New Jersey’s Fiscal Future II

Comparing Five-Year Revenue Forecasts with Current Services Budget Projections

Multi-Year Budget Workgroup: Second Annual Report

Rowan University

STEVE SWEENEY CENTER
FOR PUBLIC POLICY

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Preface: The Multi-Year Budget Workgroup

Last March, the newly formed Sweeney Center for Public Policy at Rowan University announced the formation of a Multi-Year Budget Workgroup as its first major initiative. The New Jersey state government was collecting record state revenues and building an unprecedented surplus, but the state's economy had been fueled by tens of billions of dollars in federal Covid-19 stimulus and by years of low inflation and interest rates that were coming to an end. Would revenues continue to grow or was the state facing a fiscal cliff that would force tax increases or budget cuts if a recession hit?

The Multi-Year Budget Workgroup (MYBW), a team of former high-ranking administration and legislative budget officials, policy experts, economists and academics, sought to answer that question in its June 2022 report, *New Jersey's Fiscal Future: Comparing Multi-Year Revenue Forecasts With Current Services Budget Projections*. As the Legislature went into the final weeks of negotiations over the FY23 budget, the bipartisan budget experts made the case for the state to maintain a robust surplus in preparation for the inevitable economic downturn.

This February, the Sweeney Center issued the MYBW's New Jersey Economic Outlook, authored by our chief economist, Dr. Charles Steindel, projecting that any recession – if one occurred in the upcoming year -- would be "modest and short."

This report, *New Jersey's Fiscal Future II: Comparing Five-Year Revenue Forecasts with Current Services Budget Projections* is the MYBW's second annual budget report. A short follow-up report will be issued in July to update our projections to reflect new spending or revenue changes in the adopted budget.

The Sweeney Center will continue to provide five-year revenue and expenditure projections to the Legislature and the Governor each June until New Jersey joins the 38 other states who engage in consensus revenue forecasting and transparent long-term fiscal planning. Bipartisan legislation that would require the executive and legislative branches to join together in such a process has been sponsored by Senate Minority Leader Steve Oroho and Senate Budget Chair Paul Sarlo.

The MYBW is modeled after the blue-ribbon *Facing Our Future* panel put together by the Council of New Jersey Grantmakers in 2010 to develop multi-year revenue projections and analyze whether those revenues would be sufficient to cover the cost of maintaining state services at current levels for the next five years. Richard Keevey and Ray Caprio, who developed the projections for *Facing Our Future*, serve on our workgroup.

Like our first report last June, this analysis seeks to provide insights and inform the public debate on the fiscal policy challenges that New Jersey faces as the administration and legislative leaders enter into the final weeks of negotiations on the FY24 state budget.

Members of the Multi-Year Budget Workgroup

- Steve Sweeney, general vice president of the International Association of the Bridge, Structural, Ornamental and Reinforcing Iron Workers union and former Senate president;
- Mark Magyar, director of the Sweeney Center for Public Policy, College of Humanities & Social Sciences, Rowan University, and former deputy director of the New Jersey Senate Majority Office;
- Deborah Bierbaum, senior tax policy adviser for Multistate and former New York State deputy commissioner of tax policy;
- Mark Blum, executive director of America's Agenda, Washington, D.C.
- Raphael J. Caprio, Ph.D., University Professor, Rutgers University, and director of the Rutgers Local Government Research Bureau;
- Lucille E. Davy, former New Jersey education commissioner and current member of the Rowan School Regionalization Institute;
- Matthew D'Oria, healthcare consultant, former New Jersey deputy health commissioner and deputy Medicaid director
- Chris Emigholz, Chief Government Affairs Officer for the New Jersey Business and Industry Association and former New Jersey Senate Republican budget director;
- Stuti Jha, Associate Professor of Economics, College of Humanities and Social Sciences, Rowan University
- Jeff Kaszerman, vice president of government relations for the New Jersey Society of Certified Public Accountants;
- Richard Keevey, senior policy fellow at Rutgers University and former assistant secretary of the U.S. Department of Housing and Urban Development, former undersecretary of U.S. Defense Department and former New Jersey state budget director and controller;
- Yupeng Li, Assistant Professor of Economics, College of Humanities and Social Sciences, Rowan University
- Marcela Ospina Maziarz, vice president for community and government affairs at Thomas Edison State University and former New Jersey deputy health commissioner;
- Marc Pfeiffer, assistant director of Rutgers University's Bloustein Bureau of Local Government Research and former deputy director of New Jersey Division of Local Government Services;
- David Rousseau, former New Jersey state treasurer;
- Charles Steindel, Ph.D., resident scholar at Ramapo College's Anisfield School of Business, former New Jersey Treasury Department chief economist and former senior vice president at the Federal Reserve Bank of New York;
- Ralph Thomas, former executive director of the New Jersey Association of Certified Public Accountants;
- Michael Vrancik, Sweeney Center Policy Fellow, former director of government relations for the New Jersey School Boards Association and former New Jersey Treasury Office of Management and Budget manager

Sweeney Center for Public Policy Graduate Assistants

- Arisahi Mora Lazaro, Rowan University Master of Public Policy program
- Valerie Ruscansky, Rowan University Master of Public Policy program

Executive Summary

For the past several years, New Jersey state coffers have been flooded with tax revenue consistently exceeding official Treasury revenue projections by billions of dollars each year, pushing the state budget over $50 billion and swelling the state's surplus to nearly $10 billion.

The Governor and the Legislature last June used the unexpected revenue surge to enact the ANCHOR rebate program that increased direct property tax relief from just under $1.4 billion to more than $3 billion and raise state aid to school districts by $800 million.

This year, the Governor's budget proposal would roll back a 2.5% surcharge on corporate income taxes for companies earning more than $1 million in profits in New Jersey. Democrats and Republicans have been pushing competing proposals to further increase property tax relief, with the Democratic StayNJ plan to cut property taxes in half for all senior citizens initiated by the Assembly Speaker and backed by the Senate President moving rapidly through the Legislature.

Just three months ago, It looked like the good times would never end, as the Treasury Department boosted revenue projections for the current FY23 budget year from the $50.359 billion projected last July to $54.055 billion and forecast a $53.829 billion tax harvest for the upcoming FY24.

Two months later, however, in her May 17 revenue update to the Assembly Budget Committee, Treasurer Elizabeth Muoio was forced to cut those revenue projections for those two fiscal years by over $2.2 billion as revenue collections slowed.

