STATE OF NEW JERSEY

Department of the Treasury

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Opening Statement Before The

New Jersey Senate Budget Committee

March 31, 2015

Chairman Sarlo, Budget Officer Bucco, distinguished members of the Senate Budget Committee – thank you for your kind invitation to introduce Governor Chris Christie's proposed Fiscal 2016 budget.

Allow me to introduce my colleagues at the table this afternoon: Thomas Neff, Deputy Treasurer for Budget; Charlene Holzbaur, Director of the Office of Management and Budget; and Robert Peden, Deputy Director of the Office of Management and Budget.

With your permission, I will begin with a brief overview of the Governor's $33.8 billion budget proposal and then devote the balance of my presentation to a number of issues that may be of particular interest or concern to the Committee and the public we are all privileged to serve.

Foundationally, this budget reflects and advances the Governor's continuing strategic priorities: restoring fiscal health to our public employee benefits systems, providing a smaller and more efficient State government, enhancing New Jersey's competitive position in the global race for jobs and economic development, and maintaining high-quality, critical safety-net supports and services for New Jersey's most vulnerable.

At a more incremental or tactical level, we built this budget around the Governor's core objective for Fiscal 2016: making the largest sustainable contribution to our public employee pension systems possible without imposing unacceptable impacts upon critical State programs and services or risks to our state's still-fragile economy. The budget thus includes a $1.3 billion defined benefit pension contribution, the largest in State history, almost double the Fiscal 2015 amount, and 3/10ths of the actuarially required contribution (ARC) amount. With this contribution, Governor Christie will have contributed $4.2 billion to the pension plans, nearly twice as much as any previous governor and more than the previous five administrations combined.

You are aware that the Governor's Benefits Commission is continuing its work and discussions with stakeholders. While we remain sanguine that the Commission will secure a comprehensive long-term agreement, our immediate concern is Fiscal 2016. We hope you will agree that the Governor's proposed Fiscal 2016 contribution represents a fiscally responsible and sustainable foundation for moving forward.

With that background, I would begin by reviewing the close of Fiscal Year 2015 and summarizing our revenue expectations with respect to Fiscal 2016.

While keeping a weather eye out for upcoming April final settlements in the Gross Income Tax, I am pleased to report that total tax and non-tax revenue for Fiscal 2015 has largely met expectations, with a net projected reduction of $59 million. With $343 million in anticipated lapses offsetting $288 million in supplemental needs, we remain on target to achieve the Fiscal 2015 Appropriation Act's target ending fund balance of $388 million.

We are projecting total Fiscal 2016 tax and non-tax revenues of $33.8 billion, a modest 3.8% increase year over year. With respect to our three major sources of tax revenue, we are projecting 5% growth in the Gross Income Tax, 3.5% growth in the Sales Tax, and 2.2% growth in the Corporation Tax. We believe these are reasonable estimates. I would note that the projected growth rates for Gross Income Tax and Corporation Business Tax are actually less than what we have experienced so far this fiscal year, while the steady improvement in the economy and declining unemployment supports our expectation that the Sales Tax will grow slightly above this year's rate of growth. The Corporation Business Tax growth rate accounts for anticipated utilization of EDA tax incentives.

Before leaving the general topic of revenue, I would like to touch on several important points.

First, in keeping with Governor Christie's commitment to enhancing New Jersey's competitive economic position, this budget does not include or anticipate any broad-based tax increases or changes in tax policy. On the contrary, this budget keeps faith with our business community in accommodating the final phase-in of the five-year, $2.3 billion business tax reduction initiative approved by the Legislature in 2011.

Second, this budget once again reflects the Governor's determination to reduce the State budget's reliance on non-recurring revenues, down from a high of over 13% in Fiscal 2010. There will always be some non-recurring revenues in the State budget, but the modest 2.8% level anticipated for Fiscal 2016 is evidence that we have settled on a new and much more sustainable and responsible baseline.

Third, the anticipated non-recurring resources for Fiscal 2016 include $110 million from legal settlements, a routine component of the annual State budget. This amount, less than one third of one percent of total State revenue, simply represents Treasury's understanding, based on consultation with the Attorney General's office, as to magnitude and timing of reasonably anticipated receipts from settlements in Fiscal Year 2016 across a range of litigation, including the pending settlement with Exxon Mobil.

Treasury has no role in managing the State's litigation, and thus I cannot speak to the legal merits or details of litigation or pending settlements. Nonetheless, I would like to clear up one unfortunate but understandable misconception. Contrary to suggestions in some press reports, the budget tail is not wagging the litigation dog. As I have noted, we understand that the anticipated revenue will come from a range of cases, and the total amount is modest and in line with recent years' experience. Moreover, the language in the proposed 2016 Appropriations Act that appropriates the first $50 million in natural resource cost recoveries or damages to the Hazardous Discharge Site Cleanup Fund, while allocating any excess to the General Fund as general State revenue, was first approved by the Legislature as part of the Fiscal Year 2015 Appropriations Act. Since all such settlement revenue, absent a specific law to the contrary, is general State revenue subject to appropriation, the budget language should be seen as offering assurances that a significant amount of money from future environmental settlements will be devoted to environmental cleanup, <u>not</u> as a limitation on such spending *per se*.

