FY 2006 Budget
Testimony of Treasurer John E. McCormac
Assembly Budget Committee
March 31, 2005

Mr. Chairman. Distinguished members of the Assembly Budget Committee. Thank you for the opportunity to address this committee on the Governor's proposed budget for Fiscal year 2006.

On March 1, Acting Governor Codey presented a budget that puts New Jersey on the right path to fiscal responsibility.

The Governor spoke in plain and candid terms about the challenges New Jersey faces with balancing the budget this year and in future years, and about the problems that we have had to overcome over the last several years.

The Legislature and the administration have had to close $18 billion in budget shortfalls heading into FY 2006. Another multi-billion shortfall greeted the state before the ink was dry on the budget approved around this time last year.

And, the Governor made it clear that we must work together to combat the structural problems that drive spending higher and higher each year. He warned that unless we start solving these problems right now, the budget will soon be overcommitted to fixed costs and entitlements, leaving insufficient resources left for the public policy priorities of the citizens of New Jersey. By 2010, just four short years away, health care and pension costs for public employees alone are on track to consume 20 percent of all state spending.

Mr. Chairman, we can no longer allow New Jersey's budget process to be held captive by the kind of funding commitments that tie our hands today.

Our economy is strong. At $41, 332, we have the third highest per capita income in the country. At 4.4 percent, we have one of the lowest unemployment rates in the country. We are a national and regional leader for job creation and all economic indicators are pointing in the right direction for New Jersey's future. No indicator is more current or defining than Verizon Communication's blockbuster announcement this week to place its US operations Center at the old A-T and T headquarters in Basking Ridge, a transaction personally spearheaded by Governor Codey.

By every definition, the last year has been a strong income year for the state. For FY 2006, we estimate to collect $900 million more in base income and sales tax revenues than the previous year. But while income grew by leaps and bounds, we find that our overhead expenses leaped even higher. Led by Medicaid and employee benefit expenses, mandatory costs for the FY 2006 budget increase by a staggering $1.4 billion, or nearly 50 percent more than the $900 million in income growth.

We clearly cannot depend on revenue growth alone from an improving economy to close the revenue shortfalls that are imbedded in this budget. We also cannot continue to rely on one-time revenue fixes to sustain recurring budget expenses. Governor Codey has challenged us to do more on both the revenue and appropriations sides of the budget to attack this problem.

The $1.4 billion in mandatory growth is a big problem to overcome this year, and it will become an even bigger problem to solve in the next budget because the embedded expenses won't disappear. From FY 2002 to FY 2006, mandatory and unavoidable expenses, plus property tax relief funding, have added nearly $5 billion of spending to the State budget.

The Governor set the right tone by proposing a responsible budget that is 2.2 percent below the current year budget, addresses long term budget pressures by restraining growth in fixed costs, and reduces New Jersey's reliance on one-time revenues by 70 percent. The proposed budget contains no borrowing, and cuts funding for the office of each cabinet officer by 10 percent. Leading by example, Governor Codey cut his own budget by 10 percent as well.

The proposed budget cuts spending on state operations for the fourth consecutive year, and shrinks the state workforce by 500 positions through attrition. Spending actions exceed revenue actions in this budget by a 5 to 1 margin.

The Governor has shown unique leadership and courage to shrink the size of government and make it work more efficiently and cost effectively. He's directed agencies to evaluate the effectiveness of every program. After creating the Office of Inspector General, he quickly turned to Mary Jane Cooper to root out waste, fraud and mismanagement.

The Governor sees this mission as a joint mission with the Legislature, and welcomes a concentrated effort by the State auditor and anyone else to make government more efficient and potentially reduce spending.

Problems of both immediate and long-term consequence demand that we take actions, and take actions now to resolve structural issues and meet our constitutional obligation for a balanced budget.

Let me briefly discuss the short term problem.

The budget for FY 2005 was balanced on the temporary foundation of nearly $2 billion in borrowing.

