Remarks of David J. Rosen
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To the Senate Budget and Appropriations Committee
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As you begin your consideration of the Fiscal Year 2015 Budget, we come before you to offer an update on the current year's budget situation, an explanation of our revenue forecasts and a discussion of broader revenue trends.

My discussion of State revenues may strike some as, in the words of New Jersey Hall of Fame member Yogi Berra, "déjà vu all over again." The broad economic outlook continues to improve at a slow, reasonably steady pace. State revenues fell short of the Executive's expectations again last year. And for the coming budget cycle the OLS is again projecting lower revenues than is the Executive. But this isn't entirely a repeat performance: the revenue forecasting differences are a bit smaller than in each of the last two years; State revenues, at least in nominal terms, are now projected to surpass the FY 2008 peak levels; and for a couple of smaller revenues OLS has a higher forecast than the Executive.

Let me begin with a quick review of the last year and how we got to where we are today. Two weeks ago the State released the Comprehensive Annual Financial Report (CAFR) for FY 2013. That official year-end audit indicated that State revenues fell $809 million below the amounts certified at the start of FY 2013. The total of $30.9 billion was also $271 million below the Administration's estimate last June, just before the end of FY 2013. To partially offset the hit on the FY 2013 closing balance, the Administration identified additional lapses and budget savings of $118 million. FY 2013 ended with a balance of $313.2 million, only 1.0% of audited revenues, the lowest percentage in about three decades. This FY 2013 revenue problem meant that FY2014 began with an opening balance $154 million below the amount certified when the Appropriations Act was signed.

In addition to the $154 million reduction in opening balance, the Executive has reduced its revenue forecast for FY 2014 by a net of $251 million. The largest changes in the Executive's forecast were for the gross income tax, down $111 million and the casino revenue fund, down $127 million. Various other major tax revenues were reduced by a combined net of $97 million, offset by a one-time payment of $92 million from an extraordinary action by Treasury with respect to the Tobacco Settlement Financing Corporation.

Figure 1
Fiscal Year 2014 Revenue Estimates
($ millions)

		Governor's Budget Message			
	Appropriations Act Certified	Revised Amount	Change	OLS Est. Amount	OLS vs. GBM Difference
Gross Income Tax	$13,039.0	$12,927.8	-$111.2	$12,840.0	-$87.8
Sales Tax*	8,680.0	8,680.0	0.0	8,625.0	-55.0
Corporation Bus. Tax*	2,416.0	2,419.7	3.7	2,419.7	0.0
CBT Banks & Financials	202.0	197.0	-5.0	220.0	23.0
Realty Transfer Fee	297.0	287.0	-10.0	257.6	-29.4
Assessm. on $1 Mil. Property	112.0	108.0	-4.0	94.4	-13.6
Insurance Premiums	608.0	612.0	4.0	600.0	-12.0
Inheritance Taxes	715.0	715.0	0.0	685.0	-30.0
Cigarette Tax	237.0	221.4	-15.6	236.6	15.2
Tobacco Settlement	49.2	148.0	98.8	148.0	0.0
Casino Revenue Fund	383.6	256.8	-126.8	230.4	-26.4
Other Revenues*	6,074.2	5,989.6	-84.6	5,989.1	-0.6
Grand Total, All Funds	**$32,813.0**	**$32,562.3**	**-$250.7**	**$32,345.8**	**-$216.6**

See Appendix for additional detail. Numbers may not add due to rounding.
GBM = Governor's Budget Message. * Sales and corporate energy revenues are in Other Revenues.

While the Executive revised its FY 2014 forecast downward, it remains more optimistic than the OLS forecast. The Executive's budgeted revenues are projected to grow by 5.3% above the total for FY 2013. The major tax revenues we track every month, and which account for about 88% of State on-budget revenues, will need to grow by 5.9% to achieve the Executive's revised year-end targets. However, according to the Treasury's latest monthly revenue report, the major revenues are growing by only 4.7% through the first 8 months of FY 2014. Indeed, growth for the three most recent months has slowed sharply, as December-January-February combined are up only 1.3% from those same months last year.

