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STATE AND LOCAL EXPENDITURE AND REVENUE POLICY COMMISSION

FINAL REPORT

1988

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STATE AND LOCAL EXPENDITURE
AND REVENUE POLICY COMMISSION

FINAL REPORT

1988

State of New Jersey

STATE AND LOCAL EXPENDITURE AND REVENUE POLICY COMMISSION

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GOVERNOR

July 8, 1988

To: The Honorable Thomas H. Kean, Governor, and Honorable Members of the New Jersey Senate and General Assembly

The New Jersey State and Local Expenditure and Revenue Policy Commission is pleased to transmit to you, herewith, its Final Report pursuant to P.L. 1984, c. 213, approved December 17, 1984. The Final Report 1) provides a framework for analyzing New Jersey fiscal policies, 2) examines the current conditions and trends within the state's public sector, 3) analyzes the dynamics of major state expenditure programs, 4) identifies the major fiscal problems and issues confronting New Jersey, 5) outlines the Commission's recommendations for creating a better fiscal balance with the state, 6) presents proposals for safeguarding the benefits that will result from our recommended reforms, and 7) provides illustrations of how our recommendations will effect individual households and municipalities.

The Commission focused on the two major fiscal problems that confront New Jersey. First, the state's fiscal system relies too heavily on local government to provide services. Second, the burdens of the state's tax system are not fairly distributed based on the ability to pay.

The Commission had several objectives in conducting its work including 1) ensuring that local resources are sufficient to finance local government expenditure responsibilities, 2) achieving a better balance between state and local taxes and a more equitable distribution of tax burdens, 3) improving the quality of education services, 4) sorting out the proper roles and responsibilities between the state and localities, and 5) enhancing the economic competitiveness of the state.

The recommendations contained in our Final Report are part of a comprehensive program to create a balance in New Jersey's fiscal system. The expenditure reforms will require local governments to reduce property tax burdens by $1.2 billion. The revenue reforms will make the state's tax system fairer and more responsive to the needs of our economy, while generating revenues sufficient to finance

essential state and local services. Since it was not the Commission's intention to increase the overall size of New Jersey's public sector, our program of reforms is revenue neutral. In other words, total state and local tax burdens in New Jersey will not be increased as a result of these reforms.

This report reflects the consensus of the members of the Commission. We have benefited greatly from public hearings and roundtable discussions involving a broad range of the New Jersey community. We offer our thanks to those individuals and organizations that have contributed so significantly to our efforts.

This Final Report is respectfully submitted by the members of the New Jersey State and Local Expenditure and Revenue Policy Commission.

Bruce G. Coe

Bruce G. Coe
Chairman

dg

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AND REVENUE POLICY COMMISSION

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ACKNOWLEDGMENTS

The Commission's Final Report is the end product of almost three-year's work. Several individuals have contributed significantly to our efforts along the way and deserve a special acknowledgment. First, the Commission designees have played a vital role throughout the process. The large number of issues considered by the Commission gave rise to numerous meetings of the Commission or its component task forces and subcommittees. The Commission designees helped by providing continuity and additional insights and perspectives as our work evolved (see Appendix F for listing of designees).

The Commission would also like to acknowledge the research and assistance provided by its staff over the years. The preparation of background research and policy options was extremely helpful to our deliberations. The staff also served an important role in coordinating our communications with experts from around the country and with members of the New Jersey community (see Appendix F for staff listing).

A very special note of appreciation goes to Dr. Ernest Reock of the Bureau of Government Research at Rutgers University. Dr. Reock was often indispensable to our efforts, particularly in the analysis of local school finance and municipal aid.

Harry Haushalter, the Deputy Attorney General assigned to the Commission, and Dr. Richard Kaluzny, Chief of the Office of Tax Analysis in the Division of Taxation, consistently proved to be sources of reliable advice and analysis, respectively. Robert Thompson of the Division of Taxation contributed greatly to our project throughout.

The New Jersey County and Municipal Government Study Commission provided valuable research assistance on many issues, especially on the state's trial court system. The faculty, staff, and students at the Eagleton Institute of Politics at Rutgers University also deserve special mention for their many and varied contributions.

Stuart Weiss was instrumental in the initial stages of getting the Commission office operations underway. Michael McKitish and his colleagues in the Treasury Department's Office of Fiscal Affairs helped to keep payroll, personnel and procurement activities on track. Phil Booz, of the Treasury Print Shop, often provided valuable reproduction and publication assistance.

We would also like to acknowledge the contributions of individuals who were appointed but unable to serve on the Commission until its completion including former Chairman Kenneth Biederman, Martin Blaskey, Frank Haines, Jr., John Horan, former Treasurer Michael Horn and Walter Wechsler.

More generally, the Commission would like to note that it has received full cooperation and assistance from the various state agencies and departments, the Office of Legislative Services, the State Library and Museum and many other individuals and organizations too numerous to mention. We would like to express our heartfelt appreciation to all who have contributed.

NEW JERSEY STATE AND LOCAL EXPENDITURE
REVENUE POLICY COMMISSION

FINAL REPORT

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EXECUTIVE SUMMARY

MANDATE

The legislation to establish the New Jersey State and Local Expenditure and Revenue Policy Commission, P.L. 1984, c. 213, was enacted by the State Legislature in December of 1984. The Commission was asked to conduct a systematic and comprehensive review of the state and local tax structure, the structure of state and local expenditures, and mandated spending formulas. We were directed to pay particular attention to the relationship of the tax system to the economy of the state and its localities; the relationship of state expenditures to the vitality of the economy of the state; the ability of taxpayers to pay taxes and to bear the burden of increases in government spending; the adequacy of the tax system to support needed services; and the reasonableness, efficiency, and fairness of the state and local tax system and spending formulas.

FRAMEWORK

In adhering to the systematic approach urged by our legislative mandate, we have developed a strategy to correct what we see as imbalances in New Jersey's state and local fiscal structure by building on the strengths of the state's economy and people. New Jersey's fiscal structure has evolved piecemeal over two centuries. If we are to have a structure that works well into the future, we must institute today a cohesive system of reforms to accommodate the complexities of an advanced and growing economy.

MAJOR ISSUES

The state's fiscal system relies heavily on local governments to provide services. Many of the services provided or partly financed by local governments, such as the courts, public assistance and mental institutions, are generally considered to be state services. When local governments are required to subsidize the provision of these services, traditional local services, such as public safety, roads and bridges, and recreation, are crowded out or provided at significantly lower levels. This results in an undue reliance on local governments, an inequitable distribution of burdens between state and local taxes, and a serious imbalance between local government responsibilities and the resources available to these jurisdictions to finance those responsibilities.

On the revenue side, the burdens of the state's tax system are not fairly distributed based on an ability to pay. In addition, the current system of state and local taxes unduly interferes with private decision making --- especially decisions about where to establish households or operate firms. Urban areas in particular are adversely affected by this system.

OBJECTIVES

The changes we propose have three main purposes: first, to ensure that local government resources are sufficient to finance local government expenditure responsibilities; second, to achieve a better balance between state and local taxes to relieve the pressures on taxes for local governments; and, third, to sort out responsibilities and functions between the state and localities on a more rational and logical basis. Since it is not our aim to increase the overall size of the state and local public sector in New Jersey, our package of reforms will be revenue neutral. That is, the total state and local tax burden will not increase as a result of these reforms.

These individual recommendations are part of a comprehensive program to create a balance in New Jersey's state and local government structure, reduce the reliance on local taxes, and level the playing fields upon which residents, taxpayers, and communities compete. The expenditure recommendations will result in an immediate improvement in the balance between local responsibilities and local resources and in the quality of services delivered to the state's residents. The revenue recommendations will make the state's tax system fairer and more responsive to the present and future economy of the state, while raising the revenues needed to reduce the reliance on local taxes. Finally, there are several recommendations to ensure that New Jersey remains a dynamic, desirable place in which to live and work, with a healthy fiscal system.

EXPENDITURE REFORMS

The purpose of the Commission's expenditure recommendations is first to improve the delivery of essential public services; and second, to improve the balance between local service responsibilities and the resources available to finance those services. Recommendations for expenditure reforms are proposed in the areas of local school finance, intergovernmental structure and state aid to municipalities. These proposals will result in $1.2 billion in reduced property taxes. Local governments will be required to pass through these benefits to taxpayers.

Local School Finance

The Commission is convinced that significant improvements in educational performance will not occur until we reduce spending disparities among school districts. Our recommendations will reduce disparities among districts and improve student performance, improve the quality of physical facilities, enhance the attractiveness of teaching as a profession, and address the need for early childhood education. The recommendations include a change to current-year funding in the equalization aid program and increased compensatory and debt service aid.

Intergovernmental Structural Reforms

The Commission's intergovernmental structural reforms define the proper role for the state and local governments in delivering and financing several important services including the courts, public assistance, institutions for

the mentally ill and developmentally disabled, the office of the prosecutor and county colleges. In each instance, a larger state role in financing the service is recommended.

State Aid to Municipalities

The resources available to municipalities are generally not adequate to meet their expenditure responsibilities. The problem is particularly significant for many poor jurisdictions, which also tend to face above-average needs. Local option non-property taxes do not adequately address the problem and may have adverse consequences for economic development in many areas. The Commission's recommendations will guarantee that each municipality has an adequate revenue base to finance essential services by creating a municipal equalization aid program that provides a guaranteed tax base for each municipality.

REVENUE REFORMS

The Commission analyzed each major tax imposed under state law in New Jersey. These revenue proposals will improve the efficiency and fairness of the state's tax system and offset the costs to state and local governments of lowering real property taxes.

Sales and Use Tax

The Commission recommends that the list of transactions covered by the state sales and use tax be expanded to include alcoholic beverages for on-premises consumption, cigarettes, disposable paper products, non-prescription drugs, admission charges and telephone equipment. These proposals will make the sales tax act simpler, more comprehensive in coverage, more equitable and more neutral with respect to choices made by individual households.

Gross Income Tax

The Commission's recommendations for the gross income tax will ensure that the taxpayer's burden is based on an ability to pay and that taxpayers in similar circumstances are treated similarly. The Commission's proposals will broaden the base for the gross income tax, change the rate structure and increase the progressivity of the state's overall tax system. The progressivity of the state's tax system will be increased through the introduction of a targeted property tax relief program and a consumption tax offset program to reduce the regressive impacts of consumption taxes such as the general sales or utility taxes.

Public Utility Taxes

The Commission's proposals for reforming public utility taxes will result in a more uniform tax treatment for all providers of telecommunications services as well as all energy providers.

Real Property Tax

The Commission's recommendations will improve property tax assessment through a more centralized administration, reduce the pernicious effects of the property tax in areas where further development is desired through the use of a mandatory tax on new construction, and strengthen the incentives to preserve farmland and open spaces in the state through the Farmland Assessment Program.

Business Taxes

The Commission recognizes the changing business environment brought about largely by deregulation and technological innovations. These changes have blurred traditional distinctions among industries, especially those providing various financial services. Commission recommendations will respond to these changes to ensure that competing firms face similar tax treatments.

SAFEGUARDING THE BENEFITS OF REFORM

The Commission developed recommendations to ensure that the balance created in the state's fiscal system will be permanent. These proposals will facilitate desirable economic growth and reduce institutional impediments to effective public sector budgeting and planning activities.

Economic Development Strategies

The Commission has proposed recommendations to aid orderly and balanced economic development within the state. These recommendations call for better evaluation and targeting of existing economic development programs, ensure an adequate infrastructure and the availability of affordable housing, and encourage better planning and coordination of development activities, especially among local governments.

Budget Process Issues

The Commission recommends several budget reforms to facilitate fiscal planning and control, including setting up a contingency or rainy day fund, preparation of an annual accounting of the costs of tax preferences provided, establishing limits on the dedication of revenues, the preparation of fiscal notes for proposed legislation, state government sharing of costs for state-mandated local activities, state non-fiscal assistance to improve local management efficiencies, and the establishment of permanent tax and pension study commissions.

I. INTRODUCTION

This introduction provides a framework for the Commission's decisions and lays out the organization of this final report.

STRATEGY FOR THE FUTURE

Our Mandate. The legislation to establish the New Jersey State and Local Expenditure and Revenue Policy Commission was enacted by the State Legislature in December of 1984. The Commission was convened in September 1985 and asked to conduct a systematic and comprehensive review of the state and local tax structure, the structure of state and local expenditures, and mandated spending formulas. We were directed to pay particular attention to the relationship of the tax system to the economy of the state and its localities; the relationship of state expenditures to the vitality of the economy of the state; the ability of taxpayers to pay taxes and to bear the burden of increases in government spending; the adequacy of the tax system to support needed services; and the reasonableness, efficiency, and fairness of the state and local tax system and spending formulas.

To review all aspects of state and local fiscal policy, we divided our work into four task forces: Local Government Expenditures and Financing, Economic Development, State Tax Structure, and State Government Expenditure Activities. We also established an Education Subcommittee, composed of a group of members from the Local Government and State Government Task Forces.

A Systemic Approach. In adhering to the systemic approach urged by our legislative mandate, we have developed a strategy to correct what we see as the imbalances in New Jersey's state and local fiscal structure by building on the strengths of the state's economy and people. New Jersey's fiscal structure has evolved piecemeal over two centuries. If we are to have a structure that works well into the future, we must institute today a cohesive system of reforms to accommodate the complexities of an advanced and growing economy.

The Problem of Imbalance. The major problem that we see and address is the imbalance between the state and local fiscal systems. While the State of

New Jersey as sovereign has delegated various responsibilities to county and local governments, it has not given all jurisdictions the resources they need to pay for what they are required or expected to do.

