

New Jersey Economic Insights

Dr. Charles Steindel,
Chief Economist
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Outlook New Jersey

Gains in Jobs and Auto Sales Keep New Jersey's Economic Uptrend Rolling

New Jersey

New Jersey's expansion is ongoing. While the unemployment rate backed up slightly in June to 8.7 percent, payrolls continued to grow, with June's 4,600 rise coming on the heels of May's very large 17,300 gain. New Jersey has gained nearly 75,000 jobs over the last 12 months. The unemployment rate has come down a full point since last summer, while the job growth rate of 1.9 percent overall ranks us eleventh among the 50 states and higher than every state in eastern half of the nation except Mississippi. Private sector job growth during the same period was 2 percent.

One promising aspect of the job reports in recent months has been the improvement in construction. The number of construction jobs in New Jersey in June was 6,700 higher than in June 2012, a 5.2 percent gain. Some questions had been asked about reported soft construction numbers earlier in the year, since job gains had been anticipated given demands raised by Sandy rebuilding and the marked rise in housing permits. With the recent increases, it appears that construction is starting to gain some traction, though the sector still has a long way to go to return to its prerecession peak.

Other indicators of New Jersey economic activity are also strong. June car sales were 7.8 percent higher than the June 2012 figure, and sales in the first half of the

year were the highest for that period since 2007. While overall housing permits in June were down from a year earlier, single-family permits rose sharply. Over the first half of the year they jumped a whopping 32 percent from 2012. The Federal Reserve Bank of Philadelphia estimates economic activity in New Jersey rose 3.5 percent over the year ending in June, which ranked us eighth in the nation — and quite a bit better than the overall national increase of 2.9 percent over that period.

Manufacturing also appears to be firming. The Philadelphia Fed's April survey of local manufacturers, which includes some South Jersey firms, has turned up sharply in recent months after a soft period. The survey's index of current conditions shot up from a reading of 12.5 in June to 19.8 in July. The July figure was the highest since March 2011 and is also quite high by historic standards. Other positive notes were that survey respondents reported increasing employment in July, and were quite optimistic about the outlook over the next six months.

- *The national economy is also moving up at a moderate pace.*
- *The Philadelphia Fed's April survey of local manufacturers showed a sharp improvement.*

U.S. Economic Outlook

National economic numbers continue to be on the choppy side. Retail sales excluding autos were soft in June, and housing starts fell sharply, though most of the

(Continued on page 2)

decline in starts reflected a pullback in the erratic numbers on apartment construction. On the positive side, auto sales were quite strong in June, and industrial production is growing again after the soft patch reflected earlier this year in the Philadelphia manufacturing survey.

Furthermore, orders for durable goods are on a renewed upswing. Most importantly, national job gains continue to run at around 175,000 a month, a pace consistent with some downward movement in unemployment. Aggregate growth continued to be soft in the second quarter, as growth of real Gross Domestic Product was at a modest 1.7 percent annual rate. (Because of the extensive revisions to the data that accompanies the release of the

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second quarter figures, we have not as yet been able to update our forecast. The GDP chart on page 8 shows the numbers prior to the revision.)

Financial markets have been rather turbulent over the last

two months. The stock market gave back a portion of its recent gains in June, before returning to new highs in mid-July. Long-term interest rates, including those on mortgages, are now about a full percentage point higher than their spring lows.

Many people have blamed the Federal Reserve in general and Fed Chairman Ben Bernanke, in particular, for these moves. Most specifically, at a June 19 press conference Bernanke suggested that if the labor market and the overall economy continued to improve along the lines suggested by Federal Reserve Board members and Federal Reserve Bank Presidents, the Fed could well start to reduce the size of its monthly purchases of Treasury

securities and mortgage-backed securities. The national unemployment rate at the time this “tapering” would commence would likely be around 7 percent.

Many financial market participants interpreted Bernanke’s comments as an indication that the Fed was now firmly committed to reducing its rate of monthly purchases sometime in the fall, and went further and saw the statement as suggesting that the Fed would start raising interest rates much earlier than had been thought. As a result, there was a marked sell-off in stocks and bonds, leading to a decline in the indexes and increases in long-term interest rates.

