New Jersey's Fiscal Cliff Explained

A REPORT FOR THE GARDEN STATE INITIATIVE
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In June 2023, New Jersey Governor Phil Murphy signed fiscal year 2024's budget plan into law. The $54.5 billion spending plan included a projected surplus of $8.3 billion – which is approximately 15 percent of total appropriations.[1] Just six months later in January 2024, the legislature and Governor are publicly discussing tax increases to fund emerging budget gaps. What happened to New Jersey's budget to make it deteriorate so quickly? Put simply, the state has increased spending so dramatically over the past decade that its ability to attract residents and businesses continues to wane and is not able to generate the revenues necessary to fund recurring operating expenditures.

In 2020, it was not clear what would happen to the fiscal condition of New Jersey. Prior to the pandemic, New Jersey was ranked the worst place in the country to do business, the highest in property taxes, and scored low on budget transparency and behavior that exhibited good financial management practices.[2] Further, New Jersey ranks 49th nationally in one ranking of state long-term fiscal stability, ahead of only Illinois.[3] The state was ill-prepared for a potential fiscal shock which arrived with the government response to the COVID-19 pandemic. During 2020, New Jersey like many states ordered "non-essential" retail businesses to close, shifted certain activities from in-person to remote, prohibited the gathering of parties and other social events, and paused in-person schooling.[4] The effects of these public policies are likely to be felt by citizens, taxpayers, and businesses for many years.

The federal government's fiscal response to these choices was to shower states with ample resources to avoid some of the worst potential outcomes of the resulting economic shutdown. New Jersey faced a decision on whether it would use these funds to pivot and change its fiscal behavior that had led it to be a poor place to operate a business and reside, or if it would simply kick the fiscal can down the road as it often had in the past.

The analysis here finds that New Jersey's experience with federal largesse in response to the COVID pandemic is decidedly mixed. On the one hand, it has held the line on taxes since the pandemic and even lowered tax rates in some cases; it has made required pension contributions; and it generally did not explicitly use the temporary federal funds to finance ongoing and permanent programs. These temporary federal funds, however, did facilitate the state's ability to make its pension pay-

1 From "Governor Murphy Signs Fiscal Year 2024 Budget into Law," available at https://www.nj.gov/governor/news/news/562023/approved/20230630f.shtml#:~:text=The%20%2454.5%20billion%20budget%20for,surplus%20inherited%20five%20years%20ago. .

2 Based on the Tax Foundation's *2024 State Business Tax Climate*; Tax Foundation's *Where Do People Pay the Most in Property Taxes?*, and the Volcker Alliance's *Report of the State Budget Crisis Task Force*, accessed January 2, 2024.

3 Based on U.S. News & World Report, available at https://www.usnews.com/news/best-states/rankings/fiscal-stability/long-term .

4 See, for example, https://nj.gov/governor/news/news/562020/approved/20200320j.shtml .

ments, thereby freeing up state funds. Put plainly, New Jersey was able to increase its own recurring spending in the last several years because it was generously subsidized by the federal government.

But with federal funds expiring, the state has much to do to right its fiscal boat. When inflation is accounted for, New Jersey's economy (measured as Gross State Product) has actually contracted during the last decade while the nation has expanded. Federal money essentially propped up all this excessive state spending for the past several years.

Most recently, the growth in New Jersey's taxes and spending have accelerated. Between 2013 and 2017, revenue growth was kept to around one percent per year and spending to 0.5 percent. From 2018-2022, revenue growth increased to nearly 5 percent annually and spending to 4 percent. Unsurprisingly, residents and businesses frequently cite the high level of taxes as a major concern.[5]

Furthering the precarious position for the state, over the past decade New Jersey's revenues from taxes and fees have increased about 36 percent on an inflation-adjusted basis, while general price changes in the economy have only increased 26 percent.[6] In fact, revenue from most of New Jersey's major taxes and fees have steadily increased each year – in this decade, the Corporation Income Tax has increased 92 percent in real terms while Other Major Taxes have increased over 100 percent.

If the larger economy slows or if tax revenue growth falters (as we are observing currently), New Jersey could see its sizable budget reserve consumed very quickly because the state has insufficiently controlled spending over the past several decades. This sets up what many have referred to as the "Fiscal Cliff." Specifically, New Jersey now must decide to either significantly reduce spending, or significantly increase tax rates to replace the surplus federal funds presently being consumed. At current levels and trends of spending, New Jersey needs to collect at least $5 billion of incremental revenues by 2028 on top of the 90 to 100% growth in many revenue lines over the past several years.[7]

As examples, to generate $5 billion in additional tax revenues to fill this gap, the average income tax liability for New Jersey filers would increase nearly 27% from current levels:

- » Taxpayers with annual incomes between $100,000 and $250,000 would pay an additional $1,650 annually in income taxes;
- » Taxpayers with annual incomes between $250,001 and $500,000 would pay an additional $4,700 annually in income taxes;
- » Taxpayers with annual incomes between $500,001 and $1 million would pay an additional $11,500 annually in income taxes;
- » Taxpayers with annual incomes over $1 million would pay an additional $71,000 annually in income taxes. These taxpayers tend to be very mobile and may respond to these increased rates by exiting the state.

5 See as examples WHYY "A New Poll Says Taxes Are the Top Issue of Concern for NJ Residents" November 24, 2021, available at https://whyy.org/articles/a-new-poll-says-taxes-are-the-top-issue-of-concern-for-n-j-residents/ ; and John Reitmeter, NJ Spotlight News, November 28, 2023 "Survey of NJ Business Leaders: Guarded Optimism Despite Some Tangible Gains" available at https://www.njspotlight-news.org/2023/11/closely-watched-nj-business-climate-survey-reveals-mixed-bag-especially-sales-profits-wages-hiring/ .

6 Revenue data from the FY 2022 Annual Comprehensive Financial Report of New Jersey; inflation data from the Bureau of Labor Statistics, CPI for All Urban Consumers (CPI-U) series.

7 Based on data from the Multi-Year Budget Workgroup: Second Annual Report, *Comparing Five-Year Revenue Forecasts with Current Services Budget Projections*. See "State Spending Over Time" on page 18 of this report for additional details,

Overall, taxpayers with incomes above $100,000 will shoulder nearly 90% of the tax increase necessary to just close this budgetary hole – this presumes no new spending from this tax increase.

Alternately, if the sales tax were to need to collect $5 billion in additional tax revenues (increasing from nearly $13.5 billion to $18.5 billion annually), the sales tax rate would need to increase from 6.625% to nearly 9.1%, assuming the current sales tax base was unchanged. Such a rate would make New Jersey have the highest state sales tax rate in the nation, and sixth highest nationally when combined with local sales tax rates.[8] This translates into:

- A $35,000 car purchase in New Jersey would see sales tax liability for a typical taxpayer increase from about $2,300 to nearly $3,200;
- A $500 major appliance purchase (such as a washing machine, dryer, etc.) would see sales tax increase more than 37% from $32 to $45;
- A $150 restaurant bill would see sales tax increase from nearly $10 to nearly $14.

In New Jersey, the per capita sales tax collection currently amounts to nearly $1,200 annually.[9] The average resident would be looking at more than a $400 annual increase or 30% more from the increased sales tax rate.

Alternately, if the corporate business tax were to need to collect $5 billion in additional annual tax revenues (increasing from $5.7 billion to $10.7 billion), New Jersey's already top decile in the nation corporate tax rate would need to nearly DOUBLE – potentially driving even more businesses out of the state.

Given the trend of tax reductions in many other states who are controlled by both Democratic and Republican legislatures, this analysis will demonstrate that continued acceleration of state tax rates will only undermine population, economic, and ultimately state revenue growth.

New Jersey does not have a revenue problem - but rather has a spending problem. Over the past decade, state spending has increased 28 percent on an inflation-adjusted basis; during this same period, the state's population has grown only 3.7 percent in total - and actually started to shrink in 2022.[10]

New Jersey must confront its fiscal reality and change direction:

1. New Jersey is already a highly taxed state that is dependent upon a few taxpayers for its revenues. In 2011, those making over $250,000 paid over 50 percent of the gross income tax liability; in 2020, this group paid nearly 2/3 of the tax. This trend increases the risk to New Jersey that a small number of taxpayers moving out of state has an outsized effect on future budgets.
2. NJ should pursue lowering tax rates that make the state more competitive with states that are attracting businesses and residents. The state has experienced losses in construction and information while gained jobs in education, health, leisure, and hospitality. The industries

8 The Tax Foundation, available at https://taxfoundation.org/data/all/state/2023-sales-tax-rates-midyear/

9 The Tax Foundation, available at https://taxfoundation.org/location/new-jersey/

10 Based on data contained in the FY 2022 Annual Comprehensive Financial Report of New Jersey; inflation data from the Bureau of Labor Statistics, CPI for All Urban Consumers (CPI-U) series. See section "State Spending Over Time: Key Findings" on page 18 for more details.

reporting losses tend to pay well and those that have gained tend to have significant numbers of low-wage jobs.[11] While the nation has experienced sustained job and wage growth, New Jersey's labor market appears less robust by comparison. In the last decade, New Jersey has gone from an anemic less than 1 percent growth in population annually to negative growth in 2022, all while state spending has increased nearly one-third during the same time period.

3. New Jersey needs to reform its pension systems and retiree health insurance system. These legacy costs consume nearly 20% of total state revenues and is not sustainable. The state's pension and retiree health care obligations are significantly higher than other comparable states.

4. New Jersey needs to reduce the cost of energy, infrastructure, and construction to address underlying drivers of "unaffordability" for residents. Since 2012, New Jersey's state population has grown less than 3.7 percent in total, which is only a 0.3 percent average growth rate per year. By way of contrast, during this same period, the overall US population grew by nearly 6.2 percent, for about a 0.6 percent average annual growth rate or double New Jersey's growth rate.

5. New Jersey should focus state spending on vital public services and reallocate any remaining funds that measurably increase the state's attractiveness. For example, on education, on an inflation-adjusted basis, per pupil spending has increased nearly 17 percent during a decade of declining enrollment.

