ANALYSIS OF THE NEW JERSEY

FISCAL YEAR 2000 - 2001 BUDGET

REVENUE ANALYSIS

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

MARCH 2000

NEW JERSEY STATE LEGISLATURE

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This report was prepared by the Revenue, Finance and Appropriations Section of the Office of Legislative Services under the direction of the Legislative Budget and Finance Officer. The primary authors were David J. Rosen, Maurice S. Shier, Martin Poethke, Catherine Z. Brennan, and Howard K. Rotblat.

The FY 2000-2001 Revenue Analysis represents the 28th and final revenue forecast to which Maurice S. Shier, OLS's most experienced revenue forecaster, has contributed.

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

THE FY 2000 AND FY 2001 REVENUE ANALYSIS

Introduction

This analysis has been prepared by the Office of Legislative Services (OLS) to assist the Senate Budget and Appropriations Committee and the Assembly Budget Committee as they develop the FY 2001 general 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 analysis begins with a review of trends in budgeted tax revenue over the last several decades, focused primarily on growth patterns during the 1990's. Not surprisingly, the gross income tax plays a primary role.

On pages 5 to 7, the OLS presents a summary of the FY 2000 and FY 2001 revenue estimates. The analysis then shifts to a discussion of FY 2000 year-to-date revenue collections for a selection of the major revenues. Actual revenue data are intrinsically significant and also serve as an economic indicator. This section is followed by a more detailed review of selected revenue sources. The impact of the OLS's revenue estimates on the projection of the State budget surplus is shown on page 19.

Finally, a series of appendices focus on specific economic and tax issues. In particular, the OLS has, for the first time, included in the appendix the annual economic report prepared by the New Jersey Council of Economic Advisors. The Council's report, released in January, provides a comprehensive economic overview and forecast for the State, the region and the nation. The OLS would like to thank the Council for permitting the inclusion of their analysis in this report.

Contents

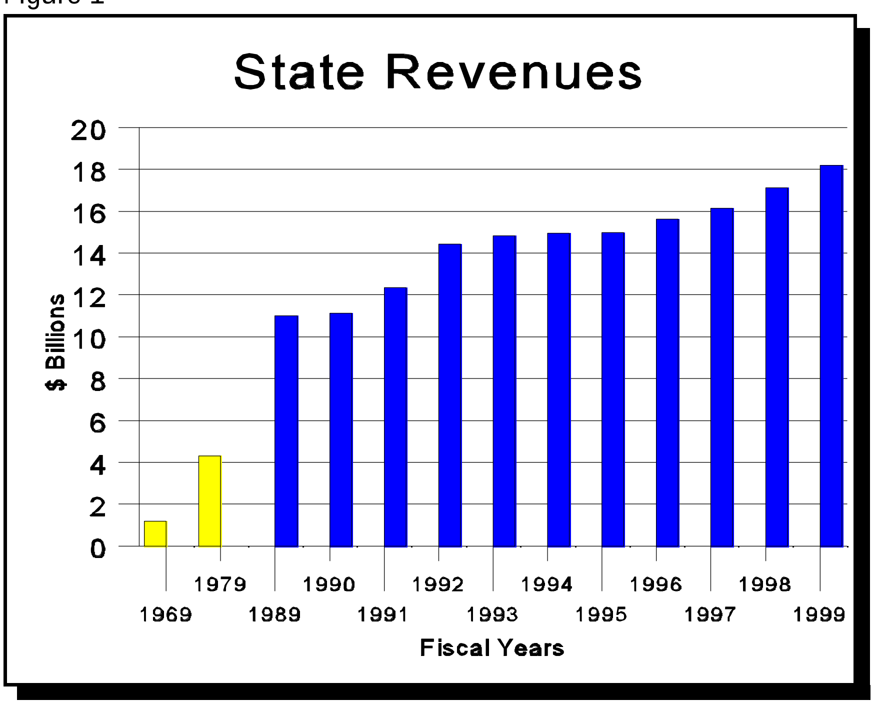
Tax Revenue Trends

The final third of the 20th Century was particularly eventful for New Jersey State tax policy and State revenue collections. Enactment of new taxes as well as changes in tax rates and structures over the last thirty years reflected evolving policy considerations, changing economic circumstances, and external pressures. Indeed, the period under review saw the enactment of the sales tax (1966) and the gross income tax (1976), as well as significant rate increases and decreases over the years. Moreover, public utility taxes have been reformed several times, new revenue sources such as casinos, the State lottery, and the petroleum products tax have been added, while other taxes, such as the parimutuel tax and the business personal property tax have been repealed. The combination of all of these influences on State tax policy has dramatically changed New Jersey's State revenue picture in just a few decades.

During the last 30 years, total State revenues have increased more than 1,500 percent. In contrast, New Jersey's population has increased by 15 percent and the consumer price index (CPI) has increased by 460 percent over the same period. In FY 1969 the State collected $1.2 billion; collections had risen to $18.2 billion by FY 1999. Figure 1 displays State revenues for FY 1969, FY 1979, and FY 1989 through FY 1999.

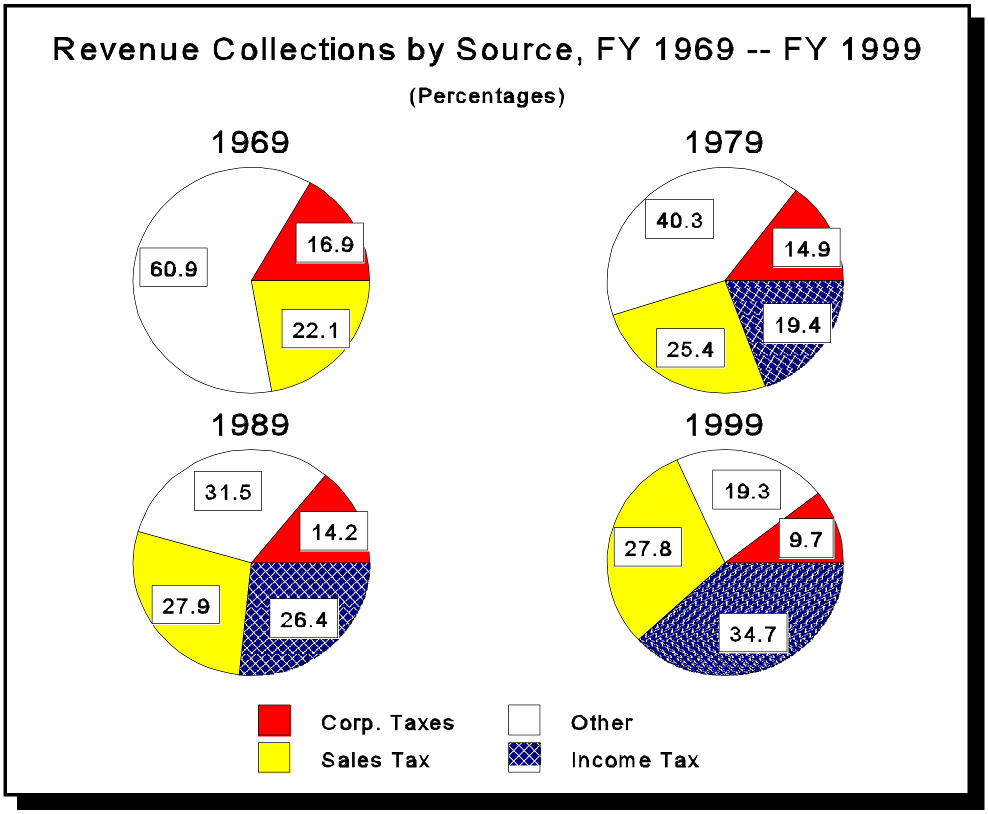
State revenues more than doubled during the 1970's and again during the 1980's, but the growth rate slowed in the 1990's. The most rapid recent revenue growth occurred in FY 1991 and FY 1992, increasing at annual rates of 11 percent and 17 percent respectively. Increases in sales tax and gross income tax rates produced sharp revenue gains during this two year period, despite recessionary economic conditions. Fiscal year 1993's slow revenue growth is attributable to the rollback of the sales tax rate from seven to six percent. Fiscal year 1994's weak growth is related to the slowly recovering economy. Fiscal year 1995 was affected by the start of the three year phased-in reduction in gross income tax rates. As the State recovery began to accelerate in the last years of the decade, State revenue growth accelerated as well, rising by just over six percent in both FY 1998 and FY 1999, about $1 billion each year.

Figure 1



Tax Revenue Trends

Figure 2



The composition of State revenues has changed significantly as well during the period. Figure 2 compares major categories of State revenues in 10 year intervals. In FY 1969 the sales tax accounted for about 22 percent and corporation taxes accounted for nearly 17 percent of total revenues. Sixty one percent of revenues came from other sources. There was no personal income tax at that time.

By FY 1999 a very different pattern is apparent. The sales tax had grown to about 28 percent of the total while corporation taxes had declined to less than 10 percent and all other revenues had dropped to just under 20 percent. However, the gross income tax, which first took effect in FY 1977, accounted for 35 percent of revenue collections as the decade of the 1990's came to an end.

In addition to the gross income tax, sales tax, and corporation taxes, there are dozens of additional revenue sources bundled together here in the "Other" category. In FY 1969, more than three of every five dollars of State revenue came from these "Other" sources, with motor fuels taxes and motor vehicle fees accounting for about 26 percentage points. Nearly 10 percent of State revenues were derived from cigarette taxes and about 3 percent from gaming revenues from the parimutuel tax (casino and lottery revenues did not yet exist). By FY 1999, the portion of State revenues from Other sources had fallen to less than one of every five dollars of State revenue, with motor fuels taxes and motor vehicle fees accounting for about 5 percentage points, cigarette taxes just over 1 percent, and gaming revenues about 6 percent (from the State lottery and casino funds -- the parimutuel tax was repealed).

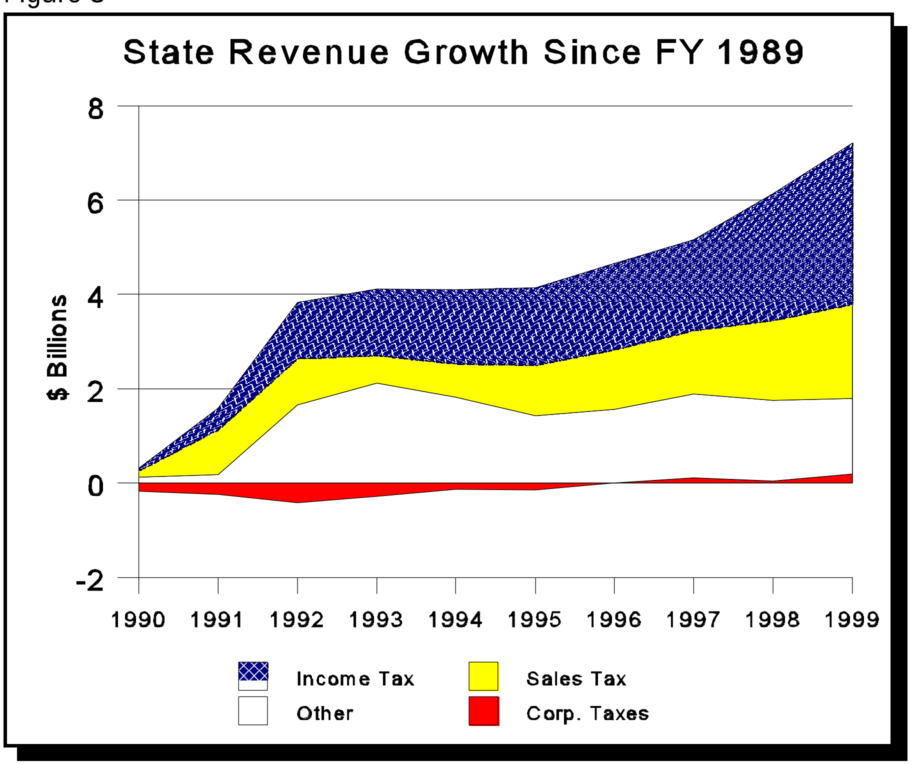
Tax Revenue Trends

Figure 3 displays State revenue growth for the past 10 years. Between FY 1989 and FY 1999, total annual State revenues grew by $7.2 billion, or about 66 percent. The income tax, the largest component of this revenue growth, increased by $3.4 billion, a jump for the decade of an even stronger 118 percent.

The sales tax was the next largest component of growth, increasing by $2.0 billion, about 65 percent. Corporation tax revenues grew by just under $200 million since FY 1989, about 13 percent. Through FY 1995 corporation tax revenues actually lagged behind FY 1989 levels. Other State revenues increased by $1.6 billion between FY 1989 and FY 1999, about 46 percent. In fiscal years 1992 through 1994, revenues in the Other category were inflated by temporary budgetary revenues (such as certain pre-payments of public utility tax revenues) and the addition of new revenues (such as Federal Medicaid uncompensated care reimbursements). Since then, the Other category has remained relatively unchanged.

Overall, the income tax accounts for 47 percent of State revenue growth since FY 1989 and the sales tax accounts for 28 percent of the total growth. Combined, the State's two largest revenues have generated three quarters of New Jersey revenue growth during the 1990's. In fact, these two tax revenues account effectively for *all* the State's revenue growth since FY 1992.

Figure 3



Appendix pages A29 and A30 display significant tax changes since 1969.

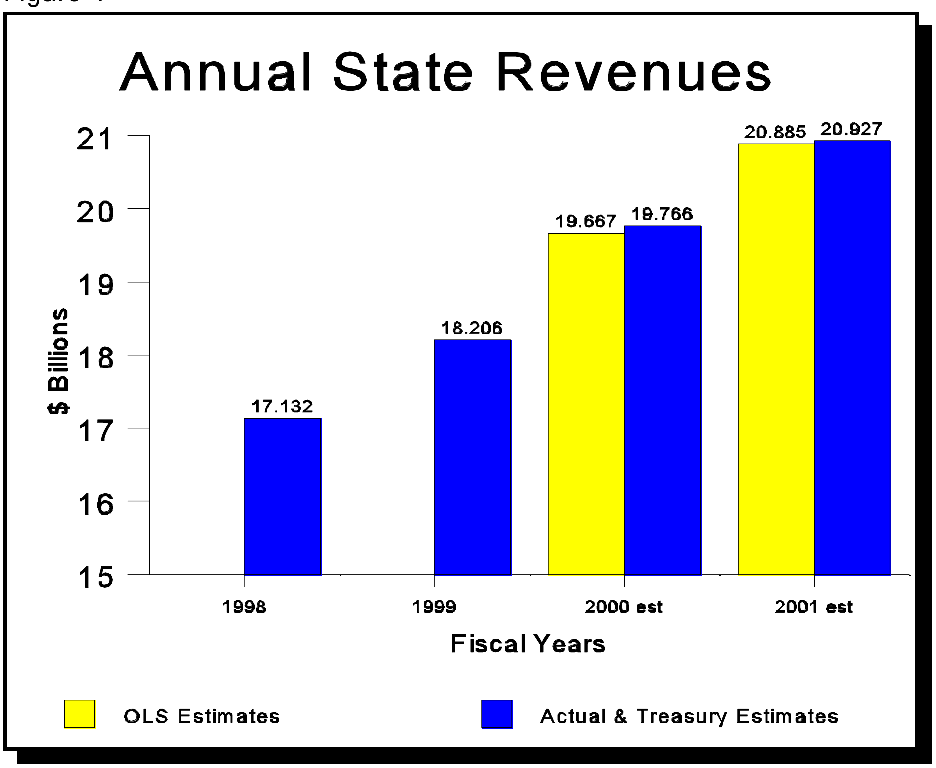
Note: State revenues as used in this section include the General Fund (and in later years the Property Tax Relief Fund, the Casino Control Fund, and the Casino Revenue Fund) that support appropriations in the budget.

FY 2000 and FY 2001 Revenue Estimates

For the fourth year in a row, the Treasury has reacted to strong economic growth by increasing its midyear revenue estimates above the amounts certified in the appropriations act. The record long period of economic expansion has generated strong consumer spending, job growth, and income increases which are expected to continue. Retail sales grew by 6.5 percent, total non-farm employment grew by 1.7 percent, or about 65,000 jobs, and personal income increased by 5.8 percent in calendar year 1999. The stock market indexes continued their remarkable increases, particularly the NASDAQ, whose composite index rose by 86 percent. The tax revenues generated by this strong economic performance continued to grow at a rapid pace.

Figure 4 below displays total State revenues from FY 1998 through the estimates for FY 2000 and FY 2001. Both the Treasury's estimates and the OLS's total estimates are shown. Each set of estimates anticipates the strong growth pattern of recent years will continue, albeit with some moderation. While there are differences between the two estimates on individual taxes, the aggregate difference in the projection of revenues available for the FY 2001 budget is less than 1 percent. This is an insignificant difference from the perspective of a revenue forecaster, but any revenue differences can be significant in the budget drafting process.

Figure 4



FY 2000 and FY 2001 Revenue Estimates

Figures 5 and 6 compare the major components of the Executive and the OLS revenue estimates for FY 2000 and FY 2001 (for greater detail, refer to pages A2 and A3 in the appendix). In January, as part of the Governor's FY 2001 Budget proposal, the Treasury reacted to the strong economy and robust revenue collections by increasing revenue estimates for FY 2000 by $503 million, a 2.6 percent change.

The Treasury's additional $503 million resulted from upward revisions in the gross income tax ($215 million) and the sales tax ($243 million), a reduction in the corporation business tax estimate ($44 million less), and an $81 million net increase in estimates for all other revenue sources.

The OLS estimates for FY 2000, listed in the fourth column of Figure 5, total $99 million less than the revised Treasury estimates. The largest differences are for the income tax ($35 million less), the sales tax ($25 million less), the corporation business tax ($16 million less), and the State lottery ($28 million less), a component of the *Interfund Transfers* category shown in the figure below.

