State Treasurer Ford M. Scudder

Senate Budget and Appropriations Committee, Budget Overview

April 6, 2017

Thank you for your kind invitation to discuss Governor Chris Christie's proposed Fiscal 2018 Budget.

Please let me take a moment to introduce my colleagues at the table this afternoon: Beth Schermerhorn, Deputy State Treasurer; David Ridolfino, Acting Director of the Office of Management and Budget; and Mary Byrne, Deputy Director of the Office of Management and Budget.

This being my first appearance before your Committee this year, please let me extend the gratitude and appreciation that all of us in the Department of the Treasury have for the special role that the Budget Chair and members play in budget introduction and enactment. I know that you spend endless time away from your families and other jobs in order to create a better budget. I will try and be thorough but to the point in today's proceeding. I also would like to assure you that should you have any questions or concerns that cannot be answered today, we will do our best to respond to you and your staff in a timely and orderly fashion.

I will start with a brief overview of what I believe to be the overarching themes of the Governor's $35.5 billion budget proposal before turning to some specific discussion points that I believe may be of particular interest to this Committee, as well as to the citizens of New Jersey who we are all privileged to serve.

Fundamentally, this Budget reflects and advances the Governor's continuing strategic priorities: providing a more efficient and structurally sound State government, enhancing New Jersey's economic competitiveness, and maintaining high-quality, critical safety-net supports and services for New Jersey's most vulnerable citizens.

I want to stress that as we advance those priorities, we continue to make significant progress in the structural integrity of the Budget. The State's unemployment rate is less than half its peak, with the State recovering all jobs lost during the Great Recession plus tens of thousands more. Our use of nonrecurring resources remains at a more responsible baseline. Our annual pension payment has moved from zero in 2010 to a record high of $2.5 billion in Fiscal 2018. The runaway rates of debt issuance and property tax growth have slowed dramatically. The Unemployment Insurance Trust Fund, which after years of improper diversions reached a peak deficit of $2.1 billion, is now running a more than $1.9 billion surplus. And the Transportation Trust Fund has gone from tapped out, to being the largest and best funded program in our State's history.

In addition to that continued economic improvement, the details of the Governor's Budget Proposal must be viewed in the context of two driving factors. First, the historic TTF reauthorization passed by the Legislature and signed by the Governor last fall represents a tremendous investment in the future of this State. Not only do the constitutionally dedicated gas tax revenues provide for a dramatic increase in funding for the State's transportation infrastructure—critical in a logistics hub and commuter state such as New Jersey—but the bipartisan agreement also lays the groundwork for increased capital investment, job formation and economic growth by making New Jersey more hospitable to people, businesses, and capital via the accompanying package of tax cuts.

Secondly, this Budget is predicated upon maintaining the Governor's commitment to securing the retirement benefits of the hard working public employees by increasing the defined benefit pension payment. The FY17 Appropriations Act includes a record pension payment of $1.86 billion, representing 4/10ths of the actuarially determined contribution or ADC, which will be made before the end of the fiscal year. The Governor's proposal for FY18 includes a new record payment of just over $2.5 billion, representing 50% of the ADC. This $647 million increase in the defined benefit pension payment, however, does place limits on our ability to address other spending requests, many of which you have heard during the public hearing process.

Bearing in mind that high level understanding, I would like to dig right in with our expectations for the close-out of Fiscal 2017 and then move on to the Governor's Budget for Fiscal 2018.

We started the current fiscal year with an opening fund balance of $482 million. Total revenue for Fiscal 2017 has largely met expectations and is now projected at $34.36 billion, a net reduction from the Appropriations Act of $247 million, reflecting both statutory changes included in the TTF reauthorization and various updated projections.

Gross Income Tax receipts, which have grown 1.5% year-to-date, when we adjust for a shift in the processing of partnership collections from the CBT, are running behind the projected annual growth rate of 4.4%. Our estimate is essentially unchanged from the original Appropriations Act forecast, adjusted only for the larger EITC.

