STATE OF NEW JERSEY

Department of the Treasury

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Opening Statement Before The
New Jersey State Senate Budget Committee
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Chairman Sarlo, Budget Officer Bucco, distinguished members of the Senate Budget & Appropriations Committee—thank you for inviting me to introduce and explain Governor Chris Christie's proposed Fiscal 2012 budget.

Before I turn to the specifics of the Governor's budget proposal, allow me to introduce the three colleagues who have agreed to join me at the witness table this afternoon: Charlene Holzbaur, Director of the Office of Management and Budget, Robert Peden, Deputy Director of the Office of Management and Budget and Dr. Charles Steindel, Treasury's Chief Economist.

I began this process last week with your colleagues in the Assembly Budget Committee and I appreciated the opportunity I had there to engage in a very serious and wide-ranging discussion of the budget and fiscal challenges the state is facing.

Last week's hearing and my appearance here today are important milestones in the second stage of what we think of as a three-stage process of budget-making.

The first stage consists of the intensive, mostly technical work that OMB, the agencies, and the Governor's Office undertake to plan, review options, and build a budget and related documentation. That process began in August and concluded with the Governor's Budget Address on February 22.

The second stage is one of public examination and review. You and your colleagues in the other house have already heard from the public and various stakeholders. Now, and for several weeks to come, you will hear from, and ask questions of, cabinet officers and members of the Administration. I am honored to be a part of that process. .

Finally, the third stage will involve direct engagement and negotiation between the legislative and executive branches resulting in the introduction and enactment of an Appropriations Act for Fiscal 2012. I look forward to that dialogue. I am confident that we will conclude the process successfully and adopt a balanced budget on or before June 30, as is constitutionally mandated.

My purpose in enumerating these three stages of budget-making is to make the point that, for us at Treasury—especially the professionals at OMB—it's almost always "budget-making time." In truth, although the popular conception is that annual budgets are distinct matters with a one-year lifespan, my first year in Trenton has convinced me that what we traditionally think of as "the budget" is actually a never-ending flow of cumulative spending commitments and revenue sources, made or identified over a very long period of time.

In the past, the formal process of adopting an annual budget bill has had, at best, a modest impact on the overall direction of the budget. From this perspective, it's easy to see why the traditional approach to annual budgeting that developed in New Jersey—and in most jurisdictions—has been "continuation budgeting," often called "current services budgeting," which essentially carries one year's spending commitments into the next *ad infinitum*.

At a basic level, current services budgeting includes five steps. First, you project how much it will cost to continue ongoing services and programs in the next year. Second, you project how much it would cost to fund all statutory and other legal spending commitments. Third, you project your revenues for the next year. Fourth, you calculate your "structural deficit" by comparing projected revenues against your two spending projections.

Whether you choose to compare revenues against continuation spending or legally obligated spending—which are rarely the same—this generally yields a horrifyingly large deficit number, particularly in recent years.

Fifth, and finally, you identify new revenues and/or "cuts" against actual or projected spending as may be necessary to balance the budget while, if you're lucky, funding a few new spending commitments which, in turn, become embedded into subsequent years' budgets.

Traditional current services budgeting has failed New Jersey.

It focuses a disproportionate amount of attention and debate on the margin—the year-to-year incremental changes in taxing and spending—as opposed to the fundamental question as to whether we're getting appropriate performance and value out of the great bulk of our spending.

Moreover, it supports a mindset that discounts the importance of, and accountability for, actually setting priorities, and encourages a use-it-or-lose-it mentality that drives "spending up to the budget." This results in both waste and an accretion of spending commitments over time. The growing weight of these commitments has exhausted our taxpayers' capacity to support them.

Governor Christie directed us to take a different approach to budgeting for FY12, one that moved away from current services or incremental budgeting and toward zero-based budgeting. Instead of cutting back to a balanced budget, he asked that we build a budget, from the ground up. Accordingly, the proposed budget before you is the product of a very different process.

Specifically, beginning last August, we added several important new features to this year's budget planning process:

- For the first time in memory, we conducted special meetings over the course of the year with every major agency of state government to review FY11 budget implementation and set the stage for the FY12 planning process. As part of this exercise, we invited the senior managers of every

agency to review ongoing privatization initiatives and identify opportunities for structural program and/or policy reform, both at their particular agency and across State government.

- Beginning last summer, the Governor's Office coordinated a series of policy reviews on major issues with significant budget implications. These included sessions on pensions and benefits reform, tax reform, Medicaid, school aid, local aid, the transportation capital program, and hospital funding.

