Report of the

State Budget Crisis Task Force

NEW JERSEY REPORT

State Budget
Crisis Task Force

This is a report of the State Budget Crisis Task Force prepared in collaboration with Richard F. Keevey, Distinguished Practitioner, at the School of Public Affairs and Administration, Rutgers University-Newark. Task Force member Ed DeSeve led and managed the production of this report.

More information is available at www.statebudgetcrisis.org

State Budget Crisis Task Force, September 2012

Table of Contents

Paul A. Volcker and Richard Ravitch introduced the July 2012 Full Report of the State Budget Crisis Task Force with the following statement:

State Budget Crisis Task Force

A Statement From the Task Force Co-Chairs

July 17, 2012

Our purpose in assembling the State Budget Crisis Task Force has been to understand the extent of the fiscal problems faced by the states of this nation in the aftermath of the global financial crisis. While the extent of the challenge varies significantly state by state, there can be no doubt that the magnitude of the problem is great and extends beyond the impact of the financial crisis and the lingering recession. The ability of the states to meet their obligations to public employees, to creditors and most critically to the education and well-being of their citizens is threatened.

The United States Constitution leaves to states the responsibility for most domestic governmental functions: states and their localities largely finance and build public infrastructure, educate our children, maintain public safety, and implement the social safety net. State and local governments spend $2.5 trillion annually and employ over 19 million workers—15 percent of the national total and 6 times as many workers as the federal government. State governments are coping with unprecedented challenges in attempting to provide established levels of service with uncertain and constrained resources.

Within the limits of time and resources, we have examined the financial condition of six heavily populated states—California, Illinois, New Jersey, New York, Texas and Virginia. While each state varies in detail, a common thread runs through the analysis, supported by information available for states generally.

What we found will not be surprising to many knowledgeable observers, but the facts have never been assembled in a way that reflects the totality of the problems.

Certain large expenditures are growing at rates that exceed reasonable expectations for revenues:

- Medicaid programs are growing rapidly because of increasing enrollments, escalating health care costs and difficulty in implementing cost reduction proposals. At recent rates of growth, state Medicaid costs will outstrip revenue growth by a wide margin, and the gap will continue to expand.

- Pension funds for state and local government workers are underfunded by approximately a trillion dollars according to their actuaries and by as much as $3 trillion or more if more conservative investment assumptions are used.

610 Fifth Avenue | Suite 420 | New York, NY 10020 | phone 646.396.9382

State Budget
Crisis Task Force

- Unfunded liabilities for health care benefits for state and local government retirees amount to more than $1 trillion.

The capacity to raise revenues is increasingly impaired:

- Untaxed transactions are eroding the sales tax base. Gasoline taxes are eroding as well, making it more difficult for states to finance roads, highways, and bridges.

- Income taxes have become increasingly volatile, particularly during and after the recent economic crisis.

The federal budget crisis will have serious spillover effects on state and local governments, and state actions will have spillover effects on local governments:

- Cuts in federal grant dollars, lower spending on federal installations, procurement, and infrastructure, and potential changes to the federal tax code all threaten states' fiscal stability.

- Pressures on local governments, caused by the weak economy and cuts in state aid, are constraining education spending, law enforcement, aid to the needy, and the institutions that make up the culture of our cities. Local government cuts pose a significant risk to the overall economic and social fabric of states.

State budget practices make achieving fiscal stability and sustainability difficult:

- While almost all states have constitutional or statutory balanced budget requirements, "revenue" and "expenditure" are not defined terms. The use of borrowed funds, off-budget agencies, and the proceeds of asset sales are not uncommon practices, often rendering balanced budgets illusory.

- The lack of financial transparency makes it more difficult for the public to understand the critical nature of problems such as pensions and other payment obligations. Temporary "one-shot" measures to avoid or delay hard fiscal decisions mask these underlying problems.

- Opaque and untimely reporting, coupled with nonexistent multiyear planning, severely hampers efforts to address these problems in a serious manner.

The Task Force is not in a position to propose changes in programmatic priorities, tax rates or structures to deal with budgetary problems. Such decisions are properly subject to the values and politics of a democratic society. Our essential goal is to inform the public of the gravity of the issues and the consequences of continuing to postpone actions to achieve structural balance. We do, however, believe that certain basic procedural approaches should be introduced and followed by all states and urge that prompt attention be given to financial relationships among all levels of government.

- The public needs transparent, accountable government. Individual states, existing associations of states, and advisory and standard-setting bodies should develop and adopt best practices to improve the quality and utility of financial reporting.

610 Fifth Avenue | Suite 420 | New York, NY 10020 | phone 646.396.9382

State Budget
Crisis Task Force

- Multiyear planning and budgeting approaches should be a normal part of fiscal planning.
- States need better tools for managing over the business cycle. A priority for states should be better use of their existing counter-cyclical tools, including "rainy day" funds and repayment of debts in prosperous periods.
- Pension plans need to account clearly for the obligations they assume and disclose the potential shortfalls and risks they face. Legislators, administrators, and beneficiaries alike need to develop and adopt rules for the responsible management of pension plans and mechanisms to ensure that required contributions are paid. States should recognize and account for post-employment benefits, such as healthcare, that they intend to continue.
- Prompt attention is needed to the effects that federal deficit reduction and major changes in the federal tax system will have on states and localities.
- States that do not have suitable mechanisms to monitor and assist local governments experiencing fiscal distress should develop them.
- Looking ahead more broadly, the recurrent problems of state finances and the growing state fiscal imbalance suggest that more fundamental approaches require attention. Tax reform at the state level may be needed to achieve revenue systems that are adequate and predictable and that minimize volatility.
- The apparent growing gap between states' spending obligations and their available financial resources points toward a need to reexamine the relationship between the federal government and the states.

The threats and risks vary considerably from state to state, but the storm warnings are very serious. Only an informed public can demand that the political systems, federal, state and local, recognize these problems and take effective action. The costs, whether in service reductions or higher revenues, will be large. Deferring action can only make the ultimate costs even greater.

The conclusion of the Task Force is unambiguous. The existing trajectory of state spending, taxation, and administrative practices cannot be sustained. The basic problem is not cyclical. It is structural.
The time to act is now.

Respectfully submitted,

Richard Ravitch **Paul Volcker**

Paul A Volcker

Chairmen

610 Fifth Avenue | Suite 420 | New York, NY 10020 | phone 646.396.9382

Foreword

Former New York Lieutenant Governor Richard Ravitch and former Federal Reserve Board Chair Paul Volcker created the State Budget Crisis Task Force because of their growing concern about the long-term fiscal sustainability of the states and the persistent structural imbalance in state budgets, which was accelerated by the financial collapse of 2008.

After extensive planning and fundraising in 2010 and early 2011, Messrs. Ravitch and Volcker recruited a board of individuals with extensive and varied careers in public service and public policy. The Task Force was officially launched in April 2011.

In addition to the co-chairs, the board of the State Budget Crisis Task Force includes these members:

Nicholas F. Brady

Joseph A. Califano, Jr.

Phillip L. Clay

David Crane

Peter Goldmark

Richard P. Nathan

Alice M. Rivlin

Marc V. Shaw

George P. Shultz

The executive director of the Task Force is Donald Boyd, on leave from his responsibilities as senior fellow at the Rockefeller Institute of Government. Ravitch and Boyd worked together to assemble a core team of experts with budget and financial planning experience at the national, state, and local levels and practical experience derived from the management of previous fiscal crises. The names of the full project team can be found on the Acknowledgements page at the end of this report.

The Task Force decided to focus on the major threats to states' fiscal sustainability. Since it was not feasible to study each of the fifty states in depth, we decided to target six states — California, Illinois, New Jersey, New York, Texas, and Virginia — for in-depth, onsite analysis. In each state, the core team worked closely with experts who were deeply familiar with the substance, structure, procedures, documents, and politics of the state's budget. The names of budget experts consulted in each state can be found on the Acknowledgements page at the end of this report. The core team and state experts conducted detailed inquiries into major issue areas including Medicaid, pensions, tax revenues, debt, the fiscal problems of local governments, and state budgeting and planning procedures. In doing so, the core team and state experts reviewed budget documents and data from the respective states and interviewed key budget officials.

The Task Force released its main report in July 2012, focusing on issues that cut across the six states. The Task Force also is preparing reports on individual states, including this report on New Jersey.

Summary

New Jersey has struggled to balance its budget for most of the past two decades. All of the major threats identified by the Task Force in its July 2012 report have contributed to this struggle and will contribute to future struggles.

Two programs dominate state spending — education and Medicaid. Both have increased significantly and will continue to stress the budget. Medicaid costs are driven by caseloads and healthcare costs, both of which are projected to continue rising. Education aid to school districts in fiscal year (FY) 2013 totals $11.7 billion — 37 percent of all state spending. In just the last two years, spending on school aid, including retirement benefits for teachers, has increased by $1.7 billion or 16 percent.

Since the mid-1990s New Jersey has underfunded its pension systems and has made no provisions for future costs of retiree health benefits. The combined unfunded liability for these retirement obligations is $84.8 billion. The unfunded liability would be higher still, but for recent action by the governor and legislature to eliminate cost of living adjustments (COLAs) for future *and current* retirees, increase employee contributions, and raise the retirement age. The state also established a seven-year "ramp" under which it plans to increase contributions each year until 2018, when it would begin to pay its full annual required contribution. In FY 2013 the state is budgeting $1.029 billion for pension contributions. The annual contribution will have to increase by as much as $ 4.5 billion between 2013 and 2018, to an estimated $ 5.5 billion, depending upon investment returns and other factors. *This estimated increase equals nearly 40 percent of the state's annual spending on education aid*. Honoring pension promises will force New Jersey to make extraordinarily difficult choices about spending priorities and taxes.

New Jersey's eroding and volatile tax structure is ill able to support state spending. The state relies on two dominant revenue sources, income and sales taxes, which account for 64 percent of all revenue. A mere 4.6 percent of income tax filers pay almost 52 percent of the revenue, making the tax volatile. When the economy suffers from a recession, income tax revenue falls sharply. The sales tax has a very narrow and eroding base: food, clothing, and many services go untaxed, and tax revenue from expanding internet sales is difficult to capture, damping revenue growth.

The state has relied heavily on nonrecurring resources to balance its budget. In 2003 nonrecurring resources accounted for 14 percent of total appropriations, and as recently as 2010 nonrecurring resources accounted for 13 percent of appropriations — in 2013 it was 4 percent of appropriations. In addition, in most years New Jersey underpaid its pension contribution or made no contribution at all. These practices have led to structurally unbalanced budgets in which current revenues do not support continuing spending commitments. This pushes difficult budget choices off to future years and is ultimately unsustainable.

Federal deficit reduction threatens New Jersey's economy and budget. The 2013 state budget includes $12 billion in federal funds. If the federal government cuts aid to state governments — as seems likely, eventually, if it makes any serious effort to reduce the deficit — the state could have a large and immediate loss of resources. A 10 percent reduction, for example, would cost the state $1.2 billion.

Local governments in most states are facing increasing budgetary pressures and in some states local governments have resorted to bankruptcy proceedings. New Jersey local governments also are under budgetary pressure. New Jersey's high

property tax, which at approximately $25 billion is more than state income, sales, and corporation taxes combined, is a policy and political issue with no easy solution. The state recently enacted a 2 percent cap on the property tax levy and legislation to limit arbitration decisions, but pressures on local government spending and services will be a continuing problem. Fortunately, New Jersey's Division of Local Government Services and Local Finance Board has exercised strong budgetary, fiscal, and debt management controls over local governments since the 1930s, helping to keep local budgets in balance.

New Jersey has relatively high debt per capita. Total debt outstanding is $33.7 billion, with approximately 73 percent issued for transportation and local school construction. The July 2012 task force report cautioned states against issuing debt for operating purposes. In three instances the state has issued long term contract bonds for operating purposes totaling approximately $4.5 billion. In 2005, the New Jersey Supreme Court ruled that such debt does not constitute "revenue" under the state constitution and cannot be used to balance the budget. The court's ruling applied prospectively to FY 2006 and beyond; thus, the state will not be able to use this inappropriate budget-balancing gimmick in the future.

New Jersey faces large unmet infrastructure needs, as do other states. It will need at least $133 billion for transportation, wastewater treatment, and drinking water over the next ten years. It has other critical needs for higher education, solid waste disposal and a wide variety of energy-related projects. Underfunded infrastructure threatens competitiveness; the longer it is ignored the larger the problem it will pose. Prioritizing needs and developing adequate funding sources will be a major challenge, given the other pressures on the budget.

Recommend Actions for Addressing Difficult Choices

New Jersey faces difficult choices. To put the state in a better position to address these choices, the task force offers the following recommendations:

- *Engage in multi-year planning and budgeting.* This will lead to better short term decisions and improve long term outcomes. New Jersey, like most states, does not make multi-year forecasts of future budgetary needs and focuses only on incremental growth of programs. Multi-year forecasts will help the public and decision makers understand the long term consequences of annual incremental budgetary decisions.
- *Strengthen and fund the state's Rainy Day Fund.* Periodic recessions will batter New Jersey's revenue, particularly given how volatile it is. To deal with these declines New Jersey should fund its Rainy Day Fund. The fund was exhausted in the last recession when $734 million was used. In the past the state has overridden requirements to deposit excess revenues into the fund. The state should follow the deposit requirements and make additional deposits into the fund so that it is prepared for the next recession, whenever that may be.
- Present the annual budget in a gross budget format so that federal and dedicated funds are included as part of the annual budget recommendation. It has been a long standing practice of the State not to include federal funds and certain dedicated as part of the annual recommended revenues and appropriations. Instead they are displayed in the budget document as dedicated revenues and expenditures (sometimes referred to as Off-Budget) and are appropriated only by language authorization. Thus, for example, the FY 2013 budget is viewed as a $32.7 billion plan when in fact it is actually authorizing closer to $48 billion. Most states present their budget in this gross format, and New Jersey already displays these resources as part of their documents. To make the budget more comprehensive and transparent in its presentation format, New Jersey should to take the next step and include all federal and dedicated funds as part of their formally announced general fund budget.

- *Strengthen the state's capital planning and develop a strategy to fund critical infrastructure.* New Jersey should develop a more comprehensive plan and use the Capital Planning Commission more fully. The state has an excellent process to identify short term capital needs, but the annual report is not comprehensive. The current capital plan only includes projects that can reasonably be expected to be funded within six years, but does not include longer-term needs. For example, when the task force reviewed the state's long-term environmental infrastructure needs, numerous documents had to be located and reviewed — the information was not readily available. Including all long term needs in one annual multi-year plan would strengthen the process and highlight total infrastructure needs. Funding these needs is critical for the state's competitiveness.
- *Review the state and local government tax and spending structure.* Given the long range fiscal challenges facing the state and its local governments, and numerous incremental changes to the tax code, the entire tax and spending systems of the state and its local governments should be examined carefully. The review should examine the volatility and competitiveness of the existing revenue system, and should examine the expenditure side of the budget for potential efficiencies and program consolidations. One effective way to do this is to establish a non-partisan or bi-partisan tax policy and spending commission.
- *Provide the necessary funding for the pension systems.* New Jersey has made significant changes to reduce the severe underfunding of its pensions systems and has established a "ramp" that will move the state toward full payment of required contributions. It has met the requirements for the first two years but funding requirements will increase substantially over the next five. The state will face difficult choices about spending priorities and taxes if it follows this payment schedule.
- *Monitor and control the costs of retirement health benefits.* New Jersey, as almost every state in the country, has not reserved any funds for retirement health benefits promised to its current and former workers. The state's unfunded liabilities have reached $59 billion and annual pay-as-you-go funding approach could reach an estimated $1.7 billion over the next five years — an increase of $600 million. Ideally, the state should begin to set aside funds for benefits it intends to continue. If that is not practical it must monitor these costs carefully, and consider ways to reduce their costs and perhaps shift more costs to the retiree.

New Jersey Budget Decision Making Process and Constitutional Provisions[1]

Nature of the Budget and Accounting System in New Jersey

The State of New Jersey operates on a fiscal year beginning July 1 and ending June 30. Pursuant to the State Constitution (Article VIII, Section II, and paragraph 2) no money may be drawn from the state treasury except for appropriations made by law. In addition, all monies for the support of state government must be provided for in one appropriation law covering one and the same fiscal year.

Furthermore, no subsequent supplemental appropriation act can be enacted if the amount of the money appropriated, together with all other prior appropriations, exceeds the total amount of revenue on hand or anticipated to be available for the fiscal year, as certified by the governor.

Under provisions of the constitution the budget must be submitted in a balanced format by the governor; the legislature must approve a balanced budget (if it does not, the governor has the responsibility to bring it into balance via a myriad of tools); and the budget must be in balance at the end of the year, including through the audit phase.

The Office of Management and Budget (OMB) director prescribes and approves the accounting policies of the state and directs their implementation. The OMB director maintains and supervises a central accounting system wherein all financial transactions relating to day to day state operations are recorded and processed.

To ensure expenditures do not exceed appropriations, New Jersey employs encumbrance accounting. Purchase orders, contracts, payroll, and all other commitments involving monetary expenditures are encumbrances. Any unencumbered and unexpended noncontinuing appropriations lapse at the end of the fiscal year.

New Jersey's financial statements are prepared in accordance with generally accepted accounting principles (GAAP), and thus the fund financial statements are based on a modified accrual basis of accounting. Specifically, revenues are estimated and recognized when they can be accrued (i.e., when they become both measurable and available for financing expenditures in that fiscal period). Appropriations are at a level sufficient to recognize all accrued expenditures and outstanding obligations in support of program operations for the fiscal period. Goods and services delivered during a fiscal period are accrued as expenditures, if not actually paid for by the end of the fiscal year.

The state's annual financial statements are prepared by OMB and are audited by the state auditor, who is appointed by the legislature. New Jersey has received an unqualified opinion (clean opinion) in every year since FY 1993. The state has been awarded the "Certificate of Achievement for Excellence in Financial Reporting" for its Annual Financial Statements (CAFR) from the Government Finance Officers Association.

To be in sync with the financial statement requirements, New Jersey employs a budgetary basis of accounting for all of its budgetary transactions, that is, using the same modified accrual basis of accounting. The budgetary basis of accounting has the following attributes: (1) recognizes encumbrances as expenditures, (2) recognizes all federal revenues related to such encumbrances, and (3) reflects all current fiscal year transactions — no roll-over of bills.

The state has a statutory requirement for a Rainy Day Fund which can be funded either by direct appropriation or, as has been the normal occurrence, crediting to the fund one-half of the revenue collected in excess of the amount certified by the governor. Over the past couple of years language has been inserted into the appropriation act that preempts the statutory requirement and accordingly no deposits have been made to the fund. The fund was depleted in FY 2008.

New Jersey has had a balanced budget in every year since the adoption of the State Constitution in 1947. As discussed later, however, New Jersey, like other states, has achieved this balance in some years through the use of gimmicks and other nonrecurring mechanisms, such as pension underpayments and bond proceeds that have allowed the state to finance recurring expenditures. But, unlike other states, New Jersey has not rolled invoices or payments or short term notes over into future years, and as a matter of practice develops resources or other actions in future years to insure a balanced budget, which results in financial statements that are crafted under generally accepted accounting principles.

The Budget Process

The budget is organized in a program structure format with three levels: statewide programs, program subcategories, and program classifications. Even though the budget structure is in a program format, the initial designation of appropriation remains departmental in focus. The budget is further divided into five broad spending categories:

- Direct State Services — operations of the government
- State Aid — payments to municipalities, counties, school districts
- Grants-in-aid — payments for services to agencies outside of the state government, but not local governments, such as Medicaid, assistance to institutions of higher education, etc.
- Capital Construction — capital projects that are funded on a “pay-as-go” basis
- Debt Service — principal and interest payments on general obligation bonds of the state

New Jersey’s budget process is comprehensive and inclusive, involving every department and agency in the executive branch, the legislature, and the judicial branch, and, through a series of hearings, the citizens of the state. The budget process begins in the summer prior to the following fiscal year with preliminary projections of revenues and expenditures that form the basis for the development of budget targets by OMB for each branch, department, and agency.

Each department and agency is then required to prepare a spending plan and strategy for operating within the established targets. This spending plan (sometimes referred to as the Planning Document) includes an analysis of the costs and priorities of every program. The planning process also provides an opportunity for agencies to submit “priority packages” of program needs in excess of the targets — but within limits and constraints established by OMB. OMB holds a series of meetings with the agencies and departments to arrive at a funding level for the submission of the formal budget.

Based upon review by OMB, and in accordance with statute, on or before October 1 of each year, each department or other agency of the government must file with the OMB director a formal request for appropriation specifying all expenditures proposed to be made for spending during the following year.

The governor's "Budget Message" is presented by the governor during an appearance before the joint session of the state legislature, which by law is convened at noon on a date on or before the fourth Tuesday in February. The Budget Message must include the complete financial program of the state government for the ensuing fiscal year and must set forth in detail each source of anticipated revenue and the purpose of recommended expenditures for each spending agency.

As part of the budget process no multi-year plan is developed. The budget has only the prior year expenditures, an update of the current year, and the projected needs for the upcoming budget year.

After a process of review by the legislature's budget committees — usually lasting three months — and including testimony by the state treasurer and a series of hearings with each cabinet officer, the budget is placed into an appropriations bill. The bill must be approved by the senate and the assembly and then submitted to the governor for review and approval. The legislature may make any addition or deletion to the governor's budget. The appropriations bill is prepared by the Office of Legislative Services, which provides staff support to the committee(s), including an independent analysis of the revenue submitted by the governor.

The governor may approve the bill, change the revenue estimates (and certify such revenue estimates), delete or reduce appropriation items through the exercise of the line-item veto power, or veto the bill in its entirety — all actions subject to legislative override by a 2/3 vote of the full legislature. The governor cannot add spending items to the appropriations bill.

Key Executive Branch Players in the Budget Process

The governor is the key player in the budget process, and has significant constitutional and statutory powers in the planning, development, and execution of the annual spending plan. Aside from the lieutenant governor, the governor is the only statewide elected official — and accordingly has wide powers in appointing a wide range of officials who have budget responsibility. New Jersey's budget process is very centralized and the governor is at the apex of the process. The governor certifies revenue for the upcoming year and has line item and veto powers, per the constitution.

The state treasurer is the single official responsible for all financial activities in the New Jersey state government, and is generally recognized as the chief financial officer of the state. Unlike any other state government, all financial officials report to the state treasurer, including the directors of: OMB, Taxation, Investments, Pension and Employee Health Benefits, Procurement, Property Management and Construction, Public Finance, State Economist, Lottery, Revenue, and Risk Management. The state treasurer is appointed by the governor and is viewed as the governor's chief spokesperson on all fiscal and budget matters, and always makes the opening presentation concerning the Governor's Annual Budget before the Legislative budget committees.

The *OMB director* is appointed by the governor but reports to and through the state treasurer. On a day to day basis the OMB director is responsible for budget planning, preparation, and execution. The OMB director participates with the state treasurer at budget discussions with the governor and the governor's staff. The OMB director is also the person who interacts on a daily basis with the cabinet officers and their staffs on matters related to all aspects of the budget. The OMB director is viewed as the expert on the details of the budget.

The OMB director is also responsible for several other major functions: payment of all state bills; operation and maintenance of the central accounting system; preparation and issuance of the Comprehensive Annual Financial Report

(CAFR); operation of the statewide payroll and position control systems; preparation of the Annual Capital Plan; and participating in the capital planning process with the Capital Planning Commission.

