Toward a Fiscally Sustainable New Jersey: Analysis and Recommendations

A REPORT FOR THE GARDEN STATE INITIATIVE
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Executive Summary

Entering a global pandemic and recession, New Jersey's fiscal condition and future were already on an unsustainable trajectory. Its workforce and population have remained flat in terms of growth, the state continues to experience an exodus of higher income taxpayers who pay the vast majority of income taxes, and its gross state product (GSP) has increased by less than 1 percent annually on average since the economic recession that began in 2007, far less than the 2.3 percent annual growth across the United States. This stagnation has left the state with the urgent need—and promising opportunity—to change its fiscal course post-pandemic by implementing the kind of bold reforms and measures that can ensure a strong and fiscally sustainable economic future for its citizens and businesses. The state needs to avoid being lulled into complacency because of more than $6 billion of one-time Federal COVID financial relief and its $4 billion repayable borrowing. In particular, New Jersey needs to address once and for all the massive underfunding of its public employee pensions (nearly $131 billion in combined underfunding) and other public employee benefits (OPEB) which includes retiree healthcare (nearly $76 billion), in addition to deferred infrastructure improvements (of at least $50 billion).

To that end, this report, which follows up on the 2012 State Budget Crisis Task Force analysis (produced under the direction of Paul Volcker and Richard Ravitch), argues that the following critical steps must be taken:

- **Hold the line on taxes in a state where residents and businesses shoulder one of the heaviest tax burdens in the nation.** New Jersey already boasts the third highest income tax rate in the nation,[1] and the worst business tax climate nationally.[2] Indeed, New Jersey's fiscal problems stem not from collecting too little revenue, but from spending too much. Among the state's greatest priorities should be ensuring that the outmigration of high-income individuals does not continue. Taxpayers who earn more than $100,000 annually make up about 24 percent of tax returns filed but pay about 86 percent of all income taxes.[3] As these residents increasingly flee the state, New Jersey faces the daunting prospect of lower income tax revenues and a population unable to support its spending.
- **Work vigorously to reform the state's ailing public pension and healthcare systems.** The state has consistently failed to make the contributions recommended by actuaries to its pension

1 Based on *State Individual Income Tax Rates and Brackets for 2021* by Katherine Loughead at the Tax Foundation, available at: https://taxfoundation.org/state-income-tax-rates-2021/#Key .

2 Based on *2021 State Business Tax Climate Index* by Jared Walczak and Janelle Cammegna at the Tax Foundation, available at: https://taxfoundation.org/2021-state-business-tax-climate-index/ .

3 Based on New Jersey Statistics of Income files from 2010 and 2016, Table 3.3b, available at: https://www.state.nj.us/treasury/taxation/soiintro.shtml.

systems, leaving the state's plans with the worst funding ratio (assets to liabilities) in the country.[4] Furthermore, pension liabilities are growing faster than the state's economy, and it is this economy that ultimately supports these systems. Elected officials need to continue to pursue options that will address the shortfall while protecting the benefits of those already retired. Among the measures that should be considered are raising the benefit-eligible retirement age of public employees and increasing contributions from employees. Retiree health care programs are also in dire need of change. Reforms might include modernizing the present cost sharing of health care costs between beneficiaries and the state, and transitioning to a defined contribution system of health care benefits where retirees are given a predetermined amount of money to purchase whatever benefits they choose.

» **Invest in infrastructure spending to address an estimated $50 billion need over the next decade[5] –** a problem exacerbated by the fact New Jersey ranks at the top nationally for many types of construction costs, which are between four to six times higher than the national average.[6] Infrastructure improvements are critical to economic development and an enhanced quality of life for millions of citizens. Elected officials must find ways to bring these costs down significantly if the state is to meet its escalating infrastructure needs without burying taxpayers under mountains of added debt. Furthermore, officials must spend money already authorized in the Transportation Trust Fund to prod needed infrastructure capital improvements. Moreover, New Jersey should cease diverting New Jersey Transit capital funds to operations instead.

» **Refocus spending to achieve a structurally balanced budget relative to revenues that is sustainable over the long-term.** Any spending reductions, however, should not target areas that negatively impact core services to citizens, or that compromise the state's ability to attract new businesses and residents. Rather than across-the-board cuts, the state should carefully analyze the entirety of its budget to determine which service areas are less critical and what efficiencies could be implemented in these nonvital services in order to protect more vital services and ensure the greatest returns to taxpayers. For example, New Jersey has one of the best public education systems in the nation, but it spends significantly more than other states, such as Massachusetts, that also have top-ranked public education programs. Targets for spending reductions should include public pension and healthcare programs (both of which are among the nation's costliest) and non-mission critical programs and departments funded by the state. Education spending might be more efficiently managed by reducing administrative costs achieved through shared back office and business operations services. New Jersey received more than $9 billion from the federal COVID relief bill passed in March 2021.[7] The state should view this not as money to establish new spending priorities, but instead as a down payment to fix fiscal problems that have been neglected for decades.

4 Based on the *The State Pension Funding Gap: 2018* by the Pew Charitable Trusts, available at: https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2020/06/the-state-pension-funding-gap-2018.

5 Based on the State's Capital Improvement Strategy, available at: https://www.njleg.state.nj.us/OPI/Reports_to_the_Legislature/transportation_capital_investment_strategy_FY2013_2022.pdf, plus the Environmental Protection Agency's Clean Watersheds Need Survey, available at: https://ofmpub.epa.gov/apex/cwns2012/f?p=cwns2012:3: .

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

7 See: https://www.nj.com/coronavirus/2021/02/third-stimulus-check-update-biden-stimulus-package-to-send-9b-to-nj-see-how-much-your-town-would-get.html.

Key Performance Indicators of New Jersey's Fiscal Health

Key Performance Indicators (KPIs) are quantifiable measures used to evaluate the success of an organization in meeting stated performance objectives. Comparison with all other states is a useful framework for KPIs for the assessment of any specific state, including New Jersey.

U.S. News & World Report's well-regarded annual ranking of U.S. states' economies measures employment, business environment and growth—all of which are important determinants of governments' financial health.[8] In this accounting for 2020, New Jersey ranks 19th out of 50— disappointing but not desperate. Digging deeper into one specific element, "fiscal stability," the state ranks 49 of 50. The stability category is broken down into two parts: long-term stability (measured by credit ratings and pension funds) and short-term stability (measured by budget balancing and liquidity), where New Jersey ranks third worst in the country (48/50) on each. The rankings below suggest that New Jersey's fiscal performance and sustainability is extremely poor compared with other states:

SELECTED KPIS FOR NEW JERSEY 2020 (1 = BEST, 50 = WORST)

KPI	New Jersey Rank
Fiscal Stability	49/50
Unemployment	48/50
GDP Growth Rate	36/50
Employment Growth	44/50
Per Capita GDP	10/50
Poverty Rate	5/50
Credit Ratings (S&P; Moody's, Fitch)	49/50
Property Tax Rate	47/50
Personal Income Tax Rate	47/50
Pension Deficit (% liabilities)	49/50
State Debt Per Capita	45/50
Quality Education of K-12 Schools	1/50

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve System, Department of Education, U.S. News & World Report

How Did New Jersey Do?

In the 12 KPIs measured, New Jersey ranked in the bottom 10 percent of all states in seven KPIs, including low credit ratings, employment rate, fiscal stability, personal income tax rate, property tax rate, state debt per capita, and pension deficit. New Jersey scored in the top 10 percent in only two categories: the quality of K-12 education and the poverty rate. And, in two of the other three categories—GDP growth rate and employment growth—New Jersey is in the bottom third.

[8] Available at https://www.usnews.com/news/best-states/new-jersey .

Introduction

The COVID-19 pandemic led to significant uncertainty and suffering not only in the United States, but globally as well. In the case of New Jersey, the human loss of life is significant and tragic. Furthermore, the pandemic's effect on the state's fiscal condition was also significant. The fiscal and budgetary conditions of the state, however, had already been eroded and weakened over several decades prior to the global pandemic of 2020. The state will need to emerge from the pandemic and create a climate hospitable to the resumption of normal economic activity while maintaining critical public services to its residents. What can New Jersey do to be competitive for residents and businesses? What are the critical institutions that need significant reforms? How can these goals be accomplished while having a fiscally sustainable state budget?

This report follows up on the 2012 State Budget Crisis Task Force analysis of the state of New Jersey.[9] At that point in time, the nation had just emerged from the 2007–2008 financial crisis, which had caused significant disruptions to government revenues and financial plans. In 2020, we experienced a worldwide pandemic but entered it after a period of significant economic recovery and improvement. What this report finds, however, is that the problems described in the 2012 report had not been sufficiently addressed. Small, marginal reforms in some areas were certainly enacted and implemented. But these reforms gave merely the appearance of addressing the problems but did not address their substance. Thus, after a decade of economic recovery, New Jersey remains very much stuck with a degraded fiscal condition similar to its position prior to the economic expansion of the post-2008 recession.

New Jersey should view its recovery from the pandemic as an opportunity to change the fiscal direction of the state. Small efforts will not suffice. Therefore, New Jersey elected officials should:

- **Hold the line on new taxes and increasing rates.** As detailed in this report, New Jersey residents and businesses are already among the most taxed in the nation.
- **Continue to reform pension and retiree health care benefits.** These legacy obligations continue to consume larger and larger parts of the budget. Liabilities are growing faster than the state's economy. There is no reasonable chance that the state can get these liabilities under control because political leaders have kicked the can down the road for too long. These costs are also crowding out other new public needs.
- **Reduce the costs of infrastructure and use all appropriated funds.** New Jersey is one of the most expensive places to build and this impedes growth. The state needs smart infrastructure

9 Available at https://www.volckeralliance.org/publications/report-state-budget-crisis-task-force.

investment, but it cannot pay some of the highest costs in the nation for it. Furthermore, it should immediately use any infrastructure funds previously appropriated but remaining idle.

