

STATE OF NEW JERSEY
Department of the Treasury
Andrew Sidamon-Eristoff, State Treasurer

Opening Statement Before The
New Jersey Senate Budget and Appropriations Committee
May 24, 2012

Chairman Sarlo, Budget Officer Bucco and all members of the Senate Budget and Appropriations Committee, thank you for this opportunity to present an update of the State's revenue position and associated adjustments to Fiscal Year 2012 and the Governor's proposed budget for Fiscal Year 2013.

For clarity, I have structured my presentation today into several component parts. First, I will review recent macroeconomic data relating to New Jersey's economy. Second, I will detail changes to the revenue estimates that were included in the Governor's Budget Message of February. Third, I will speak to the ongoing and inconsistent relationship between economic results and revenue. Fourth and finally, I will detail recommended changes to the Governor's proposed budget for Fiscal 2013 that preserve our most important policy priorities while ensuring that the budget is and remains balanced in accordance with our State Constitution.

First to New Jersey's economy. By any impartial standard of analysis, New Jersey is enjoying an economic recovery:

- Our Economy Is Growing. The April reading of the Federal Reserve Bank of Philadelphia's index of New Jersey activity — the most recent we have available — showed a 2.9 percent gain over the preceding 12 months. This indicates ongoing growth in our state's economy.

- State Employment Levels Are Up While the Unemployment Level Has Fallen. In April the number of employed New Jersey residents rose 5,600 to 4,167,000, its highest level since April 2009. Employment is up about 1 percent over the past year. The unemployment rate has moved down from its high of 9.7 percent to 9.1 percent. That rate is much too high, but there are 25,000 fewer unemployed New Jerseyans today than two years ago.

- Private Sector Jobs Are Up. Since February 2010, New Jersey has added over 71,000 private-sector jobs. 2011 was the best single year of private-sector job growth in the last 10 years. In April, we gained 6,300 private sector jobs, reversing all but 1,000 of the much-discussed losses in March. The year-over-year, or 12-month, increase in private-sector jobs has been greater than 1 percent since late 2011. This growth rate is comparable to or faster than at any time in the last economic expansion.

- State Workforce Participation Is High. Our labor force participation rate is higher than the national average, as is the share of our population that is working. Over the last year, our labor force participation rate has edged up, while the nation's has moved down. This divergence is the key reason why our unemployment rate hasn't moved down as much as the nation's. In fact, if New Jersey's participation rate had tracked national trends over the past year, our April unemployment rate would have been 8.2 percent versus the nation's 8.1 percent and New York's 8.5 percent. The bottom line is that more people are working in New Jersey, and that has apparently prompted more of our residents to enter the labor force to find a job.

- State Personal Income Is Up. New Jersey income grew markedly in 2011, increasing 4.3 percent to a new all time high of \$469.1 billion. That total includes income earned out of state, social insurance benefits, and dividends, rents and interest. Income earned by people working in New Jersey, which includes salaries, fringe benefits and non-corporate profits, rose 2.8 percent to a new high of \$314.1 billion.

- Car Sales Are Up. Vehicle sales are a key driver of our Sales Tax receipts. In the first four months of 2012, new and used car sales in the state totaled 486,479, up 12.3 percent from the same period in 2011. We realize that the year-over-year comparison for this period may be atypical, given the sharp differences in the winters of 2012 and 2011 and what that would suggest for shifts in car-buying patterns. Still, for the first 10 months of fiscal 2012, new and used car sales in the state amounted to 1.103 million, up 5 percent from the first 10 months of fiscal year 2011.

- Business Filings Are Up. New business entity filings and UCC activity are important indicators of underlying economic activity. For the calendar year to date through April, new business entity filings are up 6.6 percent, UCC filings are up 33 percent and UCC searches/status reports are up 60 percent. Clearly, our business sector is active and mobilizing.

- And Revenue Is Up. Fiscal 2012 collections through the first 10 months were \$500 million, or 2.7 percent ahead of last year. Even with our reduced estimates, Fiscal 2012 revenues will be higher than in Fiscal 2011.