It now seems much too much was inferred from Bernanke’s remarks. Other Fed officials more or less immediately commented that all Bernanke was doing was restating policies that the Fed had been setting out for months — if the economy improves enough, the Fed will start to scale back its securities purchases, but the further, more important, decision to raise rates will be based on future conditions. That’s far from a guarantee that the “tapering” will start at a certain date, and that once that process starts rate increases are sure to start fairly soon afterwards. Further Fed releases, most notably the minutes of the June 18-19 Federal Open Market Committee (FOMC) meeting, as well as Bernanke’s recent congressional testimony, and the FOMC’s statement on its July 30-31 meeting, have reinforced those points, and the stock market recouped its losses and long-term rates have edged back a bit.

In retrospect, the whole furor suggests that one would be wise not to react immediately to the instant analysis and market response to Fed statements. Calm, common-sense reading of what is actually stated is a much better guide to the likely course of monetary policy.

— *Charles Steindel*

Economic Analysis

How Progressive is New Jersey's Income Tax? An Interstate Comparison

Introduction

Discussions of New Jersey's individual income tax — the state's single largest source of revenue) often note its progressivity. A progressive tax is one in which the tax rate increases as the taxable income goes up.

New Jersey's individual income tax — with rates that range from less than zero for some low-income residents (earned income tax credit recipients can get money back from the state even if they don't owe any income tax) to 8.97 percent on income above \$500,000 — is clearly more progressive than Pennsylvania's flat tax, which sets income tax liability at 3.07 percent of income at all levels. But how does New Jersey compare to other states with graduated income tax structures?



Roger S. Cohen, Ph.D.
Assistant Treasurer for Tax
Policy and Revenue Analysis



Andrew Lai
Policy Analyst, Office of
the Chief Economist

One way to compare is to simply to look at the top rate. A number of states, such as California, Oregon, and Hawaii, have top rates higher than New Jersey's 8.97 percent. However,

looking at top rates in isolation doesn't fully capture the progressive nature of the tax. As noted, a progressive tax is one in which the total tax bill as a share of income increases as income rises. The top rate only indicates how much tax is paid on income above the bottom of the bracket (in New Jersey's case, \$500,000). To determine the overall progressivity of a tax we have to look at more of its details.

(Continued on page 4)

Progressivity ranking	State	Suits index	Bottom tax rate	Average tax rate	Top tax rate
1	New Jersey	0.289	1.4	5.47	8.97
2	California	0.229	1.25	7.15	10.55
3	Rhode Island	0.187	3.75	5.41	9.9
4	New York	0.17	4	7.65	8.97
5	Ohio	0.181	0.618	2.33	6.24
6	Minnesota	0.151	5.35	7.15	7.85
7	District of Columbia	0.144	4	8.15	8.5
8	Hawaii	0.121	1.4	7.36	11
9	Delaware	0.128	2.2	4.93	6.95
10	Wisconsin	0.118	4.6	6.82	7.75
11	Maryland	0.12	2	4.84	6.25
12	Oregon	0.066	5	8.6	11
13	Pennsylvania	0	3.07	3.07	3.07

Suits Index

Capturing all the nuances of tax progressivity is complicated, but economists have developed ways to do so. The challenge lies in defining progressivity, and finding an easy way to compare different states' tax systems directly. This is solved by a progressivity index, which boils down a state's complex income tax rules and tax schedules to a single number.

One of the most frequently used progressivity measures is the so-called Suits index, named after the economist Daniel Suits who created it in 1977. Since that time, the progressivity index has been used extensively by policymakers, analysts, academics, and other researchers.

Simply put, the Suits index measures how the distribution of taxes paid compares to the distribution of income in a population. A flat tax (like Pennsylvania's) has a Suits index of 0. As a tax becomes more progressive, its Suits index value approaches 1. As a tax becomes more regressive (tax rates fall as income rises), its Suits index approaches minus-1.

In our review, we used 2010 data on New Jersey taxpayer incomes to measure progressivity. We first computed what New Jersey taxpayers would have owed that year if our tax system was identical to that of a number of other localities — California, Delaware, the District of Columbia, Hawaii, Maryland, Minnesota, New York, Ohio, Oregon, Pennsylvania, Rhode Island, and Wisconsin. Many of these states were identified by the Institute on Taxation and Economic Policy as having the nation's most progressive state income taxes.