The Recent Economic Climate

The recession of 2007 to 2009 produced unprecedented declines in state revenue collections across the nation — and New Jersey fared no differently. The collapse affected all of New Jersey's major revenues, from the "big three" (income, sales, and corporation), which represent 72 percent of all state revenues, to smaller taxes such as realty transfer, inheritance, motor fuels, etc.[2]

During this period, the state witnessed a decrease in employment. Between January 2008, and January 2011, the state had a net job loss of 259,900 — after having increased by 244,000 the previous decade.[3] The April 2012, forecast by the Rutgers Economic Advisory Services also suggests that in New Jersey the average number of jobs in the state will not surpass the 2007 peak until 2016.

According to the Rockefeller Institute of Government a "normal" recovery would take state governments five years to return to peak levels in revenues. And with a slow recovery, as most predicted, the return to prior levels would be even longer.[4] Fiscal Year 2013 is the fifth year since the deep recession began, and New Jersey is not yet back to its peak revenue year.[5]

New Jersey's economy improved slowly and steadily during most of 2011 and early 2012. Calendar year 2011 was also the first year since 2007 in which the state's job count rose over the course of the year. The increase in private sector jobs was the largest in both absolute and percentage terms since 2000. After hitting bottom in January 2011 employment was up by 70,000 jobs in May 2012. Another 9,900 jobs were added in June, but the July numbers show a decline of 12,000 jobs.[6]

Despite the job gains, the state's unemployment rate moved to 9.8 percent from 9.2 percent (the national average is 8.2%).[7] In fact, the state's unemployment rate has been persistently higher than the national average since the beginning of 2011.[8]

According to a report released by Rutgers University on July 31, 2012, New Jersey has lagged behind its neighbors — New York and Pennsylvania — throughout the economic recovery in regaining private sector jobs lost during the recession, but recent employment growth has begun to outpace other states. A larger concern, cautions the report, is what could happen in the national economy, specifically the looming "fiscal cliff" over the next six months and its effect on New Jersey.[9]

One could list other statistical measures and discuss other reports concerning the economy both in New Jersey and at the national level — but suffice to say, a general conclusion is that the New Jersey economy is improving, albeit slowly — but that one needs to be cautious.

The Budget Situation

The Budget of the State of New Jersey was signed into law on June 29, 2012, and is projected to be in balance for the current year (FY 2013). New Jersey's budget has always had a surplus, sometimes with the use of nonrecurring resources, and if underfunding of pension obligations is disregarded.

To this latter point, the FY 2012 and FY 2013 Budgets reflect a significant turning point in addressing some of the longer range issues that have confronted the state since the latter part of the 1990s — specifically, the severe underfunding of the pension systems, and the rising costs of health benefits for current and retired employees. Meeting the commitment to fund pension benefits adequately will prove a very significant financial challenge to the state.

Revenues[10]

During the last recession, revenue collections decreased by 11.4 percent in FY 2009 and then by another 3.5 percent in FY 2010, decreasing from $32.6 billion in FY 2008 to $27.9 billion in FY 2010.

Final revenue collections for FY 2011 improved compared to the prior two years. Specifically, in FY 2011, based on the final audit, revenues increased by 2.8 percent or $780 million, with the income tax reflecting an almost identical percentage growth.

Final FY 2012 revenues are not yet available, but the current estimates (2.6% growth and $744 million increase) suggest the growth rate will be less than FY 2011, but still increasing.

The revenues in the Appropriations Act for FY 2013, as certified by the governor, reflect an increase in total revenue of 7.9 percent (an increase of $2.3 billion) with an assumption that the income tax will also grow by approximately 8 percent.

The legislative finance and budget officer has testified that the revenue for FY 2012 may be overestimated by $254 million, and by $595 million for FY 2013 — and according to more recent FY 2012 data could be higher. The legislative finance and budget officer has estimated an increase of 5 percent in the income tax, which is much lower than the governor's 8 percent estimate.

The FY 2013 Appropriation Act assumes a beginning undesignated fund balance (surplus) of $570 million and a closing surplus on June 30, 2013, of $648 million.

However, it is anticipated there are several potential factors which will reduce both the beginning and the ending balances for FY 2013 — and such reductions may be significant based upon the final determination of revenues and fiscal-year-end lapses upon the completion of the annual audit. In addition, the FY 2013 Appropriation Act assumes certain savings that may not be achieved; and certain costs, principally for Medicaid and General Assistance, may exceed the amount appropriated. These situations would further impact the projected ending fund balance for Fiscal year 2013 — and as a result other budgetary actions may be necessary during the course of Fiscal year 2013.[11]

The governor has also proposed a 10 percent reduction in the income tax to be phased in over three years with an impact of $183 million in FY 2013 and $1.1 billion by FY 2016. The legislature has withheld support until tax collections for FY 2012 and FY 2013 can be further analyzed.

Spending[12]

The Appropriations Act for FY 2013 includes $31.7 billion, an increase of $1.4 billion or 4.5 percent. It should be noted that New Jersey also anticipates receiving and spending an additional $11.8 billion in federal funds as well as spending approximately $4 billion in dedicated state revenue. These revenues and related expenditures are treated as "appropriated" or "off-budget" expenditures in the state system. However, such revenues and expenditures are fully displaced in the Budget Message and accounted for in the Comprehensive Annual Financial Report.

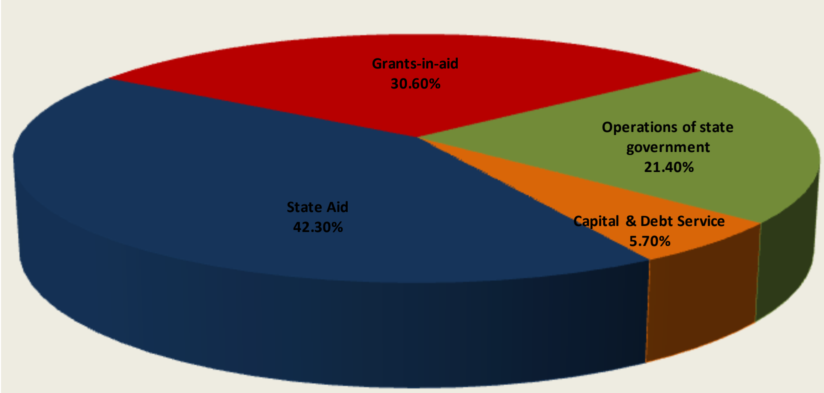
The largest components of the proposed New Jersey Budget is as follows:

Table 1 | Major Spending Components of State Budget, FY 2013

Spending	$ millions
State Aid to Schools, Municipalities & Counties	$13,396
School Aid	*11,713*
Municipal & County Aid	*1,683*
Grants-in-Aid	9,699
Medicaid	*4,100*
Higher Education	*1,988*
Community Programs	*3,212*
Homestead Rebates	*399*
Operations of State Government	6,764
Capital Construction	1,384
Debt Service on General Obligation Bonds	412
Total	**$31,655**
Source: New Jersey FY 2013 Appropriations Act.	

Another view of state spending can be seen in Figure 1 below:

Figure 1 | Major Component of State Spending, FY 2013



Source: New Jersey FY 2013 Appropriations Act.

Detailed Revenue Information — Historical and Projected

The revenues projected for the FY 2013 Budget reflect an increase of approximately 8 percent or $2.329 billion, driven principally by a projected increase of 7.9 percent in the income tax and the use of nonrecurring resources totaling approximately $1.2 billion.

Furthermore, the FY 2013 revenue estimates include the continued phase-in of reductions for the corporation tax. Specifically, four tax law amendments implemented last year are estimated to reduce revenue by $347 million in FY 2013 and $662 million by FY 2016.

Below are summarized revenue collections for fiscal years 2007 to 2011, and estimated for fiscal years 2012 and 2013.

Twenty-eight percent of revenues are combined in the one line entitled "All Other." Over a period of many years this aggregation of "All Other" revenues has varied very little from year to year, except when there have been unusual events such as the use of one-time revenue sources.

For FY 2013 there is an extraordinary increase in "All Other" revenue of $833 million compared to FY 2012. A large part of this increase represents nonrecurring revenue related principally to transfers from dedicated accounts to the general fund.

Table 2 | Revenue Collections, FYs 2007-2013 ($ millions)

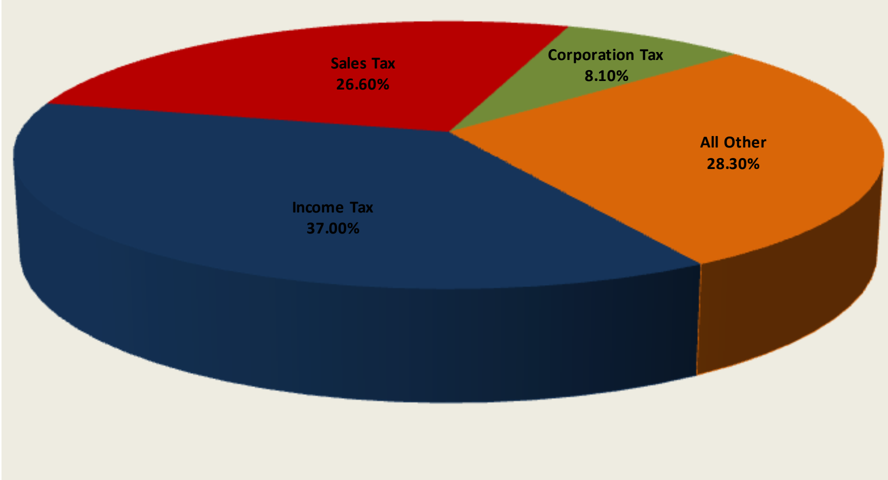
Tax	2007	2008	2009	2010	2011	2012	2013
Income	$11,727	$12,606	$10,476	$10,323	$10,617	$10,900	$11,767
Sales	8,181	8,395	7,723	7,523	7,765	8,046	8,423
Corporation	2,997	2,993	2,622	1,999	2,227	2,314	2,566
All Other	8,303	8,591	8,064	8,034	8,051	8,144	8,977
Total Tax	$31,208	$32,585	$28,885	$27,879	$28,660	$29,404	$31,733
$ Change	$2,557	$1,376	($3,699)	($1,006)	$781	$744	$2,329
% Change	8.9%*	4.4%	-11.4%	-3.5%	2.8%	2.6%	7.9%

* The sales tax rate was increased from 6% to 7% in FY 2007 (the increase in total revenue, adjusted to remove the impact of this rate increase would be 4.8% rather than the 8.9% actual increase).
Source: New Jersey Office of Management and Budget, FY 2011 Comprehensive Annual Financial Report; FY 2012 and FY 2013 Appropriation Acts.

Another view of the state's revenue structure is reflected in the figure below:

The table below shows the pattern for fiscal years 2007 to 2013 for the state's two largest revenue sources, the income tax and the sales tax.

Figure 2 | Composition of Major Revenues, FY 2013



Source: New Jersey FY 2013 Appropriations Act.

Table 3 | **Income Tax and Sales Tax Patterns, Dollar & Percentage Changes ($ millions)**

Tax	2007	2008	2009	2010	2011	2012	2013
Income Tax	$11,727	$12,606	$10,476	$10,323	$10,617	$10,900	$11,767
$ Change	$1,220	$878	($2,129)	($153)	$294	$283	$867
% Change	11.6%	7.5%	-16.9%	-1.5%	2.8%	2.7%	8.0%
Sales Tax	$8,181	$8,395	$7,723	$7,523	$7,765	$8,046	$8,423
$ Change	$1,415*	$214	($672)	($200)	$242	$281	$377
% Change	20.9%*	2.6%	-8.0%	-2.6%	3.2%	3.6%	4.7%

* Sales tax rate increased from 6% to 7% in FY 2007.
Source: New Jersey Office of Management and Budget, FY 2011 Comprehensive Annul Financial Report; FY 2012 and FY 2013 Appropriation Acts.

The legislative budget and finance officer of the Office of Legislative Services (OLS) testified before the Senate Budget and Appropriations Committee and made the following observations: there is growing evidence that the national recovery is taking hold in New Jersey; both the Executive and the Office of Legislative Services project modest growth for the remainder of FY 2012 and accelerating growth for FY 2013, albeit the Executive's growth assumptions are greater than OLS's in each of the two years; and the OLS forecast rests on the expectation of a moderately accelerating economic recovery. A more robust recovery could lead to revenue exceeding the forecast. However, the OLS believes that it is at least likely that a continuation of a weak economy will produce revenues below what is estimated.[13]

Over the two fiscal years of FY 2012 and FY 2013, involving over $61 billion in state revenue, the difference between the Executive and OLS is relatively small — slightly less than 2 percent. However, with a budget that has a projected surplus of only 2 percent ($648 million) — and based on the information included in the recent Preliminary Official Statement issued by the State, such surplus will be less — and therefore there is little room for error and therefore decision makers need to monitor carefully revenue collections.

The following chart provides a high level summary of the New Jersey Surplus, Revenue and Appropriations for fiscal years 2011, 2012, and 2013.

Table 4 | **Summary of Surplus, Revenues, Resources, and Appropriations**

	FY 2011 Final Audit	2012 Estimated	FY 2013 Per Appropriations Act
Opening Surplus	$804	$873	$570
Revenues	28,660	29,404	31,733
Federal Stimulus Resources	883	0	0
Projected Lapses	0	587	0
Total Resources	$30,347	$30,864	$32,303
Appropriations/Expenditures	29,474	30,294	31,655
Ending Surplus	$873	$570	$648

Source: Fiscal Year 2013 Appropriations Act and Fiscal Year 2011 Consolidated Annual Financial Report.

Budget Balancing Challenges

Balancing the state budget on an annual basis will remain a very daunting challenge, as program needs will continue to increase at a rate and an amount greater than current revenues. Long range challenges are even greater.

For example, the four major cost drivers in the state budget — Medicaid, school aid, current and retiree health benefits, and pension system costs — will, based on current spending patterns and recent policy changes, increase by a projected $9.2 billion over the next five years. This increase is greater than the total projected revenue growth — assuming the continuation of revenue assumptions utilized by the governor in the FY 2013 Appropriation Act.[14]

The state has appropriately committed to meet funding requirements for the pension systems, but there is an increasing cost to this policy. For example, compared to FY 2012 when $526 million was appropriated for the various pension systems, it is projected that in FY 2018 approximately $5.0 billion to $5.5 billion will need to be appropriated — an increase almost as great as the projected increase in the income tax, and more than twice the growth in the sales tax.

The underlying funding structure for retirement benefits has undergone much needed change, but is a major driver of future budgetary costs. The growth in pension requirements plus the ever increasing cost for current and retiree health benefits will crowd out other budgetary needs.

Furthermore, continuing growth in Medicaid and school aid will also limit decision making and make budget balancing difficult. The current budget is in balance, but clearly a projected budget gap is real, and thus decision makers will need to make many serious policy decisions to keep the budget in balance over the next several years.

Medicaid Fiscal Issues

Federal Overview[15]

Medicaid is the nation's largest health insurance program for low income Americans. The program was initiated in 1966 at a cost of $400 million and was intended to be financed jointly by state governments and the federal government. Today, nationwide the program covers more than 65 million people — an increase from 35 million in 2000. Nationwide the cost is more than $400 billion — up from $206 billion in 2000, and is projected by the Congressional Budget Office to increase by 7 percent per year.

Nationally, low income families with dependent children constitute approximately 67 percent of all enrollees. However, this client group accounts for only 23 percent of the cost. The dominant cost drivers are the elderly and the disabled. These groups account for 67 percent of the cost, primarily because of long term care services.

The Medicaid program is an open-ended entitlement program. Anyone meeting certain income and eligibility requirements can enroll, including children, pregnant woman, and some adults with dependent children, disabled, and the elderly.

States do not have to participate in Medicaid, but if they do the federal government requires states to offer a basic or mandatory set of benefits, such as physician care, hospital and laboratory services, and long term care services.

Most states, including New Jersey, also provide a range of optional services, such as dental, home health, prescription drugs, rehabilitation services, and personal care services. The number of optional services differs from state to state.

New Jersey, as well as many other states, provides services to groups above federal minimum thresholds.

Each state also determines how much providers are paid within federal guidelines, and whether coverage will be expanded to include nearly all adult groups less than 65 years of age and below 138 percent of federal poverty level ($22,350 for a family of four).

On average the federal government pays 57 percent of the cost of the program — with a range from 50 percent to 75 percent. Federal reimbursements are made to the states under a formula called the Federal Medical Assistance Percentage (FMAP), which varies according to each state's per capita income level. States pay the difference, and in some states local governments pay a share. The federal match for most services in New Jersey is 50 percent.

The New Jersey Medicaid Program[16]

The New Jersey Medicaid Program is administered through the Division of Medical Assistance and Health Services in the Department of Human Services.

The Medicaid program evaluates the medical needs of persons eligible for the various programs and addresses these needs through immediate and quality diagnosis, treatment, and rehabilitation of acute illness or disability, as well as providing health maintenance.

New Jersey also administers the Children's Health Insurance Program (CHIP), a federal and state funded health insurance program to help provide affordable health coverage to New Jersey's uninsured children and certain low income parents and guardians. The program is for parents or guardians with work income at or below 133 percent of the federal poverty level who do not have available or affordable employer insurance and cannot afford to pay the cost of private insurance.

Medicaid and CHIP programs serve approximately 1.29 million individuals. Currently, more than 98 percent of the New Jersey Medicaid population is enrolled in managed care. Once the transition of long term clients and behavioral health services into managed care is complete, almost all clients and services will be reimbursed on a per capita basis.

Medicaid is the second largest program in the New Jersey budget after State Aid for K-12 Education — and is approximately 17 percent of the total state budget. When federal funds are included it is the largest cost center in the budget.[17]

Two major initiatives in the past two years changed New Jersey's managed care program: (1) all persons enrolled in managed care must remain with the same managed care plan for twelve months unless special circumstances permit the person to change to another plan, and (2) New Jersey received approval of a waiver that required all dual eligible (Medicare and Medicaid) individuals to receive Medicaid services through the managed care program. The second initiative resulted in a dramatic one-month increase in enrollment of dual eligible from 33,668 in September 2011, to 129,898 in October 2011.

New Jersey is one of the most generous programs in the nation in terms of services offered and eligibility. In addition to mandated services, New Jersey offers an extensive range of optional services. Perhaps as a result, cost per enrollee is among the highest in the nation, at approximately $8,000 per enrollee, almost 50 percent more than the national average of $5,337 (see chart below). But the program is not as generous in its level of payment to providers for acute care.

In an interview, Joel Cantor, director of the Rutgers Center for Health Policy, said: "Our spending per enrollee is very high because our program covers very sick people, more so than the national average. It is not because we pay providers more than the average — we do not. Compared to the rest of the nation, New Jersey has a bigger share of spending for the elderly and people with disabilities. They are very high consumers of healthcare as they are very ill and they use long-term care services and acute medical services as well."[18]

New Jersey is an expensive state in terms of long term care for the elderly ($16,483 per enrollee) and people with disabilities ($20,554). New Jersey spends much more than the average in the nation on nursing home care versus home and community based services.[19]

Other states have cut optional services; New Jersey has largely maintained the status quo, albeit the recent waiver submitted to Centers for Medicare & Medicaid Services (CMS) in December 2011, would make certain changes.

New Jersey is average in terms of children's participation in Medicaid/CHIP (84.3% versus 84.8% rate in the U.S.), and its eligibility criteria do not appear unusually strict, so it is unlikely that New Jersey is excluding people who are covered in most other states in order to achieve the lower per capita rate.

The New Jersey Medicaid program has also demonstrated a commitment to provide comprehensive and affordable care to low income families by extending generous subsidized health care coverage for children in families whose gross family incomes which do not exceed 350 percent of the federal poverty level (FPL), and for parents up to 200 percent — when state finances permit — through both the Medicaid Title XIX program and particularly through CHIP Title XXI.

The New Jersey CHIP program has also successfully designed and administered plans with benefits, premiums, and copayments that varied for families with incomes over 350 percent of FPL.

CHIP provides subsidized health care coverage for a parent or caretaker relative of a child with earned income at or below 133 percent of the federal poverty level while continuing the subsidized health care coverage for a parent or caretaker relative of the child with gross family income between 134 percent and 200 percent of the federal poverty level, who applied prior to March 1, 2010.

The Medicaid program also provides health coverage for those single adults eligible for general assistance with incomes not exceeding 23 percent of the federal poverty level.

These programs, along with efforts to provide premium support for individuals with low incomes to purchase insurance from their employers, demonstrate New Jersey's recognition that affordability often constrains the ability of families to obtain health insurance and assistance is needed for individuals from families above Medicaid cutoffs.

The New Jersey Medicaid program does not currently offer coverage through Medicaid or CHIP to most of the population that would potentially be covered by the Affordable Care Act (ACA), the national health care overall enacted in 2010; however New Jersey does currently offer some state funded coverage to legal immigrants ineligible for Medicaid, subject to funding availability, in its Supplemental Prenatal program and the Medical Emergency Payment Program for Aliens. The acceptance of the ACA program has the potential to capture federal funds for these efforts. It should be noted that the foreign born population in New Jersey is growing and is now 20 percent, behind only California and New York — and this population was the largest source of population growth in New Jersey between 2000 and 2008.

Total Medicaid Expenditures, FY 2000 — FY 2012

State spending of Medicaid has increased significantly over the past twelve years, from $6.1 billion in FY 2000 to a projected $12.1 billion in FY 2012. The following table shows the total program expenditures for this period, and the breakout between state and federal sources.

Table 5 | Medicaid Spending, FY 2000 to FY 2011 & Appropriation for FY 2012

State Fiscal Year	Title XIX CMS-64 Expenditures ($ millions)*			Title XXI CMS-64 Expenditures ($ millions)		
	State	Federal	Total	State	Federal	Total
2000	$3,001	$3,059	$6,060	$21	$38	$59
2001	3,697	3,743	7,440	29	55	84
2002	3,855	3,905	7,761	143	265	407
2003	4,114	4,268	8,382	153	284	438
2004	3,758	4,210	7,968	119	220	339
2005	3,967	4,001	7,967	109	202	310
2006	4,666	4,741	9,407	126	235	361
2007	4,792	4,849	9,640	147	273	420
2008	4,805	4,871	9,677	164	303	467
2009	4,301	5,574	9,875	222	413	636
2010	4,254	6,315	10,569	278	518	796
2011	4,593	6,377	10,971	342	636	978
2012 Appropriation	5,369	5,669	11,038	393	731	1,124

* Excludes Clawback.
Source: Title XIX -CMS-64 Reports, New Jersey Division of Medical Assistance and Health Services.

The average annual enrollment has increased from 962,355 in FY 2006 to a projected 1.3 million for FY 2012. The average annual enrollment and its major components are shown below.

Table 6 | Average Annual Enrollment, FY 2006 to FY 2011 and Projections for FY 2012

State Fiscal Year	Average Annual Enrollment*				
	Medicaid & General Assistance	Family Care Adults & State Only	Family Care Children	Total	Total, % Change
2006	313,328	141,346	507,682	962,355	
2007	316,576	160,980	532,891	1,010,447	5.0%
2008	321,915	174,670	529,873	1,026,458	1.6%
2009	334,734	210,296	559,251	1,104,282	7.6%
2010	348,542	256,272	621,104	1,225,918	11.0%
2011	361,756	250,434	663,559	1,275,749	4.1%
2012 Projected	359,552	243,566	687,132	1,290,251	1.1%

* Enrollment groups based on monthly enrollment reports.
Source: New Jersey Division of Medical Assistance and Health Services.

