NJPP recently marked the 15th anniversary of a comprehensive report by the State and Local Expenditure and Policy Commission. It was a report that could have changed the face of New Jersey for the better through fundamental reforms in how the state raises and spends money.

The following report was prepared by Henry A. Coleman, Director of the Center for Government Services at Rutgers and a member of the NJPP Board of Trustees.

Reflections on the New Jersey State and Local Expenditure and Revenue Policy Commission
By Henry A. Coleman
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The Final Report of the New Jersey State and Local Expenditure and Revenue Policy (SLERP) Commission was issued 15 years ago this summer. The SLERP Commission was the state's most recent effort at a comprehensive review and analysis of its fiscal system-including state and local governments-and spending and revenues. This large-scale undertaking was deemed necessary because of the recognition that state and local levels of government really are parts of the same system, and that spending and revenue-raising decisions are not made in a vacuum. Thus, the mandate of the SLERP Commission, rather than getting caught up in historical and political distinctions lacking in real value, reflected the interconnections and interdependencies that characterize the real world.

This anniversary brings to mind several questions that may be of interest to policymakers, taxpayers, and anyone concerned about reforming New Jersey's fiscal system. They include:

Why was the SLERP Commission established?

What were the major policy recommendations that emerged from the commission?

How many of the commission's reforms were ever implemented?

How have the fiscal problems/conditions that inspired the SLERP Commission changed over the last 15 years?

Would the SLERP Commission reforms be appropriate in addressing current fiscal ills in New Jersey?

I think that there were both general and specific factors that led to creation of the SLERP Commission. General factors included the tax revolt that started in the mid-1970s, gained visibility with Proposition 13 in California and Proposition 2 ½ in Massachusetts, and then seemed to threaten almost all other parts of the country. Similarly, the early part of the decade of the 1980s was characterized by a relatively short but painful recession, which
forced spending reductions and tax increases in many states, including New Jersey. Finally, federal government retrenchment, especially in the form of reduced federal grants-in-aid to states and growing state spending responsibilities for joint federal-state programs such as Medicaid and Aid to Families with Dependent Children (AFDC), were contributing factors.

More specific concerns included pending court decisions on the constitutionality of the state's school funding system (the Abbott decision), and growing concerns about state-mandated local expenditures and the irrational assignment of spending responsibility for services (such as local financial responsibility for the state's trial court system, the office of the prosecutors, public assistance and mental facilities).

Perhaps most important was the growing concern throughout the state about the rising level of property tax burdens, and the troubling fiscal disparities (i.e., the difference between revenues available and spending needs) between the state and its localities, and among local units. In particular, the state's urban communities and school districts were characterized by greater spending needs, poorer service quality and higher tax rates relative to their suburban counterparts. Moreover, the distribution of tax burdens relative to household ability to pay (i.e., basing a tax on home value rather than income) was also a source of growing concern.

To many readers of this narrative, these conditions that gave rise to the SLERP Commission will seem like a description of current-day circumstances, or as Yogi Berra would say, "déjà vu all over again." Today, the federal government is requiring states to assume greater responsibility in providing healthcare services, public assistance and homeland security, while financial assistance from the federal government has been stagnant or declining relative to these devolved responsibilities. This situation is exacerbated by the economic recession that has increased spending pressures and reduced revenue flows to the state. All the while, property tax burdens continue to grow, fiscal disparities among local jurisdictions appear to widen and the tax burdens endured by low and moderate-income households continue to add to their suffering.

What major policy recommendations emerged from the commission?