- As part of our ongoing transition to performance budgeting, we required agencies to apportion their budgets across their core mission areas so that you and the public would have a clearer picture as to how the spending of your tax dollars corresponds to ongoing activities and objectives. The result is available for your review at page 55 of the Budget Summary. Each department of state government also developed key performance metrics, which are updated to track progress and available for review on the Governor's Performance Center page of the state website.

- We revised the traditional "fishbowl" process—the annual round of budget planning meetings—to include more open-ended, two-way discussion of core missions and functional program priorities. In other words, we actually asked agency leaders for their opinions! In several instances, such as hospital funding and Medicaid, the discussion led to substantive changes in our approach.

- In finalizing the Governor's proposed budget, we used a holistic "building block" approach that balanced essential objectives. Those objectives included funding core priorities, providing tax relief, enhancing government performance, and protecting the most vulnerable while also recognizing our obligation to make the tough choices necessary to support the State's future fiscal and economic health. The linkages we built into the Governor's budget between these various building blocks did not appear by accident.

There is no way to reengineer a budget process as complicated as New Jersey's in just one year. But we believe that we made very substantial progress toward a better process that breaks from the past and marks the advent of what Governor Christie has called a "New Normal" in budget-making.

Let me turn now to the substance of the Governor's proposed FY12 budget. You have the Budget Summary and the Detailed Budget, so I will not take up your valuable time with a detailed discussion. Instead, I will provide a general overview and then address some more challenging issues that I believe are of particular interest to you and the people you represent.

First a word or two about revenues. We are encouraged that, although performance of the major taxes has been uneven, revenues so far in FY11 have modestly exceeded our expectations such that we have increased our FY11 forecast by about $100 million. But please don't take this as an "all clear signal"—there are many economic and timing factors still at play; we will learn a great deal more after final income tax settlements in April.

Looking ahead, we believe that the ongoing resumption of moderate growth will help generate an additional $1.2 billion, or 4.3 percent, compared to the FY11 Appropriations Act. But once again, I am constrained to offer up a cautionary note: we have a very long way to go before we again achieve the revenues of 2008, our all-time high point.

In preparing our revenue projections for FY 12, Dr. Charles Steindel and Dr. Roger Cohen of Treasury's Office of Revenue and Economic Analysis studied the available data on trends in the national and regional economy and consulted with their colleagues around the country. We are confident that, despite the uncertainties inherent in economic forecasting, our revenue projections reflect a consensus assessment and provide a solid foundation for the budget planning process. As further support for that view, I would note that, in his testimony last week before your committee and before your colleagues in the Assembly, Dr. Rosen's overall estimates for Fiscal 2011 and Fiscal 2012 were within 0.3 percent and 0.2 percent of ours, respectively. The lack of significant divergence with

respect to revenues allows us to focus our attention going forward on the spending side of the equation.

At the top level the budget calls for the State to spend $29.4 billion in FY12, a 2.6 percent year-over-year decline and the second year of reduced spending under Governor Christie.

Even as we seek to restrain spending, the Governor's budget leverages the stabilization of our revenue base to protect core priorities such as municipal aid, higher education, and prescription drug benefits for seniors while increasing student financial assistance, providing about $250 million in additional aid to school districts, a $20 million increase for hospitals under a reformed formula, increased pay-as-you-go financing for critical transportation infrastructure projects, and doubling the Homestead Benefit.

The Governor's budget also reflects his determination to rebuild New Jersey's economy. Only a strong, competitive, and growing economy can support the quality of life and government services New Jerseyans deserve and expect.

To that end, for the second year in a row, the Governor's budget holds the line on tax increases and lays the groundwork for an economic rebound by including almost $200 million in pro-growth tax cuts with a particular focus on entrepreneurs, small business owners, and New Jersey-based companies.

While admittedly modest in relation to the budget as a whole, the Governor's responsible, sustainable, and coherent tax relief package, offered in the context of a constitutionally balanced budget, will help begin the long-overdue process of repositioning New Jersey as a home for growth.

Beyond tax cuts, rebuilding our economy will require continued progress in returning our state government to a sound and sustainable financial footing. And that, in turn, means facing up to the need to make tough choices. Building on the choices we made together last year—using FY11 as a baseline—this budget continues that process and includes another round of difficult choices, ranging

from reforming our pension and employee health benefit systems to eliminating new funding for Urban Enterprise Zones.

With your permission, I'd like to spend a moment addressing some of the areas of greatest concern.

I know many of you will have concerns about the future of Medicaid. The proposed budget contemplates saving a total of $543 million in Medicaid, $243 million in assorted savings initiatives and another $300 million through a comprehensive federal waiver. Although these are admittedly large numbers, I would note that we had to build our FY12 Medicaid budget without approximately $1 billion in federal stimulus funding that had been anticipated for FY11.

