NEW JERSEY POLICY PERSPECTIVE

February 2015

2016 Budget Preview: Unmet Needs Growing as Economy Lags

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What are the prospects for next year's state budget? In a word: bleak.

With New Jersey's chronically sluggish economic recovery, the state has serious financial problems because revenues are not growing fast enough to meet the state's biggest obligations. It has practically no capacity to invest in the assets that are the proven building blocks of a strong economy: early education, safe and efficient highways and transit, higher education or being prepared for impact of the next Superstorm.

Budgets are about more than numbers. They are about meeting the needs of New Jerseyans. In this financial crunch, it is our residents – particularly struggling working families – who feel the pain the most. A responsible budget can provide the opportunity for New Jerseyans to get back on their feet. The test of whether New Jersey's political leaders have the fortitude to make that happen is around the corner.

Slow Economic Growth Causing Pain

Why is New Jersey facing another tough budget cycle? We simply aren't producing enough jobs or seeing any real economic recovery. While the rest of the country has more than recovered all the jobs it had lost during the Great Recession, New Jersey has brought back about half, much lower than our neighbors in Pennsylvania, with 100 percent of its jobs regained, and New York with its astonishing recovery of more than twice what it lost.[1]

Hundreds of thousands of New Jerseyans remain unemployed, and over 40 percent of the unemployed have been out of work for more than six months - the second-highest share of long-term unemployment in the 50 states.[2] A higher proportion of our veterans are out of work than in any other state.[3] Families in the middle have seen their incomes decline by 9 percent since 2000.[4] While poverty rates are decreasing in most of the country, in New Jersey they continue to rise, with residents increasingly being pushed onto public assistance.[5] The state's mortgage foreclosure rate continues to be among the nation's highest, ravaging many communities and hurting the broader economy.[6] In January 2015, Atlantic City posted the highest foreclosure rate among metro areas with a population of at least 200,000[7] – a dubious honor that may last for a while as the latest round of casino closings and job losses take hold.

This economic malaise means New Jersey's state government – which funds our schools, highways, and other necessities – is in serious financial trouble. This year, New Jersey tax collections have 12 percent less purchasing power than their pre-recession peak in late 2007. Only eight other states are worse off.[8]

These chronic revenue shortages lead to short-term accounting gimmicks, like borrowing long-term just to meet immediate needs and raiding funds dedicated for important purposes like clean energy and protecting children from lead poisoning. New Jersey's bad financial management has led to the state's credit rating being downgraded a record eight times since 2010, to the point that it is now the second-lowest credit rating in the nation. A low-credit rating forces up the state's borrowing costs, requiring it to pay higher interest rates than its better-managed peers.

This is the backdrop against which the administration must craft its 2016 budget. While there are many unmet needs across New Jersey, the biggest three are:

- A near-broke fund to pay for transportation projects
- Underfunded state pension and health benefit systems
- Chronic shortchanging of New Jersey's middle-class and low-income families

New Revenue Needed to Fix State's Transportation Funding Crisis

New Jersey's transportation funding crisis has been a long time coming. Advocates have been sounding alarm bells for years about the solvency of the Transportation Trust Fund, yet no action has been taken. Now, there is no time left to delay.

The Trust Fund, New Jersey's bank for paying for renovating, modernizing and expanding highways, bridges and public transit, will be depleted by July 1, with all incoming revenue going to pay the interest and principal on bonds issued for completed and current projects. This could do enormous, long-term economic harm to New Jersey. Our location in the middle of the world's largest market is one of our greatest economic assets, but not if we don't maintain an efficient transportation network to move goods and people.

New Jersey's transportation system already is in woeful disrepair. Two-thirds of New Jersey's roads are poor or mediocre, causing commuters delays and costly car repairs.[9] Over a third of the state's bridges are structurally unsound or obsolete.[10] Rail service is fragile and prone to delays, relying on 100-year-old Hudson River tunnels that are operating at more than full capacity. If the Trust Fund is not replenished soon, projects to upgrade the state's roads, bridges and public transit will be cancelled, making it more difficult for New Jerseyans to get from point A to point B and potentially costing the state more than $1.6 billion a year in federal dollars that require state matching funds.