The state's fiscal system relies heavily on local governments to provide services. Many of the services provided or partly financed by local governments, such as the courts, public assistance and mental institutions, are generally considered to be state services. When local governments are required to subsidize the provision of these state services, traditional local services, such as public safety, roads and bridges, and recreation, are crowded out or provided at significantly lower levels. This results in an undue reliance on local governments for the types of services being provided, an inequitable distribution of burdens between state and local taxes, and a serious imbalance between local government responsibilities and the resources available to these jurisdictions to finance those responsibilities.

The changes we propose have three main purposes: First, to ensure that local government resources are sufficient to finance local government expenditure responsibilities; second, to achieve a better balance between state and local taxes to relieve the pressures on local taxes for local governments; and, third, to sort out responsibilities and functions between the state and localities on a more rational and logical basis.

Home Rule. We propose to restructure the state and local fiscal system by increasing the reliance on the state's broader tax capacity, allocating to every unit of government the resources to do what must be done. The new system presented in this report will enable local governments to provide essential services within New Jersey's tradition of home rule. New Jersey is a state with many relatively small local governments that historically have had strong local fiscal and legislative powers compared to the powers granted to local government in many other states. Local determination--the ability of citizens to make their own decisions, shape the character and future of their communities, and identify with their home governments--is a strong and cherished tradition in New Jersey. Our goal is to enhance home rule and to make it work more effectively, under a state-wide system that permits

orderly growth and is balanced, fair, and efficient.

The Right Time for Reform. We are confident that this is the right moment for serious reform. Reforms are most easily instituted in times of strength--and New Jersey is a strong and vibrant state. Several studies project that the state's diversified economy will continue to expand, that its job base is likely to increase through the year 2000, and that its unemployment rate, now at 3.6 percent, is likely to remain well below that of the nation.

Our own analysis shows that the state's finances are sound, and that this sound condition can continue into the future providing that adjustments as proposed in this report are made. We propose six major taxing and expenditure strategies for reform:

First, the structure and operation of the system for providing state aid to local school districts should tie these aid flows more closely to community needs. Our proposals are designed not only to change the system of financing, but to increase the efficacy of education as a public service in the districts in which its weaknesses are most glaring and costly for society.

Second, certain essential services, such as public assistance and the courts, which are now partly financed through local taxes, should be entirely financed through the state's broad-based revenue system. The local burden for these services is particularly heavy for the jurisdictions in which welfare dependency and crime are concentrated--which also are those jurisdictions with the fewest local resources to pay for services.

Third, other state aid should be reallocated to produce greater targeting based on community need while limiting local property tax burdens. (When all our proposals are taken into account, every locality will derive some benefit.)

Fourth, we propose modifications to improve the state's tax system and to support these reforms in the state's fiscal system.

Fifth, because some households will still bear too heavy a tax burden even after our revenue reforms, we propose a tax relief program to make the total tax system more progressive and protect family income from property and consumption tax overload.

Sixth, we believe that the state and local governments of New Jersey should subject every dollar of public spending to close, hard scrutiny. Even as we propose additional dollars for some programs, we accompany those proposals with a concern for the capacity of government agencies to carry out their public purposes. We urge additional spending in education. School districts that fail to meet specified standards regarding student performance, breadth of program, and capital facilities should be required to budget at least to the average per pupil level for all other districts which do meet those standards. We urge that traditional public assistance be converted to a comprehensive system focused on job preparation and employment, and emphasizing training, service and productivity.

Throughout our deliberations, we have consulted with state officials and carefully reviewed the state's budget. A number of our proposals promote greater efficiencies and long-run economies. While we have not attempted to write a budget for the state, we believe that all public programs should be regularly reviewed and eliminated if they do not prove to be efficient and effective.

We believe that this agenda for change is timely in light of the resurgent spirit of federalism as reflected in the energized role and initiatives of state governments across the country. State governments are increasingly taking on responsibilities in meeting the needs of their citizens and in allocating functions between state capitals and local units of government.

Our proposed system will permit an adequate level of essential public services to be provided by all local governments. It will increase reliance on the State's broad-based tax structure, while allowing distressed areas to compete for investment, thereby encouraging a more balanced pattern of land use and development in New Jersey.

We advance proposals to reform New Jersey's overall state and local financial system, with particular emphasis on the property tax. Our recommendations will promote more balance, fairness, efficiency, and orderly growth.

ORGANIZATION OF THE REPORT

The remaining part of this report is divided into seven sections. Chapter Two reviews the current conditions and trends regarding the New Jersey economy and public sector. This chapter first highlights changes in economic conditions in New Jersey relative to the nation. Next, it describes the structure of the State's public sector and the allocation of major expenditures in state and local government budgets. This chapter sets the stage for the remainder of the report.

Chapter Three expands upon the brief introduction to the state budget offered in the previous chapter and provides a detailed analysis of the recent trends in the major components of state spending. In addition, the factors influencing the level and rate of growth of these components of state spending are examined.

Chapter Four examines the major problems and issues addressed by the Commission. These issues can be broken down into two general areas: 1) the extent to which the state relies on local governments to provide and finance services; and 2) the impact of the current tax system on households and firms within the state. The two areas are, of course, related. Several specific issues are analyzed that indicate an over reliance on local government in the state. First, State government in New Jersey finances a smaller portion of total education expenditures than the average state. Second, local governments in New Jersey help to finance several services that are, in fact, state services. Finally, the responsibilities assigned to local governments in New Jersey are greater in general than the resources available to those governments to finance those responsibilities. This last problem is particularly severe for the distressed areas in the state.

The problems of the State's tax system can be grouped into two categories. The first concerns the distribution of tax burdens among taxpayers. Do household tax burdens reflect relative abilities to pay? Are businesses in similar situations treated similarly and fairly by the State's tax system? The second category deals with the impact of the tax system on current and future development activity within the state. Can we continue to be competitive within the region and the country in attracting households and jobs? Does the state's tax system distort the advantages or disadvantages of locating in different areas within New Jersey?

These are among the questions examined in Chapter Three. Not surprisingly, a major finding is that the property tax is a common thread that runs through the problems confronting the state.

Chapter Five presents the Commission's recommendations for creating the proper balance in the state's fiscal system. The strategy involves both expenditure and tax reforms. The expenditure reforms fall into three groups: local school finances, realignment of service responsibilities, and state aid to municipalities. School finance reforms cover several areas including a change to current-year financing for equalization aid, minimum spending levels for uncertified school districts, a redesign of the manner in which compensatory aid is distributed, and increased state assistance for debt service.

Commission proposals to realign service responsibilities pertain to five services: the trial court system, public assistance, payments for patients in state mental institutions, the office of the prosecutor, and the operation of county colleges. In each instance, the Commission proposes a greater state role and reduced use of local resources to meet public sector responsibilities.

The system of state aid to local government should be revised so that local resources are more in line with local responsibilities. The Commission has developed a municipal equalization aid plan that ensures that each municipality will have adequate resources to provide essential services.

These proposals will reduce fiscal burdens on local school districts, counties and municipalities. The Commission has also adopted a plan to ensure that these reduced local fiscal burdens result in property tax relief to taxpayers.

Revenue reforms discussed in Chapter Five pertain to all of the major revenue instruments used in the state. They make the overall revenue system simpler, more comprehensive, less intrusive on private decision making, and more equitable. In addition, these reforms produce revenues that are adequate to finance the state services and property tax relief recommended by the Commission. The recommendations reduce the reliance on the property tax and place more emphasis on broad-based state taxes. The regressivity of the property tax and of consumption taxes is reduced through refundable credits introduced through the State's gross income tax.

Chapter Six presents Commission proposals that will preserve the benefits of the revenue and spending reforms once they have been initiated. These recommendations include strategies for economic development programs, budget process reforms and local management efficiencies.

Chapter Seven discusses the impacts of the Commission's proposals for selected households and municipalities. The Commission recommendations are summarized in Chapter Eight.

This report focuses on the highlights of our analysis and the main features of our proposals. The Commission will publish individual supplementary reports on a number of the subjects addressed by our major proposals, including educational finance, public assistance, the courts, state aid, the property tax, the gross income tax, business taxes, and economic development.

II. CURRENT CONDITIONS AND TRENDS

This chapter presents an overview of the New Jersey economy and public sector.

NEW JERSEY'S ECONOMY

From 1982 through 1987 New Jersey experienced a period of sustained economic growth which exceeded the nation's in almost every category. Several aspects of the state's economy are worthy of note:

o New Jersey is the fastest growing state in the region with a cumulative population increase of 2.7 percent from 1980 to 1985, more than double the rate of growth in New York or Pennsylvania.

o New Jersey's per capita income, second only to Connecticut's, grew from $13,823 in 1982 to $18,626 in 1986 (see figure 1). In 1986, per capita income rose 6.3 percent in New Jersey compared to 5.2 percent for the rest of the nation.

o In November 1987, New Jersey had 3.8 million jobs. While New Jersey's population increased by 220,000 between 1981 and 1986, the state has seen 450,000 new jobs created since 1981. Over 100,000 new jobs were created between November 1986 and November 1987.

o From 1982 to 1987, New Jersey had a 13.6 percent growth in resident employment, almost 3 percentage points higher than the nation's employment growth. Its unemployment rate dropped from 9.0 percent in 1982 to 3.6 percent in November 1987, well below the November 1987 national rate of 5.9 percent.

Figure 1

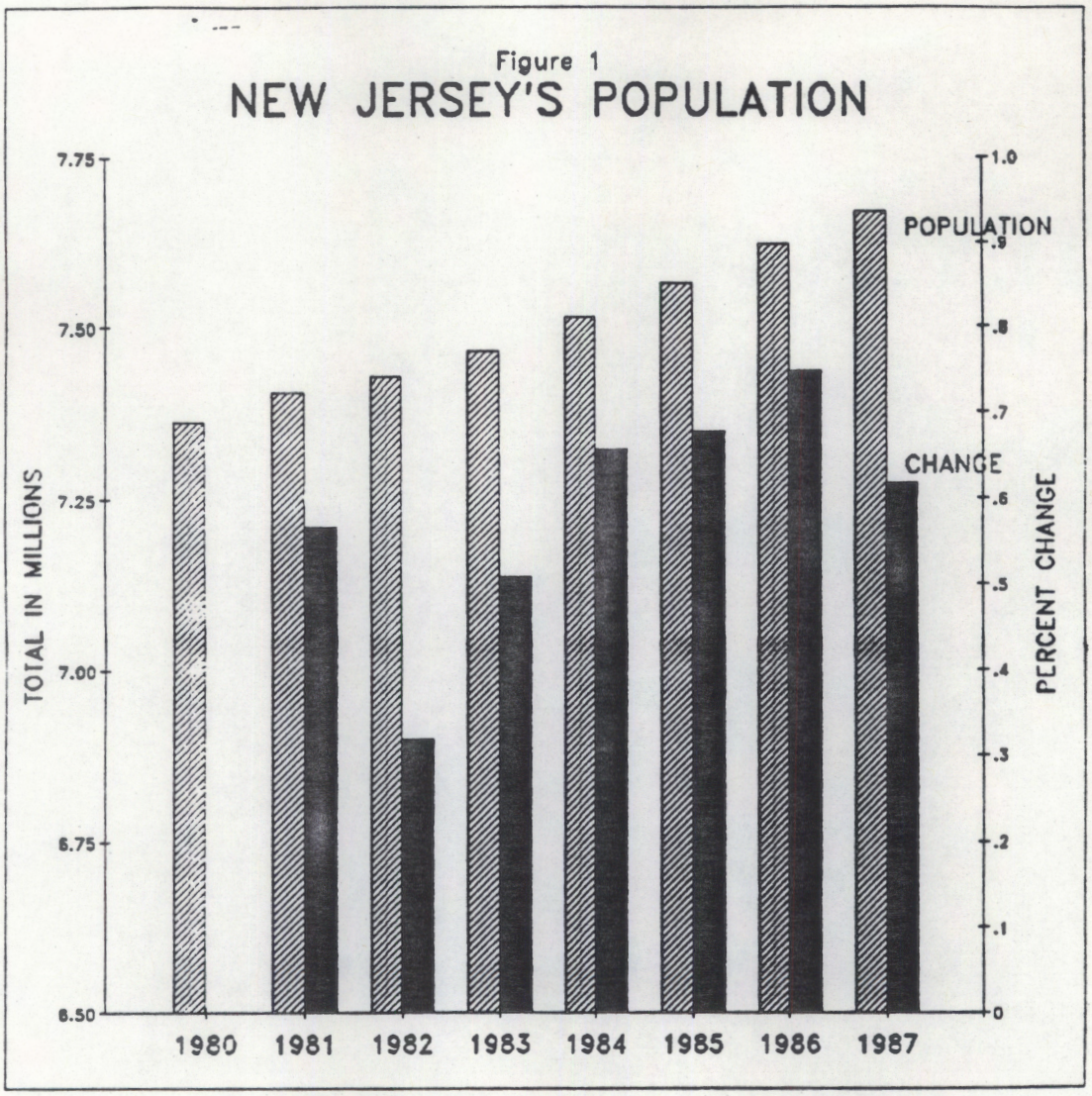

NEW JERSEY'S POPULATION
7.75
7.50
7.25
7.00
6.75
6.50
TOTAL IN MILLIONS
1.0
.9
.8
.7
.6
.5
.4
.3
.2
.1
0
PERCENT CHANGE
POPULATION
CHANGE
1980
1981
1982
1983
1984
1985
1986
1987