Even if Treasury hits its $52.802 billion revenue projection for FY24, the Multi-Year Budget Workgroup (MYBW) projects that New Jersey faces a looming fiscal crisis, with state revenues projected to fall $3 billion to $4 billion short annually of the amount needed to continue state programs and state aid at current service levels from Fiscal Year 2025 to Fiscal Year 2029.

The MYBW's fiscal policy experts and economists agree that there is an 80% probability that revenue collections will fall between $12.5 billion and $18.5 billion short of the projected expenditures needed to continue current services and state aid from FY25 to FY28 with future increases in those years limited to the 3% annual growth needed to maintain a Current Services Budget.

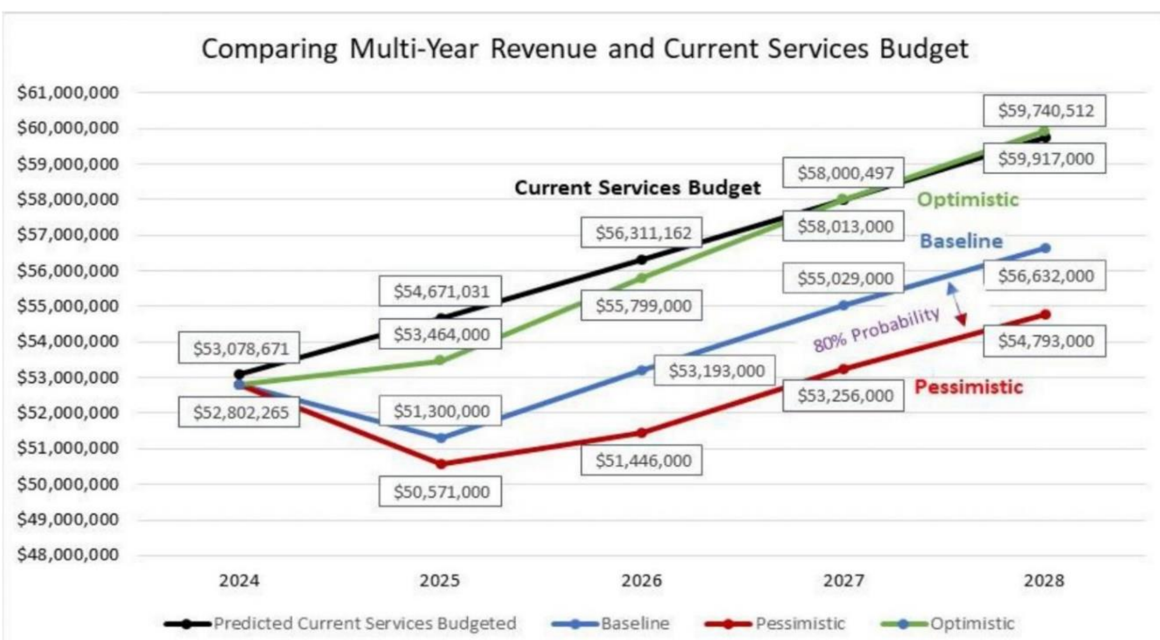
The 3% figure was arrived at using the methodology incorporated by Senate Minority Leader Steve Oroho (R-Sussex) and Senate Budget Committee Chair Paul Sarlo (D-Bergen) in Senate Bill 654, the bipartisan legislation that would require the Governor and Legislature to implement consensus revenue forecasting with five-year revenue forecasts and expenditure projections based using a Current Services Budget model.

The Current Services Budget includes funding to complete the ramp-up to full funding of the school funding formula under the School Funding Fairness Act of 2018 (S2) and $500 million a year from FY25 to FY27 to cover just over half of the NJ Transit operating deficit that will be left after federal Covid-19-related funding runs out. Relatively flat funding for pensions, debt service and municipal aid is largely offset by a projected 5.1% increase in Medicaid, Childrens Health Insurance Program (CHIP) and health benefits costs for current state workers and both teacher and state worker retirees.

Following the same methodology as last year, the MYBW's revenue forecasting subcommittee used the Treasurer's May 17 revenue forecast as a starting point, then developed three sets of revenue projection scenarios for the next four fiscal years. The MYBW then matched those three revenue scenarios with the Current Services Budget figure for that year:

- Under the Baseline scenario, revenues for FY25 to FY28 would result in a cumulative $12.5 billion short of total collections needed to cover projected Current Services Budget costs.
- Under the Pessimistic scenario, revenues for FY25 to FY28 would be a cumulative $18.5 billion below the revenue needed to continue to fund state services and state aid at Current Services Budget levels.
- Under the Optimistic scenario, revenue collections from FY25 to FY28 would be sufficient to cover the full cost of the Current Services Budget, leaving a fully adequate $6.154 billion surplus at the end of FY28.

However, the MYBW's revenue forecasting team assigns just a 20% likelihood to the Optimistic scenario, compared to 50% for the Baseline scenario and 30% for the Pessimistic scenario. Under



Five-Year Gap Between Current Services NJ State Budget and Revenue Projections

Under both the Baseline and Pessimistic scenarios, state revenues will fall $3 billion to $4.9 billion short each year from FY25 to FY28 pf the amount needed to maintain state spending at current service levels with a 3% annual increase assumed for inflation. This is a cumulative gap of $13.7 billion to $18.7 billion over four budget years that would require new revenues or cuts to current spending, even with a projected FY24 end-of-year surplus of almost $8 billion. Under the Optimistic scenario, revenues would be adequate both to maintain services at current levels and sustain a healthy surplus.

	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Projected Current Services Budget	$48,787,000	$54,642,000	$53,078,671	$54,671,031	$56,311,162	$58,000,497	$59,740,512
(Assuming 3% Annual Growth)							
Treasury Revenue Projections	$53,052,000	$52,840,000	$52,802,265				
Treasury Projected Surplus	$10,736,000	$8,488,000	$7,961,000				
Baseline							
Projected Revenue			$52,802,265	$51,300,000	$53,193,000	$55,029,000	$56,632,000
Difference between projected revenue and projected spending			-$276,406	-$3,371,031	-$3,118,162	-$2,971,497	-$3,108,512
Remaining surplus if applied to cover gap			$7,684,594	$4,313,563	$1,195,401	-$1,776,096	-$4,884,608
Pessimistic							
Projected Revenue			$52,802,265	$50,571,000	$51,446,000	$53,256,000	$54,793,000
Difference between projected revenue and projected spending			-$276,406	-$4,100,031	-$4,865,162	-$4,744,497	-$4,947,512
Remaining surplus if applied to cover gap/ deficit by FY27			$7,684,594	$3,584,563	-$1,280,599	-$6,025,096	-$10,972,608
Optimistic							
Projected Revenue			$52,802,265	$53,464,000	$55,799,000	$58,013,000	$59,917,000
Difference between projected revenue and projected spending			-$276,406	-$1,207,031	-$512,162	$12,503	$176,488
Surplus continues to grow			$7,684,594	$6,477,563	$5,965,401	$5,977,904	$6,154,392

those scenarios, New Jersey would have to spend an average of $3 billion or $4.5 billion a year to maintain state aid and services at current levels from FY25 to FY28.