Comparison of Major Medicaid Spending Categories, New Jersey to U.S. Average

The following series of charts compares major New Jersey Medicaid program expenditures to the national average for six groups of major program/service categories. For example, New Jersey expends above the national average per enrollee for the aged and disabled and for outpatient services. But, the state expends below the national average per capita for home health care and for inpatient services.[20]

Table 7 | Medicaid Payments per Enrollee, FY 2008

Enrollment Group	NJ	US
Aged	$16,483	$13,091
Disabled	20,554	14,731
Adults	4,549	2,677
Children	2,296	2,167
Unknown	0	1,061
Total	$7,982	$5,337

Notes: Includes federal & state expenditures but excludes DSH payments. Represents the average payments across all enrollees.
Source: Kaiser Commission on Medicaid and the Uninsured & Urban Institute estimates based on data from MSIS & CMS-64 reports.

Table 8 | Distribution of Medicaid Spending by Service, FY 2009

Service	NJ ($ millions)	NJ (% of total)	US ($ millions)	US (% of total)
Acute Care	$4,478	46.3%	$226,690	61.9%
Long Term Care	$3,964	41.0%	$122,082	33.3%
DSH Payments	$1,225	12.7%	$17,699	4.8%
Total	$9,667	100.0%	$366,471	100.0%

Notes: Includes federal & state expenditures; excludes administrative costs & accounting adjustments.
Source: Kaiser Commission on Medicaid and Uninsured & Urban Institute estimates of CMS-64 data.

Table 9 | Distribution of Medicaid Payments by Enrollment Group, FY 2008

Enrollment Group	NJ ($ millions)	NJ (% of total)	US ($ millions)	US (% of total)
Aged	$1,865	23.9%	$70,210	22.1%
Disabled	$4,081	52.4%	$143,329	45.1%
Adults	$645	8.3%	$41,391	13.0%
Children	$1,200	15.4%	$62,762	19.8%
Unknown	$0	0.0%	$2	0.0%
Total	$7,791	100.0%	$317,694	100.0%

Notes: Includes federal & state expenditures.
Source: Kaiser Commission on Medicaid and Uninsured & Urban Institute estimates of MSIS & CMS-64 data.

Table 10 | Distribution of Medicaid Enrollees by Enrollment Group, FY 2008

Enrollment Group	NJ (# enrollees)	NJ (% of total)	US (# enrollees)	US (% of total)
Aged	113,100	11.6%	5,363,300	9.0%
Disabled	198,600	20.3%	9,729,700	16.3%
Adults	141,800	14.5%	15,462,300	26.0%
Children	522,500	53.5%	28,966,800	48.7%
Unknown	0	0.0%	1,400	0.0%
Total	976,000	100.0%	59,523,500	100.0%

Notes: Enrollees are presumed to be unduplicated (each person is counted once).
Source: Kaiser Commission on Medicaid and Uninsured & Urban Institute estimates of MSIS data.

Table 11 | Distribution of Medicaid Spending on Acute Care, FY 2009

Acute Care	NJ ($ millions)	NJ (% of total)	US ($ millions)	US (% of total)
Inpatient Hospital	$757	16.9%	$50,898	22.5%
Physician, Lab & X-Ray	$83	1.8%	$13,401	5.9%
Outpatient Services	$666	14.9%	$25,992	11.5%
Prescribed Drugs	$406	9.1%	$15,716	6.9%
Other Services	$605	13.5%	$30,048	13.3%
Payments to Medicare	$260	5.8%	$12,035	5.3%
Managed Care & Health Plans	$1,702	38.0%	$78,600	34.7%
Total	$4,478	100.0%	$226,690	100.0%

Notes: Includes federal & state expenditures; excludes administrative costs & accounting adjustments.
Source: Kaiser Commission on Medicaid and Uninsured & Urban Institute estimates of CMS-64 data.

Table 12 | Per Capita Medicaid Spending

	NJ	US
Medicaid Spending, 2009	$9,667,209,281	$366,471,017,061
Population, 2009-2010	8,667,900	305,191,100
Per Capita Spending	$1,115	$1,201

Source: Kaiser Commission on Medicaid and the Uninsured & Urban Institute estimates based on data from MSIS & CMS-64 reports.

Efforts to Contain Costs and Improve Quality

New Jersey, like most states, has become extremely sensitive to Medicaid costs, seeking to analyze them, contain them, and reduce them. To this end, the state has been relatively successful.

In the aggregate, total Medicaid expenditures over the last six years have increased on average 4% annually (the average growth in the nation in the last decade was 8.1%), principally as the result of aggressive implementation of managed care. The New Jersey Division of Medical Assistance and Health Services reports that 98 percent of the population is now in managed care programs. The Medicaid Division also implemented approximately $300 million of cost containment initiatives in FY 2009 to 2012. Furthermore, an additional $800 million of initiatives are pending approval, including a major $300 million request waiver which was submitted to CMS in early FY 2012.

This overall cost containment has been implemented despite increases in enrollments from 1,026,000 in FY 2008 to a projected 1,290,251 in FY 2012.

The $300 million waiver request included a number of program changes ranging from helping the elderly avoid nursing homes, an especially costly part of the New Jersey Medicaid program, to reducing excess use of hospital emergency rooms, to improving the delivery of behavioral health services, launching Medical Accountable Care Organizations (ACO), and coordinating the care of dual eligible clients, those covered by both Medicare and Medicaid.[21] (The New Jersey Medicaid Waiver was approved by the federal government on October 5, 2012.)

The Medicaid program has also initiated several qualitative initiatives to improve health care of clients, such as developing community outreach programs that have empowered members to provide basic preventive health programs such as retinal eye exams, childhood obesity prevention, and targeted asthma treatment. Also, building closer relationships with hospitals is helping reduce the use of hospital emergency department utilization and provide a better level of care.[22]

Affordable Care Act in New Jersey

The Patient Protection and Affordable Care Act (ACA) seeks to increase the number of persons with health insurance coverage by expanding eligibility for Medicaid to most persons under 138 percent of poverty and making federal tax credits and cost sharing subsidies available for persons above the income level up to 400 percent of poverty. These coverage expansions become effective January 1, 2014.

The recent ruling of the U.S. Supreme Court allows the individual states to determine if they wish to expand their Medicaid programs and participate in this initiative — in effect, the decision is optional. Furthermore, the court opined that the federal government cannot threaten to withhold existing Medicaid funds if a state elects not to participate.

The impact of coverage under ACA will vary widely across states, depending on the states' uninsured rates prior to reform, income disruptions, and size and characteristics of immigrant populations. The majority of governors, including the New Jersey governor, have yet to determine if they will expand their Medicaid programs under the provisions of the ACA. Many governors wish to explore cost implications, especially beyond the first three years.[23] Furthermore, the National Association of Medicaid Directors sent 28 detailed questions to the CMS seeking clarification and answers related to issues of flexibility, access of certain groups to subsidies, and questions related to options to stop short of the 133 percent line and still receive enhanced federal help.[24]

The Rutgers Center on State Health Policy in its report entitled "Health Insurance Status in New Jersey After Implementation of the ACA" estimates that if the Affordable Care Act were implemented the number of nonelderly (those under 65) insured would increase by 234,000 individuals. More than half of the projected increase would be nonparent adults (132,000). The number of enrolled children (100,000) would also increase.[25]

The Rutgers Center on State Health Policy has also estimated that the uninsured in the state would decrease by 40 percent, from 14.5 percent of the nonelderly population to 8.6 percent, and that the number of covered persons would increase by almost 444,000. Of the 684,000 adults estimated to remain uninsured if ACA is implemented, 40 percent are thought to be undocumented immigrants.[26]

The federal government will pay 100 percent of the cost of the Medicaid expansion for the first three years and then gradually decrease its share to 90 percent in subsequent years. Based on estimates prepared by the Kaiser Family Foundation for the period 2014 to 2019, New Jersey would spend approximately $533 million and would receive $9 billion over the same time frame.[27]

Because more people will be insured, analysts expect that the states' costs for uncompensated care will decrease. New Jersey has an estimated $2 billion in uncompensated costs, including $1.3 billion in charity care for which the state reimburses hospitals for approximately $700 million.[28]

The ACA will greatly reduce federal funding for charity care after 2014. If the state elects not to expand Medicaid, then either hospitals or the state — but not the federal government — will continue to have a large uncompensated care bill but no longer will receive as much federal funding. This could result in considerable hospital financial distress and is creating political pressure for states to participate in the Medicaid expansion.[29]

The New Jersey program does not currently provide funds for people who are homeless and who are also frequent users of hospital emergency rooms. Under the ACA, individuals who are homeless will be eligible for insurance. New Jersey could consider leveraging various Medicaid services, such as health homes, to provide these high risk homeless beneficiaries with care management linked to supportive housing. This could yield significant return on investment by reducing hospitalizations and emergency department use.[30]

New Jersey must analyze these issues and related policy choices carefully to determine whether it should expand the Medicaid program.

Medicaid Conclusions

New Jersey has a fairly stable and very extensive Medicaid program with relatively modest recent growth. It has one of the most generous programs in the nation in terms of services offered and eligibility, albeit moderately lower than average costs per capita, reflecting low enrollment but very expensive enrollees, disproportionately concentrated in the elderly and disabled. In addition to mandated services, New Jersey offers an extensive range of optional services. While other states have cut services, New Jersey has largely maintained the status quo, although the recent waiver pending at CMS would make certain changes.

Costs per enrollee are almost twice the national average due to an unusually high percentage of expenditures for the elderly and disabled, for long term care patients, and because of a larger than average reliance on expensive institutionalized care.

However, per capita costs are below the national level, principally because New Jersey has fewer poor people than the U.S. average and because they enroll only 11 percent of the population versus 20 percent in the U.S.

New Jersey, like all states, faced short term fiscal problems in the program as it absorbed the loss of American Recovery and Reinvestment Act (ARRA) funds, but New Jersey has addressed the cost problems by the aggressive implementation of managed care and the use of cost saving waivers — with more to come if the recently submitted and pending waiver is approved by the federal government. Additional help would be forthcoming if the federal maintenance of effort restrictions on changes in optional benefits and eligibility are relaxed or expire.

The impact of the ACA is yet to be determined pending a decision by the governor about whether to participate in the Medicaid expansion. If approved, approximately 234,000 clients would join the Medicaid rolls — with the federal government financing 100 percent of costs in the first three years, and uncompensated care costs would decrease.

Neither the ACA nor an existing Medicaid initiative — or for that matter any national initiative — is addressing the cost drivers in the health care system. According to Dr. Joel Cantor, most existing cost control initiatives "seek to reduce utilization of low value services and change the mix of services...." Such initiatives are important but they are not addressing the cost drivers in the system. Acknowledging that price is the major factor in budgetary growth is a good start, but according to Dr. Cantor, "... finding ways to bring discipline to healthcare pricing is going to be tough." Now is the time, argues Dr. Cantor, "to bring the hidden price problem out to the open and debate how it is to be addressed."[31]

The state has a well-developed program with an aggressive plan to lessen the growth of future Medicaid expenditures. But, until the overall price of health care is addressed, Medicaid in New Jersey, as is the situation in all states, will remain one of the dominant and increasing program costs in the budget.

Underfunded Retirement Systems — Pensions and Health Benefits

Overview of Pension Systems

The Division of Pension and Benefits in the Department of the Treasury administers seven contributory defined benefit public employee retirement systems covering substantially all state and local employees. Five of the systems are active.

As of June 30, 2010, the total number of members is approximately 777,000: 514,000 active and 263,000 retired. The Public Employee Retirement System (PERS), covering state and local employees, and the Teacher's Pension and Annuity System (TPAF), are the two largest, with 689,000 members total.

According to state law, all obligations of each system will be assumed by the State of New Jersey should any retirement system be terminated. The seven systems are listed below:

Table 13 | Pension Systems in the State of New Jersey

	Actuarial Value of Assets ($ millions)
Teachers' Pension and Annuity System (TPAF)	$33,265
Public Employee Retirement System (PERS)	28,735
Local Employee Component	*18,482*
State Employee Component	*10,253*
Police and Fireman Retirement System (PFRS)	23,488
Local Employee Component	*21,297*
State Employee Component	*2,191*
State Police Retirement System (SPRS)	2,019
Judicial Retirement System (JRS)	329
Prison Officers Retirement System (PORF)*	11
Consolidated Police & Fireman's System (CP&FRF)*	11
Total	$87,858

* Both of these systems are closed with no active members.
Source: Tax and Revenue Anticipation Notes, New Jersey Official Statement, p I-55.

State law requires that all pension plans must conduct an actuarial evaluation as of the end of each fiscal year.[32] State law also requires that all pension plans must conduct experience investigations every three years to examine certain demographic and economic assumptions to ensure those assumptions are consistent with historical experience.

The actuarial valuations are completed approximately six to eight months after the end of the fiscal year. As a result, the actuarial recommended amount, for most systems, applies not to the fiscal year immediately following the fiscal year covered by the actuarial evaluations, but the second immediately following fiscal year. For example, the rate recommended as of June 30, 2010, is applicable to fiscal year 2012.

All June 30, 2012, actuarial reports have been revised to reflect the adoption of recently enacted pension reform legislation, P.L. 2011, c.78. State law provides that pension benefits are not subject to negotiations between the state and the employee members of the pension systems. The amount of contribution is contingent upon the Annual Appropriations Act. The state contribution is in addition to mandatory employee contributions. However, pension plans now have a contractual right to the annual required contribution being made by the state and its local governments and failure by the state and the local employers to make the annual required contributions is deemed an impairment of the contractual right of each member.

Legislation That Negatively Affected Pension Commitments

The problems concerning the funding of New Jersey's pensions systems have been growing for approximately twenty years, such that the unfunded liability for all state pension systems, including the TPAF system for teachers had reached $37 billion — making the systems only 56.4 percent funded. In addition, local pension systems had an unfunded liability of $17 billion — making those systems 70 percent funded. (Note that the state pays the employers' share of the TPAF system for teachers and administrators; other school district employee are covered by the PERS system and the school boards pay for those costs)

In 2005 and again in 2006 two major reports were issued that reviewed the public employee benefits in the state.[33] The reports, especially "The Report of the Benefit Review Task Force," discuss several laws enacted from FY 1992 through FY 2003 that significantly impacted the funding levels of the systems, mostly negatively, including changing methodology by which assets are measured; issuing bonds in lieu of appropriations; enhancing benefits by 9 percent for PERS and TPAF employees and retirees; enhancing benefits for PFRS employees; and enabling local employers to phase in their required contributions. Furthermore, there were at least 11 other legislative initiatives enacted which had a negative impact on the pensions system, including Early Retirement Laws in 2002 and 2008, which increased the unfunded liability.

Both reports also contained background information and a series of recommendations to reduce the unfunded liability of the pension systems and to reduce the cost to the state of health benefits for current employees and retirees. Some of the recommendations were implemented in fiscal years 2009 to 2011. Others were implemented pursuant to the wide reaching Chapter 78, P.L. 2011, enacted by the legislature and signed by the governor on June 28, 2011.

Legislation That Reduced Pension Commitments

Changes Between 2004-2010[34]

Several major changes were made between FY 2004 and 2010 to reduce long term pension costs. Some of the more significant changes which still have a positive impact on the PERS and TPAF systems include: changing the multiplier for new members of PERS and TPAF from 1/55 to 1/60; calculating the retirement allowance using the average of salary for the past five years rather than average of three years; limiting pension credit to only one employer; increasing the eligibility age for unreduced benefits from age 60 to age 62 for members hired after November 1, 2008; establishing a Defined Contribution Retirement Fund for elected and certain appointed officials (e.g., cabinet officers); and requiring an increase in pension contributions from 5 percent to 5.5 percent of annual salary (contributions increased again by Chapter 78, P.L. 2011 — as noted below).

Recent Changes and Results (FY 2011)

In a more dramatic response to the significantly underfunded condition of the pension systems, the governor and the legislature enacted Chapter 78, P.L. 2011, effective June 28, 2011, which made major changes to the pension systems. The major changes can be summarized as follows (for more details see the chapter and law cited above):

- New members of TPAF and PERS hired after June 28, 2011, will need 30 years of creditable service and age 65 for receipt of early retirement benefits without a reduction of ¼ of 1 percent for each month under 65 years of age.

- The annual benefits for new PFRS members enrolled after June 28, 2011, is 60 percent instead of 65 percent of the member's final compensation plus 1 percent for each of service over 25 years but not to exceed 30.

- Active member contribution rates increase as follows:
  - PERS and TPAF — increase from 5.5 percent to 6.5 percent plus an additional 1 percent phased in over seven years
  - PFRS — increase from 8.5 percent to 10 percent
  - SPRS — increase from 7.5 percent to 9 percent
  - JRS — increase from 3 percent to 12 percent phased in over seven years

- All automatic COLAs for current and future retirees are suspended until reactivated as permitted by law.

- The method for amortizing the pension systems' unfunded accrued liability changed from a level percent of pay method to a level dollar of pay.

As the result of these changes the state's unfunded liability was reduced by 30 percent from $37.1 billion to $25.6 billion, increasing the system funded ratio from 56.4 percent to 65.2 percent. The increase in the overall funded ratio is primarily due to the suspension to the COLA adjustments on pension benefits, effective June 30, 2011.

The state estimates that all systems will reach a minimum 80 percent funded level by the year 2041, or sooner for some systems, assuming the state makes the required contributions as prescribed by law.[35]

Furthermore, legislation enacted in 2010 (see Chapter 1, P.L. 2010) required the state to make its full pension contribution defined as 1/7th of the required amount beginning in FY 2012, and continuing until full funding is achieved in FY 2018, and in each subsequent year. The state did make this payment ($484 million) in accordance with this statute in the FY 2012 Appropriations Act and again in FY 2013 ($1,029 million). When fully phased in the estimated cost is between $5.0 million and $5.5 billion.

History of State Appropriations into Pension Funds

Appropriations made for the state's five active pension systems for the current year and the past seven years are summarized below. The contributions have ranged from 0 percent of the required amount to 57 percent and 50 percent in FY 2007 and 2008. Thus, over this period the state underfunded its required contributions by $16.5 billion. However, based on Chapter 1, P.L. 2010, the state is required to reach full funding by FY 2018.

Table 14 | History of State Appropriations to Pension Systems

Fiscal Year	Required Contribution ($ millions)	Actual Appropriation ($ millions)
2006	$1,451	$164
2007	1,779	1,023
2008	2,090	1,046
2009	2,231	106
2010	2,519	0
2011	3,061	0
2012	3,389	484
2013	3,595	1,027
Source: Issuance of Tax and Revenue Anticipation Notes, New Jersey Official Statement, p I-61.		

Background of Post-Retirement Medical Benefits (PRM)

The State of New Jersey sponsors, administers, and funds health benefit programs, including prescription drugs covering all current state employees. The state's benefit package also provides health coverage for all retired state employees, including retirement benefits for all school teachers, as well as virtually all the costs for other retired school board employees in the local school districts.

Retired employees are eligible after serving 25 years, regardless of age. Dependents are also covered for the life of the retiree (c.75, P.L. 1972). In FY 2011, the state paid health benefits for approximately 121,000 retirees and their dependents.

The state funds post-retirement benefits on a pay-as-you-go basis, which means the state does not pre-fund or otherwise establish a reserve against future expenses. For FY 2011 the state expended $1.1 billion to pay for post-retirement medical benefits (PRM).

In accordance with Governmental Accounting Standards Board (GASB) statements, the state is required to quantify and disclose its obligations to pay PRM to current and future employees. Based on the most recent valuation of these benefits contained in a report entitled "Postemployment Benefits Other Than Pension Actuarial Obligations," submitted to the state by Aon Consulting in August 2011, the state's obligation is measured at $59.3 billion. GASB 45 does not, however, impose any requirement on the state to pre-fund its PRM accrued.[36]

Recent Cost-Saving Initiatives

The cost of health benefits in the current state budget for current employees and retirees is approximately $2.2 billion. Health cost had doubled as a percent of the state budget in the previous ten years, and without any changes it was estimated that the health care for current state employees would escalate over 40 percent by 2014.[37]

In order to reduce the cost of health benefits for current employees, the governor and the legislature enacted a series of statutes to shift more of the cost to the employee. Chapter 78, P.L. 2011, effective June 28, 2011, established a new employee contribution requirement. Employees are now required to contribute a certain percentage of the cost of the premium rather than the 1.5 percent of salary provision that had been previously enacted in FY 2007 (prior to FY 2007 no contribution was required).

The percentage contribution now required (ranging from 3% to 35%) is determined based on the employee's annual salary and the selected level of coverage and policy chosen. The increased contribution will be phased in over a four year period for those employees employed as of June 30, 2011. For new employees the new percentages will be effective immediately. The law also established a floor so that no employee would contribute less than 1.5 percent of salary.

The statute has minimal impact on retiree costs, at least in the short term, as only certain future retirees will be required to pay a percentage of the cost of their medical coverage.

Chapter 78, P.L., also requires the establishment of new committees that will be responsible for setting the amounts for maximums, co-pays, deductibles, and other such participant costs. In addition, the new committees will be responsible for providing employees with plan design options with varying out of pocket costs with regard to co-pays and deductibles, including a high deductible health plan.

History of State Health Benefit Appropriations

Appropriations made for retiree medical costs over the past three years compared to the annual required contribution are summarized below. As noted above, all payments were for current retiree medical costs — no appropriations were made for future needs — creating a gap of $3.4 billion in FY 2011 and an unfunded liability of $59.3 billion.

Table 15 | Required Appropriation for Retiree Health Benefits vs. Actual

Fiscal Year	Required Contribution ($ millions)	Appropriation, Pay-as-you-go ($ millions)
2009	$4,646	$1,187
2010	$4,720	$1,327
2011	$4,917	$1,445

Source: New Jersey Office of Management and Budget, FY 2011 Comprehensive Annual Financial Report, p 90.

Bond Financing[38]

The Pension Bond Act of 1997 authorized the New Jersey Economic Development Authority (EDA) to issue $2.6 billion in bonds to fund a portion of the unfunded accrued pension liability for the state's retirement systems. Debt service on the bonds is payable based on a contract between the state treasurer and the EDA, subject to appropriations by the state legislature.

Bonds were sold to address the unfunded obligation for all of the state funded pension systems, including the TPAF system for school districts.

Unrelated to the financing per se, the statute also granted nonforfeitable rights to benefits provided under law in effect on the date members attain five years of service. According to an opinion rendered by the counsel to the New Jersey Legislature's Office of Legislative Services, this statute constitutes a contractual right. Both federal and state constitutions prohibit the impairment of a contract and therefore promised benefits are difficult to alter.

Also, PERS and TPAF employees had their contributions reduced by ½ of 1 percent for FY 1998 and 1999 with future years to be determined.

The bonds issued were capital appreciation bonds, not tax exempt; and nonrefundable. The bonds sold for 7.6 percent. Total debt service over the 32 year life of the bonds is estimated at approximately $12.3 billion.

The debt service schedule was skewed in that the first year was $95 million; $130 million in FY 2001; $230 million in FY 2010; $397 million in FY 2017; and $507 million in each of the last eight years.