6. New Jersey needs to continue to reduce its budgetary reliance on one-shot revenues and rolling surpluses, and work towards real structural budget stability – where annual spending is covered completely by annual revenues.

These actions will better align New Jersey with other states that are experiencing strong growth, reduce the state's high debt burden, and make New Jersey's public services fiscally sustainable. Such actions should decelerate the outmigration of businesses and individuals and improve the economic conditions of the state.

11 Ibid.

Context: Federal Fiscal Response to Pandemic

Prior to the global pandemic, the state of New Jersey made a series of fiscal decisions that cumulatively weakened its fiscal condition. Successive administrations had increased taxes on individuals and businesses making it harder to open or expand businesses; for decades, politicians failed to make sufficient contributions to the state's pension systems, using these funds instead to grow other state spending categories (notably in education and health care, among other areas); retiree health care costs were left unfunded; and the costs of infrastructure – both maintenance and new construction - were among the highest in the nation which led to massive underinvestment in maintenance and new projects. As a result, the state's fiscal condition eroded. While the state has a public school system ranked either first or second best in the nation based on quality, residents are also among the most taxed in the nation, the state possesses nearly the lowest state credit rating (the second lowest only to Illinois), population and economic growth are mediocre, and bonded and non-bonded debt are significantly greater than most other states' conditions.[12]

It is within this context that New Jersey entered the COVID-19 pandemic. Like many states, New Jersey received significant federal aid to help it navigate the unprecedented public responses taken – such as the closing of private businesses, remote education for children, and remote working conditions for many professionals, among other actions. The Coronavirus Aid, Relief, and Economic Security (CARES) Act was passed in 2020 which included $150 billion in immediate, direct, and flexible aid to governments to be spent by the end of 2021. New Jersey's allocation was over $3.4 billion from this package - $2.4 billion for the state itself and the other $1 billion for municipalities within the state.[13]

In the American Rescue Plan Act of 2021 (ARPA), Washington provided $350 billion in Coronavirus State and Local Fiscal Recovery Funds (SLFRF) which was intended to provide budget support and relief to states and local governments. SLFRF funds are required to be obligated (or legally binding) by December 31, 2024 and actually expended by December 31, 2026. The state portion of these funds alone are over $195 billion. New Jersey's total funding from SLFRF totals more than $6.2 billion.[14] Between CARES and SLFRF the state of New Jersey itself received more than $8.5 billion in federal funds, which is equivalent to nearly 23% of actual tax revenues for fiscal year 2019 (the last fiscal year prior to the COVID-19 pandemic). In addition, municipalities within the state also

12 New Jersey did receive six credit rating improvements in 2022 and 2023 from the three major bond rating agencies. Yet it still ranks as the second lowest nationally despite these improvements.

13 Allocation information from https://taxfoundation.org/blog/federal-coronavirus-aid-to-states-under-cares-act/ .

14 Allocation information from https://home.treasury.gov/system/files/136/fiscalrecoveryfunds-statefunding1-508A.pdf .

received billions of dollars which took the pressure off the state to provide them with additional resources.

SLFRF funding was intended to be very generous and provide longer funding than might appear necessary for a situation that is now seemingly past us. This was purposeful. The funds are intended to shore up public budgets and Congress recognized that the fiscal effects of our pandemic response would likely be delayed – meaning that the potential revenue shortfalls envisioned from economic dislocation would not impact tax bases immediately and only over several years. When the federal government passed the American Rescue and Reinvestment Act (ARRA) to address the 2007 financial crisis and its effects, a sizeable amount of money was made available immediately. However, public budgets did not face the peak of decline until 2010 when the federal funds had basically run out already. The fiscal effects of ARRA, therefore, were muted and governments needed to reduce spending and create efficiencies even with available federal funds. Hence, the structure of SLFRF money was purposely made large and longer-term compared to ARRA to avoid a repeat of public budgets having to reduce spending and increase taxes while jurisdictions were recovering from a fiscal shock.

ARPA money could be spent on seven broad categories: public health; water, sewer, and broadband infrastructure; to offset negative economic effects; to provide services to affected communities; premium pay; the replacement of revenue lost; or administrative needs. While these categories are intended to provide governments significant flexibility in how ARPA money could be spent, there were rules that prohibited using the funds for debt service, directly funding accrued pension liabilities; offsetting revenues reduced by recent tax reduction legislation; or depositing the funds in rainy day funds or other reserve funds of the government. Funds can be used, however, for improving the state unemployment trusts which many governments depleted or spent down during the economic turmoil of 2020-2023.[15] Despite some restrictions on the funds, money is fungible and governments have used these significant resources for a multitude of purposes – both for operations and capital purposes.

In addition to SLFRF, states also received federal funds for more restricted purposes. ARPA, for example, included money for schools, higher education, rental assistance, and homeowner assistance, among others.

As noted, the intent of all this federal money was to limit the potential economic fallout from the nation's response to the pandemic – which was expected to be significant public budget cuts, increased taxes, and the depletion of reserve accounts. All such actions, it was believed, would result in more economic pain for citizens. As the availability of federal money winds down, however, there are now three concerns: Firstly, how did governments spend the significant amount of money they received? Secondly, did governments use temporary federal funding for permanent ongoing and routine expenditures? And finally, what will happen to New Jersey's finances when the money is exhausted in 2026?

New Jersey's CARES and ARPA Funds Today

New Jersey was allocated and disbursed $2.4 billion in CARES money. Table A in Appendix A displays how this initial federal allocation was used by the state. Of note, the most significant portion

15 As noted by Bunch (2022), several lawsuits still seek clarity on use of funds. However, the important point for purposes here is that the legislation provides governments with significant latitude concerning how these funds may be allocated and used. https://www.volckeralliance.org/resources/195-billion-challenge-interactive

of CARES money (32.3%) supplanted the state's need to fund significant payroll and health care costs for large segments of its employees – thus freeing up state funds for other uses. Another 10% of CARES funds covered the increased costs of operating state government resulting from the pandemic. These costs included county election by mail costs, county jail cost overruns, and increased administrative costs; however, these funds also included routine operating costs associated with New Jersey Transit, state police, the judiciary, election boards, as well as a police communications system.

New Jersey received $6.2 billion in ARPA funds alone, and committed to spending about $4 billion by June of 2023 (see Table B in Appendix A). The majority of these funds were dedicated to addressing the negative economic impacts from the public response to the pandemic.

The New Jersey operating budget in 2020 collected approximately $38 billion in tax revenues and fees. Therefore, federal SLFRF money given to New Jersey alone accounted for more than 16 percent of its annual taxes, while CARES funding added another 6 percent – showing the importance in size of these federal funds to the state.

Importantly, most of these items can be considered temporary programs to address a temporary problem caused by the pandemic response. In general, New Jersey did not use federal money to establish ongoing programs that it would need to fund after federal funds expired.[16] However, these federal funds clearly permitted New Jersey to use its own funds differently than it would have in the absence of these federal funds, such as to make unprecedented levels of pension payments. While New Jersey was permitted to use federal funds to pay for routine operating costs and non-public health capital acquisitions, the state was able to make investments in its pension funds, avoid adding debt, and begin addressing long-term liabilities. The question is whether the state will be able to maintain this fiscal rectitude now that federal funding is ending.

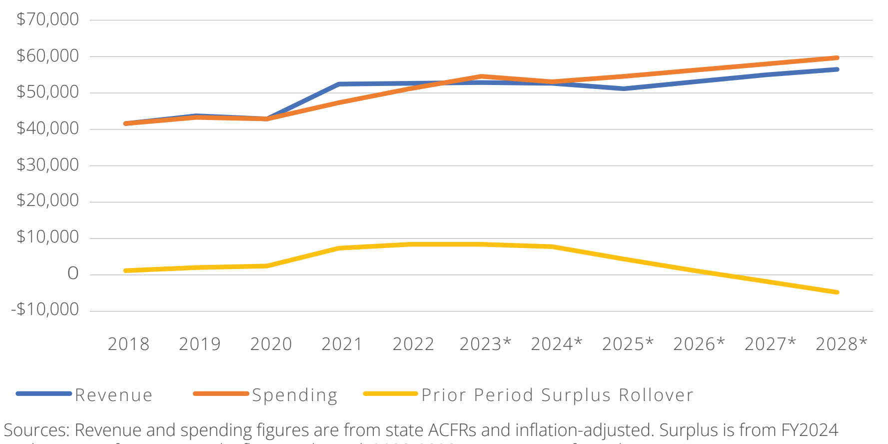
16 This contrasts with other governments that did use temporary federal money to create ongoing budgetary obligations. New York City, for example, has devoted much of its ARPA funds to recurring programs, thereby adding to out-year budgetary stress. See Thad Calabrese, *Revenue at Risk: Long-Term Strategies to Bolster NYC's Budget Against Potential Cuts in US and State Aid*, available at https://www.volckeralliance.org/resources/revenue-risk .

New Jersey's Fiscal State Depends on Temporary Surplus, Not Budget Balance

New Jersey's budget increasingly relies on surpluses rolled over from prior periods to fund the next year's budget, rather than planning on matching the revenues and expenditures in a single year. Importantly, this temporary surplus has shot up significantly because of COVID federal funds. For example, New Jersey rolled $300 million into FY2015 from the prior year – less than 1 percent of total revenues; by contrast, the state rolled over $8 billion, or nearly 16 percent of revenues, into FY2023.

While having money to roll forward is generally considered better than not, this massive surplus is the result of temporary federal funds which are now ending or already over. As shown in Figure 1, it is quite clear where this temporary funding enters the state's revenues and surplus - 2020; however, the state has also increased spending significantly as well because of perceptions that fiscal conditions have improved and money is available.

FIGURE 1: NEW JERSEY REVENUE, SPENDING, AND SURPLUS ROLLOVER, 2018-2022; 2023-2028 ESTIMATES



Sources: Revenue and spending figures are from state ACFRs and inflation-adjusted. Surplus is from FY2024 Budget in Brief, page 14 and inflation-adjusted. 2023-2028 are estimates from the MYBW.

