REMARKS OF FRANK HAINES, LEGISLATIVE BUDGET AND FINANCE OFFICER TO THE SENATE BUDGET AND APPROPIATIONS COMMITTEE APRIL 2, 2019

Chairman Sarlo and committee members, good morning. Thank you for inviting the Office of Legislative Services to address you on the subject of the Governor's proposed FY 2020 budget. I intend to keep my comments brief so we can proceed to Mr. Drescher's presentation of the OLS revenue forecast.

OLS will help you delve into the details of the budget over the next six weeks as you engage Cabinet members, agency heads and the Judiciary in your review. As usual there is a lot to digest and my colleagues are devoting much time and effort to their analyses. There are plenty of changes and ideas this budget challenges you to consider. Some of those have already come to the fore, and others will be highlighted as the budget process continues. And having held two public hearings you already know some issues the budget doesn't resolve. Your job as policymakers remains as difficult as ever.

At this point I'm going to ask you, not for the first time, to shift your gaze from the details of the budget to its bottom line – the surplus. For a business a healthy bottom line is the paramount goal - it's about profit, the more the better. Not so for government. Government may frequently need to be business-like to effectively deliver services, but if business principles always prevail, we're probably not governing as well as we should.

What then constitutes a healthy bottom line for government? How does one measure surplus adequacy? You'll get different answers to that question depending on who you ask. And there may be no single right answer.

You'll see from the graph on page 16 of the OLS Tax and Revenue Outlook that the projected surpluses for both FY 2019 and FY 2020 are improvements over those of recent years. That's a healthy trend from a fiscal analyst's perspective. Of course a fiscal analyst doesn't have to reckon with the price of an accumulated surplus the way policymakers do – a price that might be paid in the form of less after-tax income, or less adequate services.

How does our surplus measure up? The text on page 16 refers to a long-term average among states of 8.4 percent, so at about 3 percent we are well below that level. Now, one could argue that this all-states average might not be representative of New Jersey, or states like New Jersey, or that it could be pushed upward by states that have different fiscal structures and budgeting rules. So what about another yardstick?

The researchers at the Pew Charitable Trust that focus on public finance developed another measure: the number of days a state can run on its balances. The calculation is simply a state's surplus divided by its per day spending. For FY 2018 the state median was about 40 days. At about 8 days, we don't rank very well on that scale – fourth from the bottom.

The Pew test looks at surplus solely in terms of revenue replacement. There are other ways to evaluate surplus. Stress testing is another term that's prevalent in public finance circles of late. Stress testing measures available reserves - sometimes just budgetary surplus, sometimes other reserves as well – in different contexts of budgetary challenges, like surges in service demand, emergencies, and changing economic conditions, including a recession.

Yes, I said recession. The country is in the midst of one of the longest economic expansions on record. How much longer can this last? I'm no economist, so on the subject of recession you'll get no prediction from me about whether, when or how deep. Certainly our revenue forecast does not envision a recession. But should one arrive, how well prepared are we?

Pew's latest report on state surplus indicates that more states are increasing their reserves relative where they stood previous to the last recession. Twenty-three states now have more reserves than they had when entering the 2007-2009 recession. New Jersey is not among that group.

Moody's Analytics measures states' reserves against the fiscal shock of a recession through a sophisticated proprietary model. It assesses over two fiscal years the impact on each state's revenues and Medicaid spending of both a moderate recession and a severe recession. In both simulations, New Jersey was among the least able to offset fiscal shock with reserves. Under a moderate scenario, reserves fell nearly 11 percent short of the impact. Under a severe scenario, the gap between reserves and impact was about 16 percent.

Our counterparts in California, the Legislative Analyst's Office, discussed structuring the state budget with one of its budget committees as the Legislature began its evaluation of the Executive's proposed budget for FY 2020. They posed these questions among others to the committee about determining a target level of budget reserves:

*What size recession would you like to prepare for?

*What are the current levels of one-time and ongoing commitment in the budget?

*How willing is the Legislature to take other actions during a recession?

Referring back to the graph on page 16 of the Outlook, you can see our surplus position prior to the last two downturns. While those reserves were not sufficient to fully counteract the budgetary impacts of those events, they were more substantial cushions than we have at present.

So I urge that among the many difficult matters you deliberate as you craft the FY 2020 budget, you ask yourselves the same three questions as were raised in California. Your answers can have an important impact on this budget and those to come.

That concludes my remarks. I'll now turn it over to Mr. Drescher.