Figure 5
Fiscal Year 2000 Revenue Estimates
($ millions)

	Approp. Act (7/1/99)	January Revised Treasury	Treasury Changes	March Office of Legislative Services	Difference OLS vs. Revised Treasury
Gross Income Tax	$6,820	$7,035	$215	$7,000	($35)
Sales Tax	5,333	5,575	243	5,550	(25)
Corporation Business Tax	1,440	1,396	(44)	1,380	(16)
Other Major Taxes	2,358	2,392	34	2,392	0
Miscellaneous Taxes, Fees, Revenues	1,853	1,907	53	1,913	6
Interfund Transfers	1,070	1,064	(6)	1,036	(28)
Other Funds	389	397	0	397	0
Grand Total, All Funds	$19,263	$19,766	$503	$19,667	($99)

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

FY 2000 and FY 2001 Revenue Estimates

The Treasury anticipates $20.927 billion in FY 2001, as shown in Figure 6. This is a $1.161 billion increase (5.9%) over its FY 2000 estimates. The OLS is projecting $20.885 billion in FY 2001, an increase of $1.188 billion (6.2%). The OLS is estimating a slightly higher growth rate going into FY 2001, from a somewhat lower estimated base in FY 2000. The OLS total revenue projection for FY 2001 is $42 million less than the Treasury estimate.

The Treasury anticipates solid, but slowing growth in the gross income tax (GIT). GIT collections in FY 2001 are anticipated to increase $545 million, 7.7 percent over FY 2000. The sales tax is anticipated to increase $418 million, 7.5 percent over FY 2000, and the corporation business tax (CBT) is anticipated to increase $90 million, 6.4 percent.

The largest differences between the OLS and the Treasury estimates in FY 2001 are for the GIT ($30 million more), the sales tax ($53 million less), the corporation business tax ($16 million less) and the inheritance tax, a component of the *Other Major Taxes* category shown in the figure below ($30 million more).

Over the two fiscal years, the OLS projects State revenues will be $141 million less than the amount estimated in the Governor's budget submission.

Fuller discussion of current year-to-date revenue trends and more detail on specific revenues such as the income tax and the sales tax begins on page 8.

Figure 6
Fiscal Year 2001 Revenue Estimates
($ millions)

	Treasury	% Change 00 to 01	Office of Legislative Services	% Change 00 to 01	Difference OLS vs. Exec.
Gross Income Tax	$7,580	7.7%	$7,610	8.7%	$30
Sales Tax	5,993	7.5%	5,940	7.0%	(53)
Corporation Business Tax	1,486	6.4%	1,470	6.4%	(16)
Other Major Taxes	2,533	5.9%	2,538	5.5%	5
Miscellaneous Taxes, Fees, Revenues	1,821	(4.5)%	1,827	(4.5)%	6
Interfund Transfers	1,105	3.9%	1,092	5.5%	(13)
Other Funds	409		408		(1)
Grand Total, All Funds	$20,927	5.9%	$20,885	6.2%	($42)

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

FY 2000 Year-To-Date Revenues

Figure 7 on the following page displays FY 2000 year-to-date revenue collections for selected sources through the end of February.[1] Those figures are compared to the same period in FY 1999 and current growth rates through February are compared to the growth rates necessary to reach the Treasury's revised year-end targets. The gross income tax (GIT), the sales tax, and the transfer inheritance tax have shown the most robust growth through the first eight months of the fiscal year.

GIT receipts through the end of February are 6.8 percent greater than for the same time last year. While this growth rate is below the growth rate required to reach the Treasury's revised year-end target of 11.2 percent growth, the disparity apparently is due to accelerated refund payments in February and an unusually weak first quarter of the fiscal year (July-September 1999), when receipts grew by only about two percent. Treasury attributes the higher refund payments this early in the tax filing season to increased taxpayer use of electronic programs such as PC File and Telefile. Driving the weak first quarter numbers was a one percent *decline* in collections from employer withholding of taxes on employee wages. Since then withholding collections have risen nearly 10 percent, suggesting technical factors such as accounting adjustments or delays in processing tax returns may be responsible for masking otherwise strong growth during the first quarter. Indeed, quarterly estimated tax payments are up by 17 percent, a promising indicator of growing income levels.

The sales tax has been the biggest surprise of FY 2000, growing at 10.7 percent during the first four months of the fiscal year, almost twice as fast as was anticipated in the appropriations act. While the pace has slowed somewhat since then, the sales tax is still growing by 9.7 percent through February. Since this tax is the State's second largest revenue after the income tax, each additional percentage point of growth is worth about $60 million.

The transfer inheritance tax revenue is running 24 percent above the same time last year, the second year in a row with growth of more than 20 percent.

Two other significant tax revenues are running behind the growth rates required to reach the revised year-end targets. The corporation business tax is below expectations, in part due to increased refund payments in recent months. Lottery collections have been running at less than half the expected growth rate all year.

Most of the remaining tax revenues are performing close to their performance targets through the first seven to eight months of collections.

While the year-to-date collections are valuable data, revenue estimating is more complicated than simply taking the year-to-date growth rates and extending them to the end of the year. Changes in payment schedules and processing, tax law, and the economy all affect the flow of collections. The OLS notes it has been particularly difficult to analyze revenue collections in FY 2000 because of apparent anomalies in the processing and reporting of some tax returns and refund payments.

[1] These 14 revenue sources account for about 80 percent of the State's annual budgeted revenues.

FY 2000 Year-To-Date Revenues

Figure 7
Selected Year-To-Date Revenue Comparison
Through the End of February 2000 vs. 1999
($ millions)

Revenue Source	FY 1999 Actual Year-To-Date	FY 2000 Actual Year-To-Date	FY 2000 Actual % Growth	FY 2000 Year-End Treasury % Growth Target
Gross Income Tax	$3,636.6	$3,885.2	6.8%	11.2%
Sales Tax *	2,903.9	3,184.8	9.7%	10.3%
Corporation Business Tax	697.0	680.7	(2.3)%	(0.5)%
Lottery	425.5	438.1	3.0%	9.3%
Motor Fuels *	280.4	298.9	6.6%	4.5%
Motor Vehicle Fees	242.3	247.0	2.0%	1.5%
Casino	212.7	221.5	4.2%	3.4%
Transfer Inheritance	278.5	343.9	23.5%	22.9%
Insurance Premiums	103.2	101.0	(2.1)%	3.9%
Cigarette (Budgeted)	121.7	107.2	(11.9)%	(10.4)%
*Cigarette (Total)***	*276.7*	*262.2*	(5.2)%	*(9.4)%*
Petroleum Products *	119.9	124.9	4.2%	1.7%
Alcohol Excise *	41.6	42.9	3.2%	2.7%
CBT -- Banks & Financials	12.4	12.0	(3.8)%	(12.5)%
Realty Transfer *	44.2	46.5	5.1%	5.2%

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 2000 contained in the proposed FY 2001 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 1999 and FY 2000.*

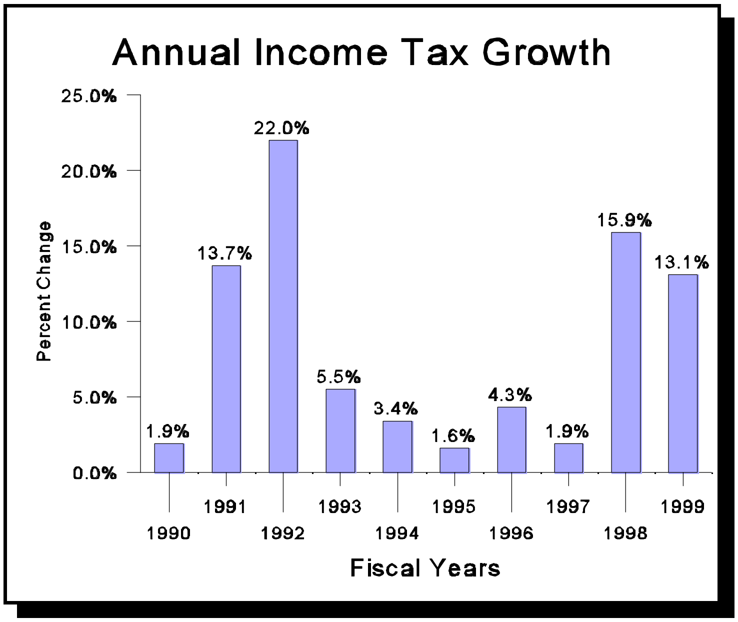
Discussion of Selected Revenue Sources

Gross Income Tax

The gross income tax (GIT) is the State budget's most important revenue source, accounting for 35 percent of total budgeted revenues by FY 1999. The GIT accounts for nearly one half of all budgeted revenue growth since FY 1989.

Figure 8 displays annual growth rates for the GIT from FY 1990 through FY 1999. 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 as the economy gradually recovered from a three year recession. During FY 1995 through FY 1997, the economy steadily improved and the Legislature enacted a phased-in a reduction in tax rates of between 9 and 30 percent for certain tax brackets. Finally, fiscal years 1998 and 1999 reflect strong income and job growth and the absence of major tax changes.

Figure 8



Income growth by upper income taxpayers in the last few years propelled the GIT surge. Data from the Department of the Treasury's *Statistics of Income*, indicate that nearly all the income growth from State tax returns during the 1990's has occurred in the income brackets above $100,000 (for an expanded discussion see appendix A17). Since these taxpayers are taxed at higher marginal rates, their income growth generates larger increases in tax revenue. In tax year 1997, 11 percent of taxpayers with income over $100,000 paid nearly 70 percent of the gross income tax.

Collections from employer withholding of taxes on employee wages remain the largest component of the GIT, but estimated quarterly payments and final year-end payments are increasingly crucial given the strong recent growth in non-wage income. Capital gains have increased by more than 30 percent annually for several years, and income from

GIT Components

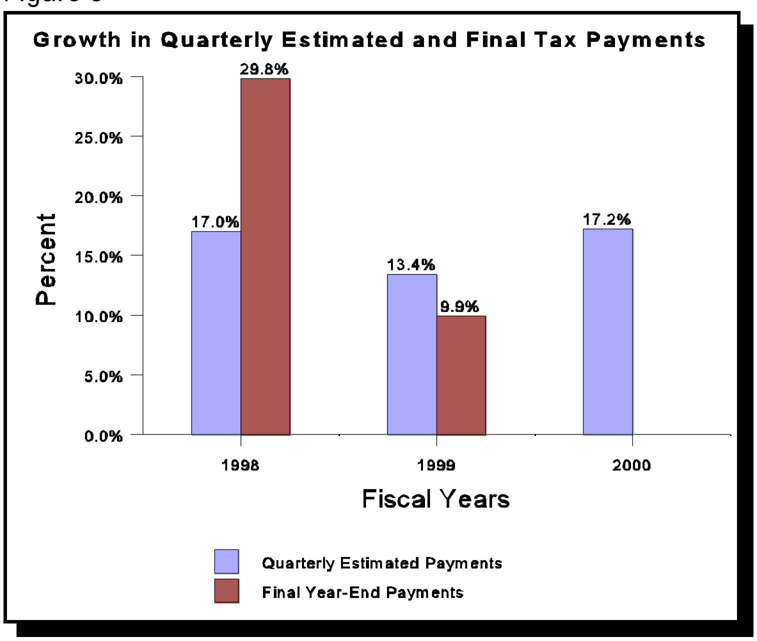
In analyzing the GIT, it is helpful to break up the revenue stream into four basic components:

1. Withholding collections are paid by employees through their employers as a deduction from each paycheck throughout the year;
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.

Discussion of Selected Revenue Sources

business profits and Subchapter S-corporations also are up sharply. Income from bonuses and stock options (which are recorded in the tax system as regular employee compensation but are functionally quite different) have also reportedly been growing, but tax return data do not separate these components from regular earnings. These sources of non-wage income are driven heavily by stock market activity, both in terms of the rapidly increasing level of stock values and in the remarkable surge in the volume of transactions. For example, the NASDAQ composite index rose a record 86 percent in 1999, with share trading volume up 35 percent. Share trading volume on the New York Stock Exchange rose over 20 percent.

Figure 9



Most GIT revenue collected from upper income taxpayers comes through quarterly estimated tax payments and through final tax payments in April. These two categories of income tax revenue have grown rapidly in recent years. Figure 9 shows the growth rates for estimated quarterly payments and final payments for fiscal years 1998, 1999, and currently available figures for FY 2000. The growth in quarterly payments has been consistently strong during this period. Final payments also have grown by high rates, but they have been subject to more pronounced fluctuations. Because of this remarkable growth, estimated quarterly payments and final year-end payments now account for about 40 percent of annual GIT collections, as compared with about 30 percent only five years ago.

<u>FY 2000 GIT</u>

While receipts from employer withholding of taxes on employee wages are up 6.8 percent in FY 2000, the growth rate has actually been about 10 percent since unusually low growth was reported during the first quarter of the year. Treasury anticipates about 9 percent growth in withholding collections for the rest of the fiscal year, as does the OLS.

The current FY 2000 figures show that quarterly estimated payments are up 17.2 percent over the same period last year. Both the Treasury and the OLS anticipate the strong growth in quarterly estimated payments will continue, as it has for the past several years.

Likewise, strong growth in estimated payments suggests final payments in April will be strong again this year. Treasury is anticipating about 18 percent growth in final payments for the remainder of this year, and the OLS expects similarly strong growth.

Unlike withholding collections, which come in throughout the year, final payments occur only once a year, making it more difficult to identify trends. The importance of and the uncertainty surrounding the April tax payments has increased as non-wage income has grown. In the last several fiscal years, the State has benefitted from unexpected additional revenues in April and May, following the receipt of final year-end payments. Another such positive April windfall is possible, but a shortfall may also occur some year. In either

Discussion of Selected Revenue Sources

case, predicting final payments and total GIT revenues is subject to increasing uncertainty.

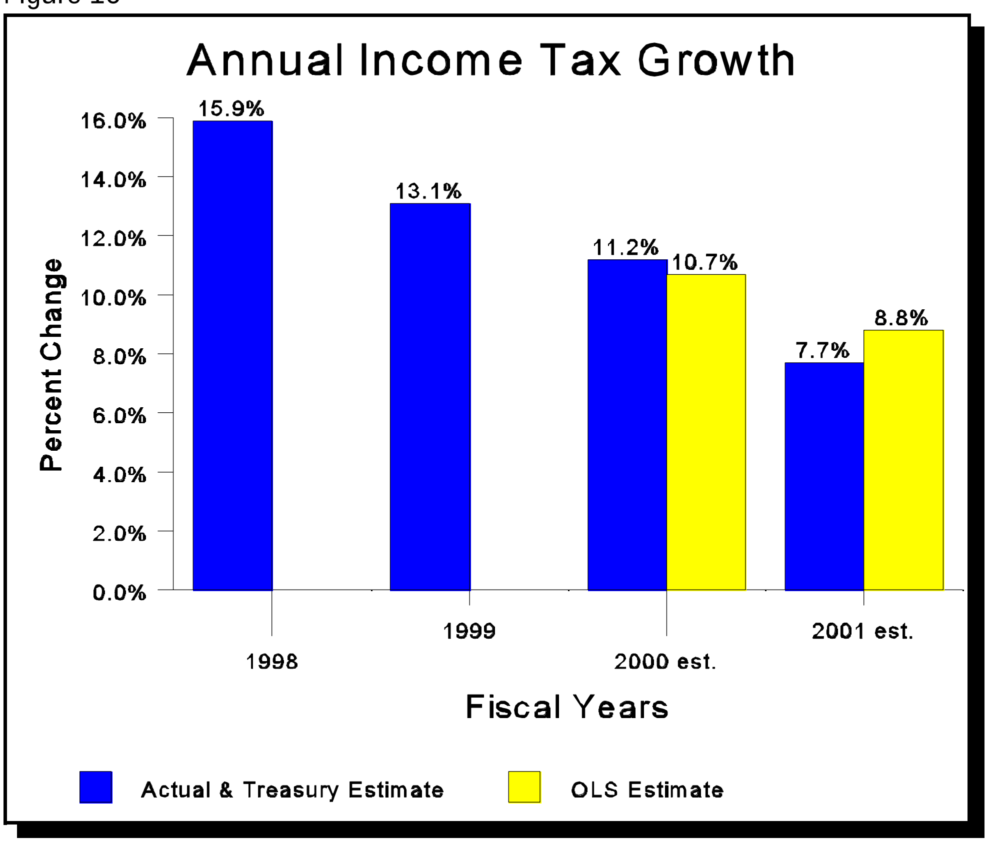
State income tax refund payments have grown by more than 10 percent during the spring each of the last several years. Treasury is estimating refund payments for the remainder of the fiscal year will grow by only about 4 percent. The OLS anticipates refunds will grow by approximately 10 percent.

Primarily due to a higher estimate for refund payments, the OLS's overall income tax estimate for FY 2000 is slightly lower than the Treasury's overall estimate. The OLS projects $7.000 billion, $35 million below Treasury's estimate of $7.035 billion. As a result, the OLS is estimating about 10.7 percent growth as compared to Treasury's 11.2 percent.

FY 2001 GIT

Treasury is forecasting a slowing in the income tax growth rate in FY 2001. The total estimate of $7.580 billion assumes a growth rate of 7.7 percent from FY 2000. Based on its projections of the four components of the GIT, the OLS is estimating $7.610 billion in FY 2001, 8.8 percent growth over FY 2000. The difference is not a fundamental difference in the views of the economy, job growth or increases in income. Both the Treasury and the OLS anticipate slowing growth in FY 2001. The OLS, however, anticipates that the strong growth in GIT revenues during the last several years will not slow as quickly as anticipated by the Treasury.