Figure 1 shows the state's expected current trajectory from increased spending, increased taxation, and rapidly diminishing surplus as federal funds are extinguished.

Between 2013 and 2017, total revenue for the state grew on average only 1 percent per year on an inflation-adjusted basis (see Table 1). Further, spending only grew 0.5 percent per year on average. By contrast, total revenues have grown 5 percent per year on average from 2018 through 2022, and spending has grown 4 percent per year on average. As noted, the state has already reported that tax revenues declined over 3 percent in FY 2024 unofficially, suggesting that the artificially high growth rate of the past few years is over. As revenues return to normal, spending is not, and this is why the state is expected to exhaust its rolling surplus by FY2027.

TABLE 1: REVENUE AND SPENDING CHANGES OVER TIME

Program	Total Growth	Annual Average Growth
Revenue Growth 13-17	4.9%	1.0%
Spending Growth 13-17	2.5%	0.5%
Revenue Growth 18-22	26.2%	5%
Spending Growth 18-22	22.7%	4%

Source: Calculated from data reported in New Jersey's Annual Comprehensive Financial Reports, fiscal years 2013 through 2022.

The state Department of the Treasury reported major tax revenues declined $1.5 billion, or 3.1 percent, from the same period last year.[17] Using forecast estimates from the Multi-Year Budget Workgroup (MYBW) – a group of former high-ranking administration and legislative budget officials, economists, academics, and other experts – for FY2024 through FY2028, several points in Figure 1 stand out. Firstly, surplus funds are exhausted by FY2027; secondly, state spending is permanently increased following federal COVID funding; thirdly, spending increases more quickly than available public revenues. This is the fiscal problem facing New Jersey.

Figure 1 shows that New Jersey has a $3 billion problem by FY2027 – because surpluses are completely exhausted and spending is greater than revenues, and this problem grows to nearly $5 billion by FY2028. In order to fill this gap with income tax increases, all New Jersey taxpayers would have to pay more. Based on the most recent data available, middle-class taxpayers would expect to pay more than $1,600 annually in income taxes, while upper income taxpayers could pay more than $71,000 more in taxes. Even lower income taxpayers are not exempted from these potential tax increases, as shown in Table 2.

TABLE 2: INCOME TAX REQUIRED TO COVER NEW JERSEY BUDGET SHORTFALL

Income Level	Filers	Percent of Filers	Estimated Total Tax ($000)	Percent of Total Tax	Current Income Tax per Filer	Additional New Taxes ($000)	Average New Tax per Filer	Change in Tax per Filer
$1 million+	24,982	0.8%	6,696,000	35.5%	268,033	1,774,800	339,076	71,043
$500,001-$1 million	53,385	1.8%	2,326,100	12.3%	43,572	616,541	55,121	11,549
$250,001-$500,000	179,803	6.0%	3,168,300	16.8%	17,621	839,770	22,291	4,670
$100,001-$250,000	731,962	24.6%	4,547,500	24.1%	6,213	1,205,332	7,859	1,647
$75,001-$100,000	333,184	11.2%	870,700	4.6%	2,613	230,782	3,306	693
$50,001-$75,000	480,244	16.2%	738,800	3.9%	1,538	195,822	1,946	408
$35,001-$50,000	387,964	13.1%	293,600	1.6%	757	77,820	957	201
$20,001-$35,000	413,011	13.9%	160,000	0.8%	387	42,409	490	103
$10,001-$20,000	296,577	10.0%	56,700	0.3%	191	15,029	242	51
$0-$10,000	71,031	2.4%	6,400	0.0%	90	1,696	114	24
Total	**2,972,143**	**100.0%**	**18,864,100**	**100.0%**	**6,347**	**5,000,000**	**8,029**	**1,682**

Source: Taxpayer and liability data from New Jersey Annual Comprehensive Financial Report Fiscal Year 2022

17 See https://www.nj.gov/treasury/news/2023/08142023.shtml .

New Jersey might opt instead to increase its sales tax rate to make up the $5 billion shortfall. The average New Jersey resident pays $1,193 annually in sales taxes.[18] The average resident would have to pay more than $440 more in sales taxes annually to fix the state's budget problem.

If the business tax were to absorb the $5 billion increase, the current tax rate – among the highest in the nation, would have to double – increasing the cost of doing business significantly in New Jersey.

18 The Tax Foundation, available at https://taxfoundation.org/location/new-jersey/

State Revenues Over Time

It is important to contextualize the massive federal spending as it relates to New Jersey's budgeting system and practices. New Jersey has a diversified portfolio of taxes and fees. Total revenues for fiscal year 2022 were nearly $52.7 billion. The state's revenues by source and ten-year trend are displayed in Table 3.

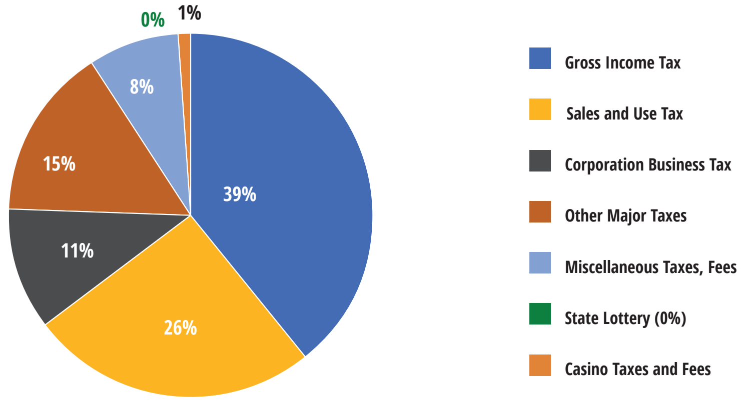
TABLE 3: NEW JERSEY REVENUE FOR BUDGETED FUNDS BY SOURCE AND TEN-YEAR TREND

Source	Amount, 2022	Ten-Year Trend
Gross Income Tax	$20,737.5	36%
Sales and Use Tax	13,446.9	27%
Corporation Business Tax	5,718.0	92%
Other Major Taxes	7,940.2	102%
Miscellaneous Taxes, Fees	4,292.2	-2%
Casino Taxes and Fees	518.2	52%
Total	**52,653.0**	**36%**

Source: New Jersey Annual Comprehensive Report, FY2022. Trend is inflation-adjusted using the CPI for All Urban Consumers (CPI-U) series from the Bureau of Labor Statistics..

Most of New Jersey's revenue sources have increased over the past decade significantly, growing 36 percent in total. Notably, the corporation business tax, paid by businesses operating in the state, has increased 92 percent during this time period. But the point is that the state is not lacking for tax revenues. Figure 2 shows the state's revenue portfolio as of 2022.

FIGURE 2: THE BIG PICTURE - REVENUE PORTFLIO FOR BUDGETED FUNDS, 2022



Source: New Jersey Annual Comprehensive Financial Report, Fiscal Year 2022

Over the past ten years, New Jersey's revenue portfolio has increasingly relied upon Corporation Business Taxes and Other Major Taxes.[19] The Corporation Business Tax has grown from 7.7 percent of the portfolio to nearly 11 percent, while Other Major Taxes have increased from over 10 percent to 15 percent. These are taxes that tend to make business more expensive to operate within the state, reduce employment opportunities, and dissuade business expansion or creation.

In addition, New Jersey increasingly relies upon those with higher incomes to generate its income tax revenues. In 2011, those making over $250,000 paid over 50 percent of the gross income tax liability; in 2020, this group paid nearly 2/3 of the tax. While such a tax policy might address concerns about equity or the well-off paying "their fair share," it also increases the risk to New Jersey that a small number of taxpayers moving out of state has an outsized effect on future budgets. Income taxes also increase the cost of residing in the state. Even a head of household in New Jersey earning $100,000 per year will owe nearly $3,000 in income taxes to the state, whereas this same individual would face no such liability in lower tax states such as Tennessee, Texas, or Florida.[20] This effect is even more pronounced at higher income levels.

Further, these same high-income taxpayers have significant volatility in their annual incomes which also exposes the state budget to increased revenue volatility. Wages – the most stable portion of income tax revenues – was the source for only 66 percent of total income taxes, a decline from nearly 73 percent in 2016.[21] New Jersey is relying upon more volatile income tax revenue sources as a result – business income and net gains, dividends, and interest. These more volatile income tax sources now make up about 25 percent of income compared to less than 19 percent in 2016.[22] Hence, this approach to tax policy increases budgetary risk that revenues will decline from these taxpayers at the same time other revenues may also be declining.

Risks of New Jersey's Revenue Portfolio on Economic Growth

It is quite clear, in fact, that this revenue portfolio is not structured well to grow the state's economy. As of 2023, New Jersey ranks last in the nation in the Tax Foundation's overall business climate index that assesses the tax systems across the US.[23] The state ranks 48th in the nation in both corporate and individual taxes and 42nd in sales tax (all as they relate to business taxation). Neighboring New York – also known as heavy taxer of businesses and individuals – ranks above New Jersey in overall business climate index. Further, while New York ranks 50th for individual taxes, it ranks 24th in corporate taxes and 43rd in sales taxes.[24] Neighboring Pennsylvania scores better in all categories compared to New Jersey. New Jersey's corporate income tax is an outlier compared to other states' tax rates. Corporate rates reach 11.5 percent and greatly exceed those of other regional states.[25]

As noted, over the past decade New Jersey's taxes and fees have increased about 36 percent on an inflation-adjusted basis, while general price changes in the economy have only increased 26 percent.[26]

19 Other Major Taxes include taxes on insurance premiums, motor fuels, motor vehicle, realty transfer, petroleum gross receipts, cigarette, alcohol, transfer inheritance, and others.

