Remarks of David J. Rosen
Legislative Budget and Finance Officer
To the Assembly Budget Committee
March 30, 2015

As you begin your consideration of the Fiscal Year 2016 Budget, we come before you to present our revenue forecasts and discuss some significant budget issues.

I am pleased that this year's budget discussions will not feature a clash of conflicting revenue forecasts. The OLS revenue forecasts for this and the upcoming fiscal years vary with those contained in the Governor's Budget Message (GBM) by analytically trivial amounts. Without the distraction of whose numbers to believe, we have the opportunity to look at important budget trends and issues.

First, though, a quick review of the forecasts. The OLS believes the Executive's forecasts are reasonable. For FY 2015 and FY 2016 combined, the OLS estimates $16.1 million more total revenue, a tiny difference of only 0.02%.

For FY 2015, the OLS is $22.5 million below the Executive. We agree on a number of important revenues, including the Gross Income tax (GIT) and the inheritance tax. Where there are differences, both higher and lower, the variances are relatively small and, I suspect, based largely on the OLS having access to more recent collection data.

For FY 2016, the OLS projects $38.6 million more overall revenue than does the Executive. Again, we agree on many specific revenues and where there are differences, those differences are relatively small. The largest divergence is for the GIT where the

OLS projects $73.0 million more than the Executive, reflecting a growth assumption of 5.5% rather than 5.0%.

Details of the OLS revenue forecasts are found in our ***Tax and Revenue Outlook*** book.

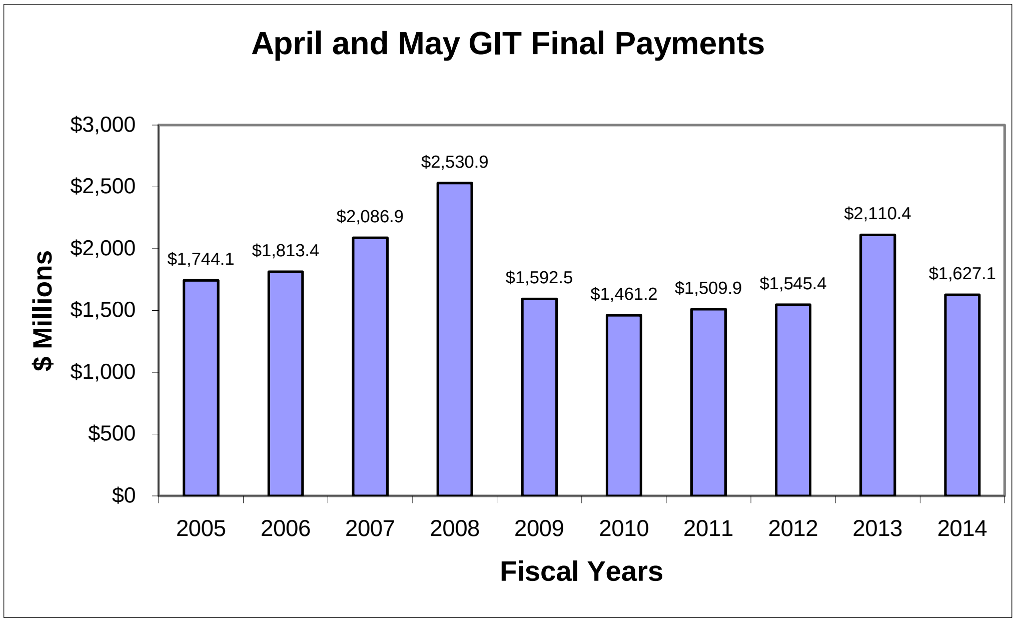
Fiscal Years 2015 and 2016 mark the fifth and sixth years of a modest national economic recovery, with New Jersey lagging the national pace. New Jersey revenues have grown at an average annual rate of 2.4% since the low point of FY 2010. Of the three largest state revenues, only the sales tax had returned to the pre-recessionary peak by 2014. The GIT is projected to top the prior peak this year, after falling short for six consecutive years. CBT revenues remain well below the peak.

The GIT is the State's largest tax revenue source, typically accounting for about 40% of budgeted revenues. Prior to the Great Recession, GIT growth tracked very closely with stock market performance. However, the GIT has averaged only a 3.7% annual growth rate for the five years after the end of the recession, not what would have been expected with the soaring stock market.