As a result, our budget actually increases state-supported Medicaid spending by $900 million to $4.4 billion in FY12 compared to the FY11 Appropriations Act, accounting for fully 15 percent of our $29.4 billion budget. Given the sheer size and continuing growth of the Medicaid component of the budget, we cannot hope to stabilize the State's financial position without bringing Medicaid spending under control. The $2.5 billion in federal stimulus funding that we received over the past three years in support of what would otherwise have been state Medicaid funding—in reality, a non-recurring revenue patch—simply deferred the Day of Reckoning and made the decisions we face today more difficult than they might otherwise have been.

Similarly, we cannot continue to defer the widely-recognized need to reform our pension and health benefit systems. Since these issues have been under more-or-less active discussion in recent weeks, I won't review the specifics except to stress that meaningful and comprehensive reform is a vital building block for a strong fiscal future, and to repeat the Governor's invitation to work with the Administration to achieve it before the end of the current fiscal year. Accomplishing this critical goal will, in turn, pave the way for an early payment of our FY12 statutory pension payment in FY11 and enable us to double Homestead Benefit property tax relief for New Jerseyans next year.

Turning to another area of concern, we know that some will disagree with our recommendation to apply sales tax collected inside the Urban Enterprise Zones to the State's General Fund.

Frankly, this represents only one of many difficult decisions we had to make to deliver a balanced budget proposal. As mitigating considerations, I would point to the fact that we propose to let the UEZs allocate about $43 million in uncommitted balances, within the applicable statutory parameters, and that zone businesses will still enjoy sales tax exemptions and the advantage of a 3.5 percent tax rate compared with the statewide rate of 7 percent.

I would also point out that EDA commissioned a consultant study that, after conducting an in-depth review, recommended we terminate the UEZ program.

In recent weeks, I have often been asked what the impact of a State Supreme Court ruling on education funding might be on the FY 12 budget.

Of course, any attempt to predict the judgment that the Court may ultimately deliver, or the remedy it may identify, would be pure speculation. But every New Jerseyan should understand that they, their families and their communities have a tangible stake in the resolution of this issue.

It's not for me to opine on legal theory or the ongoing litigation. However, as the State's chief fiscal officer, I must express my hope that the justices of the Supreme Court, in weighing the important issues before them, will give due deference to the broad discretion the Executive and the Legislature must have to protect the State's fiscal integrity, particularly in times of economic stress, as we confront a broad array of urgent and competing needs.

Finally, I know that some will demand that Governor Christie propose or accept a massive tax increase on a small number of our state's citizens to generate more revenue to "save" programs or meet speculative court-ordered spending obligations. Although I suspect we will explore this topic at length later today, I can assure you that this Governor will not sign a budget that increases taxes. As I said last year at this forum, to do so would break faith with the people

of New Jersey—already among the most highly taxed in the nation—and undermine New Jersey's economic competiveness and job creation. It is not an accident that governors of both parties throughout the nation, including Governor Andrew Cuomo of New York, have come to share Governor Christie's view that prohibitively high marginal income tax rates are anti-competitive, anti-growth, and ultimately self-destructive.

Besides, history teaches us that tax increases in New Jersey never close deficits, they simply fuel more spending. That cycle has no place in the New Normal.

In closing, we appreciate that this budget—like all proposed budgets—contains difficult and sometimes unpalatable choices. But, as the *Bergen Record* observed in a recent editorial, "... budgeting in Trenton is not so different from budgeting in the family unit. It requires choices, choices that aren't always clear-cut."

That said, let me assure you that we are open to better alternatives and would expect to see some changes emerge from the process of review and consultation with the Legislature that starts today. We welcome the fact that the final adopted budget will no doubt reflect the expertise and experience that many advocates, and many of you, contribute to the process. However, like last year, the final adopted budget needs to conform to the fiscal framework of reduced spending and no new or increased taxes that the Governor outlined in his Budget Address.

Last year, the executive and legislative branches defied expectations by negotiating a budget that protected essential priorities within a framework of fiscal responsibility. We found common ground in our shared commitment to building a better future. And we did it in a timely fashion and in full accord with our constitutional responsibilities.

This year, let us once again listen to each other, engage in an open and honest discussion, and bring our best thinking to the table, keeping our focus on

producing a budget that meets today's most pressing needs while building a dynamic future for our state. The people of New Jersey expect and deserve no less.

Thank you for giving me this opportunity and for the many courtesies you have extended to me and my staff over the past year. I look forward to working with you as the process unfolds.

I will be happy to entertain your questions.