Senator Leonard Lance took the issue to the New Jersey Supreme Court, arguing that the bonds were unconstitutional. The court demurred because the bonds were already sold (see subsequent New Jersey Supreme Court Case *Lance v. McGreevey* in 2005, which ruled that contract bonds used to fund general expenses cannot be used to balance the budget).

Aside from the Pension Bond Act of 1997, no other bonds have been sold to finance pension obligations.

Unfunded Liabilities: Concluding Observations

New Jersey's pension systems, like those in many states, are significantly underfunded. One reason is that investment earnings have fallen far short of assumptions. New Jersey has just recently reduced its interest rate assumption from 8.25 percent to 7.95 percent — now more line with other state assumptions, but still greater than their average investment returns over the last three, five, and ten year period of time. If the pension funds' investments earn less than what it assumes it will earn, unfunded liabilities accumulate. During the 2008 financial market collapse, state and local retirement systems lost nearly $1 trillion of market value, and on average investment losses were as high as 5 percent and 23 percent in 2008 and 2009, respectively.

A second serious, nonmarket related cause of pension underfunding is that some states and localities habitually skipped or underpaid their annual required contribution. These states — including New Jersey — willfully underpaid and now find it difficult to afford the contributions required to move toward full funding.

The actuarial funding system is designed to be self-correcting. It relies on assumptions about earnings, longevity of workers and retirees, projected salary increases, and other hard-to-predict factors. Most of these assumptions prove wrong to some degree. System actuaries or consulting actuaries (in the case of New Jersey) conduct periodic valuations in which evaluations are made of all the assumptions to determine whether the system is under- or overfunded. Then, typically, actuaries produce estimates known as annual required contributions (ARCs) which must be paid into the system to fund the benefits properly. Many governments pay their ARC routinely, but others do not — New Jersey was a prime violator.

Over the last seven years contribution shortfalls have totaled $16.5 billion. In 2011, the governor and the legislature made major changes to scale back pension benefits, including suspending COLAs for retirees and requiring increased employee contributions. As a result of these changes, the state's unfunded liability was reduced by 30 percent from $37.1 billion to

$25.6 billion, which increased the system's funded ratio from 56.4 percent to 65.2 percent. Furthermore, the state established a seven year ramp-up under which it would increase contributions each year until 2018, when it would pay the ARC in full. The state has made the required payment in the first two years. The current payment is approximately $1.1 billion, an underpayment of $2.6 billion.

While the actual ARC for 2018 will depend on investment performance and other factors, the annual contribution will have to increase by at least several billion dollars between FY 2013 and FY 2018 if New Jersey is to meet the requirements of this new legislation. This will force the state to make difficult choices about spending priorities.

New Jersey has also promised, in addition to pensions, substantial health care benefits to its workforce, including local teachers. New Jersey, like most states, pays these benefits on a pay-as-you-go basis rather than contributing to a funded plan (similar to pension systems). The unfunded liability based on the most recent actuary valuation is $59.3 billion, more than twice the liability of the pension systems. Annual budgetary increases necessary to fund these requests would be approximately $3.4 billion using FY 2011 as the base year.

New Jersey, like most states, is unlikely to fund this gap, as there is little incentive to do so. Pay-as-you-go costs are currently much lower than the ARC. It will be many years before the pay-as-you-go amount will exceed the projected ARC. More importantly, unlike pensions, which have legal requirements for payment, retirement health benefits are not in the same category. Most likely the prospect of large future increases would create considerable pressure to reduce these benefits. Still, for the foreseeable future, retiree health benefits, as well as health benefits for current employees, is a significant budgetary item ($2.2 billion in the current budget) and will continue to increase in the future.

Retirement pension and health benefits place different claims on the budget and the taxpayer, but it is useful to combine the two in order to gain a sense of the total potential liability. For New Jersey the combined unfunded liability is $84.8 billion.

Revenue Erosion and Volatility[39]

Overview

A main goal of tax policy is adequacy — that is, the ability to raise enough revenue to fund services the population requires. Adequacy has two elements: the ability to fund service demands over the long run, and stability over the business cycle. Unfortunately many state systems, including New Jersey's, have been failing on both counts. Specifically, the revenue base has been eroding for decades and is increasingly volatile.

The great recession produced unprecedented declines in state tax revenue collections across the nation. In New Jersey, revenues decreased by 11.4 percent in FY 2009 and fell another 3.5 percent in FY 2010. The collapse affected all the state's major revenues, from the "big two" (income and sales) to smaller taxes such as corporation, realty transfer, inheritance, and motor fuels.

Of particular relevance in New Jersey, however, is the growing dependence on income tax revenue, which is 37 percent of all state revenue. As the income tax has become more dependent on income other than wages, it has become more erratic. Also of consequence is the volatility resulting from very small numbers of large taxpayers accounting for the bulk of income tax collections.

The sales tax — which is 27 percent of all state revenue — is also volatile for several reasons. First, it is based on spending that fluctuates with income, the economy, and expectations of the future. Second, sales tax is based on a narrower mix of goods and services than overall spending; for example, New Jersey excludes food and clothing and many services. And third, all states have limited authority to require collection of taxes owed on purchases made through mail and the internet — as these sales grow, the size of the revenue deprivation will grow.

The corporation tax, which is 8 percent of all state revenue, is impacted more by tax policy issues than the economy, albeit of course, in a down economy this revenue also declines. Volatility is relatively low but potential erosion is higher than most revenue sources, mostly because of pressure and policy decisions to enact credits and exemptions to foster or target development. Another factor is the erosion introduced by the nature of having large corporate entities operating on a national basis and their method of allocating income to and among states.

There are more issues related to the corporation tax and other revenue sources, including the gasoline and the transfer inheritance tax, but for purposes of this analysis the focus will be on the income and sales taxes where volatility, erosion, and magnitude are most dominant.

New Jersey Revenue Structure[40]

Based on FY 2011 audited financial statements, the state collected $28,660 million of own-source revenue. The income tax ($10,617 million) and sales tax ($8,144 million) accounted for 65.6 percent of this revenue. The corporation tax ($2,344 million) represents approximately 8.2 percent of total state revenue.

The remaining 26.2 percent comes from eleven other major taxes, the lottery and casino, and 300 other miscellaneous taxes and fees.

The highest revenue collection year was FY 2008: a total of $32,584 million. Thus, over these three years, revenue decreased by $3,924 million, or 12.1 percent, from $32,584 million to $28,660 million. Revenues projected for FY 2013 are $31.7 billion — still almost $1 billion less than it was five years ago.

Although the level of collections has fluctuated over the past six years, the distribution or share of each source as a percentage of the total has been fairly stable.

Table 16 | Revenue Summary: Percent Distribution by Major Tax

Revenue	2006	2007	2008	2009	2010	2011
Income Tax	36.7%	37.6%	38.7%	36.3%	37.0%*	37.1%
Sales Tax	23.9%	27.6% **	27.4%	28.6%	28.3%	28.5%
Corporation Tax	10.5%	9.9%	9.4%	9.2%	7.7%	8.2%
Other Major Taxes	12.4%	9.4%	9.3%	10.0%	10.2%	10.1%
Lottery	2.9%	2.7%	2.7%	3.1%	3.3%	3.2%
Casino	2.0%	1.7%	1.5%	1.4%	1.3%	1.1%
Misc. Fees, etc.	11.6%	11.1%	11.0%	11.4%	12.2%	11.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

* One year rate increase at top brackets.
** Rate increase from 6% to 7%.
Source: New Jersey Office of Management and Budget, FY 2011 Comprehensive Annual Financial Report.

Impact of Economic Expansion and Contraction

The annual fiscal year collections of the state's four largest individual revenue sources and all other sources over a seven year period of economic expansion and contraction are presented below.

The chart reflects the impact of economic forces on revenue growth and illustrates the volatility of the state's revenue structure. Fiscal year 2008 is the perfect time to choose for comparing growth trends. The end of FY 2008 was June 30, 2008, just before the financial meltdown that began in September. The period FY 2005 to 2008 thus represents a period of growth. The period FY 2009 to 2011 starts before the September/October 2008 financial crisis and ends before the big August 2011 national "debt limit" crisis. Thus the comparison of FY 2011 to FY 2008 reflects the full impact of the downturn. The condition of the national economy has a huge impact on state finances, with total revenue increasing $3.4 billion (11.8%) in the three year expansion period but then falling $3.9 billion (12%) in the three year recession period and partial recovery period.

While the percentage change in the corporation tax is high in each period — a negative 23.4 percent and a positive 29.3 percent — the dollar change in the income tax shows where the action is. The $3.1 billion increase in the income tax from FY 2005 to FY 2008 accounts for 89 percent of the total increase in revenues. In FY 2005, the income tax accounted for 34 percent of total revenues. In the period when all revenues were suffering, the income tax decline of almost $2 billion accounted for 50.6 percent of the total decline while representing only 38 percent of total revenues.

Table 17 | Major Revenues, FY 2005-2011

Revenue	Amount ($ millions)							% Change	
	2005	2006	2007	2008	2009	2010	2011	2005-08	2008-11
Gross Income Tax	$9,538	$10,507	$11,727	$12,606	$10,476	$10,323	$10,617	32.2% $3,068	-15.8% ($1,989)
Sales & Use Tax	$7,644	$7,995	$8,610	$8,916	$8,264	$7,898*	$8,144*	16.6% $1,272	-8.7% ($770)
Corporation Business Tax	$2,368	$3,008	$3,085	$3,062	$2,665	$2,145	$2,344	29.3% $694	-23.4% ($718)
Lottery	$812	$844	$828	$882	$887	$924	$930	8.6% $70	5.4% $48
All Other	$8,773	$7,439	$6,959	$7,119	$6,592	$6,590	$6,624	-18.9% ($1,653)	-6.9% ($495)
Total	**$29,135**	**$29,793**	**$31,208**	**$32,584**	**$28,885**	**$27,880**	**$28,660**	**11.8% $3,449**	**-12.0% ($3,924)**

* To facilitate comparisons over time, the FY 2005 and 2006 Sales and Use tax totals are adjusted up to reflect a 7% rate, which actually became effective in July 2006 (FY 2007). Total revenue was adjusted by the difference between the annual actual collections and the adjusted numbers shown in the table.
Source: New Jersey Office of Management and Budget, FY 2011 Comprehensive Annual Financial Report, pp. 316-317.

The "all other" category representing the 14 revenue sources shows a steep decline from FY 2005 to FY 2006. But then it remains relatively stable from FY 2008 to 2011. This is not that surprising given that most of these sources are tied to bases which are more or less independent of fluctuations of the economy (e.g., behavior habits such as driving, smoking, drinking, and gambling, or unavoidable expenses such as utilities or insurance premiums), or are portions of the 300 plus various other revenue sources that change from year to year. Indeed, these taxes and other revenues play a role in mitigating the volatility of the tax structure.

Clearly income tax accounts for the greatest amount of volatility in the New Jersey tax structure. When the economy is in decline it has the greatest negative impact on budgetary decision making. Conversely, when the economy is expanding, the income tax shows the greatest increase.

The Income Tax[41]

The gross income tax was established in 1976. In addition to wages, the law taxes pension and most retirement plans, but not Social Security. Only four deductions are allowed: personal exemptions, medical expenses, alimony payments, and property taxes on principal residences.

Furthermore, all income tax money, per the constitution, must be used for property tax relief, which for the most part translates into state aid to municipalities, counties, and school districts, with the majority of the revenue being sent to school districts.

The income tax in New Jersey is very progressive. The tax rate structure for a married couple in New Jersey ranges from 1.4 percent below $20,001 to 8.9 percent over $500,000. For a more detailed breakdown of the rate structure see the annual report of the Division of Taxation.[42]

Specifically, based on the number of "taxable returns" (2,888,343) for calendar year 2009, 37 percent of the income tax revenues comes from taxpayers above $250,000 (34,496 filers). Taxpayers with incomes between $250,000-$500,000 pay 14.5 percent of the income tax revenue (94,959 filers); and those with income between $100,000 and $250,000 pay 31 percent of the income tax collected (628,882 filers). Sixteen percent of the income tax comes from filers with income less than $100,000.[43]

Sources of Income Receipts: CY 2007 and CY 2009 Comparisons[44]

The table on the following page for calendar year (CY) 2007, the last year before the Wall Street crisis, illustrates the causes of the volatility in gross income tax collections.

Almost $72 billion in wage, business, and capital gains income (22.4% of the total) is concentrated in the 1.2 percent of returns in the top rate bracket. Another $47.6 billion (14.8% of the total) is in the second highest bracket. These are highly volatile income sources which have the maximum impact on revenue collections when economic conditions change.

This volatility is shown in the last panel of the table and shows the change in income sources between CY 2009 and CY 2007.

In CY 2009, for example, total wages, business income, and capital gains income declined 2.7 percent, 18.3 percent, and 74.9 percent, respectively, from CY 2007 levels. But among taxpayers with more than $500,000 in New Jersey gross income, the wages, business, and capital gains declines were 26.4 percent, 27.8 percent, and 78.1 percent, respectively.

Table 18 | 2007: Gross Income Tax: Sources of Income by Gross Income Level

Gross Income	Returns	Total Income	Wages	Business Income	Interest & Div.	Capital Gains	Other Income
	(000s)	Amount ($ billions)					
< 75,000	2,817.6	$85.08	$64.58	$3.62	$4.23	$1.54	$11.12
75,000 - 100,000	313.9	$27.41	$24.33	$1.13	$0.69	$0.40	$0.87
100,000 - 200,000	572.3	$78.15	$64.38	$4.03	$2.76	$2.14	$4.83
200,000 - 500,000	183.7	$52.68	$37.76	$6.62	$2.45	$3.19	$2.65
> 500,000	51.2	$78.37	$34.92	$25.00	$3.90	$11.85	$2.71
Total	3,938.7	$321.69	$225.97	$40.39	$14.03	$19.13	$22.18
	% Share	Percent of Income Source					
< 75,000	71.5%	26.4%	28.6%	9.0%	30.2%	8.1%	50.1%
75,000 - 100,000	8.0%	8.5%	10.8%	2.8%	4.9%	2.1%	3.9%
100,000 - 200,000	14.5%	24.3%	28.5%	10.0%	19.7%	11.2%	21.8%
200,000 - 500,000	4.7%	16.4%	16.7%	16.4%	17.5%	16.7%	12.0%
> 500,000	1.3%	24.4%	15.5%	61.9%	27.8%	62.0%	12.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
		Percent of Total Income					
< 75,000			20.1%	1.1%	1.3%	0.5%	3.5%
75,000 - 100,000			7.6%	0.4%	0.2%	0.1%	0.3%
100,000 - 200,000			20.0%	1.3%	0.9%	0.7%	1.5%
200,000 - 500,000			11.7%	2.1%	0.8%	1.0%	0.8%
> 500,000			10.9%	7.8%	1.2%	3.7%	0.8%
Total			70.2%	12.6%	4.4%	5.9%	6.9%
	% Change	2007-09 Change by Income Source and Gross Income Category					
< 75,000	-2.5%	-4.4%	-4.0%	3.2%	-19.1%	-72.9%	5.8%
75,000 - 100,000	1.0%	0.7%	1.1%	-3.5%	-30.3%	-68.8%	49.1%
100,000 - 200,000	0.7%	1.1%	5.7%	-3.6%	-35.9%	-69.8%	-2.3%
200,000 - 500,000	-2.8%	-4.1%	4.5%	-5.8%	-36.6%	-68.1%	-14.2%
> 500,000	-23.2%	-35.5%	-26.4%	-27.8%	-41.4%	-78.1%	-29.1%
Total	-2.0%	-10.1%	-2.7%	-18.3%	-32.2%	-74.9%	-0.9%

Notes: Business income includes corporations, partnership, and net business profits.
All other includes pension and annuities, rental income, net gambling, alimony received, and all other.
Source: New Jersey Department of the Treasury, Division of Taxation Annual Reports.

Sources of Income Receipts: Comparisons CY 2002 and CY 2007

A similar pattern is evident in the expansion periods, as reflected in Table 19 below.

During the CY 2002 to 2007 period, business income and capital gains increased by 86 percent and 238 percent, respectively. For taxpayers in the highest income bracket (for 2002 data this was greater than $250,000, which is equivalent to about $288,000 in 2007 dollars), the increases were 138.6 percent and 301.4 percent, respectively. That is an increase of $28.2 billion, which at a marginal tax rate of 8.97 percent generates $2.5 billion in tax revenue.

Put another way, approximately 62 percent of business and capital gain income accrued to taxpayers with incomes of $500,000 in CY 2007 (55% in CY 2009) and another 20 percent (16% in CY 2009) accrued to taxpayers in the second highest bracket. How this 5 percent to 6 percent of taxpayers behaves and structures their affairs has a huge impact on the state's revenues.

Significantly, from a budget making perspective, it is almost impossible to correctly anticipate the magnitude and timing of these swings even if one was fortunate enough to understand the direction. The available economic indicators do not capture or reflect changes like the exercise of stock options, the sales of businesses, the granting of bonuses, or the retirement or relocation of senior executives, factors which often drive these changes. The state typically has to wait for the final payments to come in during April, four months after the close of the tax year and two months before the end of the state fiscal year, to gauge their cumulative effect.

Table 19 | 2002-07 Change by Income Source and Gross Income Category

Gross Income	All Returns	Total Income	Wages	Business Income	Interest & Div.	Capital Gains	Other Income
< 75,000	-4.0%	13.4%	3.2%	9.3%	22.0%	148.4%	120.4%
75,000 - 100,000	-0.8%	0.1%	0.6%	0.7%	17.5%	53.3%	-29.1%
100,000 - 250,000	42.8%	46.3%	40.8%	19.8%	130.3%	141.4%	111.7%
> 250,000	74.9%	113.0%	82.6%	138.6%	125.9%	301.4%	97.0%
Total	10.3%	45.5%	29.5%	86.3%	74.2%	238.4%	97.3%

Notes: Business income includes corporations, partnership, and net business profits.
All other includes pension and annuities, rental income, net gambling, alimony received, and all other.
Source: New Jersey Department of the Treasury, Division of Taxation Annual Reports.

Migration Issue and Rate Structure of the Income Tax[45]

Over the course of the past nine years, the argument has been made that New Jersey is losing people with high incomes and they are moving to other states, stemming principally from the top income tax rate being increased in CY 2004 to 8.9 percent for incomes over $500,000 and for a short time in CY 2009 when the top rate was increased to 10.75 percent.

Several academic studies have been conducted, with conflicting conclusions. One study conducted by faculty and staff at Princeton University in 2009 suggested that data did not support that conclusion, rather more people moved into the higher income brackets than moved from the state. Other studies done at Rutgers University (in 2008) and a more recent study performed by the chief economist for the state, as well as anecdotal stories, suggest that the data support the opposite conclusion.

Two things are clear. One is that high-income people leave the state for many reasons not related to either income or property tax rates. But over time, from CY 2004 to CY 2007, the number of high-income returns has grown. There were 35,000 taxpayers with $500,000 of gross income in CY 2004, the first year of the new 8.97 percent rate on income over $500,000. Because the tax was enacted mid-year retroactive to January 1, it is unlikely that few taxpayers moved out of the state because of the tax in 2004. Over the next three years, the number of taxpayers subject to the 8.97 percent rate increased to 39,700, 45,600, and 51,200, respectively. Part of this is normal growth, a good economy, and bracket creep, but it swamps any out-migration effect. This suggests that the state is more than replacing the number of high-income taxpayers that it loses in "normal" times.

However, the number of high-income returns did decline in CY 2008 to 46,756 and in CY 2009 to 38,496, most likely reflecting the impact of the financial crisis and the "great recession," but perhaps also because of the tax climate in New Jersey. Aggregate data do not allow us to determine how much of this shift was taxpayers migrating to other states versus just "migrating" to states lower tax brackets.

The Sales Tax[46]

For the reasons noted above, most people agree that the volatility of the New Jersey tax system is driven by the income tax and its related dependence on people of high income making payments. However, also seriously affecting the tax system is the sales tax, as it is the second largest source of revenue to the state and, while it is much less volatile than the income tax, is limited in its receipts because there are many exclusions to the base.

The current tax rate is 7 percent. It was increased from 6 percent in 2006.

The sales and use tax is imposed on the receipts from: (a) the retail sale, rental, or use of tangible personal property not specifically exempted by statute; (b) the retail sale of services, except for resale, including producing, fabricating, processing, and servicing tangible personal property and certain advertising services; (c) sales of food and drink in restaurants and other similar establishments; and (d) the sale, except for resale, of telecommunications.

Over the course of several years, the law has been amended many times to expand the scope of the sales tax to include certain services, including parking, storing, or garaging motor vehicles, tanning services, message services, investigation and security services, information services, limousine services, etc.

Exemptions to the sales tax are extensive and include: food, clothing, prescription drugs and medicines, household paper products, sales of telephones, telephone lines, central office equipment or other similar equipment, and property principally used on farms. According to the New Jersey Tax Expenditure Report, the extension of the sales tax to clothes and food, for example, would generate $2.5 billion in revenues.[47]

During the last decade the sales tax growth has not averaged more than 4 percent, discounting "recession" years when there was negative growth (for the past two years it has been 1.1% and 3.6%). So, unlike the income tax, the New Jersey sales tax does not grow extensively when the economy expands, yet still decreases when there are recessionary periods. This is in part due to the limitations of the sales tax base, which is primarily discretionary goods and services. In periods of economic expansion these purchases expand proportionally with the economy. During recessionary periods, such purchases are among the first to be suspended, deferred, or canceled. To the extent that the economic gains in personal income over the past twenty or more years have not gone to the lower 80 percent of the income distribution, economic expansion does not benefit the sales tax.

To the extent that remote sales over the internet have grown and will continue to grow even more rapidly in the future, erosion in the sales tax base will accelerate. A combination of people seeking “money saving” deals, the ability to avoid tax on internet sales, and public antipathy to government that hampers enforcement efforts means that the problem is getting harder to solve.

Certain major exemptions to the tax, such as food and clothing (which does make the tax more progressive), and the inability to tax the increasing number of transactions on the internet, limit the growth of the New Jersey sales tax.

Revenue Erosion and Volatility: Concluding Observations

New Jersey, like many states, depends on the “big two” taxes to fund its governmental operations. As noted in the above data and discussion, both the sales tax and, to a lesser degree, the corporation tax have their elements of volatility and erosion. Each of these taxes has some unique features or characteristics pertaining only to New Jersey tax law that causes taxes to react in a more volatile manner to economic factors.

The sales tax in New Jersey has a more limited base than it does in many states. If the base were broadened to include, for example, items such as food and clothing, the state would raise an additional $2.5 billion. The regressive nature of this tax change could be addressed by providing tax credits on the income tax so that the less wealthy would be shielded.

The constantly changing tax base of the corporation tax, due primarily to extending credits and deductions, but also because the corporation tax only applies to C-corporations and not to a myriad of other pass-through entities, has limited the corporation tax to a less than steady source of revenue.

But, there is no doubt that the gross income tax is where the action is. As reflected in the several tables and discussion above, the income tax generates expanding revenue when the economy is good. And, likewise, when the economy weakens so do the receipts from the income tax. This is perhaps more so in New Jersey because, as shown in the tables, the income tax is very progressive and sensitive to factors beyond wages, such as income from business, interest, stock options, and capital gains from individuals in the higher income brackets. The fact that 4.6 percent of the people who file a tax return pay 51.6 percent of the income is confirming.

