ANNUAL REPORT 2012

A Citizen's Guide To the State of The States

NEW JERSEY

EXECUTIVE SUMMARY

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Dear Citizens of the State of New Jersey,

We are pleased to present to you the Annual Report of New Jersey 2012, a joint venture of the University of Pennsylvania's Fels Institute of Government, Harvard University's Institute of Politics at the Kennedy School, and the American Education Foundation, for the fiscal year ending June 30, 2011. The data in this report were drawn from New Jersey's Comprehensive Annual Financial Reports for New Jersey ("CAFRs") from FY 2002 to FY 2011, FY 2012 and FY 2013 New Jersey budgets, the 2010 United States Census, and other official data sets and reports that we have found to be reliable sources on state finance.

This report was designed to synthesize the complicated financial information available from many sources into one easy-to-read document that provides context and creates a comprehensive analysis of trends in state government finance. We believe that citizens deserve to know "the state of the state" and we hope that our report will help explain the basics of state finance and the challenges that lie ahead. We did our best to ensure that this report reflects a nonpartisan analysis of the state's fiscal health. With all the politics and noise surrounding budgeting and state financial planning, we believe that this neutral perspective is vital when assessing budgets.

We begin the report by looking at basic demographic and financial information about the state to provide a snapshot of New Jersey's financial position. The report then moves on to discuss key budget topics that we believe are crucial to understanding financial trends such as pensions, education, and health care.

We hope that this document is both an informative and useful guide for understanding the many challenges that New Jersey faces. To find out more about the States Project and how you can get involved, please visit our website at http://www.thestatesproject.org.

Sincerely,

Joseph C. Semsar Brent Levin

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{ executive summary }

OVERVIEW

Across the country, states are grappling with difficult fiscal issues. The financial crisis of 2008 and subsequent years of stagnant economic growth have brought state finances to a near critical condition. As tax revenue fell, the country saw mass layoffs of state workers, from teachers to police officers and judiciary employees. Nevertheless, the demand for public services continued to increase. A stagnant economy sent more Americans toward public programs like unemployment insurance and Medicaid. Health care costs swelled and educational capacity was stretched to its limit. Infrastructure, including government buildings, schools, roads, and bridges, continued to deteriorate with little funding left for repair. In 2009, the federal government stepped in with much needed stimulus for the states, but those funds will expire in 2012, leaving states with even bigger deficits to fill, despite an improving economy.

The state of New Jersey suffers from many of the same issues that plague other states: high unemployment, stretched educational resources, expensive health care, and underfunded pensions. New Jersey's unemployment rate is higher than the national average, with manufacturing, construction, and information sectors taking the hardest hit in job losses. Meanwhile, New Jersey struggles with historical deficits, which have quadrupled state debt since 2001 to over $60 billion in liabilities in 2012.[1] Additionally, New Jersey's pension funds are ranked as some of the worst in the country, with liabilities estimated at $42 billion.[2] The split government in New Jersey — with Republican Chris Christie leading the executive branch and Democrats controlling both Houses of the Legislature — adds to the already challenging task of stabilizing the state's economy and passing legislation that is fiscally sound and sustainable.

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BUDGET DEFICIT

At the end of fiscal year 2011, the state had a deficit of $5.2 billion, down a full 30% from the previous year. At the beginning of fiscal year 2011, however, Governor Christie faced a budget deficit of $10.7 billion — or one-third of the entire budget. While tax increases are generally a politically unpopular strategy, they are even more difficult to implement in New Jersey, since the state already has one of the highest tax burdens in the country. Consequently, Christie attempted to close the gap by cutting funding for education ($921 million) and community development and environmental management ($472 million), as well as deferring $3 billion in benefits owed by the general fund to the state pensions.[3]

1 Dopp, Terrencce, and Martin Z. Braun. "New Jersey's Bond Rating Cut by Standard & Poor's." [http://www.bloomberg.com/news/2011-02-09/new-jersey-bond-rating-cut-by-s-p-on-growing-pension-health-obligations.html] Feb. 9, 2011.

2 Ravitch, Richard and Volcker, Paul. Report of the States Budget Crisis Task Force. [http://www.statebudgetcrisis.org].

3 New Jersey Comprehensive Annual Financial Report ("CAFR") 2011.

Christie received mixed reviews for his budget slashing efforts — from those on the left, who worry that he is gutting important social programs and from those on the right, who say that the Governor did not cut spending, but rather pushed it off to subsequent years through deferrals and accounting tricks. Either way, most economists predict that New Jersey will now face another, larger budget deficit in FY 2013, as tax revenues remain stagnant and the state is required to contribute big funds to state pension programs.[4]

"Christie received mixed reviews for his budget slashing efforts — from those on the left, who worry that he is gutting important social programs; and from those on the right, who say that the Governor did not cut spending, but rather pushed it off to subsequent years through deferrals and accounting tricks."

