ASSEMBLY BUDGET COMMITTEE HEARING
State Treasurer Elizabeth Maher Muoio
Testimony as Prepared for Delivery
September 9, 2020

Good morning, Chairwoman Pintor Marin, Vice Chair Burzichelli, Budget Officer Wirths, members of the committee.

As far as anyone can recall, we appear to be setting a record by putting together three budgets in one year.

Granted, this isn't a record anyone strives for, but we could not have gotten through it without my colleagues that are joining me here today:

- Deputy Treasurer Catherine Brennan
- Acting Director of the Office of Management and Budget (OMB) David Ridolfino,
- OMB Deputy Director Lynn Azarchi, and the entire OMB staff; and
- Martin Poethke, the Director of the Office of Revenue and Economic Analysis – or OREA as you'll hear me refer to it, as well as his staff.

They, along with those joining me here today, and countless others who work in our divisions, have been absolutely indispensable throughout this crisis. I can't thank them enough for their professionalism and dedication. September marks the seventh month since the entire world became ensnared by the COVID-19 pandemic. Our minds can become numb to the seemingly endless flow of data that has brought a relentless cascade of harm to lives and livelihood – almost 190,000 U.S. deaths, more than 14,000 fatalities in New Jersey alone, second quarter U.S. GDP down a stunning 32.9 percent, state employment still down by half a million jobs, and a New Jersey unemployment rate of 13.8 percent in July, higher than any month during the Great Recession.

You are all well aware of these troubling statistics and I don't need to recite them at length. Our August Revised Budget Report provides greater detail and we will be happy to answer any questions you may have. For now, however, I would like to focus on the big picture since we have limited time and a lot to get through both today and by the end of this month.

If there is one thing this pandemic has both laid bare and exacerbated, it is the inequities that have long underpinned our society. A recent report based on Census Bureau data found that employment was 2 percent <u>higher</u> than January levels for those making $32 an hour or more. However, employment was 16 percent lower for those making between $14 and $20 an hour <u>AND</u> 20 percent lower for those making less than $14 an hour. Although the pandemic has affected all of us, it continues to hurt the poorest and most vulnerable among us the hardest.

The disparate impact of the pandemic has also been felt along racial and gender lines. After officially peaking at 14.7 percent in April, the national unemployment rate has since fallen to as low as 7.3 percent for whites. Meanwhile, unemployment has remained in the double-digits for communities of color – at 13 percent for Blacks, 10.5 percent for Hispanics, and 10.7 percent for Asian communities.

Along gender lines, a separate report has shown us that Latina women have had the highest jobless rates throughout the pandemic, peaking at 20.8 percent in April, and continuing to remain high, coming in at 16.3 percent in June, followed by Black women at 14.2 percent. Nationally, Black men and women have recovered about 20% of the jobs they lost in the pandemic - versus almost 40 percent for white men and 45 percent for white women. The Governor's policies were developed with an eye towards addressing these glaring disparities.

Our task in preparing and adopting the Fiscal Year 2021 (FY 21) Appropriations Act is to realistically see where we are now and where we are going next. As the Governor has so eloquently stated, our goal is not simply to get New Jersey back to where it used to be, but to move us forward to where we NEED to be – essentially to make us not just stronger and fairer, but more resilient, in our post-COVID future. That means investing in areas that have historically been ignored.

To that end, it is important to understand that economic forecasters, both from the Blue Chip consensus and from the monthly Wall Street Journal survey, agree that real GDP will remain below pre-COVID-19 levels, and unemployment will remain above pre-COVID-19 levels, until 2022 at the earliest. New Jersey's economic performance will mirror that of the nation, and our fiscal condition may take years to fully recover.

Before we get to the investments that will help us address these factors, let's quickly review our latest revenue forecasts so we can all understand the resources we have to work with.

Fiscal Year 2020 – Traditional 12-Month Period

When the Governor presented his budget message on February 25, the improving revenue outlook called for steady growth to close out FY 20 with $39.465 billion. Indeed, through the end of March, State revenues were up $1.3 billion, or 6.2 percent, above the same period the prior year. Ever so briefly, we were teased by the possibility of a happy "April Surprise."

