BALANCING the BUDGET with BONDS is a BAD IDEA

COMMENTS BEFORE NJ SENATE BUDGET COMMITTEE

June 11, 2020

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Thank you for inviting me. These are difficult days in New Jersey and in our nation.

While the broader and more important issues are the health impact caused by the virus -- and the social and political turmoil in our country --- it is still important that we address the fiscal problems facing our state.

The governor and the legislature are indeed faced with difficult financial challenges. It is fair to say no one knows exactly what is going to happen to our state finances over the next 6 to 24 months.

No one has a crystal ball and no one likely has all the correct answers. One thing for sure is that while we certainly need to address our immediate needs -we must also worry about the future. Current solutions that create problems in subsequent years would be a mistake.

While other New Jersey governors faced difficult times, the magnitude of this crisis is unprecedented. The challenge must be handled carefully and limit one-time actions that will complicate and potentially ruin the state's finances for years to come.

I can remember first hand experiences working for both governors Kean and Florio as we developed scenarios to deal with budget shortfalls of up to $3 billion. Ultimately, the decision was made to reduce spending and increase the gross income and general sales tax.

Likewise, Gov. Chris Christie saw revenues drop by $2 billion as he assumed office during the recession of 2008-2009. He reduced expenditures, particularly aid to school districts.

In each case, difficult and unpopular decisions but less negative impact in the subsequent budget years.

Economic and revenue considerations

The nexus of the problem is the level of economic stress, the continuing decrease in all state revenue sources and new spending needs associated with fighting the coronavirus.

Estimating revenue under any scenario is a difficult task but now subject to more than normal uncertainty.

Under the Federal Relief and Economic Security program, $2.5 billion was allocated to New Jersey plus an approximately $1.5 billion for NJ Transit. Additional funds for Medicaid, other health programs and to local municipalities and school districts were also provided. A good start, but much more federal aid is necessary.

The governor has suggested the sale of $ 5 billion of bonds – and perhaps up to $10 billion -- to cover the shortfalls. In my judgment, that is not the best option. (more on this subject later).

Spending decisions

Under any scenario the state must make significant spending reductions — the business of government cannot be business as usual. Unfortunately, all existing programs cannot and perhaps should not be continued.

Each budget reduction will have its constituents and objectors. And, remember also that approximately 80% of budget expenditures leave state government in the form of grants and payments to 3rd parties and assistance to local governments, principally for schools – and also for debt service on existing bonds.

Most of the remaining spending relates to institutional care (prisons, mental hospitals), transportation, and state police. So, reductions will have many negative impacts.

It is difficult to argue that all spending is critical and should be funded simply by borrowing , especially when many citizens will be losing their jobs and businesses closing. The Murphy Administration has made reasonable recommendations for reductions –and has prepared an analysis of the state of our state's finances, but only through September 30, 2020.

If I were looking at the budget I would recommend the following – many of which has been suggested by the governor:

- Eliminate all new and expanded programs included in the original FY2021 budget totaling $1.2 billion, including increases for school aid.

- Immediately inform school districts they should assume the same amount of state aid received in the previous year. Further, they must be directed to develop contingency plans (for example, a 5% to 10% reduction in aid) if even last year's amount cannot be funded.

- Defer all salary increases through FY 2021 and authorize the replacement of only critical positions.

- Eliminate all programs (in current year) that the governor placed in reserve ($920 million).

- Eliminate these same programs in next year's budget.

- Initiate an aggressive furlough program through at least October, 2020 for employees not critical for direct state operations. Reductions cannot be made for institutional care, police protection and certain staff for programs whose mission must be accomplished. But non-essential employees should be furloughed. The same should occur at the local levels of government and at our universities.

- Do increase funds for medical spending, especially for Medicaid and CHIP. Given the significant layoffs occurring in the general economy, more people will need help with medical bills.

- Defer most of the proposed pension contributions ($4.6 billion was in proposed budget).

Again, none of these actions are without considerable pain, but we are in a situation where shared sacrifice is needed. However, they will serve to minimize short-term discomfort and significantly reduce future financial perils facing the state.

