

ANALYSIS OF THE NEW JERSEY BUDGET

**TAX AND
REVENUE OUTLOOK**

FISCAL YEAR

2006 - 2007

NEW JERSEY STATE LEGISLATURE

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THE FY 2006 AND FY 2007 TAX AND REVENUE OUTLOOK

Introduction

The Office of Legislative Services (OLS) has prepared this report to assist the Senate Budget and Appropriations Committee and the Assembly Budget Committee as they develop the FY 2007 appropriations bill. The OLS revenue estimates reflect a careful review of current State revenue collections, revisions to statutory law, historic revenue collection patterns, and a variety of economic data and forecasts.

The OLS projects that FY 2006 and FY 2007 revenues will be \$186 million less than the estimates in the FY 2007 Governor's Budget Recommendation. Specifically:

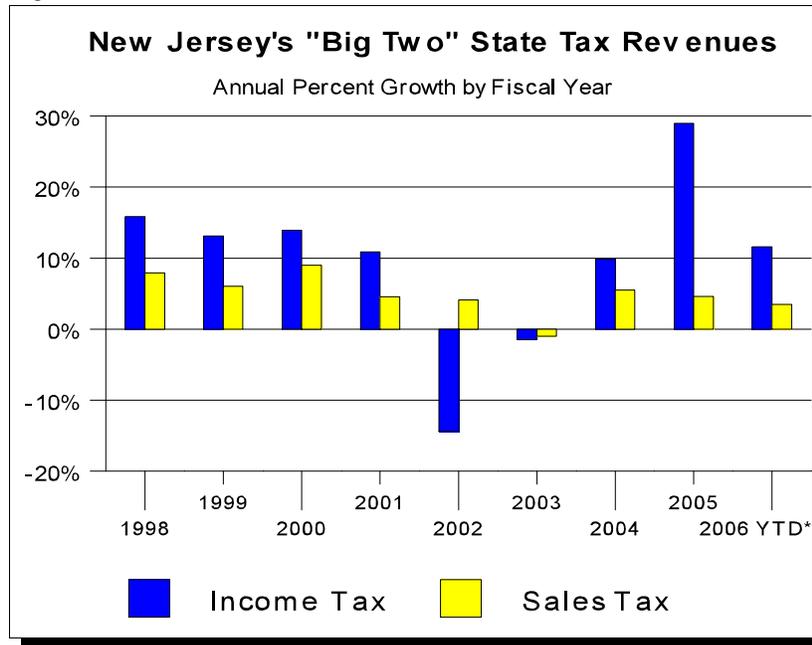
- For FY 2006, the OLS revenue estimates are \$27 million below the Executive budget estimates (page 4).
- For FY 2007, the OLS revenue estimates are \$159 million below the Executive budget estimates (page 5).

The FY 2007 Budget Recommendation assumes \$1.7 billion from Executive revenue proposals (pages 12 and 13). For the purposes of this analysis, the OLS assumes these new revenues will be implemented and, in all but one instance, will produce the revenues estimated by the Executive.

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Recap: FY 2006 Collections to Date

Figure 1



State tax revenue collections depend heavily on the gross income tax and the sales tax. These two revenues typically account for about 60% of budgeted revenues each year. After an extraordinarily difficult two-year period in FY 2002 and FY 2003, these "Big Two" revenues have rebounded. The recent growth patterns are shown in Figure 1:

- Income tax collections plummeted by an unprecedented 14.4% in FY 2002 and fell another 1.5% in FY 2003. But FY 2004 revenues grew by 10%, FY 2005 revenues grew by 29%, in part due to a tax rate increase on high-income taxpayers, and through the end of February, FY 2006 collections are up 11.6% year-to-date*.
- After declining in FY 2003, sales tax collections grew by 5.5% in FY 2004 and by 4.6% in FY 2005, close to the long run historical average of just over 5%. Through the end of February, FY 2006 collections are up by 3.5% year-to-date*.

Figure 2 contains a more detailed display of FY 2006 revenue collections through the end of February. Beyond the "Big Two" taxes, other key points include:

- Corporation business tax (CBT) proceeds have been running well above prior year levels. Current year-to-date collections are 33.7% above last year. CBT banks and financial institutions revenues are up 147.9%.
- FY 2006 is the third year of strong growth for realty transfer fee revenues, which are up 33.4% so far this fiscal year. Some slowing has appeared in recent months, as the housing market appears to be cooling.

* Year-to-Date (YTD) means July 1, 2005 to February 28, 2006. March collections data were not available at publication time.

Recap: FY 2006 Collections to Date

| Figure 2 FY 2006 Year-To-Date Selected Revenue Comparison Through the End of February 2006 vs. February 2005 (\$ millions) | | | | |
|--|-----------------------------------|-----------------------------------|---|--|
| Revenue Source | FY 2005 Actual Through Feb. | FY 2006 Actual Through Feb. | FY 2006 Actual Through Feb. % Change | FY 2006 Year-End Executive % Change Target |
| Gross Income Tax | \$5,071.2 | \$5,660.4 | 11.6% | 11.0% |
| Sales Tax * | 3,789.2 | 3,920.4 | 3.5% | 2.5% |
| Corporation Business Tax | 999.9 | 1,336.7 | 33.7% | 18.4% |
| Lottery | 514.0 | 553.1 | 7.6% | 2.5% |
| Motor Fuels * | 312.5 | 322.9 | 3.3% | (0.8)% |
| Motor Veh. Fees (Budgeted) | 104.1 | 124.3 | 19.3% | 0.5% |
| <i>MV Fees (Total) **</i> | 300.5 | 322.0 | 7.1% | 0.6% |
| Casino | 300.4 | 318.0 | 5.9% | 5.0% |
| Inheritance Taxes | 336.8 | 403.6 | 19.8% | 11.4% |
| Insurance Premiums | 129.5 | 116.2 | (10.2)% | 3.1% |
| Cigarette (Budgeted) | 374.7 | 376.4 | 0.5% | 1.0% |
| <i>Cigarette (Total)***</i> | 529.7 | 531.4 | 0.3% | 0.8% |
| Petroleum Products * | 154.3 | 135.5 | (12.2)% | (0.6)% |
| Alcohol Excise * | 47.1 | 48.2 | 2.5% | 3.0% |
| CBT -- Banks & Financials | 24.2 | 60.1 | 147.9% | 23.4% |
| Realty Transfer Fee * | 215.1 | 287.0 | 33.4% | 18.2% |

Sources: Year-To-Date revenues are from Treasury's monthly cash reports. The year-end Executive percentage change target is based on the February revised revenue estimates for FY 2006 contained in the proposed FY 2007 budget.

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

** Motor Vehicle Fees (Total) includes the off-budget dedication of \$196.0 million in FY 2005 and \$194.8 million in FY 2006 for the NJ Motor Vehicle Commission (P.L.2003, c.13).

*** Cigarette (Total) includes \$155 million deposited directly into the off-budget Health Care Subsidy Fund in both FY 2005 and FY 2006.

Fiscal Year 2006 Revenue Estimates

| Figure 3 Fiscal Year 2006 Revenue Estimates (\$ millions) | | | | | |
|---|------------------------------|-------------------|-----------------------------|-------------------|------------------|
| | Approp. Act * (7/1/05) | Executive Revised | | OLS | |
| | | Amount (March) | \$ Change From 7/1/05 | Amount (April) | OLS vs. Exec. |
| Gross Income Tax | \$10,335 | \$10,585 | \$250 | \$10,475 | (\$110) |
| Sales Tax | 6,890 | 6,733 | (157) | 6,757 | 24 |
| Corporation Business Tax | 2,455 | 2,902 | 447 | 2,902 | 0 |
| Other Major Taxes | 3,365 | 3,419 | 54 | 3,474 | 56 |
| Bond Refi. & Asset Sales | 350 | 0 | (350) | 0 | 0 |
| Other Revenues | 4,481 | 4,558 | 78 | 4,562 | 4 |
| Grand Total, All Funds | \$27,876 | \$28,197 | \$321 | \$28,170 | (\$27) |

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

* The Executive has "restated" certain miscellaneous revenue amounts by reallocating them to the income tax, corporation business tax, and sales tax. This has no effect on total Certified revenues.

Figure 3 presents the FY 2006 revenue certification from the Appropriations Act (July 2005), the Executive's March revisions as presented in the Governor's Budget Recommendation, and the OLS's forecast. Highlights of the revenue estimates include:

FY 2006 Executive:

- The Executive revised estimates for all revenues upward by a net \$321 million from the level certified in the FY 2006 Appropriations Act.
- The Executive estimate for the income tax is up \$250 million.
- The Executive estimate for the sales tax is down \$157 million.
- The Executive estimate for the corporation business tax is up \$447 million.
- The Executive estimates for other major taxes are up by a combined \$54 million.

FY 2006 Office of Legislative Services:

- The OLS total revenue estimate for FY 2006 is **\$27 million below** the Executive's revised projection.
- The OLS estimate for the income tax is \$110 million below the Executive's.
- The OLS estimate for the sales tax is \$24 million above the Executive's.
- The OLS estimate for the corporation business tax is the same as the Executive's.
- The OLS estimates for other major taxes are \$56 million above the Executive's.

Fiscal Year 2007 Revenue Estimates

| Figure 4 Fiscal Year 2007 Revenue Estimates (\$ millions) | | | | | |
|---|-----------------|------------------|-----------------|------------------|--------------------------------|
| | Executive | | OLS | | Difference OLS vs. Exec. |
| | Amount | Annual Growth | Amount | Annual Growth | |
| Gross Income Tax* | \$11,615 | 9.7% | \$11,370 | 8.5% | (\$245) |
| Sales Tax* | 8,410 | 24.9% | 8,436 | 24.8% | 26 |
| Corporation Business Tax* | 2,585 | (10.9)% | 2,585 | (10.9)% | 0 |
| Other Major Taxes* | 3,304 | (3.4)% | 3,356 | (3.4)% | 52 |
| Other Revenues | 4,738 | 3.9% | 4,746 | 4.0% | 8 |
| Grand Total, All Funds | \$30,652 | 8.7% | \$30,493 | 8.2% | (\$159) |

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

* For this table, the Executive's proposed tax policy changes are included in the totals. For a full list of the proposed changes, see Figure 10.