Figure 10



Discussion of Selected Revenue Sources

Sales Tax

The sales tax is the State budget's second largest revenue source. Over the years, this tax has regularly accounted for between 25 percent and 28 percent of total budgeted revenues.

Figure 11

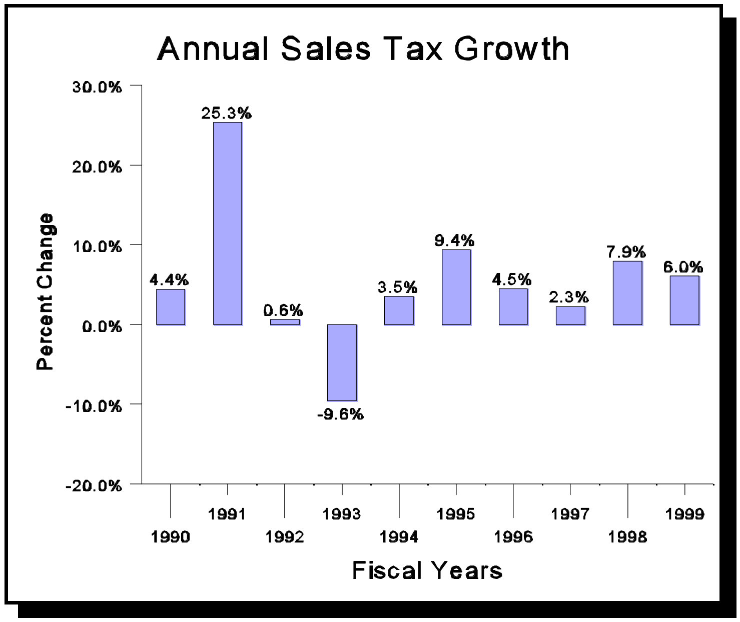


Figure 11 displays the annual growth rates for the sales tax between fiscal years 1990 and 1999. The two years in which the sales tax rate changed are clearly visible in the figure. In FY 1991, the Legislature increased the tax rate from 6 to 7 percent, and expanded the base of the tax. Accordingly, revenues increased by 25 percent that year. Two years later, the Legislature reduced the tax rate to 6 percent, and revenues declined by almost 10 percent.

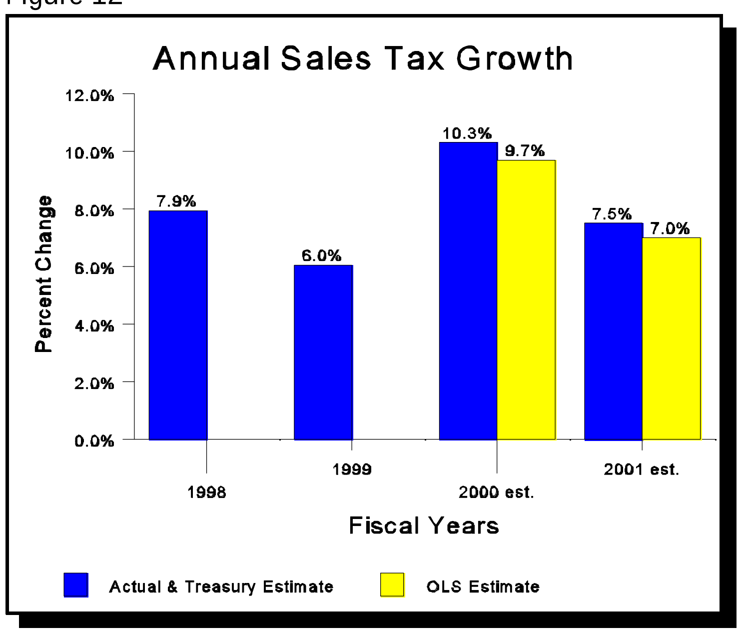
Excluding the two tax change years, the average growth in the sales tax during the 1990's was about 4.8 percent. The lowest growth was 0.6 percent in FY 1992, at the end of the State's long recession. The strongest annual growth (9.4 percent in FY 1995) occurred during the early part of the economic recovery.

FY 2000 Sales Tax

Sales tax revenues through the first four months of FY 2000 grew at a remarkable 10.7 percent growth rate over the same period in FY 1999. Retail sales during 1999 grew by a robust 6.5 percent in New Jersey. Accordingly, the Treasury is forecasting the sales tax will raise \$5.575 billion this year, or 10.3 percent more than in the prior fiscal year.

However, sales tax growth has slowed in recent months, including about 6.5 percent growth in February. The seven month growth rate is 9.7 percent ahead of last year. The Treasury's year-end sales tax target will require growth of 11.2 percent for the remainder of the fiscal year. The OLS believes a somewhat more conservative estimate is warranted. The OLS is estimating the sales tax will raise \$5.550 billion in FY

Figure 12



Discussion of Selected Revenue Sources

2000, a year-end growth rate of 9.7 percent, $25 million less than the Treasury's estimate.

FY 2001 Sales Tax

The Treasury projects a slowdown in the growth rate of sales tax revenues to 7.5 percent for FY 2001. The OLS anticipates a slightly lower growth rate of 7.0 percent. The OLS is estimating $5.940 billion next year, $53 million below the Treasury's estimate of $5.993 billion. Strong consumer confidence figures suggest a sudden drop in sales growth is not likely; retail sales are projected to moderate from 1999's strong (6.5%) growth, increasing by 4.8 percent in 2000 and 5.0 percent in 2001 according to the New Jersey Council of Economic Advisors (see appendix page A31 for additional detail). The Council also projects a decline in new vehicle registrations and in the number of residential building permits during the next two years. Accordingly, growth in sales tax revenues closer to the recent 5 percent historical average is more likely than a repeat of FY 2000's strong growth. The impact of Federal Reserve interest rate policy on economic activity such as home sales and the possible impact that higher fuel prices may have on automobile purchases is consistent with the expectation of moderating sales tax revenue growth for FY 2001.

Tobacco Settlement Funds

According to the Governor's Budget Recommendation, the State anticipates receipt of $471.2 million this year and next year from the national tobacco settlement, subject to the terms established under the Master Settlement Agreement. This amount represents the second and third annual installments of the State's share of the settlement to be deposited into a separate, non-lapsing "Tobacco Settlement Trust Fund" pursuant to budget language. Payments totaling $228 million are anticipated during the current fiscal year and they will be carried forward to FY 2001. An additional $243 million is expected in January and April, 2001.

Of the combined total available in FY 2001, $174.3 million is recommended to be transferred to the General Fund as State revenue to support various budgeted expenditures within the Departments of Health and Senior Services, Human Services, Treasury and The Commission on Higher Education. The balance, approximately $297 million, would remain "off budget" as non-State revenue. The Budget proposes that off-budget tobacco revenues be allocated for transfer to the Health Care Subsidy Fund, NJ Family Care, and the NJ Insolvent HMO Assistance Fund, with $50 million to remain in reserve.

Discussion of Selected Revenue Sources

Other Revenue Differences

Corporation Business Taxes

The Office of Legislative Services and the Treasury differ on three business related taxes: the corporation business tax, the corporation tax on banks and financial institutions, and the savings institutions tax. These business taxes (and the insurance premiums tax, for which there is no difference in the revenue estimates at this time) comprise the third largest source of State tax revenues, nearly 10 percent of budgeted revenues.

In January, the Treasury reduced its estimate of corporation business tax (CBT) revenues for FY 2000 by $44 million to $1.396 billion, due largely to an expected $50 million reduction for the initial expense of the CBT Benefit Transfer Program. This program permits certain small bio-tech and high-tech firms to sell unused tax credits to other corporations. This $50 million loss is not expected to occur until later in the Spring. Treasury's revised CBT estimate essentially matches FY 1999 revenues, declining by only 0.5 percent.

The OLS is estimating $1.380 billion this fiscal year, $16 million below the Treasury's amount. CBT revenues have declined for two consecutive months (January and February), in large part due to significant refund payments.

Figure 13
Other Fiscal Year 2000 Revenue Estimates
For Which the Treasury and the Office of Legislative Services Differ
($ millions)

	FY 2000 Treasury	FY 2000 OLS	Difference
Cigarette Tax	$223.0	$230.0	$7.0
Investment Earnings	9.0	15.0	6.0
Transfer Inheritance Tax	520.0	525.0	5.0
Motor Fuels Tax	505.0	510.0	5.0
Petroleum Products Gr. Rec.	208.0	210.0	2.0
Gubernatorial Elections Fund	1.5	1.0	(0.5)
Savings Institutions Tax	17.0	12.0	(5.0)
Corporation Business Banks & Fin.	54.0	40.0	(14.0)
Corporation Business Tax	1,396.2	1,380.0	(16.2)
State Lottery Fund	713.0	685.0	(28.0)
FY 2000 Net Difference			($38.7)

Discussion of Selected Revenue Sources

The Treasury attributes the increased CBT refunds to recently undertaken tax return processing efficiencies. It is not clear if the additional refunds are only accelerated processing, a clearing out of delayed refunds, or a more significant increase in the total level of refunds. In any case, the CBT is now running about two percent below the same period in FY 1999 and the $50 million in tax credit payments is still pending.

For FY 2001 the Treasury is estimating 6.4 percent growth in CBT revenues to $1.486 billion. One third of the $90 million estimated increase is due to growing receipts from the CBT on energy producing companies.

The OLS is estimating $1.470 billion in FY 2001, $16 million less than the Treasury. The OLS concurs with the Treasury's moderate CBT growth rate for FY 2001, but its estimate is growing from a lower FY 2000 base.

The OLS also is estimating lower CBT banks and financials tax (CBT B&F) collections and savings institutions tax collections than is the Treasury. The decline in these revenues appears to be related to changes in the structure of interstate banking and the banks' allocation of net income between states. While the CBT B&F appears to be running only a few percent below the same period in FY 1999 and ahead of Treasury's year-end target, refund payments traditionally made in February were recorded in the first week of March this year. As a result, the OLS anticipates a weakening in collections in March.

Figure 14
Other Fiscal Year 2001 Revenue Estimates
For Which the Treasury and the Office of Legislative Services Differ
($ millions)

	FY 2001 Treasury	FY 2001 OLS	Difference
Transfer Inheritance Tax	$620.0	$650.0	$30.0
Cigarette Tax	199.0	215.0	16.0
Investment Earnings	9.0	15.0	6.0
Alcoholic Beverage Excise	76.0	78.0	2.0
Gubernatorial Elections Fund	1.5	1.0	(0.5)
Tobacco Products Wholesale	14.0	13.0	(1.0)
Realty Transfer	78.0	75.0	(3.0)
Motor Fuels Tax	530.0	525.0	(5.0)
Savings Institutions Tax	19.0	12.0	(7.0)
State Lottery Fund	713.0	700.0	(13.0)
Corporation Business Tax	1,486.2	1,470.0	(16.2)
Corporation Business Banks & Fin.	67.0	40.0	(27.0)
FY 2001 Net Difference			($18.7)

Discussion of Selected Revenue Sources

The savings institutions tax has been running negative all year. While the OLS notes that the majority of collections for this tax are received in April and June, collections would have to exceed collections last April and June to reach the Treasury's year-end targets. Given current collection trends, it appears unlikely that such strong growth will occur.

Therefore, the OLS is estimating $40 million for FY 2000 CBT B&F revenues, $14 million below the Treasury's estimate. The OLS is estimating $12 million for the savings institutions tax in FY 2000, $5 million below the Treasury's estimate.

Corporate Tax Behavior and Tax Revenues

The U.S. Treasury Secretary recently commented on the increasing use of tax shelters to avoid corporate taxation. While federal personal income tax collections have risen strongly in recent years, corporation tax collections have declined. Since the New Jersey corporation business tax is based on a company's net income for federal tax purposes, tax shelters may be part of the explanation for the steady decline of New Jersey State corporation tax revenues as a percentage of total budgeted revenues (as discussed on pages 2 and 3).

To slow or reverse this trend the Internal Revenue Service has issued new rules designed to discourage sheltering behavior. Such changes might reverse this trend in future years.

In FY 2001 the OLS is estimating the CBT B&F and savings institutions collections will remain stable at the FY 2000 figures of $40 million and $12 million each. Those amounts are $27 million and $7 million below the Treasury's estimates respectively.

Transfer Inheritance Tax

The strong collections growth from the transfer inheritance tax is continuing. Revenue from this tax grew by 8 percent in FY 1998 and by 25 percent in FY 1999. So far this year, collections are up another 25 percent over the same period last year. The consensus explanation for this remarkable growth is the sharp increase in the value of estate assets, particularly stocks.

The transfer inheritance tax consists of two very different parts. One part is the inheritance tax, which is applied to the transfer to certain individuals of all personal property and New Jersey real property having an aggregate value of $500 or more. The second part (constituting approximately one-third of total collections), is the estate tax which absorbs the value of any federal estate tax credit remaining after transfer inheritance taxes have been paid. While the growth rate of this component has been robust in recent years (perhaps in part because estate planning by individuals has not kept up with the growth of assets), future collection rates could be tempered by a scheduled increase in the exclusion allowed under the federal estate tax credit, from $675,000 currently to $1.0 million by 2006.

Treasury projects growth of 23 percent in FY 2000 and 19 percent in FY 2001. Based on the continued growth in the value of assets, the OLS projects somewhat stronger growth in both years. As a result, the OLS estimates are $5 million above Treasury's in FY 2000 and $30 million above Treasury's in FY 2001.

State Lottery Revenues

State lottery revenues have underperformed expectations in every month of the fiscal year thus far. The lack of rollovers that produce large prizes and consumer interest may have played a significant role in this weakness. Nevertheless, lottery collections are up only 3.0 percent as compared to an expectation of 9.3 percent growth.

Discussion of Selected Revenue Sources

The expectation of 9.3 percent growth was predicated on the introduction of The Big Game multistate lottery, which New Jersey joined in May 1999. Revenues from this new game were anticipated to more than offset any possible "cannibalization" of revenues from pre-existing lottery games. However, overall sales and revenues have not matched expectations. If lottery sales continue at current rates, year-end receipts will fall well short of Treasury's estimates. As a result, the OLS is estimating $685 million in FY 2000, $28 million less than Treasury's estimate. The OLS notes the odds favor a return to more typical jackpots next year and anticipates some revenue growth going into FY 2001. Therefore, the OLS estimates $700 million in FY 2001, $13 million below Treasury's estimate.

The Remaining Revenue Differences

The remaining differences between the OLS and the Treasury are relatively minor and involve small differences based largely on current revenue growth patterns. The OLS believes that cigarette tax revenue and State investment earnings will be somewhat higher in both years than does the Treasury. The OLS estimates that motor fuels tax collections will be slightly higher in FY 2000, but slightly lower in FY 2001. The OLS expects petroleum products gross receipts tax revenue to be higher in FY 2000, but agrees with the Treasury's FY 2001 estimate. In FY 2001, the OLS projects lower realty transfer tax and tobacco products wholesale tax revenues. The OLS's projects higher alcoholic beverage excise tax revenue in FY 2001. Finally, the OLS expects slightly less in taxpayer dedications to the Gubernatorial Elections Fund than does the Treasury. Such designations have not exceeded $1 million in more than a decade.

An Automatic Statutory Increase in the Petroleum Products Tax?

The Petroleum Products Gross Receipts Tax, in effect since 1991, contains two parts. Certain petroleum products, such as lubricating oils, are subject to a tax equal to 2.75% of the gross receipts derived from the first sale within the State. Liquid fuels, such as gasoline, diesel, fuel oil, aviation fuel, propane, etc, are taxed at a per gallon rate.

The minimum per gallon tax rate is set at 4 cents (2.75% of $1.44, the average price of a gallon of gasoline in 1991). The law provides that the per gallon tax rate is to be adjusted twice annually (January 1 and July 1) by the Director of the Division of Taxation based upon the most recent survey of gasoline prices conducted by the Office of the Economist of the Board of Public Utilities.

Since 1991, gasoline prices have been lower than $1.44 per gallon. As a result the tax rate has remained at the statutory minimum of 4 cents. However, if the survey conducted later this Spring finds that prices are higher than the 1991 benchmark, an upward adjustment to the tax rate could occur as early as July 1, 2000. The law provides that the tax rate equal 2.75% of the average price, rounded to the nearest tenth. For example, if the average price is $1.50 per gallon, the tax rate would increase to 4.1 cents per gallon. A $2.00 per gallon price would result in a 5.5 cent tax rate. During a six month period, each penny that the tax rate rises will increase State revenue by approximately $25 million.

FY 2001 Surplus Analysis

Each year the OLS recalculates the State's year-end budgeted surplus based solely on the revenue estimates contained in this report. Figure 15 assumes that the spending plan and tax law changes in the FY 2001 Executive budget will be followed. However, any calculation of actual surplus must take into account spending (appropriation) decisions as well as anticipated revenue. Decisions on these and other matters will be made by the Executive, both appropriations committees and the full Legislature over the next three months.

As is shown in Figure 15, the Treasury estimates an FY 2001 year-end surplus of $850 million. The lower OLS revenue estimates would produce a surplus of $709 million, $141 million less than the Treasury.

Figure 15
Adjusted FY 2001
Year-End Combined Surplus
($ millions)

Treasury Estimate	$850
OLS Revenue Adjustment	($141)
OLS Adjusted Surplus	$709

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

The annual estimates of the State's surplus are point in time estimates chasing a moving target. Because of the large number of changes that occur in both spending and revenues throughout any fiscal year, the surplus changes significantly between the enactment of the annual appropriations act and the end of the fiscal year and a review by State auditors. Figure 16 below displays the "budgeted" surplus amount based on the annual appropriations act passed by the Legislature and signed by the Governor each June. The figure also displays the final surplus amount at the end of each fiscal year. The differences between the budgeted surplus and the final surplus each year are significant, and in recent years have grown significantly during the year. Accordingly, the OLS urges caution in drawing conclusions about the FY 2001 year-end surplus.