20 Based on calculations from the Tax Foundation.

21 See https://www.nj.gov/treasury/omb/publications/24bib/BIB.pdf page 63.

22 Ibid.

23 https://statetaxindex.org/state/new-jersey/

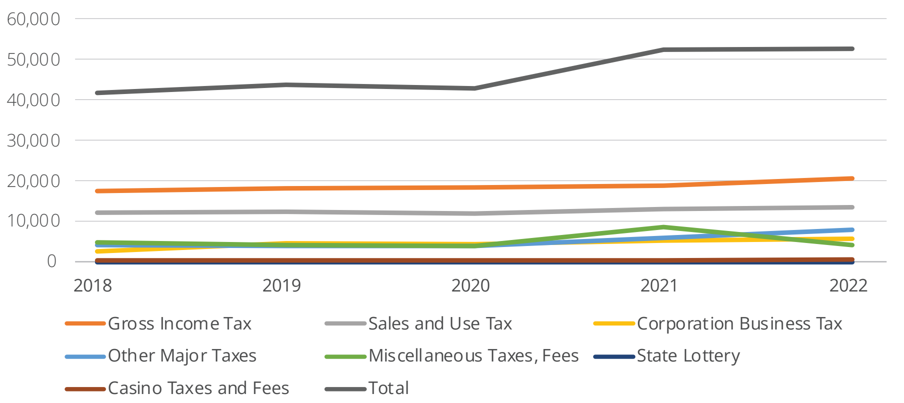
24 https://statetaxindex.org/state/new-york/

25 See Garden State Initiative *The Real Cost to New Jersey of Being an Outlier: The Impact of Steep Corporate Tax Rates*.

26 Revenue data from the FY 2022 Annual Comprehensive Financial Report of New Jersey; inflation data from the Bureau of Labor Statistics, CPI for All Urban Consumers (CPI-U) series.

As seen in Figure 3, revenue from most of New Jersey's major taxes and fees have steadily increased each year – in this decade, the Corporation Income Tax has increased 92 percent in real terms while Other Major Taxes have increased over 100 percent. The significant increase from 2020 to 2021 and 2022 comes primarily from increased revenues from the income tax, sales tax, corporation business tax, and other major taxes.

FIGURE 3: REVENUE SUMMARY FOR BUDGETED FUNDS INFLATION ADJUSTED



Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2013-2022

In addition to state taxes, New Jersey also "boasts" the highest property tax rate in the nation.[27] As a result of its high state and local taxes, New Jersey has one of the highest state-local tax burdens in the country – measured as the state and local taxes paid by residents as a percentage of net national product. While New York State leads the nation with a 2022 state-local tax burden of 15.9 percent, New Jersey is close behind at 13.2 percent (and ranks 45th nationally).[28] These percentages are effectively the tax rates paid by state residents on their income. On a per capita basis, this represents over $9,600 per New Jersey resident. Neighboring Pennsylvania, on the other hand, was only at 10.6 percent (and ranks 28th nationally), or about $6,700 per resident. New Jersey taxpayers face incentives to relocate if possible and save significant dollars annually from a lower tax bill.

A sound budget should fund recurring expenditures with recurring revenues. New Jersey had made progress over the past several years in reducing its reliance on one-shot revenue sources – such as asset sales, bond refinancings, singular recoveries from lawsuits, among others. In a prior report, we had found the state had reduced its nonrecurring revenues from 13.2 percent of the budget in 2010 to just 1.7 percent by 2020.[29] In 2021, the state itself estimated that 14.1 percent of total appropriations were funded by nonrecurring revenues, and 11 percent in 2022.[30] Even without details on these specific actions, it still represents a significant regression in the state's budgeting quality.

The New Jersey budget for fiscal year 2023-2024 anticipated nearly $53 billion of budgeted revenue, in addition to nearly $10 billion of surplus funds rolled over from the prior year.[31] The budgeted

27 https://taxfoundation.org/data/all/state/property-taxes-by-state-county-2023/

28 https://taxfoundation.org/data/all/state/tax-burden-by-state-2022/

29 See *Toward a Fiscally Sustainable New Jersey: Analysis and Recommendations* published by the Garden State Initiative.

30 Page I-22-I-23 of Financial Operating Filing of March 15, 2022, available at https://emma.msrb.org/IssueView/Details/6B9ED569DB-3469C53941A636826AC4F3 (accessed October 16, 2023).

31 See https://www.nj.gov/treasury/omb/publications/24approp/RevenuesAnticipated.pdf page A-11.

revenues are essentially flat from the FY2022-2023 fiscal year. If the larger economy slows and reduces tax revenues, New Jersey could see its sizable budget reserve consumed very quickly because the state has insufficiently controlled spending over the past several decades (see the next section for details).

Along those lines, MYBW predicts a likely $3 to $4 billion shortfall "annually needed to continue state programs and state aid at current levels from Fiscal Year 2025 to Fiscal Year 2029."[32] Further, the group estimated that under its baseline (most likely) scenario, the state is likely to be $12.5 billion short of revenues to cover current services from FY2025 to FY2028, and could be as much as $18.5 billion short.[33] In this baseline scenario, the state's operating surplus would be exhausted in FY2027, leaving the state with a nearly $5 billion shortfall in FY2028 alone. Much of this surplus, incidentally, is from federal (and not state) actions. It is only in the optimistic scenario (with no recession, inflation reverses, and interest rates are reduced quickly) where state revenues are sufficient to cover projected spending.[34] In other words, New Jersey's fiscal balance is predicated on a very rosy and unlikely scenario; absent any of these factors, the state's finances face increasing volatility.

Overall, the data here suggests that New Jersey residents face significant tax burdens relative to residents in most other states. Further, businesses also face significant extra costs to operate within the state. Hence, the business climate in New Jersey is significantly more challenging than in other states, which limits the economic growth and activity within the state.[35] New Jersey will have to continue to implement reforms aimed at attracting and maintaining businesses. For example, the current budget plan eliminated the 2.5% corporate business tax (CBT) surcharge as of December 31, 2023. As resources tighten, New Jersey will have to avoid reimposing such taxes. Adding to this challenge, the CBT for New Jersey still remains the fourth-highest rate in the nation, meaning the state has more work to do to become more competitive.[36]

Further, the current budget situation is tenuous since budget health is dependent upon reserves that largely derived from federal actions that have ended. As a result, its current fiscal balance is likely not sustainable and the state is likely to face budgetary pressures again over the next few fiscal years since budget balance is achieved not by matching annual revenues and spending but instead from rolling surpluses from year to year (again, because of federal largesse and not from state actions). This pressure will require the state to make choices around even more taxes, less spending, or abandoning its newfound discipline with its pension contributions. New Jersey faces budgetary uncertainty not because it taxes insufficiently, but because spending has grown significantly.

32 *Comparing Five-Year Revenue Forecasts with Current Services Budget Projections*, Multi-Year Budget Workgroup: Second Annual Report, page 4.

33 Ibid, page 5.

34 Ibid, page 6.

35 See Garden State Initiative *The Real Cost to New Jersey of Being an Outlier: The Impact of Steep Corporate Tax Rates* for an in-depth analysis and recommendations around tax reform necessary for business growth in the state.

36 See Matthew Fazelpoor, *Leaders: There's a lot to like in New Jersey's $54B spending plan*, July 10, 2023 NJ Biz.

State Spending Over Time: Key Findings

One of the keys to understanding New Jersey's lackluster economic performance over the past few decades is its significant increase in total public spending. As shown in Figure 3 between 2013 and 2022, New Jersey state spending increased 28 percent on an inflation-adjusted basis, while its population only increased 3.7 percent. During this same period of time, the US population grew nearly 6 percent.[37] Further, the state's population actually declined beginning in 2022.

TABLE 4: NEW JERSEY POPULATION AND SPENDING TRENDS, 2013-2022

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	10 Year Trend
Total Spending, Inflation Adjusted	40,138	39,536	40,768	41,199	41,132	41,747	43,433	42,838	47,434	51,240	27.7%
Annual Change - Spending		-1.5%	3.1%	1.1%	-0.2%	1.5%	4.0%	-1.4%	10.7%	8.0%	
NJ Population	8,933	8,985	9,034	9,077	9,120	9,175	9,219	9,259	9,280	9,267	3.7%
Annual Change - Population		0.58%	0.55%	0.48%	0.47%	0.60%	0.48%	0.43%	0.23%	-0.14%	

New Jersey appears to significantly lag national averages for population growth, a sign that it is not attracting residents compared to other locations. State spending per capita has increased from under $4,500 per person to over $5,500 in real dollars – more than a 23 percent increase. This growth results in large part from the system being saddled with legacy costs from improperly financed pensions and retiree health costs which make it difficult to reduce overall operating costs. When spending supported by federal funding, dedicated revenues, and Special Transportation Fund revenue are included, New Jersey's per capita spending is actually closer to $9,200.[38]

While New Jersey's debt service has fallen nearly one-third in inflation-adjusted dollars, this is largely a result of the low inflation environment of the time period rather than a reduction in indebtedness resulting from any state actions. As interest rates have increased sharply over the past few years, New Jersey should expect that its future debt service will increase significantly as well. Further, while capital construction has increased 322 percent during this ten-year time period, there are two concerns. Firstly, New Jersey has one of the highest costs of capital construction in the nation.[39] Hence, despite the increased spending, it is unlikely the state is acquiring as much infra-

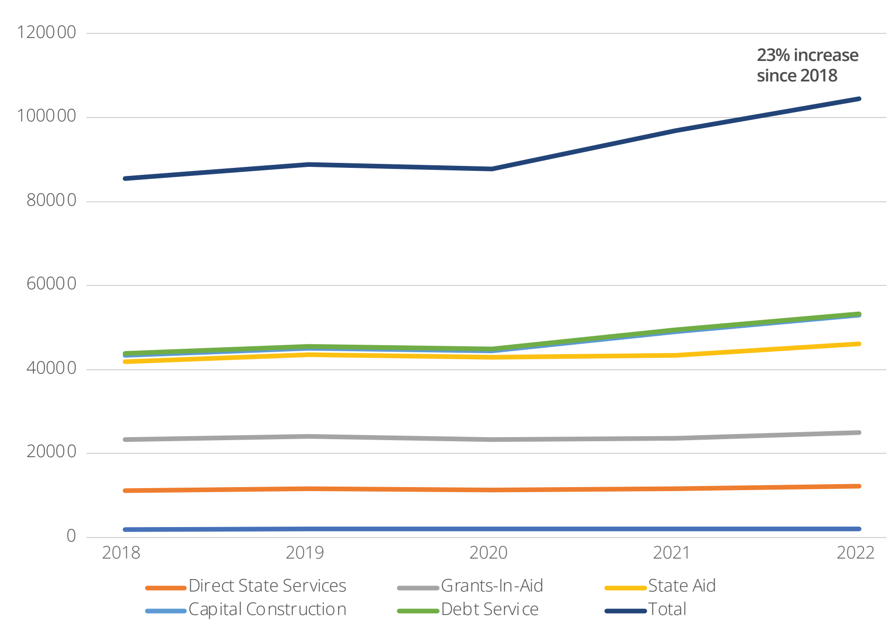
37 Based on population numbers reported at U.S. Population 1950-2023. www.macrotrends.net. Retrieved 2023-10-09.