» **Refocus spending on essential and core services.** New Jersey has a spending problem, not a revenue problem. The state needs to refocus money on services that will aid in New Jersey maintaining the well-being of its citizens while also attracting new people and businesses. Federal money from the COVID-19 relief package in 2021 should not be dedicated to new spending, but instead to addressing past fiscal neglect.

Undoubtedly, these changes will require expending great political capital for implementation. Nevertheless, it is only through large, meaningful changes that New Jersey will signal that it takes its fiscal condition seriously—the state has experienced a series of bond rating downgrades during the long economic expansion, signaling that the capital markets already have concerns about the direction of the state—and the days of gimmicks and delaying the tough decisions are behind it. Such action will place New Jersey government on the path to long-term fiscal sustainability.

The Recent Economic Climate

Overview

New Jersey's population and workforce have failed to grow over the past decade. In 2018 and 2019, New Jersey reported the third highest outmigration rate in the nation.[10] Despite this loss of population, the state's budget has continued to grow. The two issues are related: as residents and businesses choose other locations, New Jersey's tax bases decline and—in the absence of spending restraint or reductions—this requires higher taxes on those remaining to compensate.

Population and Workforce Trends

New Jersey's economy makes up about 3 percent of the entire national gross domestic product (GDP).[11] Following the economic recession that began in 2007, real inflation-adjusted GDP across the United States improved by about 2.3 percent annually.[12] By contrast, during this same time period, New Jersey's GSP increased by less than 1 percent annually on average.[13] That the economic recovery was especially slow in New Jersey is evidenced by revenues. State revenue reached nearly $33 billion in 2008 but failed to reach this level again until 2015. In other words, New Jersey needed seven years to reach its earlier peak of revenues.

New Jersey's population has been stagnant for the past decade. Between 2010 and 2019, the state's population increased less than 1 percent in total, averaging an annual growth of 0.1 percent. While New Jersey was comparable to the Northeast Region in general—which grew 1.1 percent in total during this time—it lagged the nation as a whole. Between 2010—2019, the US population increased by 6.1 percent in total and averaged an annual growth of 0.6 percent. New Jersey is attracting fewer residents than the rest of the nation (Table 1).

10 US Census Bureau, State-to-State Migration Flows, available at https://www.census.gov/data/tables/time-series/demo/geographic-mobility/state-to-state-migration.html.

11 Based on data from the US Bureau of Economic Analysis. Available at https://www.bea.gov/data/gdp/gdp-state.

12 Calculated from US Bureau of Economic Analysis Real GDP in chained 2012 dollars data series, available at https://www.bea.gov/data/prices-inflation.

13 *Ibid*.

TABLE 1: NEW JERSEY, NORTHEAST US, AND NATIONAL POPULATION AND GROWTH, 2010–2019

Year	NJ Population	NE US Total Population	National Population
2010	8,799,446	55,380,134	309,321,666
2019	8,882,190	55,982,803	328,239,523
Average Annual Growth:	0.1%	0.1%	0.6%
Source: U.S. Census Bureau, Population Division: Table 1. Annual Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico: April 1, 2010 to July 1, 2019 (NST-EST2019-01)			

New Jersey's workforce has also been stagnant for the past decade. Whereas the Northeast has experienced a meager total growth of 1.2 percent over the decade, New Jersey has had no growth at all. Meanwhile, the nation's workforce—similar to its population growth in general—has grown more than 6 percent during the decade and has averaged 0.6 percent annually. Therefore, while the Northeast overall lacks growth during a period of economic expansion, New Jersey has experienced even more lackluster labor force growth (Table 2).

TABLE 2: NEW JERSEY, NORTHEAST, AND NATIONAL LABOR FORCE AND GROWTH, 2010–2019

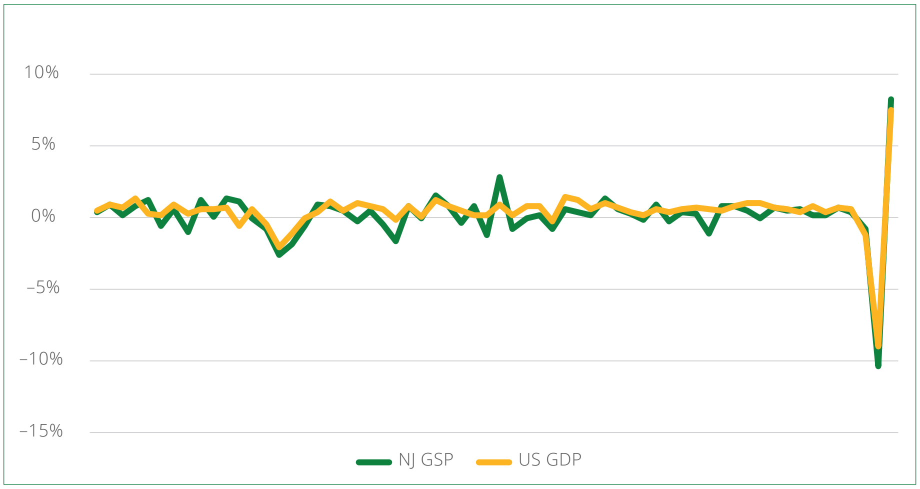
Year	NJ Civilian Labor Force (000)	NE US Total Civilian Labor Force (000)	National Civilian Labor Force (000)
2010	4,520	28,244	153,889
2019	4,518	28,585	163,539
Average Annual Growth:	0.0%	0.1%	0.6%
Source: Bureau of Labor Statistics, Current Population Survey; Geographic Profile of Employment and Employment			

Full-time and part-time employment fell by nearly 170,000 between 2008 and 2010 in New Jersey.[14] Statewide employment exceeded pre-recession levels by 2016, with strong growth in education, health services, financial services, and construction. When job growth began in 2011 and lasted through 2018, New Jersey's employment numbers grew by about 1.4 percent per year on average—compared to a national average of 1.9 percent per year on average.[15] Job creation in New Jersey, therefore, was significantly lower than national trends during a time of economic expansion. Lower job growth is associated with lower tax collections and less opportunity for current and potential citizens. In fact, comparing New Jersey's GSP growth from 2005 to 2020 (quarterly) to national GDP growth shows the state consistently lagging the rest of the nation. New Jersey's economic stagnation is associated with lower economic growth (Figure 1).

[14] Calculated from US Bureau of Economic Analysis Total Full-Time and Part-Time Employment by NAICS Industry data series, available at https://www.bea.gov/data/employment/employment-by-industry.

[15] *Ibid*.

FIGURE 1: NEW JERSEY GSP VS. US CHANGE IN GDP, QUARTERLY 2005—2020



Source: U.S Bureau of Economic Analysis. Available at https://apps.bea.gov/iTable/index_nipa.cfm.

New Jersey was one of the states hardest hit by COVID-19—with more than 310,000 cases and over 16,700 deaths as of November 2020, placing the state in the top 13 nationally. Early in the pandemic, the state had COVID-19 cases in greater numbers than almost all other states except New York. More than 800,000 jobs were lost in the immediate aftermath of the pandemic and about 40 percent of these jobs had still not returned by November 2020.[16] The state's unemployment rate was at 7.6 percent in December 2020, compared with a national average of 6.7 percent (Table 3).[17]

TABLE 3: NEW JERSEY AND NATIONAL UNEMPLOYMENT RATES, 2010-2020

Year	NJ	National
2010	9.5%	9.8%
2020	7.6%	6.7%
Source: Bureau of Labor Statistics, State and Regional Unemployment.		

Since the start of the pandemic, New Jersey's unemployment rate has been persistently higher than the national average; although national unemployment levels began to drop in May 2020, New Jersey did not see a significant decline until July 2020. Furthermore, New Jersey's labor force participation rate has dropped significantly since March 2020—from 64.8 percent to 61.1 percent in September 2020; this rate did increase to 63.9 percent by November 2020 as individuals began to rejoin the labor market.[18] Lower labor force participation is correlated with weaker economic growth due to fewer people working and higher tax rates that results from maintaining the level of government expenditures with a shrinking tax base.

Going into the pandemic, one analysis ranked New Jersey 48th in the nation in economic outlook and 45th in economic performance.[19] The 2021 budget increased taxes by about $700 million on higher income taxpayers while tax rebates were implemented for lower income taxpayers. Econom-

16 See "New Jersey Employment Increases in November," available at https://www.nj.gov/labor/lpa/pub/emppress/pressrelease/prelease.pdf.

17 See https://www.bls.gov/news.release/laus.nr0.htm.

18 See https://nj.gov/labor/lpa/content/maps/lmiupdate.pdf.

19 See the American Legislative Exchange Council, *Rich States, Poor States, 13th Edition*.

ic activity was significantly curtailed in Spring 2020; this will likely result in lower sales and income tax revenues. It is estimated that New Jersey's economy contracted 3.3 percent on an annualized basis in the first quarter of 2020 and 35.6 percent in the second quarter, compared to national averages of 5 percent in the first quarter and 31.4 percent for the second quarter.[20]

Conclusion

Even though the overall national economy grew significantly during the past decade, New Jersey did not benefit from this national growth. The state's population and workforce remained flat, a signal that the state was not competitive in attracting people or businesses. During this time, the state budget grew while the population was relatively flat. New Jersey was essentially drawing more resources from its tax base which hindered its business competitiveness. A key priority for elected officials, then, needs to be determining how to reverse this trend and make New Jersey a better place for businesses to operate and one where people want to live.