Figure 16
Fiscal Year Combined Surplus
Since FY 1990
($ millions)

Fiscal Year	Approp. Act	Final
1990	$426	$162
1991	$322	$371
1992	$514	$836
1993	$142	$1,151
1994	$411	$1,265
1995	$456	$950
1996	$549	$880
1997	$550	$1,108
1998	$550	$1,257
1999	$701	$1,268
2000*	$783	$1,176

Source: Annual New Jersey State Budgets.
* FY 2000 Final amount is the Executive's estimate as of January 2000.

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Appendix Contents:

Detailed Fiscal Year 2000 Revenue Estimates

Fiscal Year 2000 ($ millions)	Approp. Act	Executive Revised	OLS	Diff: OLS - Executive
Major Taxes:				
Sales Tax	$5,332.5	$5,575.0	$5,550.0	($25.0)
Corporation Business Tax	1,439.7	1,396.2	1,380.0	(16.2)
Motor Fuels	485.0	505.0	510.0	5.0
Motor Vehicle Fees	384.0	400.3	400.3	0.0
Transfer Inheritance	510.0	520.0	525.0	5.0
Insurance Premiums	290.0	290.0	290.0	0.0
Cigarette	233.0	223.0	230.0	7.0
Petroleum Products Gross Receipts	208.0	208.0	210.0	2.0
Corporation Business - Banks and Financial	54.0	54.0	40.0	(14.0)
Alcoholic Beverage Excise	76.0	78.0	78.0	0.0
Realty Transfer	78.0	75.0	75.0	0.0
Savings Institutions	15.0	17.0	12.0	(5.0)
Tobacco Products Wholesale	16.0	13.0	13.0	0.0
Public Utilities Excise	8.7	8.7	8.7	0.0
Subtotal, Major Taxes	$9,129.9	$9,363.2	$9,322.0	($41.2)
Misc. Taxes, Fees and Revenues				
Public Utility Taxes (State retention)	$68.4	$68.4	$68.4	$0.0
Transitional Energy Facility Assessments	176.0	216.7	216.7	0.0
Medicaid Uncomp. Care Reimbursement	440.1	440.1	440.1	0.0
MTF Revenue Fund	46.0	46.0	46.0	0.0
Good Driver Program	77.6	78.0	78.0	0.0
Motor Vehicle Inspection Fund	66.1	70.2	70.2	0.0
Investment Earnings	8.8	9.0	15.0	6.0
Other	970.5	978.4	978.4	0.0
Subtotal, Misc. Revenues	$1,853.5	$1,906.8	$1,912.8	$6.0
Interfund Transfers				
State Lottery Fund	$713.0	$713.0	$685.0	($28.0)
Tobacco Settlement Fund	92.8	92.8	92.8	0.0
Other	263.8	257.9	257.9	0.0
Subtotal, Interfund Transfers	$1,069.6	$1,063.7	$1,035.7	($28.0)
TOTAL GENERAL FUND	$12,053.0	$12,333.7	$12,270.5	($63.2)
Property Tax Relief Fund (Income Tax)	$6,820.0	$7,035.0	$7,000.0	(35.0)
Casino Revenue Fund	332.5	337.6	337.6	0.0
Casino Control Fund	55.2	58.0	58.0	0.0
Gubernatorial Elections Fund	1.5	1.5	1.0	(0.5)
GRAND TOTAL, ALL FUNDS	$19,262.1	$19,765.8	$19,667.1	($98.7)

Detailed Fiscal Year 2001 Revenue Estimates					
Fiscal Year 2001 ($ millions)	Executive	% Change	OLS	% Change	Diff: OLS - Executive
Major Taxes:					
Sales Tax	$5,993.0	7.5%	$5,940.0	7.0%	($53.0)
Corporation Business Tax	1,486.2	6.4%	1,470.0	6.5%	(16.2)
Motor Fuels	530.0	5.0%	525.0	2.9%	(5.0)
Motor Vehicle Fees	406.3	1.5%	406.3	1.5%	0.0
Transfer Inheritance	620.0	19.2%	650.0	23.8%	30.0
Insurance Premiums	300.0	3.4%	300.0	3.4%	0.0
Cigarette	199.0	(10.8)%	215.0	(6.5)%	16.0
Petroleum Products Gross Receipts	215.0	3.4%	215.0	2.4%	0.0
Corporation Business - Banks and Financial	67.0	24.1%	40.0	0.0%	(27.0)
Alcoholic Beverage Excise	76.0	(2.6)%	78.0	0.0%	2.0
Realty Transfer	78.0	4.0%	75.0	0.0%	(3.0)
Savings Institutions	19.0	11.8%	12.0	0.0%	(7.0)
Tobacco Products Wholesale	14.0	7.7%	13.0	0.0%	(1.0)
Public Utilities Excise	8.7	0.0%	8.7	0.0%	0.0
Subtotal, Major Taxes	$10,012.2	6.9%	$9,948.0	6.7%	($64.2)
Misc. Taxes, Fees and Revenues					
Public Utility Taxes (State retention)	$68.4	0.0%	$68.4	0.0%	$0.0
Transitional Energy Facilities Assessment	205.0	(5.4)%	205.0	(5.4)%	0.0
Medicaid Uncomp. Care Reimbursement	408.5	(7.2)%	408.5	(7.2)%	0.0
MTF Revenue Fund	46.0	0.0%	46.0	0.0%	0.0
Good Driver Program	67.7	(13.2)%	67.7	(13.2)%	0.0
Motor Vehicle Inspection Fund	70.2	0.0%	70.2	0.0%	0.0
Investment Earnings	9.0	0.0%	15.0	0.0%	6.0
Other	945.7	(3.3)%	945.7	(3.3)%	0.0
Subtotal, Misc. Revenues	$1,820.5	(4.5)%	$1,826.5	(4.5)%	$6.0
Interfund Transfers					
State Lottery Fund	$713.0	0.0%	$700.0	2.2%	($13.0)
Tobacco Settlement Fund	174.4	87.9%	174.4	87.9%	0.0
Other	218.0	(15.5)%	218.0	(15.5)%	0.0
Subtotal, Interfund Transfers	$1,105.4	3.9%	$1,092.4	5.5%	($13.0)
TOTAL GENERAL FUND	$12,938.1	4.9%	$12,866.9	4.9%	($71.2)
Property Tax Relief Fund (Income Tax)	7,580.0	7.7%	7,610.0	8.7%	30.0
Casino Revenue Fund	349.3	3.5%	349.3	3.5%	0.0
Casino Control Fund	58.0	0.0%	58.0	0.0%	0.0
Gubernatorial Elections Fund	1.5	0.0%	1.0	0.0%	(0.5)
GRAND TOTAL, ALL FUNDS	$20,926.9	5.9%	$20,885.2	6.2%	$-41.7

Internet and E-Commerce Sales and Use Tax Issues

The dramatic evolution of Internet technology raises numerous issues with respect to state taxes. These issues which generally relate to the basic fairness and equity of the tax systems involved and the potential erosion of state tax bases have been the subject of considerable discussion and debate for several years at both the national and state levels. Yet, they remain largely unresolved.

> Key Internet Related Sales and Use Tax (S&U Tax) Issues
>
> - Current limitations on the application of the S&U Tax to out-of-state sales can result in unequal treatment of different businesses and consumers.
> - Internet activity can result in revenue losses to state governments under current tax collection procedures.
> - Increasing conversion of tangible goods into intangible goods has adverse implications for the S&U Tax base and raises issues regarding the consistency of the tax.

BACKGROUND ON THE S&U TAX

The S&U Tax is New Jersey's second largest source of State government revenue. In FY 2000-01, it is projected to raise revenues of approximately $6.0 billion. The S&U Tax revenue makes up nearly 30 percent of all budgeted revenues.

What Is Taxed?

New Jersey's S&U Tax is imposed at a rate of six percent on the retail price of certain *tangible personal property* sold to final purchasers (unless specifically exempt). It does not apply to either real property (for example, houses) or intangible personal property (such as stocks or items sold in digital form). It also does not apply to certain items because exemptions are granted for categories of tangible goods, such as clothing, food, medical products and drugs, and manufacturing equipment. Generally, most services also are exempt from direct S&U Tax taxation, although they may be indirectly taxed to the extent that their value is incorporated into the final value of the tangible products they help produce. The S&U Tax is collected by sellers from retail customers and remitted by sellers to the New Jersey Division of Taxation.

Sales Taxes Versus Use Taxes

The S&U Tax is actually comprised of two separate levies. The first is the *sales* tax, which is applied to items which are both purchased and consumed *within* New Jersey. The companion *use* tax is levied on goods purchased *outside* of the state for use *within* the State. The combined intent of the two levies is to tax equally items that are purchased for use in New Jersey. While these two taxes are similar, the Internet-related administrative and tax collection issues associated with them are quite different.

Tax Treatment of Remote Sales.

The issue that has received by far the greatest attention in the Internet tax policy debate is the fact that often the S&U Tax may not be paid on out-of-state sales. This occurs because Internet technology facilitates the ability of businesses to conduct commerce on a remote (that is, out-of-state) basis. New Jersey has limited ability to require companies located out-of-state to collect the S&U Tax on sales to New Jersey residents that are conducted over the Internet. The same collection issues arise for the 44 other states that levy sales taxes. While this issue of S&U Tax collection is not new, state officials recognize that as the Internet grows and this type of commerce -- termed “remote sales” -- increases, there will be a steady erosion of the S&U Tax base.

PROBLEMS RAISED FOR THE S&U TAX BY THE INTERNET AND E-COMMERCE

The two problem areas for the S&U Tax posed by the Internet and its associated e-commerce activity are (1) tax inequities and (2) potential base erosion. Below, we examine each of these issues in turn, and then discuss why they occur.

Inequities Related to the Application of the S&U Tax.

Currently, New Jersey generally collects the S&U Tax only on sales where the seller has a *physical presence* in the state. This means that in many cases, the purchase of a tangible item -- a book or appliance, for example -- through the Internet (or other remote sales method) will not result in the payment of the S&U Tax. If this same transaction were to occur instead through a traditional “bricks and mortar” business in New Jersey, the S&U Tax would be applied by the seller to the purchase. This differential treatment in S&U Tax responsibilities based solely on the transaction method results in unequal treatment of both sellers (based on their sales method) and consumers (based on their means of purchase). While this tax inequity exists, there is some difference of opinion whether the tax-related "price break," the lack of S&U Tax added to the retail price, is an important factor that encourages purchasing through e-commerce retail sales or whether other factors are more important in directing consumers toward online retail buying. In addition, if Internet access predominates more among those in higher-income households than the population as a whole, this could result in a somewhat increased share of the existing S&U Tax burden being carried at the lower end of the income spectrum, especially as the Internet continues to expand.

Potential Base Erosion: Remote Sales.

The most obvious S&U Tax base erosion associated with the Internet involves remote sales. We do not know the current volume of e-commerce sales activity, the portion subject to New Jersey's S&U Tax, or the use tax payments received. Making an accurate estimate of lost revenue is complicated both by a lack of reliable comprehensive information on current Internet and e-commerce activity, and the fact that not all such activities result in New Jersey S&U Tax revenue losses. Sales of items that are covered by exemptions or that are sales between businesses for resale purposes would not result in any tax collections regardless of whether the sales took place within the State or through remote sales under traditional mail-order or e-commerce means.

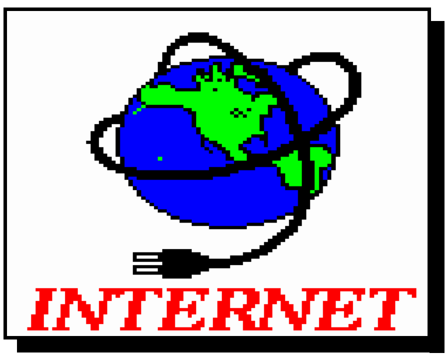
The concern in this area is not so much related to *current* losses, but rather that this amount could grow substantially in the future, as the Internet and e-commerce continue to evolve. While some other states report losses of less than 1 percent of the S&U Tax revenue base (1 percent of the NJ sales tax revenue equals about $60 million), Internet growth rates in the next three to five years equivalent to those experienced in the recent past could raise the magnitude of such losses. By 2003, such revenue losses could represent 2 to 4 percent of S&U Tax revenues.

The collections-related problems associated with the Internet and e-commerce relate primarily to the issue of "nexus" as it pertains to the use tax and the related administrative and legal barriers to collecting the S&U Tax. In simple terms, nexus refers to the degree of presence or connection between things. For state tax purposes, it refers to the degree of contact or connection required between a state and a taxpayer before the state has the legal authority to require the collection of a tax by a taxpayer. In the case of New Jersey, nexus must be established before the State can require the seller to collect the use tax component of the S&U Tax. Although states normally define nexus in statute, it still may be subject to judicial review for such purposes as determining its constitutionality. Specifically, the courts have overturned nexus statutes if they violate the due process clause or commerce clause of the U.S. Constitution.

Legal issues involving state tax nexus have a history which predates the appearance of Internet technology and e-commerce. In particular, catalog sales and telephone order sales both raise the same or similar issues regarding S&U Tax nexus as do Internet sales.

All such activities can be characterized as involving remote sales -- that is, sales where the seller is located out-of-state but the buyer and user of the purchased item is located in-state. The legal guidelines for whether a state can require companies to collect the S&U Tax on Internet sales were established by a series of Supreme Court cases dealing with non-Internet remote sales.

The general rule is that states cannot require the collection of the S&U Tax by out-of-state sellers without them having a sufficient physical presence in the state. Many Internet sellers do not have such a presence. As a result, states like New Jersey cannot require such retailers to collect the S&U Tax. Many states have sought and continue to try to broaden the definition of nexus, so that more companies and transactions will meet the "physical presence" test. However, the current "bottom line" is that, short of Congressional action, it is not possible for states to require collection of the use tax component of the S&U Tax on many Internet sales by out-of-state parties.



Does the S&U Tax Still Have to Be Paid?

New Jersey law *does* provide that *purchasers* of remote-sale taxable items are themselves liable for the use tax even if it is not collected and remitted by the seller. However, as a practical matter, the S&U Tax is routinely paid by purchasers on such out-of-state sales only in cases that involve (1) items purchased by taxpayers who are registered sellers and whose transaction records are reviewed by the State Division of Taxation during the normal course of its auditing activities; and (2) items that have legal registration requirements, such as cars, trucks, and boats. Otherwise, the tax goes unpaid unless individuals and businesses voluntarily report it. There are few such voluntary payments made.

Erosion by Technology: Conversion of Tangibles to Intangibles.

In addition to the restricted ability of state governments to require that out-of-state companies collect the S&U Tax, the technology of the Internet is increasing the rate at which certain types of products are no longer even subject to the S&U Tax. In New Jersey, as in most other states levying a sales tax, the S&U Tax is levied only on *tangible* personal property. The Internet makes it possible for certain types of products (such as music, books, and movies) to be easily converted to an *intangible* state for sale to the consumer. The process of reducing such items to "pure information," or "digitizing" them, transforms them from a tangible form (which generally *would* be subject to the S&U Tax) into an intangible form (which is *not* subject to taxation). This occurs with respect to both interstate and intrastate sales.

This process of reducing goods to their pure informational form is not new. Previous telecommunications-based technologies also were used to transform information from physical to digital form. For example, facsimile machines can be used to deliver or sell certain types of information, including reports, renderings, or similar items. However, the development and continued improvement in Internet technology has vastly expanded -- in terms of both volume, variety, and complexity -- the ability to engage in such digital exchanges. Examples of this process include the digitization of music, computer software, graphics programs, books, movies, and databases.

The revenue losses stemming from the transformation of tangible goods into intangible form are unknown and difficult to estimate. At present, they are probably not all that significant relative to the S&U Tax's base, given the technology's age and state of development. Future losses, however, are likely to be considerably more significant, as the technology used to convert information to digital form evolves and becomes more refined and wide-spread. This evolution also will increasingly raise tax administration issues regarding how to apply the S&U Tax to a world where the line between tangibles and intangibles becomes more and more blurred, and the destination or place of delivery of such intangibles may be unknown and unknowable.

The above factors raise concerns over the future health of the S&U Tax base, which has been experiencing erosion as nontaxed services have become an increasingly large share of consumer spending. The fact that New Jersey is quite reliant on the S&U Tax for revenues makes this a potentially important issue for the Legislature. Internet activity also has made more apparent the inequities inherent in the application of the tax, in that it treats remote businesses and traditional businesses (and their customers) differently.

The S&U Tax issues have long existed involving tax-base erosion, inequities between different taxpayers and different transaction modes, and administrative and compliance cost differentials. The Internet, however, has exacerbated these concerns.

WHERE DO THINGS CURRENTLY STAND ON THESE TAX ISSUES?

Resolution of the above Internet-related tax issues has not yet occurred. In fact, due to the significant debate at the national level regarding them, a federal temporary moratorium has been passed to preclude tax decisions from being made until some national consensus has been reached. Such consensus will presumably attempt to balance concerns regarding: (1) the fiscal issues the Internet poses for state and local governments; (2) tax inequities, complexities, and inconsistencies; and (3) constraints on the healthy growth and evolution of the Internet-based economic subsector.

The Federal Internet Tax Freedom Act.

The Federal Internet Tax Freedom Act (ITFA), was signed into law on October 21, 1998. It provides for a three-year prohibition against states and local governments levying taxes on Internet access, unless such a tax already was imposed prior to October 1998. It also prohibits both "multiple" taxes and "discriminatory" taxes on Internet activity.