To get the Trust Fund back on stable footing and ensure New Jersey can invest in its roads, bridges and mass transit, the state needs $1 billion to $2 billion in new revenues. There are only a few ways to get there, and they all involve taxes on gasoline, which haven't been increased in 25 years.[11] One solution, as we proposed last year, is to apply the 7 percent state sales tax to gas purchases at the pump. Another would be to more than double the tax on petroleum products at the refiner and distributor level, as proposed by Assemblyman Wisniewski.[12] Lawmakers could also raise $1 billion or more a year by increasing the 14.5 cent-per-gallon gas tax by at least 25 cents.

An increase in a percentage-based tax on gas or petroleum products is important because it will ensure that the revenue collected to pay for transportation projects rises as gas prices increase and decreases as prices drop, tying it automatically to inflation and making it less likely than the per-gallon tax to lose its value over time. However, lawmakers should not rule out an increase in the per-gallon gas tax *in addition to* a percentage-based tax increase, in order to bring even greater stability to New Jersey's transportation funding.

As a trade-off for raising the gas tax, some legislators are proposing that it be paired with a cut to or elimination of the estate tax. This proposal – which the governor suggests he could support – is hardly an equitable trade-off, especially since it would benefit only the highest-wealth New Jerseyans. It would add to an already drastic gap between our needs and the resources available to pay for them by robbing the state of up to $300 million a year. Further, a tax break for the wealthiest 5 percent or so of New Jerseyans in exchange for a gas tax hike ignores the fact that higher gas prices will disproportionately hurt New Jersey's low- and moderate-income families. A household bringing in $300,000 per year will likely absorb the added cost of gas without much notice. But for a household that gets by on $45,000 per year, getting hit harder at the pump could mean cutting corners at the grocery store or forgoing medical care.

A fairer tradeoff would be to reverse the 2010 cut to the Earned Income Tax Credit. This would ensure that the average gas tax increase for most New Jerseyans would be the same share of their income. It would also cost only about one-fifth the revenues lost by eliminating the estate tax.[13]

If a gas tax hike becomes politically impossible, cuts to other essential services in order to fund transportation will likely be considered. State aid to education may be reduced, as some are suggesting.[14] At a time when school funding has not kept pace with rising educational costs, these cuts would be devastating for school districts and would result in higher property taxes for homeowners. This gimmicky proposal would not even come close to meeting New Jersey's long-term transportation needs.

Chronic Underfunding of Benefits Has Put New Jersey in a Bind

New Jersey's longtime failure to contribute enough to pension and retiree health care benefits for public employees and their families will continue to place an enormous strain on the budget that takes effect on July 1. Next year's tab for these obligations could top $5 billion, claiming nearly 15 percent of the budget.

Like the problem with the Trust Fund, this crisis has been developing for 20 years. Back in 1994, Gov. Whitman reduced payments to the state's pension funds while eliminating the retiree health benefit fund and shifting that payment obligation to the annual budget. The governor used that $300 million instead to cover New Jersey's regular costs when deep income tax cuts made it impossible for the state to make ends meet. Gov. Whitman began a pattern of elected officials neglecting or ignoring altogether the state's obligations to fund pensions and retiree health benefits. Today, New Jersey is more than $130 *billion* short of what it will need to meet its retiree obligations.

Looking at these obligations separately can help us better understand how they affect the state budget.

Pensions

During Gov. Christie's first term, significant bipartisan efforts were made to put the New Jersey's pension system on the road to solvency. Public employees agreed to forgo some benefits and pay more for them and the state agreed to start paying more of its share. In 2010, the state's leaders committed to a seven-year ramp-up to the full actuarially required pension payments by fiscal year 2018. A year later, the state eliminated retiree cost-of-living increases and required early retirees to pay more toward their pensions while raising the retirement age to save more than $120 billion over three decades.[15]

But last spring, Gov. Christie abandoned the agreement by slashing pension funding by $2.4 billon to address a growing budget shortfall. The administration said it intends to make up for it with a $2.5 billion payment in the 2016 budget and would ramp up to required funding levels in 2019, a year behind schedule.[16] The public employee unions sued the Christie administration and a court decision is likely before the coming budget is finalized, with an almost certain appeal by the losing side. As it stands, the unfunded liability now exceeds $80 billion as the state comes into compliance with new federal accounting rules, more than doubling previous estimates, and raising the required state payments to the pension fund.[17]

It will be incredibly challenging to find an additional $2.5 billion in the 2016 budget, let alone the $5.5 billion required two years down the road. Unless New Jersey gets back on track funding its pension system, a report by the credit rating company Moody's projects that the state's two biggest pension funds could be completely broke in a decade.[18] This means the state will not have funds to pay current retirees.

