

Remarks of David J. Rosen
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To the Senate Budget and Appropriations Committee
May 24, 2012

Eight weeks ago I appeared before this Committee and presented a cautionary outlook in which OLS projected revenues \$537 million below the amount anticipated in the Governor's Budget Message (GBM) - - \$145 million in FY 2012 and \$392 million in FY 2013. At that time we did not know how the crucial April tax collections would perform. Now we do. Unfortunately, what we have learned is not good news for the State budget.

Over the last two months, tax revenues have declined year-to-year rather than increased. March collections fell by 1.2% and April collections fell by 2.0%, compared to the same months last year. Cash collections for the major tax revenues during the first 10 months of this Fiscal Year have grown, but at a rate of 2.7%, rather than the 4.8% anticipated in the GBM. Major tax revenues are up about \$500 million compared to last year at this time, but we have only achieved half of the \$1 billion revenue growth estimated by the Executive for the year that ends in five weeks.

Looking at individual taxes:

- Gross Income Tax revenues are up only 2.0% compared with a target of 4.9% growth;
- Corporation Business Tax revenues are up only 0.7% compared with a target of 3.9% growth;
- Sales Tax revenues are up 3.1% compared with a target of 3.9% growth;
- Motor fuels and petroleum tax revenues are up 2.1% compared with a target of 4.0% growth.

To put it simply, revenues are rising too slowly to achieve the year-end targets. And it appears that May collections for the major taxes will not materially improve the situation. As of this morning, the State accounting system still shows the GIT growing by only 2% and the CBT growing less than 1% compared to the same dates last May.

In addition this month brought further bad news as the annual May payments from the energy and public utility taxes indicate that these revenues will be nearly \$330 million below the GBM. This surprising development appears to be the result of a substantial drop in sales tax generated by natural gas sales which was then magnified by the prepayment structure used for the utility taxes. Owing to the large decline in prepayments this May, we are hopeful that the energy revenue will experience at least a partial rebound in FY 2013.

Based on our earlier analysis and a review of the disappointing revenue news since we last testified, the OLS must reduce its earlier revenue forecast for FY 2012 and for FY 2013. Rather than the combined \$537 million revenue shortfall projected in March, the OLS is now projecting \$1.3 billion less than the amounts in the GBM.

These are the major differences between our current forecast and the GBM:

FY 2012: \$668 Million Below the GBM

- Income tax \$230 million below the GBM;
- Sales tax \$44 million below; GBM
- CBT \$64 million below GBM;
- CBT banks and financial revenues \$38 million below GBM;
- Energy revenues \$329 million below GBM.

FY 2013: \$635 Million Below the GBM

- Income tax \$388 million below the Executive;
- Sales tax \$49 million below GBM;
- CBT \$126 million below;
- CBT banks and financial revenues GBM \$55 million below GBM;
- Energy revenues \$40 million below GBM.

More detailed revenue tables for each fiscal year are attached to the back of this statement.

Let me be clear, New Jersey is not witnessing a fiscal meltdown. Revenues are continuing to grow, but at a pace which is a good deal more modest than had been anticipated in the GBM.

Some revenues - - the income tax, sales tax, motor fuels taxes, and realty taxes - - performed only slightly lower than the March OLS forecasts for FY 2012. But if an \$11 billion revenue like the GIT misses by even a half percentage point, we lose more than \$50 million. Other revenues, like the CBT which fell \$84 million below last April's level, experienced sharp percentage shortfalls. And as we noted earlier, May brought clarity to the energy revenue situation, which accounts for one-half of the difference in 2012 between OLS and the GBM.

The shortfalls for the major taxes (other than energy) in FY 2012 roll forward into FY 2013 because there is now a lower base from which FY 2013 must grow. Indeed, the OLS has not significantly altered its growth assumptions for revenues in FY 2013. We still anticipate modest economic growth and our forecast assumes a

return to typical growth rates for the major taxes next year. The lower base in FY 2012 produced much of the added shortfall that we are now projecting for FY 2013.

I need to emphasize that our forecast for FY 2013 rests on the expectation of an moderately accelerating economic recovery. A more robust recovery could lead to revenues exceeding our forecast. However, we believe that it is at least as likely that a continuation of weak recovery (or worse) will produce revenues below those that we are presenting today. In a statement earlier this week, Moody's projected that New Jersey's revenue growth in FY 2013 will "remain in line with recent trends." If they are correct, and our revenues grow in FY 2013 at the same rate they are growing in FY 2012, revenues will come in about \$900 million below the revised OLS forecast.