Figure 2

PER CAPITA PERSONAL INCOME
NEW JERSEY AND UNITED STATES

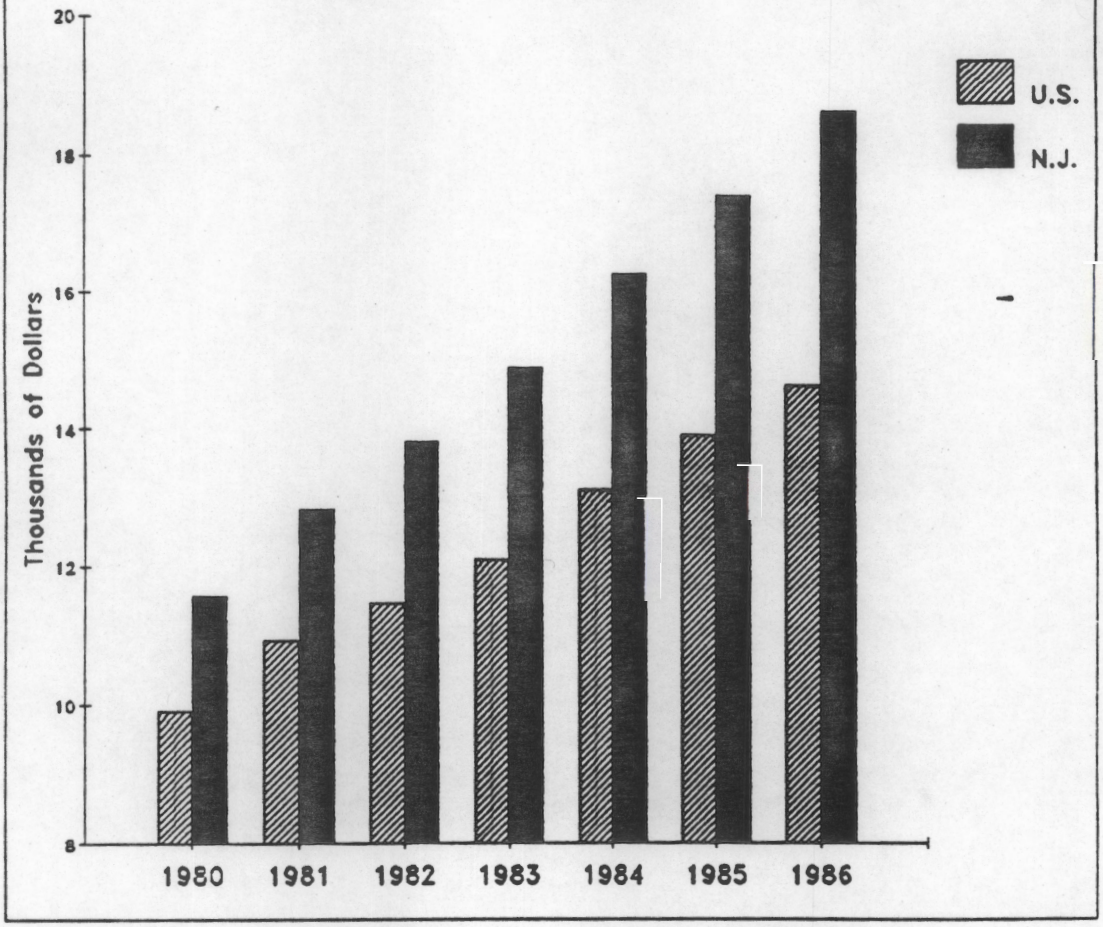
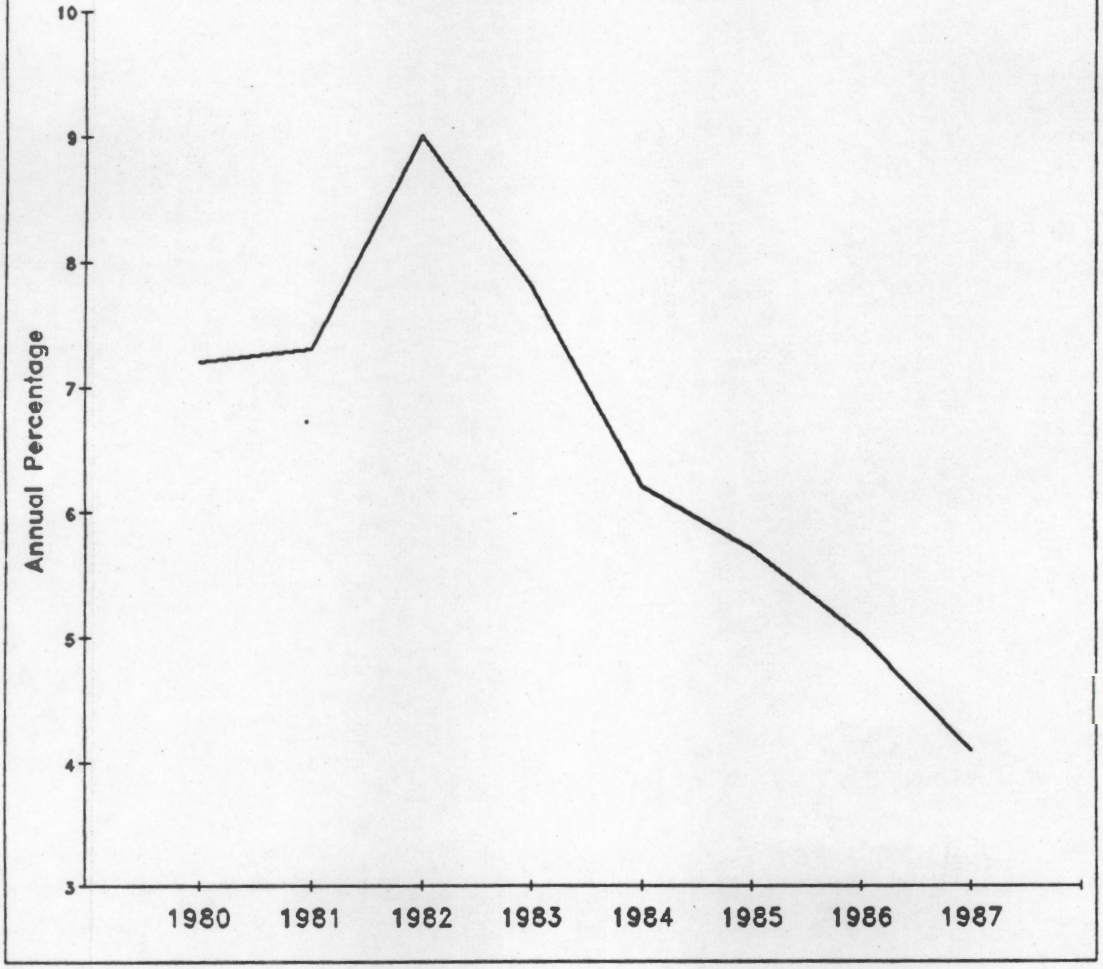


Figure 3

NEW JERSEY'S UNEMPLOYMENT RATE



o Between 1982 and 1986, almost 133,000 new business corporations were formed in New Jersey, a 30 percent increase over the preceding five years (see figure 3). During the first eight months of 1986, business incorporations rose 12 percent over the previous year, a rate that was more than double the national average.

o While the state ranks ninth in population, it ranks third both as the location of Fortune 500 company headquarters and as the location of the Forbes 200 wealthiest small companies. These lists include companies in pharmaceuticals, chemicals, scientific equipment, aerospace, forest products, and food products.

o Over 262,000 new housing starts occurred in New Jersey between 1982 and 1986. In 1987, the state added 59,500 units, up from 18,890 new units in 1982. The 215 percent increase in housing starts between 1982 and 1987 was more than double the 87.6 percent growth rate for the nation.

Projections show that New Jersey's economy will continue to expand. Its job base is expected to increase almost 37 percent by the year 2000, and its unemployment rate is expected to remain well below that of the nation. Continued economic strength depends in part upon the ability of state and local governments to provide essential services, such as affordable housing, and amenities that make New Jersey an attractive place to live and work.

OVERVIEW OF THE STATE'S PUBLIC SECTOR

This section examines the structure of government in New Jersey and the way in which the state and local governments allocate expenditures.

New Jersey Government Structure

New Jersey has 1,765 units of government including 21 counties, 567 municipalities, 616 school districts, and many special districts and independent authorities. New Jersey has traditionally been governed mainly at the local level by a myriad of small units financed by a locally imposed property tax.

Figure 4

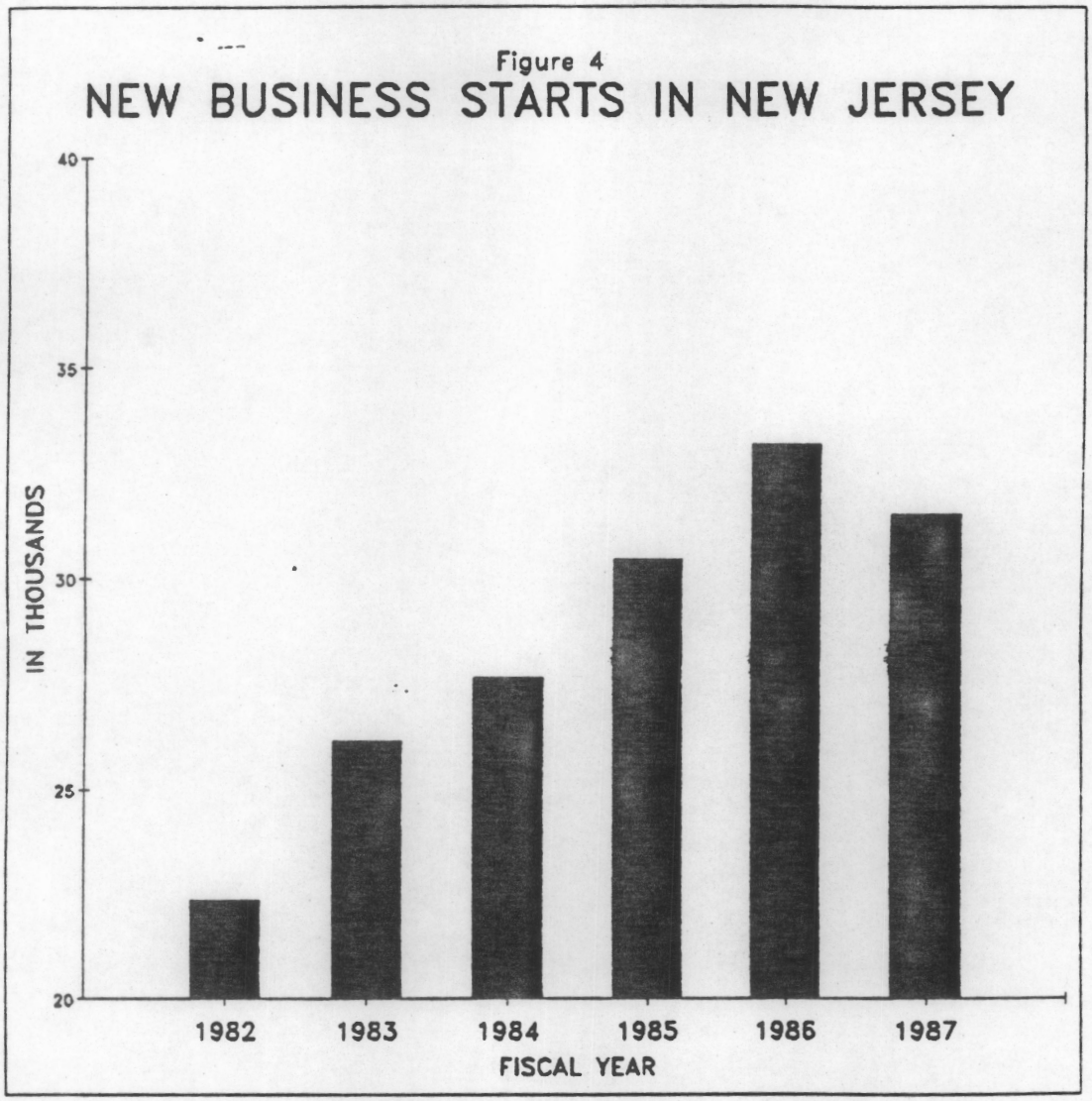

NEW BUSINESS STARTS IN NEW JERSEY
40
35
30
25
20
IN THOUSANDS
1982
1983
1984
1985
1986
1987
FISCAL YEAR

Figure 5

HOUSING STARTS
NEW JERSEY AND THE UNITED STATES

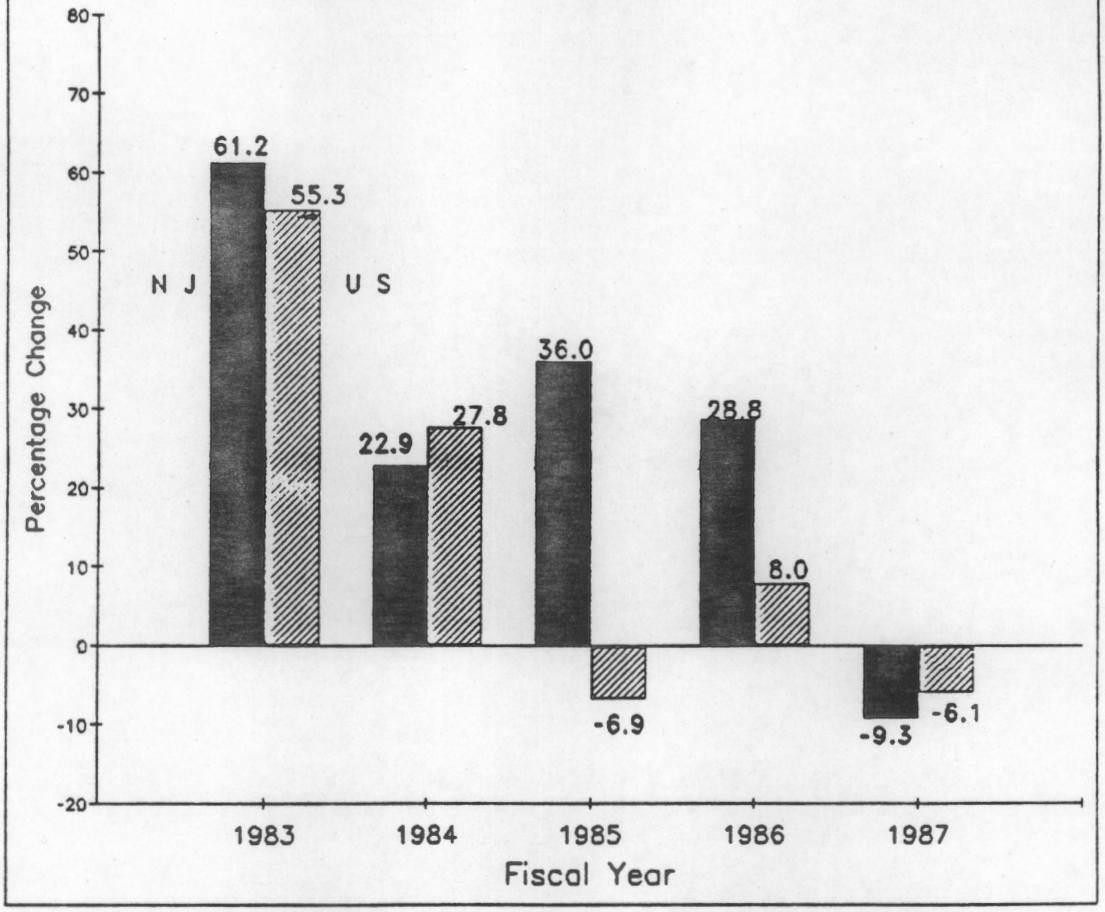


Table 1

New Jersey's Governmental Units, 1985

State Government	1
State-level public authorities and special taxing districts	24
Total state	25
Local Government	
Counties	21
Municipalities	567
School districts	616
Local public authorities and special taxing districts	536
Total local	1,740
Total State and Local Governments	1,765

Source: Compiled by Commission Staff, using information from United States Bureau of the Census; New Jersey Statutes Annotated; State of New Jersey Annual Financial Statement, Year Ending June 30, 1985; New Jersey Department of Education; and New Jersey Department of Community Affairs.