Health Benefits

While pensions have gotten most of the attention this past year, retiree health care costs are a much larger budget challenge for New Jersey. The state faces an estimated $58 billion in unfunded health benefit liabilities for both current and retired employees.[19] While New Jersey spent $2.8 billion on health benefits in the 2014 budget, representing 8 percent of expenditures, these benefits will claim 14 percent of the budget by 2024 if costs are not contained.[20]

And while pension costs are likely to shrink once a funding plan is underway and sufficient assets are in hand, retiree health care costs are covered on a pay-as-you-go basis through annual state appropriations, with no political will or practical means to prefund the benefits.

The problem is made worse by the lack of incentives for employees and retirees to choose more cost-effective health insurance plans. Most are enrolled in plans that are significantly more expensive than average. In addition, these plans will soon face heavy fines imposed by the federal government as part of the Affordable Care Act, which set limits on insurance plans in order to rein in overall health care costs. Starting in 2018, a 40 percent excise tax on many of the plans that exceed a federal cost threshold and are most popular among New Jersey retirees will go into effect, costing the state an estimated $58 million a year.[21] Unless the state diverts beneficiaries to more affordable plans, that penalty could balloon to $284 million by 2022.

Without increasing funding levels, reducing pension and health benefit costs or some combination of the two, the cost to taxpayers will only continue to grow. And grow. Policymakers' chronic failure to reckon with the state's obligations has forced the state to pay higher interest to investors who buy its bonds. New Jersey has moved from one of eight states with the highest credit rating just 20 years ago to the basement, lower than any state except Illinois.

Unmet Needs: Food Assistance, Education and Property Tax Relief

Given the enormous financial pressure these decades-in-the-making problems have on New Jersey, the state's obligation to those who need help the most – including struggling families, students and middle-class homeowners – will likely be shortchanged again next year. Funding for many vital supports has not kept pace with increasing demand, rising costs and shrinking family incomes.

Food Assistance

As poverty rates continue to rise in the state, more families have found themselves needing extra help getting food on the table. The number of New Jerseyans who receive food assistance through the Supplemental Nutrition Assistance Program (SNAP, formerly known as food stamps) has doubled since 2008 to over 876,000 in 2012, almost half of whom are children.[22] Despite the rising need, the state's response has been woefully inadequate.

Hundreds of thousands of New Jerseyans are not receiving the nutritional assistance they are entitled to in part because the state isn't doing enough to reach them. Just over 1 million New Jersey residents were eligible for SNAP in 2011, but only about 675,000 participated – leaving 325,000 New Jerseyans without these benefits that are fully funded by the federal government.[23] This 67-percent participation rate was lower than that of all but four other states, and lower than most very poor states (Mississippi, for example, has a rate of 79 percent).[24] There is clearly more the state could do to reach eligible residents.

Yet for at least six years, policymakers have refused to help our neediest residents enroll in the food assistance program – even though the federal government would cover half the costs of more effective outreach efforts. New SNAP beneficiaries would bring additional federal dollars to the state as well. If New Jersey provided SNAP benefits to 79 percent of families that qualified, the national average, it would assist an additional 140,000 New Jerseyans and obtain an additional $217 million in nutritional assistance each year.[25]

The state also needs to devote more resources to running the SNAP program. New Jersey has the second-worst record in the nation for processing SNAP applications and has failed to modernize its antiquated eligibility system. More than 1 in 4 New Jerseyans who apply for SNAP benefits don't get an answer from New Jersey within the 30-day window required by federal law.

Meanwhile the administration has failed to invest $3.2 million to help maintain the "Heat and Eat" program for 160,000 recipients – forsaking $53 in benefits for every dollar invested. This cut to the annual energy assistance payment, which amounts to $21 per household, means the loss of $170 million in federal SNAP benefits.[26] Worse, the $3.2 million needn't have come out of New Jersey's coffers; most of the other states extending Heat and Eat are using federal funds from the federal Low Income Home Energy Assistance Program. The impact on the state's economy, however, is even greater because every dollar of SNAP benefits generates almost twice that in economic activity. Failure to maintain SNAP means New Jersey would lose an estimated $300 million in economic activity at a time when the state is stuck in a post-recession rut.

Despite the growing need of New Jersey's most vulnerable residents, adequate state funding for the nutritional assistance program cannot be guaranteed. Not only is cutting SNAP insensitive to our neediest neighbors, it actually exacerbates the state's weak economic recovery.

