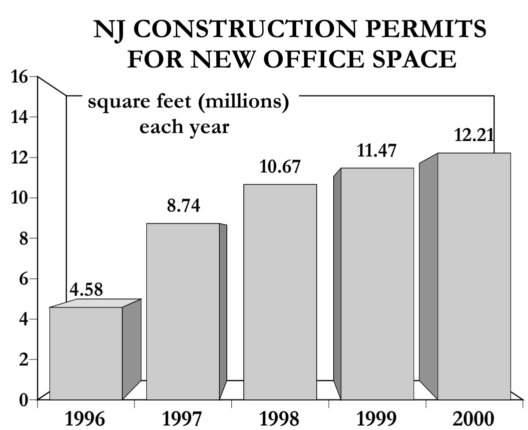
Investing in New Jersey

Eight years of economic expansion and business attraction has sustained construction for both new residences and places to work through 2000. Total construction contracts have increased an average of 10%+ over the past three years, rising to an estimated $11.3 billion for 2000. As a result, the share of NJ Gross State Product originating from construction has risen from 2.8% in 1997 to 3.2%.

Residential building, which accounts for almost 40% of construction contracts, continues to face a supply-demand dilemma. Favorable demand conditions and employment and income growth clash with supply constraints that include stringent land use and zoning policies. The bottom line for 2000 is a 4% decline in the number of new housing permits to approximately 30,600 units, but a 4% increase in the value of residential construction (which may reflect an increase in size and/or dwelling unit amenities). For 2001, supply constraints will continue to limit the number of new residential permits, but demand factors increase the value of residential investment by 3 to 4%.



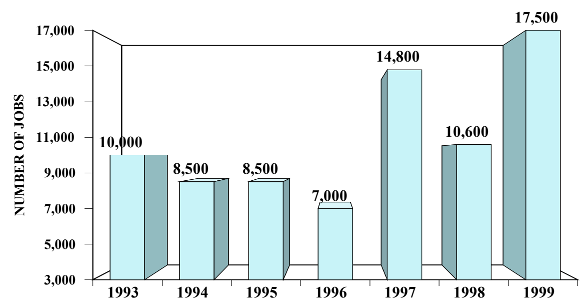
Nonresidential building (offices, industrial, R&D, retail) comprised 48% of NJ construction in 2000, its largest share since 1989. Office construction, driven by low vacancy rates and expanding job opportunities in services and finance continued to sustain nonresidential building activity.



Contributing to the nonresidential building market has been the steady increase in the number of out-of-state companies announcing a move to New Jersey (see text box). The 2000 Business Relocation Survey identified 120 companies who made a firm commitment in the past year to invest in New Jersey. This was the largest number of companies recorded since the survey began in

The 2000 Business Relocation Survey… profiles companies that made an initial investment by moving part or all of their business operations to New Jersey. The Survey is a key indicator in determining future conditions in the State's labor markets over the next one to three years. The latest Survey found:

- 120 companies who made a firm commitment to relocate to New Jersey. This was the largest annual number of new investors recorded since the survey began in 1984.



- These companies were projected to create record 17,500 direct jobs when fully staffed and operational.
- Seven out of every ten relocations fell into one of New Jersey's business growth clusters - high technology, healthcare, financial, and logistics.
- New Jersey continued to attract new businesses from a widening geographic area that included 19 states.
- 17 foreign firms were attracted to the State, up from 15 companies a year ago. Eight companies originated from the European Union, 4 from Japan, 3 from Canada, and 2 from Israel.
- Sixty percent of the business relocations originated from the neighboring states of New York and Pennsylvania.
- The largest contingent of long distance movers to New Jersey originated from technology centers in California, Massachusetts, and Virginia.
- Relocating businesses chose site locations in 18 of New Jersey's 21 counties. (The prime relocation destination for the year was Hudson County with 31 investments and over 8,600 projected jobs. Within the county, Jersey City was the location of choice with 22 new investments.
- The Middlesex-Somerset-Hunterdon labor market attracted 21 companies adding 1,300 jobs in central NJ, while Gloucester County led southern New Jersey with 14 site selections.
- 60% of the companies were granted some form of financial, labor training or site improvement assistance.

Copies of The 2000 Business Relocation Report are available from the NJ Council of Economic Advisors at 609-292-2423.