The SLERP Commission made recommendations for reform in three areas:

- Spending
- Revenue raising
- Future fiscal safeguards

Critics of the SLERP Commission have often claimed that the commission was not balanced in its approach, in that it did not propose significant spending reforms. I think that these critics actually mean that the commission did not propose significant spending reductions. Indeed, the SLERP Commission proposed significant changes in several areas of state and local spending, primarily relating to reassignment of service responsibilities between the state and local levels of government, and to the transfer of resources (i.e., state aid) from the state to various types of local units. The spending reforms were targeted to each major type of local jurisdiction (municipalities, counties and school districts), and designed to provide approximately equal amounts of assistance.
Education finance reforms dealt primarily with improving the functioning of the then-current school financing system (so-called Chapter 212) by moving to current-year funding for equalization and debt service aid, requiring adequate spending to meet educational standards, linking compensatory aid to the number of elements for which a student proved deficient and providing financial encouragement for full-day kindergarten and one year of pre-kindergarten.

Reforms targeted at county government were primarily designed to change the system under which most county spending was for providing state services (or at least services for which the eligibility and level of service provided were determined by the state and not the county). The commission recommended that the costs of operating the state's trial court system and the Office of the County Prosecutor be assumed by the state. Similarly, the commission recommended that the state take over the costs of providing benefits under both the AFDC and General Assistance programs. The commission proposed that the state should assume the costs for the various institutions for the mentally ill and the developmentally disabled. Finally, the commission suggested that the state should fulfill its pledge to provide significant support for the state's county college system. In each of these situations, the commission held that state government had the decisive role in determining spending levels, and was simply requiring counties to raise and spend money in support of those state decisions.

Finally, in recognition of the significant and growing fiscal disparities among municipalities, the SLERP Commission recommended creating a program that would reduce the effects of wealth disparities among municipalities, while preserving their local decision-making discretion.

The revenue reforms were designed with an eye toward improving the fairness of the state's tax system, maintaining New Jersey's overall competitiveness and improving the ability of the system to respond to changing market conditions. Most of these changes would result from a series of proposed base-broadening steps.

The state's Sales and Use Tax would be extended to several non-taxed consumption items (such as disposable paper products, cable television and alcoholic beverages consumed on premises), and/or to items that were subject to taxation by excise taxes but not the general sales tax (cigarettes and other tobacco products).

Base broadening under the state's Gross Income Tax consisted primarily of eliminating poorly targeted and redundant property tax relief measures and exemptions. As alternatives, the commission proposed both a comprehensive, targeted property tax relief circuit breaker (which would replace the aforementioned "system" of property tax relief mechanisms) and a Consumption Tax Offset aimed at reducing inequities resulting from reliance on regressive general and selective excise sales taxes.

The "safeguards" proposed by the SLERP Commission related to budgeting processes and procedures, and were designed to ensure that the balance, fairness, responsiveness and discipline brought about by the spending and revenue reforms would not be abated over time.
How many of the commission's reforms were ever implemented?

Overall, the SLERP Commission proposed 111 reforms as a part if its comprehensive approach to fiscal reform. State Sen. Matthew Feldman, a SLERP Commission member, introduced legislation to implement all 111 of the commission's reforms, and estimates are that at most half of the reforms were enacted at one time or in one form or another.

For example, the state has assumed over time financial responsibility for its trial court system as proposed by the SLERP Commission. Similarly, although the nation's public assistance program has undergone significant changes over the last decade, the financial role for state government in New Jersey had increased significantly prior to the federal reforms, as recommended by the SLERP Commission. The SLERP Commission proposed that state government play a larger role in financing mental institutions, and that state government pay for mandated expenditures imposed on local governments ("state-mandate, state-pay"). Finally, the SLERP Commission called for consolidating many of the individual state aid programs for municipalities and distributing the assistance based on local needs and resources. In creating Consolidated Municipal Property Tax Relief Aid, the state accomplished only a small part of what was proposed by the commission.

Of course, many of the other reforms proposed by the SLERP Commission were never enacted, including the state takeover of the costs of running the office of the prosecutor, a larger state role in financing county colleges and a means-tested circuit breaker to replace the array of uncoordinated individual property tax relief programs currently in existence. Of the laws enacted to reflect the reforms proposed by the SLERP Commission, some were ultimately repealed, such as the law extending the state's Sales and Use Tax to disposable paper products. More importantly, the commission's caution that a comprehensive approach (reflecting all of the recommendations that it had proposed) would be necessary if true reform of the current system was to result was never heeded.