If revenues fall off in FY25 and/FY26, as projected in those scenarios, or if FY24 collections wind up below the $52.802 billion projected, the Governor and Legislature would be expected to begin to cut spending or seek additional revenue for future budgets, rather than letting the surplus plummet to unacceptably low levels.

While the Treasurer's revised May 17 budget projections include a $7.961 billion closing surplus for FY24, the three Wall Street bond rating agencies that have twice upgraded New Jersey's credit rating in the past year would certainly look askance at future treasurers spending that surplus down below $3 billion, which would be less than 6% of the current budget.

The Current Services Budget only includes programs already enacted into law, so the proposed StayNJ senior citizen property tax relief initiative and other budget additions working their way through the Legislature are not included. The StayNJ program would add a total of $4.2 billion to state budget costs from FY23 through FY28, when it would hit its full $1.2 billion annual price tag.

Revenue projections do include rollback of the 2.5% Corporation Income Tax surcharge because that reduction is required under the law that extended the tax during the Covid-19 pandemic.

The Five-Year Revenue Forecast Assumptions and Methodology

Revenue Projections

For purposes of projection, New Jersey state revenues are placed into 4 categories:

1. Personal income taxes, consisting of the Gross Income Tax (GIT) and the Business Alternative Income Tax (BAIT). The BAIT, which is fully deductible against federal tax liabilities, can be credited against either the GIT or the Corporate Business Tax (CBT), but since its recent promulgation, experience suggests that it can be viewed as essentially an alternate way to pay GIT liabilities.
2. Corporate taxes, consisting of the CBT plus the separately reported taxes on energy and financial corporations.
3. Sales taxes, consisting of the Sales and Use Tax (SUT) plus the separately reported energy component.
4. All other revenues, consisting of a wide variety of taxes and fees. These include real estate transaction taxes, taxes on insurance premiums, lodging, motor fuels, tobacco products and marijuana sales, casino gaming revenues, and alcohol, as well as the transfer inheritance tax and motor vehicle license fees.
5. Personal income and sales taxes account for the largest share of revenues, followed distantly by corporate taxes (these have often been referred to as the "Big 3'). Personal and corporate income tax revenues are notoriously volatile. However, due to its much larger size, errors in the certified projections for income taxes have been historically more consequential for overall state revenues than those for corporate taxes, even though corporate tax revenues are more volatile.

Determinants of Revenues

Aside from policy changes, revenue growth is essentially determined by New Jersey's economy. In turn, since New Jersey is a large economically diverse state, changes in the national economy can be a significant determinant of New Jersey's economic performance. Medium-term changes in New Jersey's revenues (again barring significant policy changes) are generally reflective of changes in the national economy over that period.

Personal Income Taxes

A reasonable proxy for the growth of New Jersey's taxable income base for a fiscal year is the growth of the state's personal income in the previous calendar year, plus capital gains realizations by state residents.[1] Based on an analysis of available data, New Jersey's growth of its personal income base tends to be about a half percent a year less than the nation as a whole. Large movements in the capital gains proportion will have significant implications for New Jersey income

[1] Timely New Jersey personal income figures are available from the US Bureau of Economic Analysis. Our estimates and projections for capital gains realizations in recent years are based on the latest available IRS data for the nation as a whole, as well as the Treasurer's May testimony, in which she reported numbers on New Jersey taxpayer realizations in 2021 and 2022.

tax revenue, given the pronounced progressivity of New Jersey income tax rates, and the disproportionate share of capital gains realizations earned by households in high income brackets.

Corporate Taxes

The exact relationship, even at the national level, between corporate tax receipts and economic activity is hard to pin down, due to the frequent changes in tax policy. We assume that in the medium-term New Jersey's corporate tax revenues in a fiscal year will be related to the growth of national pre- tax operating earnings in the previous calendar year.[2] We also assume that these earnings will typically grow faster than current-dollar (nominal) Growth Domestic Product (GDP), given the trends of the last generation. If GDP grows faster than usual, the corporate tax base will grow even faster.[3] Likewise, profit growth will be much slower when GDP grows less than average. The upshot is that we assume that New Jersey's corporate tax base will grow 4.3 percent when national (nominal, or current-dollar) GDP grows at a trend rate of 4.3 percent.[4] If national growth is 3 percent, New Jersey's corporate taxes would be assumed to fall 8.7 percent.[5][5]

Under any scenario or set of assumptions, the projection of corporate revenues is likely to be uncertain, given the wide divergence between New Jersey corporate tax rules and those of other states and the federal government. An error band of as much as $1 billion—or close to 20 percent of New Jersey corporate tax revenue earned in recent years—is conceivable around any projection, even if all elements of the economic projection are correct. We believe that the risks are weighted to the downside, given the unique nature of New Jersey's corporate tax system and the unanticipated surge in revenues in recent years. Additionally, since we assume that the rollback of New Jersey's corporate 2.5 percent surcharge on net income over $1 million will go forward as scheduled for calendar year 2024, there is some additional reduction to corporate revenues projected for Fiscal 2025.

Sales Taxes

Although New Jersey collects sales tax on some forms of business-to-business transactions, more than half of the revenue comes from retail purchases. US Bureau of Economic Analysis data suggest that annual growth of spending in New Jersey on taxable items is typically about 1 percentage point less than national aggregate consumer spending, based on annual business expense data. The divergence reflects not only slower population and economic growth in New Jersey but also the tendency for consumer spending to shift to nontaxable services such as housing, health care, and education. We assume that sales tax growth in a fiscal year will be one percent slower than growth in national (current-dollar) consumer spending in the prior year.

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[2] Pre-tax operating earnings are profits with inventory valuation and capital consumption adjustments.
[3] We assume 10 percent more for every percent of more rapid GDP growth.
[4] The national tax base is assumed to have grown 5.3 percent at that time.
[5] The 4.3 percent trend reduced by 13 percent, which is the product of the 1.3 percent growth shortfall and 10 percent.

