STATE OF NEW JERSEY

Department of the Treasury

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Opening Statement Before The
New Jersey State Assembly Budget Committee
April 4, 2013

Chairman Prieto, Budget Officer O'Scanlon, distinguished members of the Assembly Budget Committee – thank you for your kind invitation to introduce and explain Governor Chris Christie's proposed Fiscal 2014 budget.

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

Let me move now to an overview of the Governor's $32.9 billion budget proposal.

Broadly stated, the Governor's budget protects services and benefits for the most vulnerable New Jerseyans, expands access to health care, provides stable funding for many important programs, supports additional community placements, keeps faith with our statutory commitment to our employees' retirement security, boosts both State school aid and student financial assistance to record levels, continues to fund 2011's pro-growth business tax reforms, and provides contingency funding for Super Storm Sandy-related costs.

The Governor proposes all this in the context of a fiscally disciplined budget that reduces our reliance on nonrecurring resources and still spends less than the State spent in Fiscal Year 2008. Indeed, the Governor's budget restrains spending growth to just 2.3 percent over Fiscal 2013's adjusted appropriation, which is remarkable in light of the fact that the projected $646 million increase in payments to our defined contribution pension plans accounts for about 85 percent of the year-over-year growth.

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 will take this opportunity to touch on a few major budget-related topics that I believe are of particular interest to you and New Jerseyans generally.

First, New Jersey's economy is clearly growing. Not only have Fiscal Year 2013 cash collections begun to hew more closely to our original projections, but there is a growing body of macro-economic data — everything from rising payrolls and impressive gains in car sales and housing permits 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 February 2012 through February 2013 was 3.1 percent, faster than the national average and faster than all but one state in the Northeast quadrant of the country.

Let me move to a discussion of revenue. We are currently projecting total revenue for Fiscal Year 2014 at $32.8 billion, an increase of $1.5 billion, or 4.9 percent above our revised estimate for Fiscal Year 2013. This headline number obscures distinctions between different tax types, which of course warrant separate analysis.

The projected rate of growth for the Gross Income Tax is 6.5 percent, while the projected rates of growth for the Sales Tax, the Corporation Business Tax, and the "Other" category are 4.7 percent, 7.0 percent and 2 percent, respectively.

At about 39 percent of overall revenue, the Gross Income Tax (or GIT) is by far the most important component of our revenue base. And, thanks to our highly progressive tax rate structure and the GIT's character as a tax on gross rather than net incomes, it is also extremely sensitive to the economic cycle and thus highly volatile. To illustrate, last year at this time we took some pointed but polite criticism for projecting that the GIT would grow at a rate of 8 percent during the current fiscal year. For the first nine months of the fiscal year, actual growth has been 8.6 percent, and we currently expect to finish the year with 9.4 percent growth. The year-to-date growth has been especially impressive in light of our expectation that we will not see any real "bump" from the acceleration of dividends, bonuses or capital gains transactions into December 2012, due to the so-called Fiscal Cliff, before final settlements later this month. I should note that our 6.5 percent growth projection for Fiscal 2014 does take into account our sense that some income and gains will have accelerated from calendar 2013 into 2012. As a very rough estimate, we suspect that the federally-induced change in income realizations may have enhanced GIT revenues by nearly one and a half percent in Fiscal 2013, while reducing growth by a comparable amount in Fiscal 2014.

Although the Sales Tax, which accounts for about 26 percent of revenue, has lagged expectations somewhat this year, there are some encouraging signs that it is beginning to stabilize and strengthen. Including numbers for March, the Sales Tax has exceeded our monthly targets for three months in a row. In light of the improving economy and ongoing Super Storm

Sandy recovery efforts, we are confident in our 4.7 percent growth projection for the next fiscal year.

The discussion of Sales Tax affords an opportunity to anticipate your questions regarding the revenue impact of Super Storm Sandy. Although we do not have any firm estimates, we suspect that the storm depressed revenues in the last months of 2012 by more than $100 million, primarily in Sales Tax and Casino Revenues. We expect to recoup much of the Sales Tax loss before the end of Fiscal 2013, but the timing and extent are uncertain. Similarly, we believe the recovery and rebuilding efforts will have a modest net positive effect on Fiscal 2014 revenue, primarily in Sales Tax. We have tentatively estimated that the net impact of rebuilding may be to boost Sales Tax receipts by about one-half of one percent in Fiscal 2014.