Education

High-quality education strengthens a state's overall prosperity more than any other economic policy.[27] Good schools, colleges and universities produce graduates who can find high-wage work that pays enough to support a family and provides long-term economic security. Well-educated individuals are more likely to have better health, including lower rates of premature death, and less likely to commit crimes. Supporting and expanding access to high-quality education also improves a state's ability to grow and attract high-wage employers, which in turn helps the state produce enough tax revenue for healthy state budgets. Despite these proven benefits, New Jersey's investment in K-12 and higher education has decreased considerably over the past two decades. This year the troubling trend is poised to continue.

Last year's budget was the sixth straight in which the state failed to follow its school funding formula and provide districts with the aid to which they are legally entitled. The School Funding Reform Act, which was considered a national model of state public school finance, has not been fully funded since its first year in 2008-09. Since then, New Jersey's public school districts have been underfunded by $6 billion.[28] Among other things, this means that a comprehensive pre-K program that targets low-income 3- and 4-year-olds across the state can't get off the ground. Given the stark reality of the coming budget, it will be difficult to get school funding back on track, putting schoolchildren's education and New Jersey's reputation as a national leader in public education in jeopardy.

The situation is dire for college students as well. New Jersey is spending 23 percent less per student on higher education than it did in 2008, after adjusting for inflation.[29] These cuts have driven up tuition and student fees, making it harder for New Jersey families to afford college and for the state to attract businesses that rely on a well-educated workforce. Despite some minor funding increases included in the last two budgets, this major disinvestment, which amounts to more than $2,200 per student, continues to keep higher education unaffordable for many New Jersey families, keeping their children from pursuing degrees that would help them boost their earnings as adults. In the long run, limiting access to high-quality primary education and shutting students out of higher education greatly undermines the state economy.

Property Taxes

New Jersey's property taxes, which fund schools, local services and county programs like parks, snow removal and libraries, are infamous for being among the country's highest, and residents consistently rate them as the biggest issue facing the Garden State.

Total property taxes exceeded $27 billion in 2014 and the average homeowner's property tax bill climbed to $8,161, up 2.2 percent from 2013. Because the share of commercial, industrial and other non-residential property assessments has declined, local governments and school districts have shifted a greater proportion of the tax bill to homeowners.[30] And since property tax rebates and credits were slashed during the Great Recession and have not been restored, many families – particularly those earning less than $75,000 – are paying dramatically higher property taxes. Income tax revenues already provide about $14 billion of relief to property owners in the form of school, municipal and county aid, leaving no ready source to do what every political candidate promises: cut everyone's property taxes. Moreover, given the strain on overall state finances, shifting funds from the general budget to property tax relief is not possible.

As property taxes continue to rise, relief must be targeted to those who need it the most. There is a clear need for New Jersey to provide property tax relief to working-class homeowners and senior citizens on fixed incomes. The first step would be for the administration to restore public access to information on the net effects of the property tax credits and rebates that remain so that property tax amounts can be judged for each municipality.

For the past two years, more than a million people enrolled in the largest of the property tax relief programs have been denied a credit on their annual property tax bill due to chronic budget shortfalls. The Homestead credit, which costs the state about $375 million, has been an easy target for most of Gov. Christie's tenure. It was dropped during his first year as governor, restored at less than half the credits provided by the Corzine administration for three years, and saw back-to-back delays for the past two years that deprived 1.6 million New Jerseyans of the credit until May 2015. With property taxes still increasing despite the 2 percent cap, the forgone payments only hurt those who depend upon the tax credit: senior citizens, disabled residents and homeowners trying to get by on incomes of $75,000 or less.

Looking ahead to another tight state budget, there is no guarantee that Gov. Christie won't postpone the Homestead credit payment again. If income-tax collections this spring come in lower than expected, as they have for the past three years, low- and middle-income rebate recipients, who have already endured a net 20 percent property tax hike under this administration, could be denied the credit yet again.

New Jersey Policy Perspective

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New Jersey Policy Perspective is a nonprofit, nonpartisan organization established in 1997 to conduct research and analysis on state issues. For our work on tax policy, we're grateful for support from The Fund for New Jersey and the Annie E. Casey Foundation.

Endnotes

[1] NJPP analysis of Bureau of Labor Statistics data. U.S. rate is as of January 2015; state rates are as of December 2014.
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