

**IDENTIFYING THE POLITICAL ECONOMIC TIDE
SHAPING MAJOR PUBLIC EXPENDITURE TRENDS IN NEW JERSEY
DURING THE LAST DECADE**

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1. Background

In his budget message delivered on March 1, 2005, New Jersey's acting Governor Codey has proposed a \$27.4 billion budget for fiscal year 2006,¹ which is a record \$614 million or 2.2 per cent below the budget enacted in FY2005, representing the largest spending cut in the history of the State.² The proposed budget reduces reliance on non-recurring budget actions by 70 per cent from \$2.86 billion in FY05 to \$891 million in FY06 and provides for \$2.4 billion in spending reductions, including nearly \$1.5 billion in actual cost cutting actions. Increases in mandatory funding needs of approximately \$1.4 billion, including \$289 million for Medicaid, is a major component of the State's widening budget gap problem.

The challenge of balancing the State budget is even more daunting when, as noted in the FY2006 Budget in Brief (BIB) document, it is recognized that nearly three-fourths of the money that the State receives goes out in State Aid and Grants to municipalities and school districts, direct property tax relief, health care and prescription drug coverage for seniors and the poor, support for higher education, and community programs for the disabled. The remaining 12 per cent of State spending is allocated for the operating budgets of the sixteen State departments in the Executive branch with a majority of spending on State Police, courts and prisons, institutions for veterans, mentally ill and developmentally disabled and highway maintenance.³

The Governor's Budget Message will be followed by Budget Hearings before the New Jersey Legislature gets ready to enact the FY 2006 Budget through the Appropriations Act before the start of the next fiscal year on July 1, 2005. Between now and then, expenditure items in particular will be examined carefully against revised revenue estimates by both the Governor and the Legislature since it is a constitutional requirement to balance the Budget. The passage of the Appropriations Act marks the start of a new year in State spending from the State General Fund.⁴

* The views expressed are those of the author and do not necessarily represent the views of the New Jersey Division of Taxation or of the Department of Treasury.

I would like to thank Kathy Steepy and Gary Brune and numerous others at the New Jersey Office of Management and Budget for their generous help.

¹ Fiscal year 2006 will begin on July 1, 2005 and run through June 30, 2006.

² See Budget In Brief, March 1, 2005.

³ Refer to BIB, March 2005, p. 2.

⁴ The General Fund supports the largest part of total financial operations of the State and includes revenues from taxes, most federal revenues, certain special or dedicated funds (the Casino Control, Casino Revenue, *(continues)*)

However, a quick cruising through State budget documents and other annual financial reports, undoubtedly a mind boggling exercise, would reveal that total State expenditures in a particular fiscal year includes several other components of spending outside the State General Fund (SGF) operations such as those under certain special funds, bond funds, proprietary or enterprise funds and non-recurring items. Off budget line items are examples of other spending outside the SGF.

In this analysis, the focus will be on examining a broader more comprehensive measure of State expenditures that reflects spending, including both on and off budget spending from several funding sources, including the State's own source general fund revenues, special funds, federal funds made through inter governmental transfers and bond financing. The data are primarily from the *State Expenditure Reports* (SER), prepared by the National Associations of State Budget Officers (NASBO), which provide actual State expenditure data through FY2003 and estimated numbers for FY2004.⁵

This paper attempts to analyze the annual trends in State spending in New Jersey over the last ten years, between fiscal years 1993 and 2003. Total expenditures, including both operating and capital expenditures, are examined during this period to identify political and economic tides underlying State spending trends in New Jersey. The remainder of the paper is organized as follows: Section 2 presents a snap shot of State spending in FY2003 indicating the distribution of expenditures by major fund sources and its composition by selected program categories. Section 3 compares expenditure trends in two fiscal years, FY1993 and FY2003. Growth trends by program type are also highlighted in this section. Section 4 outlines major political and economic developments and reflects on budgetary priorities during the last decade. Section 5 concludes the paper with a discussion of policy issues and reflects on topics for future research.

2. State spending in FY2003: A snapshot

Total expenditure for New Jersey was over \$36 billion in FY2003, including both operating and capital expenditures and funding from all sources. However, due to economic contraction following the stock market bubble burst in FY2002, spending slowed significantly in FY2003, which grew at 3.6 per cent, at less than one-half the rate in the previous fiscal year. FY2004 estimates show further softening (Chart 1). State funds⁶ accounted for over three-fourths of spending in FY2003 with General Funds absorbing 65 per cent of it. Spending from State funds grew at a moderate 4.6 per cent rate, below the rate posted a year ago, and is estimated to decline in FY2004, reflecting the fiscal stress facing New Jersey.

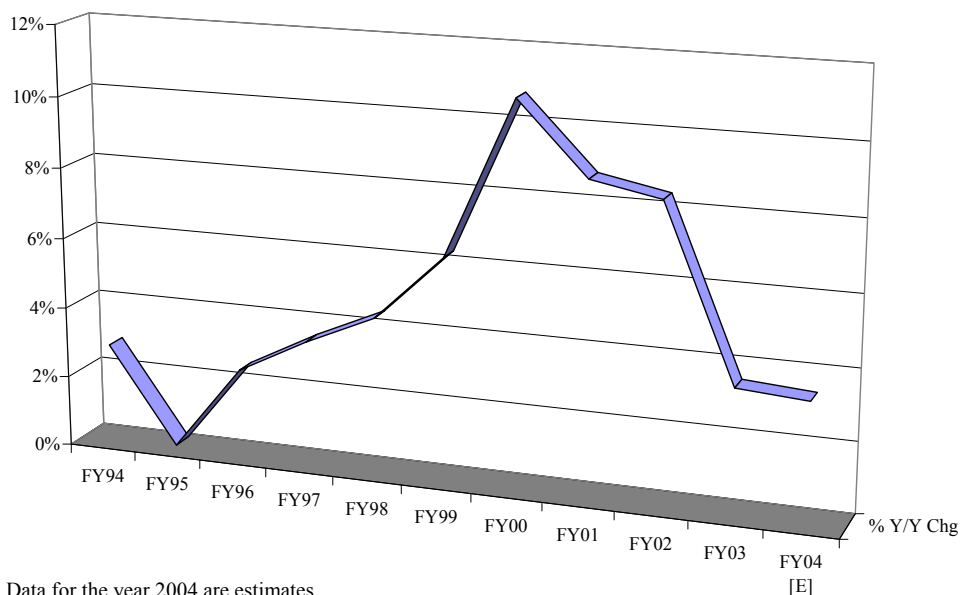
Gubernatorial Elections, and Property Tax Relief Funds), and certain miscellaneous revenue items. See the New Jersey Comprehensive Annual Financial Reports and Annual Budgets for further details.