20 Based on data from the US Bureau of Economic Analysis, available at https://www.bea.gov/data/gdp/gdp-state.

The Budget Situation

Overview

New Jersey ranks high in the amount of taxes paid as a percentage of income. New Jersey has the third highest income tax rate in the nation at 10.75 percent, while states such as Texas and Florida levy no income taxes at all.[21] New Jersey ranks 46th in the nation in property tax competitiveness.[22]

New Jersey also has the highest business tax in the nation as of 2021, at 11.5 percent of net income.[23] Whereas other states such as Florida, Georgia, Mississippi, Missouri, and Indiana have lowered their business tax rates, New Jersey attempts to lure businesses with targeted tax breaks. In 2020, the state implemented the Economic Incentive Package to award over $14 billion in tax breaks to specific companies rather than lowering rates overall for all businesses.

Tax Revenues

Since 2013, income taxes have increased as a percentage of total taxes while other taxes have declined as the state has become more dependent on higher income taxpayers to fund its budget. The state constitution dedicates revenue from the gross income tax (as well as a portion of the sales tax) to the property tax relief fund. Hence, property tax is an increasing source of local government funding that largely goes towards education. In 2016, the top 20 percent of full-time residents (those making about $117,000 or more annually in gross income) paid 86 percent of all state income taxes, up from 83 percent in 2010.[24] Forty percent of full-time New Jersey residents pay no income taxes at all, and 75 percent of this group actually experience a negative effective income tax rate after accounting for credits and refunds.[25] Clearly New Jersey is very dependent upon its top income earners to fund its budget. Sales and corporate taxes have remained fairly stable over the time period, although they have fluctuated during specific years.

The state's high tax rate makes it less competitive for businesses and individuals to move in. In 2020, the Tax Foundation ranked New Jersey last in its measure of state business tax climate— that is, how

21 Loughead, Katherine, February 17, 2021. "State Individual Income Tax Rates and Brackets for 2021." Tax Foundation, available at: https://taxfoundation.org/state-income-tax-rates-2021/.

22 Cammegna, Janelle, December 9, 2020. "Ranking Property Taxes on the 2021 State Business Tax Climate Index." Tax Foundation, available at: https://taxfoundation.org/best-worst-state-property-tax-codes-2021/.

23 Cammegna, Janelle, February 3, 2021. "State Corporate Income Tax Rates and Brackets for 2021." Tax Foundation, available at: https://taxfoundation.org/state-corporate-tax-rates-2021.

24 Based on New Jersey Statistics of Income files from 2010 and 2016, Table 3.3b, available at: https://www.state.nj.us/treasury/taxation/soiintro.shtml.

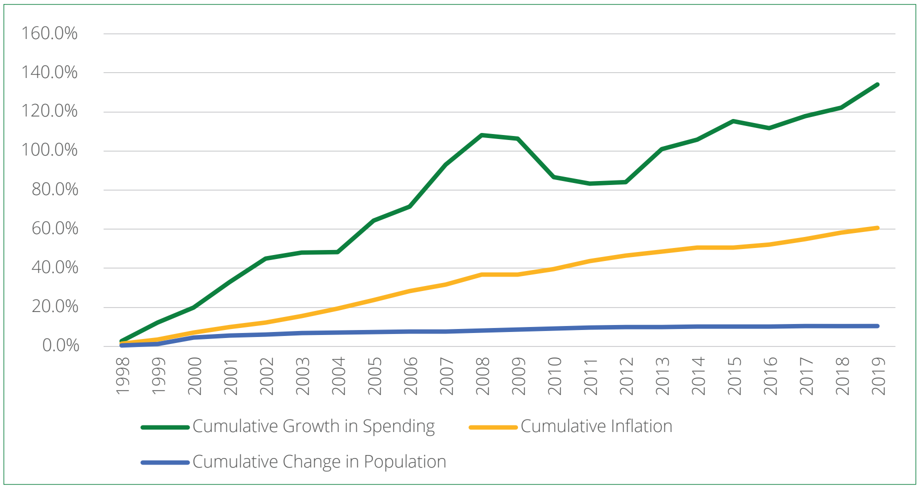
25 *Ibid.*

a state's tax laws influence economic performance—for the seventh straight year.[26] New Jersey has the highest corporate tax rate nationally.[27] Despite this, some elected officials have proposed new taxes—such as a financial transaction tax—that would add to the poor business climate of the state; the Tax Foundation has ranked the state as the worst business climate in the nation.[28]

Conclusions

No doubt, New Jersey will continue to see specific needs increase, especially in public health, health insurance, and public safety. New Jersey already taxes residents and businesses more than most other states. The problem is not too little revenue; rather, it is that the state's spending is too high and is growing at a faster pace than inflation and the state's population (see Figure 2). New Jersey already taxes its residents and businesses significantly and new taxes are likely not feasible. The state is at the limit of its ability to extract additional revenues from residents and businesses. Nevertheless, Governor Murphy has proposed a state budget for FY2022 of nearly $45 billio —a year-over-year increase of nearly 10 percent.

FIGURE 2: GROWTH IN NEW JERSEY STATE SPENDING COMPARED TO INFLATION AND POPULATION, 1998–2019



Source: New Jersey State Treasury (available at https://www.nj.gov/treasury/omb/archived-budgetpubs.shtml), Consumer Price Index (available at https://www.bls.gov/cpi/), and US Census Bureau (available at https://www.census.gov/en.html)

[26] Based on 2020 State Business Tax Climate Index published by the Tax Foundation, available at https://taxfoundation.org/publications/facts-and-figures/ .

[27] Cammegna, Janelle, February 3, 2021. "State Corporate Income Tax Rates and Brackets for 2021." Tax Foundation, available at: https://taxfoundation.org/state-corporate-tax-rates-2021/.

[28] Decroce, Betty Lou and Patrick Delle Cava, November 17, 2020. "Other states are taking notice of N.J.'s lousy business climate and are trying to pilfer our businesses and jobs." ROI-NJ.com.

Use of Budgetary Gimmicks

Overview

New Jersey, like many states, has used nonrecurring revenues to balance its budget over the years. Good financial management practice indicates that recurring expenditures ought to be paid for with recurring revenues. The use of nonrecurring revenues will result in a budget that is balanced technically, but not one that is balanced structurally.

New Jersey has long maintained a budget that is structurally unbalanced and not sustainable. The obligations of the state routinely exceed its resources and require one-shots and gimmicks to appear balanced. But on an economic basis, New Jersey's budgets remain unbalanced. For the year ending June 30, 2019, New Jersey reported a $1.3 billion operating loss for governmental activities when resources are measured using the accrual economic resources measurement of accounting rather than the cash basis it uses for budgeting.[29] This operating loss represents nearly 3.5 percent of governmental activities revenues. Nor was the annual operating deficit a one-time occurrence. Over time, New Jersey has accumulated a net position shortfall of over $202 billion from failing to properly budget for and finance all of its obligations.[30]

Types of Gimmicks

Most politicians understand that nonrecurring revenues are not an ideal method for balancing budgets. Nonrecurring actions include:

- Changing a payment date. For example, in March 2019 New York State delayed paying Medicaid to providers for several days and moved $1.7 billion in Medicaid expenditures from one fiscal year to the next.
- Deferring required pension contributions to future fiscal years, as New Jersey has done for decades.
- Issuing long-term debt for operating purposes. Debt should be issued for a term that corresponds with the benefits derived from the debt. Thus, long-term debt should be used to finance long-term assets, while cash flow needs for operating purposes should be managed with short-term borrowing if necessary.

29 State of New Jersey Comprehensive Annual Financial Report for the Year Ended June 30, 2019, Statement of Activities, page 34—35, available at https://www.state.nj.us/treasury/omb/fr.shtml.

30 *Ibid.*

These are not the only nonrecurring budgetary actions, but they are some of the most significant and problematic.[31] The Volcker Alliance notes New Jersey's frequent use of such gimmicks and has given the state a grade of "D" related to its use of gimmicks in its budgeting.[32] A recent update of this study revealed little improvement for the state.[33]

Because of its long-standing structural budget deficit, New Jersey has habitually relied upon nonrecurring actions habitually (see Table 4).

TABLE 4: DOLLAR VALUE OF NONRECURRING REVENUE AND PERCENT OF TOTAL BUDGET ($ MILLIONS), 2010—2020

Fiscal Year	$ Value of Nonrecurring Actions*	Size of Appropriations Act	Percent Share
2020	$658.24	$38,720.10	1.7%
2019	$756.80	$37,325.90	2.0%
2018	$693.41	$34,670.30	2.0%
2017	$552.15	$34,509.40	1.6%
2016	$979.77	$33,785.20	2.9%
2015	$1,138.82	$32,537.77	3.5%
2014	$1,088.24	$32,977.00	3.3%
2013	$1,012.96	$31,655.00	3.2%
2012	$1,085.93	$30,164.60	3.6%
2011	$1,910.84	$29,397.50	6.5%
2010	$4,124.45	$31,245.80	13.2%

* Does not include or reflect underfunding of the pension systems or retiree health care.

Source: State of New Jersey, Budget in Brief, various fiscal years.