Coding in each state's individual tax rules, we estimate the income tax burden for each New Jersey taxpayer as if

she had earned the same income in another state. We include standard deductions and exemptions (e.g., number of child dependents, elderly), along with earned income tax credits, if applicable. Finally, we compute the Suits index associated with each state's tax system.

Results

Our summary results are shown in the table on page 3. The actual index values are unimportant; suffice it to say, states with higher Suits index values are more progressive. We find that New Jersey has the most progressive income tax structure of all the states studied, while New York, Rhode Island, and California also have fairly progressive income tax structures (with similar Suits values). Our Mid-Atlantic neighbors Maryland, Delaware, and the District of Columbia have notably less progressive income taxes. Pennsylvania, with its proportional income tax, has a Suits index of 0 and is not progressive at all.

Why is New Jersey's income tax so progressive? Its top marginal rate in 2010 was 8.97 percent, lower than California's (10.55 percent) and the same as New York's (8.97 percent). However, both California and New York income taxes have rates substantially higher than New Jersey's at income levels below the top bracket, which offset some of the effect on progressivity of their higher top rates. (As of 2013, New York's top rate has been reduced modestly to 8.82 percent, while California's has been raised to 13.3 percent.) Also, the District of Columbia has fairly high average and top income tax rates, but its top rate of 8.5 percent hits a broad swath of the population, applying to all income above \$40,000 for both singles and married couples. New Jersey's high Suits rating is essentially the result of the marked graduation in our tax rates. They start at 1.4 percent for taxable incomes under \$20,000, then rise steadily to 6.37 percent for incomes above \$150,000 before jumping to the top rate of 8.97 percent for incomes above \$500,000.

Is a highly progressive income tax desirable? The answer depends on what policymakers want from a state income tax. If one's goal is to reduce income inequality, then a progressive system, which places a greater burden on higher earners, is appropriate. However, a progressive income tax comes with significant tradeoffs: it complicates revenue forecasting and budget planning, makes tax revenues more volatile, and likely distorts individual decision-making. In a progressive system, the forecaster must not only project aggregate income, which is a difficult enough task, but also anticipate changes to income distribution, which further complicates the job. (In this study, we assumed that all states share New Jersey's 2010 income distribution.) Moreover, progressive tax systems are associated with high top rates, which increase the risk of taxpayer flight and require the state budget to rely more heavily on the incomes of top earners, which are historically very volatile.

Conclusions

While people can disagree as to New Jersey's precise rank, there should be no question that our state has one of the most progressive state income tax systems in the nation. Alternative progressivity measures will likely yield slightly different results, and changes in the distribution of income and tax schedules in a number of states since 2010 could also affect the precise numbers. While one can debate whether New Jersey's highly progressive income tax is an overall plus or minus, there's no getting around the reality that New Jersey's income tax is highly progressive: the more one earns in the Garden State, the higher the tax bill, both in total and as a share of income.

— Roger S. Cohen & Andrew Lai

Special thanks to Dr. Charles Steindel for his insightful comments and guidance. The views expressed in this paper are those of the authors, and do not necessarily reflect those of the New Jersey state government in general or the New Jersey Treasury Department in particular.



New Jersey Business Pulse Survey

A Strong Start to the Summer

The New Jersey Business Pulse survey includes 14 questions about current and perspective conditions in New Jersey and the nation and allows respondents to give their views on other topics of their choice. A total of 54 firms responded to the May survey and 38 to the June survey. Detailed results from these and past surveys can be found at <http://www.state.nj.us/treasury/economicsurveyresults.shtml>. The website also contains charts and tables summarizing the results, as well as an explanation on how indices are constructed from the answers to the questions.

Great Expectations

In both May and June, business owners reported that overall current business conditions in the United States and New Jersey are improving moderately with the strongest gains coming from the manufacturing and professional services industries. The index for expected business conditions in the U.S. reached its highest ever level while the respective index for New Jersey reached its highest level in over a year. All sectors except for telecommunications and health care services expect conditions to improve; the latter may be a signal that worries loom over the impact of the Affordable Care Act.

In general, expectations for near future revenues from business within the state increased in both May and June over the April results. And again, all sectors except telecom and health care are optimistic about their financial futures. Firms providing products and services directly to consumers once again reported that they did not charge higher prices while also reporting that input prices have recently risen.