⁵ The State Expenditure Report (SER) is based on expenditure survey data provided by states to the National Association of State Budget Officers (NASBO). The upcoming SER showing FY2004 actual spending data is currently being compiled.

⁶ Defined by NASBO as the sum of general fund and other state funds (excludes bonds).

Chart 1

Annual Change in Total State Expenditures, FY1993 to FY2004



Data for the year 2004 are estimates.

According to the latest SER, spending from State funds declined in seventeen U.S. States between fiscal years 2002 and 2003 and estimates show that it declined in eleven States between fiscal years 2003 and 2004.⁷

Close to one-fourth of FY2003 expenditures were from federal funds and bonds with the former accounting for 20.6 per cent and the latter about 3 per cent (see Chart 2). New Jersey appears to be relying more on federal funds, particularly, to support the State's obligation to nursing homes.⁸ Spending from federal funds was \$7,451 million in FY2003, \$312 million above the year ago level and the estimated figure for FY2004 is over a billion higher.

The distribution of spending among the seven categories included in the SER, indicates that elementary and secondary education is the single largest program category, about 23 per cent, accounting for nearly one-third of general fund spending in FY2003 (see Table 1 and Chart 3). Medicaid spending is a close second at 20.6 per cent, accounting for nearly one-half of federal fund spending. The percentage share of total spending for the remaining five categories was as follows: corrections, 3.6 per cent; higher education, 7.3 per cent; public assistance, 0.7 per cent; transportation, 8.0 per cent; and all other, 37 per cent. In general, the all

⁷ See the 2003 State Expenditure Report, p. 2.

⁸ Governor's Budget Message in BIB March 2005, p. 3.

Chart 2

State Spending by Type of Funds, FY2003

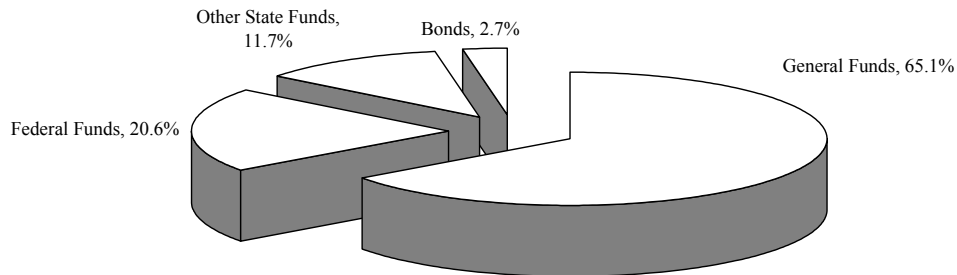


Table 1

The Distribution of State Spending by Major Functions, FY2003

Expenditure Category	Expenditure (million dollars)		percent of Total Expenditure	
	All States	New Jersey	All States	New Jersey
Elementary & Secondary Education	246,957	8,232	21.7%	22.7%
Higher Education	122,892	2,630	10.8%	7.3%
Public Assistance	24,981	263	2.2%	0.7%
Medicaid	243,623	7,458	21.4%	20.6%
Corrections	39,350	1,300	3.5%	3.6%
Transportation	92,972	2,886	8.2%	8.0%
All Other	365,922	13,448	32.2%	37.1%
Total Expenditure	1,136,697	36,217	100.0%	100.0%

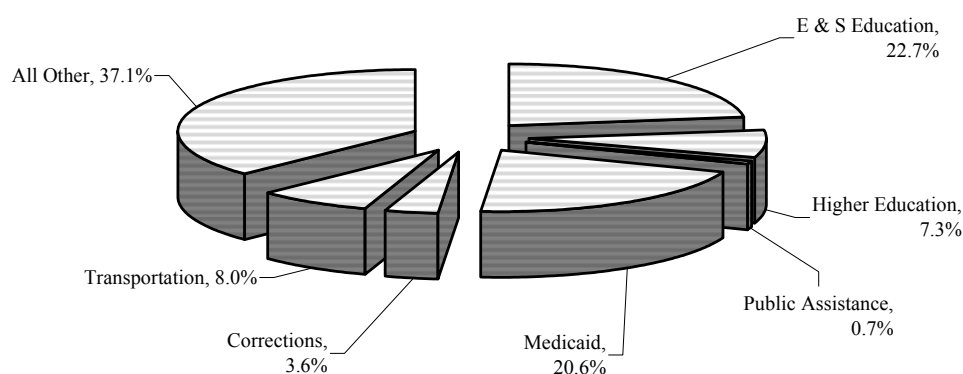
Source: Compiled from NASBO State Expenditure Reports data.

other category is a catch all aggregate of expenditures, including spending on environmental projects, public health, community and institutional for mental health and for developmentally disabled, parks and recreation, housing and other programs not covered under the six categories listed above. The *All other* category includes spending from special and dedicated funds such as the Casino Revenue Fund,⁹

⁹ It also includes the Casino Control Fund (N.J.S.A. 5, pp. 12-143), and Gubernatorial Fund (N.J.S.A. 54A, pp. 9-25.1). Spending from the Property Tax Relief Fund (N.J.S.A. 54A, pp. 9-25), which is made up of revenues from the New Jersey Gross Income Tax, is an exception as it is included under general fund spending.

Chart 3

Composition of State Expenditure by Program Type, FY2003



which accounts for revenues from the gross revenues tax on casinos that are dedicated for the reduction in property taxes, utility charges, and other specified expenses of eligible senior citizens.¹⁰

New Jersey leads in terms of spending on elementary and secondary education and has the highest per pupil spending among the U.S. States.¹¹ Spending on the all other category was significantly higher for New Jersey at 37 vs. 32.2 per cent for all States in FY2003 (see Chart 4). Spending on corrections is the third category for which New Jersey had a slightly higher share relative to all States. The share of spending on the remaining four categories trailed behind the national share, particularly, the share for higher education, which was 3 percentage points lower. However, it is important to note that State fund spending on higher education increased significantly from \$2.4 billion in FY2002 to \$2.6 billion in FY2003 with most of the increase relating to tuition and fees in New Jersey.¹²

Overall spending increased by \$1.2 billion in FY2003, weaker than the solid \$2.7 billion growth reported for the previous fiscal year. Elementary and secondary education, and Medicaid were the major drivers accounting for around three-fifths of the growth in spending in that year. Higher education, corrections and transportation related programs accounted for the remaining two-fifths of the increase while public assistance and all other categories experienced actual dollar declines (approximately