38 See Andrew Sidamon-Eristoff, February 1, 2024, "How Big Is New Jersey's Budget?" NJ Spotlight News, available at https://www.njspotlightnews.org/2024/02/op-ed-andrew-sidamon-eristoff-analyzes-nj-budget-new-york-state-comparison/ .

39 See *Toward a Fiscally Sustainable New Jersey: Analysis and Recommendations* published by the Garden State Initiative.

structure as it needs for the prices it is paying. Secondly, this capital spending was mostly financed from temporary federal COVID policies. While it is laudable that the state used temporary funding to finance these capital costs, **the state will need to find state funds to make up for the end of federal spending.**

FIGURE 4: NEW JERSEY SPENDING, 2018–2022



Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2013-2022

The Education Funding Issue

New Jersey public schools rank amongst the best in the nation. One report ranks New Jersey public schools as the second best in the nation, and they are consistently ranked in the top three.[40] While the national average for public schools is graded a "C" by another group, New Jersey consistently earns a "B+" or better.[41] All measures consistently point to a system that is higher quality than comparable states.

This does come with a price, however. Education spending from the state was over $18.1 billion in fiscal year 2022, which is more that 35 percent of all budgeted funds. Based on recent statistics from the US Census Bureau, New Jersey ranked fourth nationally in 2021 in how much it spends per pupil – at over $22,000 per pupil, edged out only by Washington, DC ($24,500); New York ($26,500); and Vermont ($23,500).[42] As shown in Table 5, while New Jersey spends the fourth most per pupil on education in the nation, New Jersey also spends the second most per pupil on employee benefits. While the national average for per pupil benefits is just under $2,400, New Jersey spends more than $4,700 per pupil for teacher health insurance, pensions, and other fringe benefits.[43] Only New York ($5,700) has a higher per pupil spending number on fringe benefits. Even Massachusetts which has a similarly high ranked public education system to New Jersey spends less per pupil.

40 https://www.usnews.com/news/best-states/rankings/education

41 https://www.edweek.org/policy-politics/map-a-f-grades-rankings-for-states-on-school-quality/2021/09

42 2021 Annual Survey of School System Finances, US Census Bureau.

43 *Ibid*.

TABLE 5: STATE SPENDING ON EDUCATION FY 2021

State	Per Pupil Spending	Per Pupil Instructional Employee Benefits
New York	$26,571	$5,659
Washington, DC	24,535	2,186
Vermont	23,586	4,328
New Jersey	22,160	4,712
Massachusetts	20,376	3,845
US Average	**$14,347**	**$2,390**

Source: US Census Bureau, 2021 and Annual Survey of School System Finances, Table 8.

New Jersey faces increased budgetary pressure due to school funding aimed at districts exhibiting greater need. The MYBW, for example, estimates that the state faces nearly $5 billion in additional expenditures through FY2028 as the state ramps up its full funding under provisions of S2 – a law designed to funnel additional aid to certain school districts.[44]

On an inflation-adjusted basis, per pupil spending has increased nearly 17 percent in the past decade (see Table 6). The majority of this increase has been borne by the state of New Jersey rather than local governments. While real inflation-adjusted spending per pupil financed by local governments has increased only one percent in the last decade, state spending has increased nearly 25 percent. This increase includes Governor Murphy's efforts to expand free meals to students across the state as well as fully funding the existing state school funding formula. Furthermore, this increase in real spending is occurring during a decade of declining enrollment. In 2013, more than 1.4 million students were enrolled in public schools in New Jersey; by 2022, enrollment had fallen near 4 percent, with the public school system having lost 53,000 students during this past decade.

TABLE 6: EDUCATION ENROLLMENT AND SPENDING PER PUPIL BY LEVEL OF GOVERNMENT, 2013-2022

	2013	2022	10 Year Trend
Enrollment	1,423,614	1,371,031	-3.7%
Spending per pupil	$23,702	$27,617	16.5%
Local	$12,755	$12,895	1.1%
State	$10,193	$12,716	24.7%
Federal	$754	$2,006	166.1%

Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2013 and 2022; data are inflation-adjusted using the CPI-U.

Overall, the data show that New Jersey's spending has grown significantly faster than its population and inflation over the past decade. Further, the increase in spending is not just related to emergency COVID funding. Total spending was up 10 percent before COVID – despite debt service spending declining nearly 35 percent during this same time. Further, while needed capital construction increased significantly, little effort has been exerted to bring down these incredibly high costs to ensure New Jersey residents receive the most benefit from their spending.

44 *Comparing Five-Year Revenue Forecasts with Current Services Budget Projections*, Multi-Year Budget Workgroup: Second Annual Report, page 15.

In addition, while the state's public education system remains the envy of many other states with its top-quality ranking, its costs continue to increase even as demand for services declines. In part, this is because the system is saddled with legacy costs from improperly financed pensions and retiree health costs which make it difficult to reduce operating costs.

In addition, New Jersey like many other states faces increasing healthcare costs. MYBW estimates that healthcare costs alone from increased Medicaid/CHIP, retiree healthcare costs, and current employee healthcare benefits are likely to add $7 billion to state spending by FY2028 – at the same time as the state is being asked to finance more education spending.[45] And these increased expenditures will be required as the New Jersey must continue to make annual pension contributions in excess of $5 billion to not lose more ground on its funding progress. Should financial markets have a down year, these required contributions could increase even more. New Jersey's budget sustainability rests on keeping spending growth much lower than it has been over the past several decades, when it has grown much faster than inflation – and probably even reducing actual spending. But the pressure seems to be for even more increases – which is not a positive outlook for the state.

45 Ibid, page 14.

State Liabilities

Like most states, New Jersey has two types of debts – bonded debt in the form of borrowings used for public purposes, and non-bonded debt in the form of unfunded pension liabilities, retiree health care obligations, and other obligations owed primarily to former and current state employees. New Jersey has made some progress on reducing its bonded and non-bonded debt over the past few years, and this effort has resulted in an increase in bond ratings. In large part, this is because politicians have prioritized reducing these types of liabilities as federal largesse flowed to the state.[46] However, New Jersey is still an outlier in terms of how much total debt it carries.

Bonded Debt: Policy that Worked

At the end of fiscal year 2022, New Jersey reported nearly $44 billion of debt outstanding. This translates to over $4,700 of bonded debt per person in the state. New Jersey's bonded debt peaked in 2021 at $48.2 billion (approximately $5,200 per person) after the state issued $4 billion in bonds to manage through the pandemic response. Nearly $21 billion of debt outstanding are in the form of revenue bonds, more than $12 billion in capital appreciation bonds, $5 billion in general obligation bonds, and the remaining in certificates of participation, tobacco settlement bonds, and others. In 2013, the state was $41.5 billion in debt, or about $4,600 per capita; hence, the decision to reduce bonded debt does seem to have worked and kept the growth of this type of liability in check. Importantly, debt as a percentage of personal income – which measures the ability of a state to pay back what it has borrowed – has fallen over this past decade as well. In 2013, this percentage stood at 8.4 percent; as of 2022 this measure stood at just 6 percent.

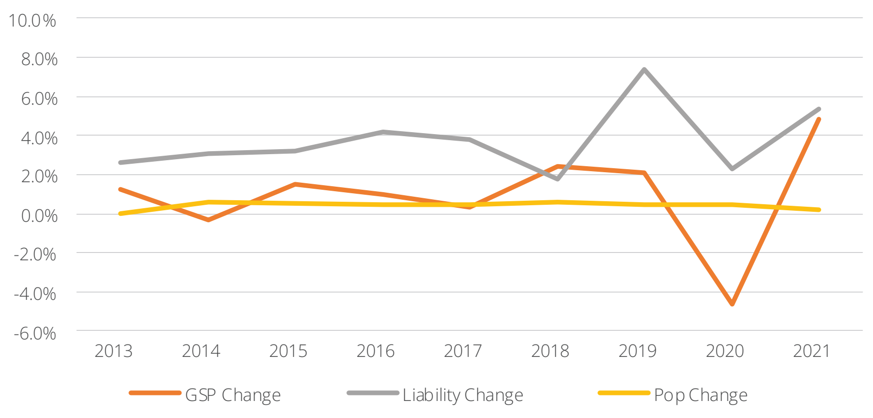
Non-bonded Debt: The Pension Problem

New Jersey currently has nearly $169 billion of unfunded non-bonded debt – mostly from pension liabilities and retiree health care obligations to both current and future state employees. New Jersey, despite its recent improvements, is still a considerable outlier in how poorly funded its pension and retiree health care obligations are. Pension contributions accounted for more than 13 percent of all spending in FY2022. The state has proudly marketed making its full pension contributions over the past several fiscal years – more than $11 billion in the past two years alone. However, despite these significant deposits, the state has made little progress on improving its funded ratio. Continued progress is completely dependent on maintaining ever-increasing pension contributions to the systems.

46 "Progress Report on NJ's Debt Load" by John Reitmeyer, *NJ Spotlight News*, April 14, 2023.