The securitization of new cigarette revenues and motor vehicle fees made it possible to spend a record amount on school aid, municipal aid and programs that provide direct property tax relief to New Jersey residents, as well as record amounts of funding for New Jersey's hospitals and higher education institutions.

This $2 billion revenue cannot be repeated – the Supreme Court's decision on this revenue feature was crystal clear – nor can it be sustained by another one shot or replaced by growth of an existing revenue. It is gone, but it cast a long shadow on this budget.

In the absence of this $2 billion one-time revenue source, the Governor faced a defining choice – grow the budget to higher levels and develop alternative revenue sources to grow spending, or spend less now and curb spending in the future to maintain a balanced and responsible budget. In choosing to spend less, the Governor made the unpopular choice of finding cuts of scale in the part of the budget that could be cut in order to offset the discontinuation of last year's huge borrowing.

With three-quarters of revenue collected by the state going right back to New Jerseyans in the form of grants and aid, and the rest committed to debt service and the fixed expenses for running the government, Governor Codey correctly said that it's not easy to cut when you give most of your income away.

The decision to suspend the FAIR Rebate program for all but senior and disabled citizens for FY 2006 was a painful and agonizing one for the Governor, much like it had to have been for the Legislature in 1992 when it made similar cuts to the Homestead Rebate program. But whether it was in 1992 or 2005, it makes more sense than cutting deeply into governmental services for the most needy.

As you know, all property tax relief programs have a dedicated source of revenue – the Property Tax Relief Fund, or more commonly known as the Gross Income Tax. For the first two years of this decade, the income tax nearly fully funded all property tax relief expenditures with only marginal reliance on general fund revenues.

That pattern abruptly changed in FY 2002 when the State committed $9.3 billion in property tax relief spending backed by $6.8 billion in property tax relief fund resources. That difference was made up through the general fund, with back-filling amounting to $2.8 billion in FY 2003, $2.5 billion in FY 2004 and $2.3 billion in FY 2005. The budget for FY 2006 more closely aligns property tax relief revenues with property tax relief spending, with projected income of $9.7 billion and projected spending of $10.7 billion.

This responsible budget makes it possible to preserve funding for municipal and school aid at last year's levels and to fund other priorities, such as public colleges and universities and our hospitals.

Under this budget, the Senior Freeze program will be fully funded, a program that provides reimbursement checks to low income senior and disabled citizens

It preserves FAIR checks up to $800 for 500,000 low income senior and disabled citizens.

The budget does more than preserve funding; it makes it possible to make the right investments in such areas as:

Mental health, where the Governor seeks $40 million in new funding to recast the State's mental health system to provide more complete and accessible and consumer-driven services; and

State government integrity, where Governor Codey proposes additional funding for the Election Law Enforcement Commission, the State Commission of Investigation, the Commission on Ethical Standards and the Office of Inspector General; and

Homeland security, where the FY 2006 budget provides $189 million to keep New Jersey safe from the threat of terrorism; and

Child welfare, where the budget boosts New Jersey's commitment to protecting children by $55 million; and;

The health care safety net, where the budget boosts funding by 8.4 percent through Medicaid, Family Care, Kidcare and other programs. We are keeping pace with the mandatory cost of these programs and funding enrollment increases, which is in stark contrast to taking health coverage away from those in need which is being done by many other states that face the same cost pressures; and

Tuition assistance which under Governor Codey's proposal will rise to more than $325 million in FY 2006, enabling us to maintain grants for all students without any cuts in their aid and add more TAGS for full-time and part-time students.; and

Veterans programs, where an additional $2 million in funding will make more room available to care for New Jersey's war veterans at the state's veterans homes.

Our ability to fund these and other priorities in the future depends in large part on how we fund them and manage the fiscal affairs of this budget today.

Regarding our long term problem, we have been clear about the fixed costs for Medicaid, PAAD and other entitlements that are scheduled to grow over the next several years. We know that the overall employee benefit costs, if left unchecked, are expected to rise from $2.2 billion this year to $6.7 billion in four years.