I suspect that some of the conversation today and in the next few weeks will concern contrasting revenue estimates. The first lesson that should be learned by a revenue estimator is humility. In our analysis book and testimony a year ago we discussed the issue of revenue forecasting error – a topic that was well explored in a March, 2011 study by the Rockefeller Institute and the Pew Center on the States. The study found that forecasting error across the country had been increasing with the greater volatility in the most important tax sources. During the period studied the median forecasting error across the country was 3.5%. Applying that error rate to the total generated by New Jersey's big three taxes would mean that half the time the revenue forecast will be off by a billion dollars or more.

Looking back over the last dozen years, the New Jersey Executive branch and the OLS have had forecasting errors in the same general range as our peers across the country. Between FY 2000 and FY 2011, the Executive median error was 3.9% and the OLS median error was 3.2%.

In the crafting of the FY 2013 budget you are going to have to make decisions about what revenue estimates to use, how much to appropriate - - and for what - - and how much surplus to set aside for unexpected contingencies. As you know the Governor has the Constitutional responsibility to certify revenues, essentially setting a cap on the amount that can be appropriated. The certification is neither a floor nor an imperative.

We would have much preferred to be delivering better news today, recognizing that adoption of the OLS revenue forecast would require at least \$1.3 billion in budget solutions – spending cuts or additional revenues – in FYs 2012 and 2013.

As to surplus, when I appeared before you in March, I noted:

We have been asked over the years what is the appropriate size for a projected year-end surplus. While some experts have suggested 3% as a good surplus, there is no simple answer to that question. The adequacy of the surplus must be considered in the context of the risks in the budget. From where I sit today a budget that combines a projected surplus of less than 1% of revenues and revenue forecasts which seem to fall at the high end of the likely range, is troubling.

Unfortunately what we have learned since March underscores the relevance of those comments.

Prior to Administration Solutions
Revised Fiscal Year 2012 Revenue Estimates
Millions of \$