Other Revenues

Some taxes in this group—most notably real estate transaction taxes, but also lodging taxes—clearly do reflect economic conditions, while the transfer-inheritance tax is more responsive to market swings which affect the value of estates. Other taxes, however, have little or no clear trends (motor vehicle license fees, for instance); others are determined by fairly complex mechanisms (casino revenues, motor fuel, cigarette taxes, etc.). The recent surge in home sales has been a major factor in collecting more than $9 billion in miscellaneous revenue (exclusive of the FY2021 receipt of emergency COVID borrowing). Our baseline assumes that going forward these receipts will generally equal the average of the previous 5 fiscal years (again, not taking into account the FY2021 borrowing, as well as the Horizon transaction), though we anticipate that the recent surge in real estate transaction revenues will roll back and anticipate that the state will realize less in investment earnings from its surplus than the large sums assumed for Fiscal years 2023 and 2024.

REVENUE SCENARIOS

The MYBW's Revenue Forecasting Subcommittee evaluated the revenue consequences of three scenarios: 1. Baseline, 2. Pessimistic, and 3. Optimistic.

The Baseline Scenario

The Baseline scenario assumes that the economy will fall into a mild recession in late 2023 and into the early part of 2024. The weakness is primarily the result of the sharp increases in interest rates generated by the Federal Reserve since the start of 2022 and the loss of the impetus provided by federal COVID relief.

The recent banking problems has led to the withdrawal of a notable number of deposits from small- and mid-sized banks, which may hamper business and real estate lending, which could accentuate softness. Federal programs supporting increased infrastructure spending and investment in areas such as chip production will have at most only a second-order effect on the aggregate economy over the next several years.

It is anticipated that inflation will continue to moderate, and with job growth ebbing and unemployment moving up, the Federal Reserve will stop boosting rates and eventually unwind some of the recent increases, setting the stage for a recovery to start in 2024, with growth gaining some moderate momentum in 2025 and 2026.

BASELINE SCENARIO							
Economic Assumptions and Revenue Projections							
(Numbers in thousands)							
	CY22	CY23	CY24W	CY25	CY26	CY27	CY28
National Outlook							
Real Gross Domestic Product Growth (year over year)	2.1	1.2	0.4	2.0	1.8	1.8	1.8
Nominal Gross Domestic Product Growth	9.2	5.2	2.7	4.1	4.1	4.1	4.1
Current Dollar Consumer Spending Growth	9.1	5.0	2.7	4.1	4.0	4.0	4.0
Personal Income Growth	2.4	5.3	2.8	4.5	4.0	4.0	4.0
Capital Gains Realizations (billions)	$500,000	$500,000	$550,000	$625,000	$700,000	$800,000	$900,000
Personal Income Plus Capital Realizations (growth)	0.1	5.2	3.0	4.7	4.2	4.3	4.2
Consumer Price Index Growth	7.1	3.3	2.4	2.5	2.5	2.5	2.5
Unemployment Rate	3.6	3.8	4.2	4.0	4.0	4.0	4.0
New Jersey							
Taxable Consumer Spending	8.1	4.0	1.7	3.1	3.0	3.0	3.0
Personal income plus realizations	-0.4	4.7	2.5	4.2	3.7	3.8	3.7
Unemployment rate	3.7	3.4	3.9	4.0	3.9	4.0	4.0
	FY22	FY23	FY24	FY25	FY26	FY27	FY28
New Jersey State Budget Revenue Projections							
Sales Tax	$13,415	$14,186	$14,175	$14,416	$14,863	$15,309	$15,768
Gross Income Tax and PT Business Alternative Tax	$24,717	$23,160	$23,596	$24,175	$25,192	$26,124	$27,109
Corporation Income Tax	$5,800	$5,576	$5,347	$4,522	$4,626	$4,732	$4,841
Other Revenues	$9,121	$9,918	$9,684	$8,188	$8,513	$8,865	$8,914
Total Revenue	**$53,053**	**$52,840**	**$52,802**	**$51,300**	**$53,193**	**$55,029**	**$56,632**

METHODOLOGY: FY23 and FY24 use Treasury assumptions for all taxes. Sales tax for FY25-FY28 calculated as increment by growth of taxable coneumer spending in previous CY. Gross Income Tax and Pass-Through Business Alternative Tax for FY25-FY28 calculated as increment by growth of personal income plus capital gains realizations. Corporation income tax for FY28-FY28 calculated as increment by formula related to natioanl nominal Gross Domestic Product growth.

This scenario has some troubling implications for New Jersey revenues over the next few years. In this environment, the stock market and home prices will likely, at best, stagnate, leading to weakness in state income tax revenue related to capital gains realizations. Also, revenue from real estate transactions—an important positive factor the last few years—is likely to fall.

Consumers will be tightening their belts, putting downward pressure on sales taxes, and the corporate profit outlook is problematic, suggesting risks to the that revenue stream.

While the subsequent economic recovery will stem losses and lead to some revival in revenues, it seems highly unlikely that growth will return to the robust pace of recent years. Thus, given an assumption that the level of services will be sustained, it is highly likely that much if not all, of the state's current large surplus will be dissipated.

The Pessimistic Scenario

The Pessimistic scenario assumes that the impact of the negative forces currently at work will be accentuated. Most notably, financial stress may become substantially larger than what is now assume. Aside from potential weakness stemming from areas such as real estate lending, the resolution of the debt ceiling stand-off suggests a somewhat faster slowdown in federal spending, which may add to constraint. The net effect could be a more substantial downturn.