As shown in Figure 5, the percentage change in pension liabilities – what New Jersey owes to current retirees and workers – has consistently outpaced the change in the economic activity within the state that must support these liabilities in the first place. Hence, even with additional funding that the state has necessarily added over the past few fiscal years, the state is not making much progress in its pension funded ratio.

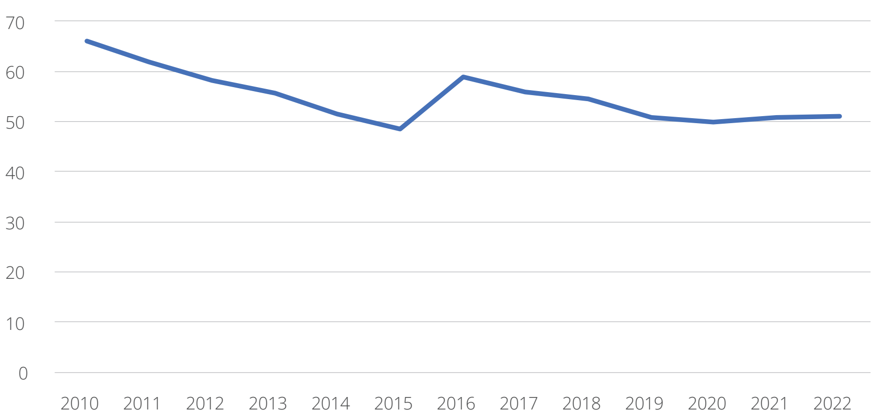
FIGURE 5: CHANGE IN PENSION LIABILITIES VS. OTHER FACTORS



Source: New Jersey Division of Benefits and Pensions, Actuarial Valuation Reports for years 2013-2021

The combined pension systems of New Jersey are just over 50 percent funded, which means the state has only saved about one-half of the money it needs to fulfill promises made to current employees and retirees (see Table C in Appendix B for details). Further, as shown in Figure 6, the funded ratio of the combined systems has not noticeably improved despite large deposits based on the actuarially-determined contributions (ADCs). The state should be lauded for making these payments to the systems, but the state should consider additional reforms that will accelerate the improvement in the funded ratio.

FIGURE 6: FUNDED RATIO



Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2010-2022

Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2010-2022

If the state wants to improve the funded ratio of the systems without significant reforms, it will require significantly more annual cash infusions into the systems. In 2022, for example, the state contributed 107.91 percent of the ADC; the state would have to make even larger contributions than this given the current size of its pension hole. This seems unlikely given competing public demands for additional tax money as well as potentially lower market returns (from higher interest rates) that are likely for the foreseeable future. The current plan for funding pensions requires the state to make contributions in excess of $6.5 billion every year – which includes the net proceeds from the lottery which was transferred to the pension system in 2017 – and growing investment earnings to pay for obligations incurred in the past but not funded.[47] Future payments for the pension system – required to just maintain the progress the state has made recently – are so significant that it will likely crowd out other state priorities. Even under the current pension funding plan, the state's pension systems are not expected to be funded at more than 80 percent until 2039 – and this assumes making contributions in excess of $6 billion annually while earning investment returns that average at least 7 percent annually.[48] If the state wants to address other important concerns, it will have to address its underfunded pension systems immediately.

If New Jersey's pension system were regulated by the Pension Benefit Guaranty Corporation (PBGC) like private pensions are, New Jersey's plans would mostly be considered to be in either "Critical Status" – with an expectation of insolvency within five years – or "Seriously Endangered" – and these PBGC assessments use much lower discount rates than New Jersey does. New Jersey's current plan for pension funding would have it move from "Critically Endangered" to not being endangered by 2039.[49] This plan also assumes the state makes nearly $100 billion of contributions on schedule every year and earns more than $80 billion of investment returns. Any deviation from these aggressive assumptions will result in the systems remaining funded below 80 percent in the aggregate.

Non-Bonded Debt – Retiree Healthcare

New Jersey also promises retirees healthcare benefits that are largely financed on a pay-as-you-go basis rather than prefunded. These benefits are colloquially referred to as Other Postemployment Benefits (or OPEB). Retirees as well as their spouses and dependents are eligible for these benefits after 25 years of service. These benefits include medical insurance, prescription drug coverage, Medicare Part B reimbursement, and Medicare Part D reimbursement. The state is also obligated to pay all teachers' health care costs even if they are employed at the local government level.

New Jersey has accumulated few assets to finance these benefits granted to employees in the past. As of June 30, 2022, New Jersey had a liability of nearly $89 billion for these retiree healthcare benefit obligations.[50] Since 2019, the state has paid between $1.6 and $1.8 billion annually for these obligations.[51] Health care cost trends are expected to be significant, so the state is likely to face two options: 1) pay increasing costs on its obligations, or 2) implement reform initiatives to reduce ongoing costs. Recently, the state faced a 20 percent increase in medical costs, and the state absorbed the bulk of the increase rather than pass the costs onto retirees. The state managed to pay for these obligations

47 See page I-49 of Financial Operating Filing of March 15, 2022, available at https://emma.msrb.org/IssueView/Details/6B9ED569DB-3469C53941A636826AC4F3 (accessed October 16, 2023).

48 See page I-60 of Financial Operating Filing of March 15, 2022, available at https://emma.msrb.org/IssueView/Details/6B9ED569DB-3469C53941A636826AC4F3 (accessed October 16, 2023).

49 Ibid

50 From New Jersey Annual Comprehensive Financial Report Fiscal Year 2022, page 388.

51 From New Jersey Budget in Brief, various years as well as page I-65 of Financial Operating Filing of March 15, 2022.

in part through reform efforts, but also from federal COVID-19 money.[52] Federal money is ending; further, if the state expends its political capital reforming these retiree healthcare benefits, the question arises whether it will have any remaining to address much-needed pension reforms.

Pension and OPEB Funding: The Bottom Line

In conclusion, the state has made efforts over the past several years to improve pension funding by increasing its annual contributions. While laudable, these efforts have not sufficiently moved the needle on the state's pension funding problem because it faces such a significant funding deficit that it is going to require significantly increased annual contributions coupled with reform efforts to get the systems to a fiscally sustainable place again. Further, while the state has successfully kept bonded debt from growing, New Jersey also faces a significant liability for retiree health care costs (OPEB).

New Jersey's overall debt situation is a significant outlier when compared to other states. As shown in Table 7, on a per capita basis New Jersey residents face total debt burdens that are multiples of neighboring states that are equally as wealthy.

TABLE 7: COMPARISON OF NEW JERSEY DEBT PER CAPITA TO OTHER STATES

	New Jersey	New York	Pennsylvania	Massachusetts
Bonded Debt per Capita	4,729	3,250	1,317	6,881
Unfunded Pension Debt per Capita	8,088	224	1,201	1,991
Unfunded OPEB Debt per Capita	9,573	2,880	809	2,196
Total Debt per Capita	22,391	6,354	3,328	11,068
Income per Capita	78,338	78,090	64,279	82,346

Source: Data from states' annual comprehensive financial report for fiscal year 2022; New York data is fiscal year 2023. Per capita information calculated.

Even on bonded debt which New Jersey has held down in recent years, it still has a per capita debt burden higher than several comparable neighbors. Further, the state's pension and OPEB obligations are significantly higher than these other comparable states. While New Jersey residents face a combined per capita debt burden of nearly $18,000 for unfunded pensions and OPEB alone, other comparable states are between $2,000 and $4,200 per person. Such liabilities retard population growth, business development, and wealth creation.

Therefore, New Jersey's elected leaders need to focus its efforts not on trying to increase the funding to these retirement benefit systems, for such efforts have consumed more and more resources while making little if any progress. Instead, political leaders should focus on reforms that will lower the outstanding debt owed to current and future retirees, which will also reduce spending and permit the state to be more competitive on taxes and business operation. Such reforms will move New Jersey towards not being an outlier in terms of its debt outstanding per capita.

52 Page I-65, Ibid.

Other Trends

New Jersey's population and unemployment are clearly linked to the economic performance of the state. States that are attractive to business and workers will have unemployment rates decline even while population grows. Since 2012, New Jersey's state population has grown less than 3.7 percent in total, which is only a 0.3 percent average growth rate per year. By way of contrast, during this same period, the overall US population grew by nearly 6.2 percent, for about a 0.6 percent average annual growth rate.

Overall, New Jersey's population is growing significantly more slowly than the rest of the country. This suggests that the state is not as competitive in attracting workers or businesses compared to the rest of the nation. In fact, during the past ten years, New Jersey's gross state product (GSP) has grown less than 9 percent in total, or about 0.8 percent annually. By contrast, the gross domestic product (GDP) of the US has grown over 50 percent in total during this same time period, or about 4 percent annually. These figures, however, are nominal. When inflation is accounted for, New Jersey's GSP has actually contracted during the last decade – by over 13 percent, or 1.4 percent annually. By contrast, the US GDP has grown nearly 20 percent – or 1.8 percent annually. Clearly, New Jersey needs to work harder to attract economic activity and workers who can reverse this decline by reforming its legacy obligations, focusing spending on key government functions, and lowering taxes on residents and businesses.

What the Future Holds

Prior to the COVID-19 pandemic, New Jersey faced an inflection point regarding its finances – would it seek to remake itself into a state that encouraged business and population growth, or would it proceed as business as usual with high taxes and high spending? New Jersey has started to get its fiscal house in order, and has received credit upgrades in the process. Nevertheless, New Jersey still ranks second to last in state credit ratings nationally, just above Illinois. This suggests that the overall improvements – while welcome and necessary – are not sufficient to make the state a place that attracts business and residents. As noted by Fitch Ratings, "Despite recent improvements, high liabilities and elevated carrying costs are likely to remain a longer-term constraint on the state's budget choices. The durability of recent fiscal improvements has not been tested through a period of economic weakness."[53] Further, despite overall progress towards a structurally balanced budget, the state has moved backwards on its use of one-shots to shore up operating revenues. Such a move is in opposition to sound public budgeting principles.

