



TREASURY NEWS RELEASE

NEW JERSEY DEPARTMENT OF THE TREASURY

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Acting Treasurer Muoio Testifies Before Senate Budget Committee

Provides Revenue Updates, Details Structural Challenges & Lays out Murphy Administration's Plans to Get New Jersey's Fiscal House in Order for FY 19

TRENTON – Acting State Treasurer Elizabeth Maher Muoio testified before the Senate Budget and Appropriations Committee at the State House today, providing a detailed update on revenue projections for both fiscal year 2018 and 2019 and detailing Gov. Murphy's plans to get the state's fiscal house in order by charting a new trajectory for New Jersey.

The following is a copy of her full testimony, as prepared for delivery:

NJ SENATE BUDGET & APPROPRIATIONS COMMITTEE

April 10, 2018

Acting State Treasurer Elizabeth Maher Muoio
Testimony as Prepared for Delivery

Good afternoon, Chairman Sarlo, Vice Chair Stack, Budget Officer Bucco, members of the committee. Thank you for the opportunity to discuss Governor Murphy's proposed Fiscal Year 2019 Budget.

First, I would like to introduce my colleagues here at the table with me this afternoon. Deputy Treasurer Catherine Brennan, Acting Director of the Office of Management and Budget (OMB) David Ridolfino, OMB Deputy Director Brian Francz, and Director of the Office of Revenue and Economic Analysis (OREA) Martin Poethke.

I'd like to personally thank each of them, as well as my front office, and the staff of OMB and OREA, many of whom have joined us here today, for their outstanding work on this budget.

Putting together and presenting a budget so soon after a significant turnover in administrations presents a unique set of challenges and I am fortunate to serve at the helm of a department of truly dedicated and experienced professionals. They were more than up to the challenge.

I know the proposals presented to you today represent just the beginning of a long process leading towards enactment of the FY19 Budget.

And, I understand, better than most who have held this position, the exhaustive time and effort you will invest in this process, and I want you to know my office stands ready to work with and assist you in any way possible as you meet with the various departments and review the Governor's proposals and initiatives.

This FY19 budget sets a new trajectory for New Jersey –

- one that acknowledges our harsh fiscal realities;
- one that recognizes the critical need to invest in our infrastructure and talent; and
- one that strives to make New Jersey a compelling place to live and work, both today and for future generations.

CHALLENGES

The challenges facing us are many:

- New Jersey's unemployment rate is still nearly a full percentage point above the national average;
- We've had 11 credit rating downgrades since 2010; and
- As we saw in the FY 17 Debt Report issued by our department two weeks ago, New Jersey's tax supported debt ranks among the three or four highest in the nation per capita.

Compounding these challenges is the fact that we are unfortunately an outlier amongst our peer states in several key respects:

- Our anemic post-recession revenue growth is still 6 percent below our pre-recession peak. Compare that to our neighboring states - New York, for example, which is up 10.2%; Connecticut is up 3.8 percent; and Pennsylvania is up 2.7 percent;
- Our surplus, or "rainy day fund," hovers just below 2 percent of budgeted appropriations when we should be targeting the national average of more than 6 percent;
- And, as we all know, we have one of the largest unfunded pension liabilities in the nation.

We cannot solve all of these challenges overnight.

However, we can own the past and meet these challenges without sacrificing the future.

So how does Governor Murphy's proposed budget begin to correct this course and get our fiscal house in order?

We start by making a record \$3.2 billion pension payment.

We boost our proposed surplus, or rainy day fund to \$743 million -- which is 50 percent higher than the surplus in last year's proposed FY18 budget.

We reduce our reliance on one-shot revenue gimmicks to a 15 year low of less than one percent.

And we take the bold steps necessary to invest in the assets that once made New Jersey a leader on so many fronts:

- By infusing an additional \$283 million in formula aid for K-12 education;
- By including the largest increase in over a decade for pre-K education, with an additional \$57 million;
- By proposing \$50 million towards our goal of providing free community college for all;

- By investing in STEM education and workforce development to ensure our workers remain some of the most educated and skilled in the nation; and
- By making the largest General Fund payment in state history to rebuild the backbone of our economy – our public transportation system – which has been hollowed out these last eight years.

These investments will ensure that our current and future workforce is prepared to meet the needs of an ever-changing economy and that our infrastructure enables us to reap the economic benefits of one of our greatest assets – our central location within the bustling northeast corridor.

