

Remarks of David J. Rosen
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To the Senate Budget and Appropriations Committee
March 26, 2008

When we come before the committee at the beginning of the budget review process our principal role is to provide you with the OLS perspective on the revenues that will be available to support the budget. Before turning to our revenue projections, I want to discuss briefly how revenues, resources, surpluses and spending come together in New Jersey budget-making.

A budget has two essential elements – spending and resources. In a typical year, for the first element one must decide which of the many needs that are voiced by groups and people throughout the State ought to be funded and calculate the cost of those needs. For the second element, the revenues (both recurring and one-shot) that are projected for the upcoming year are added to the money projected to be left unexpended from the current year. Next one must decide how much of a cushion to build into the budget. In recent years, the cushion (or budgeted surplus) has been around \$600 million. The amount to be kept as surplus is subtracted from the total resources. The remainder is the total that is available for appropriation. Usually the resources are not adequate to meet the spending needs. The budgeting process is how these two amounts are brought into balance – through decisions to cut spending or increase resources.

In his State of the State and budget messages, the Governor proposed the use of two new rules that would alter this customary budget calculus. First, he proposes that the FY2009 appropriation level should not exceed the FY2008 appropriation level. Second, in future years appropriations should not exceed recurring revenues.

Let's look at the numbers.

If we follow the Governor's first rule, spending in the FY2009 budget can not exceed \$33.471 billion (the amount appropriated last June) no matter how much money we might have on hand.

But the Governor proposes spending less than this amount, because he wants the FY2009 budget to begin the transition to his second rule.

The difference between the projected opening balance (the cash on hand on July 1) and the projected closing balance (the cash on hand the following June 30) is in effect a nonrecurring revenue. In FY2010, the Governor proposes spending no nonrecurring revenue in the budget. As a first step to this goal, he wants to limit the use of nonrecurring revenue to no more than \$500 million in FY2009.

The Governor's budget message projects the FY2008 ending balance will be \$1.434 billion. He would maintain \$600 million of the FY2008 ending balance as the projected ending FY2009 surplus. Then he would add \$500 million of the opening balance to anticipated FY2009 revenues (\$32.469 billion) and declare that \$32.969 billion would be available for appropriation in FY2009. And \$32.969 billion is the nominal appropriation level in his budget proposal.

Let's go back to \$1.434 billion balance projected for the end of the current fiscal year. The Governor proposes to use \$1.1 billion (500 million for spending and \$600 million for surplus), but what of the \$334 million still on the table?

The Governor proposes to put this money into something to be called the Long Term Obligation and Capital Expenditure Fund.

The money in the fund would be appropriated not by line-item but by language in the FY2009 budget. As a result the \$334 million is not counted as part of the spending total for the budget.

\$34 million would go for specific capital spending projects (many of which were funded by line items in the FY2008 budget) as delineated in the language at the bottom of page F-7 of the budget proposal.

The remaining \$300 million will be deposited, subject to the approval of the budget director, in the pension systems to cover some of the unfunded liabilities and the cost of the early retirement program.

There are several other important provision of this proposed language. If the FY2008 ending balance is greater than projected by the Governor, all the excess will be added to the \$300 million and used in the same way. And if the FY2009 ending balance is greater than \$600 million, those unanticipated funds would also go into the Fund. Effectively, this provision proposed for the FY2009 appropriations act would prevent using any draw down of surplus for budget purposes in 2010 – thus implementing the Governor’s second rule.

The changes in the budget rules proposed by the Governor are significant, and the Legislature, as co-equal branch of government with the Constitutional authority to appropriate, needs to consider them thoughtfully.

We are faced this year not only with changing budget rules, but a national economy that is in turmoil. As we worked on our revenue estimates, the economic picture seemed to change daily and each day’s headline was scarier than the one from the day before. Normally we include the economic forecast of the New Jersey

Council of Economic Advisors as an appendix to our report. But after talking with the head of the council, we decided that their December analysis had already been overtaken by events. I do not recall a year in which I was less comfortable with the revenue forecast we are putting before the committee.

As Donald Rumsfeld famously said “there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns -- the ones we don't know we don't know.”

I am afraid we have some of both this year.

Let me talk about what we do know. Eight months into the current fiscal year, overall revenues are doing OK. While the sales tax has been weak for the past several months, income tax withholding has been steady (while other states have seen declines) and estimated payments have been growing at 15%. The corporation business tax continues to outperform expectations. The important April 15 final payments for gross income tax and corporation business tax are based on tax liabilities for calendar year 2007 and that was a pretty good year.

Based on these factors and our daily monitoring of tax collection trends, we believe that the State will receive \$155 million more during the current year than is assumed in the Governor’s budget message. While we think the sales tax will underperform the administration’s estimate, both the income tax and the corporation tax appear stronger to us than they do to the administration.

For FY2009 we are less upbeat –and it is particularly for 2009 that the unknowns abound. If we have entered – or will shortly enter – a recession, the timing and the depth of the recession will have marked impacts on revenues. In turbulent economic times, fiscal year revenue estimates are shaped by the precise timing of changes

in the economy. When rates and directions of economic activity are shifting fiscal year revenue forecasts can be most wrong.

Our revenue forecast assumes that economic activity in New Jersey will slow dramatically, but that we will experience a mild rebound during the middle of the fiscal year. Based on those assumptions, we have projected FY2009 revenues \$289 million below the Governor's budget level. The principal differences are \$225 million less on the sales tax, \$95 million less on the income tax and \$50 million more on the Corporation Business Tax. (While we have a higher estimate than the administration for the CBT, our forecast represents a decline of nearly 10% from the current year)

It should be clear that most of the risk in this forecast is on the downside and it is easy to imagine plausible economic scenarios in which the outcome is considerably more dire than the numbers we have provided.

We maintain a dialogue with the Treasurer about revenue collection patterns and will continue to do so. Obviously we will all know something more about the economy when we come back before you in May. The nice thing about March forecasts is that they do not require any immediate decisions.

Now I want to take the OLS revenue forecasts and examine how they would impact budget making under the traditional approach or under the Governor's new formulation.

By the usual budgetary calculus, the extra \$155 million in this year would increase the FY2009 opening balance and offset all but \$133 million of the \$289 million shortfall that OLS is projecting. So the bottom-line impact for the FY2009 budget of the OLS revenue estimates would be the need to identify a combination of budget cuts and/or new revenues totaling \$133 million.

Alternatively, under the Governor's paradigm, the extra \$155 million in FY2008 would not be available for regular appropriation in 2009 – rather it would go into the Long Term Obligation and Capital Expenditure Fund. As a consequence we would have \$289 million hole in our 2009 budget – and the expenditure cuts or new revenues would have to be more than twice as large.

Every year in my remarks to the committee, it seems that I say something like “You face difficult choices this year.” I probably should have saved that comment for this budget cycle.