The Federal ITFA also established the Advisory Commission on Electronic Commerce (ACEC), which is to study Internet tax policy issues and report to Congress as to whether e-commerce should be taxed and, if so, what the appropriate taxation method would be. The ACEC is comprised of three federal officials, eight state and local government representatives, and eight representatives from the e-commerce industry, telecommunications carriers, local retail businesses, and consumer groups. By April 2000, ACEC is to deliver its report to Congress on various tax-related matters.

POSSIBLE SOLUTIONS

State-Specific Actions.

In terms of state-specific actions, the ability of New Jersey to unilaterally address Internet-related tax issues is inherently limited. The existing options would either not be particularly effective in dealing with the underlying tax policy issues highlighted by Internet development, or would raise additional -- perhaps more serious -- problems. For example, pursuing a more aggressive enforcement of nexus would not address the fundamental legal issues involved and would likely entail extensive litigation. Likewise, encouraging use tax compliance would serve to educate taxpayers as to the use tax obligation, but it would be unlikely to have a measurable impact on S&U Tax collections.

Cooperative State Actions.

Multistate compacts would seem to offer greater potential than state-specific actions. This approach would focus on designing and implementing a simplified and streamlined S&U Tax administration system, involving some or all of the following: (1) single or a reduced number of state rates, (2) standardized definitions of products, taxable items, and exempt purchases, (3) standardized and simplified tax calculation and collection procedures, and (4) exemptions for small sellers. Key goals would be to reduce S&U Tax variations among states and reduce the compliance burden for sellers, while achieving tax neutrality. New Jersey has pursued multistate approaches in the past in the areas of corporate income taxes and fuel taxes.

One specific effort in this area was developed jointly by the National Governor's Association (NGA) and National Conference of State Legislatures (NCSL) and endorsed by several other state and local government membership organizations. It was presented to the ACEC at its December 1999 meeting in San Francisco. This "zero burden" proposal would establish a voluntary system where a third party would determine the taxability of and tax rate on purchased items. The third party would also collect the tax and remit the proceeds to states. There is precedent for such third party approaches such as the International Fuels Tax Agreement and the International Registration Program. However, any cooperative approach would not at this time result in a requirement that remote sellers collect and remit the use tax for all sales. Absent Congressional action addressing the issues raised by various legal decisions, out-of-state sellers could only be required to collect the use tax if they had physical presence in the purchaser's state.

Note: This discussion draws substantially from *California Tax Policy and the Internet*, a report by the California Legislative Analyst's Office, January 31, 2000.

Exemptions and the Erosion of the Sales and Use Tax Base

While sales tax revenues have been increasing nationwide as personal income and consumption increase, a decreasing share of consumption is being subjected to the sales tax. This trend can be attributed to three factors: an increase in the consumption of services relative to more broadly taxed goods; the expansion of remote sales, including catalog and Internet sales (see Appendix beginning on page A4); and the enactment of legislation providing for new or enhanced exemptions to the tax base.[1] While the State has an inherently limited ability to address the issue of remote sales, it does have jurisdiction over what goods and services can be taxed or exempted within the State.

As this report highlighted earlier, the six percent sales and use tax currently generates almost $6.0 billion, 28 percent, of State budgeted revenues annually, second only to the gross income tax. Given the State's reliance on the sales tax, concern has recently been expressed by both the Legislature and the Governor (see P.L.1999, c.416 and Executive Order No. 103 of 1999) regarding the potential erosion of the sales tax base through statutory exemptions.

Indeed, during the 1998-1999 Session, the Legislature and Governor modified the Sales and Use Tax Act, N.J.S.A. 54:32B-1 et seq., twelve times (see Table A on following page). These enactments through the addition of new or expanded exemptions are, in total, estimated to decrease State revenues in the first full fiscal year following enactment by approximately $10 million. While each of these enactments stand on their own merits as the exercise of the Legislative prerogative to determine State tax policy, they have the effect of reducing the taxable base.

To address these concerns, the Legislature and Governor, pursuant to P.L.1999, c.416 (C.54:32B-37 et seq.) recently established the **Sales and Use Tax Review Commission** to "review any bill, joint resolution or concurrent resolution introduced in either House of the Legislature that expands or reduces the base of the New Jersey sales and use tax." This Commission, which supersedes the "Advisory Committee on the Sales and Use Tax" created by Executive Order No. 103 of 1999, is modeled after and has an analogous function to the Pension and Health Benefits Review Commission created by P.L.1991, c.382. P.L.1999, c.416 takes effect on March 1, 2000 and will apply to bills and resolutions introduced on and after this date. Bills introduced in the current session as of March 13, 2000 are listed below in Table B.

The revenue raised by the sales tax is a function of the tax base (range of taxable transactions) and the tax rate. If the tax is to raise a given level of revenue, the narrower the base, the higher the rate. Conversely, the broader the base, the lower the rate. Within the context of these relationships the Legislature considers a range of policy considerations. Although studies are limited

NEW JERSEY SALES AND USE TAX

Imposed on: Tangible personal property, unless specifically exempted, including purchases made out of State for use in State, and a limited number of services, particularly telecommunications and repairs.

Does not apply to real property, such as houses, or intangibles, such as stocks.

Major categories of exempted tangible goods: Clothing, food, medical products and drugs, manufacturing equipment, farm supplies and equipment.

Also generally exempted: services.

[1] *E-Commerce in the Context of Declining State Sales Tax Bases*, Donald Bruce and William F. Fox, University of Tennessee, February 2000.

TABLE A Legislation Enacted During the 1998 - 1999 Session that Expanded or Extended Exemptions under the State Sales and Use Tax		
		Annual Estimated Cost*
P.L.1998, c.114	Exempts sale of electricity by any municipal electric utility to customers within municipality.	$200,000
P.L.1998, c.115	Establishes Downtown Business Improvement Districts; Allows eligible municipalities to receive declining share of sales tax proceeds over a 15-year period.	$2,700,000 max. yrs 1 - 5 $1,350,000 max. yrs 6 - 10 $675,000 max. yrs. 11 - 15
P.L.1998, c.118	Exempts certain charity shop sales.	$2,300,000 maximum
P.L.1999, c.221	Expands exemptions for film, video industry.	$600,000 - $700,000
P.L.1999, c.246	Expands exemption on aircraft repairs.	$3,000,000
P.L.1999, c.249	Increases the exemption for vending machines.	$354,000
P.L.1999, c.253	Exempts firearm trigger locks.	$10,000
P.L.1999, c.254	Exempts firearm vaults.	$15,000 per 1,000 sold
P.L.1999, c.273	Exempts sales and servicing of commuter ferryboats.	$180,000 - $240,000
P.L.1999, c.314	Expands exemption for property used or consumed on farms; certain farm production and conservation services.	Indeterminate.
P.L.1999, c.416	Grants exempt status to National Guard/war veterans associations.	$190,000 - $300,000
Total sales and use tax revenues foregone to State as a result of enactments during 1998-1999 session: .... approximately $9,700,000 in first year Note: In addition to these enactments, P.L.1999, c.365 provides for sales and use tax refunds for certain purchases made between 9/17/99 and 12/31/00 by victims of Hurricane Floyd. Since this enactment provides for refunds rather than tax exemptions, it does not have the direct effect of eroding the tax base. However, over a two year period, FY00 and FY01, refunds are expected to total between $15,000,000 and $20,000,000.		

*Based on published Legislative fiscal notes and estimates. Estimates are annual unless otherwise stated.

TABLE B Bills Pending in the 2000 - 2001 Session that would Expand or Extend Exemptions Under the Sales and Use Tax		
Bill Number	Synopsis	Annual Estimated Cost*
A-171	Exempts non-gas lawn care equipment.	$2,000,000 - $5,000,000
A-360	Exempts children's car seats.	Estimate unavailable.
A-362	Exempts bicycle helmets.	Estimate unavailable.
A-567	Exempts repair and maintenance services.	$400,000,000
A-712	Exempts medical alarm equipment.	$432,000
A-926 S-1018	Exempts fire detection equipment.	$1,800,000 - $2,000,000
A-1100	Exempts books.	$48,200,000 - $60,300,000
A-1244	Exempts stolen vehicle replacement.	Estimate unavailable.
A-1334	Exempts charitable organizations.	$5,500,000 maximum.
A-1501	Exempts senior citizen non-profit organizations.	Estimate unavailable.
A-1601	Clarifies that Internet access services are not taxable.	None. Not currently taxable.
A-1603	Phases out tax on long-distance telecommunications services over six years.	Estimate unavailable.
A-1627	Allows reduced (3%) sale tax on motor vehicle sales within Urban Enterprise Zones.	Estimate unavailable.
A-1663	Provides full or partial reimbursement to new veteran-owned small businesses of sales and use tax paid.	Estimate unavailable.
A-1741	Exempts rentals between certain businesses.	Indeterminate.
A-2165 S-617	Allows reduced sales tax on certain retail sales and admission charges at places of amusement within designated urban enterprise zones.	$6,000,000
A-2182 S-1104	Exempts home improvement materials.	Estimate unavailable.
S-61	Exempts recreational safety helmets.	Estimate unavailable.
S-121	Allows reduced sales tax in historic districts.	Indeterminate.
S-186	Exempts life jackets.	Estimate unavailable.
S-523	Exempts rural electrical cooperative power sales.	$800,000

S-633	Exempts county and municipal sale of food.	Estimate unavailable.
S-733	Extends exemption on sales and repair of certain aircraft.	Estimate unavailable.
Total sales and use tax revenues which would be foregone to State if all pending bills were to be enacted .... $471,132,000, first year minimum This amount represents approximately 8.6% of FY01 estimated sales and use tax base. Note: In addition to the potential loss of revenue from the above proposed exemptions, there are additional bills pending which would also decrease the sales and use tax revenues: A-208(1R)/S52 allows vendors to retain one percent of sales and use tax collections, up to $25,000, to cover the cost of collecting the tax; A-1147 reduces the sales and use tax rate by one percent; and A-1539 creates a sales tax amnesty program for small businesses.		

*Since the majority of these bills were pre-filed in the current session, the estimates in this table largely rely on legislative fiscal notes and estimates for identical bills in the prior session.

in this area, there is evidence to suggest a positive correlation between sales tax exemptions and sales tax rates. A 1998 *Tax Analysts* study of food exemptions, for example, found that most states that exempt food have higher tax rates.[2] Moreover, the authors of that study also concluded that states which narrow their bases through preferential tax policy are "often" forced to raise rates during times of economic downturns.

Conversely, these findings also suggest that a reduction, elimination or absence of exemptions would permit the lowering of tax rates. The revenue costs of exemptions was the subject of a 1994 analysis conducted by The Office of Legislative Services. At that time, the OLS concluded that the potential broadening of the sales tax base to cover ***all*** purchases of goods and services would increase revenues sufficiently to offset the revenue cost of lowering the sales tax rate by as much as 50 percent.

An additional consideration that is raised by exemption legislation is the effect they may have on the complexity of the tax code, making collection, compliance, enforcement and administration of the sales and use tax more problematic. While not of apparent budgetary significance, this issue could become increasingly important in addressing Internet-related tax issues, since any potential multi-state compact (see discussion on page B8 of Appendix) will require simplified and streamlined tax systems, a task which, for all states, may be made more difficult by a continuation of the current nationwide trend evidencing the enactment of varied and expanded exemptions.

[2] "*Does A Food Exemption Lead to a Higher State Sales Tax Rate?* Roy Bahl, Georgia State University. and Richard R. Hawkins, University of West Florida, Special Report 98 STN 4-20, Tax Analysts, 1998.

Public Utility Tax Revenue

Fiscal Year 2001 will be the fourth 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 2001. 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 5 display the actual and anticipated revenues from the replacement taxes between FY 1998 and FY 2001 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, and will be $750 million in fiscal years 2000 and 2001 and $755 million in each subsequent fiscal year.

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

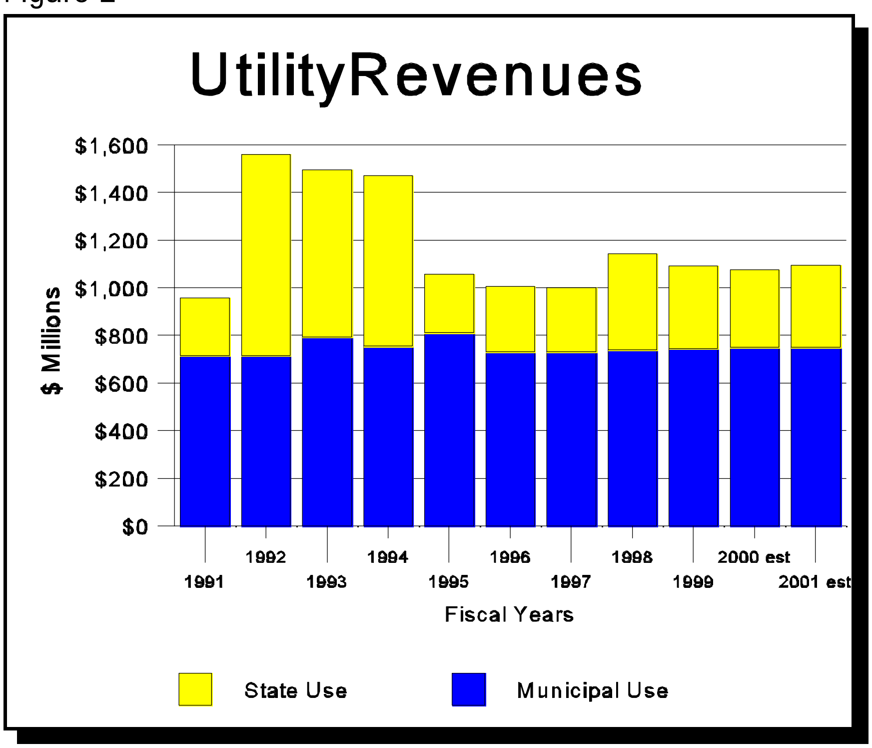


Figure 2 Actual Public Utility Tax Revenue Fiscal Year 1998 ($ Millions)			
Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax	$6.7	$510.2	$516.9
Corporation Business Tax	$3.9	$229.8	$233.7
Transitional Energy Facilities Assessment (TEFA)	$314.9		$314.9
Franchise 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

Anticipated Public Utility Tax Revenue Fiscal Year 2000

($ Millions)

Revenue Source	On-Budget (State Use)	Off-Budget (Municipal Aid)	Total
Sales and Use Tax		$541.3	$541.3
Corporation Business Tax	$30.2	$208.7	$238.9
Transitional Energy Facilities Assessment (TEFA)	$216.7		$216.7
Customer Specific Tax	$2.2		$2.2
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	$326.2	$750.0	$1,076.2

Source: Department of Treasury, January 2000.

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		$551.6	$551.6
Corporation Business Tax	$60.2	$198.4	$258.6
Transitional Energy Facilities Assessment (TEFA)	$205.0		$205.0
Customer Specific Tax	$2.0		$2.0
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	$344.3	$750.0	$1,094.3

Source: Department of Treasury, January 2000.

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Office of Legislative Services
Background Report

Gross Income Tax Rates, Revenue and the Distribution of Income: 1988 to 1997

OLS Background Report No. 18

Prepared By:
Revenue, Finance and Appropriations

Date Prepared:
November 1999

New Jersey State Legislature
Office of Legislative Services
State House Annex, P.O. Box 68
Trenton, NJ 08625-0068
http://www.njleg.state.nj.us

Gross Income Tax Rates, Revenue and the Distribution of Income: 1988 to 1997

INTRODUCTION

The 1990's have seen dramatic changes in New Jersey's income tax rates, rapid growth in New Jersey gross income, and strong increases in income tax revenues. At the start of the decade, Governor James Florio and the Legislature added several additional tax brackets with higher marginal rates for certain middle and upper income taxpayers. In the middle of the decade Governor Christine Whitman and the Legislature reduced income tax rates across all brackets by between nine percent and 30 percent. At the same time, the national and State economies first moved into a recession followed by a continuing recovery and expansion that is approaching historical longevity records. New Jersey personal income has increased rapidly, including a marked jump in taxpayers in higher income brackets, while income tax revenue has grown strongly. This paper will outline the significant structural changes occurring in the New Jersey gross income tax (GIT), the tax revenue increases, and income growth since 1988.

THE CHANGING TAX RATE STRUCTURE

New Jersey enacted its income tax in July 1976 (P.L.1976, c.47). The tax began with a simple two-rate structure consisting of a 2.0 percent rate on income below $20,000 and a 2.5 percent rate on income above $20,000. Beginning in 1983 an additional rate of 3.5 percent for incomes over $50,000 took effect (P.L.1982, c.229). The next significant changes to the GIT rate structure occurred during the 1990's. Figures A and B display those changes for joint and single filers.

