Each spring the Budget Committees begin their formal review with a hearing that provides an overview of the budget proposal. We are here this morning to present the Office of Legislative Services’ perspective on the State revenue outlook for the next 16 months and to offer some contextual comments on the budget proposal you will be examining in the weeks ahead.

New Jersey is in the midst of an extraordinary and unprecedented State revenue decline. Since revenues peaked during FY 2008 at $33.2 billion, we were hammered by an 11.2% decline in FY 2009 and an additional 6.1% drop in FY 2010. These are the two largest annual declines in the last four decades. The only other years posting revenue declines were FY 2002 and FY 1975, each down about 2.0%.

The revenue decline has been broad as well as deep. This year, the gross income tax (GIT), the State’s largest single revenue, is below FY 2006 levels. Without the estimated $1 billion temporary GIT provisions, this tax would have fallen below FY 2005 levels. Sales tax revenues are below FY 2007 levels. Corporation business tax
revenues are below FY 2003. Inheritance tax revenues are near FY 2003 levels. Real estate taxes have fallen to amounts last seen in FY 2004. Total revenues of about $27.7 billion in FY 2010 are below the FY 2005 level. $5.5 billion – five years of growth – have simply, and painfully, evaporated.

New Jersey’s revenue tumble was echoed in other state capitals. According to the Rockefeller Institute of Government, the 2009 revenue collection slump was the worst decline in more than five decades, since at least the Eisenhower Administration (the Institute’s records do not go back farther).

Moreover, as I discussed with you in January, it could take years to climb back out of this revenue ditch. The Rockefeller Institute estimates that with a “normal” economic recovery it would take states three to five years to return to the prior revenue peak. It is far from certain that this recovery will be a normal one. If New Jersey revenues were to achieve average long-term growth of about 5% annually, it would take until FY 2014 for the State to return to the FY 2008 peak.

Last June, OLS and the prior Administration both anticipated that economic recovery would produce growing tax revenues by the
middle of Fiscal Year 2010. We were both disappointed. Today OLS and the new Administration both anticipate economic and revenue recovery in FY11. And we hope we are correct.

Let’s look at some specific revenues for each of the two fiscal years. *The Tax and Revenue Outlook* book before you has additional details.

The FY 2010 Appropriations Act assumed revenues of $28.76 billion, a decline of $754 million from the audited FY 2009 total of $29.51 billion. But the revenue picture continued to deteriorate and earlier this year the Administration revised their forecast down by an additional $1.04 billion to $27.72 billion. The OLS believes the downward revision is warranted, and that some further caution is prudent. For the current fiscal year, the OLS estimates $27.64 billion for FY 2010, $81.0 million below the Executive’s revised estimates.

The principal driver for this lowered expectation is the sales tax, a revenue source that rarely declines, even during recessions. Prior to the current downturn, the sales tax declined in only two years: by 9.6% in FY 1993 because of a 1 cent rate reduction; and by 1.0% in FY 2003 during the prior recession. The current recession
has precipitated a 7.3% drop in FY 2009, while FY 2010 collections are down another 4.6% through the end of February. The Executive’s estimate of $7.523 billion is $442.0 million below the level certified last June. However, to reach that lower number would require growth of 5.1% during the last 5 months of this fiscal year. The OLS believes such growth is unlikely. Instead, the OLS assumes that 2.0% growth is possible in most of the remaining months, and estimates $7.370 billion for FY 2010, $153.0 million less than the Executive’s estimate.

Based on current collection trends, the OLS is also reducing its estimates for the corporation business tax (CBT) by $44.0 million below the Executive, and the cigarette tax by $15.2 million below the Executive.

However, OLS is not more pessimistic than the Executive on all revenue sources, and in fact we have a higher estimate for the largest revenue, the gross income tax. Unlike some of the other revenues, income tax collections are not trailing our expectations and employee withholding receipts have not dropped as much as expected. Based on withholding trends, the OLS projects GIT revenues of $10.463 billion, $70 million above the Executive’s estimate, but still below last year.
This is the point in the presentation where I raise my usual warning about GIT volatility. The GIT estimate comes with significant uncertainty due to the size and importance of collections during the April filing period. The normal uncertainty is amplified this year by the impact of the temporary law changes. The estimated $1.0 billion in revenue from these changes, offset by an estimated loss of $300 million due to new, higher tax rates in New York State that affect certain NJ residents, add a net $700 million one-time estimated windfall. The bulk of this windfall is expected in April.

Waiting for the “April Surprise” has become an annual ritual for New Jersey budgeteers, but the uncertainty about the impacts of the New Jersey and New York rate changes adds additional suspense this year. The results of the April filing season should be known by the middle of May, but at this time plausible arguments can be offered for either good or bad news.