Figure 4 presents the Executive's FY 2007 revenue estimates as presented in the Governor's Budget Recommendation and the OLS's forecast. Highlights of the revenue estimates include:

FY 2007 Executive:

- The Executive expects total revenues to grow by \$2.4 billion, or 8.7% over FY 2006, including the impact of a number of tax policy changes.
- The Executive estimate for the income tax is up \$1.03 billion, or 9.7%, over FY 2006.
- The Executive estimate for the sales tax is up \$1.68 billion, or 24.9% over FY 2006, including significant tax policy changes.
- The Executive estimate for the corporation business tax is down \$317 million, or 10.9%, from FY 2006.
- The Executive estimates for other major taxes are down a combined 3.4% from FY 2006.
- The Executive revenues include a net \$1.7 billion in proposed revenue initiatives.

FY 2007 Office of Legislative Services:

- The OLS total revenue estimates for FY 2007 are **\$159 million below** the Executive's projection.
- The OLS estimate for the income tax is \$245 million below the Executive's.
- The OLS estimate for the sales tax is \$26 million above the Executive's.
- The OLS estimate for the corporation business tax is the same as the Executive's.
- The OLS estimates for other major taxes are a combined \$52 million above the Executive's.
- The OLS assumes implementation of proposed new revenues for comparability purposes.

Budgetary Impact of the OLS Revenue Estimates

Combined over the two year period, the OLS revenue estimates are \$186 million less than the Executive's -- \$27 million less in FY 2006 and \$159 million less in FY 2007.

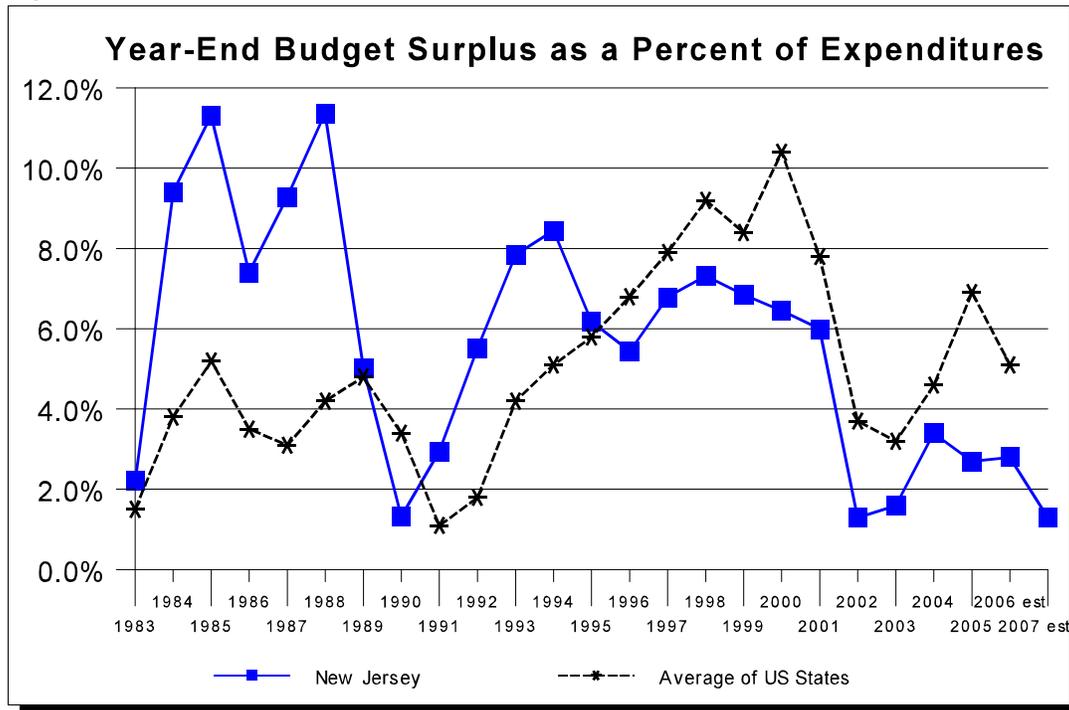
The Executive projects an FY 2007 year-end balance of \$601 million, or about 1.9% of budgeted expenditures. As part of its annual analysis, the OLS recalculates the State's year-end budgeted balance based solely on the revenue forecast differences between the Executive and the OLS. **All other things being equal, the lower OLS revenue estimates would produce a year-end balance of \$415 million.** Such a potential surplus would equal about 1.3% of expenditures.

Using either the OLS or the Executive projections, the surplus is low by historical standards for New Jersey. As is shown in Figure 5, over the last quarter century the State's

surplus has generally fallen to 2% or less during economic recessions (1983, 1990, and 2002). The State's recent structural budget problems have resulted in a series of low year-end surpluses. The 1.3% (or 1.9%) surplus is also lower than that of the national average of all states (5.1%), based on survey data compiled by the National Association of State Budget Officers.

This surplus calculation assumes that the spending plan and tax law changes in the FY 2007 Executive budget will be followed. The actual balance will be determined by numerous spending decisions as well as revenue collections. Decisions on these and other matters will be made by the Executive, both budget committees and the full Legislature during the next three months and throughout the fiscal year.

Figure 5



Discussion of Selected Revenues: Gross Income Tax

The gross income tax (GIT) remains the State's single largest revenue source, accounting for about 37% of budgeted revenues. After two years of declines in FY 2002 and FY 2003, following the precipitous drop in stock market values, growth has returned. Collections through the end of February this fiscal year are up 11.6% compared to the same time last year.

Both the Executive and the OLS expect growth to moderate somewhat for the remainder of FY 2006, as high-income taxpayers fully adjust their quarterly payments following last year's tax rate increase, and as certain one-time payments received last spring work their way out of the collections stream. The extent of this expected moderation in growth will be better understood by the middle of May, after April tax filings are recorded.

FY 2006: The Executive projects \$10.585 billion in FY 2006, or 11.0% growth over FY 2005. The OLS estimates somewhat lower revenues of \$10.475 billion, a 9.8% year-end growth rate. This estimate is \$110 million below the Executive's estimate, a 1.0% difference overall. The OLS estimate is based primarily on current trends for the major components of the GIT, plus the assumption that April and May final payments will be flat this year due to the non-recurrence of certain one-time payments that came in last April and May (see additional discussion on the next page).

Figure 6

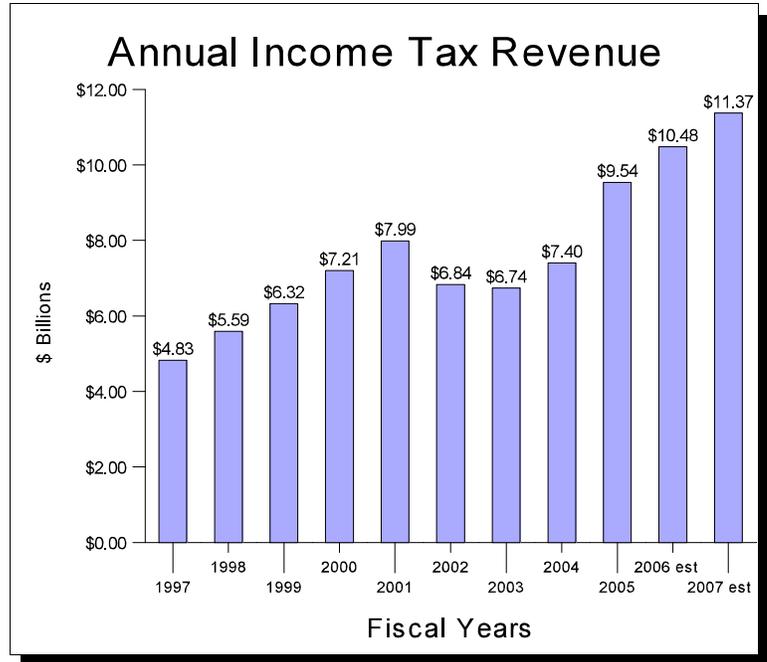
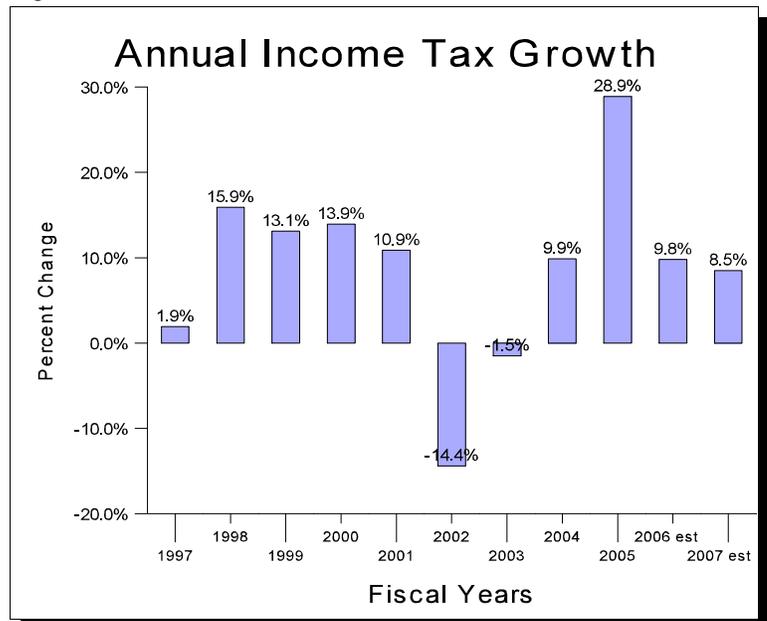


Figure 7



Gross Income Tax (Continued)

FY 2007: The Executive is estimating \$11.615 billion in GIT revenue for FY 2007, an increase of 9.7% over FY 2006. **The OLS is estimating \$11.370 billion, or 8.5% growth over a lower base.** The OLS total is \$245 million less than the Executive's total. About half of this difference is due to the OLS's lower FY 2006 base estimate and the other half is due to slightly lower growth assumptions for FY 2007. OLS's specific estimates for the GIT components are discussed below.

Both FY 2007 estimates include a reduction of \$105 million for the impact of the Executive's proposed refundable tax credit for certain low-income filers. The Executive estimates that just over 600,000 taxpayers will receive these credits. At this time, the OLS accepts the Executive's estimate for the value of this proposal.

Effect of New Top Bracket Rate Increase

Revenue from the new rate of 8.97% on income over \$500,000 (enacted in June, 2004 and first applied to Tax Year 2004) is estimated to be \$1.1 billion in FY 2005, \$900 million in FY 2006, and \$1.1 billion in FY 2007.