There are two primary reasons we believe maintaining our base forecast to be appropriate. First, the strong stock market in calendar year 2016, particularly as compared to the weak stock market in calendar year 2015, should lead to large reported increases in unearned income for Tax Year 2016. Internal and external research suggests the 10% increase in the stock market should lead to approximately the same level of growth in estimated and final payments in calendar year 2017. Indeed, we believe we are already seeing this play out.

Whereas estimated payments made during the months of July – November declined by -15.0% year-over-year at the start of FY 2017, estimated payments for December and January are 5.3% higher than a year ago. The January deadline for estimated payments is typically when taypayers may try to recalibrate their payments based on actual Tax Year 2016 income. Not only did total payments increase by 5.3% over the prior December/January period but the average payment size increased by 10%.

Secondly, the Division of Taxation, has taken a number of proactive steps to reduce the prevalence of tax refund fraud, which we believe will yield tens of millions of dollars in savings for the State, manifesting in higher GIT revenues. After accounting for such considerations, we believe Gross Income Tax receipts are in line with our forecast.

Meanwhile, Sales Tax receipts have grown 1.8% year-to-date versus a 1.0% projected rate of growth for the fiscal year. We believe this provides a comfortable margin given the rate reduction as a part of the TTF package. In order to meet the GBM estimate, sales tax receipts over the remaining four months only need to be -0.5% lower than amount collected during the same time in FY 2016, translating to a baseline growth rate of 1.5% over the remainder of the fiscal year versus 2.2% over the first eight months.

Meanwhile, February revenue numbers show year-to-date Corporation Business Tax receipts, adjusted for the early shift of partnership revenues to the GIT, grew 5.4%, once again consistent with the estimated annual rate of growth of 7.6%. It is not useful to compare preliminary March revenues because there has been a very strong behavioral response by the largest companies to the change in Federal tax filing rules for C-Corporations that is causing many companies, that used to file in March, to now file in April.

We will of course continue to monitor tax receipts, especially throughout the all-important month of April. As I know the members of this Committee well appreciate, the New Jersey tax code is incredibly progressive. The April final tax payments would represent our fourth-largest single revenue source if separated from the GIT, even though only approximately one quarter of New Jersey taxpayers owe final payments in any given year. Meanwhile, the top 1% of taxpayers provide over 35% of the State's Gross Income Tax receipts, while just the top 100 filers pay over 5.5% of all GIT payments. This reality—with such a small segment of the population driving GIT revenues and so much of the revenue collected so late in the fiscal year—creates heightened volatility in tax receipts, severely increasing the complexity of the annual budgeting process.

After accounting for forecasted revenues and adjusting resources and appropriations, respectively, for an anticipated $344 million in lapses and $106 million in supplemental needs, the result is a projected ending fund balance for Fiscal 2017 of $491 million, which becomes the opening fund balance for Fiscal 2018.

At this time, we are projecting total tax and non-tax revenues of $35.6 billion for Fiscal 2018, a modest 3.6% increase year-over-year. We are similarly budgeting Fiscal 2018 appropriations at $35.5 billion, representing growth of 2.6% against the Fiscal 2017 adjusted appropriation. Finally, we are projecting an ending fund balance of $493 million.

Job creation in New Jersey has accelerated, with more new jobs created in 2016 than in any other year in this millennium. In fact, our unemployment rate is less than half what it was just six years ago and has dropped well below the federal rate. In conjunction with an improving employment picture, low oil prices continue to provide a positive catalyst for net energy-consumer states like ours. Further, stock market gains coincide with large increases in consumer confidence, signaling widespread anticipation of an improving economic outlook.

Indeed, the Federal Reserve Board likewise has expressed renewed optimism for the economy, given multiple recent decisions to raise the federal funds target rate and expectations for two additional rate increases this year. Finally, continued increases in stock market and housing values have increased U.S. household net worth to an all-time high. Household consumption and business investment are both positively correlated with wealth, so increased asset values are therefore likely to unleash additional spending and investment, which should in turn have positive effects on the economy and all state tax bases.