As part of his budget vision, Governor Codey is assembling a special task force to investigate ways to slow down this runaway train of surging expenses so that this committee does not have to revisit this burdensome issue year after year after year into the future.

The Governor's hallmarks for this honest and responsible budget proposal are clear:

Managing entitlement growth.

Cutting the size of the budget.

Humane reductions in the workforce.

Reduced departmental spending.

Dramatic reduction of one-time revenues.

Of course this is just that – a proposal. As always, this is the time when the Legislature exercises its rights and authority as a partner in the budget process. Governor Codey has welcomed the input of legislators from both parties and invited all who care about New Jersey to come forward with their specific ideas or alternatives.

We ask, however, that all parties take into account how cuts of consequence will impact programs and services that the Governor's austere spending plan seeks to preserve.

We will also caution that the $287 million difference between the revenue estimates from the Office of Legislative Services and the administration for FY 2005 and 2006 should not trigger a rush to spend what could be misconstrued as newfound money.

As you know, revenues are updated regularly in the budget process, and March's update will fade quickly after the true picture for both fiscal years comes into focus when all the envelopes are opened from the decisive April tax collection period.

Remember also that $2 billion of FY 2006 spending is already off the table because it is committed to debt service and constitutionally mandated expenses that cannot legally be cut.

Keep in mind that of the remaining $25.4 billion, $19.9 billion is allocated for state aid for property tax relief; medical aid for family care and PAAD programs, hospital assistance, tuition aid and other programs.

The remainder is found in the State operational costs for the Legislative Judicial and Executive branches of government. And as I indicated earlier, operational costs for the executive branch, after discounting mandated increases in DYFS staffing and programs, are down for the fourth budget year in a row, 4.6 percent for FY 2006 alone.

When you break down the budget in pieces as we have, you recognize that there are severe implications to making arbitrary, across the board cuts in overall state spending.

Governor Codey targeted his economies in an honest budget proposal that humanely meets the diverse needs of New Jersey citizens.

These cuts and efficiencies are a big reason why overall spending is down for FY 2006, and why New Jersey's efforts are viewed favorably on Wall Street.

In its rating report on the State budget, Standard and Poor's remarked that Governor Codey is, and I quote "aggressively attempting to address the structural imbalance that has plagued the state over the last four fiscal years."

S and P and the other rating agencies recognize the balanced approach that this Governor is pursuing with this state budget – cutting fixed expenses and replacing one-time revenues with recurring revenues are two major barometers of fiscal responsibility recognized by Wall Street. A third is the maintenance of a surplus fund that is commensurate with overall spending levels, and, as I pleaded with this committee last year, New Jersey must rebuild its surplus above the $400 million in this budget.

On the recurring revenue side, we are taking further steps to solidify New Jersey's base of fiscal resources without resorting to any changes that result in a broad based impact on the income or sale tax.

The Realty Transfer fee and Estate Tax changes will each generate $25 million in the next and following years.

A cable franchise fee will generate $50 million on a recurring basis, while leveling the telecom playing field among all competitors in the market.

And finally, this budget seeks to promote fairness and uniformity in the State sales tax structure by making changes that modernize and seek equitable tax treatment of similar products and services. These changes will add $275 million in recurring revenues to the State budget.

Once again, I appreciate the opportunity to discuss the fiscal budget for FY 2006 in detail with this committee. I know you agree that unless honest and bipartisan efforts are made to bring spending in line with revenues, New Jersey's huge imbalance will only grow worse over time and jeopardize the programs and services we all value.

Governor Codey has maintained a level commitment to state aid to schools and municipalities and made tough, realistic choices on spending. The budget makes cuts in discretionary programs and eases mandatory spending pressures in order to put New Jersey on sound fiscal footing.

Thank your for your time and, as always, I welcome your questions in this committee room today and welcome you to visit or call me at my office to discuss any concerns you may have with the budget or my department.