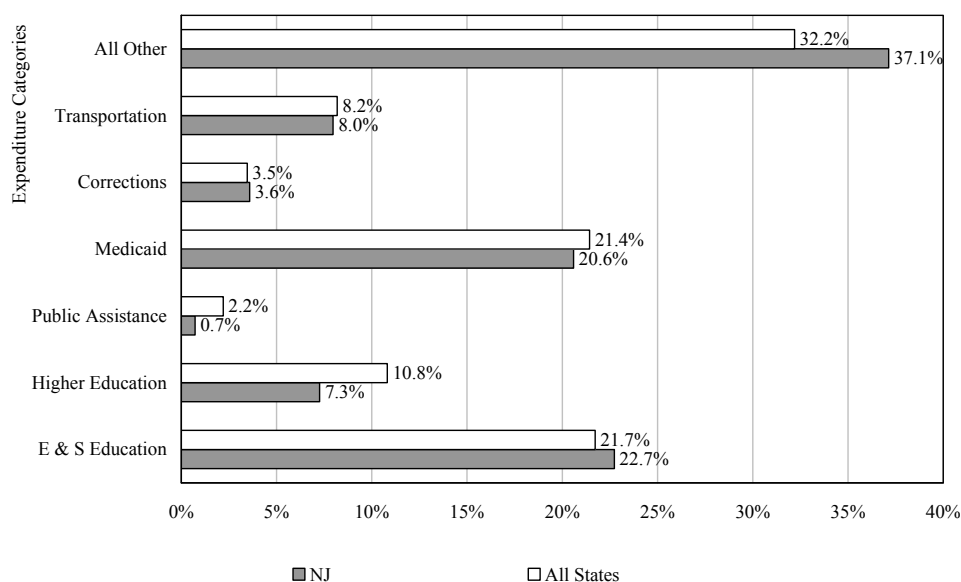
¹⁰ The provisions are contained in the N.J.S.A. 5, pp. 12-145.

¹¹ According to the U.S. Census Bureau, per pupil spending for New Jersey was \$12,202 in 2003, substantially above the national average level of \$8,019.

¹² From New Jersey's NASBO Expenditure Survey data provided by the Office of Management and Budget (OMB).

Chart 4

Expenditure Distribution by Major Functions NJ vs. All States, FY2003



\$12 million) in spending in FY2003. In terms of year over year per cent annual change, as shown in Chart 5, corrections spending showed the steepest increase due to a one time retroactive cost increase for custody settlement in FY2003 following a decline in spending the year before due to cost savings on certain overtime payments.¹³ The second largest percentual annual increase was for higher education spending (8.5 per cent), which was substantial compared to the weak one per cent growth in FY2002. The steepest annual percentual decline was reported for public assistance programs, which has generally been declining since the enactment of welfare reforms legislations by the federal government in 1996 that gave States more flexibility to move recipients from the welfare rolls into the workforce.¹⁴

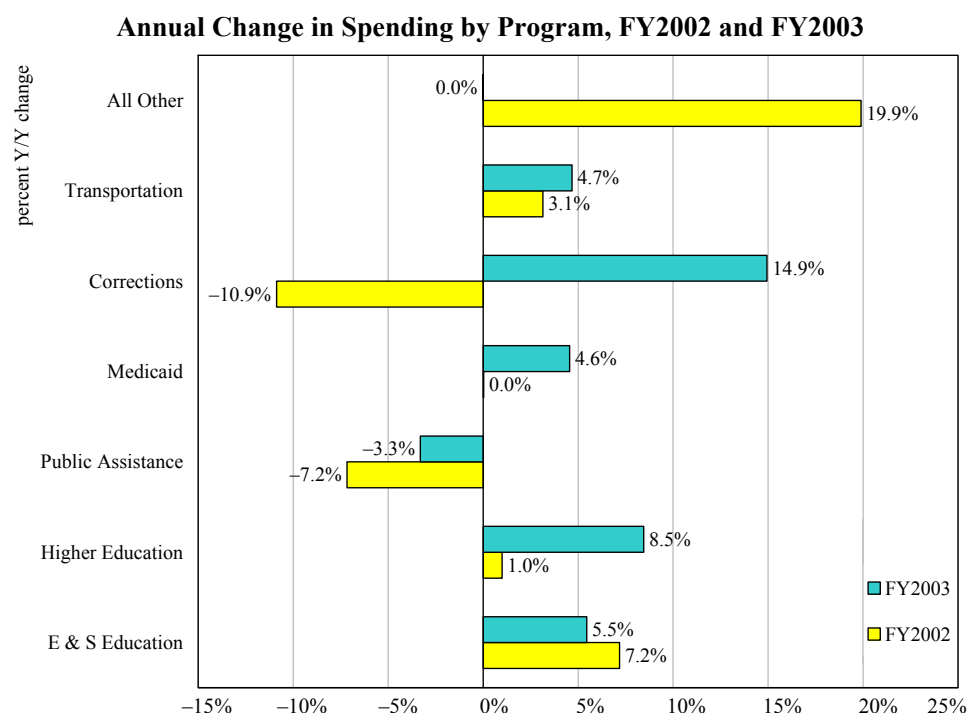
3. The trend in State spending in New Jersey

Total expenditures increased over \$14 billion in FY2003, up 64 per cent over FY1993, growing at an average annual rate of 5.1 per cent. Despite the increase of nearly \$10.5 billion in State fund spending, its share in total expenditures declined

¹³ Based on info provided by the State Department of Corrections.

¹⁴ The welfare law changes were made under the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) in 1996, which replaced Aid to Families with Dependent Children (AFDC) with the Temporary Assistance for Needy Families (TANF) block grant.

Chart 5



by 1.7 percentage points from 78.4 to 76.8 per cent between FY1993 and FY2003, respectively (see Table 2). Between these two fiscal years, general fund spending grew by 65 per cent, lagging below the corresponding growth of 70 per cent for federal fund spending.

The share of spending from federal funds went up from 19.9 to 20.4 per cent between FY1993 and FY2003 (see Chart 6). During the ten years since FY1993, spending from federal funds increased at a faster pace than from State funds, growing at 5.5 and 4.9 per cent average annual rates, respectively. Even though the ranking in terms of percentage share of total spending did not change, there appears to be a clear structural shift in the degree of reliance, particularly, on federal funds, reflecting State fiscal stress due to the economic slowdown that started in FY2001, exacerbated by the 9/11 terrorist attack.