The mid-year enactment of the rate change had the effect of inflating the revenues for FY 2005. The April 2005 collections contained substantial "catch-up" payments to cover earnings from the first half of Tax Year 2004, for which there was insufficient withholding or estimated payments. By Tax Year 2005 withholding and estimated payments adjusted to reflect the new liability and similar catch-up payments are not expected in April, 2006. Thus, while income subject to the new rate has grown annually, the revenue it produced declined between FY 2005 and FY 2006 and in FY 2007 is expected to only reach the FY 2005 level.

with significant non-wage income. Estimated tax payments are up by nearly 21% through the first two quarters of FY 2006. This strong growth may still be partially a function of the 8.97% marginal tax rate on incomes over \$500,000, as high income taxpayers adjust their payments upward from last year's initial levels. The OLS is estimating 10% growth for the rest of FY 2006, since most higher-income filers should have made their adjustments and the 21% growth is not likely to continue. The OLS estimates 12% growth in FY 2007.

Final Payments: The linchpin for any GIT estimate is the final tax payment that comes in during April and May. As with estimated payments, taxpayers who must make large final tax payments generally have significant sources of non-wage income. The OLS believes FY 2006 final payments will be essentially equal with last year due to the loss

GIT Components Underlying the Estimates:

Withholding Collections: Withholding is paid throughout the year by employees when their employers deduct a portion from each paycheck. This is the largest component of income tax collections. Withholding receipts are up 8.3% so far in FY 2006. The OLS believes solid growth of about 9% will continue in FY 2006 and FY 2007.

Estimated Payments: These payments generally are made in the months of April, June, September, and December/January by taxpayers

of certain one-time amounts paid last year as part of the "retroactive" nature of the new tax rate for high-income taxpayers. The OLS believes final payment growth will increase to 12% in FY 2007.

Refund Payments: Refund payments are issued by the State, largely in the spring and summer, to taxpayers whose tax returns show payments exceeding their tax liability. The OLS believes refund payments will grow by about 8% in FY 2006 and by 10% in FY 2007.

Sales Tax

The sales tax provides nearly one quarter of the State's budgeted revenues, second only to the gross income tax. The sales tax is a rather stable revenue source, with a long-term average growth rate, excluding changes in the tax rate or base, of about 5% per year. The most noteworthy aspects of the sales tax revenue estimates are the proposed rate increase and base expansion for FY 2007.

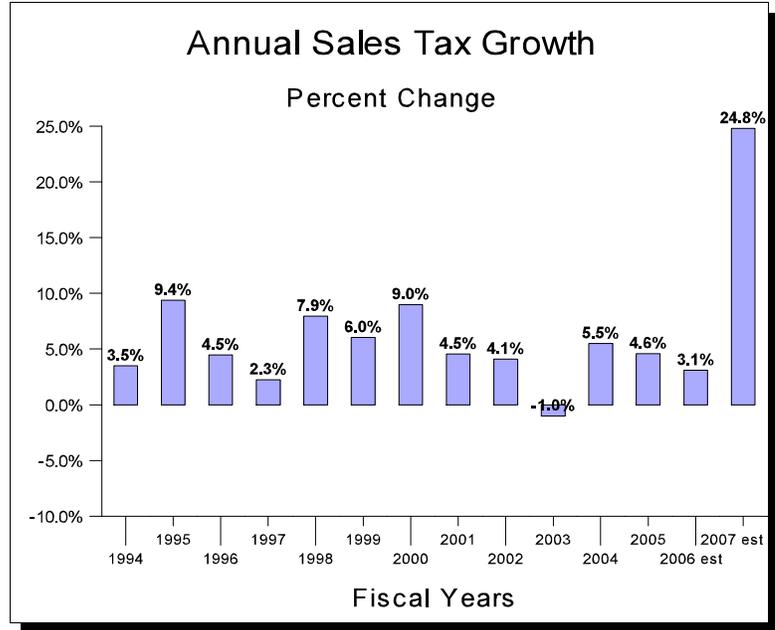
FY 2006: Sales tax collections through the end of February are running 3.5% ahead of the same period one year ago. The Executive expects this growth to slow for the remainder of the fiscal year and estimates total collections at \$6.733 billion. **The OLS expects slightly higher growth and estimates \$6.757 billion in FY 2006, \$24 million above the Executive.**

FY 2007: The Executive expects underlying sales tax growth to increase modestly to about 3.4% in FY 2007. In addition, the Executive is proposing significant tax changes worth a combined \$1.433 billion. Together, underlying growth and tax changes are expected to increase revenues to \$8.410 billion, or 24.9% over FY 2006 levels.

The largest of the proposed tax changes is the rate increase from 6 cents to 7 cents per dollar, a 16.7% change. The Executive anticipates raising \$1.085 billion from this increase, or a 16.1% change.

A second major sales tax change involves an expansion of the tax base. The Executive is proposing to expand the sales tax to include more services (see Figure 11 on page 14 for the

Figure 8



list of proposed changes). The Executive is anticipating this proposal will yield \$248 million if effective for three quarters of FY 2007.

In addition, a \$100 million proposed tax change involves the Urban Enterprise Zone (UEZ) program. The sources of this new revenue would be a restructuring of the allowed business purchase exemption and a delay in paying refunds for those exempt purchases.

The OLS agrees with the Executive's assumption that the underlying sales tax will grow modestly by about 3.4% in FY 2007. In addition to baseline growth, for comparison purposes, the OLS assumes the Executive's proposed tax changes will be adopted and yield the anticipated amounts. The OLS will provide independent analyses of these proposals as the details will be disclosed. **Since the OLS estimated a higher base in FY 2006, similar underlying growth from a higher level, plus the assumed tax change proposals, will yield an estimated \$8.436 billion next year, \$26 million above the Executive.**

Corporation Business Taxes

The Executive has significantly increased its estimates for the **corporation business tax (CBT)** and for the **CBT on banks and financial institutions** in FY 2006. Both revenues have displayed strong growth rates and the OLS agrees that a significant increase in the estimates is warranted.

The much larger CBT, the State's third largest tax revenue, typically accounts for between 8% and 10% of budgeted revenues. The Executive has increased the total CBT estimate from the \$2.455 billion amount certified last summer to a revised level of \$2.902 billion. Year-to-date collections through the end of February are running 33.7% ahead of the same period last year. This growth appears to reflect rising corporate profits, which national reports indicate grew by over 30% in 2005.

The Executive's CBT estimate for FY 2007 is \$2.585 billion, a decline of 10.9% from the FY 2006 amount. Much of this decline is due to previously enacted statutory changes -- a loss of \$205 million from the restoration of full deductibility of net operating losses, and a loss of \$40 million from the decline in the tax rate on S-corporations. In addition, profit growth is expected to moderate substantially from previous high rates. Somewhat offsetting these declines is the Executive's proposal to add a 2.5% surcharge on corporate tax liability, worth an estimated \$60 million.

The OLS concurs with the Executive's CBT estimates in both fiscal years. The estimates for FY 2006 are reasonable in light of the strong growth so far this fiscal year. The decline in FY 2007 is also to be expected. For the purposes of this report, the OLS accepts the estimate of the impact of the 2.5% surcharge. Actual receipts will depend on passage of legislation.

The much smaller CBT on banks and financial institutions has also seen strong growth in FY 2006. Year-to-date receipts are more than double the amount at the same time last year. Accordingly, the Executive has increased its estimate for FY 2006 from \$100 million to \$130

million. The Executive then anticipates a decline to \$125 million in FY 2007.

The OLS believes the current trend for the CBT on banks and financial institutions is stronger than the Executive's revised revenues. **The OLS estimates \$145 million in FY 2006 and \$135 million in FY 2007.**

Other Revenues

The OLS disagrees with the Executive on only a handful of other revenues for FY 2006 and FY 2007. Most differences in FY 2006 reflect OLS's views of collection trends, while the FY 2007 differences are largely due to "rolling over" the FY 2006 OLS base to the new fiscal year.

Motor Fuels Taxes: The Executive estimates \$543 million in FY 2006, a decline from last year's level, and \$554 million in FY 2007. The OLS believes current growth in FY 2006 is somewhat stronger and estimates \$560 million in FY 2006 and \$572 million in FY 2007.

Petroleum Products Tax: The Executive estimates \$247 million in FY 2006 and \$252 million in FY 2007. The OLS expects this revenue to shift back to historical levels after a one-time upward adjustment of about \$23 million in FY 2005. Accordingly, the OLS estimates \$230 million in FY 2006 and \$235 million in FY 2007.

Inheritance Taxes: The Executive estimates \$580 million in FY 2006, up \$80 million from the certified amount, and a decline to \$539 million in FY 2007. The OLS believes current growth in FY 2006 of 19.8% through the end of February will push this revenue somewhat higher and accordingly estimates \$600 million in FY 2006. The OLS knows of no reason to assume a decline for FY 2007 and estimates a flat level of \$600 million for next year.

Realty Transfer Fees: The Executive estimates \$455 million in FY 2006 and \$475 million in FY 2007. The OLS assumes that revenue growth will slow from its current rate of 33.4%,

but not as precipitously as the Executive anticipates. Accordingly, the OLS estimates \$475.5 million in FY 2006 and again in FY 2007.

Assessment on Million Dollar Property Sales: The Executive estimates \$86.4 million in FY 2006 and \$89.6 million in FY 2007. The FY 2007 figure includes an estimated \$17 million from the extension of this tax to certain commercial properties. Therefore, the Executive is assuming a substantial decline in revenue from million dollar residential sales. The OLS believes growth in FY 2006 will be slightly greater than the Executive, yielding \$90 million. The OLS also believes revenue from residential sales will not decline as sharply as the Executive assumes, yielding \$98 million in FY 2007, including the estimated \$17 million from commercial sales.

Cigarette Tax: The Executive is estimating \$640 million in on-budget cigarette tax revenues in FY 2006 and \$490.8 million in FY 2007. The FY 2007 amount assumes underlying cigarette sales will return to a long-term historical pattern of slow decline, falling about 2.4% from FY 2006 levels. The FY 2007 projection also includes an estimate that a 35 cent tax rate increase, from \$2.40 per pack to \$2.75 per pack, will raise an additional net \$80 million,

after accounting for a 4% additional sales decline. Total sales are expected to fall by about 6.4%.

Figure 9, below, displays the estimates for this tax and the revenue allocation for the on-budget and off-budget components. In recent years \$155 million has been distributed off-budget to the Health Care Subsidy Fund to support Charity Care payments to hospitals. In addition, beginning in FY 2007, some \$211 million are also distributed off-budget to finance payments for the cigarette tax securitization. As Figure 9 shows, total tax receipts are significantly higher than the amount displayed on-budget.

