

STATE OF NEW JERSEY

**Department of the Treasury
Andrew P. Sidamon-Eristoff, State Treasurer**

**Opening Statement Before The
New Jersey State Assembly Budget Committee
March 28, 2012**

Chairman Prieto, Budget Officer O'Scanlon, distinguished members of the Assembly Budget Committee — thank you for inviting me to introduce and explain Governor Chris Christie's proposed Fiscal 2013 budget.

Before I turn to the specifics of the Governor's budget proposal, allow me to introduce the three colleagues who 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.

In prior appearances before this committee I have described today's hearing as marking a welcome milestone in the second phase of a three-phase annual budget process.

The first stage consists of the 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 September and largely concluded with the Governor's Budget Address on February 21st.

The second stage is one of public examination and review. You and your colleagues in the other house have already heard from advocates, editorialists, and some members of the public with respect to the larger contours of the Governor's budget proposal. Now, and for several weeks to come, you will debrief Cabinet officers and members of the Administration. Thank you for again inviting me to begin that process.

The third stage, of course, will involve the introduction and enactment of an Appropriations Act for Fiscal 2013. We welcome a dialogue that leads to the adoption of a balanced budget on or before June 30, as is constitutionally mandated.

Our purpose in describing these three stages of budget-making last year was to emphasize several important changes we had made to the first, technical phase of the budget-making process for Fiscal Year 2012.

First, we began to transition away from “continuation” or “constant services” budgeting, with its traditional focus on incremental adjustments at the margin, and toward a budgeting model that focuses on actually building a budget that reflects current needs and priorities.

Second, we continued to make progress in implementing the Governor’s Performance Budgeting Initiative. For example, to give you and the public a clearer picture as to how agencies align spending with program priorities, and to complement the ongoing posting of key performance indicators to the Governor’s Performance Center page of the Governor’s Transparency website, last year’s Budget Summary included the first-ever Allocation of Budget by Core Mission Areas.

Finally, we re-engineered the annual round of budget planning meetings to include more open-ended, two-way discussion of core missions and functional program priorities.

This year’s budget planning process leveraged these changes to bring us closer to building a budget that emphasizes performance. Specifically:

- We again 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. These are essential linkages that inform the Governor’s budget and, indeed, the Governor’s approach to managing the State as a whole.
- Building on the Fiscal Year 2012 Core Mission Allocation, agencies began posting specific performance targets and related tracking data to the Governor’s Transparency Center last summer. The Core Mission Summaries in this year’s Budget Summary include this information along with performance targets for Fiscal 2013. I believe this is the first time a New Jersey budget document has aligned and published mission, metrics, and money in one place.
- Over the course of the current fiscal year, OMB worked with agencies to begin tracking expenditures by core mission area. This, and the identification of additional performance indicators for internal use, enabled agencies to begin quantifying the impact of budget alternatives on performance, which in turn empowered us to set priorities and make more informed choices.

Let me move now to an overview of the Governor's budget proposal for 2013.

For the last two and a half years, we have asked New Jerseyans to join us in confronting the need to bring New Jersey's public finances under control, to support us in making necessary tough choices, and to bear significant sacrifice — all with a view toward building a stronger New Jersey for the future. Although we are by no means “out of the woods,” the Governor's budget proposal for Fiscal Year 2013 reflects the fact that, together, we have begun to stabilize our finances. Instead of having to devote most of our attention and energy toward finding ways to meet or manage inherited and unsustainable budget commitments, we now have the opportunity — indeed I think we have the *obligation* — to look forward and make choices and investments that will nurture, strengthen, and extend New Jersey's comeback.

The Governor's budget for Fiscal Year 2013 protects services and benefits for the most vulnerable New Jerseyans, provides stable funding for many important programs, keeps faith with our statutory commitment to our employees' retirement security, boosts both State school aid and student financial assistance to record levels, funds recruitment and selection for two State Police recruit classes, expands the drug court program, and makes a crucial investment in New Jersey's long term economic competitiveness by continuing last year's important business tax reforms and instituting an across-the-board 10 percent rate cut for every New Jerseyan who pays income tax. The Governor proposes all this in the context of a restrained budget that, at \$32.15 billion, is still below the State's spending in Fiscal Year 2008.