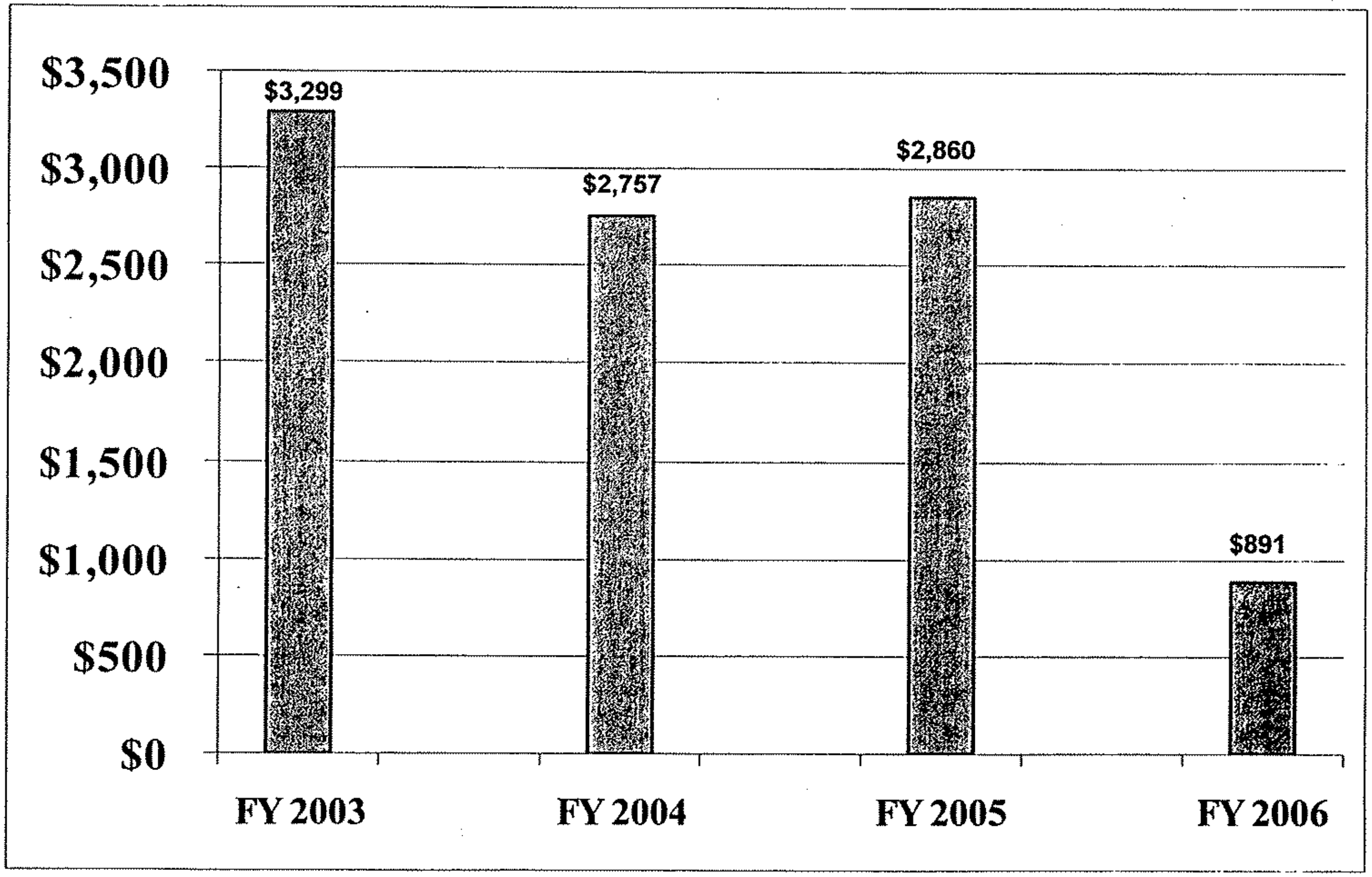
Majority Of FY 2002 Original Approp To FY 2006 Budget Growth Has Been Unavoidable Or Property Tax Relief