The OLS agrees with the Executive's \$640 million estimate for FY 2006, which is consistent with current collection patterns. However, the OLS estimates a lower amount in FY 2007. The Executive's assumption that underlying sales will decline by 2.4% is reasonable, but the OLS expects a greater loss of sales and of revenue due to the tax rate increase. Sales declines during prior tax rate increases exceeded the total 6.4% decline assumed by the Executive. As a result, **the OLS estimates on-budget cigarette tax revenue in FY 2007 of \$470.8 million, \$20 million below the Executive's estimate.**

| Figure 9 Cigarette Tax Estimates | | | | |
|--|--|---------------------|----------------|----------------|
| (\$ Millions) | | Executive Estimates | | OLS FY 2007 |
| | | FY 2006 | FY 2007 | |
| Baseline Cigarette Tax Revenue (Excluding Tax Change) | | \$795.0 | \$776.6 | \$776.6 |
| | <i>Revenue from 35 Cents per Pack Tax Increase Assuming No Sales Decline</i> | -- | \$116.0 | \$116.0 |
| | <i>Revenue Loss from Sales Decline due to Tax Increase</i> | -- | (\$36.0) | (\$56.0) |
| Net Impact of Tax Increase | | -- | \$80.0 | \$60.0 |
| Total Cigarette Tax Revenue | | \$795.0 | \$856.6 | \$836.6 |
| <i>Off-Budget Health Care Subsidy Fund Payments</i> | | (\$155.0) | (\$155.0) | (\$155.0) |
| <i>Off-Budget Cigarette Tax Revenue Bonds Payments</i> | | -- | (\$210.8) | (\$210.8) |
| Total On-Budget Cigarette Tax Revenue | | \$640.0 | \$490.8 | \$470.8 |

Proposed Revenue Initiatives in FY 2007

Figure 10 displays the Executive's new revenue proposals, many of which will require Legislative action. The Governor's Budget Recommendation assumes, and the OLS accepts for the purposes of this report, the implementation of these proposals.

| Figure 10 Executive's Proposed FY 2007 Revenue Initiatives (\$ Millions) | | |
|---|------------------|---|
| Revenue Source | Estimated Amount | Comments/Details |
| Sales Tax - Rate Increase | \$1,085.0 | Increase tax rate from 6 cents to 7 cents per \$1.00. |
| Sales Tax - Expand Base to Certain Consumer Services | \$248.0 | Expansion of sale tax to a number of consumer services (see Figure 11). |
| Sales Tax - Urban Enterprise Zone Reforms | \$100.0 | Reform the allowed exemptions for certain business purchases. |
| | | Sales Tax Subtotal = \$1.433 billion |
| Cigarette Tax Rate Increase | \$80.0 | Increase tax rate by 35 cents per pack, from current \$2.40 per pack to \$2.75 per pack. |
| Corporation Business Tax Surcharge | \$60.0 | Apply a 2.5% surcharge to existing corporate liability. |
| State Disability Benefit Fund | \$50.0 | Transfer of \$50 million from the fund's balances, projected to be in excess of \$180 million. |
| Autonomous Transportation Authorities | \$38.0 | Increase in payments pursuant to contracts. |
| Improved Collections from Audits and Enforcement | \$36.0 | No details provided. |
| State Police Rural Patrol | \$24.0 | Assessment for certain rural towns that receive police services from the State Police. |
| Extend to Commercial Properties the Assessment on Homes Sold for Over \$1 Million | \$17.0 | Extends to certain commercial properties sold for over \$1 million the same tax currently applied to homes sold for over \$1 million. |
| Surcharge on New Luxury Car Registrations | \$17.0 | One-time registration fee of 0.4% of sticker price to be applied to two kinds of vehicles: 1) those with a sticker price over \$45,000; and 2) those with EPA ratings of less than 15 miles per gallon. |
| Alcohol Beverage Excise Tax Rate Increase | \$12.0 | Tax on a gallon of beer increased 5 cents. Tax on a gallon of wine and a gallon of liquor increased 10 cents each. |

Figure 10
Executive's Proposed FY 2007 Revenue Initiatives
 (\$ Millions)

| Revenue Source | Estimated Amount | Comments/Details |
|---|------------------|--|
| Water Supply Surcharge | \$12.0 | Surcharge of 4 cents per 1,000 gallons of water imposed on owners or operators of public community water supply systems. |
| Medicaid Uncompensated Care | \$8.0 | Application for previously unclaimed federal matching Medicaid payments for certain disproportionate share hospital claims. |
| Nuclear Facilities Security Detail | \$4.0 | Assessment for costs of supplementing the private security of nuclear power plant facilities with State Police and National Guard personnel. |
| Misc. Other Revenues | \$10.0 | Unspecified. |
| | | Revenue Increase Subtotal = \$1.801 billion. |
| Income Tax Low Income Refundable Credit | (\$105.0) | Refundable tax credit for certain low-income taxpayers. Variable benefits for taxpayers with income between \$20,000 and \$30,000. |
| Total, FY 2007 | \$1,696.0 | |

| Figure 11 FY 2007 Revenue Anticipated from Proposed Sales Tax Base Expansion Executive Estimates (\$ Millions) | | |
|--|----------------|--|
| Services | Annual Revenue | Revenue Assuming 10/01/2006 Implementation |
| Landscaping Services (Nursery, Installation, Tree Care) | \$100.0 | \$65.0 |
| Membership Fees (Golf Clubs, Health Clubs, Annual Gym Renewals) | \$64.0 | \$54.4 |
| Separately Stated Shipping and Handling | \$35.0 | \$28.0 |
| Limousine Services | \$31.0 | \$23.3 |
| Air Charter Services Originating in New Jersey | \$18.0 | \$13.5 |
| Electronic Data Access | \$14.0 | \$11.2 |
| Self-Storage Services | \$11.6 | \$8.7 |
| Downloaded Movies, Videos, Music, and Software (Non-Business) | \$11.0 | \$8.3 |
| Private Investigation Services | \$11.0 | \$8.3 |
| Flooring and Carpeting Installation | \$10.0 | \$7.5 |
| Tanning, Massage, Tattoo Services | \$10.0 | \$7.5 |
| Parking (Lots and Garages) | \$8.0 | \$6.0 |
| Carpet and Upholstery Cleaning Services | \$5.0 | \$4.0 |
| Bail Bond Services | \$2.0 | \$1.5 |
| Total Revenue Raised from Base Expansion | \$330.6 | \$247.2 |

Figures provided by the Department of the Treasury, March 2006.

Appendices Contents:

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| A2 | Detailed Fiscal Year 2006 Revenue Estimates |
| A3 | Detailed Fiscal Year 2007 Revenue Estimates |
| A4 | Public Utility Tax Revenue |
| A7 | New Jersey Economic Review and Outlook for 2006 <i>NJ Council of Economic Advisors</i> |

| Detailed Fiscal Year 2006 Revenue Estimates | | | | |
|---|-------------------|-------------------|-------------------|-----------------------|
| Revenue Source \$ Millions | Approp. Act | Executive Revised | OLS | Diff: OLS - Executive |
| Major Taxes: | | | | |
| Sales Tax, Total | \$6,890.0 | \$6,733.3 | \$6,757.3 | \$24.0 |
| <i>Sales Tax, Energy</i> | 0.0 | 17.3 | 17.3 | 0.0 |
| Corporation Business Tax, Total | 2,455.0 | 2,901.7 | 2,901.7 | 0.0 |
| <i>Corporation Business Tax, Energy</i> | 53.0 | 96.7 | 96.7 | 0.0 |
| Motor Fuels | 575.0 | 543.0 | 560.0 | 17.0 |
| Motor Vehicle Fees | 294.3 | 264.8 | 264.8 | 0.0 |
| Inheritance Taxes | 500.0 | 580.0 | 600.0 | 20.0 |
| Insurance Premiums | 473.0 | 445.0 | 445.0 | 0.0 |
| Cigarette | 626.0 | 640.0 | 640.0 | 0.0 |
| Petroleum Products Gross Receipts | 255.0 | 247.0 | 230.0 | (17.0) |
| Corporation Business - Banks and Financial | 100.0 | 130.0 | 145.0 | 15.0 |
| Alcoholic Beverage Excise | 91.0 | 91.0 | 91.0 | 0.0 |
| Realty Transfer | 430.0 | 455.0 | 475.5 | 20.5 |
| Tobacco Products Wholesale | 12.0 | 13.0 | 13.0 | 0.0 |
| <u>Public Utilities Excise</u> | <u>9.0</u> | <u>10.0</u> | <u>10.0</u> | <u>0.0</u> |
| Subtotal, Major Taxes | \$12,710.3 | \$13,053.8 | \$13,133.3 | \$79.5 |
| Misc. Taxes, Fees and Revenues | | | | |
| Assessment on Homes Sold Over \$1 Million | \$60.0 | \$86.4 | \$90.0 | \$3.6 |
| Transitional Energy Facility Assessment | 235.0 | 226.8 | 226.8 | 0.0 |
| Medicaid Uncomp. Care Reimbursement | 498.7 | 493.3 | 493.3 | 0.0 |
| Telephone Assessment | 119.0 | 119.0 | 119.0 | 0.0 |
| Hotel Occupancy Tax | 67.0 | 74.0 | 74.0 | 0.0 |
| Bond Refinance/Restructuring | 150.0 | 0.0 | 0.0 | 0.0 |
| Asset Sales | 200.0 | 0.0 | 0.0 | 0.0 |
| <u>Other</u> | <u>1,596.2</u> | <u>1,613.0</u> | <u>1,613.0</u> | <u>0.0</u> |
| Subtotal, Misc. Revenues | \$2,925.9 | \$2,612.5 | \$2,616.1 | \$3.6 |
| Interfund Transfers | | | | |
| State Lottery Fund | \$820.0 | \$832.0 | \$832.0 | \$0.0 |
| Unclaimed Personal Property Trust Fund | 269.1 | 269.1 | 269.1 | 0.0 |
| <u>Other</u> | <u>270.4</u> | <u>279.6</u> | <u>279.6</u> | <u>0.0</u> |
| Subtotal, Interfund Transfers | \$1,359.5 | \$1,380.7 | \$1,380.7 | \$0.0 |
| TOTAL GENERAL FUND | \$16,995.8 | \$17,046.9 | \$17,130.0 | \$83.1 |
| Property Tax Relief Fund (Income Tax), Total | | | | |
| Property Tax Relief Fund (Income Tax), Total | \$10,335.0 | \$10,585.0 | \$10,475.0 | (110.0) |
| Casino Revenue Fund | 481.3 | 500.9 | 500.9 | 0.0 |
| Casino Control Fund | 63.3 | 63.5 | 63.5 | 0.0 |
| Gubernatorial Elections Fund | 0.7 | 0.7 | 0.7 | 0.0 |
| GRAND TOTAL, ALL FUNDS | \$27,876.1 | \$28,197.1 | \$28,170.2 | (\$26.9) |