Local Government Oversight

Structure of New Jersey Local Government[48]

New Jersey is a state of small towns, with two huge cities, New York and Philadelphia, just across its borders. The largest city, Newark, is only 3 percent of the state's population. Despite the state's population of nearly 9 million, only four cities have populations exceeding or approaching 100,000.

There are 566 municipalities, 21 counties, and 590 school districts, and more than 300 local authorities providing special local services. Many counties also provide some municipal services to their constituent municipalities as a way of providing economies of scale to reduce costs.

The property tax is the dominant revenue source for all local governments: municipal, county, and school district. Traditionally the property tax has been treated as a residual tax, meaning that after all other revenue sources have been considered to support local budget expenditures, the property tax becomes the balancing revenue source.

New Jersey has the highest property tax burden in the nation by most measures. In FY 2011, $25 billion in property tax revenue was raised from the property tax, which is greater than the combined income, sales, and corporation tax revenue collected by the state. Of the $25 billion, $13.2 billion went to school districts to support K-12 education, $7.3 billion to municipalities, and $4.5 billion to counties.[49]

In 2011 the governor and the legislature revised a property tax levy cap enacted in 2007. It is expected that the law will provide a significant limit on spending for all municipalities, counties, and school districts. Unlike the 2007 4 percent cap, which had many exceptions, the revised 2 percent cap on the increase in tax levy (amount to be raised by the property tax) has a limited number of exceptions: capital construction, debt service, emergencies, and pension and health benefits. The cap can be exceeded by a vote of the people in a referendum.[50]

In addition to the property tax, municipalities and counties receive a modest amount of state aid, and charge a wide variety of fees, licenses, permits, and a sales tax override on hotel occupancy. School districts also depend on the property tax, but receive large sums of money from the state government.

All state income tax revenue and 0.5 percent of the state sales tax is required by the state constitution to be used for property tax relief, which is disbursed principally to school districts, but also to eligible residential tax payers and municipalities in order to lessen the property tax burden.

Each municipality sets a rate that includes the dollars needed for the municipality, their school district(s), and their share of county costs. And each municipality has its own assessor with oversight provided by the county boards of taxation and the New Jersey Division of Taxation. All property in a municipality is taxed at one rate.

State Aid to Local Government Finances

State aid to local governments in New Jersey amounts to $13.4 billion, about 42 percent of the state budget (FY 2013), with the majority of this aid going to school districts. The amount appropriated for school aid in FY 2013 was $11.7 billion, which is 37 percent of the state budget. The amount appropriated for state aid to all other local governments is a modest $1.7 billion.[51]

As in most states, local governments in New Jersey complain about state unfunded mandates. In 1995 the constitution was amended to make it illegal for the state to enact unfunded mandates on local governments. But as in most states, enforcing this provision on state legislatures has been difficult, and the impact on local governments has been more a matter of annoyance than fiscal hardship. Governor Christie has directed state agencies not to issue any regulation containing an unfunded mandate unless he expressly authorizes it in writing.[52]

Probably the greatest impact on local government fiscal conditions in the foreseeable future is the prospect of lessened growth in property tax revenues under the 2 percent tax levy cap and the possibility of reductions in state aid, which could cause fiscal stress for school districts and municipalities.

State Oversight and Intervention of Local Governments[53]

The state of New Jersey has one of the strongest and most comprehensive set of laws monitoring and supervising all local governments in the state and providing intervention, control, and financial aid to localities that are in or are threatened by fiscal crisis. These laws originated during the 1930s when several local governments became insolvent and defaulted on bonds. The Division of Local Government Services in the Department of Community Affairs supervises all key financial operations of all municipalities, counties, authorities, and special districts in the state while the Department of Education oversees the financial operations of school districts.

Balanced county and municipal budgets must be submitted to the Division of Local Government Services for review, approval, and certification, and annual financial statements and annual debt statements must be filed with the state after the close of the fiscal year. Municipalities and counties operate on a modified cash basis of accounting, including a provision that requires all municipalities to budget for a “reserve for uncollected taxes” whereby the tax levy must be increased to allow for less than full tax collections based on prior tax collection. This provision alone, closely monitored by the division, is especially effective in limiting budget shortfalls.

The division does not substitute its judgment concerning the amount or purpose of local spending, but it does insure that the local budgets are properly balanced, that all necessary items such as debt service and pension payments are included, and that revenues are not overstated.

The budget certification process requires a significant amount of staff time in the division so since 1995, local governments have been allowed to self-certify that their budgets meet all of the specified state requirements, and the state only reviews in detail each proposed local budget once every three years. However, any local government that has ever been put on the watch list by the state or that has received state aid for distressed municipalities must continue to submit its budget every year for formal state review and approval. On average the division reviews between 45 percent and 50 percent of all local budgets.

The division, through its Local Finance Board, has the authority to assume control of the financial affairs of local units that encounter fiscal difficulty as defined by the board, which releases them from control when their fiscal problems have been solved. In recent years Atlantic City, Irvington, Union City, and Asbury Park have been under board control — but none are now under such control.

The division also administers a Transitional Aid Program, which provides financial aid and assistance to the state's most fiscally distressed municipalities that have agreed to pursue structural budget reforms and adhere to state oversight requirements. Prior to FY 2011, the state provided assistance to 75 municipalities in the state. But the number was reduced to 22 in FY 2011 and to 11 in FY 2012, led by Camden, Trenton, and Patterson, which have long term economic and fiscal problems. Total state Transitional Aid in FY 2012 is $140 million.

State law imposes debt limits on all local governments: 3.5 percent of three year equalized valuation for municipalities; 2 percent for counties; and 4 percent for school districts.

Local units that wish to exceed these limits must apply to the state's Local Finance Board for permission. In 2010 only six local governments were permitted to exceed their limits.

The state also has a very effective Qualified Bond Program under which the state channels state aid payments due to localities directly to bondholders. Moody's guarantees an AA rating for all bonds in this program, which services $3.5 billion in local debt for 19 local governments, including Newark and Jersey City school districts.

In addition to statutes that govern budget, fiscal affairs, debt management, and contract management, the Division of Local Government Services initiated in 2010 a "Best Practices Inventory Questionnaire," which is a constructive way to encourage municipalities to consider and embrace a range of best practices that would improve financial accountability and transparency. The 50 questions inventory must be certified by the chief financial officer and must be submitted to the state and discussed at a municipal governing public meeting.[54] Furthermore, the FY 2012 Appropriations Act tied 5 percent of various formulae state aid payments to the results of municipalities' response.

Local Government: Concluding Observations

All New Jersey municipalities and school districts (or all New Jersey local governments) have an extraordinary dependence on the property tax to support their operation. In fact, New Jersey has the highest property taxes in the country as measured by most criteria. A large part of the New Jersey state budget — approximately 42 percent — is appropriated for state aid, principally for school districts. Without such aid property taxes would obviously be much higher. Long range projections might suggest that the state will have difficulty sustaining this level of support. And the recent 2 percent "tight" property tax levy cap will pressure local governments to reduce costs and develop imaginative ways (sharing and regionalism of services) to deal with this potentially stark fiscal reality.

Some New Jersey municipalities face financial risk, particularly Camden and Trenton. Other municipalities that receive "Transitional Assistance" bear considerable watching to insure they do not become high risk. Furthermore, other municipalities, such as Newark and Patterson, because of their past fiscal problems and the pressures of unemployment and poverty, require special attention by the state.

But New Jersey has a very long and very effective history of monitoring and overseeing the finances of its local governments. As noted above, the state through the Division of Local Government Services and the Local Finance Board keep a constant "pulse on the finances of its local governments."

The Division of Local Government Services exercises strict oversight and approval of all annual budgets, debt issuance above certain statutory levels, and reviews of annual financial statements and audits. Furthermore, a staff of advisors provides assistance to municipalities in need of technical and management assistance; and statutory provisions allow the Local Finance Board to step in and manage a municipality that is in severe stress, And finally, through a very targeted "Transitional Aid State-Aid Program"[55] the state can provide additional aid to those municipalities that need extraordinary financial aid and assistance. Finally, a relatively new Office of the State Comptroller is playing a role with statutory required reviews of local unit (and state) contracts, audits of government and management practices, and reports on waste and abuse of public laws.[56]

The financial status of local governments needs constant overnight to insure they do not become an "albatross" around the overall finances of the state. New Jersey state government has developed the apparatus, both legally and operational, to step in and ameliorate the risk to the financial health of the state government.

Use of Gimmicks and Other Nonrecurring Resources

In almost every budget year for the past 30 years, one-time or nonrecurring transactions have been used on an annual basis to balance the New Jersey state budget. In some years the transactions were minimal; in other instances the magnitude was significant in terms of the percentage of the total budget.

Discussed below are twelve typical examples of actions that have been used over the course of many years to help balance the budget in New Jersey.

Some consider the use of one-time actions always undesirable. But it may be inevitable that budgeters and governors will use some of these transactions in order to address a budgetary need or to avoid an unpleasant budget reduction with the expectation or at least the “hope” that the next year will produce a better economic climate that will enable the state to eliminate the use of the nonrecurring vehicle. Unfortunately, in many instances, the economic climate either does not significantly improve or other budgetary needs require the budgeters and the governor to use another nonrecurring device to maintain current services.

Experience suggests that in most instances governors are aware that nonrecurring actions are being used and that they fully intend to avoid or diminish their use in future years. But in some instances they are not able to avoid such uses once the slippery slope has been established. Thus, the magnitude of the use of these transactions in a particular year is what has to be measured. Gross overestimation of revenues or legerdemain with regard to nonrecurring revenues chosen as a method to balance the budget usually results in the most difficult of situations, not only for the year in question but for future budgets as well.

Typical Nonrecurring Actions[57]

The twelve nonrecurring transaction examples listed below are not intended to be all inclusive, as complete details in past years are not always available, but they do serve as excellent illustrations as to the type of nonrecurring actions that were used over many budgetary years.

1. Change a payment date. A typical transaction would be to change a state aid payment date to a local government. For example, in several programs a specific statute required the payment be made four times a year, perhaps August, November, February, and May. By changing the statute so that the May payment is made in July, the state saves a one-time disbursement within the fiscal year. In most cases the local government did not lose money in their current year, as in New Jersey most local governments are on a calendar year. Furthermore, the action did not negatively impact the balance sheet or the GAAP basis of budgetary accounting since the actual statute was changed and thus there was no account payable to be booked.

2. Change tax collection date. A typical action would be for the state to change the date when taxes are due, or to implement a “tax amnesty” program wherein no interest is charged for delinquent payment. The collection of delinquent back taxes without penalty has been effective, but from a budget point of view has simply moved the money from future years to the current year.

3. Elimination of one-time "pay-as-you-go" capital appropriations. Either by switching capital purchases from a pay-as-you-go approach to a bonded approach, or by not repeating the magnitude of capital appropriation in a particular year, the state realizes a one-time gain.

4. Transfer fund balances in dedicated funds to the general fund. The state maintains numerous dedicated funds. Periodically, "excess" balances in these funds have been transferred and then appropriated to support the general fund. This had occurred principally with the Unemployment Insurance fund and the Disability Benefits fund, but also from other dedicated funds.

5. Sale of state assets. This technique has been used occasionally but in most instances for very small sale transactions, both in terms of items and dollars. The one significant asset sale was when a portion of Route 1 in the northern part of the state that directly connected into the New Jersey Turnpike was sold to the Turnpike. A one-time revenue gain was realized, but on the positive side a permanent savings on future maintenance and improvement costs was realized.

6. Pension fund changes. Over a series of years changes have been made to the pension system, including changing from book value to market value, changing the method of evaluation from "entry age normal" to "projected unit credit," and increasing the interest rate assumptions. The most dramatic change was the sale of $2.6 billion in bonds for deposit into the pension fund and the later elimination of annual state contributions to the state's pension funds.

7. Refinance debt. The state has frequently taken advantage of lower interest rates to refinance the state's debt. In these situations such refinancings also have a positive impact on the budget, as appropriations for projected debt service can be reduced in the upcoming years. It should be noted, however, that under New Jersey statute such refinancings cannot be executed unless there is a positive present value.

8. Deplete funds in retirement health benefits account. The state over a period of years was making contributions in the budget in order to address future costs related to health benefits for retirees. All funds were removed from this fund and moved into the general fund.

9. Rosy revenue scenario: making questionable revenue assumptions. Budget revenue estimates are never 100 percent accurate. In down economic times revenue estimates rarely achieve original estimates. But, it is safe to say that the revenue estimates for FY 2002, especially related to the income tax, were grossly overstated, despite warnings from the legislature's Office of Legislative Services (OLS). This action resulted in a shortfall of $1.6 billion in the income tax, causing significant disruption in the current budget and in the development of the subsequent year's budget.

10. Issuing long term debt to support the operating budget. Aside from the pension bond situation noted above, the state had never issued debt for operating purposes. But in FY 2003, FY 2004, and FY 2005, the state issued long term bonds to support the operating budget. In FY 2003 and 2004 it was executed by the Securitization of Tobacco dollars due the state over the next 30 years. In FY 2005, the state again issued bonds — this time the debt was supported by new revenues from motor vehicle surcharges. This last transaction was challenged in the New Jersey Supreme Court (*Lance v. McGreevy*) and the Supreme Court ruled the transaction in violation of the New Jersey Constitution and cannot be done in the future, but allowed the transaction to stand for FY 2005.

11. One time increase of a major tax. In FY 2010, the income tax was increased for income in excess of certain amounts, including amounts in excess of $500,000 and $1,000,000. $920 million was collected and used in FY 2010, but was not available in subsequent years.

12. Personnel actions. One-time personnel actions, such as furlough days, delays in hiring, accelerated early retirement programs, etc., can save funds for positive short term gains, most of which are not available in subsequent years.

Dollar Value of Nonrecurring Actions by Fiscal Year Related to Size of Budget

The table below shows the dollar value of major nonrecurring actions (including available opening balances) and their percentage share of the budget, for fiscal years 2003 through 2013.

Table 20 | Dollar Value of Nonrecurring Revenue and Percent of Total Budget ($ millions)

Fiscal Year	$ Value of Nonrecurring Actions*	Size of Appropriations Act	Percent Share
FY 2003	$3,299	$23,401	14.1%
FY 2004	2,883	24,003	12.0%
FY 2005	3,070	28,027	11.0%
FY 2006	1,885	27,920	6.8%
FY 2007	924	30,818	3.0%
FY 2008	1,817	33,470	5.4%
FY 2009	569	32,868	1.7%
FY 2010	3,820	28,990	13.2%
FY 2011	1,835	29,473	6.2%
FY 2012	1,223	30,295	4.0%
FY 2013	1,200	31,655	4.0%

* Does not include or reflect underfunding of the pension systems.
Source: New Jersey Office of Management and Budget, FY 2013 and Historical Budget Summary.

Gimmicks and Other Nonrecurring Resources: Concluding Observations

Over a period of at least 30 years, New Jersey has utilized at least 12 different types of nonrecurring transactions to balance the budget. The above eleven year history reflects a range of nonrecurring actions between 1.7 percent and 14.1 percent of the total Appropriations Act — with the current year returning to a more normal pattern. The use of nonrecurring actions is more prevalent during downturns in the economy (FY 2010), and when an incoming administration was left with an extraordinary large budget gap which took several years to climb out of (FY 2003 and FY 2004), following the 2001 recession and associated fiscal crises.

The actions that had the most long lasting impact on subsequent and future budgets were: the issuance of bonds for pension financing in FY 2007; the use of funds reserved for retiree health benefits in FY 2006; the exceedingly "rosy-scenario" decision in FY 2002; and the securitization of tobacco and other bonding actions to support operating costs in fiscal years 2003, 2004, and 2005.

Despite the use of these nonrecurring actions (many times quite large) the State of New Jersey managed to end each year with a positive fund balance based on GAAP and avoid a deficit in any of the subsequent years. But, these actions were not without consequences, such as requiring the state in subsequent years to raise taxes, skip pension payments, and reduce key program priorities.

The use of nonrecurring revenues saddle future budgets with a built-in dilemma: spending has been initiated or sustained with resources that by definition will not be available. Budget options and decisions in the following year are made additionally difficult. Furthermore, the use of nonrecurring resources masks the true structure of the budget and is generally unknown to the public. Ideally, all budgets should be structured in a manner such that recurring revenues support recurring expenditures, with no use of nonrecurring revenues or other gimmicks. Realistically, however, such a situation is not likely to happen. Accordingly, nonrecurring resources needs to be used in very limited circumstances and in small amounts.

Debt Provisions and Structure

The State of New Jersey has one of the highest debt burdens (not counting local debt) in the nation measured either on debt per capita basis, debt as a percentage of personal income, or debt as a percentage of gross state domestic product.[58]

Table 21 | Net-Tax Supported Debt Burden in New Jersey, 2011

Measurement Base	Measurement	Ranking
Debt Per Capita	$3,964	3rd
Debt % of Personal Income	7.8%	4th
Debt % of State Gross Domestic Product	7.2%	4th
Source: Moody's Investor Service, 2012 State Debt Medians Report.		

Constitutional Provisions

The New Jersey Constitution of 1947 states the legislature shall not create any debt which together with previous debt shall exceed at any time 1 percent of the total appropriation for such year.

Any debt above the 1 percent level must be authorized by a law, for a single object or work distinctly specified, and it must be submitted to the voters at a general election, and approved by a majority of legally qualified voters. The constitution further states that refinancings do not need to be submitted to the voters so long as the refinancing produces a debt service savings.

The constitution further states that the monies raised by the debt issuance must be applied only to the specific object stated in the item approved by the voters. Furthermore, the law must provide the ways and means, exclusive of loans, to pay the interest on the debt and also to discharge the principal within 35 years; and the law cannot be repealed until such debt and all interest is fully paid.

The constitution also states that this provision does not apply to the creation of debt for purposes of war, to repeal invasion or insurrections, or to meet emergencies caused by disaster or an act of God.

The debt limitation clause of the constitution was amended by a vote of the people on November 4, 2008. The amendment states that beginning after the effective date of the amendment, the state legislature is prohibited from enacting any law that creates debt of an autonomous state corporate entity which debt has a pledge of an annual appropriation as the means to pay the principal and interest, unless approved by voters at a general election. However, no voter approval is required provided the means to pay principal and interest on the debt is subject to appropriations of an independent non-state source of revenue paid by third persons, or from a source of state revenue otherwise required to be appropriated pursuant to another provision of the constitution.[59]

What Constitutes the Debt of the State of New Jersey[60]

New Jersey's long-term bonded debt consists of general obligations (GO) issued by the state government, and debt issued by certain state-created authorities that have issued bonds supported in whole or in part by state revenues or state appropriations.

The total debt of the state aggregates to $33.7 billion as of June 30, 2011.

The GO debt of the State of New Jersey is supported by the full faith and credit of the state. Debt service is paid from the general fund. The total general obligation debt of the state aggregates to $2.56 billion as of June 30, 2011.

For "Obligations Subject to Appropriation" (see definitions below) the state via lease or other contract or from dedicated revenues agrees to make payments in amounts sufficient to cover the debt service on the bonds. All such contractual payments are subject to appropriations by the state legislature. The total appropriation debt of the state aggregates to $31.2 billion as of June 30, 2011.

The obligations of New Jersey's counties, municipalities, and school districts and other locally-created authorities or districts are not debt of the State of New Jersey.

The New Jersey Economic Development Authority frequently issues bonds on behalf of private companies to promote or foster economic development. Such bonds are payable solely from the private company that benefits from the financing and there is no recourse either legally or morally to the state.

Several other state authorities finance capital projects with bonds that are secured by their operating revenue. The New Jersey Turnpike and the South Jersey Transportation Authority are two such examples. Their bonds are secured solely from their revenue and there is no recourse either legally or morally to the state.

Certain state authorities have issued what is commonly referred to as "moral obligations" of the state. A moral obligation bond is authorized in limited circumstance by the statutes that govern the New Jersey Housing and Mortgage and Finance Agency (HMFA), the New Jersey Higher Education Student Assistance Authority (HESSAA), and the South Jersey Port Corporation (SJPC). Such statutes provide that if the authority's revenues are insufficient and the debt service reserve fund created in connection with the authority's revenues is drawn upon to pay debt service, the state has a moral obligation to replenish such debt service reserve fund, subject to appropriation by the state legislature.

For the moral obligation bonds of the HMFA and the HESSAA, their revenues have always been sufficient to cover the debt service. Their debt service reserve funds have never been drawn upon and the moral obligation has never been exercised. The state expects that assistance will not be needed in the future, and therefore the debt numbers are not included in this report.

A portion of the annual debt service for the moral obligation bonds of the SJPC that are secured by revenues from the operation of its port facilities has been paid from the debt service reserve fund due to insufficient revenue. The state has consistently honored its moral pledge to replenish the SJPC's debt service reserve fund as needed via appropriation and therefore the debt is included in this report.

Long Term Obligations of the State of New Jersey[61]

The overall debt of the State of New Jersey, supported by general and dedicated revenue, as of June 30, 2011, is summarized below:

Table 22 | General Obligation Debt vs. Appropriation Debt, FY 2011

	$ millions
General Obligation Debt	$2,567
Obligation Subject to Appropriation	$31,153
Supported by General State Revenues	*$15,432*
Supported by Dedicated State Revenue	*$15,721*
TOTAL — General Obligation Debt & Appropriation Debt	$33,720

Source: New Jersey Office of Public Finance, Department of Treasury, State of New Jersey Debt Report for FY 2011, pp. 8-12.

Basically, the state issues three types of long term debt: general obligation debt, appropriation debt supported by a state contract or lease, and appropriation debt supported by state-dedicated revenue. With regard to the latter two bond obligations, the legislature has no legal obligation to make any appropriation.

General Obligation (GO) Debt — As noted above, GO debt must be approved by the legislature and the governor and then by the voters. Since November 1976 through November 2011, 22 bond referenda have been approved by the voters totaling $10.8 billion. As of June 30, 2011, $2.6 billion remains outstanding.

Appropriation Debt (general state revenue) — This category includes all bonded obligations for which payment of debt by the state is subject to annual appropriations by the legislature. The debt has been issued by one of several state authorities and the state has agreed by contract to make payments to the authority in sufficient amount for them to make debt service payments. Twenty-six bond sales, mostly for small amounts, have been executed under these provisions. The two largest amounts have been issued for local school construction ($11.1 billion) and pension financing ($2.6 billion). As of June 30, 2011, $15.4 billion remains outstanding.

Appropriation Debt (state dedicated revenue) — This category includes all bonded obligations, the debt service of which is payable solely from certain revenues that have been constitutionally and/or statutorily dedicated and appropriated for such purpose. Almost 90 percent of this debt relates to bonds issued by the New Jersey Transportation Trust Fund. As of June 30, 2011, $15.7 billion remains outstanding.

Listed as follows is the total outstanding and authorized and unissued debt for the past five years.

Table 23 | Long Term Outstanding and Authorized & Unissued Debt ($ millions)

Category	2007	2008	2009	2010	2011
General Obligation					
Outstanding	$2,832	$2,801	$2,527	$2,597	$2,567
Authorized & Unissued	$742	$702	$702	$893	$893
Appropriation Debt (General State Revenue)					
Outstanding	$13,336	$14,597	$15,115	$15,619	$15,432
Authorized & Unissued	$2,479	$5,129	$2,479	$1,323	$1,323
Appropriation Debt (State Dedicated Revenue)					
Outstanding	$11,844	$12,798	$13,936	$14,634	$15,721
Authorized & Unissued	$7,108	$5,936	$4,004	$3,851	$3,851
Total Debt					
Outstanding	$28,012	$30,196	$31,578	$32,851	$33,720
Authorized & Unissued	$10,329	$11,767	$7,185	$6,067	$6,067

Source: New Jersey Office of Public Finance, Department of Treasury, State of New Jersey Debt Report for FY 2011; New Jersey Office of Management and Budget, FY 2011 Comprehensive Annual Financial Report.