Unfortunately, the fiscal challenges facing us hinder our ability to address all the worthy funding requests that exist, many of which have been brought to your attention during public hearings these past two weeks. Our ability to address every worthy endeavor in the here and now is directly constrained by our financial situation, and that is why we must begin looking beyond just this year and toward a multi-year solution to get us where we want to be for our residents.

Therefore, what we present today is not a final stop, but a first step. With this budget, Governor Murphy begins to lay the foundation for a stronger and fairer New Jersey.

FY 2018 REVENUE UPDATE

Before we turn to specifics regarding the Governor’s FY19 budget recommendations, I want to update you on our assessment of expectations for the close out of the current fiscal year.

First, with regards to FY 18 revised revenues - Total State revenue growth in FY18 reflects a continuation of the slow and steady trends apparent in recent years, however, we face a troubling structural budgetary imbalance.

I’ll turn to that structural issue in detail in a moment, but first I would like to discuss our estimates for the major revenues in FY18.

As you all know, the **Gross Income Tax - or GIT** - is our largest revenue source, and it has been the strongest performer so far in FY18. The GIT has exhibited total growth of 13.7 percent through the end of February compared to the same months last year.

Baseline withholding collections, the largest component of GIT revenues, are up about 5 percent so far this year. This is a sign of steady growth in employment and wages.

However, while acknowledging this strong recent performance, it is important to note that a sizable portion of our overall growth in the GIT was due largely to three major factors:

- roughly \$253 million, which we attribute to the one-time repatriation of deferred compensation from hedge fund managers that was prompted by the sunset of a 2008 federal law;
- an estimated \$200 million in April pre-payments that enhanced our December and January collections; and
- an extra \$162 million Electronic Fund Transfer payment that will even out by the end of March.

After adjusting for these factors, we are assuming modest growth for the remainder of the current year. The GIT is expected to finish FY18 up 7.3 percent over last year. This will yield projected total revenues of \$14.98 billion, a \$598.1 million increase from the target certified last June, including the aforementioned \$253 million one-shot.

Now, turning to the **Sales Tax** - Taking into consideration the January rate reduction to 6.625 percent, the sales tax - our second largest revenue source - is up 1.9 percent through the end of February. It's now projected to end FY18 about 1 percent ahead of FY17, yielding \$9.546 billion. Even after adjusting for the rate reduction, we see an underlying growth of about 4 percent, which suggests that consumers remain confident.

In addition, the tax modernization program announced last May and undertaken by our Division of Taxation is on target to match, or slightly exceed, the \$200 million target. It's important to note, however, that most of that revenue has been reallocated out of the sales tax, where it was originally scored, and into other revenues, primarily the GIT and the Corporation Business Tax (CBT).

Turning to the last of our big three revenues – Another cause for concern is the underperformance of our **corporation business tax**, with revenue collections down 2.2 percent through the end of February.

While we expect some improvement in April through June, we have reduced our estimate to \$2.2 billion, down \$175.3 million from the certified target.

Contributing factors may be tax planning behavior flowing from the recent federal tax changes and the continued impact of various State tax credits.

What we don't know with any certainty is how approved tax credits are being utilized by taxpayers. This is partly because approximately 60 percent of awarded credits are transferred through tax transfer certificates, meaning they are sold to other companies. What we do know, however, is that tax credits are holding down the performance of the CBT, as well the Insurance Premiums Tax.

Estimates by OREA project that revenue growth for our current year could be as much as 10 percent higher if not for the utilization of these tax credits. In other words, FY18 CBT revenues could be growing by more than 12 percent if not for the assumed utilization of as much as \$449 million in tax credits this year, and this number will continue to escalate over the next several years.

I'd like to also provide a brief update on the **Inheritance Taxes**, which are comprised of both the Transfer Inheritance Tax and the Estate Tax. As you know, the estate tax was effectively repealed as of January 1 this year under Chapter 57.

And, while the transfer inheritance tax portion of this revenue is still growing by nearly 6 percent, the estate tax portion is declining more rapidly than was assumed in the June certification.

The five year "tail," which is the time horizon over which the tax was expected to phase out, has been much more accelerated. As a result, we are reducing total Transfer Inheritance Tax revenues to \$609.6 million, down by \$136.2 million, due entirely to the fall off in estate tax payments.

Another tax impacted by Chapter 57 tax law changes - the **Petroleum Products Gross Receipts Tax** - is growing due to the tax rate increase that took effect as of November 1, 2016.

