Remarks of David J. Rosen
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To the Senate Budget and Appropriations Committee
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At this point in the budget cycle we come before you to share some observations about the budget presented by the Governor and to offer our forecast of the revenues available to support that budget. The Governor's budget reflects an austere revenue outlook. I regret that our revenue forecast is even bleaker than the Governor's. Before discussing the differences between our forecasts, let me review what has happened since we last came before you to discuss revenues.

Last Spring, major revenues were growing by 4.0%. It was generally thought that we were in or about to enter a recession and that the recession was likely to persist until late in the calendar year. There was concern about the economy, but few anticipated that an historic tax revenue collapse was looming. We thought we were being quite conservative when we offered a no-growth revenue forecast for FY 2009. The first quarter of the fiscal year showed more weakness than anticipated, but the shortfall was modest. However, in the second quarter major State revenues fell by more than 8.0%, the worst performance of any quarter in the last three decades. The decline in the second quarter was led by a double digit plunge in sales and use tax collections. Preliminary data for the third quarter and OLS projections for the fourth quarter suggest that major revenues, led by plummeting income tax and corporation business tax collections, will decline by about 14% in the second half of the fiscal year.

New Jersey finds itself in the most significant revenue downturn in its modern history. Only twice in the past four decades have New Jersey's budget writers had to cope with revenues below the prior year - - a 2.1% decline in FY 1975 and a 1.9% decline in FY 2002.

According to the OLS estimates that we are presenting today, revenues for FY 2009 will be down 11% from FY 2008. For FY 2010 we project a decline of 3.7%. However, because these revenues would be supplemented with $916 million in proposed tax increases, the resulting decline will be only 0.6%.

We are not alone. New Jersey's sudden State tax revenue drop is consistent with similar sudden drops throughout the country. The Rockefeller Institute of Government reports that at least 35 states are facing declining revenues in FY 2009. The National Conference of State Legislatures reports budget gaps in 43 states.

The two sets of revenue forecasts are summarized in the tables on pages 6 and 7 of the *OLS Tax and Revenue Outlook*. The Governor's budget message reduced the FY 2009 revenue expectation by $2.388 billion from the amount certified last June. The OLS revenue forecast for FY2009 is $383 million less than the Governor's revised forecast.

For FY 2010 the Governor's budget anticipates a revenue decline of $339 million from FY 2009 – and that includes the tax increases. The OLS forecast is $223 million lower.

Over the two years, OLS estimates $606 million less revenue than is assumed in the Governor's budget. Our forecast is informed by six more weeks - - six bad weeks - - of collection data than were available when the Governor's budget was being crafted.

The three largest taxes – Gross Income Tax, Sales and Use Tax and Corporation Business Tax - account for almost three-quarters of State revenues and for each of these taxes the Executive reduced its FY2009 estimate in the budget message. And for each of these taxes OLS has a lower estimate than the Executive in both FY2009 and FY2010.

The Executive and the OLS are anticipating a multi-year revenue decline for the Gross Income Tax. The Executive has revised FY 2009 GIT revenues down by nearly $1.5 billion from certified levels. Total receipts of $11.249 billion in the current year would be 10.8% below collections in FY 2008**,** the second worst decline in the GIT's history. For FY 2010, the Executive projects a further deterioration of baseline GIT revenues to $10.5 billion, a 6.7% decline from FY 2009**.** This decline would be offset by a proposed one-year tax change affecting high-income taxpayers that would generate an estimated $788.0 million.

The OLS believes the outlook for employment, capital gains and bonuses warrants additional caution in projecting the GIT. We project $109 million less than the Executive in FY 2009 and $30 million less in FY 2010.

New Jersey sales tax collections are facing an unprecedented decline in FY 2009. The Executive has revised the estimate downward by $653 million to $7.925 billion, a 5.6% drop from FY 2008. Since the inception of this tax some 40 years ago, the only year with a greater revenue decline was FY 1993, and that decline was attributable to a reduction in the tax rate. For FY 2010, the Executive estimates a modest rebound to $8.085 billion, a growth of 2.0%.

The collapse of sales tax collections in the second quarter of FY 2009 was remarkable. While the plummeting levels of home and car sales are major factors in the decline, the weakness in the sales tax is being experienced broadly in business and consumer purchasing. OLS is slightly more cautious than the Executive about the recovery of the sales tax and we are projecting $40 million less in each year than is the Executive.

In Fiscal Years 2006, 2007, and 2008 the Executive initially projected significant declines in corporation business tax (CBT) revenue. Yet, each year this revenue remained stable or grew and the estimates were revised upward during the year. The CBT is the most difficult revenue source to project accurately. Annual CBT collections are only loosely correlated to current economic data as each fiscal year includes a mixture of payments, adjustments, refunds, and credits from a number of different tax years.