Short Term Debt[62]

The State of New Jersey since FY 1991 has annually issued "Tax and Revenue Anticipation Notes" to fund timing imbalances in the state's annual cash flow. All such imbalances related to the current year's budget. All such notes mature before the end of the year in which they are issued; therefore the state never had a balance of notes payable on the balance sheet at the end of the fiscal year. Over the past six years short term borrowings have ranged from $1.8 billion to $2.2 billion.

Long Term Debt Used for Balancing the Operating Budget

In the history of New Jersey, the state has issued long term debt (via appropriation debt) in three instances to support the balancing of the operating budget. The transactions were:

- 1997 — State Pension Funding: $2.6 billion (to fund a portion of the unfunded liability of the state pension systems and avoid making annual appropriations)
- 2004 — Securitization of Tobacco Funds: $1.5 billion (proceeds used to support the state budget)
- 2005 — Motor Vehicle Surcharges: $807 million (proceeds used to support the state budget)

The State Supreme Court in 2005 ruled that contract proceeds used to fund general expenses in the state budget do not constitute "revenue" for purposes of the Appropriation Clause of the New Jersey Constitution and cannot be used to balance the annual budget. The court's ruling was prospective and applied only to the FY 2006 fiscal year budget and beyond. No aspect of the court's decision affected either the currently proposed bond sale (motor vehicle surcharge supported bond sale) or any other prior bond authorizations.[63]

Debt: Concluding Observations

Debt is essential if states, including New Jersey, are to invest in critical infrastructure that is needed, or to smooth out cash flows within the fiscal year. While debt has grown substantially in recent decades, most states, including New Jersey, remain highly creditworthy.

As in many states, the majority of New Jersey debt is “appropriation” debt and not general obligation debt. In fact, less than 8 percent of the debt has been voted on by the public (GO debt). Future appropriation debt will be limited because of a constitutional amendment that was approved by the voters in 2008.

Treating bonded debt as appropriation debt and not general obligation debt is not automatically inappropriate. In fact, the majority of such debt was issued for transportation and school construction projects — projects of a worthy nature and clearly capital in nature.

Debt can be misused and issued for noncapital purposes, however. New Jersey used debt to finance pensions, and three times, including securitization of tobacco revenue, to finance operating costs and/or to plug holes in the budget. A challenge and court decision in *Lance v. McGreevey* has ruled such actions unconstitutional and they cannot be used in the future.

Other states use debt financing as a budget balancing technique and/or roll over their short terms notes into the next budget year. New Jersey has never rolled short terms notes into the subsequent budget year but rather has liquated such cash flow notes by June 30 of the year of issue. And, per the ruling in the above noted New Jersey Supreme Court decision, there is a strict provision against issuing debt in the future for operating purposes.

Infrastructure[64]

Overview

The status of the nation's physical infrastructure may be characterized as anything from discouraging to alarming, based on surveys of infrastructure conditions and needs. Infrastructure has been "crumbling" for so long, according to the American Society of Engineers (ASCE), that its condition deserves a grade of D.[65]

In the analysis of the six study states, the State Budget Crisis Task Force focused on the three major types of infrastructure spending: transportation (roads, bridges, mass transit), water (drinking water and wastewater, and dams), and buildings (general, K-12 schools, and higher education).

Improving the situation will be costly. In 2009, the ASCE report card highlighted an estimated five year transportation investment shortfall of $739 billion. The National Surface Transportation Infrastructure Financing Commission estimated a federal investment gap for just surface transportation of $2.3 trillion from 2013 to 2035.[66] The U.S. Environmental Protection Agency (EPA) estimates that $623 billion would be required for drinking and waste systems over the next 20 years.[67] Producing a good repair for the nation's most critical dams would require $16 billion over the next 12 years.[68] Few national estimates are available for public buildings.

New Jersey faces similar infrastructure problems. Based on information gathered from reports issued by departments of transportation and environmental protection and other sources, it is estimated that New Jersey's infrastructure needs over the next ten year period for just these two program areas is at least $125 billion. Other infrastructure needs are required for public buildings, including higher education, for which minimum cost estimates of $6.5 billion are included in the table below, But for purposes of this report the two most capital intensive programs are discussed in more detail in the subsequent sections.

Table 24 | **Projected 10-Year Infrastructure Costs in New Jersey, FY 2012-2021**

Program Area	$ billions
Transportation	$80.0
Roads	*$48.0*
Transit	*$32.0*
Wastewater & Drinking Water	$44.4
Wastewater Treatment	*$16.8*
Storm Water Management	*$15.6*
Drinking Water	*$8.0*
Other	*$4.0*
Dams	$0.4
Publically Owned Buildings (higher education, etc.)	$8.0
Total	**$133.4**

Source: New Jersey Department of Transportation and New Jersey Department of Environmental Protection.

Asset Management System[69]

Information related to the value of existing infrastructure of a state is often not publically available, but state Comprehensive Annual Financial Reports (CAFRA) may tell how the state measures the value of its existing assets (state only — not local governments).

New Jersey's Office of Management and Budget maintains such an asset management system and reports it in the CAFRA. The report includes values on land, buildings, land and building improvements, infrastructure, etc. As of June 30, 2011, the OMB reports a capital asset value of $32.8 billion with a depreciated value of $10.0 billion; thus with a net book value of $22.8 billion.

Some useful information from the system is summarized as follows:

- The majority of assets are categorized as infrastructure ($19.7 billion) with assets being maintained by the department of transportation at $25.5 billion.

- A breakdown of the assets, shown as billions, are as follows:

• Infrastructure	$19.7
• Land & Easements	4.8
• Building & Improvements	3.4
• Construction in Progress, Etc.	4.9
TOTAL	32.8

Transportation

The responsibility for constructing, maintaining, and operating the highway system in New Jersey is shared by state, county, and municipal governments, parks, and toll road authorities. Combined, these agencies own and operate 39,241 centerline miles. The state share is 2,323 while the municipal share is 24,408. The major roadways, including interstate freeways and major arterials, are under the jurisdiction of New Jersey Department of Transportation (DOT) and, to a lesser degree, one of the toll road authorities. Most of the minor arterial and collector roads are under county jurisdictions. Local streets and roads are owned and operated by municipal governments. A breakdown of road mileage by jurisdiction is as follows:[70]

Table 25 | Road Mileage by Jurisdiction, 2010

Program Area	Mileage
NJDOT	2,323
Authority	411
County	6,449
Municipal	29,408
Park	649
Total	39,240

Source: Bureau of Transportation Data Development, Roadway Systems Section, New Jersey Department of Transportation.

There are 6,514 highway carrying bridges over 20 feet long in New Jersey's bridge inventory, owned by various entities. The average design expectancy of a new bridge is 75 years. Currently, 16 percent of state, 31 percent of county municipal, 56 percent of New Jersey Transit (NJTRANSIT), and 33 percent of private bridges are older than 75 years. The average age of all bridges in New Jersey is 51 years.[71]

The capital plan of NJTRANSIT (which is a significant part of DOT's Statewide Capital Investment Strategy) is the nation's third largest mass transit provider. The bulk of all transit passengers in New Jersey depend on NJTRANSIT.

Two reports are used for transportation infrastructure planning by DOT: the Statewide Capital Investment Strategy (SCIS) and the State Long Range Transportation Plan 2030 (LPR). Additionally, several regional and specialty plans include: The Comprehensive Strategic Highway Safety Plan; The Comprehensive Statewide Freight Plan; The North Jersey Transportation Authority Regional Plan; The Delaware Valley Regional Planning Authority Transportation Plan; and the South Jersey Transportation Planning Organization.

The LPR establishes a vision and policy framework, sets forth strategies, provides a structure for guiding investments, and identifies financial resources. The LPR projects needs absent funding constraints.

The SCIS is based on projected revenue levels, not needs. The plan evaluates the budget required to bring the state's transportation infrastructure to a state of good repair.

The LRP projects a need for $200 billion for maintenance, operations, renewal, and replacement of the assets of DOT and New Jersey Transit through 2030 — approximately $80 billion of which is needed from 2012 to 2021.[72]

According to data from the U.S. Census Bureau, the Bureau of Transportation Statistics, and the Federal Highway Administration, 55 percent of New Jersey roads are rated mediocre or poor; and 35 percent of bridges are rated structurally deficient or functionally obsolete.[73]

Per the SCIS, the annual investment target for all transportation infrastructures is estimated to be $3.3 billion annually through 2021. Assuming flat funding, that would total $32.6 billion, or a shortfall of approximately $47 billion versus need. Below is a summary of the SCIS ten year construction plan:[74]

Table 26 | Transportation Construction Plan, 2012-2021 ($ millions)

Category	Desired Annual Investment Target Statewide	10-year Total Need
Road Assets	$261.5	$2,614.9
Congestion Relief	$477.9	$4,778.9
Bridge Assets	$771.1	$7,710.9
Local System Support	$405.1	$4,061.6
Safety Management	$127.2	$1,271.9
Mass Transit Assets	$1,066.9	$10,669.4
Multimodal	$46.2	$452.0
Airport Assets and Aviation Support	$17.7	$177.0
Transportation Support Facilities	$82.1	$820.5
Total	**$3,255.7**	**$32,557.1**

Source: New Jersey Department of Transportation, 2012-2021 Statewide Capital Investment Strategy, p. 2.

Environmental Programs

Wastewater needs analyses are prepared every four years. New Jersey and all states are required to report infrastructure needs to the U.S EPA. This report, known as the "Clean Watersheds Needs Survey Report to Congress," has extensive data defined by a dozen different categories and many subcategories. The current report is from 2008. The update on the next report has begun and will be completed in October 2012.

Regarding water supply needs, data are prepared differently. In short, the state submits projects in a questionnaire to an EPA contractor. The contractor reviews and either accepts or deletes the project. For accepted projects, the contractor uses a model to determine costs for each project and the total needs of the nation and of each state, including New Jersey. The current report is dated February 2009. The environmental needs data were developed from these reports.

Wastewater and Treatment and Storm Water Management

New Jersey, along with California and New York, reported the largest total needs for wastewater repairs and improvements in the Clean Watersheds Needs Survey to Congress, each with approximately $30 billion.[75]

As reported, New Jersey is:

- first by a wide margin (Pennsylvania is second at $6.0 billion) in storm water management needs ($15.6 billion);
- second nationally in combined sewer overflow (CSO) correction needs ($9.3 billion);
- third nationally in decentralized wastewater treatment needs ($2.2 billion);
- fourth nationally in needs to repair and improve its secondary treatment and advanced treatment infrastructure ($6.3 billion); and
- fourth nationally in nonpoint source pollution control needs ($1.8 billion).

The American Water Works Association, American Society of Civil Engineers, the U.S. EPA, and numerous public advocacy watchdog groups have all identified New Jersey's aging infrastructure as an area for concern. At the same time, federal funding for the New Jersey Clean Water State Revolving Fund has declined 51 percent to only $26.7 million in FY 2008, and applications for new projects have risen 29 percent.[76]

The water quality in New Jersey's streams and rivers has improved markedly; however, new water quality standards have been set without any funding for construction of the treatment processes necessary to make them a reality. Sewerage authorities are faced with the option of raising sewerage tariffs or raising funds by bonding public projects.[77]

Just as significant as the treatment processes themselves is the infrastructure that collects the sewerage and transports it to the treatment facilities. When valuable capacity is taken up by storm flows, the wastewater treatment plants are forced to discharge raw and partially treated sewage into streams and rivers. The physical components of these systems are aging quickly. Most of the sewerage collection systems in New Jersey exceed the expected useful life of 50 years. While it may be possible to extend the life of a pipe to 75 or 100 years with good maintenance, most of the infrastructure under city streets is crumbling from neglect.[78]

New Jersey makes low interest loan money available for wastewater through its Environmental Infrastructure Financing Program. The program works in partnership with the New Jersey Environmental Infrastructure Trust Program (EITP), an independent financing authority. Each program awards an equal amount of funding, subject to different interest rates and requirements.

Projects are prioritized and money is awarded through an evaluation of the nature of the problem and potential damage to receiving waters. Currently, the highest priority projects are designed to eliminate untreated discharges to waters from CSOs and damaged pipelines. Other high priority projects are along coastal waterways and those where the receiving waters do not meet the state's quality standards. Without intervention, sewerage demand is expected to exceed available treatment capacity by 2016.

The total needs for wastewater treatment, management, and remediation as of January 1, 2008 (the latest available data) is in excess of $32 billion. [79]

Drinking Water

The categories of drinking water established by the U.S. EPA include transmission and distribution, treatment, storage, source, and other. Drinking water comes from either ground water or surface water sources including rivers, lakes, other open bodies of water, and wells.

Public water systems serve 80 percent of the state's residential population, while private domestic wells serve the remaining 20 percent. Transmission and distribution systems generally account for most of a system's capital value.

While most New Jersey residents receive water from public water systems that operate without significant U.S. EPA violations, according to U.S. EPA's 2004 National Public Water Systems Compliance Report, New Jersey's water systems were cited for a total of 17,776 violations, reflecting a 9 percent increase in total violations over 1999 levels. Most of New Jersey's maximum contaminant level violations are due to exceeding the acceptable total coliform and nitrate levels.[80]

The state's drinking water infrastructure requires capital and operation and maintenance (O&M) investments to ensure New Jersey residents continue to be provided with water at an acceptable level of service. Projects supported by capital spending include constructing raw water intakes, impoundments, wells, treatment plants, and storage tanks; installing standby power generators; replacing aging and deteriorated water mains; and installing booster pumping stations to maintain adequate distribution system pressure. The projects supported by O&M spending include rehabilitating storage tanks, refurbishing pipes to remove buildup on pipe walls, and looping dead-end mains to avoid stagnant water.

A preliminary comparison of spending versus investment needs suggests that New Jersey has a drinking water infrastructure investment funding gap of at least $60 million per year.

Based on responses to a 2007 survey, the U.S. EPA estimated $7.96 billion in capital investments would be needed over the next 10 years to install, upgrade, and replace New Jersey's drinking water infrastructure.[81]

DAMS

According to statistics from the Association of State Dam Safety Officials (ASDSO), New Jersey currently owns and maintains 1,716 dams, of which 214 are classified as high hazard dams.

The New Jersey Department of Environmental Protection's Dam Safety program placed a priority on larger dams with the highest potential loss of life. As of September 2007, 67 high hazard dams and 243 of the over 400 significant hazard dams are deficient and are in need of repair. Using the methodology included in a report prepared by the Association of State Dam Safety Officials entitled "The Cost of Rehabilitating Our Nation's Dams: A Methodology, Estimates and Proposed Funding Mechanisms," dated January 2009, the estimated projected costs to repair dams in New Jersey is approximately $400 million.

The state provides low interest loans for public and private dams through a revolving fund authorized by the Dam, Lake, Stream, Flood Control, Water Resources, and Wastewater Treatment Project Bond Act of 2003. This act authorized $95 million in low interest loans for public and private dams and an additional $15 million for state-owned dams.[82]

Infrastructure: Concluding Observations

While the majority of spending for infrastructure does not occur at the federal level, federal efforts and involvement in the nation's transportation and environmental programs are well known. The federal government funds infrastructure projects in the form of grants and loan subsidies. According to a report from the Congressional Budget Office, the respective shares of spending by the federal government and the state and localities on water and transportation infrastructure have remained reasonably stable since the mid-1980s.[83] Funding for drinking and wastewater projects come primarily from local sources — a pattern that is likely to continue. Local governments and utilities use mainly debt financing for such purposes, with bonds being principally repaid from user fees.[84]

After the 2008 economic decline, the American Recovery and Reinvestment Act of 2009 (ARRA) awarded almost $87 billion nationwide for infrastructure projects.[85] New Jersey participated in this program and expended the funds principally for transportation and environmental programs, and some for energy-related projects. These funds are nonrecurring and, compared to the total need, were marginal.

Funding for infrastructure projects is declining. Funding for transportation projects, for example, from both the federal and state governments, comes principally from dedicated revenues, including the gasoline tax; but these revenues are in decline. Federal gasoline tax revenues are stagnating with dramatic effects on the availability of the federal Highway Trust Fund (HTF). The condition of the HTF is expected to worsen, and the Congressional Budget Office forecasts that the HTF will be unable to meet its obligations. Similar problems exist for many states, including New Jersey. Unless the federal and state governments are willing to raise the tax or find alternative sources to pay debt service on bonds, there will be insufficient revenues to meet the nation's transportation infrastructure needs.[86]

Though politics is inherently uncertain, it is reasonable to assume that the future will bring additional restraints on federal government spending. Such developments would hit states such as New Jersey particularly hard.

The nation's infrastructure presents a picture of failing report cards, visibly aged facilities, deferred maintenance, and mounting backlogs. The nation needs capital investment, and the funding gap is large. New Jersey, for example, has identified a need for at least $133 billion over the next ten years. Elected officials in Washington and the state governments need to address the consequences of diminishing revenues.

Education[87]

K-12 Education

Overview

Education has always been the largest single item in a state budget. When federal funds are included in the equation, Medicaid has slightly exceeded education in many states. Not in New Jersey. Education is still the single largest item in the budget, and when just state revenues are considered, it is 37 percent of the budget. In the FY 2013 state budget K-12 spending is $11.7 billion of the $31.7 billion state budget.

In addition to state aid support, the property tax is the dominant share of revenue to support local spending, at approximately $13.5 billion. Federal aid is small in comparison, at approximately $1 billion.

State government spending for K-12 education is driven by two factors: enrollment, and state formulas governing the total amount and distribution.

Any discussion of recent initiatives and funding for elementary and secondary education in New Jersey must take place in the context of a series of New Jersey Supreme Court decisions regarding educational adequacy. For more than three decades, the court has addressed the question of whether existing funding formulas, as enacted and as implemented, meet the so-called "thorough and efficient" requirement of the New Jersey Constitution.[88]

New Jersey, like many states throughout the country, has a number of urban school districts with minimal local resources and large numbers of low-income and minority students. Beginning in 1990 in the ongoing *Abbott v. Burke* cases,[89] the court has determined that children in these urban, so-called "Abbott" districts[90] must be afforded the same opportunities to learn as those children who live in wealthy suburban districts. Absent any programmatic basis for comparison, the court has said that per pupil spending on regular education in each urban district must be equal to the average spending on regular education in the wealthiest districts, and that additional spending must be provided to meet the additional needs presented by children in the urban districts. Subsequent decisions expanded these requirements to include providing preschool education as well as facilities in the urban districts. Declaring that elementary and secondary education was a state responsibility regardless of the funding sources[91] used to support it, the court also required that the additional funds required to meet its decisions could not depend upon the local tax base and taxpayers but would have to be provided by the state government.

Formula Issues and Budget Formulation

Three school funding formulas have been enacted to try to meet the court's mandates as well as provide equitable — and politically feasible — funding to all districts. The first two, the Quality Education Act of 1990 and the Comprehensive Educational Improvement Act (CEIFA) of 1996, were invalidated as applied to the 30 poor urban districts. As a result, beginning in the late 1990s the annual appropriations act provided separate funding for the poor urban districts. Until the enactment of the third formula, the School Funding Reform Act (SFRA) of 2008, state aid for most districts remained relatively flat, with increases targeted to the Abbott districts and for teachers' post-retirement programs.

The School Funding Reform Act (2008) was the Corzine administration's effort to respond to long-standing criticisms of education aid. Based upon a Professional Judgment Panel process, SFRA establishes an amount considered necessary for districts to enable their students to meet New Jersey's core curriculum standards. Additional weights are established for different grade levels and to address the expected needs of impoverished students, those with limited English proficiency, and those in special education programs. Equalization aid is the difference between the adequacy amount as determined by formula and a district's expected local contribution, as determined by a combination of its local property wealth and personal income. The additional weights for at-risk students are quite high compared with those in other states.

Implementation of this formula occurred in FY 2009. In May 2009, the New Jersey Supreme Court held unanimously that SFRA was constitutional and may be applied to the Abbott districts, provided that it was funded fully and provided that there was a review and retooling of the formula after three years of implementation.[92]

As the FY 2010 budget was being prepared, New Jersey began experiencing the effects of the 2008 recession. Fortuitously, the federal government passed the American Recovery and Reinvestment Act (ARRA, or stimulus package), which included significant funding for education. The FY 2010 budget was developed using more than $1.0 billion — the vast majority — of eligible ARRA funds to increase aid under SFRA, leaving a significant structural problem to be addressed in FY 2011.

For FY 2011, the newly elected Christie administration increased state aid by almost $242 million over the net state appropriation the prior year, but because the ARRA funds were no longer available, payments to districts were reduced by $957 million. In May 2011 (during legislative discussions on the finalization of the FY 2012 budget) a divided court determined that the FY 2011 budget had not funded fully SFRA, in direct contravention of the court's 2009 decision, and that additional funds were required in FY 2012. No retroactive payments were directed by the court.

While declining to order full funding for all districts under SFRA, the court did order that SFRA be fully funded, at least as it affected the Abbott pupils.[93] The governor agreed to add $450 million to meet the court's mandate. The legislature concurred, and decided to add an additional $150 million for non-Abbott districts. Ultimately, the final Appropriations Act for FY 2012 was a $600 million increase over the original recommendation of the governor.[94]

The current FY 2013 Appropriation Act contains an increase of almost $1.2 billion. This increase is a little misleading as, in developing the prior year's budgets, the legislature and governor agreed to move certain debt service payments ($470 million) from FY 2012 to FY 2011, which made the FY 2012 base artificially low, and therefore the increase artificially high for FY 2013.

Enrollment and Spending

New Jersey educates more than 1.4 million public school students. The state's per pupil spending consistently ranks among the highest in the nation; in 2008 to 2009, New Jersey ranked third, behind the District of Columbia and New York state, in current expenditures per pupil, according to data published by the National Center for Education Statistics (NCES).[95] The following table provides enrollments and per pupil spending for the years 2006 to 2007 through 2011 to 2012.[96]

Table 27 | Public School Enrollment and Per Pupil Spending, FY 2007-2012

Fiscal Year	Enrollment	Spending per Pupil
2007	1,440,767	$16,256
2008	1,433,498	$17,037
2009	1,434,581	$17,235
2010	1,439,070	$17,414
2011	1,430,742	$17,696
2012	1,427,881	$17,894
Source: New Jersey Department of the Treasury, State Budgets, various years.		

New Jersey's relatively high spending on education is supported primarily by local property taxes, as indicated below. Indeed, almost all local revenue in the state is derived from the real property tax. According to data compiled by the Tax Foundation for 2009, the state was ranked first in the median property tax paid on homes, property taxes as a percentage of home value, and property taxes as a percentage of the median income.[97]

Table 28 | Funding Sources for K-12 Education, FY 2007-2013

Fiscal Year	Local	State	Federal
2007	53.4%	43.1%	3.5%
2008	53.1%	43.7%	3.2%
2009	53.8%	43.0%	3.2%
2010	54.2%	37.4%	8.4%
2011	55.3%	40.2%	4.5%
2012	55.2%	40.3%	4.5%
2013 estimated	53.6%	42.9%	3.5%
Note: Note: FY 2010 and 2011 include funding from the American Recovery & Reinvestment Act. ***Source:*** New Jersey Department of the Treasury, State Budgets, various years.			