The share of bonds, which accounts for below 3 per cent of total expenditures, also increased by one percentage point to 2.7 per cent in FY2003. In that fiscal year, spending from bond financing climbed to \$967 million, which was 158 per cent above the FY1993 level. With declining gross income tax and other own source revenues, New Jersey used securitization and other bond measures to close revenue gaps during the last economic recession. This is illustrated by the

Table 2

Major Trends in State Spending in New Jersey, FY1993-FY2003

a) Expenditure by Major Functions

Expenditure Category	Expenditure (millions of dollars)		Percent of Total Expenditure		Percent of Change			Avg. Annual Growth Rate FY93-03
					Over Year ago		FY93 to FY03	
	FY1993	FY2003	FY1993	FY2003	FY2002	FY2003		
Elementary & Secondary Education	5,043	8,232	22.9%	22.7%	7.2%	5.5%	63.2%	5.0%
Higher Education	1,080	2,630	4.9%	7.3%	1.0%	8.5%	143.5%	9.3%
Public Assistance	781	263	3.5%	0.7%	-7.2%	-3.3%	-66.3%	-10.3%
Medicaid	5,053	7,458	22.9%	20.6%	0.0%	4.6%	47.6%	4.0%
Corrections	615	1,300	2.8%	3.6%	-10.9%	14.9%	111.4%	7.8%
Transportation	1,064	2,886	4.8%	8.0%	3.1%	4.7%	171.2%	10.5%
All Other	8,431	13,448	38.2%	37.1%	19.9%	0.0%	59.5%	4.8%
Total Expenditure	22,067	36,217	100.0%	100.0%	8.4%	3.6%	64.1%	5.1%

b) Expenditure by Fund Type (millions of dollars)

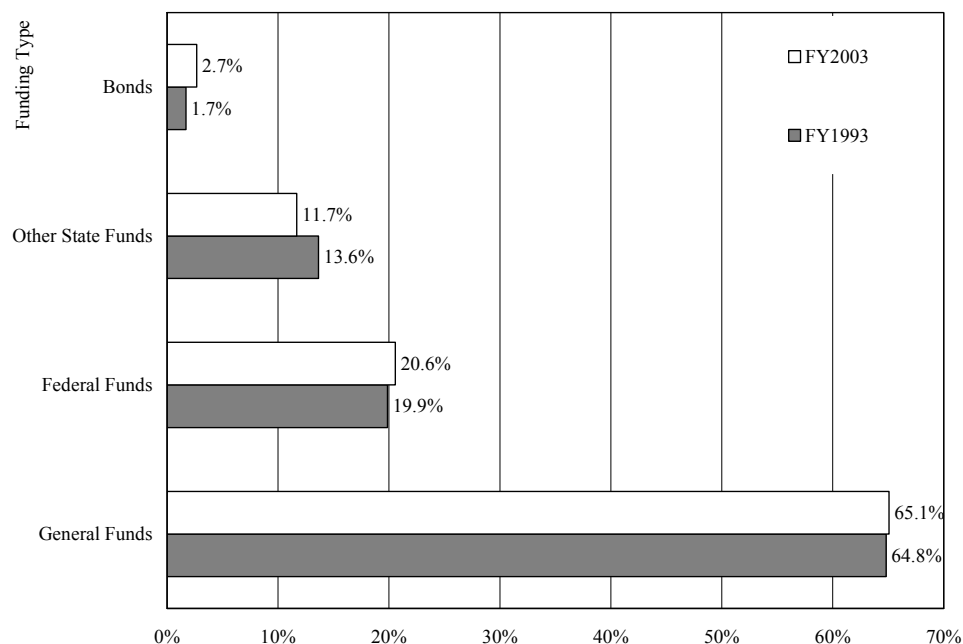
Fund Type	(millions of dollars)		Percent of Total Expenditure		Percent of Change		Avg. Annual Growth Rate FY93-03
					FY02 to FY03	FY93 to FY03	
	FY1993	FY2003	FY1993	FY2003			
General Funds	14,301	23,568	64.8%	65.1%	7.1%	65%	5.1%
Federal Funds	4,381	7,451	19.9%	20.6%	4.4%	70%	5.5%
Other State Funds	3,010	4,231	13.6%	11.7%	-7.4%	41%	3.5%
Bonds	375	967	1.7%	2.7%	-23.9%	158%	9.9%
Total All Funds	22,067	36,217	100.0%	100.0%	3.6%	64%	5.1%
State Funds (=General + Other Funds)	17,311	27,799	79.8% [a]	78.9% [a]	4.6%	61%	4.9%

[a] Percent of State funds in Total excluding bonds.

Source: Compiled from NASBO State Expenditure Reports data.

Chart 6

The Distribution of State Spending by Fund Type, FY1993 vs. FY2003



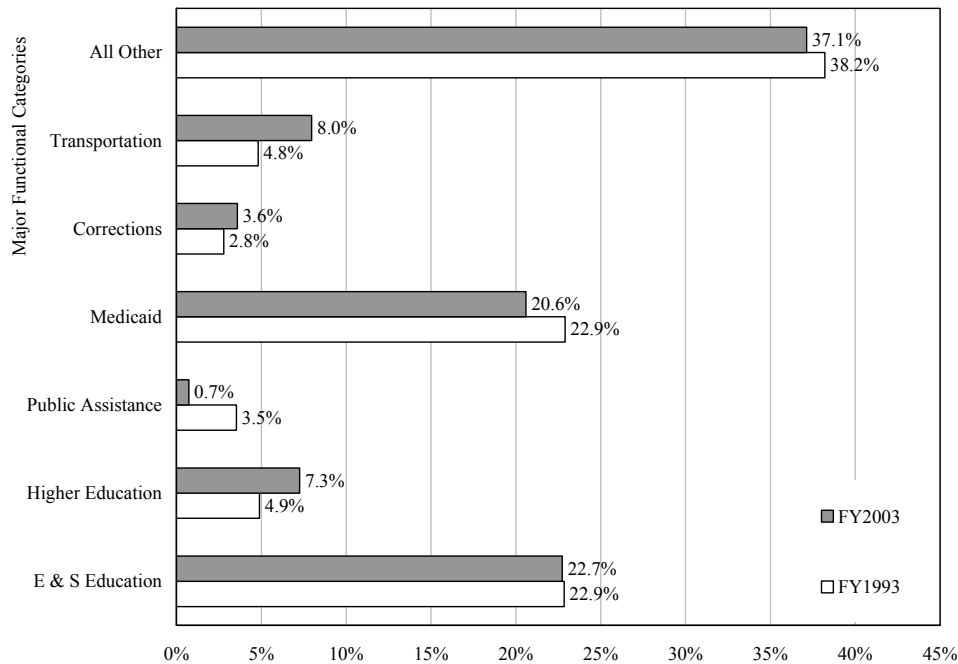
record \$1.3 billion in bond spending in FY2002 when the State income tax revenues actually fell by over one billion, its first ever double-digit drop.