New Jersey was one of the last states to impose a broad-based state sales tax when it introduced a three percent sales tax in 1966. This tax, which was increased to 5 percent in 1970 and to 6 percent in 1983, helped to finance a substantial growth in government services provided by the state or by local governments with state aid. Local governments continue to provide the services that state law authorized them to provide, such as education, police and fire protection, sanitation, public works, and recreation. However, the growth of state government functions, such as Medicaid, environmental protection, and the state college system, resulted in a much more centralized government structure, where centralization reflects the importance of state spending in total State and local spending. Between 1969 and 1982, New Jersey moved from the least centralized, ranked 50th among all the states, to among the most centralized, ranked 20th.

The shift of government responsibility from the local to the state level gained additional impetus in the school finance crisis of the early 1970s. This crisis culminated in the enactment of a new school aid formula in 1975 and the state's income-tax in 1976. These changes were part of a financial reform program in the early 1970s which markedly changed the fiscal picture in New Jersey. While the sales tax financed the growth in state government functions, the income tax financed the growth in state aid to local governments, school districts, and taxpayers. Indeed, an amendment to New Jersey's Constitution dedicates all income tax revenues to property tax relief.

The State Budget: Where the Money Goes

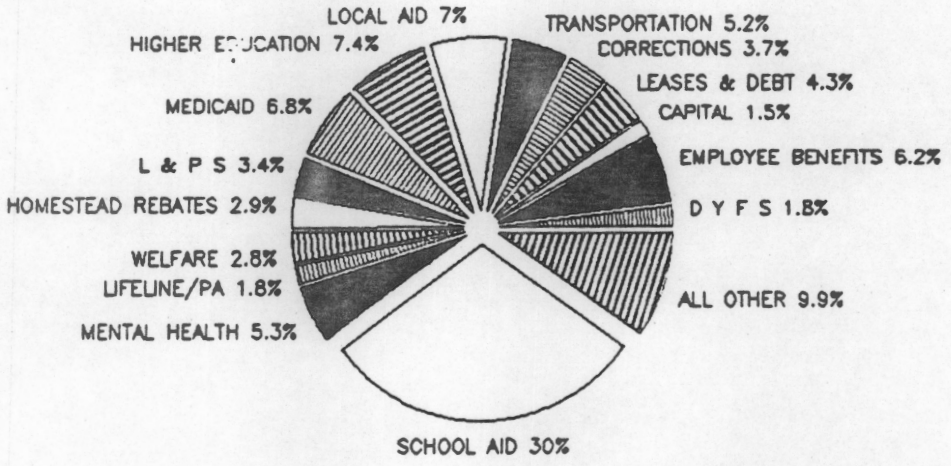
In fiscal year 1988, which ends June 30, 1988, the state anticipates spending $10.5 billion for direct services, state aid to local governments and school districts, capital construction, and debt service. This figure does not include the $2.5 billion in federal aid which the state receives nor almost $1 billion in non-budgeted funds, most of which consist of utility taxes collected by the state and largely distributed to municipalities. The amount budgeted for 1988 is 122 percent greater than the $4.7 billion spent in fiscal 1980, an average increase of 10.5 percent annually.

More than 90 percent of the budget is concentrated in 15 major programs (Table 1). By far the largest area of spending, more than one-third of the total, is for aid to local governments and school districts. These grants totaled $3,884 million in fiscal 1988. Medicaid, public assistance, Homestead Rebates, and Lifeline and Pharmaceutical Assistance account for an additional $1,505 million or 14 percent of the budget. Total spending for these programs and state aid has declined to 51 percent of the overall state budget from 60 percent in 1980.

Operating state institutions and other programs for higher education, human services (the mentally ill and retarded), and corrections takes 16 percent of the budget. An additional ten percent is for public safety, protective

Figure 6

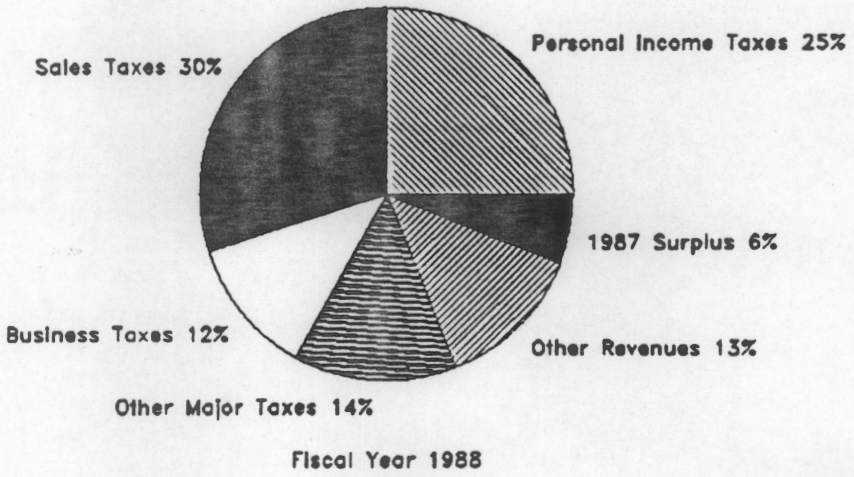
THE NEW JERSEY STATE BUDGET: WHERE THE MONEY GOES



FISCAL YEAR 1988

Figure 7

NEW JERSEY STATE REVENUES



Fiscal Year 1988

services for children and the elderly, and transportation, including capital spending for the state's road network. The budget for employee benefits, rent, debt service, and capital spending for state facilities (but not transportation) was $1,261 million, or 12 percent of total spending in fiscal 1988, up from 9 percent in fiscal 1980.

Each of these 15 major programs is important because of its current size or recent growth rate. Several of the programs have grown more rapidly than total state revenues while others have declined in relative terms. Some of the observed changes are the result of deliberate State policy decisions while others stem from economic or demographic forces beyond the immediate control of state policymakers.

Municipal and County Budgets

Municipalities budgeted $4,186 million and counties budgeted an additional $2,413 million in fiscal 1987. Of this amount, municipalities anticipated raising $1,711 million, or 41 percent of the total, through property taxes, while counties anticipated raising $1,640 million, or 68 percent through property taxes. The 1987 municipal budgets represent a 65 percent increase over the amount actually spent in 1980 while the county budgets for 1987 were 56 percent higher.

Six programs account for 83 percent of total municipal expenditures on average, with most of the direct spending concentrated in public safety and public works. In 1985, the most recent year for which detailed data are available, approximately 28 percent of the average municipal budget was for public safety, although the percentage varies depending upon whether the municipality has a paid fire department. An additional 9 percent was spent on waste removal (trash and garbage, plus sewers and sewerage), and these expenses have been increasing more rapidly than average. In 1985, municipal governments spent slightly over 7 percent of their budgets on streets and drainage, a decline from the 9 percent spent in 1980. Debt service (10 percent of all spending), general government (19 percent), and pensions and benefits (10 percent) all increased more rapidly than the overall budgets.

Table 2

Major Programs in the New Jersey State Budget, 1980 and 1988

(Does not include federal funds.)

	1980		1988		Average Annual Growth Rate (80-88)
	Expended (in millions)	Pct. of Budget	Budgeted (in millions)	Pct. of Budget	
MAJOR PROGRAMS:					
Aid to Local School Districts	$1,476.5	31.2%	$3,151.0	30.0%	9.9%
Aid to Municipalities and Counties	474.5	10.0%	732.7	7.0%	5.6%
Medicaid	296.4	6.3%	712.9	6.8%	11.6%
Public Assistance	247.1	5.2%	297.6	2.8%	2.4%
Lifeline/Pharmaceutical Assistance	57.9	1.2%	188.8	1.8%	15.9%
Homestead Rebates	276.6	5.8%	305.5	2.9%	1.2%
Higher Education	371.0	7.8%	773.8	7.4%	9.6%
Mental Health and Developmental Disabilities	252.6	5.3%	556.3	5.3%	10.4%
Transportation	250.8	5.3%	546.8	5.2%	10.2%
Law & Public Safety	131.4	2.8%	358.4	3.4%	13.4%
Corrections	87.6	1.9%	383.3	3.7%	20.3%
Youth and Family Services	56.1	1.2%	192.4	1.8%	16.7%
State Employee Benefits	237.3	5.0%	653.8	6.2%	13.5%
Leases and Debt Service	187.0	4.0%	453.2	4.3%	11.7%
Pay-as-you-go Capital	18.8	0.4%	154.7	1.5%	30.1%
Total, Major Programs	$4,421.6	93.5%	$ 9,461.2	90.1%	10.0%
TOTAL STATE BUDGET	$4,730.6		$10,497.3		10.5%

Source: Compiled by Commission Staff from State of New Jersey Budget, Fiscal Year 1982 and 1988, Trenton, New Jersey

The county budget is spread among a wider set of programs, with 8 programs accounting for 75 percent of the expenditures in 1985. Spending for various health programs, including the maintenance of patients in state institutions, accounted for 18 percent of total expenditures. Judicial costs, including the courts, prosecutors, and corrections, made up an additional 14 percent, with other public safety expenditures, primarily for the sheriff's office, another 3 percent. Spending for all of these programs has grown more rapidly than the total county budget. By contrast, spending for roads and bridges (4 percent of the total) and the welfare board (7 percent, consisting of AFDC benefits and administration) have grown less rapidly than average. As in the municipalities, debt service (8 percent of the total budget), pensions and fringe benefits (9 percent), and general government (12 percent) have also increased more rapidly than the total budget. For several of these programs, the level and rate of growth of spending is largely determined by factors beyond the immediate control of policymakers in the county or municipality.

III. DYNAMICS OF STATE SPENDING

This chapter examines the spending trends and determinants for 15 major areas of state spending which account for more than 90 percent of total state spending.

AID TO LOCAL SCHOOLS

Aid to local schools falls into six broad categories, three of which were established by the Public School Education Act of 1975, also known as Chapter 212. These three programs are: general formula aid, which supports the general program of the local district; categorical aid, which supports programs in special, compensatory, bilingual, and some vocational education; and transportation aid. Chapter 212 also provides aid for debt service and capital outlays, and the state has enacted three bond programs to assist selected districts with their capital needs. The state also pays the employers' contributions for teachers' pensions and social security. The final category,

miscellaneous grants, consist largely of special initiatives such as the minimum teachers' salary or urban initiative programs and aid to non-public schools and adult education. General formula aid is the single largest program in the state budget.

The growth of expenditures in the following programs has exceeded the average growth of the total budget.

- Categorical aid, with an average annual growth of 13 percent, reached $472 million in fiscal 1988.

- Miscellaneous grants were $38 million in fiscal 1980 and $149 million in fiscal 1988, an average increase of 19 percent annually.

- Teachers' pensions were $303 million in 1980 and $692 million in 1988, an 11 percent annual increase.

Relatively slower growth has occurred in several areas.

- Actual spending for general formula aid, which has increased 9 percent annually on average, reached $1,553 million in fiscal 1988.

- Debt service and capital aid, with average increases of 4 percent annually, reached a total budget of $106 million in fiscal 1988.

- Transportation aid, which was $179 million in fiscal 1988 and $95 million in fiscal 1980, experienced an average annual increase of 8 percent.

The growth in categorical aid can be attributed to:

- increasing numbers of pupils classified as in need of special education, so that the percentage of classified pupils in New Jersey exceeds the national average; and

- the addition of new categorical aid programs for special education in state facilities and for the preschool handicapped.

Spending for teachers' pensions and social security responds to several factors:

- Increased salaries for teachers and other members (e.g., principals) of the Teachers Pension and Annuity Fund cause increases in spending.

- Increases in the social security tax rate and base result in additional expenditures.

- Increases in the Consumer Price Index serve as the basis for cost-of-living adjustments (COLAs) to the pensions for retired teachers.