(In Millions)

Property Tax Relief (School, Municipal, Direct)	$	1,521
Health Care (Medicaid, PAAD/Senior Gold)	$	1,239
Employee Benefits and Salaries	$	1,082
Higher Education	$	214
Child Welfare Reform	$	205
Increased TTF Dedication	$	95
Other	$	136
Total	$	4,492

Nonrecurring Resources Down by 70%

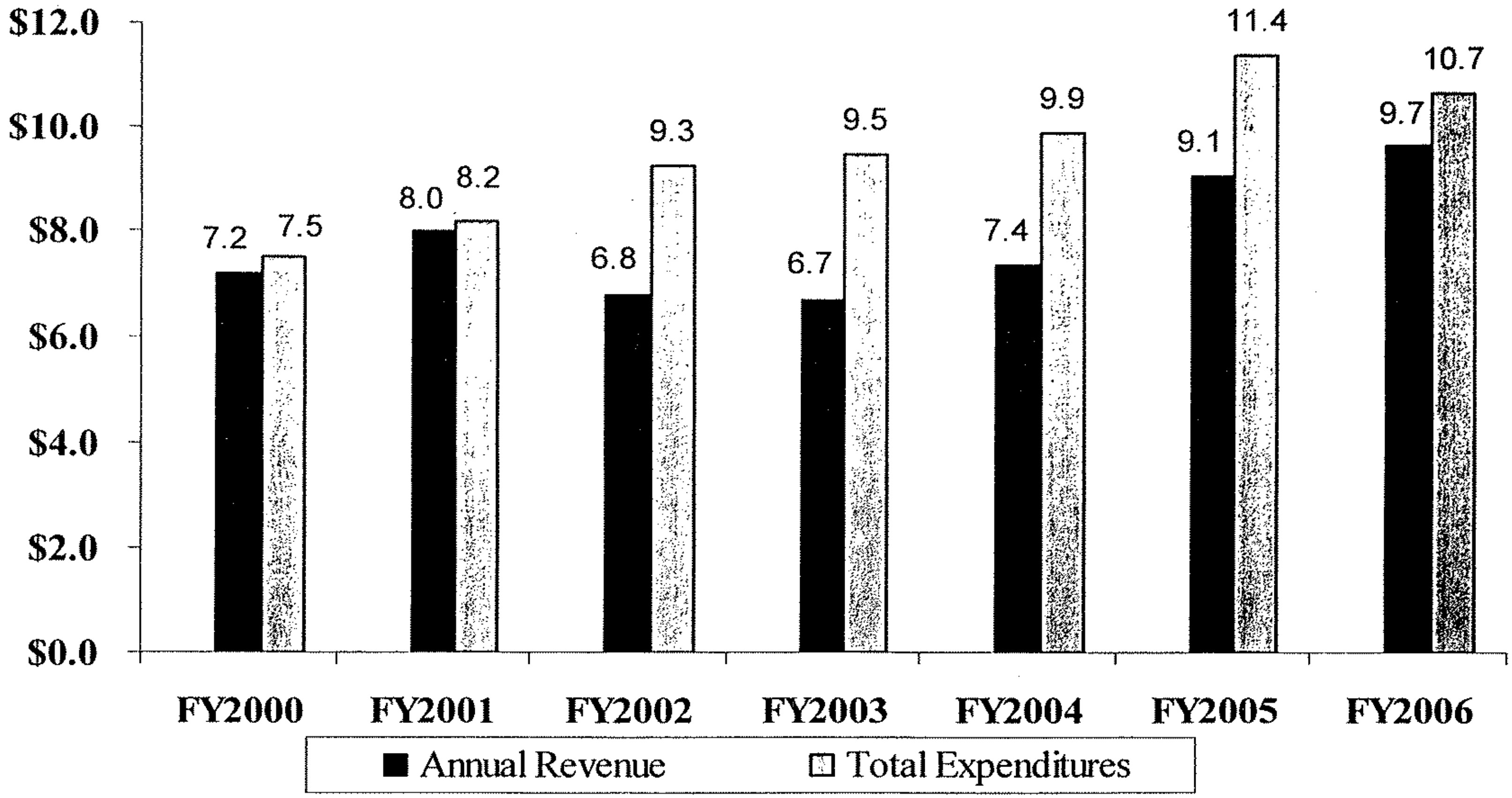
(In Millions)



Based on planned revenue actions.