Comparing trends by program categories and source of funding reveals interesting changes in the pattern of State spending between FY1993 and FY2003. Chart 7 shows the distribution of State expenditures by major functions in these two fiscal years. The increase in spending, in dollar amounts, varied across program categories ranging from a low \$685 million for corrections to a high of \$5.0 billion for the all other category. Excluding the latter, reflects that elementary and secondary education and Medicaid were the top two program areas accounting for close to two-fifths or \$5.6 billion in spending increases between FY1993 and FY2003. This was followed by transportation and higher education spending, which was up by \$3.4 billion in FY2003. With an average annual growth rate of -10.3 per cent, total spending on public assistance in FY2003 fell to near one-third the FY1993 level, primarily due to the steady decline in welfare caseloads after the passage of welfare reform.

In terms of percentual change between the two fiscal years under consideration, transportation spending jumped 171.2 per cent expanding at an average annual rate of 10.5 per cent followed by higher education (143.5 per cent)

Chart 7

State Expenditure Distribution by Major Functions, FY1993 vs. FY2002



and corrections (111.4 per cent), which increased at average annual growth rates of 9.3 and 7.8 per cent, respectively. In the remaining paragraphs the changes in the composition of spending by funding source will be highlighted in an attempt to understand the underlying structural shifts in the State's major spending programs (see Table 3). The all other category will be discussed separately. New federal legislations and reauthorizations will be listed under specific programs.

Elementary and Secondary Education (E&SE) accounts for the largest share of State fund spending, ranging from 26.5 per cent in FY1993 to 27.1 per cent in FY2003. The bulk, around 91 per cent of E&SE spending is from the State general fund revenues, which grew at an average annual rate of 5.1 per cent, at the same pace as total spending in FY2003. The rest of funding (8.5 to 8.9 per cent) comes from federal funds. Around one-tenth of total federal funds were used on E&SE in FY1993 with this share falling to 9.4 per cent in FY2003. New Jersey's spending relating to school finance has been subject to several court challenges¹⁵ on the ground that the State does not provide adequate funding to support a "thorough and

¹⁵ Abbot IV (1997) and Abbot V (1998) rulings are examples.

Table 3

The Trend in Distribution of Spending by Major Program and Fund Categories
a) Percentage of Distribution by Program Type

FY1993 Fund Type	E & S Education	Higher Education	Public Assistance	Medicaid	Corrections	Transport- ation	All Other	TOTAL
State Funds	91.1%	88.1%	60.7%	53.8%	98.2%	51.9%	88.0%	78.4%
Federal Funds	8.9%	1.9%	39.3%	46.2%	0.7%	47.6%	9.0%	19.9%
Bonds	0.0%	10.0%	0.0%	0.0%	1.1%	0.6%	3.0%	1.7%
Total All Funds	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
FY2003 Fund Type	E & S Education	Higher Education	Public Assistance	Medicaid	Corrections	Transport- ation	All Other	TOTAL
State Funds	91.5%	99.3%	61.6%	50.3%	96.8%	50.0%	82.1%	76.8%
Federal Funds	8.5%	0.7%	38.4%	49.7%	3.2%	26.0%	15.8%	20.6%
Bonds	0.0%	0.0%	0.0%	0.0%	0.0%	24.0%	2.0%	2.7%
Total All Funds	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

b) Percentage of Distribution by Fund Type

FY1993 Fund Type	E & S Education	Higher Education	Public Assistance	Medicaid	Corrections	Transport- ation	All Other	TOTAL
State Funds	26.5%	5.5%	2.7%	15.7%	3.5%	3.2%	42.9%	100.0%
Federal Funds	10.0%	0.5%	7.0%	53.3%	0.1%	11.5%	17.3%	100.0%
Bonds	0.0%	28.2%	0.0%	0.0%	1.9%	1.6%	67.7%	100.0%
Total All Funds	22.9%	4.9%	3.5%	22.9%	2.8%	4.8%	38.2%	100.0%
FY2003 Fund Type	E & S Education	Higher Education	Public Assistance	Medicaid	Corrections	Transport- ation	All Other	TOTAL
State Funds	27.1%	9.4%	0.6%	13.5%	4.5%	5.2%	39.7%	100.0%
Federal Funds	9.4%	0.3%	1.4%	49.8%	0.6%	10.1%	28.5%	100.0%
Bonds	0.0%	0.0%	0.0%	0.0%	0.0%	71.7%	28.3%	100.0%
Total All Funds	22.7%	7.3%	0.7%	20.6%	3.6%	8.0%	37.1%	100.0%

Source: Author's compilation using data from NASBO's State Expenditure Reports.

efficient education” and creates wide disparities in local property tax rates.¹⁶ “The No Child Left Behind Act of 2002”, passed by the federal government reflects new fiscal federal coordination in elementary and secondary education efforts between the federal and State governments. The FY2006 budget reflects \$102 million in supplemental spending for the Education Opportunity Aid to Abbot school districts mandated by court decisions and based on final awards.¹⁷

In contrast, a smaller fraction, 5.5 per cent of total State funds were used to finance *Higher education*, which accounted for 88.1 per cent of total higher education spending in FY1993. The composition in FY2003 changed dramatically with practically all the spending absorbed by State funds (99.3 per cent) and there were no bonds, which had accounted for one-tenth of FY1993 spending. The share of spending from federal funds also fell in FY2003. A multi billion dollar package providing tax incentives for higher education was passed by the U.S. Congress under the 1997 Taxpayer Relief Act.¹⁸ The Higher Education Act (HEA), which was reauthorized by the U.S. Congress in 1998, increased the availability of financial assistance through grants and loans for students services and institutional assistance.

The share of total State and federal funds going to *Public assistance* dropped from 9.7 to 2.0 per cent between the two fiscal years. As noted earlier, public assistance is the smallest among State programs under consideration, accounting for less than one per cent of total FY2003 spending in New Jersey, below the 2.2 per cent share for all U.S. States. Two developments are worth noting under this program:

- a) since the replacement of the old Aid to Families with Dependent Children (AFDC) with the Temporary Assistance for Needy Families (TANF) block grants, New Jersey’s spending on such assistance has fallen sharply as the State successfully moved recipients from the welfare rolls to the workforce. For instance, its share of FY2003 spending on TANF assistance program accounted for 38 per cent vs. the 65.8 per cent share under the AFDC program in FY1993,
- b) There is a dramatic increase in spending under the general assistance segment, which provides other cash assistance to eligible clients from 34.2 in FY1993 to 61.2 per cent of total public assistance spending in FY2003,¹⁹ reflecting tough economic conditions.²⁰

¹⁶ A final ruling was issued by the State Supreme Court in May 1998, which supported the Governor’s plan to implement “whole-school reform”, expand preschool programs and address school construction.