National data indicate that between 2007 and 2011, taxpayers in the top 1% saw their income decline by 27%, a bigger drop than in lower income categories. New Jersey GIT results tell a similar story.

Other preliminary national data for tax years 2012 and 2013 suggest that there has not been the strong rebound that would be expected for high income individuals well into an economic recovery.

This pattern is evident in the April and May final payments that accompany the April 15 filing of gross income tax returns, a revenue stream that would be the State's fourth largest revenue source if it were a stand alone tax. Except for the anomalous jump in the Spring of 2013 (see p. 5 of the ***Outlook***), these final payments have risen slowly, and are markedly below the levels before the recession. The softness in these payments, which come primarily from higher-income taxpayers, is consistent with the national data. This final payment pattern exemplifies how total GIT revenues have lagged expectations in recent years.



Since the end of the recession, annual New Jersey sales tax growth has varied in a range between 2.2% to 4.9%. So far this year, the tax is growing by 2.6%, but the most recent three-month period has seen growth slow to less than one percent. Both the Executive and the OLS expect growth to rebound to just above 3.0% for the remainder of this year and next year, matching the pattern of recent years. During the recovery, New Jersey's annual sales tax growth has averaged 3.5%, compared to the national average of 4.2%.

There are a number of plausible explanations for this modest growth. Nationally, economic growth has been slow coming out of the Recession and New Jersey's economic performance has lagged the nation. Internet sales, slow population growth, sluggish housing recovery and the continuing shift in consumption patterns from goods to services also hamper our collections.

Significantly, in recent years the price of goods, which are generally taxed by New Jersey, has been dropping, while the price of services, which are generally not taxed here, has been rising. As the sales tax depends on the retail price of goods, these trends would be another drag on our revenues.

I want to turn now to a revenue that has not been the subject of much forecasting debate, but has become a policy concern in the last year or so. New Jersey imposes two taxes that affect the assets of people who die – the estate tax and the transfer inheritance tax. They are reported together in the budget as a single line called inheritance taxes. The combined inheritance taxes are the fourth largest tax revenue in the budget. New Jersey is one of only two states that impose both of these taxes and New Jersey's estate tax exemption level is the lowest in the country. This year we have included a background paper on the inheritance taxes in the ***Outlook***. We appreciate that Treasury has provided us with data that allow us and you to see how many estates pay these taxes and how much they pay.

The data indicate that the two taxes do not affect the vast majority of New Jersey citizens and most of the money comes from a small fraction of those who are affected. Less than 5% of deaths in New Jersey result in estate tax liability, while the inclusion of the inheritance tax increases the number of estates subject to one or both of these taxes to about 11%.

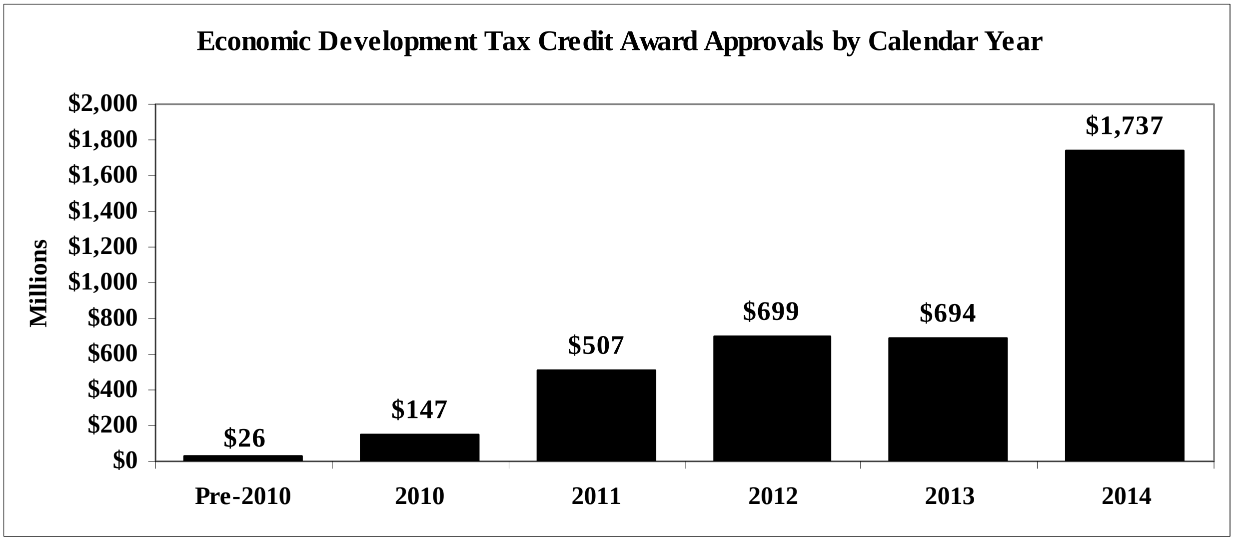
Estate Tax Collections -- FY2013			
Net Taxable Estate	# Returns	Total tax	Average Tax
$5,000,000 & Above	109	$136,207,362	$1,249,609
$2.5M -$5.0M	312	$66,467,932	$213,038
$1M - $2.5M	1,547	$94,419,537	$61,034
$675k - 1 MILLION	1,298	$28,236,237	$21,754
	3,266	$325,331,068	$99,611