But then the bottom fell out and nine months of revenue growth evaporated. Overall budgeted revenues in the traditional 12-months of FY 20 are now expected to miss the Governor's Budget Message target by $1.439 billion, a most painful shortfall to deal with in such a short period of time.

We firmly believe that the economic downturn and the resulting revenue shortfalls would have been worse if not for various federal stimulus programs funded by the CARES Act, including the Paycheck Protection Program, the $1,200 stimulus checks to individuals, and the expanded $600-per-week in unemployment benefits, which recently expired.

This $33.9 billion in federal support helped limit how far the economy sank during the spring and summer by temporarily propping up our sales tax, in particular, and helping to contain the size of the tax revenue shortfall.

This leads me to the FY 2021 revenue forecast.

FY 2021 -- Traditional 12-Month Period

Baseline budget revenue collections for the traditional 12-month period are projected to total $35.528 billion in FY 21, which is $5.633 billion lower than what we projected at the time of the Governor's Budget Message (GBM) in February. To be clear, as we've said before, this is the projected revenue shortfall in FY 21 if no new tax policy proposals are enacted.

As previously noted, the major tax revenues saw substantial declines during the final months of FY 20. Between April and July, the Sales Tax was down 14.3 percent, the Gross Income Tax (GIT) was down 5.9 percent, the Corporation Business Tax (CBT) was down 18.0 percent and Realty Transfer Fees were down 16.3 percent as the pandemic impact hit. While some of these trends are expected to ease, others have only just begun.

In general terms, revenues impacted by consumer behavior, like the Sales Tax, are expected to remain weak though the fall and winter, before growing again next spring when coming off the pandemic-weakened base. On the other hand, revenues impacted by annual income such as the GIT and the CBT, are expected to remain weak through the remainder of FY 21. Notably:

- GIT baseline collections are projected to total $14.526 billion in FY 21, $3.27 billion lower than the GBM forecast, and 10.3 percent below FY 20.
    - Most importantly, estimated payments this past spring were nearly 20.0 percent lower year-over-year, and this trend is projected to continue in the fall and carry-over into next spring's final payments.
    - Employer withholdings are forecasted to be 3.0 percent lower, year-over-year, as high unemployment and some business restrictions are expected to continue.
- CBT collections are projected to total $2.862 billion in FY 21, $969.4 million below the GBM forecast, and 26.0 percent below FY 20.
    - Firms reduced their estimated payments by almost 30.0 percent during the spring. Our forecast assumes this trend will continue with estimated payments in the fall and with final payments next spring.
- Sales Tax collections are projected to equal $9.794 billion in FY 21, $979.9 million less than the GBM forecast, and only 0.2 percent above FY 20.
    - Consumer spending, while boosted by strong sales at online marketplaces, is projected to remain below pre-COVID-19 levels in the face of continued restrictions on business activity, but growth will resume in the spring off a weakened base.
    - The end of the federal stimulus and its uncertain future will temper spending.
- Realty Transfer Fee collections are projected to bring in $361.4 million, $37.1 million below the GBM forecast, and 0.9 percent below FY 20.
    - Declines seen in the spring and summer are expected to continue in the coming months, followed by growth in 2021, but off a weakened base.

So to be very clear, while we would typically expect underlying growth of anywhere from three to five percent across our three major taxes year over year, for FY 21 we instead are expecting double digit declines in both GIT and CBT, and growth of only two-tenths of a percent in our sales tax.

I also cannot overemphasize the importance of the recently tabulated spring and summer quarterly estimated payments. Between April and July, individuals reduced their estimated payments by 20 percent and corporations reduced their payments by 30 percent. Those declines include the deferred tax payments made in July. What that means is there is essentially nothing missing. This is the most up-to-date tax payment data available. Taxpayers are signaling how they view their income prospects in Tax Year 2020, and the warning light is blinking red.

I know we will discuss this more during our question and answer session following these remarks. However, I would like to note, regarding the current difference in revenue estimates between OREA and OLS, that in order to adequately review the numbers put forth by OLS yesterday, it is critical that Treasury be given access to the underlying assumptions on which the OLS numbers were based.

As you know, Treasury's revenue forecasts are accompanied by pages of public detailed analysis, complete with references to statistics and analysis by national economic experts.

All that is currently available are the 12- and nine-month charts released yesterday and three short bullet points.