For FY 2015 the Executive is projecting revenue growth of 5.8%, although the growth estimate is only 5.1% if one excludes the Executive's proposed statutory changes that would increase tax collections.

Figure 2
Fiscal Year 2015 Revenue Estimates
($ millions)

	Governor's Budget Message		OLS Estimates		
	Amount	Annual Growth	Amount	Annual Growth	OLS vs. GBM Difference
Gross Income Tax	$13,988.2	8.2%	$13,875.0	8.1%	-$113.2
Sales Tax*	9,212.0	6.1%	9,108.0	5.6%	-104.0
Corporation Bus. Tax*	2,583.0	6.7%	2,583.0	6.7%	0.0
CBT Banks & Financials	210.0	6.6%	220.0	0.0%	10.0
Realty Transfer Fee	325.0	13.2%	291.7	13.2%	-33.3
Assessm. on $1 Mil. Property	120.0	11.1%	108.6	15.0%	-11.4
Insurance Premiums	650.0	6.2%	630.0	5.0%	-20.0
Inheritance Taxes	757.9	6.0%	750.0	9.5%	-7.9
Cigarette Tax	180.8	-18.4%	195.4	-17.4%	14.6
Tobacco Settlement	56.0	-62.2%	56.0	-62.2%	0.0
Casino Revenue Fund (CRF)	310.7	21.0%	266.1	15.5%	-44.6
Other Revenues*	6,053.8	1.1%	6,054.2	1.1%	0.4
Grand Total, All Funds	**$34,447.4**	**5.8%**	**$34,138.0**	**5.5%**	**-$309.4**

See Appendix for additional detail. Numbers may not add due to rounding.
GBM = Governor's Budget Message. * Sales and corporate energy revenues are in Other Revenues.

Repeating the pattern of the three prior years, the OLS is projecting lower revenues for both FY 2014 and FY 2015 than is the

Executive. For the current year, OLS estimates total revenues of $32.34 billion, or $217 million less than the Executive. Our growth projection for all budgeted revenues is 4.6% in FY 2014. In FY 2015, OLS estimates $34.14 billion, or $309 million less than the Executive. The OLS projected growth rate for next year is 5.5%, compared to 5.8% assumed by the Executive (or 4.8% v. 5.1% if you exclude the tax law changes). Combined, the two-year difference is $526 million. That is the smallest forecast difference in the last three budget cycles, and only 0.8% of the total revenues for the two fiscal years combined. Nevertheless, this difference represents 168% of the Executive's projected FY2015 ending surplus.

Let's look at a number of the most important State revenues.

The gross income tax (GIT) is central to each year's forecast. The GIT is the largest State tax revenue, accounting for nearly 40% of budgeted revenues and is subject to substantial volatility. The Executive has reduced its forecast for FY 2014 to $12.93 billion, assuming growth of 6.8%. The OLS is also optimistic about the GIT, projecting $12.84 billion, or 6.0% growth, yielding $88 million less than the Executive's target.

Multiple factors are in play for the FY 2014 GIT forecast. Actual cash collections so far in FY 2014 are growing by a lackluster 3.4%, only half of the Executive's target rate. But both Treasury and the OLS understand that a delay in the refund payment pattern last year is depressing the current growth rate. Last year refunds paid by the State through February were way below normal levels, which made the net revenues (the amount paid to the State minus the amount paid out by the State) unusually large. This year, with refund payments returning to their normal levels, growth in net collections looks weak because of the artificially high levels last year against which they are measured. By the end of the fiscal year this distortion will have corrected itself. That is a primary reason why both the Executive and the OLS are projecting a rebound from the currently low 3.4% growth rate.

Also important, but the cause of greater uncertainty than the refund processing issue, are two opposing factors that will significantly influence the always important April tax payments. First, growth in payments this April will be held down by an artificial bump in payments last year. As certain federal income tax rates were set to rise on January 1, 2013, many high-income filers were able to shift income realization into Tax Year 2012 to avoid that increase. This behavior produced a jump in taxable income and for New Jersey (and other states) a jump in tax payments last year. We saw increases in December and January and a 29% surge last April. Not only will the windfall from that jump in income realization not recur, but some of the income that would have otherwise been realized in Tax Year 2013 was probably taken in late 2012 instead. Treasury estimates the one-time revenue infusion may have been worth $180 million last year, while the OLS assumes an amount closer to $250 million. The actual amount will never be known, as tax returns do not have a line for "income accelerated to avoid future federal tax increases."