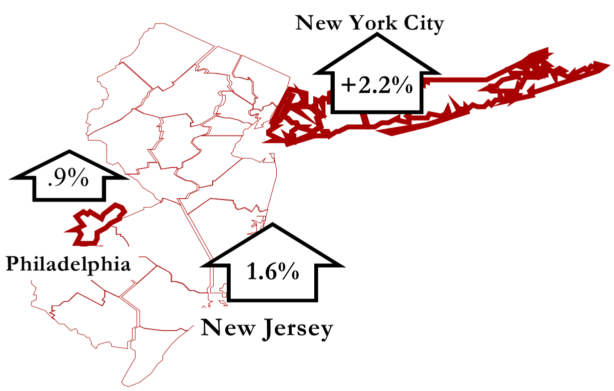
1984. With historically low vacancy rates business relocation activity created demand for new structures and contributed substantially to nonresidential construction and permit activity. However, with national and regional growth expected to ease over the next two years, office building permits (and office construction contracts) will adjust downward.

The Region

New York City continued to provide an economic stimulus to New Jersey in 2000. Employment in NYC increased by 2.2% in 2000, its 3rd consecutive year of +2% annual job gains and fastest in half a century. Since March 2000, the NYC economy has been growing more robustly than that of the nation.

Philadelphia was less of a factor in New Jersey's growth. The city added a modest 0.9% to its employment in 2000, only slightly better than Pennsylvania's statewide 0.7% gain.

Metropolitan Employment Growth
1999-2000



New Jersey Labor Markets

The five-county Newark labor area and the Middlesex-Somerset-Hunterdon labor market each grew by 2.1% in 2000 to lead all areas. Thanks in part to new investment in Newark, the Newark labor area reversed the trend of the last decade when the labor market's growth lagged the State average. As the State's largest labor area, Newark added over 20,000 jobs to pass the 1 million job mark in 2000.

New Jersey Labor Markets
Ranked by Percent Change in Employment*
1999 - 2000

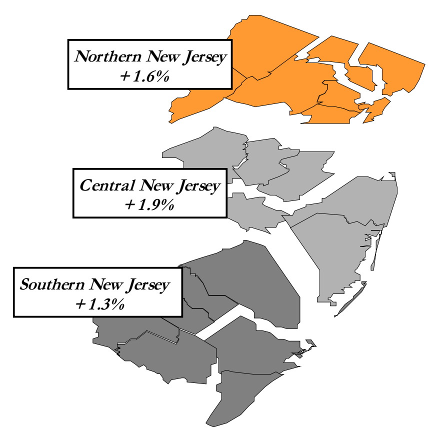
Area	Change 1999-2000 number	Change 1999-2000 percent
Newark PMSA	21.1	2.1%
Middlesex-Somerset-Hinterdon PMSA	13.4	2.1%
Trenton PMSA	3.5	1.7%
Jersey City PMSA	3.8	1.5%
Monmouth-Ocean PNSA	5.5	1.5%
Atlantic-Cape May PMSA	2.5	1.4%
Camden Labor Area	6.4	1.3%
Bergen Labor Market Area	4.4	0.9%
Vineland-Millville-Bridgeton PMSA	0.4	0.7%
Passaic Labor Market Area	0.7	0.4%
Total State	*61.2*	*1.6%*

**Annual Estimate based on 11-month average*

The Trenton (Mercer County) labor area, with employment growth at 1.7%, also exceeded the Statewide average of 1.6% for the year.

The Jersey City (Hudson County) labor market added about 4,000 jobs in 2000, almost twice the number projected in our mid-year outlook as a result of recently relocated finance and insurance companies. Job growth in 2001 will be driven by the development of office and residential space along the Hudson waterfront.

New Jersey Employment Growth
by Region, 1999-2000*



The Atlantic-Cape May area employment grew by a modest 1.4% in 2000, but growth should accelerate in the next several years with the ongoing construction of the $1 billion, 2,000-room Borgata hotel-casino to be completed by 2003, and a number of hotel-casino expansions likely to begin in 2001.