During such economically turbulent times, it is even more crucial that we have detailed insight into how OLS arrived at these numbers, particularly when it comes to Gross Income Tax.

Until we have that opportunity, it's far too risky to simply accept these estimates.

Budget Solutions

Facing roughly a $6.5 billion hole as a result of the pandemic, the Governor's proposed budget includes a balanced approach of targeted spending reductions across every state department, fair and equitable revenue raisers, an emergency borrowing proposal, and additional plans to invest federal funding.

The Governor has proposed a selection of tax policy changes beginning with the 9-month FY 21 fiscal period in order to avoid far more painful budget cuts, limit the size of borrowing, and improve overall tax equity in New Jersey.

The Governor has made it abundantly clear that he remains committed to tax fairness, and ensuring that the most fortunate among us, both individuals and corporations who have been better positioned to weather this fiscal crisis, pitch in a little more to help those who were disproportionately affected and face a much longer road to recovery.

The following tax policy proposals, totaling $1.019 billion, include an estimated $863.1 million in revenue raisers and an estimated $155.6 million in reduced appropriations for the 9-month FY 21 fiscal period (details can be found on pages 25 and 27 of the August 25th report).

Notable Revenue Raising Proposals

- First, this proposed budget asks millionaires to contribute less than two cents more on the dollar by extending the 10.75 percent tax rate to all income above $1 million, which would raise $390 million in FY 21. When coupled with the tax changes enacted at the federal level in 2017 (Tax Cuts and Jobs Act), those earning over $1 million would still see a net tax break of anywhere from $22,000 to nearly $350,000 for those earning roughly $20 million.

- The Governor's budget also proposes applying a 5 percent surcharge on federally Qualified Business Income (QBI) for individuals with income greater than $1 million, which would generate an estimated $75 million for FY 21 when it will be in effect for part of the year. These are the same individuals who have benefited from a regressive new deduction for pass-through entities that was also created under the 2017 federal tax law.

- This proposed budget also extends the CBT surtax of 2.5 percent on companies earning over $1 million for Tax Years 2020 and beyond, which would raise an estimated $210 million in FY 21.

Other proposals include increasing the Cigarette Tax to mirror neighboring states, increasing the current HMO Assessment on net written premiums, restoring the sales tax on limousines services, undoing the exemption and cap on sales and use tax for new and used yachts and boats, and raising firearms and ammunition taxes and fees for the first time since the 1960's.

After factoring in these proposals, we were still faced with a $4.6 billion hole with total budgeted revenues estimated at $36.391 billion for the traditional 12-month fiscal year. Total annual collections are expected to decline by $1.636 billion, or 4.3 percent, from the traditional FY 2020 level.

In order to help close this gap, protect many shared priorities, and weather any imminent health or economic crisis that might be around the corner, the Governor's proposed budget relies on additional solutions.

The first is to tighten state spending while making sure budget cuts were targeted, and not draconian in nature, in order to avoid the same pitfalls that stymied recovery during the Great Recession. As a result, the Governor's budget proposal includes $1.25 billion in spending reductions and solutions across all executive state departments**.** More than 90 economists and economic policy experts in New Jersey recently backed this approach in a joint letter urging the state to balance the budget with tax increases on the wealthiest residents and largest corporations instead of counterproductive budget cuts.

The Governor's revised budget also proposes to borrow $4 billion to help address the massive economic fallout created by COVID-19. As you all know, the proposed borrowing must first be approved by the legislative Select Commission on Emergency COVID-19 Borrowing. Our Office of Public Finance is currently evaluating funding options, including accessing the Federal Reserve's Municipal Liquidity Fund and/or borrowing from the public markets, to determine the optional financing strategy, with an eye towards obtaining the most favorable rates. They will draft the necessary documents for the bond issuance, which will be accompanied by the list of appropriations to be funded by this borrowing, compiled by the Office of Management and Budget.

This will all be presented to the Legislative Select Commission, which must then sign off on the borrowing level and the appropriations items in order for this funding to be included in the final budget that must be voted on by the Legislature. This whole process must be completed by September 30 in order for the Governor to be able to certify revenues for the FY 21 budget due to be enacted by October 1.