Although our revenue base is growing, the rate of growth for Fiscal 2012 so far has not met the expectations we set as of either the Fiscal 2012 Appropriations Act last June or the Governor's Fiscal 2013 Budget Message in February. As of today, before adjustments that I will describe later and subject to significant modification as we close out the current fiscal year, we expect total Fiscal 2012 revenue to reach \$29,176,946,000, approximately 1.7 percent less than projected as of February. With respect to Fiscal 2013, we are currently projecting revenue of \$31,696,059,000, a reduction of about 0.5 percent from our estimate as of February.

There is, of course, a risk that actual revenues will not meet these revised estimates, precipitating a potentially significant impact on projected fund balances. But overstating or premature recognition of risks based on both economic and non-economic projections has its own negative consequences for budget planning. In all events, I would remind you that we have both a constitutional obligation and the practical tools to make adjustments as may be necessary to manage and balance the State's budget come what may.

For both Fiscal 2012 and 2013, the major drivers of change in tax revenue have been the Gross Income Tax, the Sales Tax (including energy-related sales taxes), energy-related corporate income taxes, taxes on banks and financial institutions, and the Realty Transfer Tax (together with the assessment on real property transactions greater than \$1 million). Year-to-date, the Corporation Business Tax is short of expectations. Conversely, we have seen some modest offsetting strength in the Cigarette Tax, taxes on insurance premiums, and transfer inheritance taxes.

How can we reconcile the generally positive economic news with the fact that our rate of revenue growth has not yet met our expectations? At the high level, the explanation is deceptively simple: Our current tax system is not (nor was it intended to be) a perfect reflection of broad measures of economic growth. In other words, factors removed from broad economic trends are having a significant and unexpected impact on revenue growth.

What are those factors? Our preliminary analysis suggests that three major forces are at play.

First, thanks in part to a dramatic drop in natural gas prices, one of the warmest winters in New Jersey's recorded history, and an unusual number of weather-related power outages, we have seen a significant decline in utilities' energy-related sales tax and corporate income tax receipts, both currently and with respect to prepayment assessments for the second half of this calendar year. Although this news may not be welcome in the narrow context of a hearing on state revenues, it should be noted that many New Jersey consumers saw significant reductions in their utility bills this year, as much as 25 percent. Our back-of-the-envelope estimate is that net savings to New Jersey consumers in the first quarter may have amounted to a billion dollars or more.

Second, preliminary data suggest that some of our major corporations have been able to carry forward overpayments from prior periods to an unexpected degree, offsetting 2012 tax liabilities. This is reflected in the fact that corporate refunds year to date are up almost a third and regular payments or final settlements declined by 23 percent compared to last April even though corporations' estimated tax payments in April grew 11.3 percent over last year. However, we urge caution before drawing definitive conclusions for this year or next. The Corporation Business Tax is notoriously difficult to model and predict, and is relatively amenable to sophisticated tax planning.

Third and finally, preliminary data strongly suggest that a relatively small number of very high income taxpayers — “decamillionaires” with incomes of \$10 million or more — reported substantially less income in respect of calendar 2011 than anticipated. Although this cohort of taxpayers is very, very small — in 2010, there were just 421 resident return taxpayers in this category — their impact on overall state revenues is huge. Our analysis shows that tax received from these taxpayers can fluctuate by several hundred million dollars a year, contributing greatly to the volatility and unpredictability of Gross Income Tax revenues, generally by magnifying the growth of revenues in growth years and amplifying declines.

For tax year 2011 we have only partial information, and cannot as yet compute changes in the number of decamillionaires, but it appears that, on average, taxpayers in this group paid 10 percent to 20 percent less in 2011 than they did in 2010. This suggests that in 2011 income tax revenue from decamillionaire taxpayers may have dropped as much as \$150 million — or more, if the absolute number of such taxpayers actually fell — instead of rising. Excluding taxpayers with incomes over \$10 million, Gross Income Tax revenue may have grown more than 3 percent in tax year 2011, a rate of growth roughly equal to Fiscal 2012 and very consistent with the expansion in the state's economy.

These trends may be reflected in the fact that, in terms of both transactions and amounts paid, estimated and withholding Gross Income Tax payments in April — payments that are largely made on salary income — increased year-over-year, while regular payments — the final settlements that capture capital gains and partnership income typical of hedge fund managers — were down.