Miscellaneous grants in aid have increased for two principal reasons:

- Several new initiatives, notably the minimum teachers' salary ($59 million or 40 percent of the miscellaneous grants in fiscal 1988), have been introduced.

- Increased funding for existing programs such as the $31 million for non-public school aid in fiscal 1988, has led to greater spending.

AID TO MUNICIPALITIES AND COUNTIES

The state provides aid to municipalities and counties through a number of relatively small programs, some of which are targeted to address specific problems or areas, while other programs provide general assistance.

- Aid to municipalities and counties has grown an average of 5.6 percent annually, from $474 million in fiscal 1980 to $732 million in fiscal 1988.

- In fiscal 1980, ten percent of the state budget went to municipalities; in fiscal 1988, the figure was seven percent.

- Aid to counties increased from $74 million in fiscal 1980 to $155 million in fiscal 1988.

- Aid to municipalities increased from $400 million in fiscal 1980 to $577 million in fiscal 1988.

Changes in aid to municipalities and counties have occurred in selected programs.

- The only significant increases in municipal aid have been in the distressed cities program, begun in 1987 with $12 million and budgeted at $70 million in 1988, and aid for safe and clean neighborhoods, which increased from $16 million in fiscal 1982 to $51 million in fiscal 1988.

- Business personal property replacement revenues of $159 million and state revenue sharing of $50 million have been constant since 1978.

- The growth of aid to counties includes the addition of the county welfare equalization aid program in 1981. Funding has remained at $15 million since then.

- Aid to county colleges doubled between 1980 and 1988, reaching $108 million in 1988. This program accounts for most of the aid to the counties, even though the goal of having the state pay 43 percent of the costs of the county colleges has not been met.

- To the extent that aid is distributed according to a formula, the formulas have been used to distribute a fixed amount of money rather than to generate an open ended entitlement, as in school aid.

The above analysis excludes a substantial amount of state aid to municipalities and counties provided through "off budget" appropriations. Off-budget appropriations are dedicated funds or funds with restricted use from state or federal sources. These funds are channeled through the State Treasury by specific language in the annual appropriations law. The trend in this type of state aid parallels the state aid trends noted earlier. From fiscal 1981 to fiscal 1988, off-budget state aid increased from $510 million to $726 million, an average annual rate of 4.5 percent.

MEDICAID

Medicaid pays for medical services for two distinct groups of individuals who receive cash assistance under other federally sponsored programs. The larger group consists of recipients of Aid to Families with Dependent Children (AFDC) or individuals deemed Medicaid-eligible under rules related to AFDC. AFDC recipients use physicians and out-patient hospital services and account for less than one-third of Medicaid costs, even though they constitute more than two-thirds of the total eligible population. The smaller group of eligible individuals are recipients of Supplemental Security Income (SSI), primarily the elderly, who account for more than two-thirds of expenditures, primarily through their use of long-term care such as nursing homes and in-patient hospital services.

States share the costs of Medicaid with the federal government. In New Jersey, the state share is approximately 50 percent of total spending. States can require local governments to participate in the non-federal share of the program and may also impose cost sharing requirements on recipients or their families through premiums, co-payments, deductibles, enrollment fees, or co-insurance. From the standpoint of the recipient, Medicaid is an in-kind service, with payment going to the provider. Traditionally, Medicaid has reimbursed providers for some portion of the actual costs incurred. Alternatively, fees may be set in advance, using a rate-setting mechanism.

- In fiscal 1988, New Jersey anticipates spending at least $713 million for Medicaid, to be matched by a like amount of federal funds.

- Medicaid spending has increased an average of 12 percent each year since 1980.

Increases in spending for Medicaid are driven by two factors largely beyond the control of state policy makers:

- Health care costs, which increased 52 percent between 1980 and 1985 increased 21 percentage points more than the general rate of inflation during the same period. The inflation in health care costs has been particularly pronounced for nursing homes and hospitals, which make up almost 60 percent of all Medicaid expenditures; and

- Increased consumption of services, particularly by the elderly, who tend to use more expensive services than other eligible groups.

State policy makers have more control over other factors that influence the cost and growth of the program:

- Within broad limits established by the federal government, the state can determine who is eligible for services by setting income limits and other standards. New Jersey has expanded eligibility standards by including the medically needy, raising the income threshold, and accepting the federal options for additional groups, such as mothers and children not on AFDC. As part of its program to provide job training for welfare recipients (REACH), the state will continue Medicaid coverage to participants who would otherwise be ineligible. No federal match will be received for these costs.

- There are 29 optional services that a state may offer in addition to the 10 that the federal program requires. New Jersey offers 26 of the 29 optional services, making its program among the most comprehensive in the nation.

- A state may try to contain costs through the reimbursement method. New Jersey has moved to a rate-setting mechanism for hospital costs in an effort to contain their growth. Nursing homes, however, are reimbursed on a cost basis. Fees for physicians and other providers have been relatively constant since the 1970s.

- When the federal government reduces funding, as it did in 1981, a state must assume the reduction by increasing its share of the cost or by reducing services. New Jersey has generally increased its contribution rather than reduce services.

- New Jersey has chosen not to require local governments to share in the costs of the program. New Jersey also imposes relatively few cost sharing requirements (co-payments) on recipients or their families.

PUBLIC ASSISTANCE

There are three public assistance programs in which the state participates: Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI) for the elderly and the disabled, and General Assistance (GA) for individuals ineligible for AFDC or SSI. The federal government pays 50 percent of total AFDC costs and the counties pay 12.5 percent. State SSI payments supplement the basic federal SSI grant and are shared with the counties (25 percent). General Assistance is a state and municipal program in which the state pays 75 percent of the costs.

- Since fiscal 1980, the state's public assistance costs have increased $50 million (20 percent), an average increase of 2.4 percent annually.

Public assistance costs are determined by two factors:

- The caseload depends upon eligibility criteria and economic and demographic changes. The AFDC caseload declined from 466,000 in fiscal 1980 to an estimated 343,000 in fiscal 1988, a 26 percent decline. The SSI caseload has been steadily increasing, from 78,000 in fiscal 1980 to 90,000 in fiscal 1988.

- The amount of the grant is set through the annual budget process. The AFDC grant was increased 7 percent in fiscal 1981, an additional 7 percent in fiscal 1985, 5 percent in fiscal 1986, and 5 percent again in fiscal 1988.

LIFELINE AND PHARMACEUTICAL ASSISTANCE

These programs provide assistance to the elderly and the disabled for the cost of prescription drugs and utilities. The prescription drug program, Pharmaceutical Assistance for the Aged (PAA) was begun in 1977. After the approval of casino gambling, the program was expanded by raising the income eligibility for the elderly and including individuals who meet the higher income standards and who are disabled. The expanded program is called Pharmaceutical Assistance to the Aged and Disabled (PAA/D). Both programs now require that the recipient pay $2.00 for each prescription.

In 1979, the Lifeline Credit program was enacted and expanded the concept of targeted assistance to include utility bills. New Jersey residents who are eligible for PAA/D, SSI, Medicaid, or Lifeline receive a credit of up to $225 per year on their combined gas and electric utility bills, and the state reimburses the utility company. Tenants may receive a cash payment of up to $225 per year if they do not pay their utility bills directly. The Lifeline program is funded from taxes on casino revenues.

- The growth of these programs has averaged almost 16 percent annually. The 20.5 percent annual growth in PAA/D has been higher than that in PAA's 6.5 percent annual growth because increases in social security and other retirement benefits have pushed many households over the threshold for PAA.

Several factors affect the size and growth of the programs:

- The amount of the co-payment required for PAA and PAA/D was increased from $1 to $2 in 1978, but attempts to increase it from $2 to $3 have been defeated in the legislature.

- The prices of prescription drugs have been increasing. This may be controlled slightly by requiring that generic drugs be substituted whenever possible.

- The amount of the Lifeline Credit, which was $100 in 1980 has been raised almost annually since then, reaching the present $225.

- Demographic changes and changes in the definition of eligibility have increased the population eligible for the programs.

HOMESTEAD REBATES

The homestead rebates were enacted as part of the personal income tax package in 1976 to provide direct property tax relief to homeowners through an offset to property taxes rather than through a credit or other mechanism. The amount that a homeowner receives is determined by the property taxes paid and the value of the homestead. All homeowners receive a rebate.

- The increase in this program has been modest, only 10 percent between 1980 and 1988.

- The relative importance of the homestead rebates has declined. In 1988, the rebates totaled $306 million and represented seven percent of residential property tax revenues, compared to 14 percent in 1977, when $277 million was expended. In 1977, the rebates were 42 percent of revenues from the personal income tax; in 1987, the figure was only 12 percent.

- The amount of the rebate is slightly higher for low income households. In 1986, households with incomes under $10,000 per year received an average of $200; households with incomes above $200,000 received $191. The average rebate was $195 per household.

- As a percentage of income, the rebates are progressive. The rebate averages 3.8 percent of income for a household with a family cash income of $10,000 but 0.3 percent of income for a household with a family cash income between $50,000 and $75,000.

- Growth in the amount of the homestead rebate results from changes in the effective property tax rate factor. This factor is given relatively less weight in the formula compared to the property value factor, which has been effectively capped.

HIGHER EDUCATION

The state budget provides support for nine state colleges, Rutgers University, the University of Medicine and Dentistry of New Jersey (UMD), and the New Jersey Institute of Technology (NJIT), and grants to other colleges and universities in the state for particular programs. The state also provides aid to the county colleges and to individual students. Spending for the county colleges is included in the total for intergovernmental aid.

- Since fiscal 1980, spending for higher education has declined slightly from 7.1 percent of total spending to 6.7 percent in fiscal 1988. These figures do not include aid to the county colleges.

- Support for Rutgers, UMD, and NJIT has grown 10.1 percent on average annually, compared to 8.4 percent for the state colleges.

- Spending for support for private institutions, challenge grants, and other centrally administered functions increased an average of 9.6 percent annually from $29 million in fiscal 1980 to $60 million in fiscal 1988.

- Direct student aid increased from $35 million in fiscal 1980 to $70 million in fiscal 1988, an average annual growth rate of 10 percent.

Spending levels for higher education are determined by:

- The size of the institution

- Quality factors, such as the breadth of the course and program offerings and the faculty workload

- The relative balance between tuition and state support

According to the policy of the Board of Higher Education, tuition should cover 30 percent of the cost of undergraduate education at Rutgers and the state colleges.

MENTAL HEALTH AND DEVELOPMENTAL DISABILITIES

The state operates seven institutions for the mentally ill and nine institutions for the developmentally disabled. Since the mid 1970s, the policy has been to serve clients in the least restrictive environment possible. The community care program for the developmentally disabled consists primarily of group homes. In mental health, the state provides general subsidies to community mental health centers.

- Throughout the 1980s, the state spent slightly more than five percent of its budget ($556 million in fiscal 1988) on programs for mental health and the developmentally disabled. Of the $556 million budgeted in fiscal 1988, the state spent proportionately more on community care and less on institutions than in fiscal 1980.

- In fiscal 1988, the state received $115 million in federal funds for Intermediate Care Facilities for the Mentally Retarded and must adhere to federal accreditation standards for institutions. The state also received $19 million for community care for the developmentally disabled.

- In fiscal 1988, the Division for the Developmentally Disabled had 900 more clients than in fiscal 1980, and 43 percent or 3,999 out of 9,235 were in community-based programs, such as group homes. In 1980, only 13 percent or 1,074 out of 8,336 clients were in comparable programs.

- The number of patients in state mental hospitals declined 30 percent from 3,740 to 2,639 between fiscal 1980 and fiscal 1988, almost the same percentage as the decline in patients in state facilities for the developmentally disabled.

- o Expenditures for the developmentally disabled have increased 13.5 percent per year on average compared to 7.5 percent for mental health. In both cases, expenditures for community programs increased three times more rapidly than expenditures for institutional care.

Spending levels and patterns have changed due to policy decisions that:

- o Individuals should be treated in the least restrictive environment possible rather than be institutionalized.

- o Facilities should be maintained and upgraded rather than closed.

- o Community mental health services should be more widely available.

TRANSPORTATION

The state's transportation program falls into three categories: bus and rail subsidies, capital construction, and on-going maintenance. Bus and rail subsidies are paid to New Jersey Transit to supplement federal grants, fares, and other revenues, such as leased space or advertising. On-going maintenance includes activities such as road repair, snow removal, and engineering. Since 1985, capital construction programs have been financed through the Transportation Trust Fund.

- o Since fiscal 1980, total spending for transportation has increased at approximately the same rate as the overall budget. In fiscal 1980, the state spent $251 million or 5.3 percent of its total budget for transportation; in fiscal 1988 the state spent $547 million or 5.2 percent.

- o During the 1980s, bus and rail subsidies increased from $90 million to $175 million for an average annual increase of 8.7 percent.

- o On-going maintenance increased 8.1 percent annually from $102 million in fiscal 1980 to $190 million in fiscal 1988.

- Meanwhile, capital construction increased from $59 million to $181 million, with $143 million of the total dedicated to the Transportation Trust Fund (TTF). The total amount dedicated to the TTF will increase to $331 million per year.

- In fiscal 1988, fares covered 53 percent of New Jersey Transit's costs of rail operations and 62 percent of bus operating costs. The rail subsidies are 41 percent of costs, with other revenue making up the remaining 6 percent. Bus subsidies are 35 percent of costs, and other revenues make up 3 percent. These percentages have remained relatively constant during the 1980s.

Changes in funding for transportation respond to decisions regarding:

- The availability of public transportation and the appropriate mix of fares and subsidies

- The creation of the Transportation Trust Fund which will require capital appropriations for several years to retire debt

- The relatively slower growth for direct maintenance

LAW AND PUBLIC SAFETY

The Department of Law and Public Safety includes the major divisions of Criminal Justice, Law, the State Police, Gaming Enforcement, and Motor Vehicles. The expenses of the Division of Gaming Enforcement are borne by the casino industry through fees credited to the Casino Control Fund.