Figure A

Taxpayers Filing a Joint Return						
Marginal Tax Bracket (Taxable Income)	Marginal Tax Rates By Taxable Year					Percent Reduction Between 1993 & 1996
	Prior to 1991	1991 to 1993	1994	1995	1996	
less than $20,000	2.000%	2.000%	1.900%	1.700%	1.400%	30%
$20,000 to $50,000	2.500%	2.500%	2.375%	2.125%	1.750%	30%
$50,000 to $70,000	3.500%	3.500%	3.325%	2.975%	2.450%	30%
$70,000 to $80,000	3.500%	5.000%	4.750%	4.250%	3.500%	30%
$80,000 to $150,000	3.500%	6.500%	6.175%	6.013%	5.525%	15%
over $150,000	3.500%	7.000%	6.650%	6.580%	6.370%	9%

Figure B

Taxpayers Filing a Single Return						
Marginal Tax Bracket (Taxable Income)	Marginal Tax Rates By Taxable Year					Percent Reduction Between 1993 & 1996
	Prior to 1991	1991 to 1993	1994	1995	1996	
less than $20,000	2.000%	2.000%	1.900%	1.700%	1.400%	30%
$20,000 to $35,000	2.500%	2.500%	2.375%	2.125%	1.750%	30%
$35,000 to $40,000	2.500%	5.000%	4.750%	4.250%	3.500%	30%
$40,000 to $50,000	2.500%	6.500%	6.175%	6.013%	5.525%	15%
$50,000 to $75,000	3.500%	6.500%	6.175%	6.013%	5.525%	15%
over $75,000	3.500%	7.000%	6.650%	6.580%	6.370%	9%

Governor James Florio and the Legislature enacted a major restructuring of the GIT (P.L.1990, c.61) as part of a general reform of public school education funding (the Quality Education Act, P.L.1990, c.52) and statewide homeowner and tenant property tax rebates (the Homestead Tax Rebate, P.L.1990, c.61). Effective January 1, 1991, the new rate structure added several additional marginal tax rate brackets with rates rising to 7.0 percent on incomes over $150,000 for married joint filers and over $75,000 for single or married filing separate taxpayers[1]. The new, higher marginal rates affected approximately the top 20 percent of taxpayers.

The tax rates established by the 1990 enactments were in place for only two tax years. Beginning in 1994, Governor Christine Whitman and the Legislature enacted a series of reductions in these marginal tax rates. While maintaining the same tax bracket structure, these enactments[2] phased in a reduction in most marginal tax rates by 30 percent and the top rates by 15 percent and nine percent, as displayed in Figures A and B. Approximately four of five GIT taxpayers saw a 30 percent tax cut, while the top fifth experienced lesser percentage reductions.

[1] In addition, the legislation added the head-of-household and surviving spouse filing statuses, increased the dependent exemption from $1,000 to $1,500, and repealed the property tax deduction and credit and the tenant credit in favor of the Homestead Rebate.

[2] P.L.1994, c.2, cut all rates by five percent in 1994. P.L.1994, c.69, cut most rates by 10 percent in 1995. P.L.1995, c.165, cut most rates by 15 percent in 1996 to complete the three year phase-in. In addition, P.L.1994, c.8, increased the minimum filing threshold from $3,000 to $7,500 for joint filers ($3,750 for single filers).

STRONG INCOME TAX REVENUE GROWTH

Despite the long recession (1989-92) at the beginning of the decade and the income tax rate reductions of 1994 through 1996, income tax revenue has grown in nominal terms every year throughout the 1990's. The bars in

Figure C

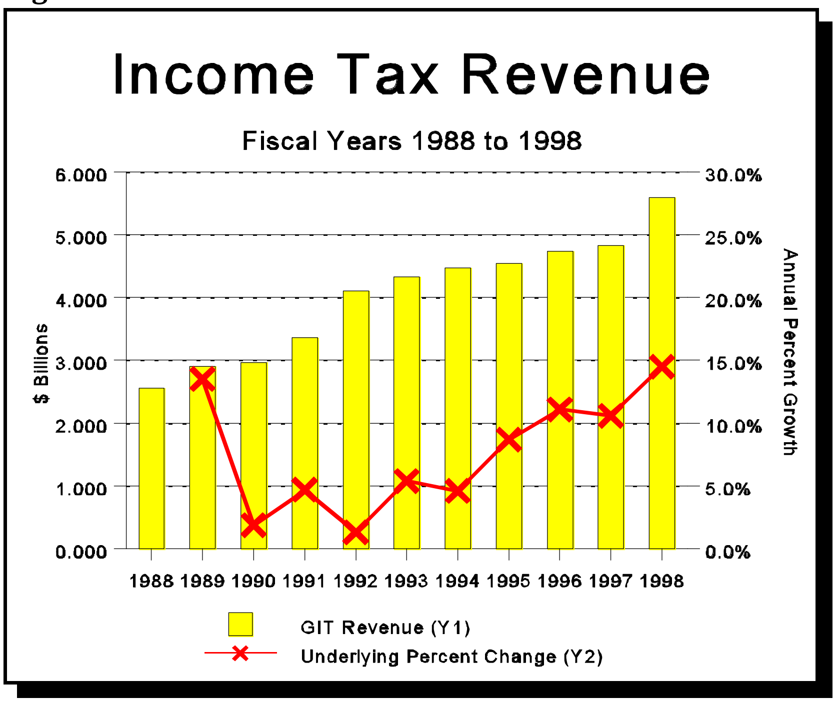

Figure C display gross income tax revenue collections by fiscal year from FY 1988 to FY 1998. The tax collected $2.56 billion in FY 1988 and increased to $5.59 billion by FY 1998, an increase of about 118 percent, or an 8.1 percent annual compound rate.

Figure C also displays the adjusted *underlying* growth rate of GIT revenue (shown with X's). The underlying growth rate is the actual growth rate adjusted to account for changes in the tax rates[3]. It is a better measure of the impact of economic change on revenue collections. Despite several years of recession, actual income tax collections jumped $740 million, or 22.0 percent, in FY 1992 following the 1991 tax rate increases. But underlying growth was only about 1.0 percent. In terms of income tax revenue collections, the tax rate increases overcame the effects of the State's deep recession. The opposite effect occurred in fiscal years 1995 to 1997 while tax rates were reduced. Actual collections grew modestly, $355 million *combined* over three years, or about 7.9 percent overall, while underlying growth averaged a strong 10.0 percent *per year*. The phased-in tax rate reductions muted the effects the State's strong economic recovery would have had on tax revenue collections. By FY 1998, actual collections and the underlying growth rate were both displaying strength.[4]

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[3] The underlying growth rate also adjusts for other influences such the 1986 federal income tax reform and the 1996 New Jersey Tax Amnesty program.

[4] Preliminary figures indicate that double digit income tax growth rates continued into FY 1999 (13.6 percent).

SOURCES OF INCOME TAX REVENUE GROWTH

Employment growth can explain some of the pattern of revenue growth in the GIT. Figure D shows the number of New Jerseyans employed between 1988 and 1997. The 1989-92 recession and the subsequent recovery are clearly visible in the chart. After considering a lag for the timing of income tax payments, the employment decline and growth matches closely with the slowdown and acceleration in the *underlying* growth rate in GIT revenues.

However, growth in employment only explains a portion of the strong revenue gains occurring in the last half of the 1990's. Even at its peak, employment has grown by less than three percent each year, well below the recent strong underlying growth rate in income tax revenue. Figure E shows that New Jersey gross income increased by about five percent per year during most of the 1990's and jumped by 10 percent in 1997. The rapid growth of income tax revenues has more to do with the level of income earned by New Jerseyans than with the number of people employed in the State.

Figure D

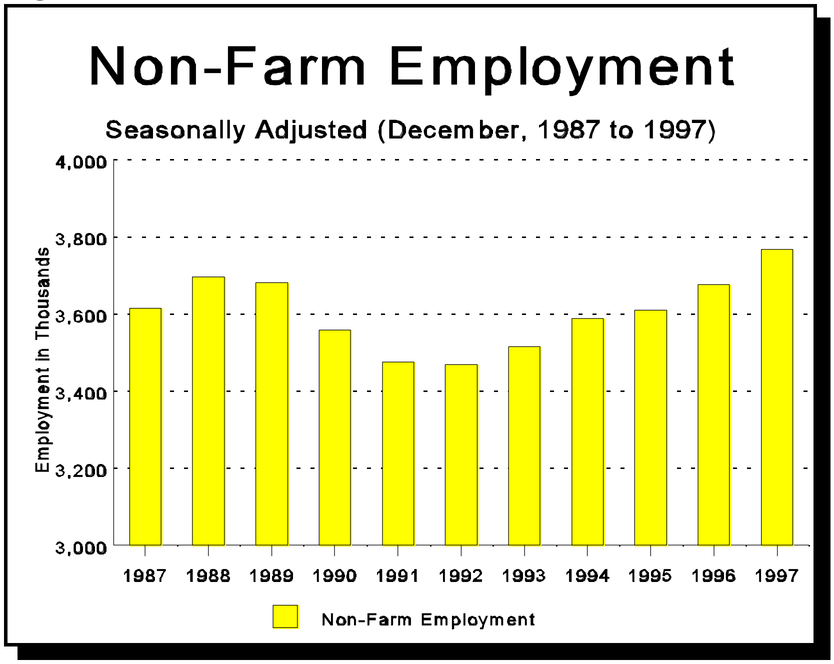
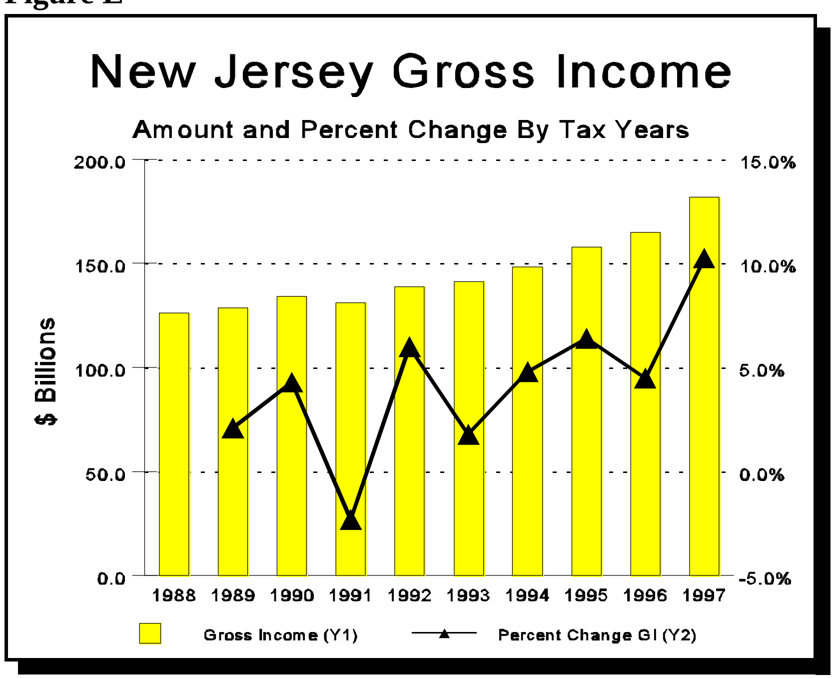


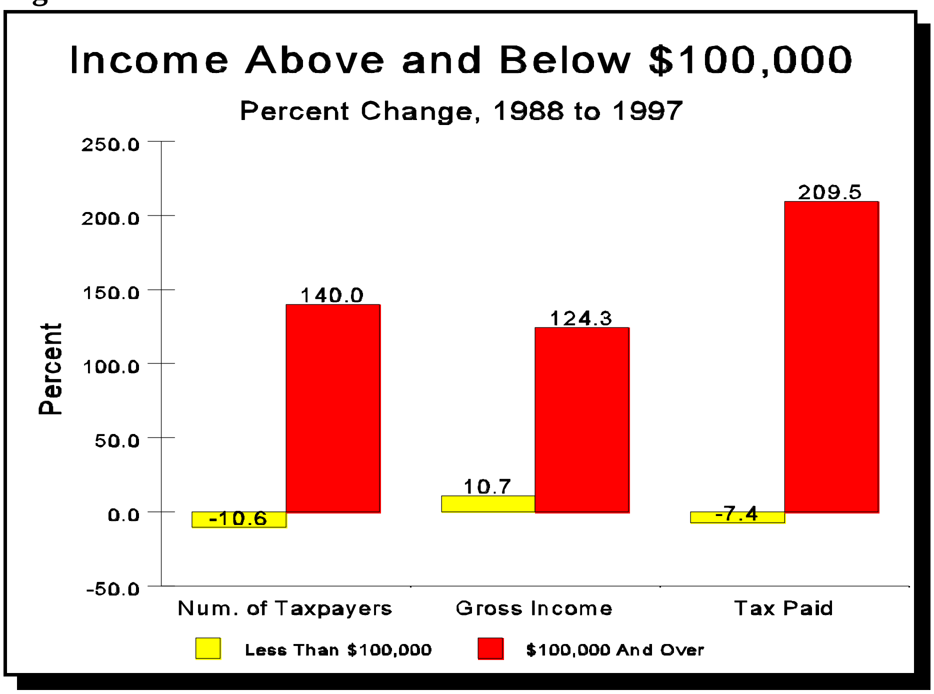
Figure E



CHANGES IN INCOME DISTRIBUTION

The strong growth in GIT revenues is a result of the combined effect of the graduated marginal tax rate system and rapid income growth among upper income taxpayers. Figure F shows the percent change between 1988 and 1997 in the number of taxpayers, gross income and tax paid for taxpayers with less than $100,000 gross income and more than $100,000 gross income. Below $100,000 the number of taxpayers and the tax paid has declined while the amount of income has increased slightly. Above $100,000 the number of taxpayers has grown by 140 percent, the amount of income has grown by 124 percent and the amount of tax paid has grown by 210 percent. Income has increased significantly among upper income levels. Moreover, since taxpayers at these higher income levels pay at the highest marginal tax rates, the tax collected has grown even more rapidly.

Figure F



The significant income growth during this period is further illustrated by gross income tax data for the years 1988, 1991, 1994 and 1997. Summaries of these data appear in Figures G through J on the following pages.[5] The figures represent tax years and do not correspond to any fiscal year because payments and refunds for a single tax year fall into two or more fiscal years. These four income tax snapshots capture a range of circumstances that have occurred since the late 1980's. They display moments in time during a period that saw both recession and vigorous growth as well as upward and downward revisions of tax rates.

[5] The data come from the *Statistics of Income*, published annually by the Department of Treasury, and income tax samples prepared and compiled by the Department of Treasury's Office of Revenue and Economic Analysis, OREA (formerly the Office of Tax Analysis, OTA).

Figure G

Tax Year 1988 New Jersey Gross Income Tax Summary	Less Than $50,000	$50,000 to $100,000	$100,000 to $500,000	$500,000 And Over	All Taxpayers
No. Returns	2,886,971	532,128	139,239	11,205	3,569,543
% of Total	*80.9%*	*14.9%*	*3.9%*	*0.3%*	*100.0%*
Gross Income ($ millions)	$53,385	$35,609	$23,699	$13,351	$126,044
% of Total	*42.4%*	*28.3%*	*18.8%*	*10.6%*	*100.0%*
Avg. Gross Income	$18,492	$66,918	$170,206	$1,191,522	$35,311
Charged Tax ($ millions)	$845	$703	$584	$375	$2,506
% of Total	*33.7%*	*28.1%*	*23.3%*	*15.0%*	*100.0%*
Average Charged Tax	$293	$1,321	$4,191	$33,467	$702

Source: 1988 *Statistics of Income*, Department of Treasury, OTA.

Figure H

Tax Year 1991 New Jersey Gross Income Tax Summary	Less Than $50,000	$50,000 to $100,000	$100,000 to $500,000	$500,000 And Over	All Taxpayers
No. Returns	2,832,552	635,613	177,845	7,646	3,653,656
% of Total	*77.5%*	*17.4%*	*4.9%*	*0.2%*	*100.0%*
Gross Income ($ millions)	$50,967	$43,174	$28,583	$8,283	$131,008
% of Total	*38.9%*	*33.0%*	*21.8%*	*6.3%*	*100.0%*
Avg. Gross Income	$17,993	$67,925	$160,719	$1,083,312	$35,857
Charged Tax ($ millions)	$882	$998	$1,084	$447	$3,410
% of Total	*25.9%*	*29.3%*	*31.8%*	*13.1%*	*100.0%*
Average Charged Tax	$311	$1,569	$6,095	$58,462	$933

Source: *Statistics of Income* tax sample, Department of Treasury, OTA, 1998.

Figure I

Tax Year 1994 New Jersey Gross Income Tax Summary	Less Than $50,000	$50,000 to $100,000	$100,000 to $500,000	$500,000 And Over	All Taxpayers
No. Returns	2,581,364	702,383	244,612	11,021	3,539,380
% of Total	*72.9%*	*19.8%*	*6.9%*	*0.3%*	*100.0%*
Gross Income ($ millions)	$47,605	$48,564	$38,930	$13,051	$148,150
% of Total	*32.1%*	*32.8%*	*26.3%*	*8.8%*	*100.0%*
Avg. Gross Income	$18,442	$69,142	$159,150	$1,184,194	$41,858
Charged Tax ($ millions)	$788	$1,090	$1,385	$658	$3,921
% of Total	*20.1%*	*27.8%*	*35.3%*	*16.8%*	*100.0%*
Average Charged Tax	$305	$1,552	$5,662	$59,704	$1,108

Source: *Statistics of Income* tax sample, Department of Treasury, OTA, 1998.

Figure J

Tax Year 1997 New Jersey Gross Income Tax Summary	Less Than $50,000	$50,000 to $100,000	$100,000 to $500,000	$500,000 And Over	All Taxpayers
No. Returns	2,307,759	748,043	341,219	19,820	3,416,841
% of Total	*67.5%*	*21.9%*	*10.0%*	*0.6%*	*100.0%*
Gross Income ($ millions)	$45,959	$52,561	$56,451	$26,636	$181,608
% of Total	*25.3%*	*28.9%*	*31.1%*	*14.7%*	*100.0%*
Avg. Gross Income	$19,915	$70,265	$165,439	$1,343,910	$53,151
Charged Tax ($ millions)	$539	$894	$1,734	$1,234	$4,401
% of Total	*12.2%*	*20.3%*	*39.4%*	*28.0%*	*100.0%*
Average Charged Tax	$233	$1,195	$5,082	$62,270	$1,288

Source: *Statistics of Income* tax sample, Department of Treasury, OREA, March 1999.