The Corporation Business Tax, which accounts for just 7 percent of revenue, has been and continues to be notoriously difficult to project, a continuing challenge for observers in and out of government. Although there are many factors at work, it's clear that the Great Recession resulted in a high level of loss carryforwards that is still "washing through" the system and restraining collections. Further, we strongly suspect that major corporations are managing their state level tax liabilities and payments to achieve long-term stability in reported after-tax earnings. We also suspect that our ongoing movement toward a single-sales factor method of computing liabilities may be driving them to use existing tax credits from past overpayments and carryforward losses more aggressively than might otherwise have been the case. Nonetheless, we believe that strong corporate profits will yield significant growth in the next fiscal year, albeit off a low base and still well below Fiscal 2011's growth of 11.4 percent.

With respect to the "Other" category, a mixed bag of tax and non-tax revenue that accounts for about 27 percent of total revenue, you will no doubt inquire as to why we are projecting $200 million of growth in the Casino Revenue Tax. Simply put, we believe that Atlantic City's prospects are improving and that the recent legislative approval of Atlantic City-based Internet gaming will lead to a significant increase in revenues next year.

We are basing our estimate on the enacted version of the legislation, which included a 15 percent tax rate and significant changes to enhance the Internet gaming experience and streamline the regulatory process so that New Jersey can implement the statute without undue delay and move quickly to secure international leadership in this area. In this regard, we are confident that the speed with which the Division of Gaming Enforcement is implementing the regulations will reduce the time needed to achieve the higher range of revenue estimates calculated in the earlier forecasts.

I can't leave the "Other" category without noting, again, that this category includes revenues from a variety of miscellaneous taxes as well as recurring and nonrecurring non-tax resources.

Of course, some level of nonrecurring resources – such as debt service savings from debt restructuring or defeasance, the use of available balances in dedicated funds to support similar programs elsewhere in the budget, or even tax revenue that is phasing down due to previously adopted reforms – is an expected and normal part of the annual budget process. Nonetheless, we are proud that the Governor's budget for Fiscal 2014 reflects dramatic and continuing success in reducing our reliance on nonrecurring resources, from a high of 13 percent in the Fiscal 2010 Appropriations Act to a projected low of just three percent next fiscal year.

In this context I would acknowledge that some observers may have concerns over our proposal to use resources from the Clean Energy Fund to support State energy costs. As you know, this is not a new concept or budget mechanism, and although the amount for Fiscal Year 2014 exceeds the Fiscal 2013 amount it is lower than the Fiscal 2012 amount. Moreover, as was the case in previous years, 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.

Your colleagues in the Senate raised questions with Commissioner Simpson yesterday regarding our recommendation not to draw on General Fund resources to support the State's Transportation Capital Program in Fiscal 2014. As is often the case in government and elsewhere, the simple answer is the best: Given the many competing demands on our budget, and given the fact that the Transportation Trust Fund will have adequate cash resources on hand to support the ongoing $1.6 billion annual Transportation Capital Program without resorting to unplanned or additional borrowing, it makes sense to devote our limited General Fund resources to other priorities. In other words, we don't need to use General Fund resources or additional bonding to continue supporting the Transportation Capital Program in Fiscal 2014.

How could this be? Several factors have aligned in our favor.

First, the last three Transportation Trust Fund bond issues generated about $250 million in "bond premium," which is cash we can use to support the Capital Program. Please allow me to correct some prevailing misconceptions as to what bond premium is and means.

To begin with, please understand that the existence of bond premium does not imply that we are paying more interest than we should. Quite the contrary.

Our paramount objective when pricing a bond issue is to achieve the lowest possible true interest cost over the life of bonds, typically 30 years. Think of true interest cost as the price the State ultimately pays to borrow a given amount of money. Computing true interest cost involves estimating the time value of money and at least three variables that move in relation to one another: the face or par value of bonds authorized, the coupon interest rate on the bonds, and the actual amount of proceeds realized upon sale of the bonds, sometimes referred to as original issue price.

If a bond sale features a coupon rate that is higher than the market rate, investors will pay more than the par amount (or accept a lower yield) for the privilege of owning the bond and receiving that higher coupon interest rate. The sale will thus generate more proceeds that the par amount of bonds sold; these excess proceeds constitute premium. Everything else being equal, the true interest cost in relation to the actual proceeds will exactly equal the market rate of interest.

But all else is <u>not</u> equal. Underwriting banks and other financial advisors have counseled New Jersey and other public issuers that, for certain market and tax accounting reasons, institutional investors find bonds issued at a premium to be slightly more attractive investments, meaning they will accept a slightly lower yield on such bonds. This can make a real difference in financing costs over time. For this reason, we are advised, and history has borne out, that selling at a slight premium (i.e. with a coupon slightly above market) assists in the marketing of our bonds and generally results in a lower true interest cost. In other words, pricing bonds at a premium is entirely, and appropriately, a function of market conditions and saves us money.