Trends for several other smaller tax revenues are also slightly more promising. Accordingly, the OLS projects somewhat higher collections than does the Executive for realty transfer fees and taxes, for inheritance taxes, and for corporate taxes on banks and
financial institutions. While these OLS estimates are higher than those of the Executive, it is significant that they are still lower than the amount certified last June for realty and inheritance taxes.

Turning to Fiscal Year 2011, the Executive anticipates modest growth of about 2.0% for total revenues of $28.27 billion. Most revenues are expected to grow by varying degrees as the economy recovers. Among the major revenues, only the GIT is expected to decline, a drop of $448.0 million, down 4.3%, due to the loss of the estimated $1.0 billion in temporary tax provisions. The FY 2011 revenue projection includes just over $300 million from various tax and revenue proposals that will require separate Legislative action.

The OLS also expects slow growth for FY 2011, slightly less than the Executive’s projections. Overall, the OLS projects $28.10 billion, $167.7 million less than the Executive.

The largest difference is for the sales tax, as the OLS number grows from a lower base in FY 2010. The OLS projects $160 million less for the sales tax than does the Executive. Fundamentally, both forecasts assume 4.4% sales tax growth for
FY 2011, including an estimated $65 million from the proposed repeal of Bergen County blue laws.

The OLS is also lower than the Executive by modest amounts for several other revenues: insurance premiums, realty transfer fees, cigarette taxes, corporation taxes on banks and financial institutions, and inheritance taxes. While both the Executive and OLS expect these revenues to grow, the relatively small differences are due to the OLS assuming more modest growth rates for next year.

The OLS is higher by relatively small amounts for two revenues: the GIT and the corporation business tax. For the GIT the difference is due largely to a higher base in FY 2010, not a significant difference in growth rates. For the CBT, the OLS believes somewhat more robust growth is possible as net income rises coming out of the recession.

The revenue estimating differences between the Executive and the OLS are relatively minor. The combined 2-year difference is $249.4 million, or less than one percent. The largest difference is for the sales tax, for which the OLS anticipates $313 million less over the two fiscal years combined. That sales tax difference is
due to underperformance so far this year that will make it nearly impossible to achieve the Executive’s target for FY 2010. That difference then rolls into next year.

The sales tax difference is partially offset by the GIT forecasts for which OLS is higher than Executive by $124 million over the two years. Whether OLS’ slightly more upbeat outlook is justified hinges on the very uncertain April income tax returns. By mid May, we will have a much better idea if these large and important tax payments have matched the estimated targets, or have produced either a positive or negative surprise.

Now I want to shift focus from the revenues available to support the budget to some elements of the proposed budget plan. Compared to other budget proposals offered in difficult fiscal circumstances, this budget proposal relies decidedly more on spending reductions and less on revenue enhancement. Nevertheless, the budget proposal does include more than $600 million in State resource solutions, including both revenue raisers and fund diversions, and assumes Federal action that would provide New Jersey nearly $500 million in enhanced Medicaid funding.
But, it is on the spending side that this budget is extraordinary. State aid to school districts and municipalities is the biggest part of the State budget and has sustained unprecedented and dramatic cuts. How these cuts will manifest themselves at the local level has been a primary focus of initial reactions to the budget proposal. Less attention has focused on how the budget proposal ends or curtails a large number of grant programs that have existed for years. Additionally, while there are cuts to State operations, the impact of the budget proposals in this area is perhaps least clear. The budget saves about $800 million by pushing three-quarters of the cost of the capped tax year 2009 homestead rebate payment into the fiscal year 2012 budget. And the budget proposal continues the pattern of failing to meet the State’s pension contribution obligations, this time for a record shortfall of $3 billion. These issues have been raised in the public hearings and will no doubt be part of the discussion in the weeks ahead.

As we seek to support the efforts of the budget committees, the OLS fiscal staff is facing its own constraints this year. While the hearing schedule has not started earlier than usual, the concentration of large, complex departments in the first few weeks has presented difficulties. Perhaps more significantly, the details of this budget have become available at a slower pace, with less
elaboration and much later than in any previous year. The full budget was still not available this morning – more 3 weeks after the budget message. This has forced us to modify the budget materials we will be producing for you, as we adapt to the truncated timelines. In past years after receiving the budget materials we had time to send a series of discussion questions to each department to be answered before their initial departmental hearing. This year we have had to send a set of 10 common questions to all departments - with some targeted discussion points to be sent later. Our analysis books will be reduced in scope and, frankly, will have more holes in them than they should.

In the past, we tried to present to you a full picture of the departmental budget recommendations so that you could focus your questions during the budget hearings on particular issues that interested you. This year, you and we will be learning about the budget recommendation as we go through the hearings.

The staff of OLS looks forward to assisting you before, during and after the individual departmental budget hearings and then as you undertake the extraordinary task of crafting the Fiscal Year 2011 appropriations bill.