Finally, we have lowered our expectations with respect to revenue from the State Lottery in Fiscal 2015. Although I anticipate that we will discuss the Lottery at greater length when I appear before you later this spring to discuss the Department of the Treasury's budget, I would reassure you that this adjustment largely reflects industry-wide trends rather than specific challenges with respect to the management of New Jersey's State Lottery. State lotteries comprise a mature industry that is facing increasing competition from other forms of gaming and ongoing, demographically-driven shifts in consumer preferences that have increased lotteries' relative reliance on interstate games featuring large jackpots. The first seven months of this year saw a statistically unusual decline in large jackpots, together with mounting evidence of "jackpot fatigue," the industry term for the phenomenon that it seems to take ever-larger mega-jackpots to stimulate and sustain casual player interest.

Please allow me now to touch on the expense side of the ledger.

As I noted previously, we built this budget around the Governor's objective of funding a significant and sustainable increase in the defined benefit pension contribution. In fact, the budgeted increase in pensions accounts for 62% of the year over year growth in spending. Adding in mandatory increases for public employee health benefits boosts that percentage to 77% of year over year growth. At roughly $4.9 billion, the combined cost of public employee pensions and health benefits accounts for approximately 14% of the Fiscal 2016 budget. This fiscal reality necessarily constrained our ability to accommodate other needs within the State budget and compelled us to engage in a priority-setting process that in turn framed the narrative details of this year's budget.

Some highlights:

First, the Governor's 2016 budget continues to restrain the growth in discretionary State spending. The budget does not include any major new program initiatives. Spending for the Executive Branch will increase by just 1%. Indeed, core State spending --- by which I mean State spending apart from pensions, health benefits and debt service --- has been essentially flat at roughly $25 billion since the beginning of Fiscal 2012. In part, this reflects an 11% decline in the size of the State workforce since Governor Christie took office.

Second, the budget holds aid to schools, municipal aid, and aid to institutions of higher education flat. Each of these important program areas warrants further discussion.

- Although the Governor's budget holds aid to schools flat at just over $9 billion, I would note that the budget includes an allocation of adjustment aid to ensure that no district experiences a year over year decrease in K-12 funding. Similarly, assessments for School Development Authority debt service are frozen at Fiscal Year 2014 levels to avoid a net loss of formula aid funding. The Fiscal 2015 per-district amounts for PARCC readiness and per pupil growth aid will continue in Fiscal 2016. Finally, I must point out that total School Aid, which includes direct State payments to education such as pensions, post-retirement medical benefits and teachers' Social Security, will top $12.7 billion, a 35% increase in State funding since Fiscal 2010.

- The Governor's budget continues the recent practice of reducing CMPTRA aid to accommodate inflationary increases in Energy Tax Receipts aid, functionally and appropriately combining CMPTRA and ETR into a single aid program. Separately, the budget allocates just over $107 million to Transitional Aid, a reduction of $14 million net of a transfer of $18 million from Transitional Aid to the CMPTRA base. Since Fiscal 2013, we have reallocated a total of almost $89 million from Transitional Aid to the CMPTRA base as some localities have demonstrated a need for increased CMPTRA base aid and/or earned "graduation" from the Transitional Aid program's intensive oversight requirements. This dynamism is exactly we hoped and expected to experience at the time we consolidated a series of special aid programs into Transitional Aid as part of the Fiscal 2011 budget.

- The Governor's budget increases student financial assistance by almost $16 million, mostly to support a 2% increase in Tuition Assistance Grants (TAG), while holding aid to senior public and independent colleges and universities flat. Importantly, for the senior publics, this will include a $38 million shift from direct operating aid to fund increases in fringe benefit costs. Currently, the State bears a legacy commitment to support fringe benefits for over 21,443 positions at the senior publics --- approximately 69% of the total --- at an average cost of $35,206 per year. At a time when every level of government is struggling with the rising cost of employee benefits, we think this represents a modest and appropriate sharing of the burden.

Third, when Governor Christie made the decision to expand NJ FamilyCare, our state's $15 billion Medicaid program, under the federal Affordable Care Act, a key objective and expectation was that a dramatic expansion of Medicaid and ACA exchange enrollment would lead to a significant drop in the demand for uncompensated hospital care, historically supported through the State-funded Charity Care program.