Employment

New Jersey's labor market has generally lagged national and regional trends. Over the past decade, New Jersey's unemployment rate has been higher than the national average rate in eight years (see Figure 7). In 2012, New Jersey reported a 9.3 percent unemployment rate while the national rate was 7.8 percent. At the end of 2023, while the national unemployment rate declined to 3.7 percent, New Jersey reported a 4.8 percent unemployment rate in December, with the number of employed residents employed declining.[54] Making the employment picture even more grim – New Jersey has also reported a declining labor force of 10,700, and employed residents fell 15,500.[55] Another concern is that the state has experienced losses in construction and information while gained jobs in education, health, leisure, and hospitality; the industries reporting losses tend to pay well and those that gained tend to have significant numbers of low-wage jobs.[56] While the nation has experienced sustained job and wage growth, New Jersey's labor market appears less robust by comparison.

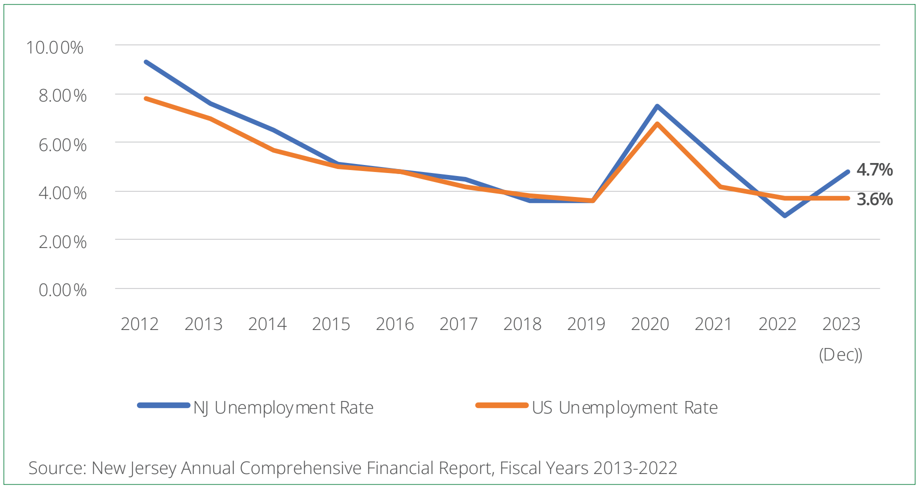
53 https://www.fitchratings.com/research/us-public-finance/fitch-rates-1-25b-new-jersey-transportation-trust-fund-auth-program-bonds-a-outlook-stable-06-11-2023

54 See Charles Steindel, PhD. *GSI Analysis: December '23 Jobs Report – Another Mixed Month for New Jersey's Labor Market*, available at https://www.gardenstateinitiative.org/reports/dec23jobs/ .

55 See Charles Steindel, PhD. *GSI Analysis: November '23 Jobs Report – November Was Another Disappointing Month for New Jersey's Labor Market*, available at https://www.gardenstateinitiative.org/reports/nov23jobs/ .

56 Ibid.

FIGURE 7: NJ VS. US UNEMPLOYMENT RATE, 2012–2023



Source: New Jersey Annual Comprehensive Financial Report, Fiscal Years 2013-2022

Debt

New Jersey is significantly in debt. In various measures of debt outstanding, the state ranks third or fourth in the nation.[57] Further, new debt issued by the state will be more expensive going forward because the Federal Reserve has increased the federal funds rate 11 times since 2022. Whereas New Jersey's improved credit rating will dampen the increase a bit, the cost of future debt will be significantly greater than past debt.

Although New Jersey should be commended for holding the line on debt recently, it will become more difficult to exercise fiscal discipline in the future. Further, any new debt issuance will be much more expensive and refinancings are not going to be a viable strategy for budgetary savings going forward because of increased interest rates. State officials will need to analyze every project in need of funding to ensure it provides some public service that will aid in bettering the lives of state residents.

Infrastructure

According to the 2021 ASCE Infrastructure Report Card, New Jersey's roads in need of repairs cost the average driver in $713 annually from poorly maintained transportation infrastructure.[58] This is in addition to the $1.58 billion capital schools need, as well as necessary investments in water systems and dams. As noted in a prior report, New Jersey has already increased taxes that fund the Transportation Trust Fund (TTF) which is used for the maintenance of bridges, roads, and transit.[59] About half of the money collected by TTF in fiscal year 2024 ($3.2 billion) via the motor fuels tax, the petroleum products tax, the sales and use tax, and toll road contributions are expected to be used for existing debt service and the other half for transportation costs.[60] About 40 percent of this money goes to highway maintenance, nearly 40 percent to New Jersey Transit, and the remaining

57 From NJ Treasury, Office of Public Finance, *2022 Debt Report* page 60 and 61.

58 https://infrastructurereportcard.org/state-item/new-jersey/

59 See *Toward a Fiscally Sustainable New Jersey: Analysis and Recommendations* published by the Garden State Initiative.

60 https://www.nj.gov/ttfa/future/documents/FinalFY24FinancialPlanforWebsite.pdf

to local government projects.[61] While highway conditions have improved overall – with acceptable pavement conditions for 79 percent of roads compared to 59 percent in 2012 – 21 percent of roads are still measured as being in "poor" condition.[62]

Given the deficits in infrastructure maintenance and investment in the past, New Jersey is likely to need to increase its efforts in this area. However, the state is already one of the most taxed in the nation. Further, New Jersey faces one of the most expensive construction costs nationally according to one estimate.[63] Construction costs since the pandemic have spiked – due to material and labor shortages – with one estimate being that cost increases between 2020 and 2022 amount to about 87 percent.[64] Another estimated that New Jersey construction costs peaked at between 17 and 20 percent increases annually, adding significantly to already-expensive infrastructure costs.[65] While this is not a uniquely New Jersey phenomenon, it will affect the state acutely because it started with such a high degree of construction costs to begin with.

Rising Energy Costs

Already, the state's residential electricity rate is the third highest versus five neighboring or nearby states and the 10th highest nationwide, while the rate New Jersey industries pay is second highest among nearby states and ninth highest nationwide.[66]

Contrary to industry trends, New Jersey's residential electricity rates climbed 4.6% last year – the largest rise among nearby states (as rates in four of the six states actually fell) – to 16.18 cents per kilowatt hour, compared to the U.S. average rate of 12.07 cents. That translates into a $145.13 electric bill for a New Jersey home using 900 kWh a month, or over 30% higher versus the U.S. average of $108.63. This is the typical New Jersey homeowner's electric bill at a time when low-cost natural gas contributes 36% and nuclear energy 57.5% of the energy sources to generate the state's electricity. As renewables reach the required levels that Governor Murphy's 2020 Energy Master Plan (EMP) envisions, electric bills will inexorably surge further ahead of other states.[67]

Since the EMP was released, New Jersey's Board of Public Utilities has subsidized alternative energy production such as offshore wind and solar without clarity about what the final cost of such proposals will be.[68] In November 2023, the power company developing the Ocean Wind 1 and Ocean Wind 2 offshore wind projects abruptly announced that it would not proceed with the project.[69] The state has recently re-granted contracts to a new Offshore Wind provider again without proper reviews, due diligence, or rigorous cost-benefit analyses required of such important investments. This past behavior is likely to result in inevitable rate hikes for energy consumers in the future. New Jersey should move towards expanding its energy generation capacity but in ways that will benefit the

61 https://www.nj.gov/ttfa/capital/

62 https://www.nj.gov/transportation/about/asset/pdf/2022TAMPFactSheets.pdf

63 https://midwestepi.org/2017/05/03/what-are-road-construction-costs-per-lane-mile-in-your-state/

64 https://edzarenski.com/2022/12/20/construction-inflation-2023/

65 https://www.njfuture.org/2023/07/20/with-recession-in-the-forecast-how-prepared-is-njs-economy-for-upcoming-rain/

66 Institute for Energy Research, *https://www.eia.gov/state/rankings/?sid=US#/series/31* , accessed January 22, 2024.

67 Institute for Energy Research, *New Jersey Consumers Should Expect Electricity Rate Increases*, available at https://www.instituteforenergyresearch.org/renewable/wind/new-jersey-consumers-should-expect-electricity/ , accessed January 22, 2024.

68 See Regina M. Egea and Dianne Solomon, *Enough Talking. It's Time to Deliver Affordable and Reliable Energy to New Jersey.* Available at https://www.gardenstateinitiative.org/op-ed/enough-talking-its-time-to-deliver-affordable-and-reliable-energy-to-new-jersey/ (accessed January 3, 2024).

69 See Regina M. Egea, *What Now? New Jersey Has to Hit the Reset Button on Its Energy Policy – and Get It Right*. Available at https://www.gardenstateinitiative.org/op-ed/what-now-new-jersey-has-to-hit-the-reset-button-on-its-energy-policy-and-get-it-right/ (accessed January 3, 2024).

ratepayers of the state.[70] This will require the state to focus on quantifiable costs, benefits, and the fiscal effects on residents and businesses.

Uncertainty with Federal Tax Code

Finally, the federal Tax Cuts and Jobs Act (TCJA) is set to expire at the end of 2025. While there is much uncertainty surrounding its possible renewal, policymakers should focus on how a potential reversion in federal tax policy will potentially affect New Jersey taxpayers. While the TCJA limited the amount of state and local taxes (SALT) residents could deduct from their tax liabilities (thereby increasing federal taxation on New Jersey residents because of the high state and local taxes paid), it also increased the threshold for being subject to the alternative minimum tax (AMT) which saved many taxpayers significant money. While many lawmakers have focused on the limitation to SALT and the costs to New Jersey taxpayers, few have acknowledged the savings that have accrued to New Jersey taxpayers from no longer being subject to AMT. If tax policy reverts to pre-TCJA levels, it is uncertain whether New Jersey residents will benefit overall or not: top federal tax rates would increase and more taxpayers would be subject to AMT, but taxpayers could deduct more SALT. This uncertainty should concern New Jersey officials because the state is already a tax outlier, and this has the potential to make the state even more expensive for residents.

70 Garden State Initiative, *Ne Jersey's Energy Future: At What Cost to You?* Available at https://www.gardenstateinitiative.org/research/new-jerseys-energy-future-at-what-cost-to-you/, accessed January 22, 2024.