New Jersey Review & Economic Outlook: 2001 - 2002

						Forecast	
(Current $ or Nos.)	~~1996~~	~~1997~~	~~1998~~	~~1999~~	~~2000~~	**~~2001~~**	**~~2002~~**
Gross State Product (bill)	$279.2	$294.1	$319.2	$335.5	$355.6	$372.7	$391.3
Personal Income (bill)	$247.4	$260.7	$278.3	$291.5	$308.4	$324.4	$339.6
Retail Sales (bill)	$76.2	$81.9	$86.0	$94.0	$102.2	$106.0	$111.3
New Vehicle Registrations (000's)	533.1	537.6	550.6	582.5	675.7	641.9	642.0
Non-Resident.Contracts (mill)	$2,962	$3,618	$4,098	$4,670	$5,230	$5,230	$5,492.0
Residential Building Permits (No.)	24,200	28,020	31,344	31,980	30,669	27,602	27,602
Consumer Price Index (All Urban)	111.3	113.9	115.7	117.9	121.6	124.6	127.7
(Real 1992$)							
Gross State Product (bill)	$250.9	$258.2	$275.9	$284.5	$292.4	$299.1	$306.4
Personal Income (bill)	$222.3	$228.9	$240.5	$247.2	$253.6	$260.3	$265.9
Retail Sales (bill)	$68.5	$71.9	$74.3	$79.7	$84.0	$85.1	$87.1
Non-Resident.Contracts (mill)	$2,660.9	$3,176.5	$3,541.9	$3,961.0	$4,301.0	$4,197.4	$4,299.4
Employment (000's):							
Total Non-Farm	3,638.90	3,724.60	3,800.80	3,866.1	3,926.9	3,970.0	4,017.0
Manufacturing	483.5	481.9	478.0	466.5	460.2	453.4	447.0
Service Producing Industries	2,458.80	2,539.8	2,615.5	2,688.7	2,740.2	2,781.0	2,819.9
Unemployment Rate (%)	6.2%	5.1%	4.6%	4.6%	3.8%	4.0%	3.9%

						Forecast	
% Change from previous year:	~~1996~~	~~1997~~	~~1998~~	~~1999~~	~~2000~~	**~~2001~~**	**~~2002~~**
Gross State Product (Current $, bill)	3.9%	5.4%	8.5%	5.1%	6.0%	4.8%	5.0%
Personal Income (Current $, bill)	4.9%	5.3%	6.8%	4.7%	5.8%	5.2%	4.7%
Retail Sales (Current $, bill)	3.7%	7.5%	5.0%	9.3%	8.7%	3.7%	5.0%
New Vehicle Registrations	4.8%	0.8%	2.4%	5.8%	16.0%	-5.0%	0.0%
Non-Resident.Contracts (mill)	6.9%	21.4%	13.3%	14.0%	12.0%	0.0%	5.0%
Residential Building Permits (No.)	12.6%	15.9%	11.9%	2.0%	-4.1%	-10.0%	0.0%
Consumer Price Index (All Urban)	2.9%	2.4%	1.6%	1.9%	3.1%	2.5%	2.5%
(Real 1992$)							
Gross State Product (bill)	1.9%	3.2%	6.9%	3.1%	2.8%	2.3%	2.4%
Personal Income (bill)	1.8%	3.4%	5.1%	2.8%	2.6%	2.6%	2.1%
Retail Sales (bill)	0.8%	5.1%	3.4%	7.3%	5.4%	1.2%	2.4%
Non-Resident.Contracts (mill)	3.9%	18.6%	11.5%	11.8%	8.6%	-2.4%	2.4%
Employment (000's):							
Total Non-Farm	1.1%	2.4%	2.0%	1.7%	1.6%	1.1%	1.2%
Manufacturing	-2.8%	-0.7%	-0.8%	-2.4%	-1.4%	-1.5%	-1.4%
Service Producing Industries	2.1%	3.3%	3.0%	2.8%	2.0%	1.4%	1.4%

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The Legislative Budget and Finance Officer is the chief fiscal officer for the Legislature. The Legislative Budget and Finance Officer collects and presents fiscal information for the Legislature; serves as Secretary to the Joint Budget Oversight Committee; attends upon the Appropriations Committees during review of the Governor's Budget recommendations; reports on such matters as the committees or Legislature may direct; administers the fiscal note process and has statutory responsibilities for the review of appropriations transfers and other State fiscal transactions.

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Individuals wishing information and committee schedules on the FY 2002 budget are encouraged to contact:

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State House Annex
Room 140 PO Box 068
Trenton, NJ 08625

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