¹⁷ See BIB, p. 5.

¹⁸ See NASBO reports posted on their website at www.Nasbo.org for discussion of various federal and state law changes.

¹⁹ According to the latest Budget in Brief, general assistance caseloads increased by 44 per cent between FY2001 and FY2004.

²⁰ Aside from receiving cash assistance during hard economic times, disadvantaged clients become eligible for basic health coverage when they receive the GA cash assistance. This tends to increase the number of GA caseloads.

Among the different programs, contribution from federal funds is the highest for *Medicaid*, which is the primary health care safety net for low income parents, children, the elderly and the disabled in New Jersey. It is a means tested entitlement program jointly financed by States and the federal government.²¹ For instance, the bulk, 53.3 per cent, of all federal funds was spent on Medicaid in FY1993 accounting for 46.2 per cent of total State spending on Medicaid that year. In FY2003 the corresponding share for total federal funds was 49.8 per cent, down 3.5 percentage points but it accounted for almost one-half of New Jersey's spending on the program. On the whole Medicaid spending increased by 47.6 per cent between the two fiscal years and remains a major driver of escalating mandatory budgetary growth in New Jersey. It is expected to account for around one-fifth of additional budgetary mandates, \$289 million, as indicated in the proposed FY2006 budget.

Although the *Corrections* category represents the second smallest program, accounting for below 5 per cent of total State spending, the size of spending in dollar amounts more than doubled in FY2003. The share of total State funds spending on Corrections increased by one percentage to 4.5 per cent in that year. However, they accounted for a slightly smaller percentual share of total Corrections spending, which fell from 98.2 in FY1993 to 96.8 per cent in FY2003 while the share of spending from federal funds increased from below 1 to 3.2 per cent during the same time points. The contribution of bonds also diminished due in part to the completion of the Southwoods prison, which is the largest State institution in New Jersey.²²

Spending on *Transportation* increased at the fastest pace at 171.2 per cent rate (up by \$1.8 billion) between FY1993 and FY2003 with an average annual growth rate of 10.5 per cent, the highest among all the categories. The most significant shift is in the dramatic growth in spending from bond funds, which accounted for 24 per cent of total State spending on transportation in FY2003 vs. the less than one per cent share reported for FY1993. The significance of the role of bonds is also reflected by the fact that the bulk of total spending from bonds, 71.7 per cent, was on the Transportation category in FY2003, which was significantly above the low allocation of 1.6 per cent in FY1993. The Transportation Trust Fund (TTF) for instance, issues bonds to finance transportation improvements projects in New Jersey.²³ The second shift relates to the somewhat smaller role of federal funds. For instance, one tenth of all federal funds were allocated to this category in FY2003, down from the 11.5 per cent corresponding share in FY1993. Another way to observe this trend is to compare the share of federal funds in total transportation spending by the State, which also fell from 47.6 to 26 per cent

²¹ See the Kaiser Commission on Medicaid and the Uninsured report based on Medicaid Spending survey which discusses the major sources of cost increases associated with this program. For info on other state health spending refer to the NASBO's 2000-01 *State Health Care Expenditure Report*.

²² Typically construction of prisons and other capital projects span over several years affecting the inter temporal distribution of expenditures. The Southwoods correctional facility opened in FY1997.

²³ Revenue from the gasoline excise tax is constitutionally dedicated to fund the Transportation Trust Fund. Other dedicated revenues include the Petroleum gross receipts tax and certain sales taxes on new car sales.

between the two fiscal years. The share of State funds going to transportation increased by two percentage points to 5.2 per cent while the share of State funds in total State transportation spending remained around 50 per cent between the two fiscal years.

Expenditure on the *All other* category escalated by over \$5 billion or 59.5 per cent between FY1993 and FY2003, largely on account of the spike in spending from federal funds. For instance, the allocation of total federal funds to this category increased by 11 percentage points to 28.5 per cent in FY2003. The share of federal fund spending in total expenditures on the all other group also increased from 9 in FY1993 to 15.8 per cent in FY2003. State funds accounted for the bulk, 82.1 per cent, of total expenditures on the all other category; however, this represents a drop of 6 percentage points from the high 88 per cent share in FY1993. The share of total State funds allocated to the all other category also fell by 3 percentage points from 42.9 to 39.7 per cent between FY1993 and FY2003, respectively. The declining shift in spending from bond funds, which account for a small fraction of the total of *All other* expenditures, is another notable development. For instance, the share of total bond funds allocated to the *All other* category slid from 67.7 to 28.3 per cent between FY1993 and FY2003, respectively.

4. Major political and economic developments timeline

This section begins by outlining the underlying political and economic background during the ten years from FY1993 to FY2003 under consideration to help us shed light on the observed trends in State spending in New Jersey during that period.

The ten years span an interesting range of political events:

- a) Governors, their terms and their party affiliations²⁴ (Table 4),
- b) Gubernatorial election years during the study period.

There were three gubernatorial elections in New Jersey between FY1993 and FY2003 during which following two governors were elected with one of them reelected to a second term. In January 1994 (or FY1994) Governor Whitman started her first term as Governor followed by her reelection and start of second term in January 1998 (or FY1998). The third election was in November 2001 when Governor McGreevey was elected and he was sworn in January 2002 (FY2002). During this period there were two Presidential elections in the U.S. when President Bill Clinton (Democrat) won his second term in the 1996 election and President Bush (Republican) won his first Presidency in 2000.

- c) Geopolitical conflicts include the September 11, 2001 terrorist attack followed by the war on terror in Afghanistan that had started on October 7, 2001; the war with Iraq since March 2003 and the creation of Homeland Security related

²⁴ See the Manual of the Legislature of New Jersey 2004 for details.

Table 4

NJ Governors, Their Terms and Their Party Affiliations

Name	Date Sworn to Office	First Budget	Last Budget	Party Affiliation	Elected [E]/Acting [A]²⁵
Jim Florio	1/90	FY1991	FY1994	Democrat	E
Christie Whitman	1/94	FY1995	FY1998	Republican	E
Christie Whitman	1/98	FY1999	FY2001	Republican	E
Donald DiFrancesco	1/01	FY2001	FY2002	Republican	A
John Farmer, Jr.	1/02	n/a	n/a	n/a	A
John Bennett	1/02	n/a	n/a	Republican	A
Richard Codey	1/02	n/a	n/a	Democrat	A
James McGreevey	1/02	FY2003	FY2005	Democrat	E
Richard Codey	11/04	FY2006	FY2006	Democrat	E

activities since late 2002, a post 9/11 development with budgetary implications. More than \$300 million were appropriated for security programs between FY2002 and FY2003.