PESSIMISTIC SCENARIO

Economic Assumptions and Revenue Projections
(Numbers in millions)

	CY22	CY23	CY24W	CY25	CY26	CY27	CY28
National Outlook							
Real Gross Domestic Product Growth (year over yea	2.1	-1	0.5	1.5	2	1.8	1.8
Nominal Domestic Product Growth	9.2	3	2.5	3.5	4	3.8	3.8
Current Dollar Consumer Spending Growth	9.1	2.5	2	2.5	4	3.8	3.8
Personal Income Growth	2.4	3.3	2	2.5	4	4	4
Capital Gains Realizations (billions)	$500,000	$300,000	$200,000	$250,000	$325,000	$400,000	$500,000
Personal Income Plus Capital Realizations (growth)	0.1	2.3	1.5	2.7	4.3	4.2	4.3
Consumer Price Index Growth	7.1	3.3	2	2.3	2.5	2.5	2.5
Unemployment Rate	3.6	4	5.5	5.5	5.2	5	4.7
New Jersey							
Taxable Consumer Spending	8.1	1.5	1.0	1.5	3.0	2.8	2.8
Personal income plus realizations	-0.4	1.8	1.0	2.2	3.8	3.7	3.8
Unemployment rate	3.7	3.8	5.3	5.5	5.2	5.0	4.7
	FY22	FY23	FY24	FY25	FY26	FY27	FY28
New Jersey State Budget Revenue Projections							
Sales Tax	$13,415	$14,186	$14,175	$14,317	$14,531	$14,967	$15,386
Gross Income Tax and PT Business Alternative Tax	$24,717	$23,160	$23,596	$23,840	$24,363	$25,283	$26,231
Corporation Income Tax	$5,800	$5,576	$5,347	$4,415	$4,251	$4,307	$4,276
Other Revenues	$9,121	$9,918	$9,684	$8,000	$8,300	$8,700	$8,900
Total Revenue	$53,053	$52,840	$52,802	$50,571	$51,446	$53,256	$54,793

METHODOLOGY: FY23 and FY24 use Treasury assumptions for all taxes. Sales tax for FY25-FY28 calculated as increment by growth of taxable coneumer spending in previous CY. Gross Income Tax and Pass-Through Business Alternative Tax for FY25-FY28 calculated as increment by growth of personal income plus capital gains realizations. Corporation income tax for FY28-FY28 calculated as increment by formula related to natioanl nominal Gross Domestic Product growth.

While in this environment inflation could come down fairly notably soon, and the Federal Reserve could well rapidly change its policy stance, bringing down interest rates more rapidly than in the baseline, this will not be enough to quickly rectify the situation.

This scenario would severely stress state revenues in FY25—the negative forces assumed in the baseline would be even stronger--leading to a more rapid dissipation of the surplus.

The Optimistic Scenario

Under the Optimistic scenario, current financial problems proved to be short-lived, inflation moves down steadily, and the Federal Reserve moves to reverse interest rate hikes more quickly. While the economy stays soft in 2023, there is nothing that looks like a recession The stock market and profits prove to be fairly resilient. The housing market, though, softens as the boom fades. Economic activity is on a higher level throughout the horizon than envisioned in the baseline.

In this scenario, the downward pressure on state revenues in FY25 is much less marked. While growth in FYs 26 and 27 is not appreciably different than the baseline, the level of revenue is higher, allowing the state to sustain current services without fully dissipating the surplus.

OPTIMISTIC SCENARIO

Economic Assumptions and Revenue Projections
(Numbers in millions, all others are percentages)

	CY22 2022	CY23 2023	CY24W 2024	CY25 2025	CY26 2026	CY27 2027	CY28 2028
National Outlook							
Real Gross Domestic Product Growth (year over year)	2.1	1.8	2.5	2.5	2.3	2.0	2.0
Nominal Domestic Product Growth	9.2	5.4	4.8	4.6	4.5	4.3	4.3
Current Dollar Consumer Spending Growth	9.1	5.8	4.8	4.5	4.0	4.0	4.0
Personal Income Growth	2.4	6.0	5.8	4.7	4.2	4.0	4.0
Capital Gains Realizations	$500,000	$700,000	$700,000	$800,000	$850,000	$900,000	$1,000,000
Personal Income Plus Capital Realizations (growth)	0.1	6.8	5.6	5.0	4.3	4.1	4.2
Consumer Price Index Growth	7.1	4.4	5.6	5.0	4.3	4.1	4.2
Unemployment Rate	3.6	3.5	3.6	3.7	3.8	3.9	4.0
New Jersey							
Taxable Consumer Spending	8.1	4.8	3.8	3.5	3.0	3.0	3.0
Personal income plus realizations	-0.4	6.3	5.1	4.5	3.8	3.6	3.7
Unemployment rate	3.7	3.4	3.4	3.5	3.6	3.8	3.9
	FY22	FY23	FY24	FY25	FY26	FY27	FY28
New Jersey State Budget Revenue Projections							
Sales Tax	$13,415	$14,186	$14,175	$14,714	$15,228	$15,685	$16,156
Gross Income Tax and PT Business Alternative Tax	$24,717	$23,160	$23,596	$24,806	$25,914	$26,889	$27,846
Corporation Income Tax	$5,800	$5,576	$5,347	$5,645	$6,057	$6,438	$6,715
Other Revenues	$9,121	$9,918	$9,684	$8,300	$8,600	$9,000	$9,200
Total Revenue	**$53,053**	**$52,840**	**$52,802**	**$53,464**	**$55,799**	**$58,013**	**$59,917**

METHODOLOGY: FY23 and FY24 use Treasury assumptions for all taxes. Sales tax for FY25-FY28 calculated as increment by growth of taxable coneumer spending in previous CY. Gross Income Tax and Pass-Through Business Alternative Tax for FY25-FY28 calculated as increment by growth of personal income plus capital gains realizations. Corporation income tax for FY28-FY28 calculated as increment by formula related to natioanl nominal Gross Domestic Product growth.

Likelihood of the Scenarios and Their Implications

At this time, it seems that only a modest probability of around 20% can be assigned to the Optimistic scenario. The economy and markets have proven to be somewhat surprisingly resilient over the past year, so it seems reasonable to assign a higher probability to the Baseline scenario (50%) than to the Pessimistic one (30%). Given this assessment, it appears that there is a very strong likelihood—80% or so—that the state will dissipate its surplus sometime in the next few years if the current level of services is sustained.

The Governor's budget proposal projects a surplus of nearly $8 billion at the end of FY24, which will provide a cushion allowing time to take steps to address the fiscal crisis.

Under the Baseline scenario, the state would spend down its surplus by FY27, assuming current levels of services are maintained, and revenues are not increased. Under the Pessimistic scenario, the state would dissipate its surplus a year earlier, in FY26.

Under the Optimistic scenario, the state will be able to fund current levels of services without tax increases (other than the scheduled rollback of the highest corporate rate) and retain a cash surplus at the end of FY28.

It should be noted that all scenarios assume that the latest Treasury projection of FY24 revenues will be achieved. However, if the economic and financial environment is in line with the pessimistic scenario, it is possible that revenues will fall short of expectations, thus implying that the state's surplus could be dissipated more rapidly.