Further observations

Will this be sufficient? Perhaps, especially if augmented by a reasonable amount of additional federal assistance.

The Administration should develop several scenarios for the FY 2021 budget to be discussed with the Legislature -- with each having detailed estimates of each revenue source and specific and detailed appropriations.

If additional federal aid is not received - almost inconceivable , but of course possible, then additional actions will likely be necessary, including tax increases.

Certainly, we should also include a review of the state's tax expenditures — the $30 billion in tax credits, deductions, preferential tax rates, and tax base adjustments currently in the tax code benefiting select corporations and individuals. Surely, some of these tax breaks were ill conceived and/ or have out -lived their usefulness and should be eliminated, reduced, -- or perhaps suspended for several budget cycles.

Furthermore, consider taxing New Jersey residents who generally work in New York but are now doing most of their work from home. Currently, these New Jersey residents pay over $4 billion in taxes to New York. We can legitimately re-capture some of these revenues.

Selling bonds

In my opinion , selling bonds for operating purposes must be avoided – not only because it has been deemed unconstitutional by the New Jersey Supreme Court, but much more important -- it is bad public policy.

By definition, the amount will be a one-time revenue source. What does the state do the following year? This would create a double negative impact, since any federal aid will also likely be one-time.

For example, say a $ 40 billion state budget for FY 2021 includes $ 5 billion to $10 billion in revenue from a bond sale and $ 3 billion in one -time federal revenue. In the FY 2022 budget both of these revenue items will disappear as well as paying debt service of at least $350 million. Then what – another bond sale?

Some will argue that revenues will return to normal (pre-COVID-19) levels. This is not likely -- at least for many years. After a much less disastrous 2008 recession it took 6 years for the state to return to prior revenue levels.

It is best to bite the bullet for the remainder of this year and next than to invite fiscal struggle for many years thereafter.

The various local governments, including school districts, will also be severely stressed. Each depends on the local property-tax revenue that will likely decrease, as will state aid. It is time to think of structural options since 74% of all statewide spending occurs at the local levels of government.

New Jersey's Wild Card

The 10,000-pound gorilla is the pension fund. At the end of this virus-induced-disaster, pension funds will be in worse condition than before the pandemic and may be in their worse condition ever.

However, to borrow is even worse. It is far better to defer pension payments, then slowly put the funding back on track. Just as important, seriously consider leveraging and/or securitizing several state-owned assets and transferring such assets to the pension fund.

Now is the time to alter the pension systems by considering some of the recommendations from the Path to Progress Report. *For* example*, a*ccepting the pension recommendations will reduce long-term costs and NOT impact current retirees or those already vested. The report also contains some recommendations to reduce costs of local schools and municipalities. I do not agree with all of the recommendations but they should be carefully examined.

These budgetary pains and corresponding economic slowdown will likely be significant and sustained under any scenario. The appropriate adjustments must be on a matching scale, although not necessarily across the board without regard to the distribution of suffering.

Finally -- the state must always be mindful of both the short- and long-term implications of the budget adjustments that are made.

Before I conclude my comments, let me reiterate my major points:

- WE can and should reduce spending , but to people who think we have sufficient leverage to solve the entire problem in that manner – they are not being realistic and will mislead the public;

- Borrowing at the $ 5 to $10 billion level will lead to a disaster in subsequent years. The issue is not simply the debt service on the bonds, albeit that is an issue, but the real problem is the one-timeless of the revenue source

- Additional help from the federal government must be vigorously pursued by NJ and all the states and their various national organizations;

- We should defer as much of the pension contribution as necessary and also address the long-range pension problem;

- More taxes -- never a great option- - is in my opinion inevitable. Best to do it now and carefully explain to the public why it is a realistic and viable option and why the Legislature supports it. Perhaps a short time deferral of some tax expenditures.

Thank you and I am happy to answer any of your questions.

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Currently, he is a Fellow at the National Academy of Public Administration in Washington; an executive in residence at the Bloustein School of Planning and Policy, Rutgers and a visiting lecturer at the Woodrow Wilson School, Princeton University.