- In fiscal 1980, the department spent $132 million, including $12 million for gaming enforcement. The amount spent represented 2.8 percent of the state budget.

- In fiscal 1988, the total budget for the department was $358 million, including $34 million for gaming enforcement. The amount budgeted was 3.4 percent of the total budget.

- The total increase in the department's budget was 173 percent, or an average of 13.4 percent each year.

- Spending reflects staffing levels and decisions regarding the methods to be used by the Division of Motor Vehicles to register drivers and for inspecting and registering vehicles as well as increases in the State Police.

CORRECTIONS

The state provides a variety of prison facilities and programs ranging from supervision to maximum security incarceration. In 1979, the state enacted a revised Code of Criminal Justice, which had as one goal making the sentencing process more uniform, swift, certain, and severe by increasing the probability and length of incarceration for all classes of offenders. Subsequent legislation has further increased the scope of these policies.

- Since fiscal 1980, the budget for the Department of Corrections has increased more than 300 percent from $88 million to $383 million.

- The budget increase stems directly from an increase in the number of state inmates. In fiscal 1980, the state correctional facilities held 6,400 inmates; in fiscal 1988 the figure was estimated to be 18,000.

The increase in the number of prisoners in turn resulted from changes to the criminal code, specifically:

- Required sentences for certain offenses

- An increase in the time to be served before parole

As a result of the changes in eligibility for parole, the current prison population size will be maintained through the 1990s.

YOUTH AND FAMILY SERVICES

The Division of Youth and Family Services (DYFS) is charged with administering the state's child welfare laws and policies, including the development of a network of foster homes and subsidized adoption placement. The division has offices in each county. The counties pay for 25 percent of the costs of foster care and subsidized adoption. The Division makes extensive use of federal funds, particularly from the Social Services Block Grant, to provide services.

- In fiscal 1988, the Division's budget was $192 million, an increase of 242 percent over the $56 million spent in fiscal 1980. The cost of foster care, subsidized adoption, and other out-of-home placements was $74 million in fiscal 1988.

- The number of children under supervision has increased from approximately 42,000 in 1980 to 52,000 in fiscal 1988.

The increased budget has resulted from:

- The amount of federal funds available to DYFS, which is $16 million less than the amount received in fiscal 1980

- The assumption of cost increases in the federally-funded services, including the salaries of caseworkers, rather than a reduction in services

- Commitment to a staffing pattern based upon national workload standards for caseworkers

- An increased number of out-of-home placements

- Expansion of programs to include shelters for the homeless

- Expansion of the mission to include programs for abused elderly as well as abused children

STATE EMPLOYEE BENEFITS

State employee benefits consist of employee pensions, cost-of-living adjustments (COLAs), health benefits and social security. Employees contribute to the pension fund, with the contribution rate based upon the employee's age at entry into the system. The state pays for two percent of the contribution, however, as an offset to the employee's contribution to social security. No employee contribution is required for the basic health care plan, although there are both deductible and co-payment provisions. Recently, the state has encouraged the use of health maintenance organizations (HMOs), some of which do require regular contributions but which make no additional charge for services. Retired employees receive COLAs equal to 60 percent of the change in the consumer price index in addition to their regular pensions. The state also extends health care benefits to employees who retire with 25 or more years of service.

- Basic pension contributions are the largest employee benefit cost item, $236 million in fiscal 1988, followed by social security ($195 million) and health care benefits ($189 million).

- Expenditures on employee benefits increased at an average annual rate of 13.5 percent between fiscal 1980 and fiscal 1988, reaching $654 million in fiscal 1988. Health care costs have increased most rapidly over the period (15.2 percent on average) while basic pension benefits increased least (12 percent). COLAs and social security costs increased at the same rate of 13.9 percent annually.

Increased spending for employee benefits has resulted from:

- The increase in the size of the state workforce, which has grown 10 percent since 1980

- Increases in the average level of wages for state workers. The average salary of a state employee increased 84 percent between 1980 and 1988

- Increases in employer social security contributions resulting from federal policy changes

- Increases in the consumer price index which serves as the basis for COLAs

- Lack of integration of employee state pensions with social security benefits received

- Replacement ratios for state pension benefits

- An increase in the number of retired workers, both regular and early retirees, and in their expected lifespan after retirement

- The two percent offset for employees contribution to social security

- Full state funding of basic coverage of health care benefits for employee dependents

COLAs and health care benefits for retired state employees are funded through the annual budget rather than through the pension funds. Employees make no contributions toward these benefits.

FIXED COSTS
(Rent and Debt Service)

Fixed costs consist of expenditures by the state to meet lease agreements and expenditures to meet debt service obligations. Budgeted expenditures for fiscal 1988 totaled $453 million, or 4.3 percent of the state budget.

The major portion of this total ($348 million) is used to meet the debt service requirements on $2,774 million in outstanding indebtedness as of June 1987.

- Fixed costs have increased a total of 142 percent between fiscal 1980 and fiscal 1988, an average annual increase of almost 12 percent. The average annual increase in expenditures for rent and leases was 21.2%, more than double the 9.8% increase in spending to service outstanding debt.

- Debt service was budgeted at $348 million in fiscal 1988, an increase of $184 million over the amount budgeted in fiscal 1980.

- The state's rent budget increased from $22 million in fiscal 1980 to $105 million in fiscal 1988.

These increases have been caused by:

- An increase in the size and scope of government operations, which requires additional office buildings and other facilities

- A commitment to long-term leases for office space built for the state by public authorities

- An increase in the state's outstanding debt, from $1,775 million in 1980 to $2,774 in 1988

While some of the earlier debt has been retired, New Jersey's voters have approved 19 bond issues worth $2.4 billion since 1980, much of which has yet to be issued.

PAY-AS-YOU-GO CAPITAL (excluding Transportation)

The non-transportation capital budget of the state pertains to funds for the construction of new physical facilities, the procurement of selected equipment, major repairs and rehabilitation to existing state-owned facilities,

and for major environmental programs, such as toxic waste clean-up, park improvements, and flood control. Pay-as-you-go capital expenditures are financed from general revenues rather than through the issuance of debt. These capital expenditures totaled $155 million or 1.5 percent of the fiscal 1988 budget, a 700 percent increase over the $18.5 million budgeted annually from 1980 through 1988.

The increase has been made necessary by:

- The increase in size and scope of government operations
- Growing environmental concerns
- The high level of interest rates
- Recession-induced deferred maintenance of the state' facilities

PERSONNEL

Personnel is generally the largest component of the costs of direct state services. Although some services are provided through contracts with private providers, most direct services are provided by employees of the state, and employees are required to administer the contracts and the aid programs. Exclusive of state aid, grants to individuals, and debt service, the largest cost center within the major programs of state government is personnel.

Personnel costs are translated into budgeted dollars in several categories, including:

- Basic salaries of employees
- Annual salary increases (across-the-board raises)
- Merit increments
- New employees
- Pension allocations
- Health benefits
- Social security
- Miscellaneous expenses, such as clothing allowances
- Reclassifications and salary adjustments

This section discusses dollars appropriated for employee salaries, including increments and across-the-board raises, and changes in the number of employees.

- Approximately $1,850 million (not including federal dollars) is allocated for salary costs of state employees in the fiscal 1989 budget. In addition, the state supports approximately $210 million of the salary costs at Rutgers, University of Medicine and Dentistry of New Jersey, and New Jersey Institute of Technology.

- This $2,060 million represents 19.6 percent of the total budget, but 45 percent of the budget when state aid, debt service and capital construction are excluded. In fiscal 1980, 18.6 percent of the total budget went for salaries.

- When fringe benefits costs are added to salary costs, the cost of personnel in fiscal 1988 increases to $2,713 million and represents 26 percent of the total budget or 60 percent of the budget exclusive of state aid and capital financing.

- During the past eight years, the average increase per year in salary costs has been 10.1 percent.

The following discussion reflects increases in the number of employees on the payroll, including federally funded and special services positions, but not counting Rutgers and UMD.

- From December 1980 to December 1987, the state payroll increased 10.4 percent or less than 1.4 percent per year.

- The largest percentage increases during this time were in three departments: Corrections (92 percent), Environmental Protection (37 percent), and Law and Public Safety (22 percent). More than 3,800 new employees were added in the Department of Corrections as a result of significant expansion in the inmate population.

Table 3

State Personnel

	December 31, 1980	December 31, 1987	Average Annual Growth
Total Number of Employees	67,945	75,038	10.4%
Direct Salary Expenses	$ 703.9 million	$ 1,676.2 million	11.5%

Source: New Jersey Office of Management and Budget

Major determinants of spending patterns on personnel include:

- o across-the-board salary increases
- o increases in the size of the state workforce
- o merit pay increments

IV. MAJOR ISSUES

While New Jersey has a political tradition of home rule, local governments are legally creatures of the state. Their existence, functions, and powers are prescribed by the State Legislature. New Jersey's recent prosperity does not obscure several very real and significant problems in the state's fiscal system. First, several studies revealed that the school finance system has not produced its intended results. School districts with smaller tax bases are

still taxing more and yet spending less per pupil than districts with larger tax bases. Second, these poor municipalities are facing annual fiscal crises, deteriorating public services and facilities, and ever higher property tax rates.

The two problems are, of course, related. In Robinson v. Cahill, 62 N.J. 473 (1973), the New Jersey Supreme Court declared that a thorough and efficient school system could not be provided as long as "municipal overburden" inhibited poorer school districts from availing themselves fully of the funding power afforded them under the school aid formula.

New Jersey contains some of the nation's richest and poorest local jurisdictions. The extreme poverty, deprivation, joblessness, racial isolation, homelessness, and crime have made some of the state's major cities national symbols of misery --- even as New Jersey itself has become a national symbol of economic success. Based on an index that uses census data, the most recent research shows that eight of the nation's 25 most distressed cities are located in New Jersey. Updates to this index cannot be completed until data from the 1990 census are available. While changes have occurred in some cities since 1980, it is likely that the general patterns have not been significantly altered.

Even in areas that are not considered distressed, New Jersey's heavy reliance on local government and local taxes encourages ratable chasing and discourages more balanced economic development.

In addressing the more specific issues that follow, the Commission focused on the intergovernmental aspects of the state's fiscal system --- the role of the state and its local governments in delivering and financing services. Problems with the current fiscal relationships between and among units of government in New Jersey are the greatest threat to the continued ability of the public sector to accommodate the future needs of its residents. The issues addressed by this Commission are not new and they reflect ongoing political debates. Their resolution will require the development of a political consensus.

RELIANCE ON LOCAL GOVERNMENTS AND LOCAL TAXES

New Jersey's excessive reliance on local governments and local taxation pervades the delivery of public services. The State's reliance on local resources in education is currently being challenged in a major court case, Abbott v. Burke. Local governments, especially counties, are forced to pay a large part of the costs of providing several state services. In addition, there are significant disparities in the size of the tax base available to finance services provided locally.

Local School Finances

The New Jersey school system is, in effect, two school systems. While many school districts provide an excellent education, other school districts, including many of those in urban areas, do not. The school districts where pupils do least well on measures of performance are school districts with few resources and low current expenditure levels, which have trouble attracting the best teachers, maintaining their physical facilities, and delivering good educational services.

In the legislation that established the Commission, we were asked to conduct a comprehensive study of the ways in which state financing of education has been implemented and to recommend structural changes in the education aid formulas consistent with the state's goals of providing a thorough and efficient education, equalizing local funding resources and addressing the special needs of students.

Net current expense budgets per pupil vary significantly among school districts within the state, ranging in 1986-87 from a high of $12,719 to as little as $2,269. The statewide average is $5,230. One-tenth of the school districts spend less than three-quarters of the state average per pupil while about one-fifth of the districts spend more than 125 percent of the state average.

There is no question but that some public school districts in New Jersey provide an education as fine as can be secured anywhere. We make no proposals that would jeopardize the programs of these schools. However, we find that the problems that prevent poor districts from reaching the state average in their educational program are worsening and must be addressed now before more serious decline takes hold. Because local taxes are the major source of funding for county and municipal governments as well as school districts, school expenditures must compete with other services and are often held down to avoid excessive total tax rates.

Several factors influence the level of educational performance within a school district. The Commission is aware that experts disagree about the effects of spending on educational performance. But we are convinced that we will not see significant educational improvements unless we raise spending and service levels in school districts that are performing poorly.

Despite some exceptions, school districts with high drop-out rates and low student performance are school districts with low resources and low expenditure levels. Of 19 school districts cited by the Department of Education in 1986-87 as having been uncertified for more than two years, 16 had below-average budget levels.

The Present State Education Aid System. State aid accounts for 43 percent of all elementary and secondary education expenditures in New Jersey, which is below the national average of 50 percent for the state share of elementary and secondary public school spending. This figure has been going up in New Jersey and nationally in recent years as state governments have increasingly taken a stronger leadership role in education reform.

The present system seeks to assure that all districts have access to equal resources for their locally determined programs and to pay for capital

improvements and debt service. The state also subsidizes the additional cost of educating children with special needs that prevent them from succeeding in regular school programs, including children who have academic, social, economic or environmental problems.

The present school aid system has not met its goals. Aid for locally determined programs and capital spending is based on the previous year's budget. Each district must therefore pay for necessary increases solely from its own resources. Prior-year funding discourages spending for needed programs and facilities, especially in poor districts which have the lowest spending levels and the least ability to raise taxes. The current system also is not consistent in the way it compensates districts for providing preventive and remedial programs for students at risk of failure. The state's Department of Education is now recommending to the Governor that the compensatory aid formula be changed to recognize the increased cost of remedial training in multiple skill areas for children with more than one deficiency. At the same time, however, the Department is also recommending to the Governor that the aid for each area be cut. The Governor will forward these changes to the Legislature and they will become effective in the absence of legislative action.