New Jersey improved in this area over time, although FY2021 saw this improvement halt abruptly. In 2010, for instance, nonrecurring actions accounted for more than 13 percent of general fund appropriations. These actions had dropped to only 2 percent by 2020. Nevertheless, the size of the nonrecurring actions to plug the budget are still relatively significant. Furthermore, these numbers are understated because of the state's inability or unwillingness to fund pensions adequately. For example, in 2018 New Jersey deferred over $2.5 billion in recommended pension contributions. If it had generated one-time revenue or expenditure actions to pay the pension contributions, the percent share of nonrecurring actions would have approached 10 percent, not 2 percent. Thus, the importance of these pension deferrals is significant.

The improvement in reliance on nonrecurring actions ended with the FY2021 budget. The state used over $4 billion of borrowing to cover operating expenditures, and this action was approved by the state's courts. Subsequently, Senate President Stephen Sweeney stated that the borrowing was

[31] See the 2012 Report of the State Budget Crisis Task Force for more details. Further details on budget maneuvers are available from the Volcker Alliance's *Truth and Integrity in State Budgeting: The Balancing Act*, which details additional tactics and grades each state on their use of such maneuvers.

[32] Volcker Alliance, February 20, 2020, *Truth and Integrity in State Budgeting: The Balancing Act*, available at: https://www.volckeralliance.org/publications/truth-and-integrity-state-budgeting-balancing-act.

[33] John Reitmeyer, March 31, 2021. "Pension Payment Plan Aside, NJ Has Fiscal Issues, Report Says." *NJ Spotlight News* available at https://www.njspotlight.com/2021/03/volcker-alliance-analysis-state-budgeting-practices-report-card-nj-mostly-d-no-a/.

completed too hastily, and the state should have waited "to get a clearer picture of our revenues."[34] Estimates of nonrecurring actions in this budget are around 15 percent,[35] returning New Jersey to budget behavior it took the better part of a decade to improve upon. Furthermore, the FY2021 budget includes $4.7 billion of expected pension contributions—the most ever by New Jersey and yet still short $1 billion from the actuarially determined contribution needed. Therefore, the FY2021 15 percent of appropriations funded by nonrecurring actions seems more like a floor than a ceiling for the upcoming year.

Conclusions

The use of non-recurring one-shots and borrowing (both explicit, such as issuing bonds, and implicit, such as not funding pensions and retiree health care) to plug budget shortfalls is the very definition of a structurally imbalanced budget. New Jersey has relied upon these for so long that changing this behavior will require real reforms to spending and political leadership to get there.

34 Stacey Barchenger, March 26, 2021. "NJ Borrowed Billions Because of COVID. Why the Senate's Top Democrat Regrets Tt." *Northjersey.com*, available at: https://www.northjersey.com/story/news/new-jersey/2021/03/26/nj-borrowed-covid-billion-bond-senate-president-sweeney-gov-murphy/7003269002/?utm_source=northjersey-Daily%20Briefing&utm_medium=e-mail&utm_campaign=daily_briefing&utm_term=list_article_thumb.

35 John Reitmeyer, September 28, 2020. "No Public Testimony. Court-Sanctioned Deficit Spending. NJ Budget Like No Other." *NJ Spotlight News*, available at: https://www.njspotlight.com/2020/09/no-public-testimony-court-sanctioned-deficit-spending-nj-budget-like-no-other/.

Pensions and Health Benefits

Overview

New Jersey has accumulated nearly $131 billion of unfunded pension liabilities. This poor financial status exists even after taking extraordinary actions such as placing the state lottery system into the pension system and also issuing pension obligation bonds to fund some of the liabilities. The poor financial health of the pension systems is the result of decades of failing to make pension payments that are actuarially determined to cover the costs of the benefits provided. As of 2018, New Jersey had the worst-funded combined pension plans in the nation. Whereas New Jersey's combined pension systems are funded less than 40 percent, the national average was 71 percent.[36]

Furthermore, New Jersey has accumulated $76 billion of liabilities for unfunded retiree health care benefits.[37] The costs of these benefits are growing faster than the rest of the state's budget, which means they will increasingly crowd out other public spending priorities. Unfortunately, the state failed to use the economic growth of the last decade to sufficiently address these growing liabilities.

In 2019, New Jersey spent 13 percent of its total appropriations on pensions and retiree health care. However, this does not account for the underfunding of pensions and retiree health benefits which is the norm for New Jersey. If the state funded these benefits properly, nearly 23 percent of state appropriations would be spent on pensions and retiree health care.[38] In other words, a full quarter of the budget would be spent on these legacy costs.

Pension Plans and Scope of the Issue

The state of New Jersey administers seven defined benefit public employee pension systems that cover virtually all state and local public employees. As of June 30, 2018, these systems have a combined membership of 453,555 active members (that is, public employees currently working who will be eligible for benefits upon retirement) and 333,044 retired members. Between June 30, 2013, and June 30, 2018, active members in the seven systems declined by 3 percent while retired members increased 13 percent. Of the seven systems, five have more retirees than active members.

As noted by the state itself, "As a result of lower-than-recommended contributions by the State to the Pension Plans for an extended period, lower than assumed investment returns on an actuarial

36 Based on the June 11, 2020 *The State Pension Funding Gap: 2018* issue brief by the Pew Charitable Trusts, available at: https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2020/06/the-state-pension-funding-gap-2018.

37 Comprehensive Annual Financial Report, FY 2019, page 110, available at https://www.state.nj.us/treasury/omb/fr.shtml.

38 Authors' calculation, based on assumption that total appropriations remain the same and the unfunded pension contribution is fully funded.

basis, benefit enhancements enacted during the late 1990s and early 2000s, and reductions in member contributions, the Pension Plans experienced a deterioration in their financial condition."[39] Furthermore, according to state law, all obligations of each retirement system shall be assumed by New Jersey should any system be terminated.[40]

TABLE 5: PENSION LIABILITIES, ASSETS, AND FUNDED RATIOS ($ MILLIONS), 2015-2019

Year	Total Liabilities	Net Position	Net Pension Liabilities	Funded Ratio
2015	$196,608	$83,482	$113,126	42.5%
2016	$217,142	$81,355	$135,787	37.5%
2017	$243,591	$75,348	$168,243	30.9%
2018	$221,601	$79,313	$142,288	35.8%
2019	$212,440	$81,527	$130,717	38.4%

Source: NJ Comprehensive Annual Financial Reports, 2015—2019

Table 5 shows the financial status of the combined New Jersey pension systems over the past five years since new accounting standards were implemented. In 2015, the combined systems were funded 43 percent—meaning that the systems had only 43 cents in assets for every $1 it owed beneficiaries. The funded ratio dropped below 40 percent in 2016 and has yet to recover to this already low bar. The state deposited the lottery into the pension system in 2016. Even with this deposit, the assets (net position) of the pension system have remained flat. Essentially, the pension systems are unable to accumulate assets because the required benefit payments consume a significant portion of any investment gains and new contributions. In 2019, for example, a total of $8.2 billion was contributed (between members and the state itself) to the state pension funds and all other trust funds and earned $5 billion in investment returns, for total additions of $13.2 billion to the fiduciary funds of the state.[41] The systems, however, paid out more than $12.3 billion during the year. Analyzing the last six years, despite more than $92 billion of deposits (including from the lottery system) and investment returns, these funds paid out nearly $83.4 billion—thereby only adding to the funds less than $7 billion, all during an era of unprecedented stock market growth.

Pension liabilities over the past decade have grown faster than the state's GSP. Figure 3 compares the cumulative change in the state's GSP versus the combined pension liability from 2011—2019. Figure 4 demonstrates that what New Jersey owes employees and retirees is growing significantly faster than the underlying economy that must support this liability. This is not sustainable. Furthermore, Figure 4 shows that pension liabilities are growing faster than assets.[42]

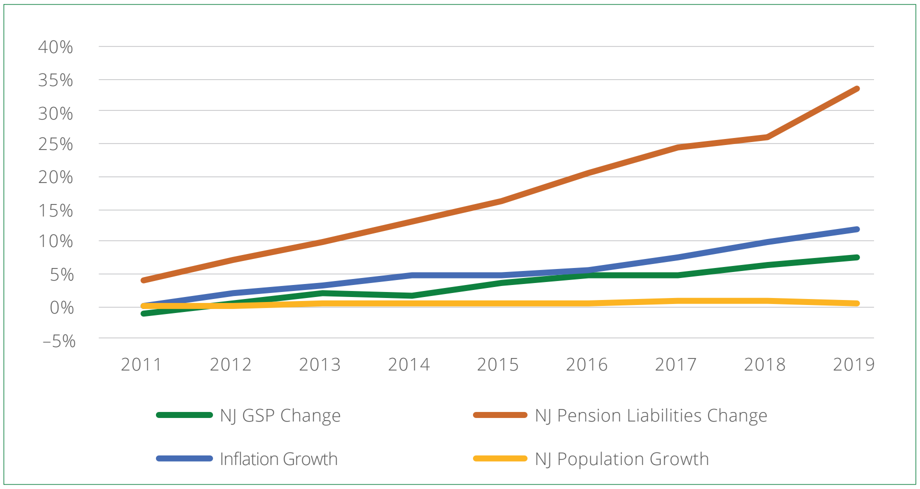
[39] State of New Jersey, Official Statement for General Obligation Bonds, dated January 7, 2020, page I-53.

[40] Comprehensive Annual Financial Report, FY 2019, page 101, available at https://www.state.nj.us/treasury/omb/fr.shtml.