Proposed Solutions

Given its current course and speed, New Jersey is already experiencing a tightening operating budget as federal COVID funds wind down and access to cheap credit ends. How can New Jersey better attract businesses and individuals to the Garden State and fuel future economic growth?

1. Other states' moves to strategically moderate tax burdens and increase regulatory flexibility to increase their competitiveness are squeezing New Jersey's elected officials. New Jersey remains one of the highest personal and business taxed states in the nation. Further, the concentration of tax revenues from fewer and fewer individuals and corporations exacerbates the risk of remaining a tax outlier. As many industries are no longer limited by geographic location, business owners can move their businesses to friendlier climates such as Tennessee, Texas, or Florida among others and quickly reduce their fixed costs.[71] Further, the state has significant property tax pressure only being addressed through annual, one-time rebates that are geared towards narrowly-defined homeowners and are subject to annual state budget vagaries. If such rebates were to be "crowded out" from the state budget, property owners would view this as a tax increase. Further, the state should replenish its unemployment trust funds with remaining federal surplus rather than with the fees now being paid by employers - which is adding to the differential of operating within New Jersey compared to other states.
2. Elected officials need to pursue pension and OPEB reforms in earnest as these obligations are no longer manageable. When combined, these legacy costs consume nearly 20 percent of the annual state operating budget. These resources could be better used for existing priorities rather than legacy obligations. Current law suspends COLA increases until the pension systems reach an 80 percent funded ratio, and retirees have not received COLAs since 2011. Reinstating these COLAs would cost upwards of $3.6 billion annually in additional pension benefits,[72] and rapidly erode any funding progress on pensions. The state is in a position where it has a financial albatross around its neck because the pension system is so poorly funded; and yet beneficiaries are receiving less and less benefits as inflation erodes the value of their pensions. Reform all around is needed.
3. Further, New Jersey needs a process that results in a fiscally sustainable budget reduces its budgetary reliance on one-shot revenues and rolling surpluses. The state should plan to

71 Garden State Initiative *The Real Cost to New Jersey of Being an Outlier: The Impact of Steep Corporate Tax Rates*.

72 https://www.nj.com/opinion/2023/05/the-state-pension-system-is-healing-dont-cripple-it-again-editorial.html

fund all recurring expenditures with recurring revenues. One-shots that occur can be dedicated to pay-as-you-go capital financing, debt relief, pension investments, or prefunding OPEB. But one-shot revenues and surpluses from the prior year should not be relied upon to balance annual operating budgets and spending plans.

4. New Jersey pays more than any other state in the nation for construction costs, energy, transportation, water, and general infrastructure systems. These investments often make sense from an economic development perspective but the state cannot get the returns it requires on these investments until the cost of energy, infrastructure, and construction are benchmarked to competitive states. New Jersey should prioritize reforms that bring the cost of construction down incrementally over several years which would permit the state to get more projects funded at current budget levels. This reform might even help draw in federal resources which are necessary to fund the state's infrastructure needs.

5. New Jersey has considerable assets, such as a strong public school system, wide transportation systems, and generous healthcare and social services for those in need. These public services are vital to attract families and businesses. But the state can no longer fund this relatively expansive and growing array of services. Just as households have to prioritize where to spend their money, New Jersey needs to recognize that some programs have outlived their need and usefulness. By focusing on today's core and vital services, the state can eliminate antiquated and less cost-effective programs and thus maintain funding for today's programs while not asking taxpayers to continuously shoulder a growing tax burden.

Appendix A

TABLE A: NEW JERSEY CARES FUNDS USES, 2020-2021

Area and Description	Amount (in millions)	Percentage of Total
BROADBAND/DIGITAL CONNECTIVITY	$49.0	2.0%
ECONOMIC ASSISTANCE TO BUSINESSES		
Small business grants	$292.9	
Other assistance	$ 55.1	
Total Economic Assistance to Businesses	$348.0	14.5%
ECONOMIC ASSISTANCE TO INDIVIDUALS/EMPLOYEES	$ 0.6	0.0%
EDUCATION AND CHILD CARE ASSISTANCE		
Higher education	$225.1	
School re-opening and remote learning	$ 98.6	
Total Education and Child Care Assistance	$323.7	13.5%
EMERGENCY RESPONSE MEASURES	$22.8	0.9%
HOUSING ASSISTANCE		
Rental assistance	$90.7	
Small business lease assistance	$25.7	
Small landlord program	$ 4.9	
Utility assistance	$10.4	
Total Housing Assistance	$131.7	5.5%
Increased Costs of State Operations	$230.1	9.6%
LOCAL GOVERNMENT ASSISTANCE	$73.2	3.0%
PUBLIC HEALTH		
Testing and safe isolation	$93.5	
Other public health	$14.8	
Total Public Health	$108.3	4.5%
SOCIAL SERVICES		
Child care capacity	$193.3	
Food assistance	$ 45.1	

Area and Description	Amount (in millions)	Percentage of Total
Other services (homelessness, provider supports, substance treatment, etc.)	$101.1	
Total Social Services	$339.5	14.1%
STATE PAYROLL AND HEALTH BENEFIT COSTS	$776.8	32.3%
TOTAL	$2,403.7	
Source: https://gdro.nj.gov/tp/en/financial-analysis/financial-summary#		

TABLE B: NEW JERSEY ARPA FUNDS USES, THROUGH JUNE 2023

Area and Description	Amount (in millions)	Percentage of Total
PUBLIC HEALTH		
Trauma and emergency room preparedness at hospitals	$650.0	
HVAC and water systems within schools and small businesses	$184.5	
Fire departments, law enforcement, and community health centers	$ 51.0	
Mental health initiatives	$ 80.0	
Total Public Health	$865.5	21.6%
NEGATIVE ECONOMIC IMPACTS		
Rental and utility assistance to prevent eviction and homelessness, affordable housing development, and mitigate lead paint	$1,300.0	
Special education	$184.5	
Small business support	$170.0	
Child care – staff recruitment and retention, and facility development	$220.0	
Upgrades to Liberty State Park	$ 50.0	
Direct payments to undocumented workers	$120.0	
Total Negative Economic Impacts	$2,044.5	51.1%
PUBLIC HEALTH-NEGATIVE ECONOMIC IMPACT PUBLIC SECTOR CAPACITY		
Modernize unemployment processing system	$25.0	
Upgrades to motor vehicle commission facilities and State's online platforms	$50.0	
Total	$75.0	1.9%
INFRASTRUCTURE		
Improvements to public places	$ 35.0	
Water projects to improve climate resilience	$300.0	
Total	$335.0	8.4%
REVENUE REPLACEMENT		
Reduce flooding risks and enhance resiliency in Meadowlands Area	$105.0	
Construction of medical research centers at each Rutgers University campus	$315.0	
Local economic development issues	$ 60.0	
Total	$480.0	12.0%
ADMINISTRATIVE		
Monitoring of programs	$200.0	5.0%

Area and Description	Amount (in millions)	Percentage of Total
TOTAL	$4,000.0	

Source: New Jersey Recovery Plan: State and Local Fiscal Recovery Funds 2023 Report, available at: https://gdro.nj.gov/tpbackend/documents/New_Jersey_2023_Recovery_Plan_Performance_Report_7_31_23_FINAL.pdf

Appendix B

The various state pension systems are themselves unevenly funded (see Table C), and funds are not transferrable or payable between these systems. Further, some of the obligations in the below table are not technically the states', but are instead local governments'. However, if a locality were unable to pay obligations owed, it is likely that the state would have to step in to pay – even if only temporarily.

TABLE C: NEW JERSEY PENSION SYSTEMS FUNDED STATUS

System, 2022	Total Pension Liabilities	Net Position	Net Pension Liabilities	Funded Ratio
PERS	69,310,085	35,707,805	33,602,280	51.5%
TPAF	74,699,134	26,533,143	48,165,991	35.5%
PFRS	46,972,675	33,543,253	13,429,422	71.4%
CPFPF	2,895	2,185	710	75.5%
SPRS	4,059,815	2,135,924	1,923,891	52.6%
JRS	879,178	182,560	696,618	20.8%
POPF	3,526	5,136	(1,610)	145.7%
Total	195,927,308	98,110,006	97,817,302	50.1%
Income per Capita	78,338	78,090	64,279	82,346

Source: New Jersey Annual Comprehensive Financial Report, Fiscal Year 2022

Why aren't the pension funds showing improved financial condition despite massive infusions of tax dollars to the system – more than $11 billion combined in the last two fiscal years alone?[73] Importantly, despite these large contributions, only FY2022's contribution met the ADC's recommendation; the other years were still less than actuarially required.

Pension funds generate cash to pay to retirees form two primary sources – annual deposits from the state of New Jersey and investment returns from existing asset allocations. Investment returns are becoming increasingly volatile. Meanwhile, pension funds primarily use cash to pay benefits to retirees and these are relatively smooth. Currently, New Jersey's pension funds pay so much cash out to retirees that the current contributions do little if anything to alleviate the funding issues from the past. Since 2014, only 3 of the 7 state pension systems has improved its net position – again, despite massive recent deposits into the systems.[74] Since 2014, New Jersey has contributed and earned nearly $140 billion in its pension systems. During this same time, the systems paid out $125 billion in benefits and

73 Data from State of New Jersey, Division of Pensions and Benefits, Financial Statements for June 30, 2022, page 6.

74 *Ibid*, pages 54-60.

other expenses. Therefore, despite tens of billions of dollars in both taxpayer contributions as well as investment returns, the New Jersey pension systems only increased its net position by about $15 billion between 2014 and 2022 – despite this period being a bull market for investments with returns averaging nearly 11% annually. Further, during this same period, the actuarially accrued liabilities increased about 34 percent – resulting in the funded ratio being virtually unchanged despite the state's efforts.[75]

75 Calculated from State of New Jersey, Division of Pensions and Benefits, Statutory Funded Ratios and Unfunded Liabilities, Comparison Charts.