

**REMARKS OF FRANK HAINES,
LEGISLATIVE BUDGET AND FINANCE OFFICER
TO THE
SENATE BUDGET AND APPROPRIATIONS COMMITTEE
APRIL 5, 2016**

Chairman and committee members, good morning. You have well begun the annual Rite of Spring that is the Legislature's review of the Governor's proposed budget. Collectively you have already spent hundreds of hours in public hearings receiving testimony from hundreds of New Jerseyans – parents, students, taxpayers, association executives, university presidents, school and municipal officials, among others – all concerned about the impact the State budget will make, or may not make, on their lives and the lives of those they represent and care for. Today you commence the next phase of the process -- the scrutiny of the details large and small of the State budget, and the dialogue with the heads of the other two branches of government as they appear before you over the next seven weeks to discuss their own particular areas of responsibility.

As you make this investment of hundreds more hours of your collective time and attention, the staff of the Office of Legislative Services will do our utmost to help you understand this budget, its broad strokes as well as its intricacies. We will provide you with analyses of the departmental and Judicial branch budget recommendations. We will elicit responses to questions on agency programs and services, point out budget highlights, identify significant changes in funding and language provisions that place conditions on that funding, and underscore the results that are expected from the expenditure of public dollars.

And we will remain at your service after you conclude your review of the budget and move on to the challenge of crafting and approving an appropriations bill that allocates the State's finite resources to best meet the diverse and pressing needs of the citizenry.

The budget for FY 2017 the Governor has presented to you is, by conventional measurement, the largest budget ever recommended by any Governor of this State, totaling \$34.8 billion. If we consider federal funds in addition to State revenues, then this budget of \$53.8 billion is the second largest ever proposed. In its broad outlines the FY 2017 budget is much like its immediate predecessors. Two-thirds of the revenue expected in FY 2017 come from just two sources, the gross income tax and the sales and use tax. Local education aid in all its forms is the largest category of State spending. The sum of State *and* federal dollars allocated to providing health care and other services to the State's elderly, disabled and disadvantaged exceeds the amount allocated to any other purpose. Grants in Aid and State Aid account for three-fourths of State spending.

Since the Great Recession wreaked havoc on our economy we have been on a gradual return to the pre-recession peak. By some measurements we have arrived there or have surpassed that level, but by others we still have a ways to go. Through 2014, our Gross State Product, adjusted for inflation, had not yet achieved its previous high point, growing at an annual rate of only 0.8% since 2009. It is likely that when 2015 data are released they will show us at or perhaps just above the peak that preceded the downturn. The employment picture improved during 2015, with payroll employment growing by 65,200 jobs, a rate of 1.9%. The unemployment rate fell during 2015 and has continued to fall in 2016, to the point where we are now, at 4.3%, below the national rate of 4.9%. But job growth has still not improved to the point where we have

returned to pre-recession employment levels. According to Moody's Investors Service, we have recovered 87% of the jobs lost in the Great Recession, while the nation as a whole has replaced 154% of lost jobs.

Through 2015, both total personal income and income per capita, measured in current dollars, have grown annually since 2009, albeit at modest rates averaging about 3%, and are well past the ceiling attained before the Great Recession. We remain ranked third among states in per capita personal income, and in both 2014 and 2015 our rate of growth exceeded the national average. State revenues finally surpassed their pre-recession levels in FY 2015, and have grown in total annually since FY 2010. Overall, this is not what one would call a rapid rebound from the lows of the end of the previous decade, but for the most part growth in broad economic indicators and State revenues has been steady if not spectacular, and the outlook is for more of the same.

I would now like to take stock of certain elements of uncertainty that could affect the FY 2017 budget as proposed. You have all heard the truism before: a budget is a plan, based on predictions and assumptions about the future, both on the revenue side and the spending side of the ledger. And since the future does not always cooperate, some elements of even the best thought-out plan will not turn out as envisioned or intended. By identifying these items early in the process I hope to give you as much time as the calendar allows for you to weigh their gravity as you develop the budget you eventually send to the Governor for approval. Some of these items, which I present in no particular order, will come as no surprise to any of you.