The 1988 data (Figure G) represent a peak year during the 1980's economic boom based on employment figures and consumer confidence measures. The 1991 data (Figure H) represent the low point of the long recession during the early 1990's and reflect tax collections under the marginal rate increases enacted in 1990. The 1994 data (Figure I) represent one of the first years of rebounding growth during the long recovery, and reflect the first year of the three year phased-in marginal rate reduction. Finally, the 1997 data (Figure J) represent one of a series of years with strong economic growth and the year after the phased-in marginal rate reductions were completed. The 1997 data are also the most recent year with detailed tax and income data available.

TAX REVENUE DEPENDS INCREASINGLY ON HIGHER INCOME TAXPAYERS

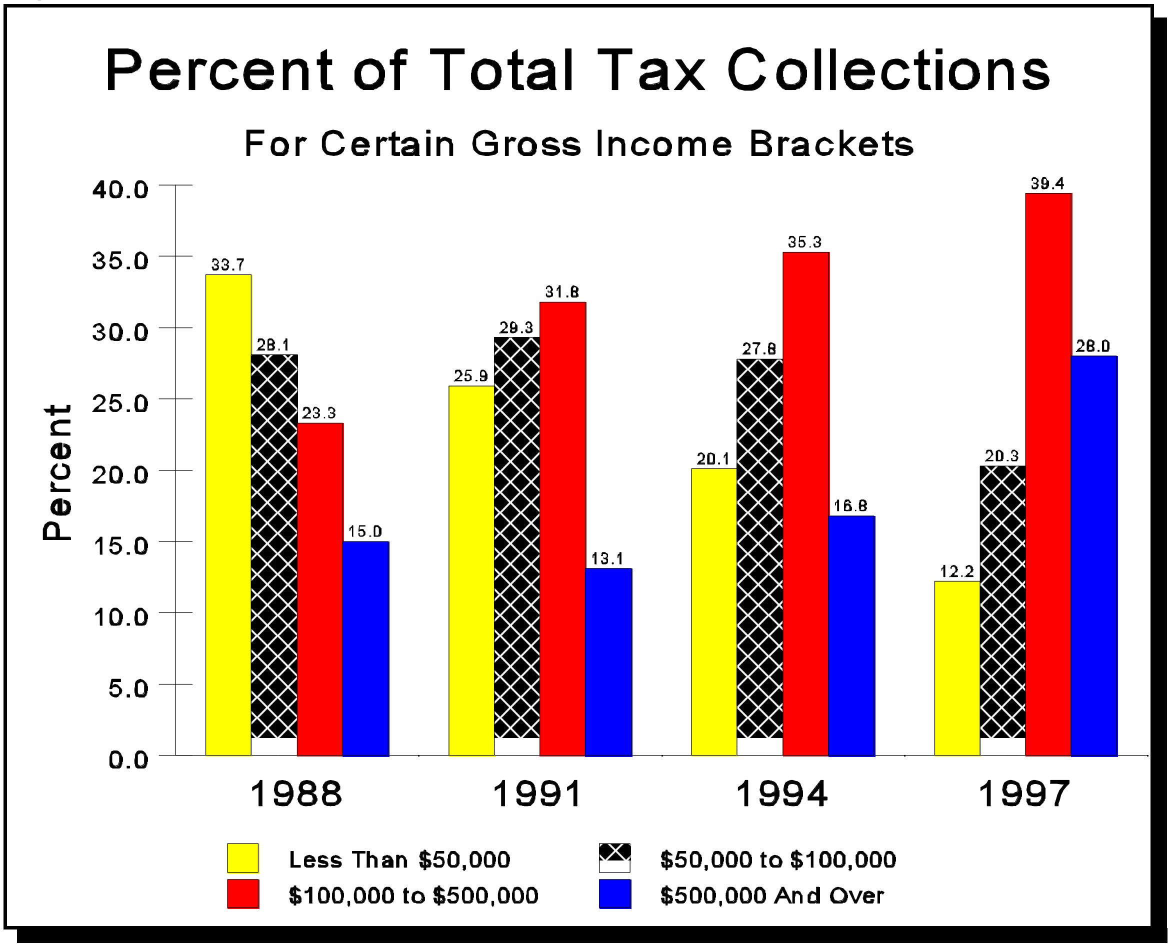
Higher income taxpayers have become more critical for the State's income tax revenues. Figure K on the next page displays selected data from each of the four detailed figures. This figure shows how total tax collections (charged tax) have shifted away from lower income taxpayers to upper income taxpayers. In 1988, taxpayers with income below $50,000 paid 33.7 percent of charged tax, while taxpayers with income over $500,000 paid 15.0 percent of charged tax. By 1997, these percentages were nearly reversed. The lower income group paid 12.2 percent of charged tax, while the higher income group paid 28.0 percent of charged tax. A similar but less pronounced shift has occurred between the two middle income brackets.

Part of this shift is a result of changing marginal tax rates and part is a result of economic change and income growth. The marginal tax rate for the highest income levels was increased from 3.5 percent in 1988, to 7.0 percent in 1990, and was reduced to 6.37 percent in 1997 (see Figures A and B for detail). Those taxpayers are paying more tax in large part because of higher tax rates. The lower (and middle) income groups have seen a reduction in marginal tax rates of 30 percent since the early 1990's, reducing their share of the total tax liability.

The shift of taxpayers can also be explained by the movement of taxpayers out of or into different tax brackets. The minimum filing threshold was increased in 1994, removing several hundred thousand taxpayers from the tax rolls and reducing the number of filers at the lower income levels.[6] In 1988 the lower income group consisted of 2,886,971 tax filers accounting for 80.9 percent of all tax returns, but in 1997 they consisted of 2,307,759 tax filers accounting for only 67.5 percent of tax returns. In addition, as income rises, taxpayers move into higher tax brackets. When incomes rise because of inflation, this phenomenon is referred to as "bracket creep." Incomes also rise as people move into higher paid jobs. As can be seen in Figures G through J, the number of taxpayers in the *$500,000 and Over* bracket has grown from 11,205 in 1988 to 19,820 in 1997, a 77 percent increase.

[6] The minimum filing threshold will be increased further over a three year period between tax year 1999 and tax year 2001, pursuant to P.L.1999, c. 260.

Figure K



Like New Jersey, many other states have found increasing concentrations of income in higher-income ranges. For example, California has had a similar experience according to a recent study by staff of the California Legislative Analysts Office:

> Over the long term, the share of total AGI (adjusted gross income) attributable to the top 20 percent of taxpayers has consistently increased, going from 41.7 percent of the total in 1975 to 53 percent of the total by 1995. During this same period, the share of income at the very top end of the distribution -- that for taxpayers with incomes exceeding 99 percent of the population -- doubled from 7 to 15 percent.[7]

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[7] Williams, Brad, Robert Ingenito, and Jon David Vashe, *Forecasting Revenue Receipts in the States: Current Challenges in California*, National Tax Journal, Vol. LII, No. 3, p. 366.

THE IMPACT OF THE STOCK MARKET AND CAPITAL GAINS

The concentration of income in California accelerated between 1995 and 1997, with the share of income attributable to the top 20 percent of taxpayers growing from 53 percent to 56 percent. The California study identifies the growth of capital gains income as a key element in explaining the rapidly changing distribution of income. Between 1995 and 1997 capital gains realizations nearly doubled.[8] This growth in capital gains is directly related to the growth in stock market equity values and increased stock market transactions. Indeed, the stock market is not only driving capital gains income, but also wage income. According to the California study, "a significant portion of employee compensation in recent years has been in the form of stock options."[9] Unfortunately, tax collection data in most states, including California and New Jersey, do not distinguish between regular wage income and wage income from stock options, so the relative share is unknown.

In New Jersey the composition of income may also be changing. As in California, New Jersey capital gains income has grown significantly in recent years, from $2.8 billion in 1991 to $10.5 billion in 1997. For the *$500,000 and Over* bracket capital gains are up from $1.0 billion to $5.5 billion during that period. Capital gains for the highest income bracket have grown to 20 percent of gross income in 1997 compared with 12 percent in 1991 (similar figures were not collected in 1988).

A study of New Jersey income tax data by analysts in the Department of Treasury found a consistent pattern of strong growth among higher-income taxpayers:

> Three things ... stand out. First, all the income growth since 1994 has occurred in the 10.5 percent of returns reporting more than $100,000 in NJGI (New Jersey gross income). The amount of income below $100,000 is virtually unchanged since 1991. There are a number of obvious explanations (bracket creep, more two career households, and a higher filing threshold), but the concentration above $100,000 is remarkable. Second, growth is positively correlated with income level, with the strongest growth concentrated in the highest income classes. Third, the growth pattern in 1997 does not look substantially different than that in 1996.[10]

That pattern of consistent growth among higher-income taxpayers extended to the strong growth in capital gains income. Total capital gains realizations increased by 33 percent in 1995, 42 percent in 1996, and 38 percent in 1997. The New Jersey study notes, "the relative importance of capital gains as a share of total income has also increased but less as a dramatic surge in 1997 than as a continuing trend."[11] The authors suggest that 1998 and 1999 will see a continuation of the trend of strong growth in income over $100,000.

In addition, the authors caution that given the growing importance of capital gains income, the income tax revenue forecast "is increasingly sensitive to which financial market outlook is adopted."[12] As GIT revenues are more dependent on higher income taxpayers, and as those taxpayers are increasingly dependent on income from the financial markets, policy makers and future State budgets may be more dependent on the financial markets as well. During recent

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8 ibid, p. 368.

9 ibid, p. 369.

10 Kaluzny, Richard L., and Thomas M. Beam, *Forecasting Personal Income Tax Revenue: Recent New Jersey Experience*, National Tax Journal, Vol. LII, No. 3, p. 350.

11 Ibid, p. 353.

12 Ibid, p. 360.

strong economic growth this dependence has filled State tax revenue coffers rapidly. That revenue growth may stop suddenly during a weakening economy.

CONCLUSION

The New Jersey gross income tax system changed significantly between 1988 and 1997. The State now has a highly graduated rate structure with more than twice as many brackets. The highest marginal rate is nearly double the highest rate of a decade ago. New Jersey income has increased rapidly during this period of time, particularly as the economic recovery that began in the middle of the 1990's continued to strengthen. Moreover, driving this strong income growth was a marked jump in higher income taxpayers and in income derived from higher income brackets. Reflecting the change in the tax rates and the shift in income to higher brackets, nearly 70 percent of the State's income tax revenue in 1997 was paid by the 11 percent of taxpayers earning over $100,000. These shifts also coincided with the 1990's stock market boom, and the increasing importance of capital gains income and wage income from stock options. Recently, capital gains income has been increasing by over 30 percent per year. The highest income taxpayers are nearly twice as dependent on capital gains income in 1997 as in 1991. These structural and economic shifts may affect New Jersey budget policy decisions well into the next decade.

Fiscally Significant Changes to the Three Major Taxes Since 1969

Sales and Use Tax

1969	3% tax rate (tax effective beginning in 1966).
1970	Rate increase to 5%.
1983	Rate increase to 6%.
1990	Rate Increase to 7%; base expanded to include telecommunications services, cigarettes, alcoholic beverages, etc.
1992	Rate reduction to 6%.

Gross Income Tax

1969	No tax in effect.
1976	Tax enacted. Rates of 2% below $20,000 and 2.5% above $20,000.
1982	New bracket at a 3.5% rate for income over $50,000.
1985	Property tax on homesteads made deductible.
1991	Additional tax brackets and rate increases for single filers with income over $35,000 and joint filers with income over $70,000. Top rate increased to 7%. Property tax deduction eliminated.
1994 to 1996	Three year phased-in reduction of tax rates. A 30% reduction for single filers below $40,000 and joint filers below $80,000. A 15% and 9% reduction for higher income brackets. New rates range from 1.4% to 6.37%.
1996	Property tax on homesteads made deductible up to $10,000.

Corporation Business Tax

1969	4.25% tax rate applied to net income.*
1972	Rate increase to 5.25%.
1975	Rate increase to 7.25%.
1980	Rate increase to 9%.

Fiscally Significant Changes to Other Taxes Since 1969, Discussed in the "Tax Revenue Trends" Section

Motor Fuels Taxes

1969	7 cents per gallon.**
1972	Rate increase to 8 cents per gallon.
1988	Rate increase to 10.5 cents per gallon on gasoline and 13.5 cents per gallon on diesel.
1991	Additional tax on petroleum products at a rate of 4 cents per gallon.

Cigarette Tax

1969	14 cents per pack tax rate.***
1972	Rate increase to 19 cents per pack.
1982	Rate increase to 24 cents per pack.
1984	Rate increase to 25 cents per pack.
1988	Rate increase to 27 cents per pack.
1990	Rate increase to 40 cents per pack.
1998	Rate increase to 80 cents per pack. $155 million off-budget dedication for health care.

* The corporation business tax began in 1884 as a franchise tax on capital stock. In 1946 it was changed to a tax on net worth. In 1959 a tax on net income was added to the net worth tax. The net worth tax portion was phased out between 1982 and 1986.

** The motor fuels tax began in 1927 at a rate of 2 cents per gallon.

*** The cigarette tax began in 1948 at a rate of 3 cents per pack.

New Jersey Review and Economic Outlook 2000-2001

State of New Jersey
Council of Economic Advisors
January 2000

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 2000-2001 Revenue Analysis.

NEW JERSEY REVIEW & ECONOMIC OUTLOOK FOR 2000-2001

Forecast Summary: ***"These are very, very good economic times, and more of the same lies ahead"***

Chairman, Council of Economic Advisors

The New Jersey Outlook

Participating fully in a strong national expansion, this review of the State's economy finds little room for improvement. The only low economic points for the past year were most welcomed - unemployment and inflation.

The 2000-2001 outlook anticipates a continuation of the longest economic expansion in history. However, the sources of the State's near-term growth will shift somewhat with future gains based on increased investment activity and an expanding New York City/Northern NJ regional economy.

Summary: New Jersey Forecast (% Chg)

	2000	2001
Gross State Product (Current $)	**5.4%**	**5.9%**
Personal Income (Current $)	**5.7%**	**4.8%**
Retail Sales (Current $)	**4.8%**	**5.0%**
Consumer Price Index (All Urban)	**2.4%**	**2.5%**
Total Non-Ag Employment	**1.4%**	**1.3%**

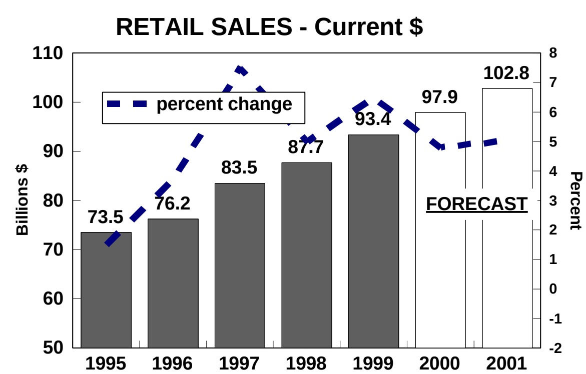
The U.S. Outlook

The U.S. economy has shaken off the effects of a world financial crisis, a doubling of world energy prices within the past year, labor shortages, and catastrophic weather to record over 106 consecutive months of economic expansion. Favorable data revisions recently indicated higher U.S. growth & productivity, less inflation and more investment than earlier measured.

For the near term the national economy may experience an investment induced moderation in growth early in the New Year. But high consumer confidence, solid fundamentals, an improving international economy and low inflation contribute to another two years of real GDP growth - though about one percentage point slower than the previous two years. In the absence of the usual imbalances that presage a recession (or soft landing) the leading threat to the outlook is interest rate increases by an inflation wary Federal Reserve.

The Consumer

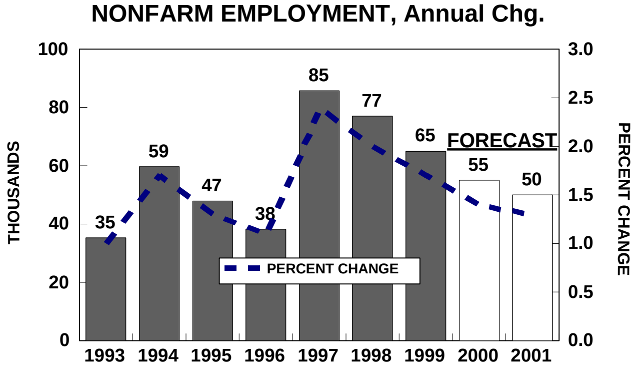
Consumer sentiment supported by new jobs, rising incomes and stable interest rates, led to another record setting year for retail sales. Sales will exceed $90 billion, up almost 7% from the previous year. Sales received an additional boost from the highest level of home building in a decade and another strong year for travel & tourism. Strong sales also led to the creation of 16 thousand jobs in retailing, the sector with the second largest number of new jobs for 1999. New vehicle registrations rose 5.1% to 577 thousand, the highest volume since 1988.

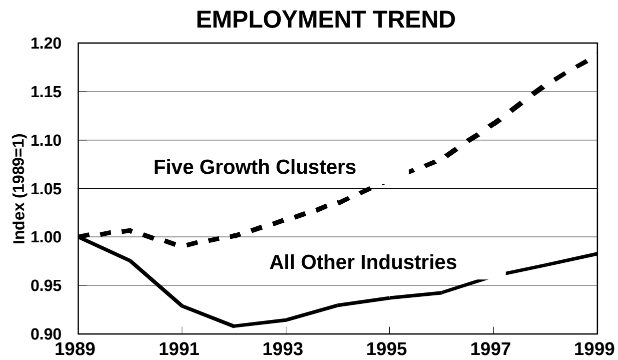


The outlook for retailing remains robust, rising by 4.8% in 2000 and 5.0% in 2001, as the expansion continues and price increases remain subdued. However, sales will be tempered by slower job and income growth, rising levels of consumer debt, and higher interest rates.

