Testimony of State Treasurer Bradley Abelow
Assembly Budget Committee
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Mr. Chairman. Distinguished members of the Assembly Budget Committee. Thank you for the opportunity to come before you to discuss Governor Corzine's budget for FY 2007.

As you know, Governor Corzine began his budget address by borrowing a line from his predecessor about the condition of New Jersey's Finances. Governor Codey said New Jersey "was pretty much broke." Governor Corzine said Governor Codey "was pretty much right."

In order to regain our path to fiscal solvency and responsibility, Governor Corzine has espoused certain fundamental principals:

We must stop spending more than we take in;

We must stop borrowing to pay today's bills;

We must rely much more heavily on spending cuts and savings than on new revenues to balance our books;

We must maximize federal revenues and reimbursements available to us;

We must be smart in finding ways to mitigate the impact of these cuts to protect the most vulnerable in our state.

And finally, we must ensure that our fiscal policies encourage economic growth in our communities and across our state.

Mr. Chairman, while these principles are clearly reflected in this budget, I will admit the math can be a little confusing. The budget contains $2.5 billion in constrained growth and spending cuts. This budget eliminates 75 programs entirely. It also reduces appropriations below last year's level for 130 programs, and reduces the rate of growth in FY 2007 for approximately 30 programs.

Despite these far reaching actions, total appropriations are still projected to rise by more than nine percent, from $28 billion to $30.9 billion. The growth in the proposed budget reflects the costs of various mandates, contracts and the coming due of past deferrals. It is not a result of large-scale spending initiatives launched by this administration.

When spending reductions of the magnitude proposed in this budget exceed the value of increased revenues, common sense suggests that overall spending should be flat, if not lower, as compared to the current year's budget. New Jersey's budget, however, defies this basic principle of math. The cost drivers in our spending plan are dramatic, the fiscal trap doors are copious and the perils they pose to the State's fiscal solvency are real and immediate. Absent our efforts to reign in the growth of spending, New Jersey's budget was on a track to total close to $34 billion in the next fiscal year. The simple fact is that many may object to cuts in programs in this budget but without them, State spending would be more than $2.5 billion higher in FY 2007.

The challenges we face with the FY 2007 budget have been many years in the making. Over the course of several administrations, the budget began to stray away from the basic concept of matching recurring expenses with recurring revenues. One-time infusions were incorporated into the budget to help offset sudden cost increases or insufficient performance of revenues.

In the 1990s, the gimmicks ranged from changing the valuation methods of our pension assets, to issuing a $2.8 billion pension bond. As pointed out by the Benefits Review Task Force, the valuation change reduced contributions to the pension system by hundreds of millions of dollars. And, the pension bond used borrowed money, rather than General Fund revenues, to make the pension system's unfunded liability disappear. Well, the unfunded liability is back with a vengeance, topping more than $12 billion today, and the debt service for the pension bond alone will cost taxpayers about $180 million in the FY 2007 budget.

In this decade, the structural shortfall was papered over in FY 2005 with more than $2 billion in securitization bonds. The ripple effect of these bonds is being felt for the first time this year, both in the form of having to meet spending needs once supported by the revenue from the bonds, and in the form of less General Fund revenue from cigarette taxes, which now are dedicated to meeting bond holder obligations

At some point in time, New Jersey's reliance on temporary, one-time solutions evolved into an addiction. The addiction ultimately snowballed into a structural imbalance. That imbalance today has become so acute, that only structural and painful actions can steer New Jersey back on the right path to fiscal responsibility.

Last year the Legislature took a first step in that direction; this budget proposes that we take a giant step down that path.

In building his first state budget, Governor Corzine looked at the state's finances with his eyes wide open. He saw a balance sheet undermined by costs that were growing out of control, bills that had long been deferred and fiscal resources that could not possibly rise to levels needed to sustain the upward spiral of programmatic expenses.

We're all familiar with the big, one-time revenue crutches:

Deferring hundreds of millions of dollars in contributions to our pension system;

Diverting hundreds of millions of dollars from the unemployment insurance fund to pay for indigent care and Medicaid expenses;

Borrowing tens of millions of dollars to pay out job creation grants for the states business employment incentive program;

By contrast:

This budget appropriates $1.3 billion to meet obligations to the pension system. This year's payment is larger than the combined General Fund cash contributions to the system over the last nine years.