How have the fiscal conditions that inspired the SLERP Commission changed over the last 15 years?

The SLERP Commission began its work in the fall of 1985, and issued its Final Report in July 1988. The total state budget was under $8 billion at the start of the commission's activities, and it had grown to $10.4 billion by the time the final report was released. Of course, the Fiscal Year 2004 state budget totals $24 billion.

While much has changed about state and local finances in New Jersey in the years since the SLERP Commission report was issued, the property tax remains the dominant revenue source in the state.

As the table below shows, in 1985, the three largest state taxes-Gross Income Tax, the General Sales and Use Tax and Corporation Business /Banking and Financial Corporations Tax-toted less than the property tax levy for the state.

By 1988, the gap had widened. And in 2002, the total yield for the property tax continued to surpass the combined totals for the GIT, the SUT and the CBT.
<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Income Tax</th>
<th>Sales &amp; Use Tax</th>
<th>Corp. Business Tax</th>
<th>Property Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>$1.94 bil.</td>
<td>$2.26 bil.</td>
<td>$1.03 bil.</td>
<td>$5.58 bil.</td>
</tr>
<tr>
<td>1988</td>
<td>$2.56 bil.</td>
<td>$3.04 bil.</td>
<td>$1.32 bil.</td>
<td>$7.76 bil.</td>
</tr>
<tr>
<td>2002</td>
<td>$6.84 bil.</td>
<td>$5.99 bil.</td>
<td>$1.88 bil.</td>
<td>$16 bil.</td>
</tr>
</tbody>
</table>

Source: New Jersey Legislative Manual (various years), Skinder-Strauss Associates.

If the SLERP Commission's major reforms had been implemented in 1988, property taxes would have been reduced by about $1.2 billion, with personal income and general sales taxes increasing by almost $450 million each. In total, the three major state revenue sources would have combined to exceed property taxes by about $1.75 billion. This would have taken place with no change in the total amount of state and local taxes collected because the reforms were revenue neutral.

In many respects, it is unfortunate that the State of New Jersey has not moved faster and more forcefully to address some of the fiscal concerns confronting the state over the last 15 years. Much of the 15-year period since the SLERP Commission report was released has been characterized by significant growth and prosperity for the state. Such prosperity, especially at the state level, would likely have provided the resources necessary to finance many of the proposed reforms (such as state assumption of current local responsibilities and increased state aid to local jurisdictions and individuals for property tax relief), without the need to increase extant taxes or impose new taxes. More importantly, steps taken during a more prosperous period would have lessened the likelihood of fiscal reforms being viewed as a back-door attempt to increase taxes or the overall size of the state and local government sector.

However, recent years have seen the state's fiscal fortunes take a dramatic turn back to the pre-SLERP Commission days. For example, the state budget has experienced deficits of $3 billion and $6 billion for Fiscal Years 2003 and 2004, respectively, with the Fiscal Year 2005 outlook of a $4 billion deficit looming. While some of this shortfall surely represents a cyclical decline, there is a general consensus that the state is experiencing a significant structural deficit as well. A structural deficit is said to exist when ongoing revenues are not adequate to meet recurring expenditures. In New Jersey, this results in large part from a failure to modernize the state's tax system.

The strong reliance on the local property tax seems to have continued unabated, and the number of individual tax relief programs and business tax abatement programs continues to proliferate. Concerns about losing more-mobile upper income residents to lower-tax states further limits the extent to which the state is willing to resort to increases in the General Sales and Use Tax or Gross Income Tax to help address the problems. Meanwhile, the relative growth of the service sector and increased importance of remote sales (mail-order catalogs, home shopping networks and the Internet) have undermined the ability of the
state's SUT to help generate revenues sufficient to meet current and/or future spending needs. So, things are bad and potentially could get a lot worse.