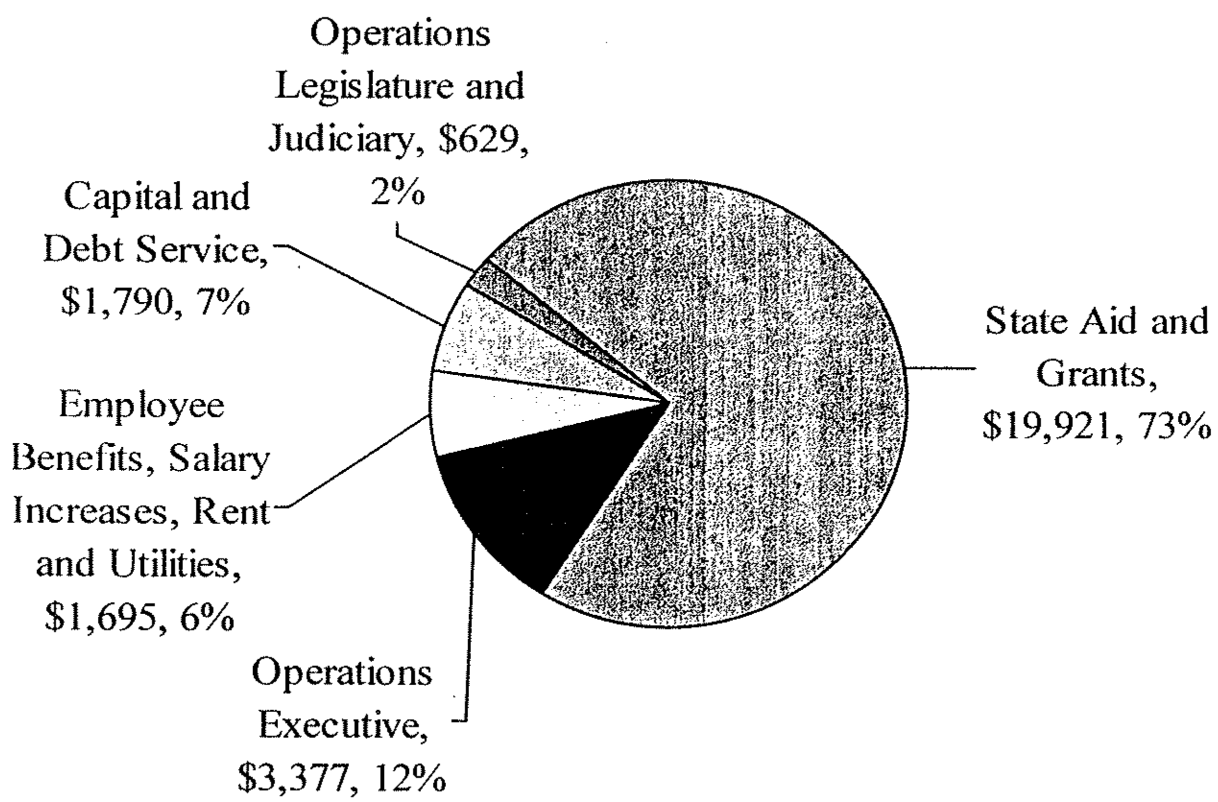
Property Tax Relief Programs/ Income Tax Revenues

(In Billions)



Where Does the Money Go – State Aid and Grants Represent 73% of Budget

(In Millions)



$.73 cents of every dollar goes to Property Tax Relief and Grants in Aid