State Aid Appropriations for Elementary and Secondary Education

For purposes of this report, state aid for elementary and secondary education may be grouped into four categories: direct payments to public school districts (including charter schools), payments made to other entities on behalf of public school districts, aid for early childhood education, and other specialized programs. The direct payments are primarily based upon formulas, although these are often modified by budget language to meet fiscal constraints. Direct payments also include specially designated appropriations or "earmarks" made through budget language.

Payments on behalf of districts consist primarily of actuarially determined contributions to the retirement fund for teachers and other certificated staff, payments for post-retirement health insurance for teachers, the employer's share of social security, and debt service on bonds issued through state entities to finance local construction. The failure by the state to make contributions to the pension fund has led to significant underfunding, as discussed in a separate section of this report. The school construction program is discussed below.

Aid for early childhood education is targeted to low-income districts, particularly the original "Abbott" districts. Districts in turn may contract with local providers, who must use certified staff. Although the SFRA contemplated covering low-income children in all districts, budget constraints have limited the expansion.

In the category of other specialized programs, by far the predominant program is aid to nonpublic schools in such nonsectarian areas as textbooks, transportation, nursing, auxiliary services, and some services for the disabled. Aid to nonpublic schools was $101.6 million in FY 2007, dropped to $79.5 million in FY 2011 and FY 2012, and rose by $3 million in 2013. Prior to FY 2011, this category included grants for adult education, and throughout the time period the category includes $4.9 million in support of vocational programs carried out by entities other than school districts.

The following table summarizes all state aid appropriations for elementary and secondary education.

Table 29 | K-12 Education Aid, FY 2007-2013 ($ millions)

Fiscal Year	Direct Payments to Districts	Payments on Behalf of Districts	Early Childhood Education	Other Specialized Programs	Total K-12 Education Aid
2007	$6,908.2	$2,683.8	$576.8	$138.7	$10,307.6
2008	$7,269.7	$2,889.5	$589.9	$151.8	$10,900.9
2009	$7,848.7	$2,948.0	$543.8	$120.0	$11,460.6
2010*	$8,102.8	$2,322.6	$596.1	$108.8	$11,130.4
2011	$7,145.8	$2,464.6	$613.3	$84.4	$10,308.1
2012	$7,819.3	$2,028.7	$613.3	$84.4	$10,545.7
2013 estimated	$8,014.4	$2,977.4	$633.7	$87.4	$11,712.9

Note: 2010 amount for "direct payments to districts" and "total K-12 Education Aid" include $1,056,9 million from ARRA.
Source: New Jersey Appropriations Acts, various years.

School Construction Program

With the enactment of the New Jersey Educational Facilities Construction and Financing Act of 2000, and its 2008 amendments, the state has authorized a total of $12.5 billion for school construction and renovation. The Abbott districts have been allocated $8.9 billion, with the state paying 100 percent of eligible costs; other districts have been allocated $2.6 billion, including $150 million for vocational schools. The other districts receive grants totaling 40 percent of eligible costs. The act was the response to a 1998 New Jersey Supreme Court decision on required supplemental funding for pupils in the Abbott districts. In that decision, the court ordered that the state remediate facilities deficiencies in the Abbott districts.[98] Debt service payments on this program have been steadily increasing as the bonds for school construction have been issued. In FY 2010, for example, $265 million was appropriated, and by FY 2017 the amount will increase to approximately $400 million.

Federal Aid for Education

Federal aid has historically been a relatively small portion of the amount spent on K-12 education, as seen in the chart that summarizes funding sources. The majority of federal funds come from the Individuals with Disabilities Education Act (IDEA) and Title I of the Elementary and Secondary Education Act, as indicated in the table below. New Jersey's districts receive only minimal amounts of direct support, such as Impact Aid, from the federal government.

Table 30 | **Federal Aid to New Jersey, Total and Selected Programs, FY 2007-2013 ($ millions)**

Fiscal Year	Total Federal Aid	IDEA — Basic State Grant	TITLE I — Grants to LEAs	Federal Stimulus Funds
2007	$846.7	$340.2	$281.2	$0.0
2008	$797.9	$342.1	$213.2	$0.0
2009	$722.4	$245.3	$191.7	$162.2
2010	$2,187.0	$355.5	$333.0	$1,309.6
2011	$973.0	$331.1	$318.7	$161.1
2012	$872.2	$360.0	$297.4	$0.0
2013 estimated	$836.3	$361.0	$299.0	$0.0
Source: New Jersey Budget, various years.				

As discussed earlier, more than $1 billion in stimulus funds was used in FY 2010 to increase state aid; the remaining stimulus funds were augmented allocations for IDEA (both the Basic State Grant and Preschool Grants) and Title I. IDEA funding also represented the vast majority of the stimulus funds still available in FY 2011, $136.5 million from the Basic State Grant and $3.4 million from Preschool Grants.

Demographic/Enrollment Changes

The National Center for Education Statistics provides projections of education statistics. In the most recent edition (September 2011), New Jersey's pre-kindergarten to grade 12 enrollment is projected to decline by 0.5 percent between the Fall 2008 and Fall 2014, but to increase by 1.5 percent between 2014 and 2020, an overall increase of 1 percent between 2008 and 2014. Enrollment in grades pre-kindergarten to 8 is projected to increase 0.1 percent between 2008 and 2014, and by 1.7 percent between 2014 and 2020, an overall increase of 1.9 percent. Enrollment in grades 9 through 12 is projected to decline by 1.7 percent between 2008 and 2014 but then increase by a modest 0.9 percent between 2014 and 2020, for an overall decline between 2008 and 2020 of 0.9 percent.[99]

These projections do not extend to population subgroups or individual districts. Dynamic changes in either of them could affect state aid calculations under the current formula. But taken as a whole, these projections suggest that demographic changes will not have a significant effect on state aid for elementary and secondary education in New Jersey.

Concluding Observations: Outlook for Education Aid

Governor Christie's FY 2013 budget recommendation would have made changes to the funding formula itself. In press statements and a paper released on February 23, 2012,[100] the governor and his acting commissioner of education proposed modifying SFRA to reduce the weights assigned for low-income and limited English proficiency students, and to use average daily attendance as the measure of enrollment, not the single point enrollment count historically and currently used as the basis for calculating foundation budgets and state aid. Taken together, these changes would have their most immediate impacts on poorer, low-, and working-class districts, which have higher proportions of low-income students and lower attendance rates. The legislature removed the budget language implementing these changes; however, school aid will be allocated according to the deleted language.

If the governor and commissioner wish to pursue formally these changes, they can pursue several possible actions: introduce legislation to change SFRA; propose the changes as part of the three-year evaluation of SFRA that New Jersey's Supreme Court had in mind in the Abbott case; or propose similar language in the FY 2014 budget.

Because the FY 2013 Appropriations Act reduces aid to several Abbott districts, it is likely, or at least possible, that it will be challenged in court — always a major issue of school financing in New Jersey.

It should be noted that New Jersey has enacted a limitation of 2 percent on the annual growth of districts' property tax levies. This limit should result in slower growth in expenditures and therefore in the demand for increases in state aid. Already, the state has seen a significant reduction in negotiated salary increases for teachers, from an average of 4.55 percent three years ago to an average of 2.15 percent in contracts settled since January 2011, according to the New Jersey School Boards Association.[101]

Governor Christie's education agenda has also focused on expanding the use of charter schools and inter-district choice programs, and tax credit scholarship programs for children attending failing schools. In addition, teacher tenure reform has been a major gubernatorial initiative. To that point, legislation was enacted in August 2012, to reform tenure laws to include teacher evaluations, rewards, and tenure as ways to affect student achievement.

Notwithstanding actions taken by the courts, it is fair to conclude that funding for K-12 schools will continue to be a growing portion and the largest single component of the state's budget. It could be even larger if recent formula actions are challenged and sustained in the Supreme Court.

Higher Education

Overview

Public higher education in New Jersey is provided by 12 four-year colleges and universities and 19 community colleges. In the fall of 2011, the three public research universities (Rutgers, the University of Medicine and Dentistry, and the New Jersey Institute of Technology) enrolled 45,563 full-time and 5,608 part-time undergraduate students, and 13,782 full-time and 9,939 part-time graduate and professional students. The nine state colleges and universities enrolled 63,358 full-time and 30,423 part-time undergraduate students, and 3,398 full-time and 10,488 part-time graduate and professional students. The community colleges enrolled 93,848 full-time and 82,269 part-time students, for an overall enrollment of 321,069 undergraduates and 37,607 graduate students in public institutions.[102]

Significant changes to the governance and financing of public higher education occurred in 1986 and 1994. In 1986, the State College Autonomy Act was enacted. The *New Jersey State College/University Trustees' Reference Guide (Sixth Edition)* summarizes the major provisions as allowing the colleges and universities to administer their own budgets; accept grants and contributions; manage their own property; invest their own funds; retain unexpended balances at the end of the year; fix tuition and fees; establish academic programs; and name their own institution.[103]

Previously, the Board of Higher Education established tuition rates for the sector, and the state budget included tuition receipts as General Fund revenues. It should be noted that these changes brought the powers and responsibilities of the state college trustees more in line with those of the trustees of the three universities.

The Higher Education Restructuring Act of 1994 eliminated the Board of Higher Education and replaced it with a much smaller, coordinating Commission on Higher Education and a Presidents' Council. The role of the commission was to approve changes to overall mission (e.g., moving from offering masters' degrees to doctoral programs) and new institutions, while the Presidents' Council approved programs. The commission had no regulatory authority over tuition rates. (Effective August 2011, an executive order by Governor Christie eliminated the commission, replacing it with a cabinet-level secretary of higher education. It is too early to determine what effect, if any, this change will have on either finance or governance.)

Finally, New Jersey historically treated independent colleges and universities as essential elements in the higher education system. Although modest in amount, operating aid was historically paid to these institutions, and public capital and equipment programs have included allocations to the institutions. The FY 2011, 2012, and 2013 budgets eliminated the operating aid to these colleges, however. Independent college presidents also rotate as the chair of the Presidents' Council.

Perhaps as an outcome of this history, New Jersey developed a relatively robust student assistance program, becoming what may be called a "high tuition, high aid" state. The Tuition Assistance Grant (TAG) program provides generous assistance to students in both public and independent institutions. Grants were equal to full tuition in many cases, especially for students in the lowest income brackets. More recently, however, the amount of the grant has lagged behind actual tuition increases. The Educational Opportunity Fund (EOF) program supplements both TAG and federal Pell Grants for educationally and economically disadvantaged students, and, equally important, funds on-campus programs to assist students with college life.

New Jersey also has the dubious distinction of sending a large proportion of its high school graduates to colleges outside the state. According to a recent report by the College Board, New Jersey ranked sixth from the bottom of the 50 states and the District of Columbia in the percentage of residents who enrolled for the first time in a college within the state, at only 63 percent. Conversely, the same report indicated that New Jersey does not attract significant numbers of out-of-state residents to its colleges, ranking first in the percentage of students who were from the state where they were enrolled (New Jersey was tied with Michigan and Texas at 92%).[104] The migration of college-bound students is even greater for those attending four-year institutions; nearly 60 percent choose to attend college out of state.[105] This figure has persisted over several decades; only the creation and expansion of the community college system altered the overall outmigration figures by offering the in-state alternative of a two-year program.

State Support for Higher Education

State appropriations provide grants to institutions, which are autonomous entities. The grants or other aid vary according to the sector being supported. The state also provides grants directly to students to offset their tuition and in some cases fees. Finally, the state pays debt service on bonds issued for several capital programs.

Public four-year colleges and universities receive institutional support grants as well as separate grants to cover fringe benefits for an agreed-upon number of state-supported faculty and staff. The public four-year colleges and universities may also receive grants towards salary cost of living and increment adjustments.

Under normal circumstances, tuition and fees at the public four-year institutions are set by the boards of trustees; the legislature rarely imposes direct tuition caps as part of the budget. The Fiscal Year 2011 Appropriations Act did, however, contain language limiting increases in tuition rates and required educational and general fees to 4 percent. The actual mechanism specified was a reduction to an institution's support grant equal to twice the revenue derived by the institution from tuition and/or fee increases in excess of the 4 percent cap.

Community colleges receive aid from the state's 21 counties as well as the state. For FY 2013 state aid to community colleges is $159 million. The 14 "independent institutions with a public purpose," as they are called, are eligible for modest grants and have participated in the capital programs.

The chart below summarizes appropriations for higher education for fiscal years 2007 through 2013.

Table 31 | Appropriations for Higher Education, Original Appropriation, FY 2007-2013

Fiscal Year	$ millions
2007	$2,230.7
2008	$2,296.7
2009	$2,266.1
2010	$2,272.8
2011	$2,221.3
2012	$2,093.0
2013 estimated	$2,236.4
Source: New Jersey Appropriations Acts, various years.	

Concluding Observations: Outlook for State Higher Education Support

It is a commonplace of commentary on state budgeting that higher education is the single largest discretionary component of a state's budget, particularly because an alternative revenue source, tuition and fees, is readily available. New Jersey has been no different from other states that have treated support for higher education as discretionary and balanced their budgets by reducing their support for higher education. Supporting this observation, the $143 million increase in appropriations from FY 2012 to FY 2013 is attributable almost exclusively to fringe benefit and debt service, not operational support. Two recent proposals could, however, create significant demands for additional funding.

In August 2012, legislation was enacted to ask the voters in November to approve $750 million in borrowing to build and renovate campus facilities at the state's public and private colleges. If approved the proceeds would be allocated as follows: $300 million for Rutgers University; $247.5 million split among the remainder of the four-year colleges; $150 million for county colleges; and $52.5 million for private colleges.

Furthermore, renewing existing, legislatively authorized capital programs, a proposal under discussion, would also lead to increased debt service payments by the state. The impetus for both these capital-oriented proposals was the report of a task force chaired by former Governor Thomas Kean which concluded that New Jersey has been underinvesting in higher education, both operationally and with regard to its capital infrastructure.[106]

A second major initiative occurred in August 2012 when the governor signed legislation that will merge most of the University of Medicine and Dentistry of New Jersey into Rutgers University and the School of Osteopathic Medicine into Rowan University — which in fall 2012 opens a new allopathic school of medicine in Camden.[107] Rowan would also replace UMDNJ as the state's third research university. The legislation also establishes a complex structure involving Rutgers and Rowan to coordinate undergraduate, graduate, and professional schools of Rutgers-Camden. No estimates of the costs associated with these mergers have been made available.

Neither of these proposals focuses on demographic changes, in part because New Jersey anticipates only minimal changes over the next several years in the number of high school graduates, the traditional source of demand.[108] More broadly, unless a state is faced with precipitous increases or declines in the college-age population, other policy considerations may be more important than demographics in determining expenditures for higher education. In New Jersey, for example, calls to increase the capacity of New Jersey's public four-year institutions currently reflect a desire to retain more in-state students while at the same time attracting more students from out-of-state, not a response to the numbers of high school graduates in the state. Similarly, workforce retraining efforts may yield expanded demand for postsecondary education, particularly in community colleges.

Impact of Federal Deficit Reductions Actions

New Jersey receives, in addition to the $31.7 billion budget (supported by state revenue), on average approximately $11.8 billion per year from the federal government. Broad categories of federal grants include transportation, Medicaid, public assistance, elementary and secondary education, environmental protection, labor and workforce development, and health care, among others. The largest federal revenue item is for Medicaid totaling approximately $6.4 billion in FY 2012. A summary of the major sources by program area follows:[109]

Table 32 | Federal Aid in New Jersey Budget, FY 2012

Program	$ millions
Medicaid	$6,400
Child Support, Food Stamps, Child Care, etc.	$1,100
Education	$975
Transportation	$918
Labor & Workforce Development	$480
Health	$378
Environmental Protection	$257
All Others	$1,266
Total	$11,774
Source: New Jersey Office of Management and Budget, New Jersey Budget Summary, FY 2013.	

Federalism has been at the core of the nation's political system since the ratification of the Constitution. There have always been tensions between the states and the federal government, and these tensions have manifested themselves in many ways. The relationships that exist today are perhaps best described as fractured. Many states resent rules and many in the federal government fear that without rules, states will enact laws or initiate programs that run counter to the national interest. These tensions will increase as the federal government seeks to lessen its budget deficits.

Though the tensions will affect both state and local governments, the states will be impacted most directly, through federal funding cuts and tax changes. Expenditure reductions are twofold. First, direct grants under both entitlements programs such as Medicaid and discretionary programs such as education assistance, health programs, labor and workforce development, and infrastructure are likely to be reduced. In addition, direct federal expenditures on goods and services to support the federal government's own activities are likely to shrink. Potential changes in federal tax policy also could have negative effects, such as the elimination of deductibility of interest of state and local bonds. And, perhaps most importantly, no substantive dialogue is taking place between the federal government and the states on the effects tax or spending policy changes might have on states. A 10 percent reduction would cost the state $1.2 billion.

The federal government and state groups such as the National Governors Association and the National Conference of State Legislatures need to seek forums for joint modeling, discussion, and planning to insure that there are no unintended consequences on state governments.

Conclusions and Recommendations

Overview

Under provisions of the constitution, New Jersey has always submitted, executed and completed the fiscal year with a balanced budget; and prepared its financial statements in accordance with generally accepted accounting principles (GAAP) — and its' budget is formulated in the same manner. However, while New Jersey meets legal requirements to balance its budget, over much of the last two decades it has accomplished this only by skipping or not fully funding actuarially required pension contributions, and by utilizing nonrecurring resources. The state faces major fiscal threats in years ahead and will have difficult choices if it increases pension contributions to actuarially required amounts. To put the state in a better position to address these choices, the task force offers the following recommendations.

Engaging in Multi-Year Planning and Budgeting

The budget process could be improved significantly by requiring the budget to contain projected future expenditures and revenues over a five year period.

Public projections of long range funding requirements under current law, reflecting projected caseloads and inflation, will make clear during the budget process the longer-run impact of budgetary decisions. For example, during the budget deliberations for the FY 2013 budget both the governor and the legislature proposed reductions in the income tax and the continuation of scheduled reductions in the corporation tax. Long-run projections would have shown clearly that this would create outyear budget gaps: pension contribution increases alone will exceed any reasonable projection of growth in the sales and corporation taxes combined. Additional appropriation increases will be needed for school aid, Medicaid, health benefits for current and retired employees, municipal aid, infrastructure requirements, and a wide variety of other program needs.

Annual budget decisions have consequences for future years, and decision making would be much better informed if all players in the process can see these impacts clearly, measured against a projection of what it would cost to continue current services. A current-services projection is not a funding target, and most likely New Jersey will never have the resources to fund such needs, but a long range projection would be a useful benchmark to guide decision making.

Strengthen and Fund the State's Rainy Day Fund

New Jersey has a "Rainy Day Fund" law and over the years funds have been accumulated and drawn down as needed. Today, the Rainy Day Fund is empty. The last remaining amounts totaling $734 million were used during the recent economic down period, culminating with the FY 2009 budget.

The Rainy Day Fund can receive direct appropriation each year as a specific budgetary decision. Generally, however, funds have been credited if revenues exceed original projections: the law requires one-half of the overage to be deposited into the Rainy Day Fund. However, in the last two years the governor and legislature have included language which eliminated this provision so that no revenue overage could be applied to the Rainy Day Fund, but instead was credited to general surplus.

It is important that New Jersey accumulate reserves in the Rainy Day Fund not only by the overage method, but also through an annual appropriation to the fund. One thing is certain — the normal business cycle will always exist. Sometimes the business cycle will result in positive revenue growth and other times revenues will decrease or increase only marginally. A healthy Rainy Day Fund will help the state address the most critical or unexpected needs without perhaps requiring unfortunate and untimely program reductions or taxes increases.

Include Federal Funds and Dedicated Revenues as Part of the Formal Budget Recommendation

When New Jersey displays its appropriations and revenues as part of its Annual Budget it does not include federal funds or certain dedicated revenues. These revenue sources and related appropriations amount to approximately $16 billion a year. These dollars are included in tables in the Budget document and are part of the displays and descriptions of each department's budgetary resources and presentations — yet, the overall budget numbers that are viewed by the public do not include such numbers. In FY 2013, for example, the budget is displayed as spending $31.7 billion — yet actually the total expended on state programs is closer to $48 billion.

This is a historical and long standing practice of the State — but a practice that is not followed by most other states. The state has always viewed these revenues and expenditures as "dedicated" or 'off-budget.' But, from an overall budget planning and execution point of view they are integral to overall decision-making. This practice is not rooted because of any desire to hide funds. In fact, all dollars are displayed in the budget document, and in the last two years the Governor has made a special point of displaying these dollars and other special funds in a table in the "Citizens Guide to the Budget." Furthermore, the annual audit and the State's Comprehensive Annual Financial Report include these funds as part of the general fund audit. The state should take the next step and include all federal and dedicated funds as part of the total General Fund Budget as presented to the Legislature — among other benefits it would add to transparency.

Strengthen Capital Planning and Develop an Infrastructure Funding Strategy

The state has a formal and quite detailed capital planning process with oversight provided by a statutory Capital Planning Commission. As a matter of practice the seven year plan, and especially the first year, only contains projects that can reasonably be expected to be funded. The long term infrastructure needs of the state, however, are not entirely reflected in the seven year capital plan. Instead a myriad of other documents need to be searched and reviewed. This process could be significantly improved by having all of the capital needs of the state displayed and reported in the capital plan.

The state should use the commission and the plan to capture and report on infrastructure needs of the state over a ten to twenty year time frame. To a large extent the future infrastructure needs of the state are now recorded in various and disparate documents required by the federal government for transportation and environmental needs. Including them in one document would enable the state to more easily and effectively evaluate its long term infrastructure needs — a need that is growing in terms of projects and costs.

Review the State and Local Government Tax and Spending Structure

Given the long range fiscal challenges facing the state and its local governments, and numerous incremental changes to the tax code, New Jersey should review the entire tax system and review more comprehensively future spending needs. The overlapping and multiple local jurisdictions in the state lead to inefficient allocation of scarce resources and a comprehensive study should examine the interactive role between state government and its local jurisdictions.

Most experts in state and local finance conclude that statewide revenue systems are antiquated relics that are volatile and eroding. New Jersey is no different than the norm. The bases for taxes no longer reflect fully economic activity in the state. With reduced resources, the annual battle over which programs have priority and which taxes should be reduced, or increased, or somehow altered is intensifying.

Furthermore, other trends in the tax systems have not been fully evaluated. For example, as sales move to the internet, sales tax, property taxes, and corporate and payroll taxes are lost as physical stores go out of business in favor of entities that conduct business on the internet. Furthermore, the long term effects of tax-free or tax-reduced business attraction programs are unclear, and, as part of an overall tax system evaluation, merit consideration.

The last time New Jersey undertook a detailed commission-driven review of spending and revenue structures was 1987 when Governor Kean appointed the State and Local Spending and Revenue Commission to review state and local spending and tax policy. New Jersey would benefit from a gubernatorial appointed citizen-commission to review the entire state and local tax and spending structure.