In sum, 2011 appears to have been an unusual year in which the growth of the incomes earned, and taxes paid, by typical taxpayers were both noticeable and stronger than the growth and taxes paid at the very, very top.

Only time will tell whether this year's results reflect a reduction in reportable gains across a stable base of very high income taxpayers in New Jersey or, conversely, a reduction in our base of such taxpayers due to outmigration or tax planning, or a combination of the two. But we do know one thing for sure: This is yet more evidence of the irrefutable fact that we have a highly progressive income tax system that is reliant on a tiny fraction of taxpayers — a characteristic that is contributing to extreme and arguably harmful volatility.

As fascinating as the foregoing academic conjecture may be, I suspect your more immediate concern is on charting the path ahead. Accordingly, please allow me a few minutes to outline adjustments to our financial plan for the remainder for Fiscal 2012 and changes to the Governor's proposed budget for Fiscal 2013 that preserve our most important policy priorities while ensuring that our budget is, and remains, balanced in accordance with our State Constitution.

With respect to Fiscal 2012, our revised plan recognizes both additional lapses and reduced supplemental needs totaling \$100 million, additional revenues of \$27 million from the Tobacco Settlement Fund, and a combined \$24 million in available fund balances from the Motor Vehicle Commission and the Workforce Development Fund. In addition, to preserve ending fund balance, we propose to reduce planned Fiscal 2012 supplementals for the Health Benefits Fund and the School Employee Health Benefits Fund by \$98 million and to accelerate the recognition of \$200 million in available balances from the Clean Energy Fund from Fiscal 2013 to 2012. With these adjustments, we can recognize the \$514 million reduction in revenue and still expect to end Fiscal 2012 with a fund balance of \$524 million.

Turning to Fiscal 2013, we have identified adjustments in three categories to offset the reduction of \$162 million in revenue: appropriations adjustments, trend savings, and fund balance solutions.

First, we have identified \$295 million in appropriations adjustments. Significantly, this includes a recommendation to repurpose \$260 million from anticipated Fiscal 2013 pay-as-you-go (PAYGO) financing for the Governor's proposed five-year Transportation Capital Plan. This is a one-year initiative, and we do not make this recommendation casually.

Please be assured that we remain committed to increasing the PAYGO component of the Transportation Capital Program dramatically when compared to previous Transportation Trust Fund authorizations. Accordingly, after taking this change into account, PAYGO funding will comprise \$1.5 billion or almost 33 percent of incremental appropriations under the proposed five-year Transportation Capital Program, triple the PAYGO commitment under the previous five-year authorization. Please also be assured that we remain committed to providing a full \$1.6 billion per year for State and local projects under the Transportation Capital Plan.

The category of appropriations adjustments also includes reducing the planned funding for salary increases for Fiscal 2013 from \$40 million to \$20 million. We will work with the agencies to achieve the necessary workforce and management efficiencies.

Second, based on current patterns in costs and program utilization, we expect a total of \$150 million in trend savings. This includes \$108 million in debt service savings from various refunding transactions, almost \$20 million in lower employee benefit costs, and a variety of miscellaneous savings that reflect trends in program costs.

Finally, we have identified an additional \$79 million in Clean Energy Fund balances that can be used for budget relief without impacting BPU's ongoing clean energy program project portfolio.

With all these various adjustments in place, we now project the Fiscal 2013 ending fund balance to remain at \$300 million. Our objective, of course, will be to manage that number up over the course of the fiscal year.

Before closing, please allow me to anticipate your first question: "Mr. Treasurer, if revenue has not met expectations, how can we possibly afford, let alone justify, an income tax cut?" In response, I would note that a budget of more than \$31 billion should be thought of as an amalgamation of ongoing and current policy priorities and investments. The Governor, in conjunction with the Legislature, is responsible, and accountable, for making choices among competing priorities. In our view, investing in a modest across-the-board income tax cut that will improve New Jersey's long-term economic competitiveness is and ought to be a top policy priority for New Jersey.

Thank you for your time and attention. I am happy to entertain your questions.