While this phenomenon will have an adverse effect on our April GIT growth, the strong performance of the stock market will have a positive impact. As we have discussed before, stock market movement has a substantial effect on the direction and magnitude of GIT revenue changes and that impact is seen most clearly in the April collections. During Tax Year 2013 the S&P 500 index jumped 29% and that will enhance our collections this Spring. The OLS anticipates this boost will outweigh the loss of the one-time revenues from the tax base, and that April collections will rise by about 5% over last April. Presumably Treasury expects growth in April as well, but the OLS does not have access to Treasury's monthly GIT projections.

Once the April returns are tabulated by the middle of May, we will know if our optimism was well placed. There is a chance that the "April Surprise" could yield additional GIT revenue. We would not be shocked – and in fact would be delighted – if this April provides a bountiful surprise. But it is also quite possible that an April Surprise might take collections below both the OLS and the Executive estimates.

For FY 2015, both the Executive and the OLS assume growth slightly above 8%. Since the OLS starts from a lower FY 2014 base, its FY2015 estimate is also lower, by $113 million. Should the five-year old bull market falter this year, these forecasts could prove overly optimistic.

The sales tax is the State's second largest revenue. The Executive projects $8.68 billion in FY 2014, growth of 5.4% over audited FY 2013 collections. For FY 2015, the Executive projects underlying growth of 5.0%, plus new revenues of $98 million from three tax initiatives. The OLS is lower in both years, projecting $8.625 billion in FY 2014, $55 million less than the Executive, and $9.108 billion in FY 2015, $104 million less than the Executive.

Current sales tax growth appears to be good, at 5.6% through the end of February. However, that rate masks a sharp slowdown in recent months. Through the end of November, the sales tax was soaring, up 10% over the same months a year before. But since November, sales tax growth has slowed to only 0.4% for December through February. This slowdown was influenced by strong sales tax performance in these months in the prior year and by this winter that we would all like to forget. The OLS is optimistic that growth will improve going forward, averaging 3.5% for the remainder of FY 2014, and then 4.5% for FY 2015. These growth assumptions yield the OLS's lower totals than the Executive projects.

The other revenue for which there is a significant difference between the Executive and OLS is the Casino Revenue Fund (CRF). The Executive certified $384 million for FY 2014, but then reduced that estimate by $127 million five weeks ago. Presumably the bulk of this reduction is due to the underperformance of the new 15% internet gaming tax. However, the Executive is no longer providing its forecasts for the 15% internet gaming tax separately from the 8% traditional casino tax. In FY 2015 the Executive estimates CRF revenues of $310.7 million, but has not provided distinct estimates for the two taxes.

Last February and May, the Executive projected $180 million from the internet gaming tax. This amount was reduced to $160 million with the adoption of the Appropriations Act last June. However, according to monthly reports by the Division of Gaming Enforcement, the tax has generated only $4.22 million between the last week of November, 2013, and the end of February, 2014. Monthly amounts have been rising, from $1.1 million in December, to $1.4 million in January, and $1.5 million in February.

The OLS expects internet gaming to achieve a monthly average of about $2.0 million for the final four months of FY 2014, yielding an estimate of $12.0 million total for the fiscal year. For FY 2015 the OLS believes a $4.0 million average for the 12 months is achievable, producing $48 million in tax revenue. The OLS estimates $206 million from the 8% casino tax in each year. Overall, the OLS is estimating $26 million less for the CRF in FY 2014 and $45 million less in FY 2015 than is the Executive. Whether all or most of this difference stems from internet gaming is not knowable in the absence of more information from the Executive.

For a number of important revenues, the OLS concurs with the Executive’s forecasts in both years. The State’s third largest tax revenue, the corporation business tax (CBT), is projected to yield $2.42 billion in FY 2014 and $2.583 billion in FY 2015. Based on current collections trends, the OLS believes these CBT forecasts are achievable. Indeed, if a recent slowdown in CBT refund payments turns out to be more than just a processing or timing delay, the OLS thinks an upward revision in the CBT may be possible when we return before the Committees in May.