This is an extraordinarily tight turnaround, but if anyone can handle this challenge, it is this Treasury team with whom I am fortunate to serve, dedicated professionals who have deftly overcome hurdles left and right since the pandemic began. I also want to thank the members of the Legislature, particularly leadership, for their support on this critical component of the budget.

At the end of the day, this funding is crucial to protecting our core priorities and services, ensuring we do not default on our obligations, and helping to address long-standing disparities and ensure that New Jersey's recovery includes all of its residents.

To that end, the Governor's revised budget:

- Does NOT cut K-12 aid, post-secondary tuition assistance, or operating aid for senior public colleges and universities, and provides for expansion of pre-K;
- It restores funding for the Homestead Benefit and Senior Freeze property tax relief programs and does not decrease core municipal aid; and
- It does not impose new burdens on Medicaid recipients or curb the Child and Dependent Care Tax Credit.

It invests $60 million in the Clean Water and Drinking Water programs to ensure safe and modern water infrastructure statewide.

It increases the Earned Income Tax Credit (EITC) to 40 percent while proposing to expand age eligibility to assist tens of thousands of more young adults.

And, notably, it includes a new proposal from the Governor to launch a statewide Baby Bonds initiative. This will provide a $1,000 deposit for the approximately 70-75,000 babies that will be born in 2021 into families whose income is less than 500 percent of the Federal Poverty Level, or $131,000 for a family of four. When these children turn 18, they can withdraw these funds to help them pursue higher education, buy a home, start a business, or pursue other activities that will help close the wealth gap. It's estimated that this program will benefit three out of four children born in New Jersey.

The Governor's revised budget also includes a nearly $4.9 billion contribution to bolster the state pension system. This represents 80 percent of the Actuarially Determined Contribution (ADC) and will be the largest percentage of the ADC contributed in 25 years.

For those who have argued that skipping the pension payment would be the preferable option to take right now, I'd like you to keep the following in mind - had the state been meeting our assumptions and making the full required payment for all those years, instead of repeatedly skipping or shorting the pension system, our annual contribution this year would not be an 80 percent ADC payment of $4.9 billion, but instead a 100 percent ADC payment of roughly $750 million.

Think of what we could have accomplished with the billions and billions of dollars that have gone instead towards making up for years of skipped pension payments.

The Governor is determined to make good on his commitment to fully funding the pension, not only because it is responsible fiscal stewardship, but because the state made a promise to its public employees. These are many of the same people who have been serving on the frontlines throughout this pandemic – police and fire, teachers, home health aides and countless other dedicated public servants.

Finally, this budget also helps us begin rebuilding our reserves to a healthier level of $2.2 billion. It's important to remember how quickly the cushion we had been building for the last few years disappeared in the face of this crisis. We've already seen the danger and witnessed the volatility this crisis is capable of producing. For the first nine months of this budget, we were looking at $1.3 billion in revenue GROWTH over last year. Then, in just four months' time, it all evaporated.

I cannot stress how crucial these reserves are during such economically turbulent and unprecedented times, particularly given that OREA estimates our revenues could take at least another $1 billion hit if the very real possibility of another coronavirus resurgence materializes.

Without healthy reserves, in the face of further downturns we will be forced to make draconian cuts on top of limiting eligibility for critical social services. We all heard the outcry when we were forced to defer funding key priorities in the three month budget. Without a healthy reserve and reliable and sustainable revenue that the Governor can certify, critical programs like Senior Freeze, Homestead benefits, school payments, and municipal aid – key elements in keeping property taxes in check – will all be threatened if economic conditions force another sudden drop in revenues and a rise in expenditures.

That is precisely what the surplus is designed for.

It's incumbent upon us to plan for the best while still preparing for the worst. This means making the investments necessary to ensure that New Jerseyans are able to count on the government services and support they so desperately needed to tackle this crisis, while also taking steps to address the economic disparities that have been further exposed by this pandemic. At the end of the day, that's what the Governor's revised budget proposal strives to do.

Thank you. We are happy to entertain any questions now. To the extent we do not have the answers readily available today we will follow up as soon as possible. Additionally, over the past two weeks we have provided thousands of pages of supporting information and documents to both OLS staff and to budget staff members in the respective partisan offices, and we will continue to make ourselves available for any follow up questions or concerns.

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