Please allow me to spend a moment to clarify some apparent confusion in measuring growth in the State budget. Specifically, I want to assure you that this year's budget proposal reflects very modest year-over-year growth in spending.

It's tempting, but fundamentally misleading, to compare the Governor's proposed budget with last year's Appropriations Act and conclude that spending will rise by 8.2 percent. As we all recall, last year's Appropriations Act did not include about \$383 million in various items of spending on which the Executive and the Legislature had not reached agreement. Further, the Fiscal Year 2012 Appropriations Act reflected the use of \$468 million of Fiscal Year 2011 resources to fund Fiscal Year 2012 debt service obligations, an acceleration that had the effect of boosting the nominal growth rate between Fiscal Year 2012 and Fiscal Year 2013. Taking these various adjustments and ordinary supplemental spending into account, the year-to-year growth will be 3.7 percent.

But even the 3.7 percent figure doesn't really present a true picture of the underlying growth in State spending. As you know, the Governor's budget proposal includes a defined benefit pension plan payment of almost \$1.1 billion, the largest ever. This represents an

increase of \$587 million from Fiscal Year 2012 as we continue to phase in the full actuarially required contribution over seven years. If you exclude this extraordinary increase from the calculation, real or underlying growth comes to 1.8 percent. For many of the same reasons, the projected increase from the adjusted Fiscal 2012 appropriation for the Executive Branch, excluding interdepartmental expenses and local pensions and health benefits, is just 1.7 percent

Going even further, another way to assess the underlying rate of growth in the cost of running state government is to compare State appropriations for direct state services in the Executive Branch. From that perspective, the Governor proposes to spend 3.9 percent less on the Executive Branch in Fiscal Year 2013 than in Fiscal Year 2012, thanks to savings that include reduced overtime, continued attrition, and an institutional closure.

You have the Budget Summary and the Detailed Budget before you. Over the coming weeks you will have an opportunity to explore the proposed budget with my Cabinet colleagues at length, so I will not take up your valuable time with a recitation of minute detail. Instead, I would ask for leave to touch on a few major issues that I believe are of particular interest to you and New Jerseyans generally.

Let me begin by thanking the Senate President for agreeing with the Governor that New Jerseyans deserve income tax relief. What a refreshing change it is to engage in an informed debate over what type of income tax relief we will extend to our beleaguered taxpayers, rather than to continue a pointless rhetorical stalemate over increasing taxes!

The Governor's plan is simple: restore the Earned Income Tax Credit (EITC) to a full 25 percent of the federal credit and reduce income tax rates in every bracket by 10 percent over three years beginning January 1, 2013. The EITC increase will bring our already robust state benefit to the very top tier among the 24 states that have an EITC, increasing the average benefit to \$550 when fully phased in.

Just as the EITC increase will provide a much needed boost to low-income working families, the Governor's income tax rate cut will help boost New Jersey's competitive position in our region and with it our long-term prospects for growth and jobs. We recognize that New Jersey needs to compete on many fronts, on everything from the quality of our physical infrastructure to the educational attainment of our workforce to the scope of our public services. But we cannot afford to ignore the documented role that taxes, particularly income tax rates, play in decisions on business location and expansion.

As New York Governor Cuomo said last October before reducing his state's top rate below New Jersey's top rate: "The competitiveness of this state is hurt when you're one of the

highest tax states in the nation, and businesses and people are more mobile than ever before.” He went on to say that he believes “that point is all but inarguable.”

We agree with Governor Cuomo: rates do matter, especially if, like New Jersey, you have the most progressive rate structure and the highest marginal rates in your region. That’s why Governor Christie’s modest, phased-in tax rate cut is so critical to our economic future.

Before leaving the subject of taxes, let me spend a few moments on revenues. We are currently projecting total revenue for Fiscal Year 2013 at almost \$31.9 billion, an increase of almost \$2.2 billion or 7.3 percent above our revised estimate for Fiscal Year 2012. Once again, this headline number obscures important detail and nuance. For example, the projected rate of growth for the Gross Income Tax, taking into account the Governor’s proposed income tax cut, is 6.3 percent, while the projected rates of growth for the Sales Tax, the Corporation Business Tax, and the “Other” category are 4.7 percent, 10.9 percent and 10.2 percent, respectively. The point here is that it would be a serious mistake to assume that all revenue is alike. Each category, and sub-category, merits its own separate analysis.