In 2013, the 109 largest estates (about 3 percent of those paying the estate tax - or one of every 655 decedents) paid nearly 42 percent of the revenue. Conversely, the 40 percent of taxable estates that were valued between $675,000 and a million dollars, paid an average tax of about $22,000 and accounted for less than 9 percent of the total revenue.

The pattern for the transfer inheritance tax is somewhat less concentrated at the high end but that tax exempts transfers not only to spouses, as is the case with the estate tax, but also transfers to children, grandchildren, parents and grandparents.

A second background paper in the ***Outlook*** looks at the current and potential future impact of economic development tax credits.

In recent years, New Jersey's economic development strategy has increasingly featured the granting of tax credits for businesses that meet certain requirements. According to the Division of Taxation's "2015 New Jersey Tax Expenditure Report," the division expects taxpayers to increase their use of Urban Transit Hub Tax Credits against corporation business tax (CBT) liabilities from $30.0 million in FY 2014 to $103.4 million in FY 2015 and $135.9 million in FY 2016. This practice is rapidly becoming a relevant factor in CBT revenue projections.



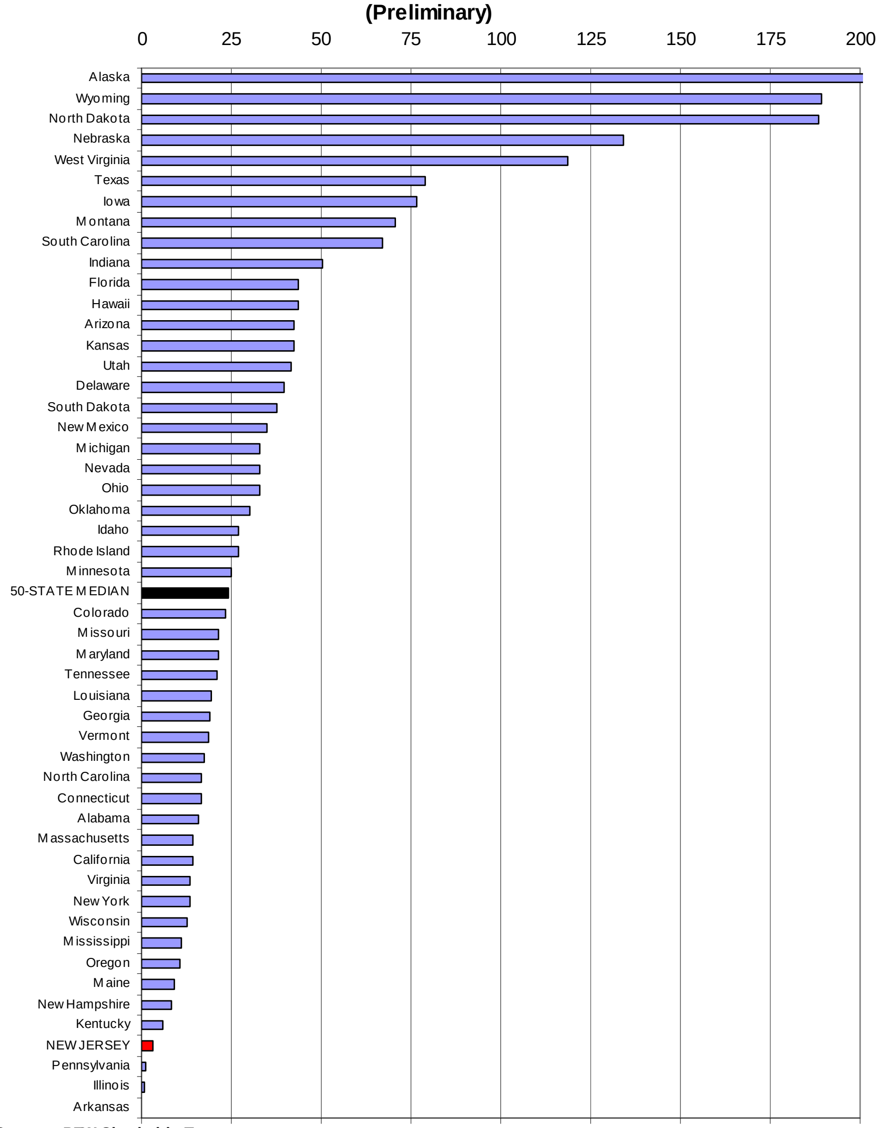
Looking to future revenue impact, this graph depicts the recent acceleration in economic development tax credit application approvals. Before calendar year 2010, the Economic Development Authority (EDA) had approved only a cumulative $26.4 million in economic development tax credit applications. In calendar year 2010 it approved $146.9 million. By calendar year 2014 approvals soared to $1.7 billion. In total, the EDA approved some $3.8 billion in economic development tax credit applications through the end of 2014.