The revenue side of every budget entails forecast risk. Revenue forecasters are never perfect. We have discussed in previous years the volatility of our revenue structure. Our personal income tax comprises about 40% of our revenue base, and relies on less than 1% of taxpayers

for nearly one-third of that revenue. Non-wage income can fluctuate widely and unexpectedly, and when it does we see surprises in April and May, good or bad. Other tax and revenue sources are subject to forecast error as well, but even small departures from our expectations for the income tax can make other problems seem small by comparison. A one percent forecasting error in the income tax estimate is worth \$140 million. We may be facing an unusual degree of income tax forecast risk if news reports are true that the person ranked by Forbes Magazine as the wealthiest New Jersey resident has shifted personal and business domicile to another state. And while the sales tax has proven to be more stable over the years, a missed forecast in a tax that generates over one quarter of total revenue can be significant. A one percent error in the estimate for the sales tax is worth \$100 million. Seemingly small errors have large budget impacts.

As was the case in FY 2016, the FY 2017 budget provides no funding in anticipation of new contracts with Executive Branch employee representatives, other than to meet the cost of step increments up the salary range for certain employees. Most contracts expired on June 30, 2015. Contract settlements may not occur in time to affect FY 2017 salaries, but if that comes to pass the budget may not make adequate provision.

In a similar vein, New Jersey Transit has settled contracts with several of its unions. The new contracts are not yet ratified and contract details are not fully known. There could be an impact on the amount of subsidy the State is providing to the agency in FY 2016 and FY 2017.

Changes to employee health benefit plans have been approved that took effect in calendar 2016. Savings of more than \$100 million are expected in both 2016 and 2017, and the FY 2017 value of these savings is \$197 million. In addition, the FY 2017 budget assumes additional changes in

plans – changes not yet adopted and perhaps not yet fully developed – to save \$250 million.

The FY 2017 budget recommends \$15 million to fund tort claims, and \$10 million for the cost of medical malpractice claims for the medical schools at Rutgers and Rowan universities and for University Hospital. Total funding needs for these purposes are averaging \$35 million and \$45 million per year, respectively.

The budget provides a base allocation of \$10.4 million for the Department of Transportation's winter operations. This compares to an average cost of about \$115 million in recent years.

For these last three items alone, if the recent averages equal the worst case scenario for FY 2017, then there would be a gap of \$160 million.

The possibility of Medicaid disallowances is a perennial risk to state budgets, and ours is no exception. Seventeen program audits by the federal Office of the Inspector General, focusing on claim documentation and cost allocation methodologies, are in either draft or final form. They are under dispute and subject to appeal and revision. Both the timing and amount of potential disallowances are uncertain, but in the aggregate are estimated in the hundreds of millions of dollars. \$100 million is reserved against whatever liability may arise from resolving these audits.

The Supreme Court has heard oral arguments in the case of *Berg v. Christie*, which seeks to overturn the current suspension of retiree cost of living adjustments. It is unknown when and how the court will rule. The impact on the State of a ruling in favor of the plaintiffs, and the timing of that impact, are also unknown, but that ruling would at some point increase the annually required contribution, perhaps substantially. A report by Moody's Investors Service in January 2016 made an

assumption that the reversal of the COLA freeze would increase the full annual employer's contribution by about 30%. If that higher requirement applied to FY 2017, the State's contribution, at 40% of the full amount, would increase by an additional \$500 million. Local employers would be affected as well, but Moody's did not attempt to estimate that impact. The OLS cannot confirm or refute Moody's assumptions or estimates.

And last but certainly not least: the budget assumes the receipt of \$1.6 billion in resources from the Transportation Trust Fund Authority to support transportation system costs in FY 2017. No source of funding has been identified.

One of the counterweights to the possibility that these risks affect the budget plan for FY 2017 is a projected surplus of \$780 million.

Before my colleague Catherine Brennan presents the OLS revenue forecast for FY 2016 and FY 2017, I have two last observations. The budget for FY 2017 may be the last one approved while the only lawful location in New Jersey for casino gaming is Atlantic City. And the budget for FY 2017 may be the last one approved in which there is discretion over how much the State pays to the defined benefit pension funds, and when those payments must be made. The budget after this one may be subject to a changed environment, with different opportunities and challenges. I am sure you will be mindful of these possibilities as you set yourselves to the task at hand.