We appreciate your particular interest in examining the basis for our Gross Income Tax projections. Although Dr. Charles Steindel, our Chief Economist, will be happy to speak to the details, allow me to summarize our analysis.

First, New Jersey’s economy is clearly coming back and growing. Not only have Fiscal Year 2012 cash collections begun to hew more closely to our projections, but there is a growing body of macro-economic data — everything from rising payrolls and falling jobless claims to an increase in business filing activity, the rising stock market, and record levels of personal income — that is trending favorably. Just recently, for instance, the Federal Reserve Bank of Philadelphia noted that New Jersey’s rate of growth from October through January exceeded that of the nation as a whole and was twice that of New York.

Second, as the ongoing economic recovery solidifies, New Jersey stands to benefit disproportionately from two technical characteristics of its Gross Income Tax that, in concert, make valid state-to-state comparisons exceedingly difficult, if not impossible.

The first technical feature of note is that New Jersey’s rate structure is highly progressive, with the result that our revenues are closely tied to the fortunes of high-income taxpayers’ non-salary income, such as capital gains, which tends to increase at a faster pace at the beginning of an economic expansion than salary income. You will recall that last year Dr. Rosen and I both spoke to the fact that our progressive rate structure’s heavy reliance on high income taxpayers fuels extreme volatility. In 2009 and 2010, that meant a precipitous drop in income tax revenues as the markets melted down. Here now is a somewhat more welcome

“upside” example: for a given level of growth in personal income at the beginning of an economic expansion, we would expect to capture a much bigger share of rising non-salary incomes than other states with a less progressive rate structure. Another way to characterize this phenomenon is to note that ongoing increases in gross income will likely increase our average effective rate, since taxpayers in higher brackets earn much of this additional income. Each 0.1 percent increase in the effective rate translates into a 3 percent increase in GIT revenue.

The second technical feature concerns the fact that New Jersey’s income tax is a gross income tax and is not based on federal adjusted gross income (AGI), as is the case for most other states. This has a critical impact on the computation of taxable income as the economy emerges from recession. In states that use federal AGI, businesses and investors can typically carry forward losses from the recession and apply ongoing losses from one category of business income against profits in another to reduce their taxable income.

New Jersey generally restricts taxpayers’ ability to use loss carry-forwards and to net gains and losses across different categories of income. The upshot is that, in the early parts of an economic expansion, taxable incomes — and thus revenue — in New Jersey will tend to grow more rapidly than they will in a state that uses federal AGI as the base for computing taxable income. I should acknowledge that the important business tax reforms you approved last year will reduce this impact over the next few years.

With respect to the historically unpredictable Corporate Business Tax, we freely admit that we were pleasantly surprised with Fiscal Year 2011’s rate of growth. Using that as a base, and in view of recent strong national pretax profits and the fact that loss and overpayment carry-forwards from the recession appear to be on the wane, we expect strong growth for the Fiscal Year. I should note, however, that our growth projection includes an estimated \$66 million from accelerating our processing and resolution of administrative tax disputes.

Our projections for the Sales Tax simply reflect historical experience with respect to the economic cycle.

I can’t leave the subject of revenue without touching on the “other” category, which collectively constitutes our second largest source of revenue. You will note that we are projecting an increase of 11.3 percent over last year’s Appropriations Act, which sounds significant in relation to economic growth expectations. But this, again, begs explanation. This category includes revenues from both a variety of miscellaneous taxes, which bear varying degrees of correlation to ambient economic trends, and non-tax revenues, some of which have no connection to economic trends whatsoever. For example, the General Fund will benefit

from the reallocation of available balances in the Clean Energy Fund and municipal Affordable Housing and Neighborhood Preservation accounts. The use of dedicated fund balances to support similar programs elsewhere in the budget is a normal part of the annual budgeting process and is not subject to economic vicissitudes. So, as a purely economic and financial matter, there's nothing "optimistic" about building a budget on the expectation that we will be able to use these revenues.

The foregoing discussion of the "other" revenue category should caution us against drawing facile comparisons to other states. Just as there are different methods of computing taxable income, there is no standard definition of "revenue" across the states. For instance, some appear to include federal grants, which we generally do not. Moreover, states make their forecasts at different times and under a range of governance procedures.