The CBT collection experience in FY 2009 is quite different from the three previous years. While collections actually grew by 2.8% in the first quarter of FY 2009, second quarter revenues plummeted by 24% and subsequent months have continued to fall. Indeed, for perhaps the first time in the State's history, total CBT refund payments for January and February combined exceeded total CBT payments – the CBT actually paid out $45 million more in those two months than it took in. Through the end of February, CBT collections are now down 26.7% below the same period last year.

Accordingly, the Executive estimates a significant drop in collections for FY 2009 and again in FY 2010. FY 2009 Executive estimates have been reduced to $2.35 billion, a drop of $320 million below the $2.67 billion certified last June, and 21.7% below FY 2008. The FY 2010 CBT estimate of $2.03 billion assumes a further decline of 13.6% from FY 2009.

Based on recent collections, OLS estimates $150 million less from the CBT than the Executive in FY 2009, and $30 million less than the Executive next year.

In addition to the declines in the three largest tax revenues, this downturn is affecting our revenues broadly with almost all of revenues showing great weakness. The steepest fall-off has been in the revenue source tied most closely to the housing industry – the realty transfer fee. The Executive has reduced FY 2009 revenue estimates to $260 million, 18.9% below last year, and projects $234 million in FY 2010, another 10.0% drop.

The OLS projects realty transfer fee revenue $50 million below the Executive estimate in FY 2009, and $24 million below the Executive in FY 2010. In addition, the OLS estimates that revenues from the assessment on sales of property valued at over $1.0 million will be lower than the Executive estimates by $11 million in FY 2009 and by $10 million in FY 2010.

Remarkably, according to our projections, the realty transfer fee will produce less revenue in FYs 2009 and 2010 combined than it yielded in FY06.

Let me offer a word of caution about revenue estimates coming from both the Executive and OLS. In the past I warned the committee that revenue estimating is inexact and that the numbers we offer will be, to at least some degree, wrong. It should now be obvious that those statements were not expressions of false modesty. Whatever the normal margin of error is in our forecasts, it is much larger than that this year. Typically when the Executive and OLS disagree on revenues it is safe to assume that the final result will fall somewhere between the two estimates. Not so this year - - it is just as likely that the end result will be higher than the Executive's number or lower than ours.

The unanticipated revenue collapse experienced by New Jersey is being shared – to a greater or lesser degree – by our counterparts across the country. Facing burgeoning budget holes, the states turned to Washington for emergency budget relief. As dire as the current budget situation is for New Jersey and our sister states, we would be in a much more difficult position if the American Recovery and Reinvestment Act had not be enacted. While ARRA provides enhanced funding for a range of programs and activities, its biggest impact on State budgets is filling part of the revenue hole. In the current fiscal year, New Jersey will be using $854 million from ARRA for budget relief. In FY 2010, the proposed budget would use $2.2 billion of federal money to offset the revenue decline.

In the discussion point questions that OLS is sending to each department head, we are asking for detailed information about the federal stimulus money that will be coming to each department – or in some cases, flowing through the department. You will be receiving copies of those responses prior to each department's budget hearing.

In case my comments have not been gloomy enough, I need to make several additional points.

The very economic forces that are driving the State's revenue decline - - unemployment, foreclosures, plunging stock values and bankruptcies - - are also causing pain for its citizens. These conditions produce increased demand for certain State services. It is the irony and the tragedy of the situation that when needs are growing our resources are dwindling.

The proposed budget has a projected year-end balance of $502 million. While this would be viewed by most budget experts as too small a cushion for a budget of nearly $30 billion, it is especially troubling in a year with so much risk of further revenue volatility. If the OLS revenue forecast is correct, even that small projected year-end balance would be transformed into a deficit. Of course, it is in difficult budget years that providing an adequate surplus is most challenging, but we need to recognize the risk in having such a small buffer against adverse events.

While the budget problems of FY 2009 and FY 2010 are more than sufficient to occupy our attention, we should not lose sight of the budget situation we are likely to face to FY 2011. More than $2.5 billion of base spending in FY 2010 is being paid for with revenues that are not scheduled to recur to 2011. Few economists are projecting a robust recovery from this recession and it is quite possible that the revenue problem for 2011 will be as large or larger than this year's. At the same time, the constrained spending in the FY2010 budget will make it more difficult to find further savings in FY 2011.

As always the staff of the Office of Legislative Services stands ready to provide you with whatever assistance we can in the weeks and months ahead.