FIVE-YEAR SPENDING: ASSUMPTIONS AND METHODOLOGY

The Current Services Budget for FY25 to FY28 is a baseline spending plan that shows the projected costs of continuing state services and state aid at current levels with normal inflation. As such, it differs from a true Multi-Year Budget that would include recommendations for major policy changes in the years ahead to improve services, cut costs and meet policy priorities. While our revenue forecasts are identical to those that would be required under Senate Bill 654, our Current Services Budget is similar in approach, though less detailed, than the document that would be required under the Oroho-Sarlo consensus revenue forecasting bill.

Like the 2010 *Facing Our Future* report that was the last to provide a five-year current services projection for the state budget prior to our Multi-Year Budget Workgroup study last June, our Current Services Budget for FY22 to FY28 provides an aggregate picture at the macro level in major spending areas for FY22 to FY28, particularly those programs that make up major cost centers or have been the subject of large increases.

State budget expenditures have risen by more than 50% since FY17, driven largely by a $5 billion ramp-up to the full Actuarially Required Contribution to the pension system for teachers and state workers that had been underfunded for decades and by a $3.3 billion increase in state aid to education under the provisions of the School Funding Fairness Act of 2018.

Overall state expenditures – including federal aid, the Transportation Trust Fund, and revolving and dedicated funds that provide funding in addition to the $52.8 billion supported by state revenues – grew with equal rapidity. In response to the Covid crisis, federal funding jumped from $13.9 billion in FY19 to $16.3 billion in FY20 and peaked at $23.billion in FY23 before dipping to $21.8 billion for the upcoming FY24 budget year.

Under the Current Services Budget developed by the Multi-Year Budget Workgroup, total spending is projected to rise from $52.802 billion in FY24 to $59.508 billion in FY28 – a total increase of 12.8% over four years that averages out to 3.2% a year and is just 0.1% higher than the 12.6% increase produced by the annually compounded 3% increases used to compare with the three revenue scenarios in the opening chart.

The largest increases are:

- $4.9 billion over four years to complete the ramp-up to full funding of the S2 school funding formula in FY25, with 3% a year added for inflation in future years.
- $7 billion to cover increases in Medicaid/CHIP, public employee health benefits and other healthcare spending from FY25 to FY28; and
- $500 million a year in increased state aid to NJ Transit for FY26 to FY28, covering just over half of the operating deficit created by the spend-down of billions of dollars of federal subsidies provided in the wake of Covid-19 enabled the state to reduce its own operating subsidy.

PROJECTED CURRENT SERVICES BUDGET

Completes S2 ramp-up to full funding in FY25. Funding for debt service and municipal aid held flat from FY25 to FY28. Medicaid, CHIP, DMAVA veterans homes, and health benefits for current state workers and teacher and state worker retirees projected at 5.1% growth from FY25 to FY28. Pension costs are actuarial projections. All other spending increased 3% annually for inflation.

	FY22 Actual Expenditure	FY23 Projccted Expenditure	*FY24 Projected Expenditure*	*FY25 Projected Expenditure*	*FY26 Projected Expenditure*	*FY27 Projected Expenditure*	*FY28 Projected Expenditure*
TOTAL NJ STATE BUDGET APPROPRIATIONS (with 3% assumed for FY25-FY28)	**$51,096,125**	**$52,839,642**	***$52,802,265***	***$54,386,333***	***$56,017,923***	***$57,698,461***	***$59,429,414***
MAJOR SPENDING INCREASES							
<u>Previously Committed Spending Growth</u>							
1. K-12 School Formula Aid	$9,127,256	**$9,920,000**	**$10,750,000**	**$11,450,000**	**$11,793,500**	**$12,147,305**	**$12,511,724**
% Change		10.9%	8.4%	5.6%	3.0%	3.0%	3.0%
(includes complete ramp-up to full formula funding in FY25)							
2. Direct Property Tax Relief Programs							
Currently Budgeted	**$1,386,300**	**3,009,500**	**$3,018,000**	**$3,026,523**	**$3,035,070**	**$3,043,641**	**$3,052,236**
% Increase		238.7%	2.6%	9.2%	5.8%	5.4%	5.2%
<u>Medicaid/Healthcare Cost Increases)</u>							
(FY25-FY28 increases reflect new CMS 5.1% inflation projection)							
1. Department of Human Services	**$7,040,291**	**$8,307,958**	**$8,993,828**	**$9,452,513**	**$9,934,591**	**$10,441,256**	**$10,973,760**
Medicaid/Children's Health Insurance Program (CHIP)	$4,509,000	$4,454,000	$5,777,000	$6,071,627	$6,381,280	$6,706,725	$7,048,768
(Adjustments to Medicaid/CHIP reflect $665.2M being returned to General Fund due to continued increased federal Covid-19 aid, $116.2M increase to NJ FamilyCare to replace lost Covid-19 aid)		-$665,200	$116,000				
2. Public Employee Health Benefits							
Health Benefits for Current State Employees	$1,496,364	$1,677,764	$1,760,945	$1,850,753.20	$1,945,141.61	$2,044,343.83	$2,148,605.37
Post-Retirement Medical Benefits for Teachers, State Employees	$1,946,460	$2,113,587	$2,310,885	$2,428,740.14	$2,552,605.88	$2,682,788.78	$2,819,611.01
Health Benefits Total, Active and Retirees	**$3,396,342**	**$3,791,351**	**$4,071,830**	**$4,279,493**	**$4,497,747**	**$4,727,133**	**$4,968,216**
% Change		11.6%	7.4%	5.1%	5.1%	5.1%	5.1%
3. DMAVA Veterans Nursing Homes	**$67,888**	**$70,645**	**$72,582**	**$76,284**	**$80,174**	**$84,263**	**$88,560**
4. Health Care Accessibility and Affordability Fund (Horizon Payment)		**$600,000**	**$100,000**	0	0	0	0
<u>NJ Transit Post-Covid Funding Operating Deficit</u>							
NJ Transit Budget	**$2,678,100**	**$2,710,500**	***$2,866,600***	***$2,964,300***	***$3,051,500***	***$3,143,045***	***$3,237,336***
Covid-19 Relief (CARES, CRRSAA, ARPA)	$1,030,700	479,200	$808,800	$749,300	$0	$0	$0
NJ Turnpike Funding	$325,000	$721,000	$440,000	$455,000	$470,000	$484,100	$500,000
NJ Transit State Operating Subsidy	$100,000	$100,000	$140,000	$140,000	$140,000	$144,200	$140,000
Farebox Revenue	$536,700	$687,200	$776,300	$795,400	$813,300	$837,699	$862,830
Continued TTF Capital to Operating Transfers	$432,200	$362,000	$334,000	$334,000	$334,000	$334,000	$334,000
Clean Energy Fund	$82,100	$82,100	$70,100	$70,100	$70,100	$70,100	$70,100
Commercial Revenue/Other Reimbursements	$321,600	$317,100	$297,400	$301,100	$306,300	$311,500	$316,700
NJ Transit Revenue Subtotal	*$2,828,300*	$2,748,600	$2,866,600	$2,844,900	$2,133,700	$2,181,599	$2,223,630
NJ Transit Revenue -to-Expenditure Differential	**$150,200**	**$38,100**	**$0**	**($119,400)**	**($917,800)**	**($961,446)**	**($1,013,706)**
Likely Increase in State Aid or Operating Subsidy					*$500,000*	*$500,000*	*$500,000*
MAJOR EXPENDITURES PROJECTED AT ZERO OR LOW GROWTH							
0							
1. Pension Contribution from State Budget							
Pension costs decline slightly with funding at 100% of ARC. Pension also receives $1 billion annually from NJ State Lottery	**$5,543,157**	**$5,472,720**	**5,713,000**	**5,706,400**	**5,703,900**	**5,703,200**	**$5,688,900**
2. Debt Service		**$4,300,000**	**$4,155,000**	**$4,100,000**	**$4,100,000**	**$4,050,000**	**$4,050,000**
Decrease in debt service reflects savings from Debt Defeasance Fund expenditures							
3. Municipal Aid							
Municipal aid had been historically flat for two decades	**$1,585,600**	**$1,662,000**	**$1,593,000**	**$1,593,000**	**$1,593,000**	**$1,593,000**	**$1,593,000**
Subtotal for State Expenditures Listed	$28,246,834	$36,634,174	$38,507,240	$39,824,213	$41,377,983	$42,433,997	$43,566,397
Projected % Growth in Expenditures Listed		15.8%	*6.2%*	*4.3%*	*4.6%*	*3.2%*	
Expenditures not listed (3% growth factored in FY25-FY28)	$22,849,291	$16,205,468	$14,295,025	$14,723,876	$15,165,592	$15,620,560	$16,089,177
Total Current Services Budget (Expenditures Itemized)	**$51,096,125**	**$52,839,642**	**$52,802,265**	**$54,548,089**	**$56,543,575**	**$58,054,557**	**$59,655,573**
Total Current Services Budget at 3% Growth			**$52,802,265**	**$54,386,333**	**$56,017,923**	**$57,698,461**	**$59,429,414**
Difference ($220M average on $57.5B median budget)				*$161,756*	*$525,652*	*$356,096*	*$226,159*