Touching on the proposed reallocation of Clean Energy Fund and municipal Affordable Housing and Neighborhood Preservation fund balances affords me the opportunity to address these and other areas of the proposed budget that may be of particular concern to you.

Some advocates have expressed concern over our proposal to use resources from the Clean Energy Fund to support State energy costs. Although the amounts for Fiscal Year 2013 are indeed higher than in previous years, it's important to note that this is not a new concept or budget mechanism. It's also worth pointing out that the amount remaining in the Clean Energy Fund will remain sufficient to meet all of the Board of Utilities' planned project expenditures, so there will be no diminution of ongoing clean energy programs.

For Fiscal Year 2013, we are also proposing to transfer unused, uncommitted balances that would otherwise automatically revert to the State by statute to the General Fund with the specific purpose of supporting programs for affordable housing for households and individuals with low and moderate incomes. These include, but are not limited to: rental assistance, homelessness prevention, residential services for individuals with developmental disabilities or mental illness, parolees and other individuals in the criminal justice system, shelter assistance, and emergency assistance for individuals and families facing homelessness. I should point out that we also plan to use New Jersey's share of the state-federal settlement with large mortgage loan servicers to support many of the same programs and services.

The Governor's Fiscal Year 2013 budget reflects a series of budget-neutral adjustments arising from a proposed realignment of programs and responsibilities across State government. The budget does not anticipate any net savings from these changes because our principal objective is to rationalize and enhance a range of functions and services, including services to the aging, people with disabilities, women, children and families. Accordingly, I would invite

you to defer your questions about the specific changes and their impacts on agency budgets to the impacted Cabinet officers later in the process.

I anticipate that some of you may inquire as to whether the Governor's budget also reflects the proposed restructuring of our higher education system. It does not. Although we understand that the proposals will have important financial impacts at the institutional level, the implications with respect to the State's budget are less profound. For that reason, we thought that it would be less confusing and more transparent to pursue the restructuring on a separate track, outside the State budget process. This issue is of major importance and deserves its own, independent, review and consideration.

Before leaving the general subject, I should note that the Governor's Budget includes more than \$2 billion in state dollar appropriations for higher education. Of particular note, the budget provides almost 8 percent in additional student financial assistance, bringing it to the highest level ever, and includes a more than \$30 million increase in Tuition Assistance Grants for qualified New Jersey students.

Some of you may want to know if the Governor's proposed budget contains additional detail regarding the Governor's five-year Transportation Capital Program, which anticipates a reauthorization of the Transportation Trust Fund. In accordance with the plan announced last September, the Governor's proposed budget contains \$89.1 million in additional debt service to support the Trust Fund, inclusive of \$77 million in respect of a planned issuance in Fiscal Year 2013. We are preparing the necessary legislation and anticipate working with the Legislature to reauthorize the TTF before the end of Fiscal Year 2012.

Turning to another area of concern, the Governor's budget continues the longstanding practice of supporting our municipalities through a combination of resources from the Consolidated Municipal Property Tax Relief Act (CMPTRA) and the Energy Tax Receipts Property Tax Relief Fund (ETR). Together, these two programs will provide stable funding for our municipalities at \$1.3 billion. Nonetheless, and despite the fact that the State has been meeting its full legal obligations, some in local government would like the State to disaggregate these two funds for budgeting purposes and advance additional ETR revenue to localities. Although we are aware of the historical context, at this time we do not have the financial flexibility to make discretionary adjustments to meet this longstanding request. I would, however, point out that there are different ways to score assistance to localities. For instance, we believe that our localities should take full cognizance of the \$267 million in first-year pension contribution savings they received this year as a function of the bipartisan pension reforms you adopted last spring. By any scoring, that's real savings for local property taxpayers.

I will stop here and thank you again for the opportunity to appear before you. We appreciate that today marks the “end of the beginning,” and look forward to a process of review and consultation with the Legislature that will, no doubt, deliver an even better budget. I am confident that, working together, we will reach a final, constitutionally balanced budget agreement that protects our core priorities and builds a stronger future for the people of New Jersey.

I will be happy to entertain your questions.