Excluding the performance of the Petroleum Products Tax, which is solely dedicated to transportation projects, and excluding the factors temporarily inflating the GIT, the year-to-date growth rate of our major revenues falls to 4.5 percent. This compares to the 6.2 percent rate assumed in the FY18 certification.

STRUCTURAL ISSUES

And this brings us to our structural issues. The CBT and the estate tax, once among our top General Fund revenue producers, have seen declines, as has the sales tax, creating an unsustainable, structural revenue path.

While total State revenue collections are growing, nearly all the growth is occurring within two dedicated revenue sources, and primarily within the GIT.

The GIT, while it is growing, is constitutionally restricted to the Property Tax Relief Fund (PTRF). Meanwhile, the state's more flexible General Fund is supported by revenues from the sales tax, the CBT, and the estate tax, which are flat or declining and now account for 55 percent of budgeted revenues – as opposed to 70 percent of the budget twenty years ago.

Even before recent statutory enactments, the Legislature's now retired former Budget Officer, David Rosen, warned about looming structural issues between the General Fund and the Property Tax Relief Fund in testimony before the Budget Committees in May of 2015.

At that time, Dr. Rosen stated, "Over time, and despite a few dips, income tax revenues have grown more robustly than the State's other revenue sources. Consequently the PTRF has become an increasingly large share of the State budget." He went on to note that, "This trend is important because it may soon be limiting the State's budget flexibility."

Exacerbating this structural trend, Chapter 57, enacted in 2016, is on track to reduce General Fund revenues by approximately half a billion dollars this fiscal year, and by one billion dollars next fiscal year, due to the reduction in the sales tax and the elimination of the estate tax.

In addition, Chapter 98, enacted in 2017, will further constrain general resources by shifting an additional billion dollars of Lottery revenue from the General Fund to support State pension funds.

Taken together, these long term trends in revenue growth and recent enactments have combined to create a "perfect storm" - resulting in unsustainable structural rigidity.

Let me be clear - **General Fund revenues are insufficient to support General Fund appropriations.** Furthermore, the option to shift spending out of the General Fund to the PTRF has been *completely exhausted*.

Our General Fund is the source from which we pay for the operations of State government, which encompasses everything most people think of when they think of the budget:

- from hospital charity care payments to snow removal;
- from the protection and placement of children in foster care to operating our developmental centers;
- from correctional institutions to drug courts; and
- from pension payments to debt service payments - the list goes on.

To mitigate this structural imbalance, we are proposing to move \$788.5 million in Energy Tax Receipts revenue from a traditionally off-budget account to an on-budget account. Since this revenue falls within the sales tax, it can be categorized as General Fund revenue.

To ensure that the municipal aid that Energy Tax Receipts have historically funded remains constant, that same \$788.5 million amount previously funded off-budget, will be appropriated from the PTRF. This accounting change will have NO impact on municipal revenues and towns will see NO change in the amount of money they receive.

However, without this transfer of funding authority, millions in General Fund appropriations would need to be cut - not next year or in some future year - but NOW, in the remaining months of FY 18.

In addition, without this accounting shift, the General Fund will run out of authority to post ANY supplemental appropriations through the end of this fiscal year.

FY 2019 REVENUE ESTIMATES/PROPOSALS

Turning now to FY19 revenues - It is important to note that, in addition to the structural problems facing the current fiscal year, our upcoming fiscal year budget also faces unsustainable trends.

A “status quo” FY19 budget using simple baseline growth in both revenues and appropriations would result in spending down all of the State’s surplus and yielding a year-end deficit. In other words, in this new budget, if we were to propose NO new revenues, NO new spending, and back out all legislative adds from June of 2017, we would STILL have a deficit in FY19.

This is not only unsustainable, it’s unacceptable, and the Governor is proposing a series of new revenue and budget initiatives to get our fiscal house in order.

When accounting for these new revenue initiatives, our total FY19 revenues are projected to grow by \$2.0 billion, or 5.7 percent. These new initiatives will account for \$1.565 billion of this revenue growth.

With regards to the FY19 **Gross Income Tax** we are projecting growth of \$1.252 billion, up 8.4 percent in FY19. About half of this trend, or 4.1 percent, comes from the underlying baseline, reflecting continued moderate wage and employment growth and solid gains from non-wage income sources.

The Governor’s proposed tax changes add another 4.3 percent, after taking into account the administration’s proposed tax expenditures.

In order to ensure that the tax burden does not fall disproportionately on the middle class, the proposal institutes a 10.75 percent marginal tax rate on every dollar earned above \$1.0 million, which will generate \$765 million.