State aid for capital facilities assists school districts in paying debt service. As with equalization aid, these payments are a percentage of the prior year's debt service payments, with the percentage varying inversely with the wealth of the school district. Because state aid only covers a percentage of the prior year's debt service, school districts must bear the entire cost of starting a capital facilities program from their own property tax base, working a hardship on those districts that have trouble raising funds for their day-to-day efforts.

Allocation of Service Responsibilities

The current assignment of service responsibility between the state and local government does not always promote accountability, equity, and efficiency. Several services currently provided and financed by local governments, especially counties, could be better provided by the state.

The present fiscal structure exacerbates the problems of distressed areas and over reliance on local taxes:

- o Expenditures on services, such as the courts and public assistance, are a large or growing component of county budgets and therefore increasingly limit expenditures on discretionary local services.

- o There are significant variations in the levels, costs and quality of services among local jurisdictions. The highest caseloads and costs and lowest service quality are generally associated with the poorest jurisdictions.

- o There is inadequate accountability in that the jurisdictions that make the ultimate decisions about spending levels are not the same as the jurisdictions that bear the burden of raising revenues to finance the services.

Public Assistance. New Jersey's fragmented public assistance system is characterized by large disparities in caseloads and expenditures among counties and municipalities, by a lack of coordination among agencies providing related services or serving similar clientele, and by a lack of incentives to enable recipients to become more self-sufficient.

The history of welfare reform efforts has taught the country that income redistribution cannot be a local function. Even large better-off communities with diverse economies cannot implement public assistance programs effectively, and small and impoverished jurisdictions certainly cannot. Yet New Jersey's system of public assistance requires mainly distressed municipalities to pay a large share of welfare costs.

Public assistance in New Jersey consists of several components (see table below). The State of New Jersey pays for 75 percent of the non-federal costs of Aid to Families with Dependent Children (AFDC) benefits; counties pay 25 percent of benefit costs plus all non-federal administrative costs.

Supplemental Security Income (SSI) payments are made by the state in addition to the basic federal social security grant to the aged, disabled, and

blind. This is a federal payment, but many states, New Jersey included, supplement this amount. The State of New Jersey pays 75 percent and the counties pay 25 percent of the supplement.

Another important part of our system of safety net payments for the poor is General Assistance (GA). New Jersey provides cash and medical assistance to individuals, usually adult males or married couples without children, who do not fit one of the federally defined categories for AFDC eligibility. The state pays 75 percent and municipalities pay 25 percent of GA benefit costs plus all administrative costs.

Medicaid, which is the largest federally aided welfare program in New Jersey as well as one of the fastest growing, pays for health care for individuals eligible for AFDC and SSI. Of the $1 billion spent by the federal government and the State of New Jersey in 1986, nursing home care accounted for over one-third, and in-patient hospital care accounted for another third. Both services primarily benefit the elderly.

Municipalities in several counties, such as Bergen, Essex, and Hudson, are required to pay 25 percent of in-patient hospital costs for General Assistance recipients who are not covered by Medicaid. These costs account for half of Newark's and Jersey City's total expenditures on welfare benefits.

Table 4
Public Assistance in New Jersey, 1986

Program	Caseload	Non-federal costs (in millions)	Share of Non-federal Costs		
			State	County	Municipal
AFDC	367,766	$242.0	75%	25%	
SSI	86,964	$ 32.0	75%	25%	
GA	26,740	$ 78.0	75%		25%
EMERGENCY	2,000	$ 2.5	75%	25%	--
MEDICAID	283,000	$535.0	100%	--	--
Total Costs		$889.5	$801.0	$69.0	$20.0

Note: Figures may not total due to rounding.
Source: Compiled by Commission Staff from State of New Jersey Budget, Fiscal Year 1988, Trenton, New Jersey.

The State spent $266 million in 1985 for AFDC, SSI, GA and Emergency Aid benefits. Counties spent $69 million and municipalities spent $20 million, exclusive of administration costs. These county expenditures accounted for about five percent of all county property tax collections. All counties, however, do not bear comparable burdens. The proportion of a county's population receiving AFDC or General Assistance benefits in 1984 ranged from a low of 0.7 percent in both Hunterdon and Morris counties to a high of 13.8 percent in Essex. We are once again confronted with the problem of disparities: the wealthiest counties carried light caseloads, and the poorest counties bore heavy caseloads.

These fiscal disparities are reflected in local taxes. While Morris county devoted only 1.6 percent of its property tax levy to welfare, Essex spent 14 percent. Parallel disparities persist in the General Assistance program. Many municipalities have no General Assistance program costs. Alternatively, 13 communities accounted for 63 percent of total municipal expenditures on this program.

We focus attention on these welfare programs because of their intergovernmental implications. New Jersey is one of only 16 states relying on local governments to help finance and administer AFDC.

The Trial Court System. In 1982, the Supreme Court Committee on Efficiency concluded that New Jersey does not have a cohesive trial court support system. Expenditure decisions are made by 15 assignment judges, who are state employees. Those decisions are implemented by a group of employees paid by the counties. There is no single, centralized control over the allocation or use of court resources. Rather, the trial court system is a fragmented system characterized by inefficiencies resulting from duplication of activities, restraints on the use of resources, unclear lines of supervision and accountability, and inequities in funding and service levels. The fractionated system significantly increases costs and impedes efficiency.

Trial court costs are a large and growing portion of county budgets. Counties paid almost 82 percent of the $240 million in total costs in 1986. The State of New Jersey pays a smaller share of trial court system costs than all but nine other states.

Service levels and costs vary significantly among the 21 counties and, again, the poor bear a higher burden than the wealthy for providing this service. The costs range from Bergen County's low of $11.50 per capita to Essex County's high of $32.87. Statewide average per capita costs in 1986 were $20.53, nearly double 1980's costs of $10.87.

Prosecutors. The Office of the County Prosecutor is administered by a constitutional officer appointed by the state. Like the trial court system, prosecutors present fiscal problems for counties in that fiscal decisions regarding the amount and use of resources are made by employees of the state, while the expenses are paid in large part by the county. Under this system, the prosecutor and the state judiciary ultimately determine the level of support for an office over which county officials have no control. Costs per capita, which averaged $8.69 in 1985, ranged from a low of $5.33 in Burlington County to a high of $14.80 in Atlantic County. Several counties which have among the highest costs per capita for this function are also among the lowest in property tax base per capita. The recent rate of growth in the costs of operating the Office of County Prosecutor is greater than that of the average total county budget.

Patients in State Mental Institutions. Payments for patients in state mental institutions include expenditures for the care of both the mentally ill and the mentally retarded. County governments in New Jersey bear a significant portion of this burden. The costs of institutional care for indigent patients confined to state-operated facilities are, in large part, a county responsibility. These county costs are mandated by State law with no county control over patient treatment or caseload. The operating costs of hospitals are determined by the State House Commission, a State panel with no county representation. County payments support indigent patients treated at any of the nine state institutions for the retarded or any of the seven state facilities for the mentally ill. (Five counties operate their own facilities for the mentally ill.)

In 1986, counties spent $105 million to meet their share of the costs for 2 million regular patient days. Per capita expenditures for these services vary considerably among counties and fall most heavily on urbanized counties with relatively few fiscal resources. These per capita expenditures ranged from $4.35 in Hunterdon County to $21.29 in Hudson County.

County Colleges. The county college system was created as part of a state plan to improve post-secondary education in New Jersey. The first colleges opened in 1966 in Atlantic, Cumberland, Middlesex, and Ocean Counties. Currently, there are 19 community colleges, some covering more than one county, serving approximately one-third of total state higher education enrollment.

In 1983, the aid formula was changed to a system based on the college's operating costs, rather than a fixed dollar amount per student. The present formula calls for operating costs to be reimbursed at not less than 43 percent of total general expenditures for the base year. The base year is always two years prior to the current budget year. However, state contributions to the county colleges have consistently fallen short of the 43 percent figure.

Allocating State Aid to Localities

In calendar year 1985 New Jersey transferred about $1.3 billion to municipal governments in the form of grants-in-aid and reimbursements of property tax credits, thus contributing about 33 percent of municipal revenue. The state also provided grants-in-aid to county governments, contributing about 8 percent of county revenue. While most state aid to municipalities is in the form of unconditional grants, nearly all state aid to county government is in categorical grants designated for such uses as county colleges, welfare, and other social and public health services.

The present state aid system tends to reinforce the current pattern of property wealth by benefiting communities with relatively large property tax bases more than communities with smaller bases. The aggregate distribution of funds from the state's 12 municipal unconditional aid programs is not related to need. The wealthiest fifth of New Jersey municipalities receives $165 a year per resident while the poorest fifth gets $134 per resident. This municipal aid system has evolved piecemeal over a long period. It is dictated by the distribution of the two largest aid programs, public utility gross receipts and franchise taxes and business personal property tax replacement revenues. The distribution of revenues from these two programs reflects the location of properties previously taxed by local jurisdictions and is not directly related to the current needs of these jurisdictions.

IMPACT OF THE TAX SYSTEM ON HOUSEHOLDS AND FIRMS

New Jersey's recent prosperity has resulted in unprecedented surpluses in state revenues, while some local governments have seen dramatic increases in their tax bases. Local governments do not automatically reap the benefits of economic growth, nor has the growth been balanced among jurisdictions.

Who Pays New Jersey's Taxes

People pay taxes, not institutions or products. People pay taxes in their roles as consumers, workers, or owners of capital.

Answering the question of who pays a tax is easier when the tax is imposed directly on the income of a household, and more difficult for taxes paid by businesses, since those taxes can be shifted to consumers (through higher prices), workers (through lower wages), or owners (through reduced profits or equity). For example, property tax incidence is especially difficult to analyze in that there is little agreement about whether the tax is a wealth tax on property owners or an excise tax on consumption. A tax on wealth may be progressive while an excise tax on consumption may be regressive.

Using 1980 data, the Regional Plan Association (RPA) estimated that a family of four with an income of $17,000 paid 9.4 percent of its income in property, sales, and income taxes, while a family with an income of $75,000 paid 7.3 percent. The pattern described by the RPA is regressive because the effective tax burden declines as income increases.

The Department of Finance and Revenue of the District of Columbia annually compares the tax burdens for households at five income levels within each state. It then calculates an index of progressivity for each state by comparing taxes as a percent of income at the lowest and highest income levels examined. The New Jersey tax system is more regressive than the national average but in the middle among states in the region (Delaware and New York are more progressive in their overall tax system while Connecticut and Pennsylvania are more regressive).

Consumption Taxes. New Jersey's sales tax is the major revenue source for state government, yielding an estimated $3.0 billion in fiscal 1988. The state also relies heavily on utility taxes, which are also based upon consumption. Indeed, New Jersey's utility tax burdens are among the highest in the nation. The role of excise taxes, such as those on motor fuels, cigarettes, and alcohol, has been declining in relative terms, primarily because the tax is imposed on the quantity rather than the value of the items purchased.

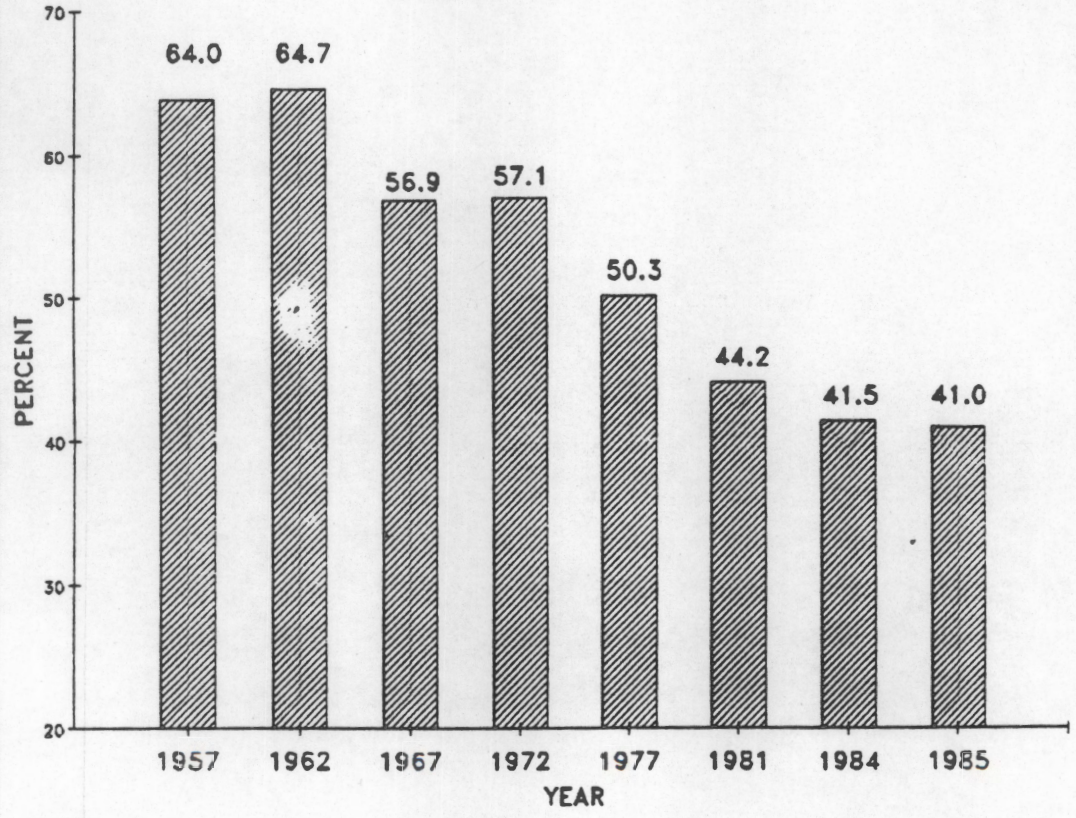
It is possible to estimate the incidence of consumption taxes on the assumption that these are passed along to the individual consumer. The New Jersey Division of Taxation estimated that households with income of $10,000 paid 4.3 percent of their income in sales, utility, and excise taxes, while households with income of $55,000 paid 1.7 percent. This pattern is heavily influenced by the state's high utility taxes.