Potential Hiring on the Horizon

In addition to optimism about business conditions, several firms reported that they plan to increase the size of their staff — with the strongest sentiment coming from medium sized businesses, those with 10 to 99 employees, and large companies of 1,000 or more employees. Furthermore, May's survey results had the strongest ever reporting on the ease with which firms could find qualified job candidates in New Jersey.

Conclusion

These two months of survey results suggest that New Jersey's businesses are going to continue to grow and produce higher levels of revenue and more jobs without boosting prices for goods and services.

— *Joseph Mengedoth*

The New Jersey Business Pulse Survey has been created to look beyond conventional economic data and gather views in real time directly from a diverse group of businesses in the state. If your New Jersey firm is interested in participating in this monthly survey, please contact Mary Filipowicz at 609-633-6781.

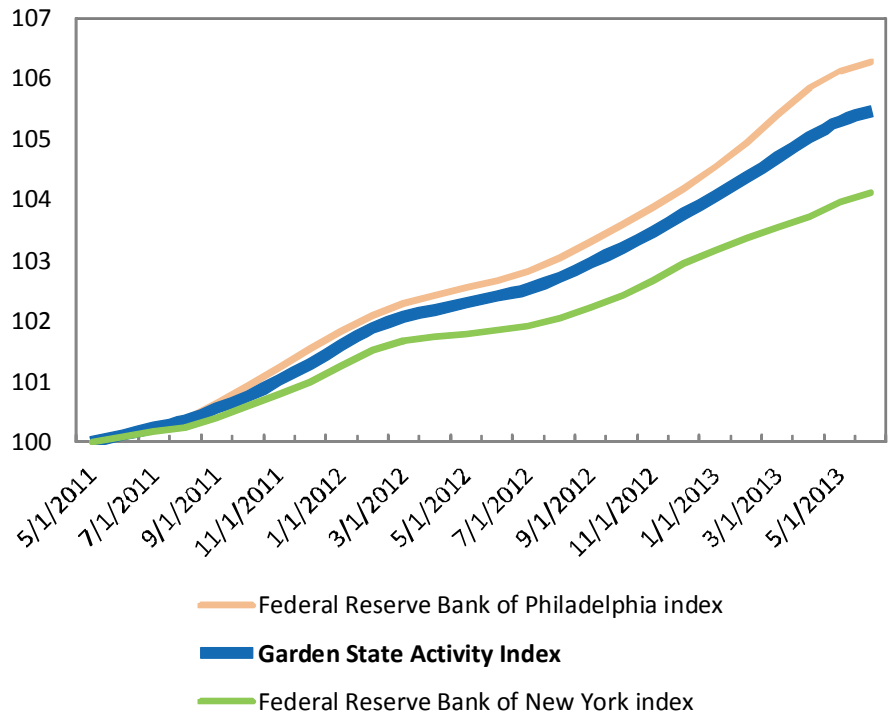
Garden State Activity Index

The *Garden State Activity Index* is our broad measure of monthly economic activity in the state of New Jersey. The index incorporates information from three sources: the Federal Reserve Bank of New York's coincident index, the Federal Reserve Bank of Philadelphia's coincident index, and the Philadelphia Fed's South Jersey Business Survey.

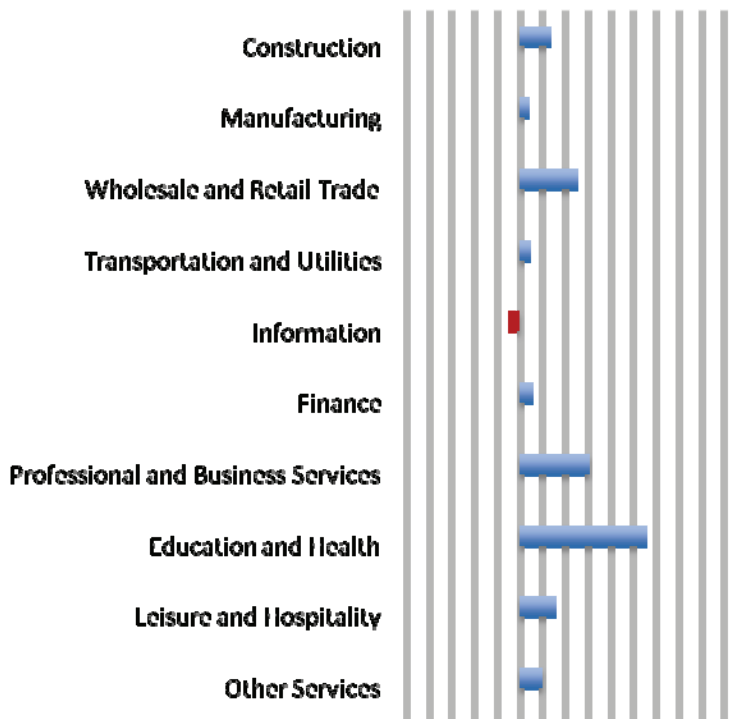
To construct the *Activity Index* we use principal components analysis, which takes a weighted average of the three Fed indicators. The composite index reflects the current state of the New Jersey economy.