Further promoting tax fairness, the property tax deduction cap will be increased to \$15,000, benefiting over 540,000 taxpayers.

Additionally, over half a million working families will save an additional \$27.2 million through the Governor’s proposal to increase the Earned Income Tax Credit (EITC) to 40 percent of the federal benefit. Over the next three years, these same families will realize savings estimated at \$75.2 million.

A new, non-refundable Child and Dependent Care Tax Credit based on the federal program will provide an estimated \$14 million in assistance to an estimated 74,000 taxpayers.

It’s also important to note, while discussing the Gross Income Tax, that, as a measure of fairness, the Governor’s proposal also includes closing the carried interest loophole, which would be payable under the GIT. However, because that proposal requires neighboring states to enact similar legislation prior to taking effect, that measure is not scored in this budget.

Turning to the State’s largest source of General Fund revenue - **the Sales Tax** - we are projecting growth of \$846 million, up 8.2 percent in FY 19. Without the Governor’s initiatives, which include an increase in the sales tax rate and broadening of the tax base to include new economic realities, sales tax baseline revenues would only grow by 2.4 percent next year, underscoring the structural problems in the General Fund I previously mentioned.

Our proposed restoration of the 7.0 percent sales tax rate will add \$546 million to those base revenues. The proposed broadening of the sales tax base to include transient accommodations and ridesharing services will raise another \$27 million, while enhanced tax enforcement of certain remote sales will yield an estimated \$40 million.

The Governor’s proposed budget also focuses on stabilizing the **Corporation Business Tax** as a revenue source. CBT revenues are projected to grow by \$237 million, or 10.8 percent in FY 19. While federal tax changes under the Tax Cut and Jobs Act (TCJA) are expected to improve conditions for corporations,

baseline growth of 5.8 percent is moderated by continued use of various State tax credits as already mentioned.

FY19 growth will be driven by the Governor's proposal to modernize our corporation business tax structure, which was last overhauled in 2002. The proposed omnibus plan is expected to yield a net \$110 million.

Under this proposal, New Jersey will join more than half the states and the federal government by instituting combined reporting with a limited "water's edge" election, which will eliminate tax minimization strategies by large corporations.

It will also include market-based sourcing, which will increase the burden on out-of-state service providers while reducing the burden on New Jersey companies who face double taxation if they do business in another state that utilizes market-based sourcing.

Finally, the Administration's proposal will seek to hold New Jersey revenue collections "harmless" from the multitude of provisions under the recent federal tax law changes, which would otherwise erode New Jersey's tax base.

Finishing up with the **Transfer Inheritance and Estate Taxes** - The Estate Tax portion of the Transfer Inheritance Tax will have largely phased-out in FY 19. Total collections from this revenue are projected to fall to \$466.3 million, down 23.5 percent from FY18. All of the decline is due to the elimination of the Estate Tax, which is expected to yield only about \$72 million, down from a peak of over \$400 million in past years.

Additional revenue increases and decreases in the budget can be found in the Governor's Budget Recommendation, the Budget in Brief, or through information provided to OLS in response to recent revenue related questions.

FY 2019 EXPENDITURES

I'd like to move now to expenditures for FY19. As I said earlier, this budget utilizes our proposed revenues to take the bold steps necessary to invest in the assets that once made New Jersey a leader. This budget puts us on a path towards meeting our fiscal obligations, while at the same time making critical and long overdue investments that will help strengthen our state and provide for greater future economic growth.

This means continuing to ramp up funding for our ailing pension system by recommending a contribution of \$3.2 billion, the largest single year pension contribution ever - putting us on a path towards achieving full ARC funding by FY23.

For decades New Jersey has treated our pension obligations as a payment of last resort rather than as an obligation that should, and must, be met each and every year. Our bloated unfunded liability has been the result. We have heard from ratings agencies that the state's failure in this regard has played a significant role in our numerous credit downgrades, and the Governor is unequivocally committed to continuing to escalate those payments until we achieve full funding.

Another goal in restoring our fiscal health involves building up our state surplus, or "rainy day fund." Ratings agencies have repeatedly stressed the importance of the need for a higher surplus rate relative to budget appropriations. Unfortunately this is another area in which New Jersey is an outlier compared to the rest of the country. As I mentioned, the national surplus rate average is 6 percent. In comparison, New Jersey's surplus hovers historically between 1 and 2 percent.