This budget uses General Fund revenue to pay for charity care.

We're going back to pay-as-you-go funding for the BEIP grants, directing about $160 million from the general fund for this program in FY 07.

We're slashing non-recurring revenues by more than 70 percent compared to last year's level, from $1.8 billion to under $500 million.

Paying our bills in this manner means that our bottom line will increase in FY 2007. However, the appropriations amount is indicative of not more base spending, but of a more transparent accounting of what we spend, as well as a more straightforward connection between recurring expenses and recurring resources.

Let me touch briefly on the challenges we face with recurring expenses, and explain how we are working to restrain this growth.

In addition to the $1.1 billion increase in pension funding, benefit costs continue to place major strains on state finances. Health care costs for retired and active public employees are each rising above the $1 billion level in FY 2007.

To help relieve the upward pressure of these costs, the FY 2007 budget proposes several growth constraints, including a mandatory, 10 percent premium share for unclassified, non-aligned employees, and mandatory use of generics and mandatory use of mail order prescriptions for all active state employees. These reforms will yield State budget savings this year, and the savings will reoccur in succeeding fiscal years.

Medicaid costs continue to place significant strains on the budget. But, again, the FY 2007 fiscal plan seeks economies and efficiencies in order to shave the growth of these expenses.

For example, the budget proposes to achieve $145 million in pharmaceutical-related savings through bulk purchasing options for both the Medicaid and the State Health Benefits program.

Another $17 million will be saved in Medicaid and the SHBP by changing the reimbursement methodology for prescription drugs. And, our Medicaid costs will be further controlled by asking for a $2 co-pay on prescription drugs in fee for service and managed care plans, with a co-pay limit of $10 per month. This initiative will yield $13 million in savings without placing an undue burden on Medicaid participants.

The budget also makes good on Governor Corzine's commitment to leverage and maximize federal funding available for State administered programs. The proposed hospital provider assessment of 5.5 percent will generate a federal match of $215 million to be distributed to hospitals statewide, and will target much deserved relief to hospitals with a higher than average Medicaid client base.

We recognize and respect that many hospitals object to the provider assessment. There will be objections from various constituencies impacted by the health care reforms we propose. However, in reality, there is simply no way to reduce spending and leverage the resources available to us without causing pain. In many respects, leaving hundreds of millions of dollars in federal revenue on the table would be more painful and more tragic to New Jersey. As articulated by Governor Corzine, we sought ways to mitigate the impact of these actions to protect the most vulnerable, while also being true to our constitutional responsibility for a balanced budget.

Under better circumstances, we would also devote far more resources to our important aid programs, particularly those that provide much-needed property tax relief. But, to those who would argue that this budget is not responsive to State aid needs for property tax relief, we would point their attention to the fact that this budget includes funding for more than $15 billion in property tax relief. That's almost 50 percent of total State spending dedicated to property tax relief. Of this amount, $10.4 billion is in support of local school districts for FY 2007. This represents an increase of approximately $1 billion over FY 2006.

With a budget shortfall of approximately $4.5 billion, reductions and economies represent only a partial solution to our structural problem.

Achieving balance and regaining some solid fiscal footing moving forward requires more sacrifice in the largest section of the budget -- the three-quarters of our spending devoted to aid and grants.

As such, we've recommended that our large formula aid programs, for both school and municipal assistance, be funded in the aggregate at current-year levels Aid to our senior public universities, county colleges and independent colleges has been cut by 10 percent, and increases for fringe benefits, estimated at $122 million will be absorbed by the public colleges.

The belt is tightening around State government operations as well.

Total Executive Branch operational spending on Direct State Services for FY 2007 is cut by $196.7 million, or 5.9 percent off a base of about $3.3 billion. It is important to note that Executive Branch operational spending represents only about 10 percent of all State budget spending.

A total of 1,000 positions will be eliminated government-wide. This reduction will impact 1 out of every 15 employees who do not serve "at a post" and will save the State approximately $67 million.