| Detailed Fiscal Year 2007 Revenue Estimates | | | | | |
|--|-------------------|----------------|-------------------|----------------|--------------------------|
| Revenue Source \$ Millions | Executive | % Change | OLS | % Change | Diff: OLS - Executive |
| Major Taxes: | | | | | |
| Sales Tax, Total | \$8,410.4 | 24.9% | \$8,436.4 | 24.8% | \$26.0 |
| <i>Sales Tax, Base</i> | 6,944.0 | 3.4% | 6,970.0 | 3.4% | 26.0 |
| <i>Sales Tax, Energy</i> | 33.4 | | 33.4 | | 0.0 |
| <i>Sales Tax, Proposed Tax Changes</i> | 1,433.0 | | 1,433.0 | | 0.0 |
| Corporation Business Tax (CBT), Total | 2,585.3 | (10.9)% | 2,585.3 | (10.9)% | 0.0 |
| <i>CBT, Base</i> | 2,462.6 | (12.2)% | 2,462.6 | (12.2)% | 0.0 |
| <i>CBT, Proposed Tax Changes</i> | 60.0 | | 60.0 | | 0.0 |
| <i>CBT, Energy</i> | 62.7 | | 62.7 | | 0.0 |
| Motor Fuels | 554.0 | 2.0% | 572.0 | 2.1% | 18.0 |
| Motor Vehicle Fees, Total | 275.2 | 3.9% | 275.2 | 3.9% | 0.0 |
| <i>Motor Vehicle Fees, Base</i> | 258.2 | (2.5)% | 258.2 | 2.5% | 0.0 |
| <i>Motor Vehicle Fees, Proposed Fee Increase</i> | 17.0 | | 17.0 | | 0.0 |
| Inheritance Taxes | 539.0 | (7.1)% | 600.0 | 0.0% | 61.0 |
| Insurance Premiums | 462.0 | 3.8% | 462.0 | 3.8% | 0.0 |
| Cigarette Tax, Total | 490.8 | (23.3)% | 470.8 | (26.4)% | (20.0) |
| <i>Cigarette Tax, On-Budget Base</i> | 410.8 | | 410.8 | | 0.0 |
| <i>Cigarette Tax, Proposed Tax Changes</i> | 80.0 | | 60.0 | | (20.0) |
| Petroleum Products Gross Receipts | 252.0 | 2.0% | 235.0 | 2.2% | (17.0) |
| Corporation Business - Banks and Financial | 125.0 | (3.8)% | 135.0 | (6.9)% | 10.0 |
| Alcoholic Beverage Excise, Total | 106.0 | 16.5% | 106.0 | 16.5% | 0.0 |
| <i>Alcoholic Beverage Exc., Base</i> | 94.0 | 3.3% | 94.0 | 3.3% | 0.0 |
| <i>Alcoholic Beverage Exc., Proposed Tax Changes</i> | 12.0 | | 12.0 | | 0.0 |
| Realty Transfer | 475.5 | 4.5% | 475.5 | 0.0% | 0.0 |
| Tobacco Products Wholesale | 14.0 | 7.7% | 14.0 | 7.7% | 0.0 |
| Public Utilities Excise | 10.0 | 0.0% | 10.0 | 0.0% | 0.0 |
| Subtotal, Major Taxes | \$14,299.2 | 9.5% | \$14,377.2 | 9.5% | \$78.0 |
| Misc. Taxes, Fees and Revenues | | | | | |
| Assessment on Properties Sold Over \$1 Million | \$89.6 | 3.7% | \$98.0 | 8.9% | \$8.4 |
| Transitional Energy Facilities Assessment | 186.3 | (17.8)% | 186.3 | (17.8)% | 0.0 |
| Medicaid Uncomp. Care Reimbursement | 448.1 | (9.2)% | 448.1 | (9.2)% | 0.0 |
| Telephone Assessment | 119.0 | 0.0% | 119.0 | 0.0% | 0.0 |
| Hotel Occupancy Tax | 74.0 | 0.0% | 74.0 | 0.0% | 0.0 |
| Other New Revenue Proposals | 110.0 | | 110.0 | | 0.0 |
| Other | 1,730.6 | 7.3% | 1,730.6 | 7.3% | 0.0 |
| Subtotal, Misc. Revenues | \$2,757.6 | 5.6% | \$2,766.0 | 5.7% | \$8.4 |
| Interfund Transfers | | | | | |
| State Lottery Fund | \$836.0 | 0.5% | \$836.0 | 0.5% | \$0.0 |
| Unclaimed Personal Property Trust Fund | 311.3 | 15.7% | 311.3 | 15.7% | 0.0 |
| Other | 300.2 | 7.4% | 300.2 | 7.4% | 0.0 |
| Subtotal, Interfund Transfers | \$1,447.6 | 4.8% | \$1,447.6 | 4.8% | \$0.0 |
| TOTAL GENERAL FUND | \$18,504.4 | 8.5% | \$18,590.8 | 8.5% | \$86.4 |
| Property Tax Relief Fund (Income Tax), Total | | | | | |
| <i>Income Tax, Base</i> | 11,720.0 | 10.7% | 11,475.0 | 9.5% | (245.0) |
| <i>Income Tax, Proposed Tax Changes</i> | (105.0) | | (105.0) | | 0.0 |
| Casino Revenue Fund | 468.1 | (6.6)% | 468.1 | (6.6)% | 0.0 |
| Casino Control Fund | 63.5 | 0.0% | 63.5 | 0.0% | 0.0 |
| Gubernatorial Elections Fund | 0.7 | 0.0% | 0.7 | 0.0% | 0.0 |
| GRAND TOTAL, ALL FUNDS | \$30,651.7 | 8.7% | \$30,493.1 | 8.2% | (\$158.6) |

Public Utility Tax Revenue

Energy utilities in New Jersey are subject to the sales and use tax, the corporation business tax (CBT) and the transitional energy facility assessment tax (TEFA), a tax intended to phase out over time. Telecommunications utilities are subject to the CBT. The revenues are divided into two categories: **municipal use**, which are "off budget" and **State use**, which are "on budget."

Figure 1 below displays public utility revenues between FY 1991 and FY 2007. (Collections through FY 1997 were under the old public utility tax system.) The State use portions from FY 1992 to FY 1994 included substantial 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 4

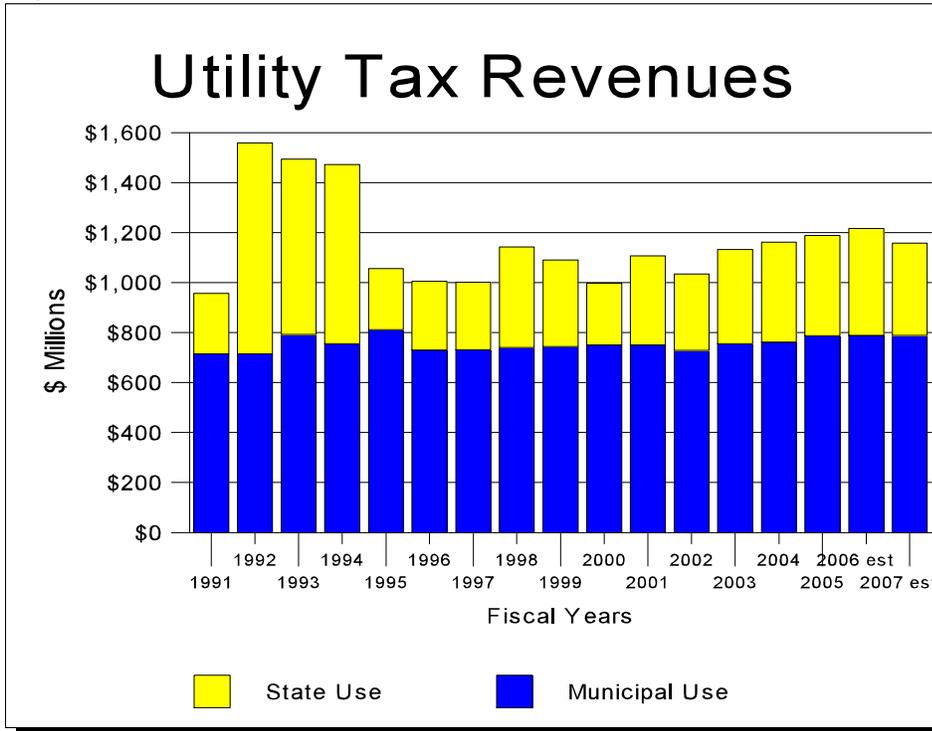
display the actual and anticipated revenues from the replacement taxes between FY 2005 and FY 2007 in greater detail.

From a budgeting perspective, the *municipal use* tax revenues are credited to the Energy Tax Receipts Property Tax Relief Fund, are considered "off budget", and are allocated to municipalities under a statutory formula. These amounts are not included in either the anticipated revenues or the amount of State aid appropriated in the annual appropriations act. This amount has grown to an estimated \$788.5 million in FY 2006 and in FY 2007.

The "on budget" *State use* portion consists primarily of TEFA revenue. TEFA was originally scheduled to end in FY 2002. However, P.L.2001, c.433, extended the assessment through FY 2006. Then, P.L.2004, c.43, further extended the

TEFA. Payments are now scheduled to phase down beginning in FY 2007 and the final payments will be received in FY 2010. The Executive is estimating TEFA payments of \$226.8 million in FY 2006 and \$186.3 million in FY 2007. Total on budget collections are estimated at \$427.8 million in FY 2006 and \$369.4 million in FY 2007.