Provide the Necessary Funding for the Pension Systems

New Jersey's pension system is significantly underfunded because of investment shortfalls and failure to contribute actuarially required amounts. Over the last seven years the contribution shortfall totaled approximately $17 billion. But unlike many states, New Jersey has taken appropriate steps to correct the situation if it can stay on the course it has set for itself.

The governor and the legislature enacted laws in 2011 to freeze COLAs for retirees and require an increase in employee contributions. As a result the state's unfunded liability was reduced by 30percent from $37 billion to $25 billion and the funded ratio increased to 62.2 percent from 56.4 percent.

New Jersey also established a process to increase contributions to actuarially required amounts over a seven year period. The first two years have been funded, but funding requirements will increase substantially over the next five years. This will force the state to make difficult choices about spending priorities and taxes.

Monitor and Control the Costs of Retirement Health Benefits

New Jersey, as almost every state in the nation, has not reserved any money for retirement health benefits promised to its current and former workers. All benefits are structured on a pay-as-you-go basis. We estimate that these costs will approach $1.7 billion over the next five years — an increase of approximately $600 million.

Ideally, the state should begin to set aside funds for benefits it intends to continue. If that is not practical it must monitor these costs carefully, and consider ways to reduce their costs and perhaps shift more costs to the retiree.

Endnotes

1 All information contained in this section is derived from the "FY 2011 Comprehensive Annual Financial Report (CAFR) of the State of New Jersey," pp. 47-51; and the Official Statement for the issuance of "New Jersey Tax and Revenue Anticipation Notes," December 6, 2011, pp. I 4-10; and New Jersey Statutes: N.J.S.A.52:27B-10, et seq.; and FY 2013 New Jersey Budget Summary, February 12, 2012, Trenton, NJ.

2 See various New Jersey Appropriations Acts for applicable fiscal years; and various "Budget Summary" documents published by the New Jersey Office of Management and Budget, Trenton, NJ.

3 See "Forecast of April, 2012," from report entitled "New Jersey: The Recovery is Underway," Rutgers Economic Advisory Service, Bloustein School of Planning and Public Policy, Rutgers University (New Brunswick, NJ, April 2012).

4 As quoted in the report entitled "Tax and Revenue Outlook for FY 2012," New Jersey Office of Legislative Services, (Trenton, NJ, March 2011).

5 See State of New Jersey, FY 2013 Appropriations Act (Trenton, NJ, June 29, 2012).

6 As reported in "New Jersey: The Recovery is Underway," op. cit. and updated information.

7 See News Release, New Jersey Department of Labor and Workforce Development, Trenton, NJ, July 19, 2012, and updated information.

8 As reported in "Forecast of July, 2012," from report entitled "New Jersey: The Recovery Sputters Along," Rutgers Economic Advisory Service, Bloustein School of Planning and Public Policy, Rutgers University (New Brunswick, NJ, July 2012).

9 See article entitled "New Jersey Trailing U.S. Growth, But Recent Gains is Encouraging, Say Economist," http://njbiz.com/article/20120731/njbiz01/120739965/-1/enews_dailT2.

10 All revenue data are from information in the New Jersey FY 2013 Appropriations Act (Trenton, NJ, June 29, 2012).

11 See Preliminary Official Statement of the State of NJ, dated September 12, 2012, page I-16 (Trenton, NJ).

12 Ibid.

13 David Rosen, New Jersey Legislative Budget and Finance Officer, Testimony before Assembly Budget Committees (Trenton, NJ, May 23, 2012).

14 See report issued by the Council of New Jersey Grantmakers, "Facing Our Future" (Trenton, NJ, February 2012).

15 All information and data describing the scope of the federal Medicaid program obtained from material issued by and available on the web sites of the U.S. Department of Health and Human Services, and the Center for Medicare and Medicaid Services at www.cms.gov.

16 General description and information concerning the New Jersey Medicaid program was taken from the web site of the New Jersey Department of Human Services and the Division of Medical Assistance and Health Services at http://www.state.nj.us/humanservices.us and http://www.state.nj.us/humanservices/dmahs/home.

17 See New Jersey State Appropriation Act for FY 2013, op. cit.

18 As reported in an interview with Beth Fitzgerald, Spotlight New Jersey, December 11, 2011, www.njspotlight.com.

19 Statistics related to New Jersey and its comparison to other states can be found on the Kaiser web site at http://www.statehealthfacts.org/profileind.

20 All six charts obtained from Kaiser's Health Care Fact web site — specific references are listed after each chart.

21 For a complete discussion of the contents of the state's Medicaid waiver see web site of the New Jersey Division of Medical Assistance and Health Services at http://state.nj.us/humanservices/dmahs/waiver. See also testimony of New Jersey Commissioner of Human Services before New Jersey Assembly Budget Committee (Trenton, NJ, May 2011).

22 Data provided in reports from the New Jersey Division of Medical Assistance and Health Services as filed with the CMS.

23 Information obtained from various reports describing the contents and impact of the U.S. Supreme Court decision, including Kaiser Health News reports, at www.kaiserhealthnews.org

24 Dylan Scott, "Medicaid Directors Question CMS on Supreme Court Decision," *Governing Magazine*, www.governing.com (Washington, DC, July 9, 2012).

25 Joel Cantor, Dorothy Gaboda, Jose Nova, and Kristen Lloyd, "Health Insurance Status in New Jersey After Implementation of the Affordable Care Act," Rutgers Center for Health Policy (New Brunswick, NJ, August 2011). See Executive Summary.

26 Ibid.

27 "How Much Would Medicaid Expansion Cost Your State?" *New York Times*, July 7, 2012, and based on data from Kaiser. htpp://economix.blogs.nytimes.com/2012/07/02.

28 "Health Insurance Status after Implementation of Affordable Care Act," op. cit.

29 "Hospitals Worry Over Cut in Fund For Uninsured," *New York Times*, July 27, 2012.

30 For a more detailed discussion of this issue see "Medicaid — Financed Services in Supportive Housing for High-Need Homeless Beneficiaries: The Business Case," Michael Nardone, Richard Cho and Cathy Moses, Center for Health Care Strategies, Hamilton, NJ, June, 2012.

31 Joel Cantor, "The Hidden Driver of Health Care," New Jersey Spotlight, www.njspotlight.com, June 20, 2012.

32 Informational copies of these evaluations are available on the web site of the New Jersey Pension Division and Health Benefits at http://www.state.nj.us/treasury/pensions/financial-rprts-home.htm.

33 See "The Report of the Benefits Review Task Force," submitted to Acting Governor Richard Cody. Philip Murphy, Chairman (Trenton, NJ, December 1, 2005); and "Public Employee Benefit Reform Hearings." Report of the Special Session of the Joint Legislative Committee of the New Jersey Legislature (Trenton, NJ, November 15, 2006).

34 Ibid. The above two reports provide a description of most of the proposals described in this section. In addition, see section entitled "Notes to the Financial Statements" for the Division of Pension and Health Benefits for Fiscal Years 2004 through FY 2010; and specific laws, especially Ch1, P.L. 2010, Chapter 89, P.L. 2008, Chapter 103, P.L. 2007, Chapter 92, P.L. 2007.

35 Information obtained from "Briefing Charts and Information," released on October 14, 2010, by the New Jersey Department of Treasury, Trenton, NJ.

36 Details concerning the funding for post-retirement Medical benefit, including the Aon Consultants report, can be found in the Annual Report of the Division of Pension and Benefits (Trenton, NJ) and the specific charts in the Official Statement of the State of New Jersey for the issuance of "Tax and Revenue Anticipation Notes," op. cit., pp. I-65,66.

37 New Jersey State Treasurer, "A New Era in Public Pensions & Benefits" (presented at conference held at Rutgers University, Newark, NJ, September 30, 2011.)

38 For a full discussion of the bond financing of pension systems, see Judith Cambia, "Take the Money and Run: How Fiscal Policy from the 90s to Now Threatened New Jersey's Future," New Jersey Policy Perspective, Trenton, NJ, August 1, 2001. For the related information concerning projected debt service and bonds, actual and projected, see New Jersey Debt Report for FY 2011, issued by the Office of Public Finance, State of New Jersey (Trenton, NJ, December 2, 2011) p. 46.

39 Grateful acknowledgment is given to Richard Kaluzny, PhD, former director of revenue and economic analysis, Division of Taxation, NJ Department of Treasury, who contributed to this section of the report, including developing and analyzing all of the detailed research tables (see also further footnote).

40 All revenue and tax information has come from the Annual Financial Statements (CAFR) of the State of New Jersey, op. cit.

41 Information and data related to all aspects of the Income tax can be found in the Annual Report(s) of the Division of Taxation, State of New Jersey, Trenton, NJ.

42 Ibid.

43 See FY 2011 New Jersey Comprehensive Annual Financial Report (CAFR) prepared by New Jersey Office of Management and Budget, Trenton, NJ, op. cit., p. 320.

44 All data and information related to tables and charts come from the Annual Reports(s) of the Division of Taxation. Calculations by Richard Kaluzny, PhD, former director of revenue and economic analysis, Division of Taxation, New Jersey Department of Treasury.

45 For a deeper discussion on both sides of the argument, see the following reports: Douglas Massey, PhD, et al., “Trends in New Jersey Migration: Housing, Employment and Taxation,” Princeton University (Princeton, NJ, October 2007); Roger Cohen, Andrew Lai, and Charles Steindel, “The Effects of Marginal Tax Rates and Interstate Migration in the U.S.,” Office of the Chief Economist/Office of Revenue and Economic Analysis, New Jersey Department of Treasury (Trenton, NJ, October 2011); Roger Cohen, Andrew Lai, and Charles Steindel, “Tax Flight Has Tangible Effects on Income Tax Revenue,” State Tax News, Office of the Chief Economist & Office of Revenue and Tax Analysis, New Jersey Department of Treasury (Trenton, NJ, February 2012); and Charles Varner and Cristobel Young, “Millionaire Migration and State Taxation of Top Earners,” *National Tax Journal*, 64 (2), 2011, pp. 255-284.

46 Description of the sales tax can be found in the Annual Report of the Division of Taxation, op. cit.

47 “A Report on Tax Expenditures in New Jersey.” New Jersey Division of Taxation, Department of Treasury (Trenton, NJ, February 21, 2012), p. 10.

48 For a discussion on New Jersey local government structure, and the source of many observations made in this section, see Ernest Reock, Jr., Alma Joseph, and Michele Collins, “New Jersey,” in *Home Rule in America* (Washington, DC: CQ Press, 2001).

49 For allocation of property tax by level of government, see Abstract of County Ratables for 2011, New Jersey Division of Local Government Services, New Jersey Department of Community Affairs, Trenton, NJ.

50 See P.L. 2010, c.44; and N.J.S.A. 40A:4-45.5 for description of the 2% cap law.

51 See FY 2013 State appropriations Act, op. cit.

52 See N.J.S.A. 52:13 H for the statutory provisions covering the law and its provisions.

53 For details related to the finance powers and responsibilities of the Division of Local Government Service and the Local Finance Board concerning local budget law, local fiscal affairs law, local bond law, and local public contract see the following citations: N.J.S.A. 40A:2-3; N.J.S.A.40A:4;N.J.S.A. 40A:5a; N.J.S.A 40A:11 and the web site of the Division of Local Government Services, www.nj.gov/dca/lgs.

54 See web site of the Division of Local Government Services for discussion of use of questionnaire and best practices, www.nj.gov/dca/lgs.

55 For a more detailed discussion of Transitional Aid program and other state aid programs of the Department of Community Affairs provided to local government, see web site: www.NJ.gov/dca/lgs.

56 See www.nj.gov/comptroller for a discussion of powers of the New Jersey State Comptroller.

57 Examples of nonrecurring actions and gimmicks based on the author’s knowledge and experience as New Jersey Budget director and comptroller.

58 Data excerpted from “2011 State Debt Medians Report, Moody’s Investors Service” (New York, June 2011).

59 See New Jersey Constitution, particularly Section II, Article VIII.

60 All data, including definitions, in this section can be found in: “State of New Jersey Debt Report for FY 2011,” issued by the New Jersey Office of Public Finance, Department of Treasury (Trenton, NJ, December 2, 2011); and FY 2011 Comprehensive Annual Financial Report, Note 10 — Long Term Obligations, issued by Office of Management and Budget, Trenton, NJ, as of June 30, 2011, op. cit.

61 Ibid.

62 Information researched and obtained from records at the offices of New Jersey Office of Management and Budget. Trenton, NJ.

63 See *Honorable Leonard Lance, et al. v. Honorable James E. McGreevey, etc.* as reported in the Syllabus of the New Jersey Supreme Court, argued July 22-26, 2004.

64 Grateful acknowledgment is given to Mr. James Houston, a former senior executive in the NJ Office of Management and Budget and the NJ Department of Health who did the majority of the research related to this section and helped with the writing and structure of this section.

65 See Congressional Budget Office, “Public Spending on Transportation and Water Infrastructure” (Washington, DC, November 2010).

66 See “2009 Report Card for America’s Infrastructure.” American Society of Civil Engineers, March 25, 2009.

67 See “Drinking Water Infrastructure Needs Survey and Assessment 2007: Fourth Report to Congress,” U.S. Environmental Protection Agency; and “Clean Watersheds Needs Survey 2008: Report to Congress.” Environmental Protection Agency, Washington, DC, 2008.

68 “Cost of Rehabilitating Our Nation’s Dams: A Methodology, Estimate and Proposed Funding Mechanism,” Association of State Dam Officials (Lexington, KY, January 2009).

69 See discussion in FY 2011 New Jersey Comprehensive Annual Financial report, Note 1 G (5) — Capital Assets and a detailed listing obtained from records maintained by the Financial Statement Section, New Jersey Office of Management and Budget, Trenton, NJ, op. cit.

70 Bureau of Transportation Data Development, Roadway Systems Section, New Jersey Department of Transportation, Trenton, NJ. See also http://www.state.nj.us/transportation/refdata/roadway/pdf/hpms2010/njprmbj_10.pdf.

71 New Jersey Department of Transportation, “2012-2021 Statewide Capital Investment Strategy” (Trenton, NJ, March 24, 2011), p. 6.

72 New Jersey Department of Transportation, New Jersey’s Long Range Transportation Plan (Trenton, NJ, October 2008), p. 28.

73 Information from “State Budget Crisis Task Force Report” and their analysis of data from U.S. Bureau of the Census (highway mileage); Bureau of Transportation Statistics (road conditions); Federal Highway Administration (bridge conditions).

74 New Jersey Department of Transportation, “2012-2021 Statewide Capital Investment Strategy,” op. cit., p. 2.

75 U.S. Environmental Protection Agency, “Clean Watersheds Need Survey 2008 Report to Congress,” op. cit, p. viii.

76 New Jersey Section, American Society of Civil Engineers, “2007 Report Card for New Jersey’s Infrastructure,” page not numbered.

77 U.S. Environmental Protection Agency, “Clean Waters Needs Survey 2008 Report to Congress,” op. cit., p. B-2.

78 New Jersey section, American Society of Civil Engineers, op. cit.

79 U.S. Environmental Protection Agency, “Clean Watersheds Needs Survey 2008 Report to Congress,” op. cit., pp. B-2, B-4.

80 New Jersey Section, American Society of Engineers, op. cit.

81 U.S. Environmental Protection Agency, “Drinking Water Infrastructure Needs Survey Assessment, Fourth Report to Congress,” op. cit., February 2009, p. 8.

82 New Jersey Section, American Society of Civil Engineers, op. cit.

83 Congressional Budget Office. ”Trends in Public Spending of Transportation and Water Infrastructure, 1956 to 2004 (Washington, DC, August 2007).

84 U.S. Conference of Mayors, “Who Pays for the Water Pipes, Pumps, and Treatment Works? — Local Government Expenditures on Sewer and Water - 1991-2005” (Washington, DC, 2007).

85 See Recovery Act Spending, Breakdown of Funds Paid Out at www.recovery.gov.

86 For further discussion see the following two reports: U.S. Government Accountability Office, “Highway Trust Fund: Nearly All States Received More Funding Than They Contributed in Highway Taxes Since 2005, www.gao/assets/590/589908.pdf (Washington, DC, June 2010); and Congressional Budget Office, “The Budget and Economic Outlook: Fiscal Years 2012-2022, (Washington, DC, January 2012).

87 Grateful acknowledgment is given to Robert K. Goertz, PhD, former senior executive in the NJ Office of Management of Budget and the NJ Department of Education, who was the principal author of this section of the report.

88 Article VIII, §IV, ¶1 of the New Jersey Constitution states: “The Legislature shall provide for the maintenance and support of a thorough and efficient system of free public schools for the instruction of all the children in the State between the ages of five and eighteen years.” This requirement first appeared in the constitution of 1875.

89 The Education Law Center of New Jersey, attorneys for the plaintiffs in the suit, has an excellent summary of the litigation as well as copies of the court decisions on its web site: http://www.edlawcenter.org/cases/abbott-v-burke/abbott-history.html.

90 There are now 31 such districts. Together, they educate approximately 20% of the state’s school population and half of the students of color.

91 New Jersey relies primarily on local property taxes and a statewide income tax to fund elementary and secondary education. Roughly 55% of revenues come from property taxes and 42% from state revenues, with the remainder coming primarily from federal funds. These percentages have been relatively consistent over time.

92 *Abbott v. Burke XX*, 199 N.J. 140 (2009), decided May 28, 2009. This and all other Abbott decisions are available on the Education Law Center's web site.

93 *Abbott v. Burke XXI,* M-1293-09, decided.

94 See Governor Christie's message in signing the FY 2012 Appropriations Act, available in the *Fiscal Year 2011-2012 Citizens' Guide to the Budget* (Trenton, NJ: Office of Management and Budget, October 2011), available at http://www.state.nj.us/treasury/omb/.

95 U.S. Department of Education, National Center for Education Statistics, Common Core of Data (CCD), "National Public Education Financial Survey (State Fiscal)," 2008-09 (FY 2009), v.1a.

96 These figures differ from other published data for two reasons. First, enrollment numbers are those reported by districts effective October 15 of each year (or the nearest date if October 15 falls on a weekend or holiday). This count is used to calculate state aid and is published in the annual budget. Second, per pupil spending is calculated using state expenditures and district budgets, not actual audited expenditures. While not strictly comparable to the measures used in reporting to NCES, using these measures does, however, permit current estimates to be included in this report. The FY 2013 Budget did not publish the October 15 count and so figures are not included in the table.

97 See "Property Taxes on Owner-Occupied Housing, by State 2009," Tax Foundation calculations of U.S. Census Bureau data, http://taxes.about.com/gi/o.htm?zi=1/XJ&zTi=1&sdn=taxes&cdn=money&tm=8&f=00&su=p284.13.342.ip_p504.6.342.ip_&tt=2&bt=1&bts=0&zu=http%3A//www.taxfoundation.org/taxdata/show/1913.html.

98 *Abbott v. Burke V,* 153 N.J. 480, decided May 21, 1998. The mandate that the state provide 100% of eligible costs was confirmed in *Abbott v. Burke VII,* 164 N.J. 84, decided May 25, 2000. In 2005, the Court intervened again as it became clear that funding had been exhausted; see *Abbott v. Burke XIV,* 185 N.J. 612, decided December 19, 2005.

99 National Center for Education Statistics, "Projections of Education Statistics to 2020." Tables 6, 8, and 10 (Washington, DC, September 21, 2012).

100 The governor's press release can be found at: http://www.state.nj.us/governor/news/news/552012/approved/20120223a.html. "Education Funding Report," Trenton, NJ: New Jersey Department of Education, February 23, 2012, obtained at: http://www.nj.gov/education/stateaid/1213/report.pdf.

101 Noted on the home page as of July 28, 2012, www.njsba.org.

102 Source: Integrated Postsecondary Education Data System (IPEDS) Institutional Characteristics Survey, Fall 2011, as reported on the New Jersey Higher Education web site: http://www.state.nj.us/highereducation/statistics/Enr2011Preliminary.htm.

103 *New Jersey State College/University Trustees' Reference Guide (Sixth Edition),* Trenton, NJ, New Jersey Association of State Colleges and Universities, 2006, p. 5.

104 http://trends.collegeboard.org/college_pricing/report_findings/indicator/907 Data are for fall 2008 enrollments.

105 See, for example, Alyssa R. McCloud, "Migration Patterns of College Students in New Jersey: A Synthesis of the Data and Literature." Dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, Seton Hall University, 2009.

106 See "N.J. voters to decide whether to approve $750M in higher education borrowing," www.NJ.com, August 9, 2012, and "The Report of the Governor's Task Force on Higher Education," Trenton, NJ, December 1, 2011, available at: nj.gov/highereducation/PDFs/KeanReport_high_edu.pdf.

107 See "N.J. lawmakers pass bill for Rutgers-Rowan-UMDNJ merger," www.NJ.com, June 28, 2012, and "The University of Medicine and Dentistry of New Jersey Advisory Committee, Final Report," Trenton, NJ, January 25, 2012, available at http://www.scribd.com/doc/79361689/UMDNJ-Advisory-Committee-Final-Report.

108 For New Jersey, the National Center for Education Statistics projects that there will be between 92,000 and 94,000 high school graduates each year between now and 2020-21. See Tables 14 and 15 in W.J. Hussar and T.M. Bailey, *Projections of Education Statistics to 2020 — Thirty-ninth Edition* (NCES 2011-026). U.S. Department of Education, National Center for Education Statistics. Washington, DC: U.S. Government Printing Office.

109 See Federal Revenue section of "New Jersey Budget Summary for FY 2013," February 21, 2012, p. 134, et seq.

ACKNOWLEDGEMENTS

Advisory Board

Chairs

Richard Ravitch

Paul A. Volcker

Members

Nicholas F. Brady

Joseph A. Califano, Jr.

Philip L. Clay

David Crane

Peter Goldmark

Richard P. Nathan

Alice M. Rivlin

Marc V. Shaw

George P. Shultz

Task Force

Donald Boyd
Executive Director

G. Edward DeSeve

Suzanne Garment
Counsel

Peter Kiernan

Donald Kummerfeld

Carol O'Cleireacain

Haley E. Rubinson

Jonathan Cavalieri

Lucy Dadayan

Pat Fuchs

Lisa Montiel

Nicole Wiktor

Funders

The work of the Task Force was made possible form a number of generous funders. We would like to thank all of them for their support –those listed alphabetically below as well as those wishing to remain anonymous.

The Community Foundation of New Jersey

The Ewing Marion Kauffman Foundation

The Fund for New Jersey

The Geraldine R. Dodge Foundation

The John D. and Catherine T. MacArthur Foundation

The Nathan Cummings Foundation

The Open Society Foundations

The Peter G. Peterson Foundation

The Robert Wood Johnson Foundation

We appreciate the financial support from the funders and the research and analysis prepared by State Partners. All conclusions and opinions expressed within are the responsibility of the Task Force.

State Partners

California

California Forward

James P. Mayer

Fred Silva

Illinois

The Institute of Government and Public Affairs at the University of Illinois

David F. Merriman

Richard F. Dye

Andrew Crosby

Nancy W. Hudspeth

Martin Luby

New Jersey

Richard F. Keevey

New York

The Nelson A. Rockefeller Institute of Government

Robert Ward

Brian Stenson

Texas

Billy Hamilton

Vicki Anderson

Virginia

The Center on the Public Service of George Mason University's Department of Public and International Affairs

Paul Posner

Frank Shafroth

Jim Regimbal

Darrene L. Hackler

State Budget
Crisis Task Force

www.statebudgetcrisis.org