The Invisible Budget Hides Spending Choices
Outta Sight Spending

You can read the state budget cover to cover and still not know how much state government costs. You won’t know because, unlike most states, New Jersey doesn’t keep track of a crucial area of spending.

When most people think of a state budget, they think of transactions that are basically simple: The state pays someone to do something, buys a particular item or gives out the dollars that start or maintain a program. But, in addition to these direct payments, another equally important type of government spending comes in the form of various tax exemptions written into the law. The technical term is “tax expenditures.” They are also called tax preferences because they represent preferential treatment.

Though most states make this information public, it’s not in New Jersey’s state budget document, or anywhere else that is readily accessible. Millions, maybe billions of dollars of spending come from this “invisible budget.”

Just like “regular” spending, tax preferences are policy decisions that reflect the government’s priorities. The only real difference is that instead of collecting and paying out money, this money doesn’t come in at all. It happens, for example, when New Jersey chooses not to impose sales taxes on prescription medicine or it grants a tax credit to certain businesses.

Those are spending choices; they take money from the state Treasury, just like funding a program or salary, because any law that reduces the tax obligation of an individual or business has
the same overall effect on the budget as a law requiring the state to buy something or pay someone. Another way of thinking about it: Every dollar the state doesn’t receive in tax revenue is a dollar it must raise by increasing existing tax rates or taxing something else—or by providing fewer services.

**Knowledge is Power**

That doesn’t mean every tax exemption is inherently wasteful and should be eliminated. The point of making this spending visible is to understand the full picture, so that important decisions can be made with all the facts.

New Jersey, for example, doesn’t charge sales tax when someone buys clothing. How much revenue does this cost the state? Pennsylvania loses nearly $900 million a year from not taxing all or some clothes; New York about $600 million from its partial exemption; and Connecticut about $120 million. We know because those states compile the information in regular tax expenditure reports. New Jersey policymakers know only that not taxing clothes cost the state more than $300 million 11 years ago because no update has been done since.

Whether the best policy is to tax all clothes, no clothes or some clothes, ignorance of the financial impact calls any policy into question. The same could be said of decisions to exempt from state income tax contributions to some forms of retirement plans but not others; to give tax breaks to some but not all businesses; or cut a deal on local property taxes for new condo developments.
Full, accessible disclosure of all spending made through tax expenditures or preferences would bring openness and accountability needed to help put New Jersey government finances on a firm footing. It would produce better informed decisions and broader debate.

Because this form of spending is largely invisible, it gets less scrutiny—from inside and outside of government. Once adopted, it can become more or less eternal, with no review from year to year. In contrast, the direct spending in the state budget is evaluated to some degree every year; without explicit language it can’t be reauthorized.

But tax expenditures are usually buried in the tax code, created by laws allowing them to continue indefinitely, without reauthorization and without a review of their impact on the state’s financial situation or an analysis of whether they are working as hoped. They become immune to economic down-turns and changing priorities, unlike other spending.

**Best Practices**

The federal government, nearly 40 states and the District of Columbia recognize the need to know and make public the revenue foregone through exemptions, credits, abatements and deductions created by the tax code. The federal government has produced tax expenditure reports since 1975. The first state to do so was California in 1976.

How much money are we talking about? Some states forego billions of dollars a year in revenue as a result of tax expenditures. Washington State reports loss of nearly $99 billion a year from 567 state and local tax expenditures; Oregon nearly $29 billion from 362 expenditures; and Illinois
nearly $7 billion from 214. The governor’s budget in Pennsylvania lists over 100 pages of spending through the tax code.

Some examples:

**Annual Report on New York State Tax Expenditures**, New York State Department of Taxation and Finance, Division of the Budget. [http://publications.budget.state.ny.us/eBudget0809/fy0809ter/taxExpenditure.pdf](http://publications.budget.state.ny.us/eBudget0809/fy0809ter/taxExpenditure.pdf)


New Jersey Policy Perspective has for a number of years documented the need for such information. In January 2006, Gov. Jon Corzine’s Budget and Re-engineering Government Transition Policy Group recommended that the state compile and publish tax expenditure information. For the FY 2007 budget cycle, the state Division of Taxation developed a basic framework for a report identifying 121 sales and use tax exclusions and exemptions, 44 gross income tax exclusions and 28 corporate business tax exclusions. But nothing else has been done.
The most useful tax expenditure reports are comprehensive, detailed, timely and easily accessible. Some states require a high level of analysis, including periodic evaluation of whether each tax expenditure should be continued. Washington’s governor is required to review tax expenditures every four years and recommend to the legislature any that should be repealed.

Reports generally include a list of all tax expenditures, the authorizing statute, an explanation of what each expenditure does and an estimate of its cost in foregone revenue.

Some state reports include the stated goal of each tax expenditure, an assessment of its effectiveness in achieving its purpose and analysis of the number and socio-economic status of those benefiting from them. Some reports show how much money local governments lose in revenue from property exempted from taxation and what the impact is on taxpayers.

Come on, New Jersey

New Jersey has the opportunity to learn from other states in order to promote honest discussion of real choices.

Legislation that would require a comprehensive, yearly tax expenditure report would be a significant step forward for New Jersey.

It would help policymakers and the public better understand how and where money is spent and evaluate the true costs of many financial decisions that today lack effective scrutiny.
To Learn More:


New Jersey Policy Perspective is a nonprofit, nonpartisan organization established in 1997 to conduct research and analysis on state issues.