Moving from the national economy to localized New Jersey factors, the legislated phase-out of the Estate Tax is already having a positive impact, sway that will only increase once the tax is fully repealed. In addition, we are in the final stages of selectively hiring new revenue-enhancement employees at the Division of Taxation, including auditors and research analysts, that will lead to far higher levels of compliance—all while maintaining a headcount that's below the appropriated amount. Each of these factors will inure to the benefit of all of our major taxes.

It is this economic backdrop that provides the basis for our Fiscal 2018 revenue forecasts. As is true of any year, much of the anticipated revenue growth is derived from our three major sources of tax revenue. At this time, we are projecting 3.6% growth in the Gross Income Tax, 1.7% growth in the Sales Tax, and 5% growth in the Corporation Business Tax.

- As it relates to the Gross Income Tax, the inherent projected growth rate is actually 4.4%, but decreases to 3.6% after netting out certain adjustments related to the TTF legislation.
- The baseline projected increase in the Sales Tax is 4.8%, but decreases to 1.7% due to the TTF changes. This underlying growth rate is higher than what we have experienced so far this fiscal year, but we anticipate the strong increases in employment and withholding that we have already been observing will translate into increased household consumption.

Before leaving the revenue side of the ledger, I would like to note that Governor Christie's proposed Fiscal 2018 Budget continues his commitment to reducing the State Budget's reliance on non-recurring resources, down dramatically from a high of over 13% in Fiscal 2010 to 2% in Fiscal 2018. There always will be some non-recurring resources in the State Budget, whether in the form of revenues or savings. But the Governor has clearly established a new and much more sustainable and responsible baseline.

Included amongst the non-recurring resources is a planned $325 million in asset sales. However, this is both a one-time resource and recurring savings. As part of the continuing concerted effort of this Administration to reduce the size and footprint of State government, the State has vacated 1.5 million square feet of State-owned properties in the past seven years – many being sold and bringing in revenues of more than $10 million. Lease payments have decreased by $15 million annually.

Today, the Department of the Treasury is in the process of analyzing additional State properties to be sold prior to the end of FY 2018. A portion of the anticipated asset sales is linked to the Federal Communications Commission's broadband spectrum auction. It is anticipated that the value of the sale will be announced by the FCC this spring.

In sum, our revenue estimates are prudent—consistent with our continually strengthening economy yet also in line with five-year average growth rates.

Moving next to the expense side of the ledger, this Budget continues Governor Christie's commitment to rebuilding a sustainable pension system, including a $2.51 billion defined benefit pension plan contribution.

This represents the largest pension payment in our State's history, 5/10ths of the ADC, a $647 million increase over the FY17 amount and nearly double the Fiscal 2016 amount.

With this payment, Governor Christie will have contributed almost $8.8 billion to the pension plans, far more than any previous Governor and more than 2.5 times the amount contributed under the previous five administrations combined.

To ensure that we can afford this sizeable increase in pension funding, as well as other investments, the Governor's Budget calls for continued efforts to produce cost savings in public employee and retiree health care costs. Despite the significant reforms of 2010 and 2011, the rising costs of defined benefit pensions and health benefits continue to burden State and local government. 82% of the growth in spending in the State's Fiscal 2018 Budget will go to increased spending on pensions, employee health benefits and debt service.

While we continue to believe that broader, longer-term reforms are necessary, we cannot allow the dramatic escalation in health care costs to continue unabated, thus the need in this Budget to make a down payment on future reforms.

In particular, the incomparably generous health benefits packages for active and retired public employees is hampering the Administration's ability to devote additional resources to the pension system or other priorities.

While there have been some admirable changes to the health benefits plans in the past few years, we can and must build upon those previous successes in a number of areas. With hard work and continued cooperation, further successes can be achieved that reduce cost while still providing substantially similar levels of care for our State employees, freeing up funds for other priorities in State, local and household budgets.