Employment

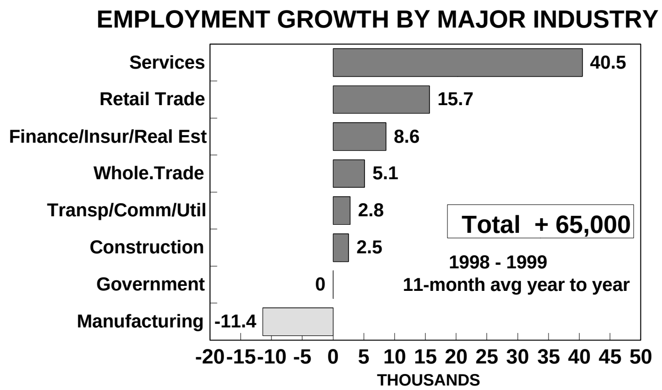
About 65,000 jobs were added in 1999, an increase of 1.7% over the year. The forecast calls for continued, but slower job growth of 1.4% in 2000, as a slowing national economy and tightening labor markets, especially for skilled specialties, constrain job growth.





Continuing a long-term trend, the majority of the added jobs were in the services sub-sector. Business services industries accounted for 20,000 of the 40,500 additional services jobs in 1999. Computer software services and personnel supply companies added 15,000 jobs, or 75% of the growth in business services.

In **entertainment**, two to three new casinos will follow the completion of the Brigantine Tunnel project. The Republican National Convention in Philadelphia will provide an additional boost in 2000, especially in southern counties. Escalating rents in Manhattan, and the availability of a significant amount of new office space on the Hudson Waterfront will continue to attract NY **financial** firms to New Jersey.



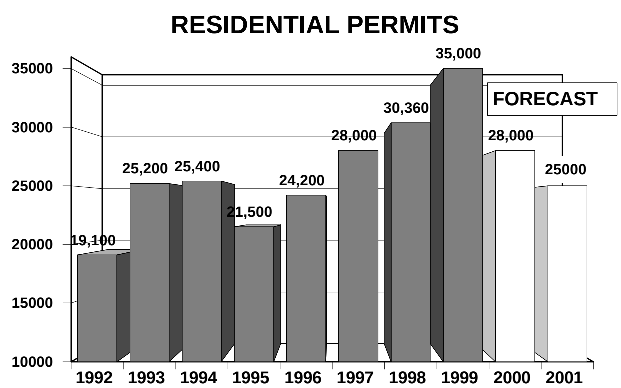
Investing in New Jersey

Strong growth in the number of planned projects during 1999 should boost both residential and nonresidential construction and related investment activity in 2000 and beyond.

The decade of the 90's began with very sluggish **housing** construction, with permits averaging about 20,000 per year. The resultant small supply increases coupled with strong job growth, rising disposable incomes, stable interest rates and modest home price increases, led to a rebound in building activity. Housing permits for 1999 will near 35,000 units, the highest level since 1988. This assures continued healthy spending for construction and household furnishings in 2000.

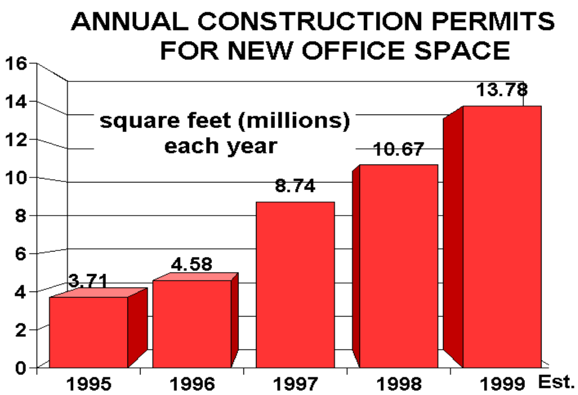
New Jersey's industry "growth clusters", a sub-grouping of industries identified as having location advantages in the State, collectively grew by 2.6% in 1999, over twice the rate of 1.2% for all other N.J. industries. The ten year (1989-1999) performance of the five clusters, (Health, High Tech., Logistics, Financial, and Entertainment) has been equally impressive.

The five clusters will continue to be a driving force in the economy of 2000 and beyond: **high technology** industries are expanding to meet rapid advances in information processing and communications technology. The **logistics** cluster industries will take advantage of significant investments in Newark Airport and the Port of NY-NJ infrastructure. New technologies, and increased demand for health services by an aging population will spur exceptional growth in the **health** cluster industries.



Nonresidential building activity, including office, commercial, industrial and others, is the best proxy for fixed investment at the State level. Permits for all buildings were up by 19% in 1999, for an estimated $5.4 billion in future construction spending.

Strong demand for office space continues to drive up building activity. With office vacancy rates in the 12% range in northern & central N.J. and even falling below 1% in the Hudson Waterfront submarket by mid-1999, permits authorized in 1999 will deliver over 13 million square feet to the office market. Since much of this new office space is already fully leased, there is little evidence of overbuilding. Vacancy rates should remain steady for at least two years.



A significant amount of office space was absorbed in 1999 by internet firms, such as DLJ Direct, Barnes & Noble.com, Datek, and National Discount Brokers. New Jersey is poised to benefit from the rapidly expanding internet industry because of the State's location and the availability of "smart" office space equipped with state of the art fiber optic networks, large floor areas, and high capacity electrical systems – all critical to online operations.

Global Trade

Exports from New Jersey, clearly reflecting the general weakness in World demand were flat for 1999 at about $22 billion, up from $21.8 billion in 1998. Shipments to developed countries have been relatively stable, with the newly developing countries accounting for most of the trade increases.

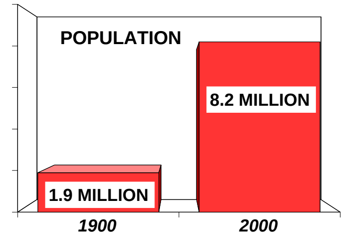
The leading destination in export growth was the PacRim, led by exports to S. Korea and Japan. New

New Jersey: Then & Now
1900 to 2000

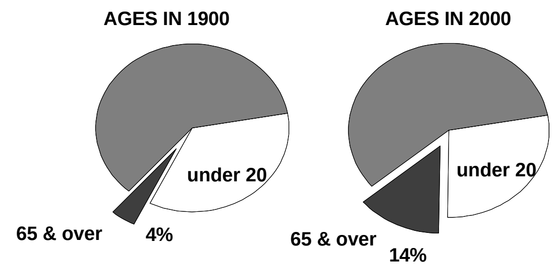
DEMOGRAPHICS

In 1900 NJ's population ranked 16th with 1.9 m residents - by 2000 there were 8.2 m and a no. 9 rank.

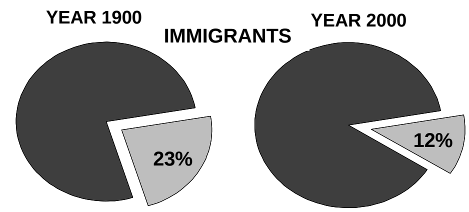
In 1900 NJ ranked 3rd in population density - by 2000 NJ was no.1.



NJ is aging - In 1900 only 4% of the population was aged 65 or older - by 2000 about 14% of State residents are aged 65 or older.



In 1900 immigrants accounted for **23%** of the population - by 2000 12% of the population claimed overseas origins.

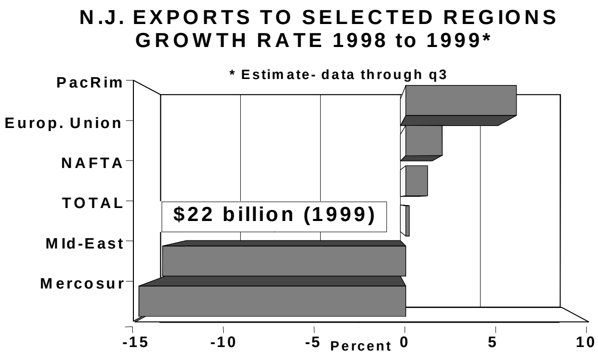


INDUSTRY	**1900**	**2000**
Manufacturing Employment	326,000	457,000
Manufacturing % of Labor Force	35%	10%
Annual Wage per Worker	$ 336	$ 47,000
Output per/worker	$ 1,304	$ 93,000
NJ Mfg Output as % of US	5.5%	2.6%
NJ's Largest Industry	Manufacturing	Services
Employment (000's)	326.0	1,200.0

TOP 10 MANUFACTURERS (Ranked by Shipments)

	1900		**2000**
1	Copper Smelting & Refining	1	Chemicals
2	Silk & silk goods	2	Food
3	Foundry & Machine shop products	3	Petroleum/coal
4	Slaughtering & meat packaging	4	Printing & publish
5	Woolen, worsted & felt goods	5	Industrial Mach.
6	Wire	6	Electronic Eqpt.
7	Leather	7	Instruments
8	Tobacco manufacture	8	Transportation Eq.
9	Electrical machinery	9	Fabricated metals
10	Chemicals	10	Paper

Jersey's largest export markets, the European Union (+2.0%) and NAFTA (+1.2%), recorded modest gains. Export activity with Israel dropped off sharply, which lowered overall exports to the mid-East. With Brazil and Argentina still reeling from the effects of currency devaluation, N.J. exports to the Mercosur common market posted double-digit declines for the year.

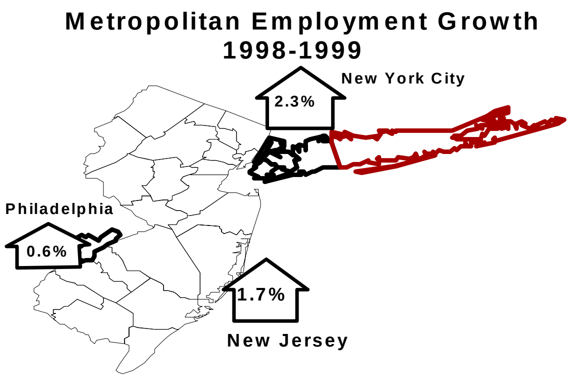


For 2000, expect modest improvements in State international trade with exports rising by approximately 5% led by the sale of technology goods and healthcare products.

The Region

In the Mid-Atlantic states, strong employment growth in New York City (2.3%), in 1999, offset much slower growth upstate to push the statewide growth to 1.8%, marginally ahead of N.J.'s 1.7%. While the financial sector remains a critical component in the NYC economy, recent expansion is broad-based including business services, tourism, and rapid growth in the film industry. The economy of the northern N.J. counties will continue to benefit from this regional growth engine.

In Pennsylvania, Philadelphia jobs grew by only 0.6% in 1999, while the statewide increase was 0.9%.



Critical Issues & Public Policy

Economic policy from Washington D.C. is not expected to have significant impacts on the near term New Jersey outlook. Last year a strong economy and a booming stock market led to solid tax revenue gains. However, the mounting budget surplus, exceeding $120 billion, triggered tax cut proposals that failed to secure a presidential signature. Despite the continuing fiscal temptations of budget surpluses, a slower growing economy and an election year political stalemate makes it increasingly unlikely to expect any changes in fiscal policy that will impact the State's economy significantly during the next two years.

However, two other policy changes, one national in scope, the other initiated by the State, are likely to influence economic activity during the forecast period.

Energy price deregulation and open markets have already begun the competitive allocation of electric energy across the State. Scheduled rate reductions and energy excise tax cuts will boost consumer and business bottom lines by more than $1 billion for 2000-2001. These cost savings are large enough to advance personal income by +.2% in each of the next two years. The energy deregulation program will have two distinct impacts on the State's economy: 1) it will lower costs to existing residents and businesses directly through lower costs (analogous to a permanent tax cut), and 2) will improve the State's business climate by reducing interstate differences in energy costs thereby influencing the future location decisions of businesses to New Jersey.

Repeal of the Glass-Steagall Act separating banking, insurance, investments and other financial activities is likely to trigger further acquisitions, mergers and restructuring within the entire FIRE sector (Finance, Insurance, Real Estate). This sector has been identified and included as one of five leading future growth 'clusters' for the State. The Finance sector has been a major contributor to both jobs and high incomes throughout this recovery and in light of this deregulated environment it may be advisable to review economic development policy towards the attraction and retention of financial businesses.

Council of Economic Advisors

(Current $ or Nos.)	1995	1996	1997	1998	1999	**Forecast** **2000**	**2001**
Gross State Product (bill)	$266.70	$279.20	$294.10	$309.10	$ 327.3	**$ 345.1**	**$ 365.4**
Personal Income (bill)	$235.40	$247.40	$260.70	$275.50	$ 291.5	**$ 308.0**	**$ 322.9**
Retail Sales (bill)	$73.50	$76.20	$83.50	$87.70	$ 93.4	**$ 97.9**	**$ 102.8**
New Vehicle Registrations (000's)	508.9	533.1	537.6	549.6	577.6	**548.7**	**548.7**
Non-Resident.Contracts (mill)	$2,769.6	$2,961.6	$3,618.0	$3,878	$3,828	**$ 4,211**	**$ 4,421**
Residential Building Permits (No.)	21,500	24,200	28,000	30,360	34,726	**28,000**	**25,000**
Consumer Price Index (All Urban)	108.1	111.3	113.9	115.7	117.9	**120.7**	**123.7**
(Real 1992$)							
Gross State Product (bill)	$ 246.7	$ 250.9	$ 258.2	$ 267.2	$ 277.6	**$ 285.9**	**$ 295.2**
Personal Income (bill)	$ 217.8	$ 222.3	$ 228.9	$ 238.1	$ 247.2	**$ 255.1**	**$ 260.9**
Retail Sales (bill)	$ 68.0	$ 68.5	$ 73.3	$ 75.8	$ 79.2	**$ 81.1**	**$ 83.1**
Non-Resident.Contracts (mill)	$ 2,562.1	$ 2,660.9	$ 3,176.5	$ 3,352.1	$ 3,246.8	**$ 3,487.8**	**$ 3,572.9**
Employment:							
Total Non-Farm (000)	3600.7	3,638.90	3,724.60	3,800.80	3,865.4	**3,920.0**	**3,970.0**
Manufacturing (000)	499.2	483.5	481.9	478	466.5	**457.1**	**450.2**
Service Producing Industries (000)	2403.2	2,458.80	2,539.8	2,615.5	2,688.7	**2,743.7**	**2,793.7**
Unemployment Rate (%)	6.4	6.2	5.1	4.6	4.5	**4.4**	**4.6**

Percent Change from previous year:	1995	1996	1997	1998	1999	**Forecast** **2000**	**2001**
Gross State Product (Current $, bill)	4.0%	3.9%	5.4%	5.1%	5.9%	**5.4%**	**5.9%**
Personal Income (Current $, bill)	5.7%	4.9%	5.3%	5.7%	5.8%	**5.7%**	**4.8%**
Retail Sales (Current $, bill)	1.5%	3.7%	7.5%	5.0%	6.5%	**4.8%**	**5.0%**
New Vehicle Registrations		4.8%	0.8%	2.2%	5.1%	**-5.0%**	**0.0%**
Non-Resident.Contracts (Current $, mill)	3.2%	6.9%	21.4%	7.2%	-1.3%	**10.0%**	**5.0%**
Residential Building Permits (No.)	-15.4%	12.6%	15.7%	8.4%	14.4%	**-19.4%**	**-10.7%**
Consumer Price Index (All Urban)	2.5%	2.9%	2.4%	1.6%	1.9%	**2.4%**	**2.5%**
Gross State Product (92$, bill)	1.5%	1.9%	3.2%	3.5%	3.9%	**3.0%**	**3.3%**
Personal Income (92$, bill)	3.3%	1.8%	3.4%	4.0%	3.8%	**3.2%**	**2.3%**
Retail Sales (92$, bill)	-1.0%	0.8%	5.1%	3.4%	4.5%	**2.3%**	**2.4%**
Non-Resident.Contracts (92$, mill)	0.7%	3.9%	18.6%	5.5%	-3.1%	**7.4%**	**2.4%**
Employment:							
Total Non-Farm (000)	1.3%	1.1%	2.4%	2.0%	1.7%	**1.4%**	**1.3%**
Manufacturing (000)	-2.0%	-2.8%	-0.7%	-0.8%	-2.4%	**-2.0%**	**-1.5%**
Service Producing Industries (000)	2.4%	2.1%	3.3%	3.0%	2.8%	**2.0%**	**1.8%**

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Dr. Joseph J. Seneca, *Chairman*

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George R. Nagle, *Executive Director*

with Thomas J. Brown and Cardella Ansley

50 Barrack St.

Trenton, New Jersey 08625

Phone: 609-292-2423 E-mail: cernagl@commerce.state.nj.us

OFFICE OF LEGISLATIVE SERVICES

The Office of Legislative Services provides nonpartisan assistance to the State Legislature in the areas of legal, fiscal, research, bill drafting, committee staffing and administrative services. It operates under the jurisdiction of the Legislative Services Commission, a bipartisan body consisting of eight members of each House. The Executive Director supervises and directs the Office of Legislative Services.

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.

The Office of Legislative Services Central Staff provides a variety of legal, fiscal, research and administrative services to individual legislators, legislative officers, legislative committees and commissions, and partisan staff. The central staff is organized under the Central Staff Management Unit into ten subject area sections. Each section, under a section chief, includes legal, fiscal, and research staff for the standing reference committees of the Legislature and, upon request, to special commissions created by the Legislature. The central staff assists the Legislative Budget and Finance Officer in providing services to the Appropriations Committees during the budget review process.

Individuals wishing information and committee schedules on the FY 2001 budget are encouraged to contact:

Legislative Budget and Finance Office
State House Annex
Room 140 PO Box 068
Trenton, NJ 08625

(609) 292-8030 Fax (609) 777-2442