[41] These other trust funds include the defined contribution retirement program, local government retired system, supplemental annuity collective trust, and alternate benefit long-term disability fund.

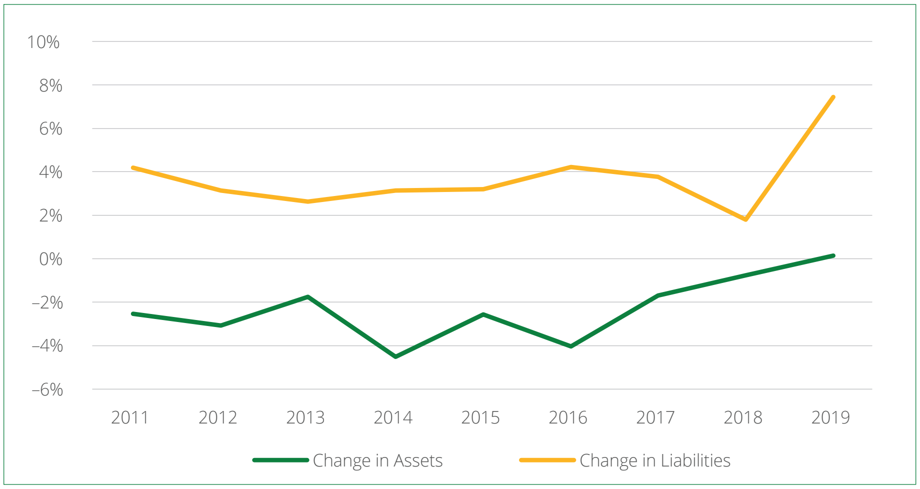
[42] The data in Figures 3 and 4 do not follow the new generally accepted accounting principles as used in Table 5 and are from the New Jersey Division of Benefits and Pensions, Actuarial Valuation Reports for years 2011—2019, available at https://www.state.nj.us/treasury/pensions/actuarial-valuations.shtml. Furthermore, 2016 does not include the deposit of the lottery system into the pension systems.

FIGURE 3: CHANGE IN PENSION LIABILITIES VS. OTHER FACTORS, 2011–2019



Source: New Jersey Division of Benefits and Pensions, Actuarial Valuation Reports for years 2011—2019

FIGURE 4: ANNUAL GROWTH IN NJ PENSION ASSETS AND LIABILITIES, 2011-2019



Source: New Jersey Division of Benefits and Pensions, Actuarial Valuation Reports for years 2011—2019

The state systems are unevenly funded. Table 6 shows the seven systems' funded status as of 2019. Although the small prison officers' pension fund (POPF) is almost fully funded, the rest are significantly underfunded. The police and firemen's retirement system (PFRS) is only 58 percent funded. The public employees' retirement system (PERS) for general state employees is slightly over 40 percent funded. The remaining funds—including the teachers' pension and annuity fund (TPAF), the judicial retirement system (JRS), the state police retirement system (SPRS), and the consolidated police and firemen's pension fund (CPFPF)—are all funded less than 40 percent.

TABLE 6: NET PENSION LIABILITIES AND FUNDED STATUS BY SYSTEM ($MILLIONS) AS OF JUNE 30, 2019 - BASED ON GASB 67 REPORTING ($ MILLIONS)

System	Total Pension Liabilities	Plan Fiduciary Net Position	Net Pension Liabilities	Funded Ratio
PERS	$72,866.2	$29,472.4	$43,393.8	40.5%
TPAF	$86,797.5	$22,991.1	$63,806.4	26.5%
PFRS	$46,797.6	$27,098.6	$19,699.0	57.9%
CPFPF	$5.7	$1.8	$3.9	31.0%
SPRS	$4,849.7	$1,790.0	$3,059.7	36.9%
JRS	$922.0	$167.7	$754.3	18.2%
POPF	$5.3	$5.2	$0.0	99.2%
Total	$212,244.0	$81,526.8	$130,717.1	38.4%

Source: NJ Comprehensive Annual Financial Report, FYE 2019, page 104

If New Jersey's pension systems were regulated the way the private pension systems are by the Pension Benefit Guaranty Corporation (PBGC), these pension systems would all be in the "critical" or "red zone" for funding purposes because the funded status is below 65 percent—suggesting a risk of insolvency. Red zone plans must implement plans that lead to the system not being critical within ten years. Such a system would be required to develop measures including increased contributions and reduced benefits to achieve improved funding status over a short period of time (that is, over short amortization periods), even forcing these changes on retirees and other beneficiaries.[43] Also of importance is the fact that the systems overseen by PBGC use discount rates that are much lower than the ones used by New Jersey's pension systems. Lower discount rates result in larger pension liabilities. Current discount rates used by the PBGC vary between 3 and 4 percent, compared to New Jersey's 7.3 percent. In other words, New Jersey's pension systems would be even more poorly funded if it used the same standards as private pensions. One report pegs New Jersey's unfunded pension liabilities at nearly $200 billion when a risk-free discount rate is used to estimate the liabilities, for an estimated 34 percent funding ratio in 2019.[44]

State Appropriations

Over 20 years of contributions to the pension systems are summarized in Table 7. The contributions have ranged from 0 percent to 61 percent of the actuarially determined contributions—amounts that are not sufficient to improve funding levels. Contributions in 1997 include the proceeds from a bond issue by the state of New Jersey, the 2018 contribution includes $976 million from lottery proceeds, and 2019 includes $1.1 billion from lottery proceeds. In other words, even the relatively decent years' contributions derive not from better financial discipline, but from one-time cash sources. This reality speaks to the state's structural budget deficit in which recurring obligations are not matched by recurring revenues.

The increase in recommended contributions is also quite striking. While inflation between 1997 and 2019 increased general prices by 62 percent, New Jersey's recommended actuarial determined

[43] For details on PBGC regulations, see "Multiemployer Pension Plans: Report to Congress Required by the Pension Protection Act of 2006" available at https://www.pbgc.gov/documents/pbgc-report-multiemployer-pension-plans.pdf.

[44] "Unaccountable and Unaffordable: Unfunded Public Pension Liabilities Total Nearly $5 Trillion," 2020, American Legislative Exchange Council, available at: https://www.alec.org/app/uploads/2020/06/2019-Unaffordable-FINAL.pdf.

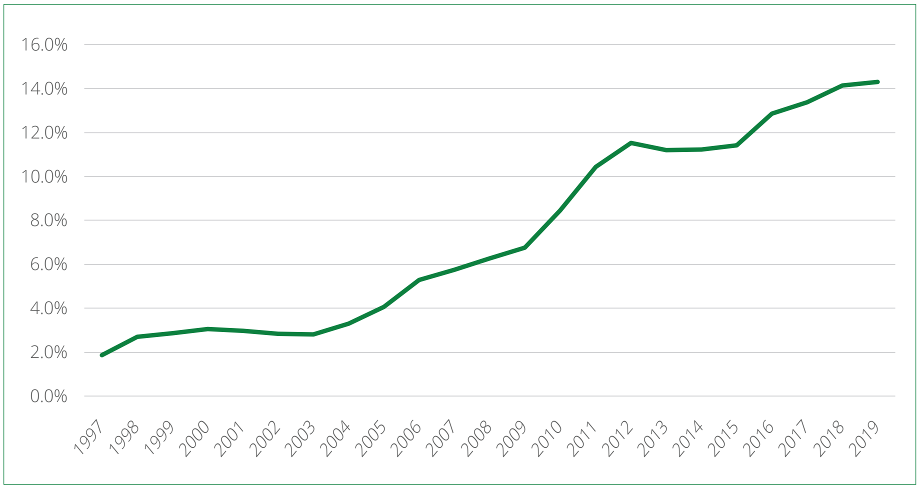
pension contributions increased by nearly 1,700 percent. Although much of this growth reflected factors such as increase in pay and tenure of public workers, it was accelerated by chronic underfunding, as well as a major increase in benefits in 2001. Importantly, the contribution never reached 100 percent during this long time period. As shown in Figure 5, recommended pension contributions are growing significantly as a share of total state appropriations.

TABLE 7: HISTORY OF PENSION CONTRIBUTIONS, 1997-2019

Valuation Year Ending June 30	Actuarial Recommended Contribution (000)	Actual Contributions (000)	Percentage
1997	$297.6	$104.6	35%
1998	$443.9	$90.2	20%
1999	$511.4	$284.2	56%
2000	$583.4	$63.7	11%
2001	$629.6	$0	0%
2002	$654.8	$0.6	0%
2003	$663.0	$10.4	2%
2004	$783.2	$26.4	3%
2005	$1,066.2	$61.1	6%
2006	$1,450.8	$164.4	11%
2007	$1,778.6	$1,023.2	58%
2008	$2,089.8	$1,046.1	50%
2009	$2,230.7	$106.3	5%
2010	$2,518.7	$0	0%
2011	$3,060.5	$0	0%
2012	$3,391.4	$484.5	14%
2013	$3,600.2	$1,029.3	29%
2014	$3,691.2	$699.4	19%
2015	$3,935.4	$892.6	23%
2016	$4,353.5	$1,307.1	30%
2017	$4,663.1	$1,861.6	40%
2018	$5,017.9	$2,484.1	50%
2019	$5,352.2	$3,276.0	61%

source: NJ General Obligation Bond Official Statement, January 7, 2020

FIGURE 5: PENSION ACTUARIAL RECOMMENDED CONTRIBUTION AS PERCENTAGE OF ANNUAL APPROPRIATIONS



Source: New Jersey Budgets in Brief, various years; and NJ General Obligation Bond Official Statement, January 7, 2020

The state's actuaries have projected the future funding status of the pension plans for the next 30 years based on assumptions about contributions, investment returns, and making the recommended deposits into the pension systems. The plan forecasts that the systems' fiscal health will stabilize over the first decade of the plan, then slowly improve over the second decade, and finally reach relative financial health in the third decade.