REVENUES AND EXPENDITURES

New Jersey's revenues for 2011 were $55.9 billion. The majority of revenues collected by the state of New Jersey can be categorized into three groups: taxes, operating grants, and charges for sales and services (or user fees). New Jersey collected $26 billion in tax revenue, which comprised the largest portion of state revenue at just under 50% of the total. User fees amounted to 18%, or $10.2 billion, and operating and capital grants stood at 32%, or $17.9 billion.[5]

The state of New Jersey spent a total of $61.2 billion in the 2011 fiscal year, down 2.9% from 2010.[6] The largest areas of spending were education at 23.0% of total expenditures, and government direction, management, and control at 19.1%. Other major areas of spending included health care at 18.6% and the Unemployment Compensation Fund at 11.8% of expenditures.

NET WORTH, ASSETS, AND LIABILITIES

According to the State Comptroller, New Jersey has a negative net worth of $34.2 billion.[7] New Jersey's net worth is calculated by taking the difference between the total assets of the state (measured at $36.9 billion) and the total liabilities ($71.1 billion). Theoretically, that means that if New Jersey sold off all of its assets to pay all of its debts, the state would still owe $34 billion, or nearly $3,900 for every man, woman, and child in the state.[8] Because of New Jersey's high debt,

4 "N.J. faces $10.5 Budget Deficit Heading into New Year." The Star Ledger. [http://www.nj.com/news/index.ssf/2010/07/nj_continues_to_face_105b_budg.html] and FY 2012 Budget Summary, State of New Jersey. [www.state.nj.us/treasury/omb/publications/13bib/BIB.pdf].
5 New Jersey CAFR 2011.
6 Ibid.
7 New Jersey CAFR Statement of Net Assets, 2011.
8 Ibid.

slow recovery from the recession, and lack of a plan to shore up deficits in coming years, New Jersey received three credit rating downgrades last year, from Moody's, Standard & Poor's, and Fitch. While some spending cuts have been implemented, the state still has a long way to go in order to ensure long-term solvency. Given the current projections of New Jersey's 2012-2013 budget deficits, the prognosis for New Jersey remains negative.[9]

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DEMOGRAPHICS

New Jersey's total population is 8,791,894, or 2.8% of the American population, as reported by the 2010 Census.[10] The state has a high population density, but the total population only increased 4.5% between 2000 and 2010 — half the rate of the national average. The slow population growth is likely due to the high cost of living and high income taxes in New Jersey. Immigrants make up 20% of the state's population and account for 28% of its workforce.[11] In 2010, the median income for New Jersey households was $69,400, about $20,000 more than the national average.[12] A little over 9% of New Jersey residents live below the poverty line.[13] About half of New Jersey residents have acquired some form of college degree, and about a third have at least a bachelor's degree. Weak growth in the manufacturing and information industries, which took a major hit during the Great Recession, contributed to a higher-than-national average unemployment rate of 9.1% in late 2011.

HEALTH CARE

The Health and Human Services budget was $11.4 billion in fiscal year 2011, representing 18.6% of the state budget, second only to education.[14] As in many states, the Great Recession and the retirement of Baby Boomers have driven up the costs associated with funding public health programs. While health care costs in New Jersey have grown more slowly than in other states,

9 Oliff, Phil and Mai, Chris and Palacio, Vincent. "States Continue to Feel Recession's Impact. Center on Budget and Policy Priorities. [http://www.cbpp.org/cms/index.cfm?fa=view&id=711] ; "N.J. revenue shortfall increases at least another $50M in May." New Jersey Star Ledger. June 5th, 2012. [http://www.nj.com/news/index.ssf/2012/06/nj_revenue_shortfall_increases.html].

10 United States of America. Census Bureau. 2010 Census Interactive Population Search. Web. 26 Jan. 2012. [http://2010.census.gov/2010census/popmap/ipmtext.php?fl=34].

11 Springer, Jason. "Immigrants make up 28% of NJ Workforce." BlueJersey. [http://www.bluejersey.com/diary/10056/].

12 U.S. Census Bureau. American FactFinder. 24 Jan. 2012. Web. [http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_10_1YR_S1901&prodType=table].

13 U.S. Census Bureau. New Jersey Quick Facts. Web. 26 Jan. 2012. [http://quickfacts.census.gov/qfd/states/34000.html].

14 New Jersey CAFR 2011; "Fiscal 2011 Budget in Brief." New Jersey Office of Management and Budget. [http://www.state.nj.us/treasury/omb/publications/11bib/BIB.pdf]. Page 91.

total per capita health expenditures in the state are still above the national average ($7,583 vs. $6,815). Potential reforms by Governor Christie include revising Medicaid eligibility criteria and eliminating negative cost incentives in the system by moving away from a "fee-for-service" model to a "managed care" model.