This is unacceptable, as it leaves us critically vulnerable in the event of an economic downturn. The states that bounced back most successfully after the Great Recession were those with strong rainy day

funds. While we are not predicting the next recession, we have to be prepared, and we cannot reasonably expect, given the current national climate, that a federal bailout would be forthcoming.

We need to start treating our surplus not as a yearly source of extra revenue to be spent, but as a true, standalone “rainy day” fund that must be allowed to grow and reach levels that will provide us with the protection and cash flow we need in challenging times. This administration is committed to working towards that goal. This budget proposes a surplus level of \$743 million, \$250 million more, or 50 percent higher than the surplus proposed in the FY18 budget as introduced.

Finally, ratings agencies have also been clear regarding the importance of reducing our reliance on one-shot revenues. This budget does just that.

In addition to investments aimed at restoring the state’s fiscal health, the Governor’s Budget also makes investments that will help put New Jersey on a path for strong, sustainable growth, and builds the foundation that the next generation will need to learn, work and live in tomorrow’s New Jersey.

INVESTING IN THE FUTURE

I will focus on the two largest of these funding initiatives for FY19 - education and infrastructure.

The Governor believes that New Jersey needs a world-class education system to support our students and grow our economy. This budget makes significant investments at all stages of the education spectrum through:

- An increase of \$57 million that will allow 3,500 four year olds to gain access to Pre-K this year;
- An additional \$283 million in formula aid for K-12 education that will put us on a four-year path to fully fund the Supreme Court-approved funding formula;
- \$34.5 million for new and expanded workforce training initiatives that will help state residents enter high-skilled careers via paid apprenticeships and other programs that may include college credit;
- A bolstering of critical student aid for higher education by strengthening the Tuition Aid Grants and Educational Opportunity Fund programs; and
- Finally, a \$50 million investment to help reduce the financial obstacles to earning an associate’s degree by establishing new assistance programs for recent high school graduates and adults who have yet to complete their community college degrees.

The other major investment component in the Governor’s budget is in infrastructure, more specifically New Jersey Transit. This investment is long overdue, and for those of us who sat on last year’s Joint Oversight Committee, we saw first-hand the dire consequences that result from a LACK of investment in our transit system.

NJ Transit was once held up as a national model for mass transportation but is now infamous as a source of stress for the hundreds of thousands of New Jersey commuters who regularly cope with overcrowding, cancellations, delays and breakdowns. Not only do New Jerseyans need and deserve a better mass transit service that is safe and dependable, our future economic success depends upon it. That is why the Governor’s budget proposes making the largest General Fund payment in state history to start rebuilding this backbone of our state economy.

Beyond these two major initiatives, we are also seeking to ensure the health and safety of our residents:

- By researching the causes and developing solutions to address gun violence through a \$2 million initiative to establish a new Gun Violence Research Center at one of our state universities.

- By ensuring women have access to critical health screenings, primary care and expanded family planning services, through a \$7.5 million appropriation; and
- By investing \$100 million in preventative and treatment programs that will combat an opioid epidemic that has ravaged communities across our state;

In fact, over 10 percent of our budget is focused on addressing the healthcare needs of our State.

Having served on your side of the table, I can truly appreciate the challenges you face as you make decisions that will affect our State's residents. At the same time, serving the last few months in this new role, has been an eye-opening experience. Once we had the chance to really open the books, it became readily apparent that decisions made over the past eight years, and in some cases over the past two decades, have had a devastating impact on our state's finances.

Now, it's time to face the facts. Our economic engine is on life support. We're one of only two states that have failed to return to our pre-recession revenue rates. We've given away the store, so to speak, when it comes to tax credits. We've reached a dangerous precipice when it comes to borrowing. Our surplus is still not at a level that ratings agencies, or this Administration, find acceptable.

The good news is we are more than ready to meet these challenges.

We are in a truly unique position now. We have the chance to work together...to take a step back and examine the full fiscal landscape...to put an end to easy, short-term fixes...and to work towards collective, long-term solutions – ones that will generate new, permanent sources of revenue, continue to build a healthy surplus and drastically reduce our reliance on borrowing.

Again, no first budget is going to be able to solve all problems and turn our state around overnight. The fiscal realities we inherited coming into office meant that we were unable to fund many worthy priorities and causes. **But this budget proves we can own the past and meet these challenges without sacrificing the future.**

We are proud of the budget we are presenting to you today. It is a BOLD budget, focused on the New Jersey of today AND tomorrow. And we look forward to working with you to make it a reality.

Thank you again for giving me the opportunity to speak and thank you for your service on this committee. I'll be happy to answer any questions you may have.

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