Would the SLERP Commission reforms be appropriate in addressing the current fiscal ills in New Jersey?

The Final Report of the SLERP Commission was declared "dead on arrival" (four months before it was produced, no less!). However, many SLERP Commission supporters and other advocates of reform have contended that, with appropriate adjustment for inflation, the fiscal reforms proposed by the commission would still represent a significant improvement to the current state and local fiscal system in New Jersey.

While there may be some doubt as to whether many of the specific reforms proposed by the commission would still be apropos, I think that the SLERP approach to solving the state's fiscal problems would be very useful. By "SLERP approach" I mean that the type of fiscal reforms needed must:

**Be comprehensive in nature**

The state's revenue system must be viewed in its entirety, with careful attention paid to the balance among revenue instruments. Similarly, spending reforms must be undertaken with an eye toward not only providing the level and mix of services desired, but also choosing the most appropriate level/unit of government to provide the service.

**Emphasize broad tax bases and low tax rates**

In reforming the state's revenue/tax system, the focus must be on broadening the various tax bases and keeping tax rates as modest as possible to promote equity, efficiency (minimize distortions in decision making in the marketplace), competitiveness and compliance/simplicity objectives.

**Focus on enhancing equity in fiscal system**

The overall distribution of tax burdens among taxpayers must be aligned with widely accepted notions of taxpayer's ability to pay.

**Target tax relief**

In order to make the best use of limited resources and to direct tax relief to where it is most needed, state aid to local governments and to individuals needs to be better targeted. For example, a single, means-tested individual circuit breaker should be substituted for the current array of poorly targeted and poorly coordinated property tax relief programs. A truly enlightened program would also incorporate the concept of a Consumption Tax Offset proposed by the SLERP Commission to provide relief to individual taxpayers no matter what the source of the excessive tax burden.

State aid to local governments should also be directed at each type of local government-counties, municipalities and school districts-in recognition of the fact that they all play a
role in the current system in terms of delivering services and, therefore, in generating the need for property tax revenues. To isolate one type of local jurisdiction for blame (or support) would be to ignore the contributions made by other units to the problem (or to the potential solutions). While it might not be necessary to develop reforms that produced nearly equal dollar amounts of benefits to each of these three types of local units as proposed by the SLERP Commission, some attention to each and to the right balance is in order.

**Emphasize how the fiscal system (both spending and revenue raising) responds to changes**

The state's fiscal system needs to be flexible and responsive to changes in the level and distribution of economic growth, changes in the demographics of the state's population (especially with respect to the number of children and senior citizens, with their unique demands for services and limited ability to contribute as workers) and changes in technological advances (i.e., the Internet provides benefits and produces costs for the state's fiscal system).

**Balance the need to update and the need for stability**

To facilitate planning by businesses and households, policymakers must recognize that frequent and abrupt changes to the state's tax and spending policies create uncertainty, while also recognizing that changes in the economy, technology, demographics, etc. are inevitable and no specific set of spending programs or revenue instruments will remain appropriate indefinitely, without periodic review and adjustment.

**Be accountable**

State and local tax and spending policies should be transparent, so that all citizens and taxpayers understand who benefits from services provided and who bears the burdens of revenues raised. In particular, "incidence" analyses, which periodically report on how the tax burden falls on people at different income levels, and comprehensive "tax expenditure" reporting, detailing how much money the state gave up in various tax breaks, would go a long way toward furthering this objective.

In sum, current conditions in New Jersey are very reminiscent of the circumstances that gave rise to the SLERP Commission. Moreover, there were many valuable lessons learned from the SLERP Commission, both in terms of specific reforms proposed and the approach used to address the fiscal ills of the state, that remain appropriate and useful. Rather than being viewed as "dead on arrival," these reforms deserve serious consideration in our efforts to improve the fairness and functioning of the state's fiscal system.

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