Revenue Source	Executive Estimate	Executive Revised	Executive	OLS Revised	Difference	Difference
	Feb 2012	May 2012	Change Feb to May	May 2012	OLS May - Exec Feb	OLS May - Exec May
Major Taxes:						
Sales Tax, Total	\$7,811.0	\$7,585.6	-\$225.4	\$7,567.0	-\$244.0	-\$18.6
<i>Sales Tax, Base</i>	8,071.0	8,045.6	-\$25.4	8,027.0	-\$44.0	-18.6
<i>Dedicated Transfer to PTRF</i>	-620.0	-611.0	\$9.0	-611.0	\$9.0	0.0
<i>Sales Tax, Energy</i>	360.0	151.0	-\$209.0	151.0	-\$209.0	0.0
Corporation Business Tax, Total	\$2,393.7	\$2,338.0	-\$55.7	\$2,274.0	-\$119.7	-\$64.0
<i>Corporation Business Tax, Base</i>	2,314.0	2,314.0	\$0.0	2,250.0	-\$64.0	-64.0
<i>Corporation Business Tax, Energy</i>	79.7	24.0	-\$55.7	24.0	-\$55.7	0.0
Inheritance Taxes	666.9	674.0	\$7.1	675.0	\$8.1	1.0
Motor Fuels Tax	545.0	545.0	\$0.0	540.0	-\$5.0	-5.0
Insurance Premiums Tax	502.0	550.0	\$48.0	530.0	\$28.0	-20.0
Realty Transfer Fee	200.0	195.0	-\$5.0	183.0	-\$17.0	-12.0
Motor Vehicle Fees	479.0	483.0	\$4.0	483.0	\$4.0	0.0
Cigarette Tax	286.0	296.6	\$10.6	283.0	-\$3.0	-13.6
Petroleum Products Gross Receipts Tax	225.0	225.0	\$0.0	222.0	-\$3.0	-3.0
Corporation Business - Banks and Financial	118.0	100.0	-\$18.0	80.0	-\$38.0	-20.0
Alcoholic Beverage Excise Tax	98.0	104.0	\$6.0	104.0	\$6.0	0.0
Tobacco Products Wholesale Tax	20.4	20.4	\$0.0	20.4	\$0.0	0.0
Public Utilities Excise Tax	13.8	13.8	\$0.0	13.8	\$0.0	0.0
Subtotal, Major Taxes	\$13,358.8	\$13,130.5	-\$228.4	\$12,975.2	-\$383.6	-\$155.2
Misc. Taxes, Fees and Revenues						
Assessment on Property Sold Over \$1 Million	80.0	77.0	-\$3.0	77.0	-\$3.0	0.0
Transitional Energy Facility Assessment	176.0	112.2	-\$63.8	112.2	-\$63.8	0.0
Public Utility Taxes (State Retention)	105.0	110.0	\$5.0	110.0	\$5.0	0.0
Medicaid Uncomp. Care Reimbursement	434.2	434.5	\$0.3	434.5	\$0.3	0.0
Telephone Assessment	125.5	125.5	\$0.0	125.5	\$0.0	0.0
Hotel Occupancy Tax	86.0	82.0	-\$4.0	82.0	-\$4.0	0.0
Affordable Housing (Fair Housing)	28.2	28.2	\$0.0	28.2	\$0.0	0.0
Good Driver	73.0	75.0	\$2.0	75.0	\$2.0	0.0
Other	1,510.9	1,518.1	\$7.2	1,518.1	\$7.2	0.0
Subtotal, Misc. Revenues	\$2,618.8	\$2,562.5	-\$56.3	\$2,562.5	-\$56.3	\$0.0
Interfund Transfers						
State Lottery Fund	967.0	967.0	\$0.0	967.0	\$0.0	0.0
Unclaimed Personal Property Trust Fund	237.0	237.0	\$0.0	237.0	\$0.0	0.0
State Disability Benefit Fund	38.2	38.2	\$0.0	38.2	\$0.0	0.0
Tobacco Settlement/Securitization	53.8	54.9	\$1.1	54.9	\$1.1	0.0
Enterprise Zone Assistance Fund	98.2	98.2	\$0.0	98.2	\$0.0	0.0
Mortgage Servicing Settlement Fund	0.0	0.0	\$0.0	0.0	\$0.0	0.0
Clean Energy Fund	10.0	10.0	\$0.0	10.0	\$0.0	0.0
Other	238.4	251.8	\$13.5	251.8	\$13.5	0.0
Subtotal, Interfund Transfers	\$1,642.6	\$1,657.2	\$14.5	\$1,657.2	\$14.5	\$0.0
TOTAL GENERAL FUND	\$17,620.2	\$17,350.1	-\$270.1	\$17,194.8	-\$425.4	-\$155.2
Property Tax Relief Fund (Income Tax)	\$11,132.0	\$10,900.4	-\$231.6	\$10,902.0	-\$230.0	\$1.6
<i>PTRF Transfer from GF (Sales Tax)</i>	<i>\$637.5</i>	<i>\$628.5</i>	<i>-\$9.0</i>	<i>\$628.5</i>	<i>-\$9.0</i>	<i>\$0.0</i>
Casino Revenue Fund	\$247.5	\$244.2	-\$3.3	\$244.2	-\$3.3	\$0.0
Casino Control Fund	\$53.1	\$53.1	\$0.0	\$53.1	\$0.0	\$0.0
Gubernatorial Elections Fund	\$0.7	\$0.7	\$0.0	\$0.7	\$0.0	\$0.0
GRAND TOTAL, ALL FUNDS	\$29,691.0	\$29,176.9	-\$514.0	\$29,023.3	-\$667.7	-\$153.6