Likewise, the OLS concurs with the Executive’s estimates for the motor fuels and the petroleum products taxes.

The OLS is lower than the Executive for a number of smaller tax revenues, such as the realty transfer fee, the insurance premiums tax, and inheritance taxes. These differences reflect year-to-date growth rates below what is needed to achieve the Executive’s year-end targets.

On the other hand, the OLS is more optimistic than the Executive for the cigarette tax and the CBT on banks and financial institutions. Both of these revenues are currently performing somewhat better than the growth rates necessary to achieve the Executive’s year-end targets. Our ***Tax and Revenue Outlook*** report provides more detail on these and other revenues.

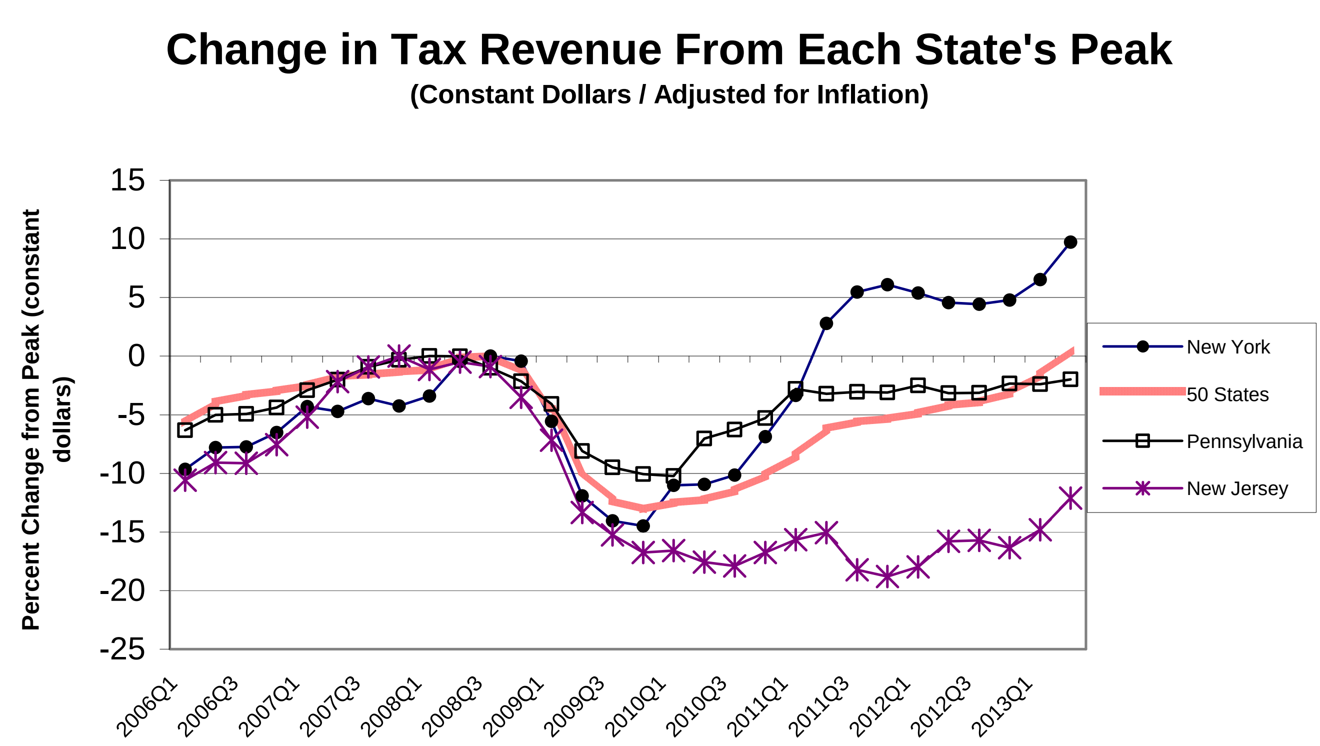
The OLS presents a revenue forecast to this committee each year to provide you with a second opinion on the level of revenue available to support the budget you are considering. Our annual analysis tends to focus on the current year and the upcoming year, but it is probably useful to consider a longer perspective as well.