Of course, not all of the $3.8 billion will hit CBT collections right away. Some projects may not meet the stipulated development criteria and their credits would never be used. And the use of the credits that are earned will be spread over a period of many years. It should be noted, however, if the GBM recommendation to convert the unpaid BEIP grants into future tax credits is effectuated, the pool of credits impacting the CBT would increase by more than $640 million.

More difficult to quantify than the revenue loss from these tax credits is the possible revenue gain (in the same or other taxes) from the economic activity that would have not occurred but for these credits.

A third budget consideration, one that I have discussed – perhaps belabored – in recent years, is the size of New Jersey's budget surplus. Revenue forecasting errors nationally average above 3%, yet New Jersey has been operating with a budget cushion of about one percent. When revenues do not match expectations we are forced to make significant mid-year spending cuts. A recent national analysis by Pew looked at how long states could function on their budget reserves. New Jersey's surplus would cover only three days of expenditures and places the state at 47th place among the 50 states.

Figure 12: Days Each State Could Run on Reserve Funds, FY14 (Preliminary)



Source: PEW Charitable Trusts

Before closing I want to touch briefly on how the budget proposal deals with two of the biggest budget concerns – transportation and pensions.

The proposed capital plan for the transportation trust fund is about the same size in FY 2016 as in FY 2015. Between available balances, loan repayments and further borrowing it appears that the fund will be able to cobble together enough cash to pay for its FY 2016 spending plan. Unaddressed for now is how we will pay the post-FY 2016 expenses for projects that have been authorized through FY 2016 and what the capital program will be beyond FY 2016. The bottom line is that we can squeak through FY 2016, but something is needed beyond that point.

Turning to pensions, under existing law the FY 2016 budget should appropriate $3.095 billion for pension payments, which would constitute 5/7s of the full actuarially determined required employer pension contribution. In his budget speech, the Governor called for an overhaul of the pension and health benefit system and pointed to **A Roadmap to Resolution**, the report of his pension reform commission. The budget proposal before you reflects neither the statutory amount nor the amount that might be required under the **Roadmap** plan. Rather, the budget recommendation would provide $1.3 billion, 3/10s of the actuarially determined contribution and the Budget Summary refers to this as part of a ten year phase-in.

As you wrestle with decisions for this year's budget you will have many sources of information. The budget committees heard from many citizens during the public hearings and their testimony is now online at the budget link on the Legislative homepage. OLS has prepared discussion point questions for each department and responses to those questions will be made available prior to the pertinent hearings. In addition, you will be receiving the department-by-department OLS analyses of the Governor's Budget Message. These analyses will provide budget highlights for each department and identify and explain proposed changes to line items and language provisions. As always, the fiscal staff of the Office of Legislative Services remains ready to respond to your questions and provide whatever support we can in the weeks ahead.