The contributions required to meet these aggressive targets, however, are larger than the most recent pension contributions. Furthermore, these large pension contributions must be sustained over three decades. Past actions by the state are indicative of the difficulties in continuing the needed improvements in the pension systems. The state is likely to find itself managing ever-depleted funds that effectively reverting to pay-as-you-go financing where benefits and other current spending would compete directly with benefit payments to retirees.

Hence, this plan that forecasts strong fiscal health for the systems by 2047 depends upon significant annual state contributions and strong consistent investment returns as well. If one or both of these does not happen, the systems will not stabilize and will not return to fiscal health. The past several decades strongly indicate that the state lacks the fiscal fortitude to follow through with this long-term funding plan.[45] It is not realistic to expect that this pension funding plan will proceed suitably and that the systems will return to fiscal health without significant and politically difficult reforms.

Retiree Health Benefits

New Jersey, like most governments, also promises retirees health benefits that are funded largely on a pay-as-you-go basis. Retirees, as well as their spouses and dependents, with 25 years or more of service are eligible for these benefits, which include benefits for medical, prescription drugs, Medicare Part B reimbursement, and Medicare Part D reimbursement. Furthermore, the state is

[45] If the pension funds become exhausted, New Jersey would need to pay for pension benefits from current revenues. Beyond violating notions of intergenerational equity, the share of the state budget devoted to pension funding in either the actuary's plan or the pay-as-you-go possibility is significant and would potentially hamper the state's ability to provide revenue for other services or to reduce current taxes.

required to pay the health care costs of teachers (both local teachers as well as those employed in higher education) who retire with sufficient service credits and covered dependents, as well as qualified police and firefighter retirees and dependents.[46] This is a quirk of history since teachers have never worked directly for the state. The state paid $1.9 billion in 2018, $1.8 billion in 2019, and budgeted $2.7 billion in 2020 to pay for these benefits.[47] Because no assets exist to fund these liabilities, New Jersey must pay the entire amount each year. However, if the full expense were paid (meaning that the state was prefunding future retirees' benefits as it does with pensions), the annual outflow would be closer $3.2 billion. As of June 30, 2018, New Jersey reported an unfunded actuarial liability for these health benefits of $76 billion.[48]

These retiree health care costs are estimated to grow in excess of 5 percent annually. As noted earlier, total revenues have grown at 2.5 percent from 2013 to 2020 in New Jersey; hence, these retiree health costs are expected to increase faster than available revenues, suggesting that these costs will consume an increasing portion of the budget absent serious reform efforts.

Conclusions

New Jersey's pension systems are significantly underfunded. This underfunding exists despite budgetary gimmickry such as issuing pension obligation bonds and contributing the state lottery to the pension systems. The most significant problem has been that for many years the state government failed to make the annual required contributions. This is a political problem rather than a market failure. Prior administrations have studied the problem, but actions to stem the problem have been lacking.[49] Although the state has a plan for improving funding and has publicly committed to that plan, it is predicated on a discipline that has been absent for the much of the past 20 years. Whether this discipline can be resurrected during a pandemic that is causing stress in public budgets is questionable.

Since 1997, New Jersey has skipped nearly $38 billion in recommended pension payments—and over $40 billion when gimmicks are excluded. Despite reforms in 2011, such as suspending cost-of-living adjustments and increasing contributions from members, the unfunded liabilities of the systems have only continued to increase—rising from $113 billion in 2015 to $131 billion in 2019. Furthermore, retiree health benefits add another $76 billion to the state's liabilities. Between these two categories of spending, the state should be funding over $9 billion of costs annually, but instead is at best funding $6.5 billion—meaning that the state continues to fall further and further behind in funding these liabilities. These combined unfunded liabilities indicate that each household in New Jersey owes over $64,000 for retiree benefits alone (pensions and healthcare).[50] Furthermore, these benefits were earned in the past. Hence, New Jersey taxpayers owe this money for services consumed in the past but not properly funded—violating intergenerational equity.

It seems unlikely that New Jersey will be able to find the additional revenues necessary to proper-

46 N.J.S.A. 52: 14-17.32f, passed in 1987 and amended in 1992; and P. L. 1997, c. 330 and P. L. 1989, c. 271.

47 New Jersey Budget in Brief, FY2020, page 16, available at https://www.nj.gov/treasury/omb/index.shtml#currentpubs.

48 New Jersey Comprehensive Annual Financial Report, FY 2019 page 89, available at https://www.nj.gov/treasury/omb/fr.shtml.

49 For example, the New Jersey Pension and Health Benefit Study Commission formed in 2014 and issued several reports examining the pension and health care funding challenges. These reports are available at https://www.nj.gov/treasury/pensions/pbsc.shtml. Elected officials have taken no action based on these recommendations.

50 Calculated as the unfunded pension and OPEB liabilities divided by the number of households in New Jersey (from https://www.census.gov/quickfacts/NJ).

ly fund its pension and health benefits. As noted, New Jersey already would have to increase their current funding significantly just to keep these liabilities from growing even more. Elected leaders will need to expend political capital to implement further reforms beyond those already adopted—these reforms must not only increase current funding but must also bring down the cost of current and future liabilities and achieve savings in medical costs. Making these benefits financially sustainable through reforms is arguably the most critical task facing elected leaders today. Few other efforts will be successful as long as these legacy costs continue to consume more and more of governments' budgets. Governor Murphy has proposed making a $6.4 billion full contribution to the pension system in the 2022 budget.[51] Whether these resources could be better deployed by reducing the pension systems' costs through reforms remains an open question.

Nationally, it is also time to consider transitioning public pensions to The Employee Retirement Income Security Act of 1974 (ERISA) funding rules and regulations that are applicable to private plans.

As to retiree health care benefits, the state should consider moving pre-Medicare retirees onto state health insurance exchanges. This would permit the state to transition to a defined contribution plan in which retiree benefits are capped at some reasonable and affordable level rather than maintaining the current open-ended defined benefit plan.

[51] Joseph De Avila, February 22, 2021, "New Jersey Governor to Propose Full Pension Payment for First Time Since 1996," *Wall Street Journal*.

Infrastructure

Overview

New Jersey has significant amounts of infrastructure that has suffered extensive deterioration. The state has not maintained its physical plant adequately, which likely means that extensive future investments will be necessary just to maintain the existing infrastructure, let alone expand it to meet the new and developing needs of the state's taxpayers.[52] Infrastructure will demand more attention and more financing because of the neglect of the state—which occurred even over the past decade when the economy was reasonably strong. Much like other long-term issues, such as pensions and retiree health care, New Jersey failed to take advantage of good economic times to get its financial house in order with respect to infrastructure.

Capital Investments

Public infrastructure comprises long-lived assets owned by governments that are used in economic activity, human capital development, and the provision of public and private services. State-level infrastructure is frequently focused on transportation, such as roads, bridges, and mass transit; buildings, used for providing general government services but especially education which is capital-intensive; and utilities, notably drinking water, sewer systems, waste treatment, water collection technology, and power development and transmission. This list is not exhaustive.

As a nation, America's infrastructure is inadequately maintained. The American Society for Civil Engineers (ASCE) delivers an assessment of the nation's infrastructure in a report issued every four years. The latest report, issued in 2021, grades America's infrastructure as a C-. A grade of D implies that infrastructure is in poor to fair condition and mostly below standards deemed acceptable by engineers, while a C grade implies significant deficiencies that require attention. The implication is that these assets are approaching the end of their useful lives and are at risk of failing. This report has been published and updated over 30 years and the overall grade has remained below average and declining during most of that time; while the overall grade was a C in 1988, it had fallen to a D in 2009 and had improved only marginally to a D+ by 2017. Further, most of the individual categories have also declined or remained stagnant. While the grades have eroded, so have the infrastructure assets that make up the grades. In 2001, the ASCE estimated it would require $1.3 trillion over ten-

52 ASCE "Report Card for New Jersey's Infrastructure, 2016."

52 *Ibid*, page 4.

years to bring these assets back into average states of repair; by 2021, this estimate had increased to $5.9 trillion because of the lack of investment and attention of governments.[53]

New Jersey reflects the same broad trend of the nation. Its 2021 report card grade was a C—; in 2016's report every major category except one was graded as a C or lower (solid waste was the sole exception with a B— grade).[54] Other categories such as bridges, roads, transit, parks, drinking water, among others were all ranked as below average. The report prior, in 2007, gave New Jersey a grade of C—, suggesting that New Jersey is not maintaining its infrastructure adequately and the trend is towards more neglect. The 2021 report found 8 percent of bridges to be structurally deficient, meaning they needed major repairs or replacement. While public ridership had increased (at least prior to the pandemic), funding had not grown at all. More than 37 percent of the roads were deficient, which costs the average New Jersey driver more than $700 annually in increased vehicle maintenance costs, lost time due to road congestion, and increased fuel costs.[55] In other areas of infrastructure, New Jersey also ranks poorly. Its energy infrastructure is ranked 40th in the nation, internet access 23rd, and transportation 46th.[56]

The state has taken some steps to address the maintenance of its bridges, roads, and transit which are largely funded through the state's Transportation Trust Fund (TTF). In November 2016, the petroleum products gross receipts tax was increased. This plan assumes a $16 billion capital program over eight years; combined with federal funds, the plan assumes total capital outlays of $32 billion between 2017 and 2024. Prior to 2016, the TTF was backed by 2.5 cents on each gallon of gasoline sold in the state. Since then, the amount has been increased to 37.5 cents in 2016, and then to 41.5 cents in 2018. In October 2020, the tax was increased to 50.5 cents per gallon. The recent increase was a result of a reduction in gasoline consumption resulting from the global pandemic. The law that raised the tax in 2016 had an automatic increase in the tax rate built into the legislation should the trust fund need additional resources for infrastructure spending. Voters approved a constitutional amendment in 2016 as well which dedicates the motor fuels tax to transportation projects and authorizes $12 billion of bonding capacity.