The 5.1% projected increase in healthcare costs, the completion of the S2 school funding formula ramp-up, and the increased subsidies for NJ Transit are largely offset by:

- virtually flat funding for the state's pension system now that the full Actuarially Required Contribution is being made;
- a projected slight reduction in debt service payments despite higher interest rates because of expenditures from the Debt Defeasance Fund annually;
- The expected continuation of flat funding for municipal aid, which has been frozen at less than $1.6 billion for more than two decades.

All other spending is projected to grow at a 3% annual rate, including direct property tax relief, which jumped from $1.386 billion in FY22 to $3.09 billion in FY23 with the full implementation of Governor Murphy's ANCHOR property tax rebate program.

The StayNJ initiative that would cut property taxes in half for virtually all senior citizens is not included in the Current Services Budget because it has not been enacted. If approved as proposed, the StayNJ plan would add $4.2 billion to state spending: $300 million each in FY23 and FY24, $600 million in FY25, $800 million in FY26, $1 billion in FY27 and $1.2 billion in FY28 when it would be fully implemented.

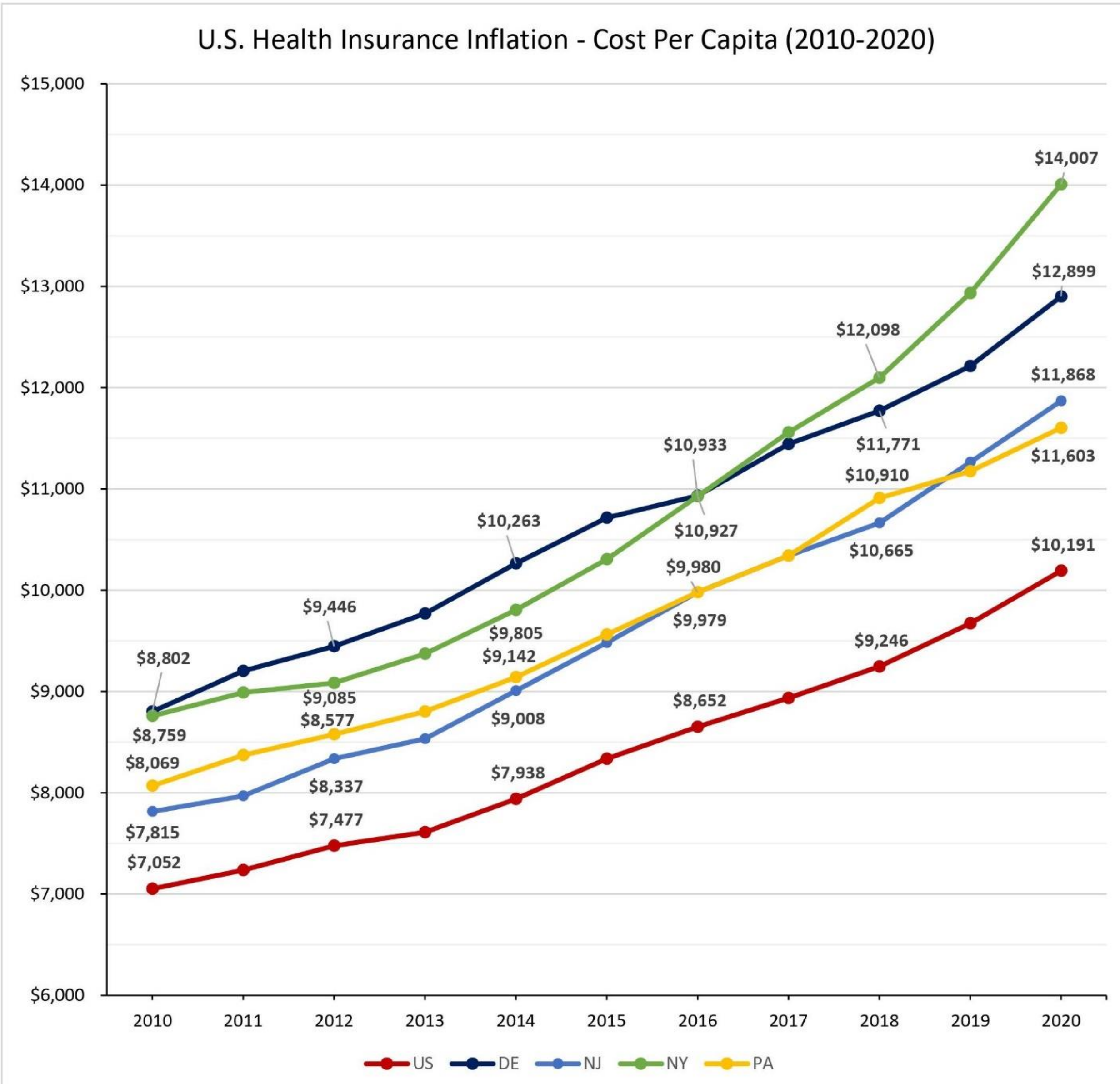
Medicaid and Healthcare Spending

Overall healthcare costs are expected to rise faster than other programs. The MYBW's Current Services Budget applies a 5.1% annual Healthcare Costs Multiplier to the $8.99 billion budget for the Department of Human Services, the $3.79 billion budget for healthcare benefits for current state employees and teacher and state worker retirees, and the $72 million budget for Department of Military and Veterans Affairs nursing homes.

The 5.1% increase for the next five years is up from the 4.75% multiplier in last year's report in accordance with the U.S. Centers for Medicare and Medicaid Services, which changed its projection from 4.75% to 5.1% through 2030. The New Jersey Health Care Affordability, Responsibility and Transparency program said it expected New Jersey to track the national average in its percentage increases in a report last spring.

The enormous amounts of federal aid provided for healthcare during Covid-19 makes any effort to track trends since FY20 meaningless, particularly for future forecasts.

The FY 2024 budget includes approximately a 7% increase in state Medicaid funding a third of which was needed to account for the loss of supplemental federal Medicaid Public Health Emergency funding which will expire in Dec 2023. While $116.2 million had to be added to the NJ FamilyCare program to make up for federal Covid-19 funding disappearing in FY24, that was more than covered by a $665.2 million in extra federal funding in FY23 that will enable that amount to be returned to the General Fund at the end of the budget year. Medicaid costs are projected to increase in FY 2024 despite the number of individuals enrolled declining by 4% as the state begins redetermining program eligibility. Including both federal and state funds,



New Jersey per capita healthcare costs are lower than New York State, but above Pennsylvania, Delaware and the national average.

SOURCE: U.S. Centers for Medicare and Medicaid Services

Indicative of the difficulties involved in forecasting healthcare costs in the wake of Covid-19 is the NJ FamilyCare program, which average 5.79% growth from 2000 to 2020, but only 2.6% in the three years immediately prior to the pandemic. Since the start of the pandemic, the average year over year growth for the NJ FamilyCare program has been 9.5%. It is too soon to say whether expenditures for FY 2025 and beyond will revert back to the long-term trend growth rate of 5.79% or possibly the recent trend rate prior to the pandemic of 2.6%. FY2025 projections will not be available until the next fiscal year.