Figure 1



| Figure 2 Actual Public Utility Tax Revenue Fiscal Year 2005 (\$ Millions) | | | |
|---|--------------------------|-------------------------------|------------------|
| Revenue Source | On-Budget (State Use) | Off-Budget (Municipal Aid) | Total |
| Sales and Use Tax | \$41.5 | \$763.1 | \$804.6 |
| Corporation Business Tax | \$30.7 | \$24.7 | \$55.4 |
| Transitional Energy Facilities Assessment (TEFA) | \$239.6 | | \$239.6 |
| Customer Specific Tax | \$2.2 | | \$2.2 |
| Franchise and Gross Receipts Tax Water and Sewer Utilities | \$75.8 | | \$75.8 |
| Public Utility Excise Tax Water and Sewer Utilities | \$10.4 | | \$10.4 |
| Total | \$400.2 | \$787.8 | \$1,188.0 |

Source: Department of Treasury, March 2006.

| Figure 3 Anticipated Public Utility Tax Revenue Fiscal Year 2006 (\$ Millions) | | | |
|--|--------------------------|-------------------------------|------------------|
| Revenue Source | On-Budget (State Use) | Off-Budget (Municipal Aid) | Total |
| Sales and Use Tax | \$17.3 | \$788.5 | \$805.8 |
| Corporation Business Tax | \$96.7 | | \$96.7 |
| Transitional Energy Facilities Assessment (TEFA) | \$226.8 | | \$226.8 |
| Customer Specific Tax | \$2.0 | | \$2.0 |
| Franchise and Gross Receipts Tax Water and Sewer Utilities | \$75.0 | | \$75.0 |
| Public Utility Excise Tax Water and Sewer Utilities | \$10.0 | | \$10.0 |
| Total | \$427.8 | \$788.5 | \$1,216.3 |

Source: Department of Treasury, March 2006.

| Figure 4 Anticipated Public Utility Tax Revenue Fiscal Year 2007 (\$ Millions) | | | |
|--|--------------------------|-------------------------------|------------------|
| Revenue Source | On-Budget (State Use) | Off-Budget (Municipal Aid) | Total |
| Sales and Use Tax | \$33.4 | \$788.5 | \$821.9 |
| Corporation Business Tax | \$62.7 | | \$62.7 |
| Transitional Energy Facilities Assessment (TEFA) | \$186.3 | | \$186.3 |
| Customer Specific Tax | \$2.0 | | \$2.0 |
| Franchise and Gross Receipts Tax Water and Sewer Utilities | \$75.0 | | \$75.0 |
| Public Utility Excise Tax Water and Sewer Utilities | \$10.0 | | \$10.0 |
| Total | \$369.4 | \$788.5 | \$1,157.9 |
| Source: Department of Treasury, March 2006. | | | |

*New Jersey Economic Review and Outlook
for 2006*

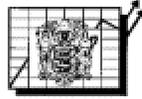
*State of New Jersey
Council of Economic Advisors
February 2006*

The Office of Legislative Services thanks the Council for permitting the reproduction of its annual economic report in the following appendix pages of the FY 2006-2007 Revenue Analysis.

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2006

**“Restoring confidence in New Jersey’s economy and improving economic growth while solving the state’s structural fiscal problems is the policy challenge for 2006.”
Joseph J. Seneca, Chairman**

New Jersey Review and Forecast: Summary



The New Jersey economy remains strong and the outlook for 2006 is for continued growth in employment and income. In many ways, New Jersey has an enviable economic profile – a large and balanced employment base with a record number of people working, income and wealth levels that are among the highest in the country, a well-educated and productive workforce, and over-representation in employment in key high-paying service sectors.

However, there is worrisome evidence that the state’s economic advantages are eroding. In 2005 the state’s employment growth rate lagged well behind that of the nation and the composition of the state’s job growth was concentrated in relatively lower-than-average pay sectors. In addition, a longer-term erosion of the state’s science and technology employment base also raises questions about the future direction of the economy and emphasizes the need for an aggressive economic development policy. At the same time, the state’s persistent structural fiscal deficit must be addressed, but it must be done in a way that does not damage the economy.

In 2005, the state added 37,200 jobs for a .9% increase (December 2004 to December 2005). The state’s employment rate of growth was significantly below the 1.5% job increase of the nation, despite two major hurricanes that caused significant employment losses in the Gulf Coast region. In 2004 New Jersey added 46,300 jobs. Thus, employment growth in 2005 was down by 9,100 jobs from a year earlier. However, nearly one-third of the 2004 job gain was in the public sector. Private sector employment in New Jersey in 2005 grew by 35,400 jobs, and exceeded the 31,300 private sector job gain of 2004.

The largest job increases in 2005 were in Leisure and Hospitality (15,700 jobs), Education and Health services (13,000 jobs), and Trade, Transportation, and Utilities (11,700 jobs). Significant employment losses continued in Manufacturing (-14,100 jobs). The

Construction sector (-1,800 jobs) and the Information sector (-1,600 jobs) also lost employment.

Personal income growth in New Jersey was solid with a 5.3% gain between the third quarter of 2004 and the third quarter of 2005. For the first three quarters of 2005, personal income rose by 5.8% over the same period in 2004. Housing activity in 2005 continued to be very strong and new residential permits approached 39,000, the highest annual total of the decade. Home prices also continued to rise rapidly with the median price of an existing single family home in New Jersey increasing by 13.6% between the third quarter of 2004 and the third quarter of 2005. However, the long-awaited, and frequently forecasted, cooling of the housing sector is finally underway. By the end of 2005, a significant increase in unsold housing inventory, a slowdown in price appreciation, and a marked decline in housing sales in New Jersey all pointed convincingly to a slowing housing sector in 2006.

New Jersey’s export sector remained a strong engine of growth in 2005 as exports increased by 9.4% to \$21 billion. This increase in exports, along with rising volumes of import traffic handled by the state’s ports, supported growth in economic activity in transportation, warehousing and distribution.

| Summary: New Jersey Forecast (% Change) | | |
|---|------|------|
| | 2005 | 2006 |
| Gross State Product (Current \$, bill)* | 5.1% | 5.0% |
| Personal Income (Current \$, bill) | 5.2% | 5.3% |
| Retail Sales (Current \$, bill) | 4.8% | 4.9% |
| Consumer Price Index (All Urban) | 3.9% | 3.8% |
| Total Non-Ag Employment | 0.9% | 1.0% |

* U.S. GDP (current dollars) grew by 6.3% in 2005.

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2006

The U.S. Economy



The national economy grew by 3.5% in 2005, down from the very strong growth of 4.2% in real Gross Domestic Product in 2004. Employment increased by 2 million jobs in 2005, or by 1.5%, despite the damages and disruptions of two hurricanes that constrained job growth in September and October. Inflation continued its worrisome trend upward and the Consumer Price Index rose by 3.4% for the year, up from the 3.3% gain in 2004. Energy costs, with several spikes and subsequent declines during the year, soared by 17.1% after rising by 16.6% in 2004. These increases continue to create echo effects through the overall structure of prices and bring increased concerns of a further acceleration in inflation in 2006.

In addition, productivity growth for 2005 slowed to 2.7%, the slowest pace since 2001 and unit labor costs rose by 2.4%, which was more than twice the increase of 1.1% in 2004. The combined effect of sustained higher energy costs and rising unit labor costs suggest further interest rate increases and a slowing national economy in 2006. The nation's trade deficit set another record, continuing long-standing concerns about the effects on the U.S. economy of any significant withdrawal of foreign lending to the U.S. The housing sector is (finally!) slowing as price gains moderate and unsold housing inventory grows. This is likely to cause the rate of increase in consumer spending to slow with a dampening impact on growth.

The national outlook is for slower, but solid growth in 2006 with real GDP rising by 3.4%. The nation should again generate 2 million jobs. However, inflation is the wild card and any acceleration in the rate of increase in prices could drive interest rates up significantly. Reasons for concern consist of rising energy prices and their spreading effects, rising unit labor costs, increased capacity utilization, and growing pricing power by producers.

Employment Profile



One of the disturbing employment trends for New Jersey over the last year has been the convergence

between the state and national unemployment rates. In December 2004, the New Jersey unemployment rate was 4.2% and the national rate was 5.4%. By year's end, the national rate had declined to 4.9% but the New Jersey unemployment rate increased to 4.7%. This occurred despite the weakness in the national job market caused by two major hurricanes in the autumn of 2005.

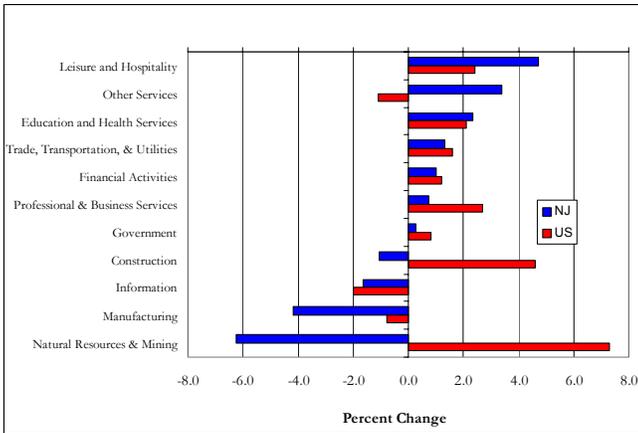
The state added 37,200 jobs in 2005, including 35,400 in the private sector. As of December 2005, total employment in New Jersey was 4,069,400, or 2.7% above the cyclical low of 3,961,800 jobs in July 2002 and 1.1% above the previous peak of 4,024,00 jobs reached five years ago in December 2000. The state's job growth rate in 2005 of .9%, however, trailed the national growth rate of 1.5%. Within these total employment trends, New Jersey's job performance lagged in almost every above-average-pay business sector. In contrast, the state's job growth in the below-average-pay sectors was generally better than that of the nation.

In Manufacturing, a sector with above-average pay, the state lost 14,100 jobs for a rate of decline of 4.2%. Nationally, manufacturing jobs fell by .8% over the same time. In several key above-average-pay service sectors, the state's job growth was tepid and its rate of increase was generally below that of the nation. New Jersey added 4,400 jobs in Professional and Business services, for a growth of .8%, versus a national employment gain of 1.2%. In Financial Activities, the state added 2,900 jobs, or 1%, compared to a 1.2% increase in this sector nationally. In the Information sector, the state's performance was better than the nation's, although it lost 1,600 jobs for a 1.6% decline in contrast to a 2% drop nationally in this sector.

Instead, the state's job growth was concentrated in three below-average-pay service sectors and in these areas New Jersey outperformed the national economy. The state added 15,700 jobs in Leisure and Hospitality (mostly in the food services sub-sector) for a growth rate of 4.7% compared to a national growth rate of 2.4% in this sector. Education and Health services grew by 13,000 jobs, or by 2.3% in New Jersey compared to a 2.1% growth rate nationally. Most of the New Jersey job growth in this sector was in direct health care services. Employment in Other Services (typically repair, maintenance, personal care services, etc.) increased by 5,300 jobs in New Jersey, or by 3.4%, compared to a national decline of -1.1%.

NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2006

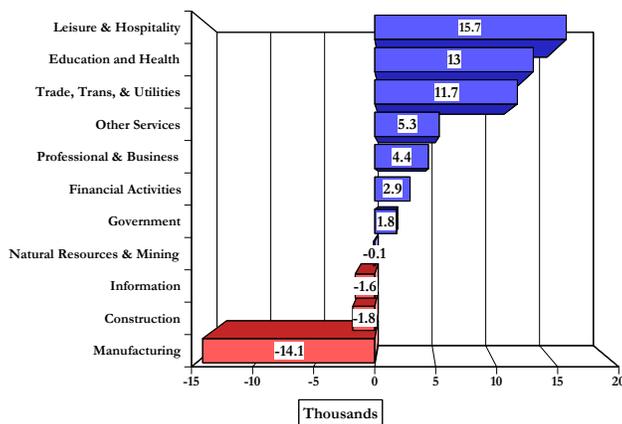
Percent Change in Non-farm Employment by Sector: NJ vs. U.S. (Dec. 2004 to Dec. 2005) (Seasonally adjusted)



(* U.S. rate of change based on revised December 2005 figures. Revised figures for New Jersey not yet available.)

Employment in Trade, Transportation, and Utilities rose by 11,700 jobs in the state, or by 1.3% compared to a national rate of increase of 1%. Most of the increase in jobs in this sector in New Jersey was in wholesale and retail trade. Construction employment fell by 1,800 jobs, or by 1.1% compared to a growth in construction employment nationally of 3.5%. As rebuilding from the damages of the hurricanes accelerates in the Gulf Coast Region in early 2006, this differential is likely to widen.

NJ Employment Change (000) by Sector, 2004-05



New Jersey ranked 17th among the fifty states in terms of absolute job gains for 2005, although the state has the 9th largest economy in terms of total employment. The state's rate of employment growth (.9%) for the year ranked 37th among the fifty states.

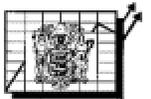
An appropriate key long-term objective of the new administration is to return New Jersey's employment growth rate to equal or exceed the national level and to rebalance the composition of job growth to once again include the higher paying service sectors. To this end, the immediate task is to regain the confidence of the New Jersey business sector for investment and expansion and also to support science and technology based economic growth.

Top Twenty States by Absolute Change in Total Non-farm Employment December 2004 - December 2005 (Seasonally adjusted, in thousands)

| Rank | State | Absolute Change: Dec. 2004 - Dec. 2005 |
|------|-------------------|---|
| 1 | Florida | 248.1 |
| 2 | California | 233.7 |
| 3 | Texas | 153.5 |
| 4 | Arizona | 108.9 |
| 5 | Washington | 78.2 |
| 6 | Nevada | 68.7 |
| 7 | Pennsylvania | 64.4 |
| 8 | Georgia | 64.1 |
| 9 | New York | 62.4 |
| 10 | Illinois | 61.3 |
| 11 | Oregon | 56.4 |
| 12 | North Carolina | 52.9 |
| 13 | Utah | 49.6 |
| 14 | Virginia | 41.2 |
| 15 | Colorado | 40.2 |
| 16 | Wisconsin | 38.9 |
| 17 | New Jersey | 37.2 |
| 18 | Maryland | 34.2 |
| 19 | Minnesota | 33.5 |
| 20 | South Carolina | 31.0 |

(Source: U.S. Bureau of Labor Statistics)

Personal Income and Consumer Spending



The past year was a good year for income gains in New Jersey. Record corporate profits and Wall Street bonuses will continue to fuel strong gains in income. Total personal income in New Jersey grew by 5.3% from the third quarter of 2004 to the third quarter of 2005. This rate of increase trailed the national growth in income of 5.6%, but exceeded that of Pennsylvania (5.2%),

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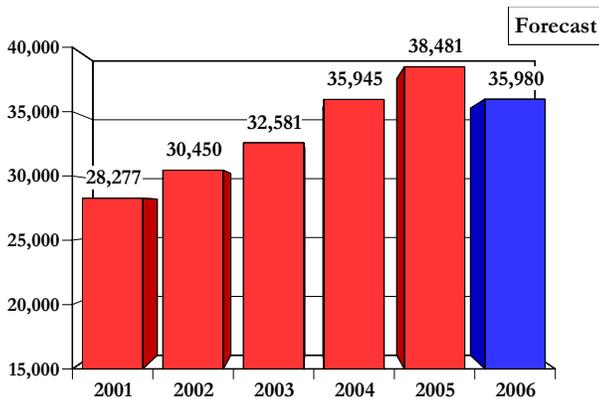
Connecticut (5%), and New York (4.8%). However, the rate of increase in personal income has been slowing over the year suggesting slower consumer spending going forward into 2006.

In addition, rising costs for gasoline and for home heating will continue to dampen consumer spending in 2006. Energy prices have been volatile during the last year, but overall energy costs at the start of 2006 are about 30% higher for gasoline and 38% higher for natural gas for residential use than a year ago. These sizeable increases reduce spending on other goods and services and result in a significant flow of dollars out of the state compared to the expenditures that they displace.

The housing sector and its related expenditures on furnishings and renovations will also ease in 2006 after a long run of boom conditions. Rising mortgage rates, slower income growth, and the effects of high house prices have led to increases in unsold housing inventory, longer time on the market, and a decline in contract sales. As of November 2005, contract sales in New Jersey were down by 13% compared to a year earlier. Unsold housing inventory was up 37% through November 2005.

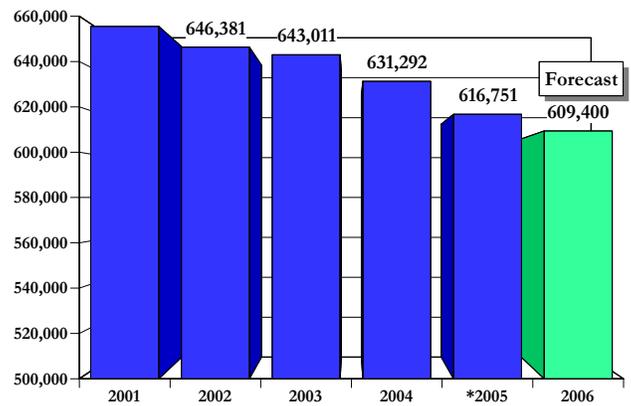
While the outlook is for a slowdown in the housing sector this year, housing enjoyed a particularly strong year in 2005 in New Jersey. Residential building permits totaled over 38,000 for the year and this was the highest yearly total of the decade. The median price of an existing single family home increased by 13.6% between the 3rd quarter of 2004 and the 3rd quarter of 2005. Although this rate of increase was lower than earlier quarters in 2005, this gain continued to support additional home equity loans and consumer spending in New Jersey.

NJ Residential Building Permits, No.



New vehicle sales continued their decline from a peak in 2001, but remained at high levels. The stop-go use of dealer incentives during the year and the several spikes in the price of gasoline echoed through the new vehicle market, causing significant volatility in monthly new vehicle registrations. Through October of 2005 new vehicle registrations were down by 4.4% over the same period a year ago. Vehicle sales will continue to be supported by modest job and income growth in 2006, but will also be affected by higher energy prices, rising interest rates, and shifting consumer tastes across vehicle types. The net effect is likely to result in a continuation of the downward trend in new vehicle registrations in 2006.

NJ New Vehicle Registrations



(*Forecast value for 2005 based on data through October.)

Consumer Prices



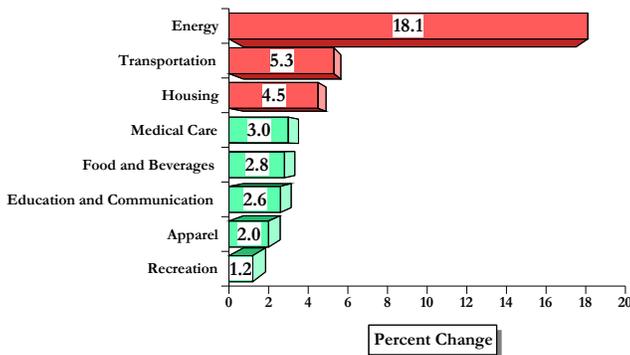
At the national level, inflation continues to trend upward. In 2005, the personal consumption price index – a gauge closely monitored by the Federal Reserve – rose by 2.8%, up from a 2.6% pace in 2004 and 1.9% in 2003. Energy prices have risen steadily in early 2006 and are likely to remain high with continued strong demand from an improving world economy and robust growth in China and India. The Consumer Price Index for all urban consumers rose by 3.4% in 2005 compared to a 3.3% gain in 2004, and 1.9% in 2003. The energy component of the CPI jumped by 17.1% last year and rose by 16.6% in 2004.

Consumer prices in the New Jersey/New York metropolitan area mirrored these trends, but at even higher

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rates of increase. Through November 2005, inflation in the region rose by 3.9%, slightly above the 3.8% increase of a year earlier. Energy again led the components of the index with a very large 18.1% increase. Transportation prices rose by 5.3% and housing by 4.5%. Increases in the other components of consumer prices were more moderate with medical prices rising by 3% and food and beverage prices by 2.8%. However, the overall higher rates of increase in prices in the region, combined with significantly higher house prices and taxes make the region a high-cost location for both consumers and businesses.

NY/NJ Consumer Price Index, by Expenditure Category, % Change 2004-05
All Items = 3.9 %



New Jersey's Science Based Business Sectors In Focus

New Jersey has a long tradition of innovation. The state's science-based business sectors – telecommunications, pharmaceuticals, and biotechnology – have been a major source of the state's prosperity. However, with deregulation, globalization, technical change, and increasing competition, there has been long-term erosion in both the absolute and the relative size of the state's science and technology sectors. A recent study found that the state's share of the nation's employment in key science based sectors declined significantly between 1990 and 2004. Moreover, the absolute level of employment in these sectors was 9,800 jobs lower in 2004 than in was in 1990!

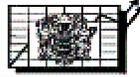
Many states have increasingly emphasized a science-based economic development strategy. New Jersey pioneered such an approach in the 1980s and should return to implementing economic policies that enhance the entrepreneurial environment, make strategic investments in promising new areas of research, and build the capacity of the state's research universities.

| New Jersey's Share of National Employment 1990 and 2004 | | |
|--|------------|------------|
| Sector | 1990 | 2004 |
| Pharmaceutical and Medicine | 20.2% | 13.8% |
| Computer and Electronics Manufacturing | 3.2 | 2.4 |
| Telecommunications | 5.8 | 3.9 |
| Wired Telecommunications | 7.8 | 4.7 |
| Wireless Telecommunications | 4.2 | 2.8 |
| Internet Service Providers/Data Processing | 6.1 | 3.5 |
| Scientific Research and Development Services | 6.6 | 5.1 |
| Computer Systems Design and Related Services | 6.4 | 4.3 |
| Management, Scientific, and Technical Services | 5.1 | 3.8 |
| Architectural, Engineering and Related Services | 3.6 | 3.3 |
| Total | 5.2 | 4.1 |

Source: An Economy at Risk: The Imperatives for a Science and Technology Policy for New Jersey, (http://policy.rutgers.edu/scitech_report.pdf). See also <http://www.state.nj.us/scitech>.