To look at how revenue trends over time have impacted the budget choices available to the committee we turned to some interesting work done by the Pew Charitable Trusts. Pew analyzed how tax revenue collections in all 50 states were affected by the Great Recession and how the collections have responded since. Pew used the quarterly tax data collected by the Census Bureau for the period running from before the recession through the second quarter of calendar 2013. They adjusted the data for inflation, so that changes could be viewed in constant dollars, and for seasonal variations.

Looking at the aggregate tax collection for all 50 states, the high point, before the recessionary revenue plunge, occurred in the third quarter of calendar year 2008 and the bottom was reached in the fourth quarter of 2009 – at a level 13.1% below the peak. It took until the second quarter of 2013 for collections to return to the prior high point, as measured in constant dollars.

In New Jersey the recessionary decline started sooner, went deeper and lasted longer. Our revenue peak came in the fourth quarter of 2007 and the decline continued through the third quarter of 2010 - falling to a level 17.9% below the peak. And New Jersey's recovery has been markedly slower. By the third quarter of 2013, when the 50 state total had finally turned positive (0.5% above the prior peak), New Jersey was still 12.1% below its prior peak.

Not only did New Jersey lag the national trend, we also trailed our neighbors. New York returned to its peak in the second quarter of 2011 and was 9.7% above that peak by the second quarter of 2013. Pennsylvania had not yet returned to its prior peak in 2013, but was down only 2%. Maryland and Massachusetts, two states that bear demographic and tax structure similarities to New Jersey remained just below (0.3% and 0.2%, respectively) their earlier peaks by 2013.



The Pew Charitable Trusts' analysis of U.S. Census Bureau's Quarterly Tax data.

It is important to note that not all of New Jersey's revenue underperformance compared to the other states is attributable to weaker economic growth. Some states enacted tax increases during the period and others experienced boosts from the recent surge in energy production. However, it is also true that for this period New Jersey's growth in jobs, personal income and gross state product has lagged the nation.

While there may be a range of possible explanations for New Jersey's economic performance, there is little doubt that it has been impacted by long-term trends and national and global developments.

Whatever the causes, the budget implications of New Jersey's lackluster recovery from the recession are profound. If our growth had mirrored the national performance, we would have had about $3.3 billion more revenue in FY2013 to support our budget.

That amount is about the size of the appropriation for the operations of the entire Executive branch.

Our budget discussion would be very different if we had an additional $3.3 billion in revenue. In FY2014 we could have:
Fully funded the statutory homestead rebate program and the school aid formula; Or cut the income tax rates by 25%;
Or funded 7/7s of our pension obligation and had a billion dollars left over to start prefunding our post-retirement medical obligations; Or repealed the corporation business tax, the estate tax and the transfer inheritance tax; Or funded virtually every wish you heard during the public hearings.

But, of course, we do not have the luxury of an extra $3.3 billion.

For the third year in a row, revenues have fallen significantly short of the amounts certified. Compared to certification, we were down $554 million in FY2012, $809 million in FY2013 and either $251 million or $467 million (using either the Executive or OLS forecast) in FY2014 . So for this three-year period, our revenue collections are $1.6-1.8 billion below what was anticipated in the budget certifications.

Budget choices are always difficult to make. Without the luxury of the revenue growth experienced elsewhere, you face even harder choices than your counterparts in some other state capitals.

As you wrestle with decisions for this year's budget you will have many sources of information. The budget committees heard from 173 separate witnesses during the public hearings and their testimony is now online at the budget link on the Legislative homepage. OLS has prepared discussion point questions for each department and responses to those questions will be made available prior to the pertinent hearings. In addition, you will be receiving the department-by-department OLS analyses of the Governor's Budget Message. These analyses will provide budget highlights for each department and identify and explain proposed changes to line items and language provisions. As always, the fiscal staff of the Office of Legislative Services remains ready to respond to your questions and provide whatever support we can in the weeks ahead.