The Current Services Budget reflects the Governor's announced intent to commit $700 million in revenues, received from Horizon Blue Cross Blue Shield of New Jersey as a result of its conversion to a mutual holding company, to a new Health Care Affordability and Accessibility Fund to maintain and increase access to access to healthcare coverage and improve healthcare outcomes. Of that amount, $600 million is allocated to the FY23 budget and only $100 million to FY24, so it has no impact on long=term budget growth projections.

Education Funding

Formula aid to education, which makes up almost 20% of the budget, is projected to increase from $10.75 billion in the FY24 budget to $11.45 billion in FY25 to complete the seven-year ramp-up to full funding under the provisions of S2.

That increase includes the $600 million needed to reach full funding under the formula, plus an additional $100 million in aid for districts impacted sharply by S2 funding reductions whose school aid cuts were reduced by a $100 million supplemental appropriation in April 2023. It is assumed that this additional funding will be added to the base going forward, rather than being a one-time enhancement, because reducing the districts to their original S-2 levels would mean much deeper cuts in their 2024-2025 school year budgets.

Education aid is expected to continue to increase 3% in FY26 and beyond. Potential challenges in the future, including addressing learning loss resulting from the pandemic and inflation, are likely to add pressure on the Legislature to increase school funding further. The School Funding Task Force proposed in S-354 (Gopal/Oroho)/A-3578 (Mukherji, Benson, Pintor-Marin) could reexamine issues such as potential flexibility within the 2% levy cap and policies that would promote K-12 school district regionalization.

NJ Transit's Funding Cliff

NJ Transit is the only state agency require by law to provide a multi-year budget, which is the reason that fiscal experts and transit advocates are fully aware that the agency is heading into a major budget crisis starting in FY26.

The state budget provided more than $400 million in operating support to NJ Transit in FY20, and Senate President Steve Sweeney and Senate Majority Leader Loretta Weinberg had just announced plans to dedicate a 1% Corporation Income Tax surcharge, plus $200 million from the NJ Turnpike and Clean Energy Fund, to increase NJ Transit funding when Covid-19 hit in March 2020.

NJ Transit and other transit agencies across the nation suffered severe drops in ridership and received billions of dollars in aid in all three federal pandemic relief packages, enabling the state to cut its NJ Transit operating subsidy to just $100 million. Heading into the FY23 budget year, NJ Transit still had $2.037 billion in Covid relief funds left, but it spent $479 million that year, allocated another $808 million to balance its FY24 budget and will spend the remaining $749 million in FY25.

The following year, in FY26, NJ Transit will have a $917 million gap that would grow to $961 million in FY27 and $1.02 billion in FY28 with normal 3% inflation. To put NJ Transit's funding crisis in perspective, the $917 million budget hole is almost 30% of the agency's projected $3.05 billion operating budget for FY26, and that already includes its $470 million in dedicated NJ Turnpike Authority funding. Fare increases are likely, but the gap cannot be made up from commuters: Total farebox revenue for NJ Transit rail, bus and light rail was just $637 million this year.

The MYBW Current Services Budget assumes that the Legislature will increase its current $100 million NJ Transit operating subsidy by providing an additional $500 million a year to the agency starting in FY26 to avert massive service cuts and/or fare hikes. This would make up just over half of NJ Transit's operating deficit for the three-year period.