

SUMMING UP:

New Jersey's Prosperity Depends on Immediate Fiscal Reforms

To restore the foundations for growth and make the most of New Jersey's potential, significant reforms are required in how the state sets priorities and handles its finances. New Jersey's fiscal crisis will get much worse unless we make a commitment to restore integrity to the state budget. New Jersey's next governor and Legislature must prepare to take strong, deliberate action.

The most immediate and critical fiscal policy problem is the huge gap between what the state sets aside for pensions for retired government employees and how much those obligations will cost. The state's unfunded pension obligations in 2016 were at least \$66.2 billion and, if more conservative assumptions are made about asset value, investment returns, and contribution levels, could be as large as \$135.7 billion.

If we do not confront this and other fiscal challenges, we cannot have the things we value, such as high-quality education for our children, clean air and water, a safe and reliable transportation system, and cities and towns that support a growing economy.

Fixing New Jersey's fiscal problems will be neither quick nor painless, but the work must begin immediately. The public interest of the state depends on strong leadership to take bold action of a scale required to make meaningful change.

Key Recommendations

Adopt a balanced, multi-pronged approach that combines spending reductions and revenue increases to address the pension and retirement benefits crisis and to generate additional resources necessary to support the well-being of all state residents.

This could include a combination of steps to cut spending and raise revenue, such as:

- Curtail health care costs for retired public workers to levels commensurate with leading private employers (produces about \$1.4 billion a year).
- Reverse state tax reductions included in the deal to replenish the Transportation Trust Fund, such as phasing out estate/inheritance tax, reducing income tax on retirement income, and reducing the sales tax rate (produces about \$1.3 billion a year).

- Adjust the Gross Income Tax to increase yearly revenue by 10% (produces about \$1.4 billion a year).
- Increase the sales tax rate to 8% (produces about \$1.4 billion a year).

These measures would generate approximately \$5 billion a year in additional revenue. These options are a starting point for political discourse; they are unequivocally on the order of magnitude required to address a crisis of this scope and severity. If these actions are not taken, others of corresponding size and seriousness need to be.

In addition to adopting reforms needed to remedy the pension crisis, update New Jersey's revenue system to better reflect today's economy. This would produce more for public investment, reduce the structural budget imbalance, and mitigate some built-in inequity.

- Expand the number of services, such as investment counseling or interior decorating, that are subject to sales tax.
- Adopt Combined Reporting, to end the practice under which large, multi-state businesses avoid New Jersey taxes by shifting profits made in this state to other states. This could produce up to \$290 million a year.
- Legalize and regulate the recreational use of marijuana, which could yield up to \$300 million per year in additional state revenue.
- Work with other states to encourage Congress to improve states' ability to require Internet and other "remote" sellers to collect sales tax.
- Consider limiting the adverse impacts of proposed tax increases on economically disadvantaged residents by exempting New Jerseyans below the federal poverty line from paying any New Jersey Gross Income Tax.

Get ready for the next recession by replenishing the state rainy-day fund.

New Jersey's combined end-of-year budget surpluses and rainy-day reserves (money set aside for emergencies) are near a 25-year low and significantly below the average for all states, as a percentage of spending.

Stem the proliferation of tax expenditures.

In fiscal year 2017 alone, "back-door spending"—money given out through exemptions written into law rather than through budget appropriations—totaled \$23.9 billion. Closer monitoring is needed to provide an accurate view of state spending and to promote meaningful debate over whether various subsidies, including those to businesses, are effective.

New Jersey's Prosperity Depends on Immediate Fiscal Reforms is one of seven reports in the *Crossroads NJ* series produced by The Fund for New Jersey to inform debate in this pivotal election year. The full text of the reports and other information about Crossroads NJ are available at www.fundfornj.org/crossroadsnj.

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