Based on the most current monthly data, New Jersey's economy has continued to grow at a healthy pace over the past 12 months. This past June, the state's economy reached an index level of 3 percent, higher than the level in June 2012.

— *Joseph Mengedoth*

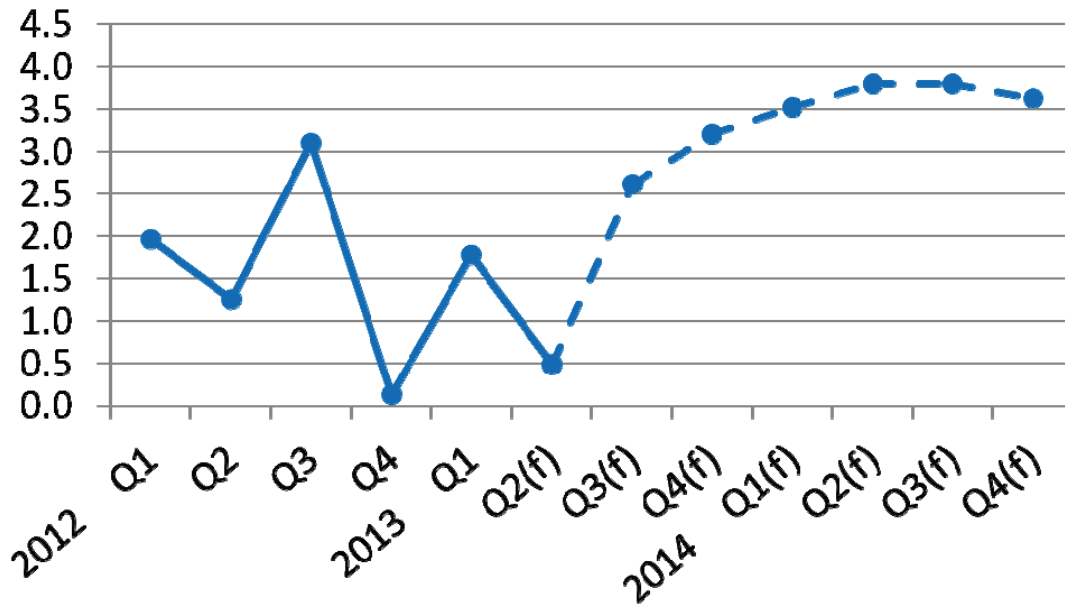


Private Industry Employment Trends



Change in Thousands of Jobs
April—June 2012 to April—June 2013

Real U.S. GDP Growth



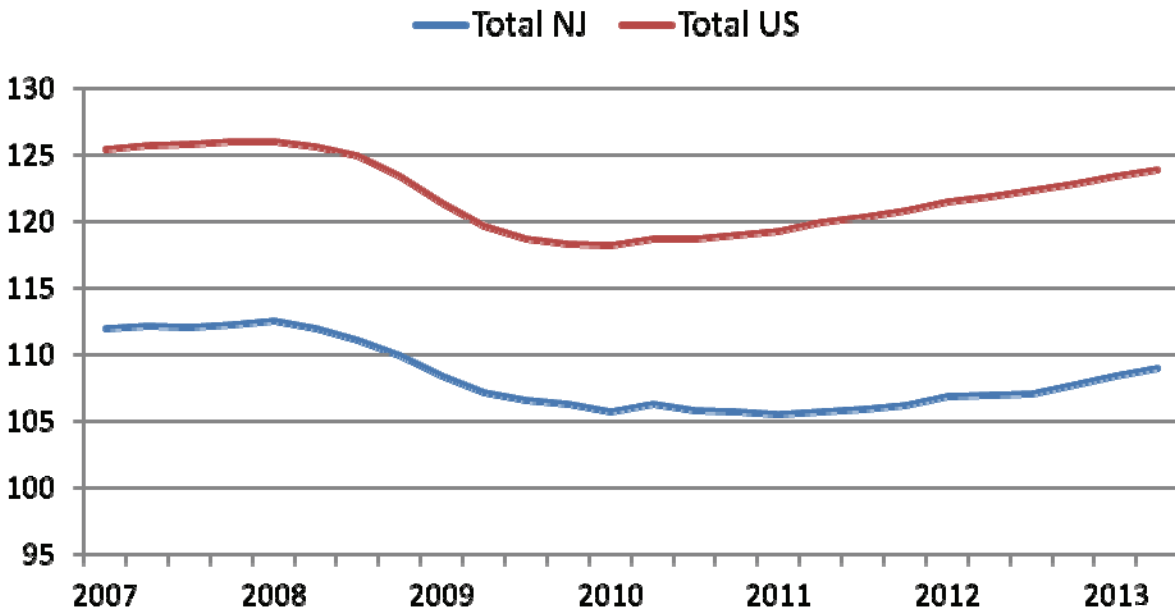
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Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment (Relative Employment 1990=100)

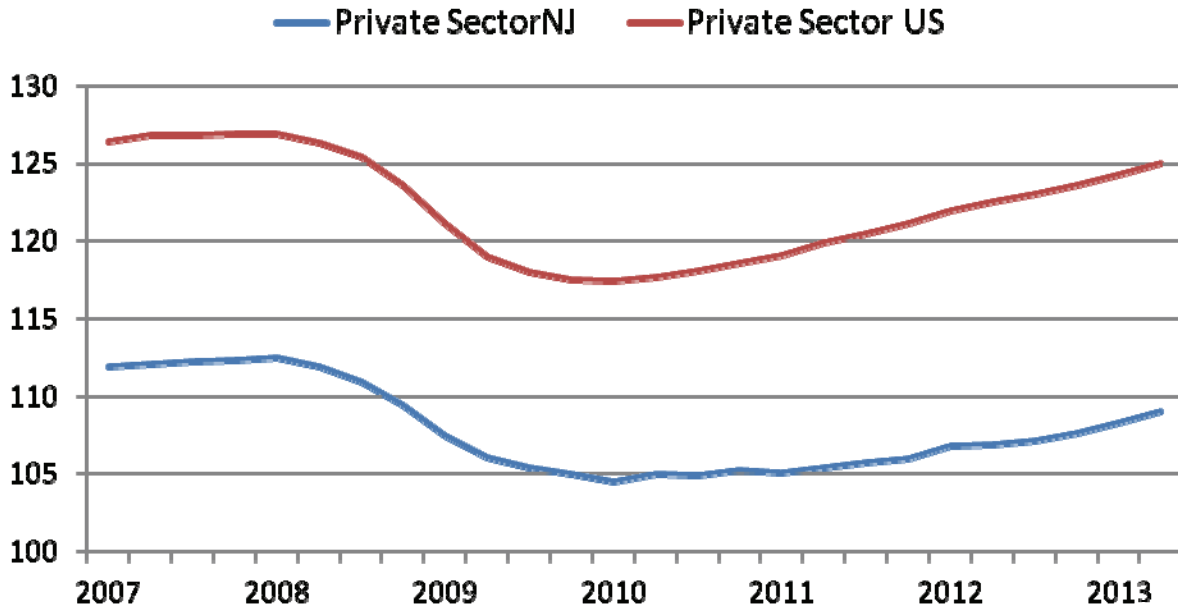
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



State & National Job Trends

Private Sector Jobs (Relative Employment 1990=100)

This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



Data source: U.S. Bureau of Labor Statistics, New Jersey Department of Labor

Explanatory note: These charts track trends in total and private sector employment in New Jersey and compare them with those of the nation as whole measured against a 1990 baseline.

Disclaimer

This communication is for informational purposes only and is not an offer, solicitation or recommendation regarding the purchase of any security of the State of New Jersey or any governmental authority of the State of New Jersey. The views expressed herein are solely those of Dr. Steindel and do not necessarily represent the views of the State Treasurer or any other official of the State of New Jersey.