First and foremost, it is imperative that the School Employees Health Benefits Program institute the same common sense contract and plan design changes made last year by the State Health Benefits Program. These changes simply remove excess costs from the system, saving significant funds for employees, the State and local governments.

In addition, the Administration will work with the Legislature to implement transparent disclosure of all out-of-pocket expenses for out-of-network procedures, another common-sense reform that will remove, from the health care system, unnecessary costs, as well as unfair and unanticipated burdens for employees.

Following these reforms, the State will save $125 million. Moreover, employees will benefit from lower premiums, and local governments and school districts will also save approximately $127 million, constituting meaningful property tax relief.

I want to emphasize that these reforms are not just good for government budgets and taxpayers. They are good for the employees themselves, who now pay an average 20% of health insurance premiums and thus will save an aggregate $30 million. In other words, our interests are aligned because with reforms, government budgets are controlled, taxpayers get relief, and so do the rank and file employees. We all pay more than we need to for health care.

Finally, I will close by highlighting a few noteworthy spending items of the Fiscal 2017 Budget.

- First, the Governor's Budget continues to restrain the growth in discretionary State spending. Spending for the Executive Branch will increase by only 0.7%. Core State spending—in other words all spending other than pensions, health benefits and debt service—has remained essentially flat under this administration at approximately $2 billion below Fiscal 2008 levels.
- Second, the Fiscal 2018 Budget builds upon the Governor's commitment to work with the Legislature to come to the aid of those citizens battling the scourge of drug addiction. Inclusive of a variety of new initiatives and increased investments to combat the addiction epidemic, Governor Christie has made an unprecedented increase in the amount of funding provided for mental health and addiction services since he took office, increasing the amount of combined State and federal funding by 52%, from $283 million in the Fiscal 2010 Appropriations Act to a recommended $430 million in his Fiscal 2018 budget.
- Third, this Budget once again provides the highest amount of State support for education in New Jersey history, surpassing the previous spending level for the seventh consecutive year. The Fiscal 2018 Budget proposes spending more than $13.8 billion on education, an increase of $523 million from Fiscal 2017. Of the total school aid, almost $9.2 billion represents direct aid to schools. Every school district will receive at least the same K-12 funding in Fiscal 2018 in order to uphold New Jersey's commitment to education. From

Fiscal Years 2010 to 2018, State funding for school aid will have increased by 46 percent.

- Fourth, the Governor's Budget continues providing over $1.5 billion of municipal aid, essentially the same level of regular aid as in past years. In addition, as already noted, property tax savings will be achieved with the enactment of the changes to the SEHBP. Direct Property Tax Relief programs that benefit individuals also will continue at the same benefit levels as in Fiscal 2017.
- Fifth, the Budget provides $2.2 billion for higher education. Support for public colleges and universities is essentially flat year-over-year. However, student financial assistance will increase, chiefly due to growth in the Tuition Aid Grants which includes 2,000 new awards as well as award amounts increasing by 2% over Fiscal Year 2017.

Lastly, I would like to correct a misunderstanding that flowed out of yesterday's hearing as related to funding for New Jersey Transit. In Governor Christie's first budget, NJTransit received $1.277 billion in funding from all sources, State and federal. For the Fiscal 2018 Budget that is increased to $1.76 billion, a 38% increase in funding under this Administration. And, that growth does not take into account the $140 million in supplemental TTF aid that the organization will receive this year as a result of the $400 million TTF supplemental that was enacted a few days ago or one-time federal FAST Act monies received in FY17. This enhanced operational and capital funding provides NJTransit with the requisite resources for all of its needs, including contractual escalations and salary increases, additional maintenance and capital investment, and installation of Positive Train Control.

Thank you for the opportunity to appear before you to discuss the Governor's Fiscal 2018 budget, as well as your patience with my lengthy opening statement. I will be happy to entertain your questions.