All this suggests is that the state of New Jersey has significant infrastructure that has suffered extensive deterioration. The state has not maintained its physical plant adequately which likely means extensive future investments will be necessary just to maintain the infrastructure let alone expand it to meet new and developing needs of the state's taxpayers. Infrastructure will demand more attention and more financing because of the neglect of the state, even over the past decade when the economy was reasonably strong. Much like other long-term issues, such as pensions and retiree health care, New Jersey failed to take advantage of good economic times to get its financial house in order with respect to infrastructure.

53 Data from https://infrastructurereportcard.org/infrastructure-is-everywhere/.

54 ASCE "Report Card for New Jersey's Infrastructure, 2016," available at https://www.infrastructurereportcard.org/wp-content/uploads/2013/02/ASCE-Report-Card-for-NJ-Infrastructure-6.16.16.compressed.pdf.

55 See https://infrastructurereportcard.org/state-item/new-jersey/.

56 U.S. News &World Report's Infrastructure Rankings, available at https://www.usnews.com/news/best-states/rankings/infrastructure.

Funding Issues

One reason for the state of New Jersey's infrastructure is the cost of building and maintaining it. One organization ranks New Jersey as Number One nationally in the cost to construct one mile of roadway and in acquisition costs, and Number Two in engineering costs.[57] Roadway construction costs are more than five times as expensive in New Jersey than the national average; the state faces six times more expensive acquisition costs, and nearly four times more in engineering costs.[58] Certainly some of these increased costs are because of the state's density and numerous urban areas, both of which typically increase construction costs. But many states with dense and urban areas are for building and maintaining infrastructure than the national average.[59] No doubt personnel and fringe benefits costs contribute significantly to New Jersey's above average construction costs. Because New Jersey is such an expensive location to build and maintain infrastructure, less is done. And because efficient and reasonable infrastructure can help states grow both economically and demographically, New Jersey's inability to maintain or invest in infrastructure has long-term implications for its desirability and growth.

As noted, much of New Jersey's transportation infrastructure is funded through the TTF. The state projects flat funding through 2029. The state asset management plan expects TTF funding of $1.24 billion annually through 2024 and anticipates this funding declining to $1.23 billion annually thereafter.[60] These state funds are expected to be matched by over $1 billion in federal funds, which increase to over $1.3 billion in 2029. While this plan predicts a slight uptick in total transportation funding through 2029, it actually shows a drop in real purchasing power when accounting for inflation. New Jersey expects total purchasing power to decline from nearly $2.4 billion in 2019 to less than $1.9 billion in 2029.[61] The state estimates that it requires $1.43 billion annually just to maintain (not improve) its roads and bridges.[62] Over the past few years, the TTF has not spent all authorized funds.[63] The state should determine why transportation capital projects have slowed and use the funds already authorized for these crucial projects. Furthermore, New Jersey habitually shifts capital funds to cover operating costs for New Jersey Transit, leaving new investment and maintenance deferred.[64]

The Statewide Capital Investment Strategy sets targets on what the state should spend annually on transportation infrastructure needs. The current target is nearly $3.3 billion annually, or $33 billion over a decade (assuming flat funding).

In addition to transportation, New Jersey has significant needs to reach the water quality and water-related public health goals of the Clean Water Act (CWA). According to the federal Environmental Protection Agency, New Jersey has $17.5 billion of documented needs in order to bring it into

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

58 *Ibid.*

59 For example, New York has construction costs that are one-third as expensive and engineering costs one-half as expensive as they are in New Jersey. Pennsylvania has construction costs about one-seventh as expensive and engineering costs one-eighth as expensive as New Jersey.

60 From NJ Transportation Asset Management Plan, August 2019.

61 *Ibid,* p. 7-6.

62 *Ibid,* p. 7-19.

63 Garden State Initiative, "New Jersey Transportation Fund Authority (TFFA) GSI Analysis: NJ Transportation Construction Has Slowed." Available at https://static1.squarespace.com/static/5956385fe4fcb5606a4d46ac/t/5e4d5431bd2cb73d25ebdcdf/1582126129150/New+Jersey+Transportation+Trust+Fund+Authority.pdf .

64 "Gov. Murphy and NJ Transit: When Will He Learn?" *Star-Ledger Editorial Board*, March 1, 2021.

compliance with federal law. Even if spread over several decades, this suggests the state should be financing hundreds of millions of dollars in capital expenditures annually to reach these goals.

The Gateway Program is the planned expansion of the Northeast rail line used by Amtrak and NJ Transit to increase commuter rail access between New Jersey and New York. It is estimated that this investment could double rail access between the two regions. When it was first announced in 2011, the project was estimated to cost $13.5 billion and need about nine years to complete. By the following year, the price tag had increased another $1 billion and the timeline had grown to fourteen years. Funding remains unclear for the program—New Jersey had pledged money and it was estimated that the state portion could top $5 billion before delays resulting from the Trump administration. The price of the project has steadily increased over time, which contributes to the problem. It seems that the price tags of these expensive infrastructure projects are ever increasing, which makes the state hesitant to invest in needed projects when it appears the ultimate cost is open ended.

Conclusions

New Jersey faces growing infrastructure needs of over $50 billion in investments over the next decade.[65] Some of this money will come from the federal government. Some will come from debt financing, although New Jersey already ranks high nationally on debt per capita rankings. The rest will come from taxes and fees paid largely by New Jersey residents who already pay some of the highest taxes in the nation. Some of these infrastructure projects focus on moving commuters into and out of New York City. To the extent that New York and New Jersey might work together to finance such projects, these large and important projects begin to seem more doable.[66] Furthermore, New Jersey has unused but authorized TTF funding available that it should rapidly deploy to invest in crucial transportation infrastructure.

Nevertheless, infrastructure is critical for economic development and quality of life issues. As infrastructure needs continue to increase, New Jersey officials will see other legacy costs such as existing debt, pensions, and OPEB, competing for the dollars that could be devoted to infrastructure investment. The state neglected to significantly improve infrastructure—and also its indebtedness—during the past boom time. Now it finds itself having to figure out how to make these improvements. The current state culture and political process makes it difficult to make the correct choices that will improve the state's structural budget deficit, get its obligations under control, and improve the competitiveness of the state relative to others. Instead, the process rewards easy decisions—such as failing to reform or fund pensions—that simply kicks difficult decisions further into the future.

[65] Based on the State's Capital Improvement Strategy, available at https://www.njleg.state.nj.us/OPI/Reports_to_the_Legislature/transportation_capital_investment_strategy_FY2013_2022.pdf, plus the Environmental Protection Agency's Clean Watersheds Need Survey, available at: https://ofmpub.epa.gov/apex/cwns2012/f?p=cwns2012:3:

[66] For example, the Gateway Project was a proposed cross-state infrastructure project which was to be financed 50 percent from the federal government and 25 percent from each state. Collaborative infrastructure projects are feasible.

Education

Overview

New Jersey prides itself on its public schools. In 2020, the state topped the nation's public school ranking for student achievement, edging out Massachusetts.[67] While the nation's public schools were ranked as a C overall, New Jersey earned a B+.[68] This highly ranked school system is not inexpensive, though. New Jersey spends the fourth most per pupil in the nation and significantly more than Massachusetts. Furthermore, education spending remains the largest expenditure in New Jersey. Current elected officials have called for increased funding for education. The state will need to balance spending on education with other areas and perhaps look for efficiencies that will not affect education quality and possibly lead to further population loss in the state.

Education Spending in the State

More than 1.4 million students are enrolled in grades K-12, although the number of students has shrunk over the past few years. In the FY2021 budget, the department of education was appropriated $15.6 billion, which makes up over 47 percent of the $32.7 billion in general fund appropriations. New Jersey consistently ranks as one of the highest spenders on a per capita basis on K-12 education, spending in excess of $22,000 per student per academic year and increasing over the past few years (see table 8). Only New York, Washington DC, and Connecticut spend more on a per pupil basis. Massachusetts, which competes with New Jersey for the top public school ranking nationally, spends less per pupil than New Jersey does—primarily through lower teacher benefits. Furthermore, New Jersey's school districts are much smaller than those of many other states, which may increase the administrative costs of running these districts. In fact, the state has begun to study regionalization of school districts to reduce the number of school districts in an attempt to potentially reduce costs.[69] New Jersey school districts should consider a significant shift to sharing business operation costs. Such a move would maintain local autonomy and pedagogical quality while reducing administrative costs.

67 From Heyboer, Kelly, September 2, 2020, "N.J. Has the Best Public Schools in the Nation — Again, Ranking Says," *NJ.com*, available at https://www.nj.com/education/2020/09/nj-has-the-best-public-schools-in-the-nation-again-ranking-says.html.

68 *Ibid*.