Prior to Administration Solutions
Revised Fiscal Year 2013 Revenue Estimates

Millions of \$

Revenue Source	Executive Budget	Executive	Executive	OLS Revised	Difference	Difference
	Feb 2012	Revised May 2012	Change Feb to May		OLS May - Exec Feb	OLS May - Exec May
Major Taxes:						
Sales Tax, Total	\$8,182.3	\$8,156.8	-\$25.5	\$8,094.0	-\$88.3	-\$62.8
<i>Sales Tax, Base</i>	8,449.3	8,422.8	-\$26.5	8,400.0	-\$49.3	-22.8
<i>Dedicated Transfer to PTRF</i>	-647.0	-646.0	\$1.0	-646.0	\$1.0	0.0
<i>Sales Tax, Energy</i>	380.0	380.0	\$0.0	340.0	-\$40.0	-40.0
Corporation Business Tax, Total	\$2,666.0	\$2,666.0	\$0.0	\$2,540.0	-\$126.0	-\$126.0
<i>Corporation Business Tax, Base</i>	2,566.0	2,566.0	\$0.0	2,440.0	-\$126.0	-126.0
<i>Corporation Business Tax, Energy</i>	100.0	100.0	\$0.0	100.0	\$0.0	0.0
Inheritance Taxes	713.0	725.0	\$12.0	725.0	\$12.0	0.0
Motor Fuels Tax	565.0	565.0	\$0.0	560.0	-\$5.0	-5.0
Insurance Premiums Tax	515.0	575.0	\$60.0	550.0	\$35.0	-25.0
Realty Transfer Fee	240.0	240.0	\$0.0	210.0	-\$30.0	-30.0
Motor Vehicle Fees	466.4	466.4	\$0.0	466.4	\$0.0	0.0
Cigarette Tax	274.3	271.6	-\$2.7	270.0	-\$4.3	-1.6
Petroleum Products Gross Receipts Tax	228.0	228.0	\$0.0	230.0	\$2.0	2.0
Corporation Business - Banks and Financial	165.0	165.0	\$0.0	110.0	-\$55.0	-55.0
Alcoholic Beverage Excise Tax	108.0	112.0	\$4.0	108.0	\$0.0	-4.0
Tobacco Products Wholesale Tax	20.4	20.4	\$0.0	20.4	\$0.0	0.0
Public Utilities Excise Tax	14.0	14.0	\$0.0	14.0	\$0.0	0.0
Subtotal, Major Taxes	\$14,157.4	\$14,205.2	\$47.8	\$13,897.8	-\$259.6	-\$307.4
Misc. Taxes, Fees and Revenues						
Assessment on Property Sold Over \$1 Million	100.0	100.0	\$0.0	90.0	-\$10.0	-10.0
Transitional Energy Facility Assessment	121.5	121.5	\$0.0	121.5	\$0.0	0.0
Public Utility Taxes (State Retention)	105.0	110.0	\$5.0	110.0	\$5.0	0.0
Medicaid Uncomp. Care Reimbursement	409.4	410.8	\$1.4	410.8	\$1.4	0.0
Telephone Assessment	125.0	125.0	\$0.0	125.0	\$0.0	0.0
Hotel Occupancy Tax	95.0	95.0	\$0.0	91.0	-\$4.0	-4.0
Affordable Housing (Fair Housing)	228.2	228.2	\$0.0	228.2	\$0.0	0.0
Good Driver	73.0	77.0	\$4.0	77.0	\$4.0	0.0
Other	1,611.8	1,650.8	\$39.0	1,650.8	\$39.1	0.0
Subtotal, Misc. Revenues	\$2,868.8	\$2,918.3	\$49.5	\$2,904.3	\$35.5	-\$14.0
Interfund Transfers						
State Lottery Fund	1,095.0	1,095.0	\$0.0	1,095.0	\$0.0	0.0
Unclaimed Personal Property Trust Fund	193.0	193.0	\$0.0	193.0	\$0.0	0.0
State Disability Benefit Fund	38.2	38.2	\$0.0	38.2	\$0.0	0.0
Tobacco Settlement/Securitization	53.3	53.3	\$0.0	53.3	\$0.0	0.0
Enterprise Zone Assistance Fund	102.8	102.8	\$0.0	102.8	\$0.0	0.0
Mortgage Servicing Settlement Fund	75.0	75.0	\$0.0	75.0	\$0.0	0.0
Clean Energy Fund	210.0	210.0	\$0.0	210.0	\$0.0	0.0
Other	220.0	217.6	-\$2.4	217.6	-\$2.4	0.0
Subtotal, Interfund Transfers	\$1,987.3	\$1,984.9	-\$2.4	\$1,984.9	-\$2.4	\$0.0
TOTAL GENERAL FUND	\$19,013.4	\$19,108.3	\$94.9	\$18,786.9	-\$226.5	-\$321.4
Property Tax Relief Fund (Income Tax), Total						
<i>PTRF Transfer from GF (Sales Tax)</i>	<i>\$664.5</i>	<i>\$663.5</i>	<i>-\$1.0</i>	<i>\$663.5</i>	<i>-\$1.0</i>	<i>\$0.0</i>
Casino Revenue Fund	\$287.0	\$284.0	-\$3.0	\$267.0	-\$20.0	-\$17.0
Casino Control Fund	\$55.1	\$55.1	\$0.0	\$55.1	\$0.0	\$0.0
Gubernatorial Elections Fund	\$0.7	\$0.7	\$0.0	\$0.7	\$0.0	\$0.0
GRAND TOTAL, ALL FUNDS	\$31,857.5	\$31,696.0	-\$161.4	\$31,222.2	-\$635.2	-\$473.8