Another factor working in our favor is that we have an opportunity to prioritize projects that are supported by federal funds, which will favorably impact the Transportation Trust Fund's State-supported cash flow needs in Fiscal 2014. This, combined with the previously noted bond premium, will allow us to continue to support the ongoing Transportation Capital Program in Fiscal 2014 without having to issue additional debt.

Turning to programmatic matters, I know many of you have welcomed the Governor's decision to expand our Medicaid program under the federal Affordable Care Act (ACA). Although I will defer to Commissioner Velez on the various components and policy implications, I would like to note briefly that we do expect to realize savings in Fiscal 2014 and beyond as we take advantage of the ACA's federal reimbursement rates for Medicaid expansion populations. Against that, we recognize that there will be some additional costs, including so-called "woodwork" costs as the ACA's individual mandate drives Medicaid-eligible individuals to enroll rather than face penalties. We estimate that cost at $41 million in Fiscal 2014.

For a third straight year, the Governor's budget includes a record amount of school aid. Aid to schools, inclusive of formula aid, will increase \$97 million. No district will experience a reduction in formula aid per se.

We recognize, however, that many districts will experience a year-over-year increase in school construction debt service costs. This is solely a function of the fact that debt service is returning to previously scheduled levels after a period of short-term savings due to debt refinancing in prior years. Let me explain.

As you will recall, since Fiscal 2011, the Economic Development Authority has charged districts 15 percent of their proportionate share of debt service on bonds it issues in support of non-SDA school construction and renovation. The State pays the remaining 85 percent. For Fiscal 2014, the debt service schedules for the outstanding bond issues include significant increases in principal and interest payments. The resulting \$13 million increase in school district assessments will affect 494 districts, averaging \$26,315 per district, although a handful of districts are facing substantially higher increases.

Turning to municipal aid, 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 \$1.36 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, we again do not have the financial flexibility to make discretionary adjustments to meet this longstanding request.

I would, however, take this opportunity to remind you that assistance to localities can also take the form of avoided costs. For example, the bipartisan pension and health benefits reforms of 2011 will save our local governments approximately \$443 million in Fiscal 2014. This amount rises to approximately \$586 million if you factor in savings due to revisions to actuarial salary expectations that were, in part, enabled by the bipartisan Cap 2.0 and associated interest arbitration reform. By any measure, that's real savings for local property taxpayers.

I understand that many of you are vitally interested in the status of our pending procurement for sales and marketing services in support of the State Lottery. You will appreciate that we have taken great care in managing this complicated procurement. We are particularly concerned with planning a smooth transition for our employees and retail partners. Although I am not at liberty to share detailed information at this time, I can assure you that the process is ongoing and is expected to reach its conclusion very soon. I have every expectation of being able to speak to it at length when I appear before you again later in the month to discuss the proposed budget for the Department of the Treasury and intergovernmental accounts.

We appreciate that you may be concerned about the effect of the federal sequester on New Jersey's economy and revenues. At a high level, we view the sequester as primarily a national economic event, which has the potential to retard growth in the middle two quarters of the year. A cooling off of the national economy, which appears to have grown at a fairly brisk rate in the first quarter, would naturally have some negative consequences for New Jersey, but we think these would only moderate our expansion, not imperil it.

Similarly, we expect state-level impacts to be limited. The sequester primarily restricts direct spending on federal operations and procurement—the closure of the Mercer County air traffic control tower is an example. Ironically, however, this may be the one circumstance in which New Jersey's bottom ranking in terms of direct federal spending places it at a comparative advantage. To be blunt, we have less at stake. We estimate the cuts in the state as amounting to several hundred million dollars in the context of a five hundred billion dollar economy. Although the impact on affected individuals, businesses, and communities will certainly be serious, the macro economic impacts on the state as a whole, and State revenues, will be modest.

Finally, the Governor's Budget Message includes a proposed $40 million supplemental for Fiscal 2013 to meet State funding contingencies associated with the impact of Super Storm Sandy. At this point, I cannot yet predict the extent to which we will need to draw upon this appropriation. The major agencies engaged in response, recovery and rebuilding are still in the process of tabulating costs arising from the storm and submitting claims for federal reimbursement where appropriate. Treasury, including the Office of Management and Budget and the Division of Risk Management, is working with the several agencies and the Governor's Office of Recovery and Rebuilding to help refine and manage these claims, and to identify resources to meet matching requirements, if necessary. This process is ongoing and can be expected to continue for many months, if not years.

I will stop here and thank you again for the opportunity to appear before you. I will be happy to entertain your questions.