I am happy to report that we are realizing those expectations. Now, with more than 390,000 New Jerseyans newly insured through NJ FamilyCare and another 250,000 insured through the federal marketplace, we are seeing a substantial decline in documented Charity Care claims and a concomitant increase in Medicaid dollars flowing to New Jersey's hospitals. So far, the Department of Health has seen an estimated reduction of over $400 million (or more than 40%) in documented Charity Care claims for calendar 2014. Comparing the calendar 2014 Charity Care claims to the Fiscal 2016 budget for Charity Care yields an overall Charity Care subsidy rate of 87%, up from an estimated 63%.

Although different hospitals obviously serve different communities and have different payer mixes, the takeaway is clear: the ACA is driving fundamental changes in health care finance and significant net new dollars into our hospital system.

Taking advantage of this historic rebalancing and the ongoing infusion of new federal Medicaid dollars, the 2016 budget recommends a $148 million reduction in State and federal funding for Charity Care offset by a $27 million (or 27%) increase in State and federal support for graduate medical education, benefitting 35 hospitals, and a $45 million increase in State and federal funding for Medicaid physician reimbursement rates for certain primary and specialty care services, an important initiative to ensure appropriate access to care. The total reduction in combined State and federal funding for hospitals --- not counting the increase in Medicaid --- will be approximately $120 million.

Fourth, I would like to draw your attention to the Governor's budget recommendations with respect to the 4% dedication of Corporate Business Tax revenues. As some of you will appreciate, the recently adopted constitutional amendment imposed dramatic changes in the allocation of the 4% dedication and created serious budget challenges for the Department of Environmental Protection and many of its important water resources and cleanup programs.

In an effort to prevent undue harm to those programs, and in conformity with the new constitutional dedication, the fiscal 2016 budget allocates almost $20 million of the total $80 million dedication for acquisition, development and stewardship of lands to support the management and stewardship of the State parks, and almost $14 million to recreational land development and conservation in the form of capital improvements to State parks. The budget allocates the remaining $46 million in accordance with the 2009 bond act allocation between open space preservation, farmland preservation, and historic preservation.

We understand that various stakeholders have expressed different, albeit not entirely consistent, views on this matter. In response, I would only note that we believe that the Governor's budget advances a practical and reasonable approach to apportioning limited available resources across competing priorities.

Fifth, I understand that there is great interest in the question as to whether and how the Governor's budget impacts the future of the Transportation Trust Fund Authority (TTFA) and the related Transportation Capital Program. As you know, the Department of Transportation will forward a TTFA Financial Plan to the Legislature shortly as part of the annual budget process. That plan will show cash resources sufficient to support an estimated total of $1.127 billion in State transportation project costs in Fiscal Year 2016, per the existing TTFA authorization. These resources will include cash balances of $281 million, authorized bond proceeds of $627 million, and a repayment of $241.5 million in Fiscal 2015 cash advances to New Jersey Transit.

In sum, the Governor's budget, and the related TTFA Financial Plan, will support the final year of the current five-year TTFA authorization. There is no proverbial Sword of Damocles hanging over the State's transportation capital program as of July 1, 2015. This does not, however, obviate the critical need to secure a new reauthorization of the TTFA as soon as practicable to support appropriate long-term capital program planning and project management. To that end, as you are aware, the Governor and the Commissioner of Transportation have been engaged in an intensive dialogue with a range of stakeholders, including the Legislative leadership.

Sixth, I would be remiss if I did not spend a few moments elaborating on the Governor's recommendation for legislation to permit the voluntary conversion of outstanding Business Employment Incentive Program (BEIP) grant commitments into refundable tax credits. This will insulate the State's timely fulfillment of its important contractual commitment to businesses that agreed to relocate or stay in New Jersey under the BEIP program from the vagaries of the annual appropriations process.

Although we are still working on details with our colleagues at the Economic Development Authority, the general concept is to make the tax credits available to electing businesses in equal installments over a period linked to their converted BEIP grant agreement's remaining term and compliance period. In addition to proposing a structure that limits the fiscal impact on the State in any one year, we will propose that the credits be made available for use beginning in Fiscal Year 2017. We believe that this deferral is warranted in light of the anticipated complexities attendant to the conversion process and represents a reasonable tradeoff to businesses in exchange for the benefits of greater certainty going forward. Businesses that choose not to convert would of course continue to qualify for BEIP grants subject to appropriation. We are gratified by the strong bipartisan support we have received and look forward to working with the Legislature on this important initiative.

Finally, I would like to close with a brief "infomercial". As part of our ongoing transparency and performance budgeting initiatives, most agencies' sections in the Fiscal 2016 Detailed Budget again include financial information and key performance indicators in a Core Mission Summary. Of course, this information and more is available on-line and updated periodically throughout the year. If you have not had the chance to review this material, I urge you to do so. This year, we've gone one step further: we have posted multiple years of traditional Evaluation Data, heretofore available only in static printed form, to the web in a spreadsheet form that can be downloaded and manipulated for analysis.

Thank you for your patience with this lengthy opening statement and the opportunity to appear before you. I will be happy to entertain your questions.