EDUCATION

New Jersey operates two systems of public education: kindergarten through twelfth grade (K-12), and a system of public universities and community colleges which provide higher education at a reduced cost to the state's citizens.

The state spends more on "educational, cultural, and intellectual development" (which includes K-12 funding) than any other component of its budget, comprising 23% of total spending, down 6.1% from the previous year. In fiscal year 2011, the state budget allocated $10.7 billion to K-12 education, and $10.3 billion in fiscal year 2012, a 3.9% decrease.[15] New Jersey relies on its local tax revenue base to fund K-12 education, with local tax revenue accounting for 58.9% of all K-12 spending. New Jersey is the third-highest spending state per pupil behind Washington D.C. and New York.

Governor Christie has proposed various types of reform, including structuring teacher compensation by merit instead of seniority and increasing the number of charter schools in the state. New Jersey is ranked second in the nation on educational achievement, behind Massachusetts, thanks to the state's strong national standardized test performance, achievement gains, high school graduation rate, and the availability of Advanced Placement classes.[16] However, the state's students perform poorly on the SAT, which is used in college admissions and serves as an indicator of academic success in college.

The state spent $5.7 billion on higher education in 2011, more than on public safety and transportation combined.[17] New Jersey has three public research universities, nine state colleges and universities, and 19 community colleges. Still, a lack of state investment to meet capital needs, outdated regulations, and increased administrative costs have led to high school graduates deciding to leave the state for college, a problem Governor Christie has called the "brain drain." To make matters worse, 66% of New Jersey higher education students graduate with debt, the eleventh-highest percentage in the country.

PENSIONS

New Jersey's pension system covers over 720,000 current workers and retirees and has seven distinct retirement systems, a separate system of health benefits, and a number of other programs designed

15 "The Governor's FY 2012 Budget." New Jersey Office of Management and Budget. [http://www.state.nj.us/treasury/omb/publications/12bib/BIB.pdf]. Page 65.
16 "K-12 Achievement." EdWeek. [http://www.edweek.org/media/ew/qc/2011/16sos.h30.k12.pdf].
17 New Jersey CAFR 2011.

to provide for public employees during their employment and retirement. New Jersey, unlike most other states, manages all its state as well as local pension obligations.[18]

As with nearly every other state in the union, New Jersey is struggling with controlling the costs of pension benefits for state employees. To help overcome the looming $53.9 billion pension deficit, Governor Christie reached a deal with the legislature in 2011 to increase employee pension and health care contributions, reduce annual cost-of-living increases for current and future retirees, raise the retirement age from 60 to 65 for new employees, and cut final compensation for new employees. While the legislation reduced costs in the short term, the current unfunded liability estimate for New Jersey is still a whopping $42 billion.[19] In addition, the state is continuing to withhold its full general revenue contributions to the pension fund; in 2011, Christie skipped a $3 billion contribution to the pension fund in order to help balance the general budget.

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THE FUTURE

The state's fiscal year 2013 budget provides an indication of the course New Jersey is charting. Governor Christie signed the $31.7 billion budget into law on June 29, 2012. The budget prioritizes job growth and includes no tax increases. In contrast to Governor Christie's past policies, his new budget is now increasing state aid to schools and doubling up on state pension contributions based on growing tax revenue projections. To make New Jersey the "economic engine of the region" again, Governor Christie says, the new budget is a dose of "fiscal sanity that restores New Jersey's economic future."[20] The governor criticized the Legislature for failing to enact the 10% cut in income tax that he proposed in his budget.

Worryingly, predictions show that Governor Christie's budget is already producing a budget deficit in 2012, and analysts are skeptical that it will help put New Jersey on the path to fiscal stability. With stagnant income tax reported and almost 6% of the budget funded by non-recurring revenue, investors remain wary of the state budget's health.[21] The state's budget situation is particularly difficult because the Federal Reserve predicts two more years of slow national economic growth.

18 Ravitch, Richard and Volcker, Paul. Report of the States Budget Crisis Task Force. [http://www.statebudgetcrisis.org].
19 Ibid.
20 "Gov. Chris Christie budget speech full text." [http://www.nj.com/politics/index.ssf/2012/02/gov_christie_budget_speech_liv.html]. Feb 21, 2012.
21 Kaske, Michelle and Dopp, Terrence. "Christie Budget Nears Approval As Financing Worsens: Muni Credit." Bloomberg. [http://www.bloomberg.com/news/2012-06-25/christie-budget-nears-approval-as-financing-worsens-muni-credit.html].

Worse yet, the federal government is providing significantly less fiscal aid compared to its assistance immediately after the economic crisis. All of these factors spell trouble for the already struggling New Jersey economy and budget. ★

The State of the States

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