- d) The Economic time line during the tens years under consideration indicates that the State was enjoying one of the longest period of economic expansion in recent history with the last two fiscal years, FY2002 and FY2003, suffering economic contraction, particularly, after the stock market started plummeting in FY2002.

The above outlines the major political and economic timeline within the period of review. Based on New Jersey’s spending data primarily extracted from the NASBO’s State Expenditure Reports we find that overall State spending has grown at positive rates in all the ten years and spending grew at an average annual rate of 5.1 per cent, which was similar to New Jersey’s Gross State Product average annual growth during the same period.

The spending growth appears to be generally responsive to the State of the underlying economic conditions, particularly, the phase of the economic cycles. Take for instance the early Nineties when spending growth was slow as the economy was pulling out of an economic recession. In contrast, New Jersey’s total spending

²⁵ Due to rather unusual circumstances, New Jersey had four acting Governors from January 1 to January 15, 2002 before Governor McGreevy was sworn into office on January 15, 2002. Having John Bennet and Richard Codey as co-Presidents of the New Jersey Senate, for instance, made them take turns as acting governors for the State.

grew at a rapid pace, in the late Nineties to early 2000's with the stock market boom, increasing at an average annual growth rate of 8.5 per cent between FY1998 and FY2002.²⁶ The State experienced an increase of nearly \$9 billion in total expenditures with an average increase of \$2+ billion during these four fiscal years.

The solid growth in State fund spending, which includes general fund revenues, during the expansionary years also supports the above observation. The Gross Income tax, which is the single largest source of State own source general fund revenues, accounting for over one-third of total State revenues, increased by solid double-digit growth rates, ranging from 10.9 to 15.9 per cent, during the economic expansion and stock market boom before taking a nose dive in FY2002, following the stock market crash in 2002 and the resultant economic slowdown. This record growth in State income tax revenues fueled long term spending commitments, including both new and expanded programs. Despite the tanking of the GIT revenues, which fell by more than 14 per cent, these State programs remained on the budget leading to serious fiscal pressures as reflected in the slowdown in State spending growth since FY2003.

The shift in the composition of spending under the public assistance category towards General Assistance and other cash assistance programs during the economic slowdown is a case in point illustrating that State spending trends are indeed affected by the economic environment. Even the TANF caseloads appear to be increasing after declining for years when the State was able to move recipients from the welfare rolls to jobs, which were available at the time when the economy was expanding. As indicated in the FY2006 budget,²⁷ the number of TANF emergency assistance recipients increased by nearly 151 per cent between FY2001 and FY2004 due to the increase in the need for rental assistance. The public assistance programs are generally designed to be anti recessionary to provide support for economic hardships.

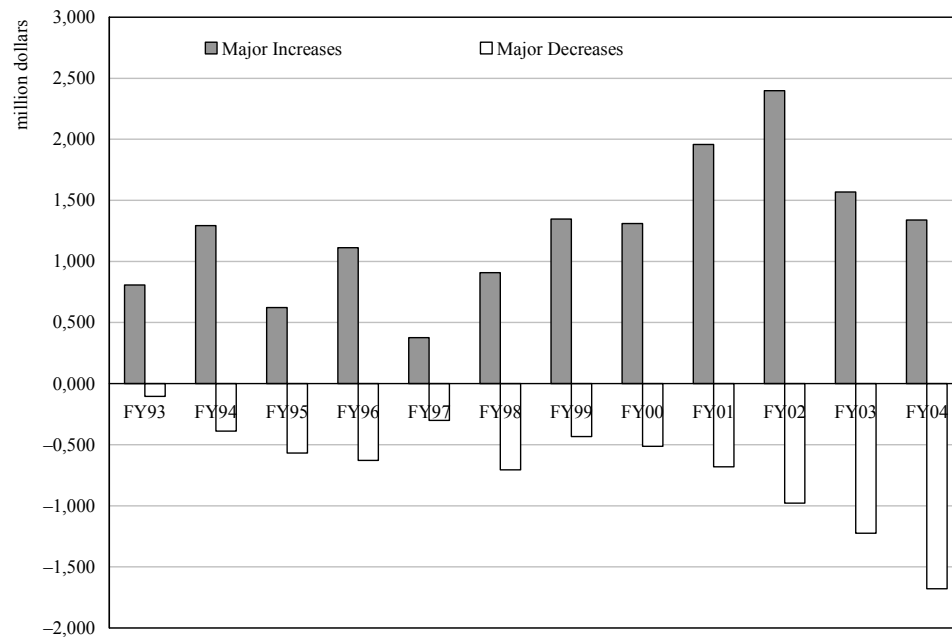
Now let us examine how the political environment may have affected the pattern and trend in State spending in New Jersey. As indicated in the Table 4 overleaf, there is sort of a sandwich situation with democratic governors at both the beginning and end years with a two term republican governor in between. It would be useful from a policy maker's perspective to know how the political philosophies, say of Governors, influence the State spending structure and trends. In general the Governor's Budget message (GBM) should reflect his or her spending priorities. Chart 8 indicates the trend in major increases and major decreases in appropriations during FY1993 and FY2004. It is interesting to note that the first and last two years (FY1993-FY1994 and FY2003-FY2004) represent transition periods: the first set is associated with a period when the economy is transitioning from a contraction from the early Nineties while the last two years also are transition ones moving from contraction to slow economic recovery. In contrast the eight years in between

²⁶ The U.S. stock prices started to fall sharply after peaking in March 2002. The major stock market indexes experienced sharp drops by October 2002.

²⁷ FY2006 BIB, p. 21-22.

Chart 8

Major Increases & Decreases in Appropriations, FY1993 to FY2004



include some of the best economic years for New Jersey; FY2002 being an exception.

Two of the largest major decreases were in FY2003 and FY2004 under democratic Governor McGreevey and the size of major increases were below the average increase under the second term republican Governor Whitman. The average net change was minimal in that period. It is interesting to observe that both the average of major increases and net change increased significantly in the second term of Governor Whitman. For instance, the average size of net increases in appropriations went up by 132 per cent from \$755 million under the first term to \$1.753 billion in the second term. The average size of the net change in appropriations grew at a higher 438.6 per cent rate climbing from -\$205 million to \$1.102 billion. Based on these results, one could hypothesize that a second term Governor has relatively more freedom in setting the level and distribution of appropriations. It is possible that “not running for elections” adds to the degree of freedom in budgetary planning related decision making. This probably explains why Acting Governor Codey is being able to propose historic reductions in State spending and other budgetary changes, including a steep reduction in non-recurring budget actions, which are likely to suffer political will from candidates seeking election.