All told, the growth constraints and programmatic cuts total about $2.5 billion, yet well short of erasing a total shortfall of $4.5 billion.

The balance of the shortfall is largely made up through a series of revenue enhancements, including a one penny increase in the State Sales Tax; an extension of the Sales Tax to various services to keep pace with modern changes; a 2.5 percent surcharge on the Corporation Business Tax; and a 35 cent increase in the Cigarette Tax.

The combination of cuts and revenue enhancements, while dramatic in size and wide in scope, underscores the true message of this budget and this approach to budgeting.

The approach is simple -- we as a state have to pay the bills for the operations of government.

There is no reason to doubt our capability to do so, given the proper discipline, and our revenues are proof positive that New Jersey's economy remains diverse and healthy.

Let me briefly discuss revenues.

We project FY 2006 revenues to be $321 million, or 1.2 percent above targets. This performance is due in large part to the Gross Income Tax, which is revised upward to $10.6 billion, an increase of $250 million compared to June 2005 certified revenue estimates. This represents an increase of 11 percent rather than the 8.4 percent growth anticipated last June.

The Corporation Business Tax is estimated to generate $2.8 billion in FY 2006, which is $403 million above original estimates of $2.4 billion. The strength in the CBT and Gross income tax collections offset underperformance of the sales tax, which is now estimated to generate $6.7 billion, or 2.5 percent under targets.

For FY 2007 we anticipate continued healthy growth in our income tax. We forecast the GIT to rise by 9.7 percent to $11.6 billion.

With an increase and extension of the sales tax, we're forecasting a $1.7 billion increase from this revenue source, bringing total collections in FY 2007 to $8.4 billion.

The revenue forecast for the CBT is down by $282 million in FY 2007 to $2.5 billion. This decline takes into account the lost revenue due to the resumption of the full net operating loss deductibility, the reduction in the tax rate on S-Corporations from 1.33 percent to 0.67 percent and the addition of a 2.5 percent surcharge.

Calibrating these revenues to a more sound approach to spending is a prudent step. It makes it possible to meet several key but modest policy objectives of this administration.

One of the Governor's top priorities, adding 10 percent to the property tax rebate level from FY 2005, is one of the sacrifices of the budget. The available fiscal resources make it only possible to increase last year's rebate by 10 percent. This increase still means that the maximum rebate for senior and disabled residents will rise to $1,320, while the maximum rebates for non-seniors would increase to $385.

The property tax burden carried by the state's low and moderate income seniors will also be alleviated through the Senior property tax freeze program. The FY 2007 budget provides for a $20.5 million increase in funding for a program that last year provided property tax reimbursement checks averaging more than $600 to152,000 senior households.

Tax relief is coming in the form of a 100 percent refundable credit of income taxes for the working poor. Governor Corzine's proposal will eliminate the income tax burden on 414,000 households, and significantly reduce the income tax on an additional 200,000 taxpayers.

The Governor has also proposed key, realistically funded initiatives in his budget to:

Help low income families find affordable housing;

Assist working families with after school care needs by doubling funding to New Jersey After 3,

Combat gang violence through the creation of a specialized law enforcement unit in the Attorney General's Office;

Fight hunger through new investments in food pantries statewide;

Expand Kidcare coverage to 50,000 more children;

and target new resources to helping families with special educational needs.

To be clear, we cannot and will not shrink from our responsibility to begin attacking the budget's structural deficit. This combination of strong spending restraints and moderate but necessary revenues put us on the path to fiscal stability and responsibility.

Mr. Chairman, over these first 70 days, this administration has made an honest effort to understand and remedy the fiscal ills surrounding this budget. I have the highest respect for the experience of this committee and the dedication you all have to the budget process. I welcome your ideas and suggestions for finding less painful ways to cut and restrain State spending.

Despite the challenges posed by the State's financial difficulties, we have taken steps to achieve the objectives of making sure the State no longer spends more money than it takes in; minimizing impacts of budget cuts on the most vulnerable New Jerseyans, and laying a foundation for strong economic growth in the future.

I would be happy to answer any questions you have on the budget at this time.