69 John Mooney. "Has time finally come for school consolidation?" *NJ Spotlight News*, March 29, 2021 available at https://www.njspotlight.com/2021/03/regionalization-steve-sweeney-legislation-financial-incentives-feasibility-studies/?utm_source=NJ%20Spotlight%20%20Master%20List&utm_campaign=d6c823cc45-EMAIL_CAMPAIGN_2021_03_29&utm_medium=email&utm_term=0_1d26f473a7-d6c823cc45-398669726&ct=t%28EMAIL_CAMPAIGN_03_29_2021%29&mc_cid=d6c823cc45&mc_eid=03a2d6b37e.

TABLE 8: PUBLIC SCHOOL ENROLLMENT AND PER PUPIL SPENDING, FY2013–2019

Fiscal Year	Enrollment	Annual Change	Spending per Pupil	Annual Growth
2013	1,432,614		$18,867	
2014	1,415,589	-1.2%	$19,074	1.1%
2015	1,415,468	0.0%	$19,621	2.9%
2016	1,410,379	-0.4%	$20,459	4.3%
2017	1,407,384	-0.2%	$21,131	3.3%
2018	1,404,052	-0.2%	$21,464	1.6%
2019	1,401,387	-0.2%	$22,296	3.9%
Source: New Jersey Comprehensive Annual Financial Report, Fiscal Year 2019				

Nominal spending per pupil increased more than 18 percent between 2013 and 2019, while overall inflation increased less than 12 percent during this time. Furthermore, enrollment declined 2 percent during this time period while total spending continued to increase. Hence, the cost of education has increased faster than inflation even while educating fewer students.

New Jersey's high spending for schools is paid for primarily by local government funds (see table 9), but the state does provide a significant amount of funds as well. For years, the Tax Foundation has ranked New Jersey as having the highest effective property tax rates in the nation at 2.38 percent of total home value—ahead of second-place Illinois, which was at 2.32 percent in 2015.[70] Residents and businesses have limited tax capacity. To the extent that local property taxes are high and consuming a significant share of this capacity, the state's ability to also tax residents is constrained.

TABLE 9: FUNDING SOURCES FOR K-12 EDUCATION, FY 2013–2019

Fiscal Year	Local	State	Federal
2013	53.8%	43.0%	3.2%
2014	54.3%	42.6%	3.1%
2015	54.1%	42.9%	3.0%
2016	53.3%	43.7%	3.0%
2017	53.2%	44.0%	2.9%
2018	53.7%	43.4%	2.9%
2019 (estimated)	52.5%	44.7%	2.8%
Source: New Jersey Comprehensive Annual Financial Report, Fiscal Year 2019			

Governor Murphy has made the expansion of preschool opportunities for more children a priority and had made additional funding available for school districts with free or reduced-price lunch student populations of 20 percent or higher of the total student population. The governor has also publicly committed to fully funding the existing school funding formula, which some have estimated as increasing annual state spending at about $1 billion.[71] It seems likely, therefore, that the state has committed itself to more funding statewide while existing K-12 commitments continue to grow and budgetary resources are shrinking (or at least not growing).

[70] See https://files.taxfoundation.org/legacy/docs/property_taxes-01.png.

[71] https://www.njspotlight.com/2019/03/19-03-14-spelling-out-how-school-funding-formula-needs-to-be-overhauled/.

Conclusions

New Jersey's education system is a real strength from which elected officials could build from to attract residents and businesses. While expensive relative to other states, New Jersey's schools do produce in general highly rated services. Officials might look to improving efficiencies in administration or in benefits given to employees and retirees as a way to control costs with minimal effects on quality of services. Furthermore, New Jersey should move to significant shared services between school districts to drive down unproductive administrative costs without negatively influencing school quality. Recent efforts to regionalize school districts to save money on non-instructional spending categories should be pursued and encouraged as well.[72]

[72] See Bergeron, Tom, March 10, 2021, "Could 275 School Districts in N.J. Soon Be Consolidated? (We've Got the List)," *roi-nj.com*, available at https://www.roi-nj.com/2021/03/10/education/275-school-districts-in-n-j-could-soon-be-consolidated-weve-got-the-list/?utm_source=ROI-NJ+MAIN+Newsletter+List+%282%2F4%2F19%29&utm_campaign=ca2cd15684-EMAIL_CAMPAIGN_2021_03_11_02_25&utm_medium=email&utm_term=0_6732b2b110-ca2cd15684-44340509

Overall Conclusions

New Jersey had an opportunity during the economic expansion that ended with the pandemic in 2020 to get its fiscal house in order for long-term sustainability. State leaders chose instead to make small, incremental changes—perhaps believing that was all that was possible, or perhaps because that was all they were willing to try. But the reality is that, while New Jersey has some real strengths that make it attractive to businesses and residents, it also has some significant weaknesses that cannot be ignored any longer.

New Jersey has one of the best public education systems in the nation and should strive to maintain the quality of that public service. However, political officials need to refocus spending overall. Targeted reductions and efficiencies should seek to accomplish this rather than across-the-board cuts. Elected leaders will need to determine what spending is critical, what spending is preferred but can be reduced, and what spending the state can absolutely do without. This task might be accomplished through a zero-based budgeting exercise in which agencies justify their current spending plans with definitive output and outcome measures. Such an effort might lead to efficiency reforms that repositions state spending.

The state currently spends $38 billion annually in its operating budget and another $42 billion when all other spending (such as capital, unemployment, lottery, and others) is considered. However, this spending never seems sufficient. The state needs to enact budgets that are economically balanced and sustainable, not budgets that are simply balanced on a cash basis. New Jersey should plan to generate budget surpluses through reduced and redirected spending in nonessential services to address the significant obligations it has already accumulated. In the education sector, efficiencies in business operations and shared services in education are possible to save money without negatively influencing classroom quality.

Refocusing spending in the operating budget is necessary because New Jersey already heavily taxes its residents. In other words, the state has a spending problem, not a revenue problem. New Jersey needs to ensure that the outmigration of high-income residents does not continue. Between 2008 and 2017, New Jersey experienced growth in the number of tax filers of 4.2 percent; however, growth in those making $500,000 or more annually was only 2.5 percent during the same time.[73] New taxes that simply go to fund new spending is short-sighted given the state's significant legacy obligations. These new taxes would also further hinder growth, and New Jersey needs growth to deal with its legacy costs.

73 Based on Statistics of Income data from the State of New Jersey Department of the Treasury.

In terms of its capital budget, New Jersey officials need to reform infrastructure spending. New Jersey requires significant investment in current and new infrastructure to be competitive, and the cost of borrowing is currently very low. However, New Jersey cannot remain the most expensive state in the nation for construction costs. These costs need to be addressed and brought down significantly because the state will otherwise find that any debt issued for infrastructure is insufficient and simply leaves New Jersey further indebted.

Most importantly, the state's legacy obligations of unfunded pensions and retiree health care costs are so enormous, and are growing faster than the state's economy, that no reasonable person can expect the state to catch up on its decades of neglect without serious and substantive reforms. Therefore, elected officials ought to pursue reform options that reduce these unfunded obligations even if it requires amending the state constitution. Reforms should protect those who are already retired so that current pensions are not reduced. But elected officials should seek older retirement ages, less generous benefit accruals, and increased contributions from beneficiaries. In retiree health care costs, the state should also move to reform benefits. Beneficiaries should share more of the health care costs with the state. Ideally, the state could move to a defined contribution system of health care benefits in which retirees are given some amount of money to purchase whatever benefits they choose. The contribution could be limited so that it is affordable to the state. Retirees who are not yet eligible for Medicare could use this defined contribution to purchase health insurance on the state insurance exchanges.

By holding taxes constant while reducing the growth of spending in the operating budget, New Jersey would signal that it is no longer deferring the difficult choices it faces. Such decisions would move the state toward an economically balanced budget where recurring revenues are sufficient to meet recurring expenses each year. Rather than plugging budgets with one-shots and gimmicks as is the current practice and as it has been for decades, New Jersey would find itself in better condition to move forward and grow in a sustainable manner. In reality, New Jersey will need to run not just balanced budgets, but surpluses for some period of time. Again, this means not cash surpluses only but real surpluses in which revenues are greater than spending. This approach, in combination with reforms to existing obligations, is the only path to long-term sustainability. This in turn would also signal businesses and residents that New Jersey was a place where future financial conditions would be predictable, taxes would be predictable, and core services would be protected.

Recommended Actions

- » **Avoid increasing taxes, especially on high-income individuals but also middle-income residents.** New Jersey already imposes a high tax burden on its residents, and the Tax Foundation ranks New Jersey as having the worst business climate in the nation.
- » **Pursue vigorous pension reform, even if this requires a constitutional amendment**. New Jersey has the worst-funded state pension systems in the nation. The sizes of New Jersey's unfunded pension liabilities are so large—$131 billion—that funding them at the levels required to correct the problem is no longer a serious option.
- » **Seek reforms in the cost of infrastructure maintenance and expansion**. New Jersey needs to invest in infrastructure, but it cannot remain the most expensive place in America to build as it currently is for many types of infrastructure. Even marginal improvements in the cost of infrastructure will free up money that can then be invested in improving more infrastructure.
- » **Enact plans to redirect spending in the operating budget**. The state should analyze the entirety of its budget, determine what service areas are not needed or are not crucial, analyze whether efficiencies might exist to protect other services, and work to protect prioritized programs that might enhance the desirability of New Jersey to new residents and companies. Efficiencies in business operations and shared services in education are possible ways to save money without negatively influencing classroom quality.

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