A quick review of governor's budget messages, presented in the Budget in Brief (BIB) document, reflects some of the revealed preferences of governors and other decision makers. The FY2002 BIB, the last under Governor Whitman is a case in point. Her commitment to environmental programs including open space preservation is reflected in her recommendation of \$116 million for the Department of Environmental Protection, including the newly proposed dedication of \$25 million from New Jersey's Realty Transfer fee for the reconstruction of State park and wildlife facilities and \$10 million to rehabilitate public and private dams. In addition she recommended the constitutional dedication of \$98 million to the Garden State Preservation Trust Fund for open space programs.²⁸ She was also instrumental in recommending large capital appropriations of \$1.2 billion of which the single largest was for the Transportation Trust Fund. These priorities are reflected in the expenditure growth trends that are being analyzed. For instance the all other category that includes spending on environmental projects and other capital projects increased by 19.9 per cent in that fiscal year. The growth in spending out of bonds is also reflected in the steep annual per cent increase in the share of bonds in total State spending in FY2002.

The politics of the Governor's preferences on the revenue side of the budget also has the potential to affect spending trends both directly, through dedication for particular expenditure categories for instance, or indirectly, through a particular type of fund such as general fund spending. Governor McGreevey's FY2003 BIB is a case in point. Also, depending on the revenue initiatives being proposed, the impact on spending could be either temporary²⁹ or permanent.³⁰ One of the major revenue enhancement initiatives proposed by the Governor was corporate tax reform to promote tax fairness. In FY2003, it generated around \$2.5 billion in revenues that were deposited in the State general fund. However, there is another effect of the CBT tax reform via the increase in revenues from the 4 per cent share that is constitutionally dedicated for certain environmental programs.³¹

Other influences of politics on State spending trends can be observed under intergovernmental transfers and joint program initiatives. New Jersey participates in Medicaid, and has a generous program as it provides all the optional services, including prescription drugs and home health care. However, the spending on Medicaid keeps rising uncontrollably due to federal mandates, which have been escalating. According to the latest budget message, Medicaid mandates are expected to increase by nearly 137 per cent to \$289 million in FY2006.

²⁸ See State of New Jersey, *Budget in Brief*, Fiscal Year 2001-02, p. 24.

²⁹ For instance, the use of tax amnesty measures generates one time revenues that could be used to fund a new non-recurring expenditure or provide general fiscal relief.

³⁰ The FY 2004 increase in the Realty Transfer Fee rates, for instance, represents permanent changes to a tax source that did not change in 19 years.

³¹ In 1996 a constitutional dedication was made to divert 4 per cent of annual revenues from the New Jersey Corporation Business Tax for Site remediation and water monitoring environmental programs. Since such spending is included in the all other category, the CBT growth would contribute to a growth in spending in the all other category.

Federal legislation changes also affect the pattern of State spending. After the tragic events of September 11, 2001, the U.S. Congress passed the Homeland Security Act and created the Department of Homeland Security in 2002.³² New Jersey has tried to stay on top on this front despite the declining share of per capita federal funds, since the federal government was using a population based formula that was diverting relatively more money to some rural States such as Vermont and Wyoming instead of New Jersey with a higher potential terrorist threat.³³ New Jersey has been attempting to fill the gap by adding new surcharges on car rentals and monthly telephone bills to pay for several programs, including enhanced 911 service, wireless calls, municipal aid for Homeland security grants.

This case illustrates intergovernmental transfers among all the three levels of government, introducing another layer of local politics in shaping State spending. As noted earlier that the bulk of State expenditures, around 71 per cent, are on State Aid and Grants-in-Aid to local governments, including school districts in New Jersey. An analysis of local government activity would provide a more complete understanding of all activities in the State, however, it remains outside the scope of this paper. In particular, the SERs data are not suitable for such an analysis.

5. Conclusion and beyond

State spending trends in New Jersey in the last ten fiscal years were examined using data in the State Expenditure Reports compiled by NASBO. It is important to keep in mind that the NASBO data are based on survey data provided by States so the quality of the data is dependent crucially on the accuracy and completeness of the survey response. Total expenditures including both operating and capital expenditures were included in the data. However, it would be useful to extend the analysis to study the structure and trends in State capital spending separately.

The trends were studied in the context of various economic and political settings to identify significant factors affecting the underlying structure of State spending in New Jersey. State general fund accounts for the bulk of spending and E&SE and Medicaid remain the two single largest program categories in the State spending.

In attempting to understand the spending trends major economic and political events were tracked. Major changes in appropriations shown in budget documents were reviewed to understand the revealed preferences of the governors. It was interesting to observe that seeking election, reelection or not and the term currently being served by the governor may also influence the budgetary proposals in the State.

³² Refer to 6 U.S.C. 101 for details.

³³ Under the Urban Area Security Initiatives grants.

There are several other issues that affect State spending trends such as supplemental appropriations. The actual spending for a particular fiscal year depends on both what was budgeted originally through the Appropriations Act and through supplemental appropriations during the course of that fiscal year. The issue of on-budget and off-budget spending should be explored as well. Another useful item for future research would be to study the pattern of non-recurring (the so called one-shots) revenues on current and future State spending trends.

It would be useful to include spending by local governments to get a better understanding of what goes on in the State as a whole, particularly, in areas where spending decisions are made by both the State and local governments. There are so many important expenditure issues that would be better understood if local government issues including those relating to school finance reform; inequality in the distribution of expenditures on K-12 spending; and local options revenues are included in the analysis.³⁴

Future efforts should be directed in generating *user-friendly* data format in the State budget documents such as those showing expenditure data by major program categories. This would facilitate the understanding of where the budget dollars are actually spent by funding sources in a particular fiscal year. Currently, it is a difficult task to extract such information from the State Budgets and Comprehensive Annual Financial Reports without help from the OMB staff. One of the reasons being that different accounting and reporting concepts are used to prepare these documents. For instance, the latter conforms to the generally accepted accounting principles (GAAP) while the former uses budgetary basis accounting, which recognizes encumbrances³⁵ as expenditures and reflects transactions only for the current fiscal year. The goal should be to enable the reader to easily identify total expenditures in a particular fiscal year on any specific expenditure program of interest and to understand the underlying sources of funding in the State budget.

³⁴ For a discussion of expenditure issues relating to local governments in New Jersey refer to the New Jersey State and Local Expenditure and Revenue Commission Report.

³⁵ In the budget glossary, "encumbrance" is defined as a reservation of funds for future payment (disbursement) to liquidate an obligation incurred, usually by the issuance of a purchase order or the execution of a contract calling for payment in the future.

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