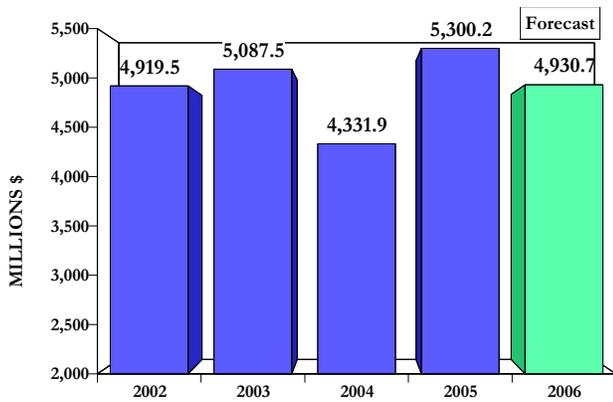
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Investing in New Jersey



Non-residential construction jumped significantly in the last half of 2005 with major renovation projects by Verizon, Pfizer, Novartis and Citigroup. For the year, contracts rose by a robust 22% after falling by 14.9% in 2004. However, the underlying driver of office space demand, new jobs in professional and business services, finance, and information remained weak. The vacancy rate for Class A office space in the 11 county north and central New Jersey area improved in 2005 with a significant amount of vacant space absorbed. At the end of the year the vacancy rate for Class A space was 20.7%, down from 25.6% in the first quarter of 2005. However, this rate is high by historical standards and further significant declines will depend on new job creation in the key office space business sectors. The outlook for 2006 is for a decline in activity as job growth remains modest and existing vacant space continues to be absorbed.

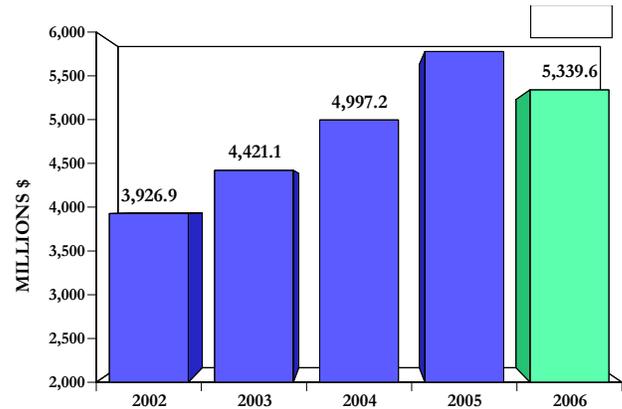
NJ Non-Residential Construction Contracts, \$



(Source: New Jersey Department of Labor)

The housing market had another very good year in New Jersey. The value of residential construction contracts grew by 15.6% in 2005 from a gain of 13% in 2004. This was the result of the decade high level of residential building permits and increases in new housing construction and home renovations throughout the state. With increasing mortgage rates and lower contract sales activity, residential contracts should retreat in 2006.

NJ Residential Construction Contracts, \$



(Source: New Jersey Department of Labor)

International Trade

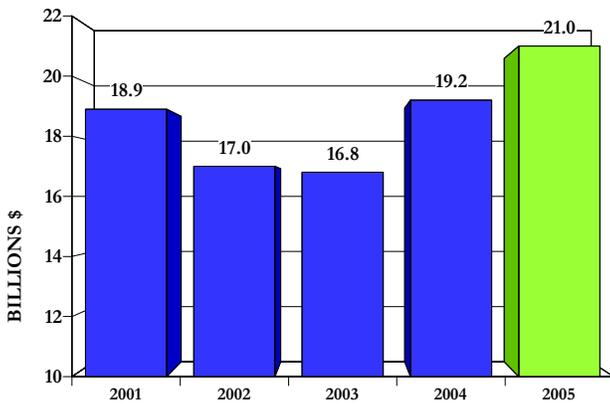


Foreign trade continues to boost the New Jersey economy in a major way. Exports rose by 9.4% to \$21 billion in 2005. This followed a 14% gain in 2004. Major destinations for the state's exports in 2005 were Canada (\$4,771 M), the United Kingdom (\$1,766M), Germany (\$1,294 M), Japan (\$1,254 M), Mexico (\$1,197 M), France (\$817 M), and Italy (\$795 M). New Jersey also exported \$598 M to China. The state's major export commodities were industrial machinery, electric equipment, optic, photo and medical instruments, vehicles, organic chemicals, and pharmaceuticals. The outlook for 2006 is for continued strength in the New Jersey export sector as economic growth improves in the state's major trading partners and the dollar weakens after increasing in value in 2005.

In addition, the Port Authority of New York and New Jersey received the third largest number of containers (4.5 million) of all U.S. ports in 2004. This was the result of the enormous increase in imports into the United States. Imports continued to grow significantly in 2005 and further increases in container traffic have led to gains in employment and economic activity in transportation, warehousing and distribution activities in New Jersey.

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New Jersey Exports, \$ Billions



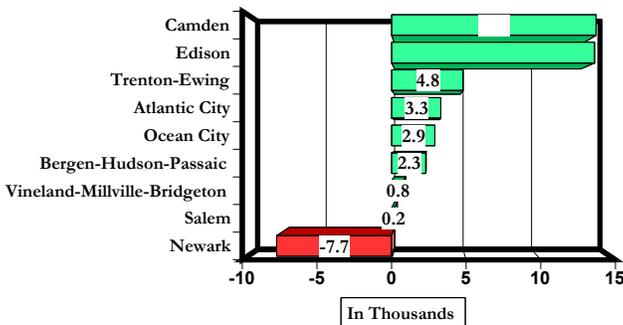
(Source: US Department of Commerce)



New Jersey Labor Markets

Within the state, the largest employment increases from December 2004 and December 2005 were in the Camden (13,700 jobs) and Edison (13,600 jobs) labor markets. Smaller gains occurred in the Trenton-Ewing (4,800 jobs), Atlantic City (3,300 jobs), Ocean City (2,900 jobs) and Bergen-Hudson-Passaic labor markets (2,300 jobs). The Newark labor market lost 7,700 jobs.

New Jersey Labor Market Non-Ag Payroll Employment Change, 2004-05
(In Thousands)



(Source: New Jersey Department of Labor)

NJ COUNCIL OF ECONOMIC ADVISORS

About the Council of Economic Advisors:
Established by law in 1993 (P.L. 1993, Chapter 149).

The Council is an advisory organization reporting directly and independently to the Executive branch of government, the Legislature and the public.

The Council prepares an Annual Report and a mid-year Report analyzing current New Jersey economic conditions and forecasting future developments, assists the Governor's Office in the preparation of the annual budget message, and advises the Governor and Legislature on public policies affecting the State's economy.

The Council consists of a Chairman appointed by the Governor and several legislative appointees.

The Council members are:

Dr. Joseph J. Seneca, Chairman
Members: Steven K. Brisgel, Victor H. Boyajian, Esq.,
C. Mark Dadd, Frederick Kelly, PhD.,
George Zoffinger

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NEW JERSEY ECONOMIC REVIEW & OUTLOOK FOR 2006

| | NJCEA Forecast | | | | | |
|--|----------------|---------|---------|---------|---------|---------|
| <i>(Current \$ or Nos.)</i> | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
| Gross State Product (bill \$) | 362.3 | 377.8 | 394.0 | 416.1 | 437.3 | 459.2 |
| Personal Income (bill \$) ¹ | 333.0 | 337.8 | 343.4 | 362.2 | 380.9 | 401.1 |
| Retail Sales (bill \$) | 105.0 | 106.7 | 109.4 | 114.3 | 119.8 | 125.7 |
| New Vehicle Registrations (000) | 655.5 | 646.4 | 643.0 | 631.3 | 616.8 | 609.4 |
| Non-Res. Construction Contracts (mill \$) | 5,017.6 | 4,919.5 | 5,087.5 | 4,331.9 | 5300.2 | 5,194.2 |
| Residential Building Permits (No.) | 28,277 | 30,450 | 32,581 | 35,945 | 38,481 | 35,980 |
| Res. Construction Contracts (mill \$) | 3,885.7 | 3,926.9 | 4,421.1 | 4,997.2 | 5778.0 | 5425.5 |
| CPI (1982-1984=100) ² | 187.1 | 191.9 | 197.8 | 204.8 | 212.7 | 220.8 |
| <i>Employment</i>³ | | | | | | |
| Total Nonfarm (000) | 3,990.2 | 3,972.5 | 3,985.9 | 4,032.2 | 4,069.4 | 4,109.4 |
| Manufacturing (000) | 381.9 | 358.3 | 344.3 | 337.0 | 322.9 | 315.8 |
| Private Service-Providing (000) | 2,829.1 | 2,834.3 | 2,852.4 | 2,882.5 | 2,933.9 | 2,982.1 |
| Government (000) | 613.5 | 616.7 | 625.8 | 640.8 | 642.6 | 643.5 |
| Percentage Change from previous year: | | | | | | |
| | | 2002 | 2003 | 2004 | 2005 | 2006 |
| <i>(Current \$ or Nos.)</i> | | | | | | |
| Gross State Product | | 4.3 | 4.3 | 5.6 | 5.1 | 5.0 |
| Personal Income | | 1.4 | 1.7 | 5.5 | 5.2 | 5.3 |
| Retail Sales | | 1.6 | 2.5 | 4.5 | 4.8 | 4.9 |
| New Vehicle Registrations | | -1.4 | -0.5 | -1.8 | -2.3 | -1.2 |
| Non-Res. Construction Contracts | | -2.0 | 3.4 | -14.9 | 22.4 | -2.0 |
| Residential Building Permits | | 7.7 | 7.0 | 10.3 | 7.1 | -6.5 |
| Res. Construction Contracts | | 1.1 | 12.6 | 13.0 | 15.6 | -6.1 |
| CPI (1982-1984=100) | | 2.6 | 3.1 | 3.5 | 3.9 | 3.8 |
| <i>Employment</i> | | | | | | |
| Total Nonfarm | | -0.4 | 0.3 | 1.2 | 0.9 | 1.0 |
| Manufacturing | | -6.2 | -3.9 | -2.1 | -4.2 | -2.2 |
| Private Service-Providing | | 0.2 | 0.6 | 1.1 | 1.8 | 1.6 |
| Government | | 0.5 | 1.5 | 2.4 | 0.3 | 0.1 |

1. 2005 estimates as reported by the BEA.

2. CPI for NY-NJ-CT-PA metropolitan area.

3. Employment figures for 2001-2005 are seasonally adjusted December totals.

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 2007 budget are encouraged to contact:

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