Property Taxes. New Jersey relies heavily on the property tax, which accounts for 98 percent of all local tax collections--substantially above the

Figure 8

PROPERTY TAXES AS A PERCENT OF STATE AND LOCAL TAXES IN NEW JERSEY

1957 TO 1985



Source: ACIR

U.S. average of 75 percent. New Jersey's 1985 property tax burden of $717 per capita was almost two-thirds greater than the national average of $435. New Jersey's property tax collections exceeded $6.5 billion in fiscal 1987.

The incidence of the property tax will significantly influence the incidence of the state's total tax system since the property tax accounts for over 43 percent of all state and local taxes. Incidence refers to the extent to which taxpayers bear the burden of the tax. It is important to distinguish between the legal and economic incidence of the property tax. The legal incidence refers to the taxpayer billed by the municipality and therefore liable for remitting payment. The economic incidence refers to the taxpayer who actually bears the burden of the tax. Legal and economic incidence may differ because the true economic burden of the tax may be shifted away from the taxpayer with the legal responsibility to pay the tax. For example, a landlord may be legally responsible for paying property taxes although that landlord may pass the actual burden of the tax on to tenants through higher rents. In the case of homeowners, the incidence issue is complicated by the fact that property taxes may be partially or completely capitalized into the value of the house. This means that the owner of the home at the time that the property taxes were initially imposed will bear the full brunt of the true tax burden through reduced value of the house. Since economic incidence is a difficult and elusive concept, the remainder of this report will focus on the legal incidence of the property tax.

The New Jersey Property Tax Assessment Study Commission concluded in 1986 that the distribution of property taxes in the state was regressive. The ratio of property taxes to gross income was significantly greater for individuals and families with incomes below $10,000 than for those with incomes above $25,000. Similar patterns were evident among municipalities. More recent data from the Division of Taxation supports the conclusion of that commission (see Table 5).

Figure 9

HOMEOWNER PROPERTY TAX BURDENS IN NEW JERSEY

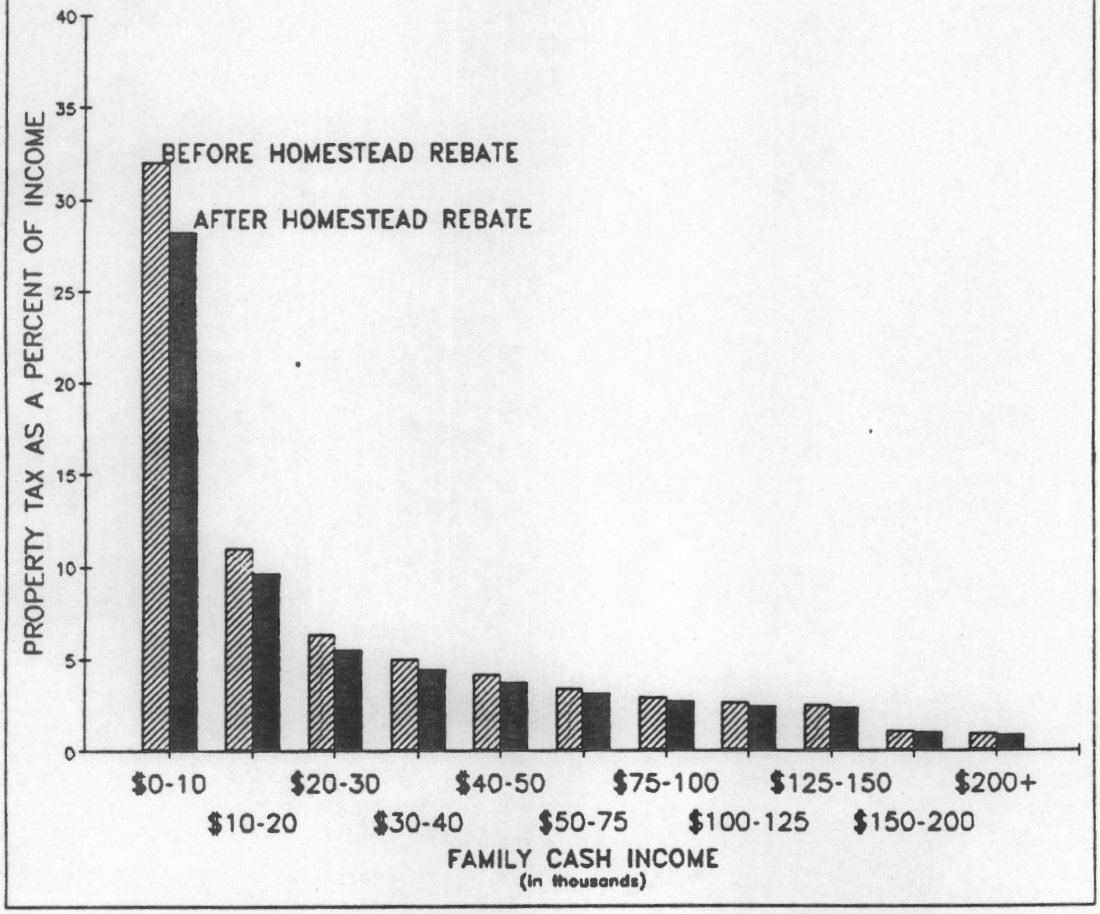


Table 5
1986 Property Tax Burdens by Income Class -- Homeowners

Family Cash Income (in thousands)	Mean Cash Income	Property Taxes	Homestead Rebate	Net Property Taxes
under $10	$ 5,323	$ 1,706 32.05%	($200) (3.76%)	$ 1,506 28.29%
$10 - $20	$ 15,188	$ 1,678 11.05%	($207) (1.36%)	$ 1,471 9.69%
$20 - $30	$ 24,967	$ 1,592 6.38%	($202) (0.81%)	$ 1,390 5.57%
$30 - $40	$ 34,806	$ 1,758 5.05%	($196) (0.56%)	$ 1,562 4.49%
$40 - $50	$ 44,827	$ 1,887 4.21%	($193) (0.43%)	$ 1,694 3.78%
$50 - $75	$ 61,061	$ 2,132 3.49%	($187) (0.31%)	$ 1,945 3.19%
$75 - $100	$ 85,568	$ 2,551 2.98%	($188) (0.22%)	$ 2,363 2.76%
$100 - $125	$110,140	$ 2,941 2.67%	($189) (0.17%)	$ 2,752 2.50%
$125 - $150	$136,132	$ 3,460 2.54%	($186) (0.14%)	$ 3,274 2.41%
$150 - $200	$172,030	$ 3,750 1.18%	($188) (0.11%)	$ 3,562 1.07%
over $200	$434,681	$ 4,322 0.99%	($191) (0.04%)	$ 4,131 0.95%
overall	$ 55,440	$ 2,040 3.68%	($195) (0.35%)	$ 1,845 3.33%

( ) = decrease in property tax burden
% = percent of income
family cash income = New Jersey gross income plus any pension exclusions all social security and retirement income, tax-exempt interest income, and all cash transfer payments.

Source: New Jersey Division of Taxation (unpublished data).

For example, the average property tax burden for homeowners with incomes between $20,000 and $30,000 was almost three times greater than the comparable burden for homeowners with incomes between $150,000 and $200,000. Homeowners with incomes under $20,000 paid an overall 11 percent of that income as property taxes while homeowners with incomes over $200,000 paid less than one percent of their incomes in property taxes. The state's Homestead Rebate and Homestead Tax Relief Act programs have reduced the overall property tax burdens for all income categories. Average homestead rebates range from $207 for households with incomes between $10,000 and $20,000 to $186 for households with incomes between $125,000 and $150,000. Since the average size of a homestead rebate does not vary significantly across income intervals, the relative tax burdens among these income classes are not changed by the program.

Gross Income Taxes. The Gross Income Tax has become state government's second largest revenue source, reaching an estimated $2.6 billion in fiscal 1988. Revenues are dedicated to property tax relief and used for state aid to school districts and municipalities and for direct property tax relief to residents.

New Jersey depends heavily on the property tax as a source of revenue compared to other states. New Jersey ranked second among states in the nation in its reliance on the property tax as a percent of total state and local general revenues in 1985. Conversely, of the 43 states that levied an income tax in 1985, New Jersey ranked 35th in the portion of total revenue derived from that tax. In other words, only 8 states relied on their income tax to a lesser degree than New Jersey.

The income tax is potentially among the most progressive taxes, depending upon the rate structure and the definition of the base--what may or may not be excluded or deducted from income. New Jersey's tax base permits few deductions or exclusions, and the Commission strongly believes that this broad definition is to be preferred.

The state's rate structure, however, is roughly proportional. When first enacted, the income tax had only two rates: 2 percent on taxable income under $20,000 and 2.5 percent on income above that amount. The tax package enacted on December 31, 1982, added a third rate, 3.5 percent on incomes over $50,000. In 1985, the effective rate -- the actual tax paid as a percentage of income -- varied from 0.96 percent for households with taxable income under $5,000 to 2.67 percent for households with taxable income over $100,000. Thus, the effective rates are more progressive than the rate structure might suggest.

Business Taxes. While the income of corporations is taxed by the Corporation Business Tax or similar taxes, corporations also pay utility taxes, property taxes, and sales taxes (on goods that are not used to produce other goods). The income of owners of unincorporated businesses or partnerships is taxed by the gross income tax. Regulated utilities are the major exception to the principle of taxing corporations on the basis of their net income; utilities are taxed on the basis of their gross receipts.

The Corporation Business Tax is state government's third largest revenue source, yielding an estimated $1.4 billion in fiscal 1988. Taxes on business personal property acquired before 1977 and on savings institutions yield an estimated $23 million each.

The utility taxes are estimated to yield slightly more than $1 billion in fiscal 1988. These taxes have been the state's most volatile. The receipts of energy utilities are extremely sensitive to fuel prices, which tripled during the 1970s and early 1980s. The volatility of utility receipts, coupled with the high rates, has led to much criticism of the tax. The tax on the telecommunications utilities has also been criticized for treating companies differently in what has become an increasingly competitive environment.

The Effect of New Jersey Taxes on Economic Development

A major concern of the Commission is the effect of the New Jersey tax structure on the economic development of the state and its local jurisdictions. This section discusses the effect of New Jersey's taxes on the state's competitiveness with other states, and the effect of intrastate tax differentials in the property tax on individual jurisdictions.

Interstate Competitiveness. Most economic research has found the major influences on location decisions to be such factors as proximity to markets, availability of resources (especially labor) and business climate. While early research looked primarily at manufacturing, more recent research has examined non-manufacturing activity and focused more on the role of state and local taxation.

Most studies of firm location have concluded that state and local taxes have at most only a modest influence on where firms locate, expand or contract their operations. Some studies suggest that corporate income and property taxes may be more important determinants of location for capital-intensive firms. Other research has found that tax differentials in similar or neighboring states may be a more critical determinant than the actual level of taxes within a state. In addition, personal income taxes may indirectly influence firm location by affecting household location and therefore labor availability. State-regulated employment costs, such as unemployment insurance and workers compensation, may also influence local decisions for some firms.

To the extent that firms view state and local taxes as an equitable price to be paid for services they require, the availability of such basic quality-of-life services as education and a clean environment may encourage relocation or expansion. However, the impact of government services on firm location relative to other factors, such as labor or energy costs, remains unclear. Even less is known empirically about the impact of state and local regulations on firm decisions.

The Commission's research revealed that tax competition among states is not the major determining factor in attracting or retaining firms because: 1) state and local taxes paid by businesses are deductible from federal taxes; 2) state and local tax and spending policies may attract and retain businesses by providing essential services; and 3) market demand and supply of goods and services and factors of production, such as labor, remain the principal determinants of business location.

Intrastate Tax Differentials. While state and local taxes are not the most important factors affecting interstate location decisions, the Commission did find that intrastate real property tax differentials may affect the location of households and businesses. In fact, the major problem with real property taxation in New Jersey is that disparities among jurisdictions in property tax rates pose a disincentive to economic development in higher property tax rate jurisdictions.

To the extent that property taxes affect an investor's return, otherwise desirable investment may be discouraged in jurisdictions with high property taxes. Thus the Commission's findings do not bode well for New Jersey's cities. Property taxes, and therefore the costs to a business, are higher in cities. Income, and therefore local demand for goods and services, will be relatively lower in cities. Moreover, desirable public services may be inferior to services in suburban areas. Finally, the combination of high taxes and poor services may offset any other advantages such as inexpensive and abundant labor, or access to transportation hubs, markets or suppliers.

IV. CREATING A BALANCE

To produce a balance in the state's fiscal system, the Commission has proposed both expenditure and revenue reforms.

EXPENDITURE REFORMS

The goals of these expenditure proposals are first to improve the delivery of essential public service; and second, to improve the balance between local service responsibilities and the resources available to finance those

services. Recommendations for expenditure reforms are proposed in the areas of local school finance, intergovernmental structure and state aid to municipalities.

Local School Finance

The Commission's education reform recommendations will ensure that local districts have the resources necessary to provide the appropriate educational program for students in their districts. Implementing these changes will require $393 million in additional state spending for education.

The Commission proposes that general formula aid be paid on the basis of a school district's current budget rather than the previous year's budget. This change will reduce the need for school districts to finance desired increases in spending entirely from their own resources.

Providing aid on a current-year basis means that each school district's budget must be estimated, since the State and local school boards develop their budgets at almost the same time. The Commission has concluded that the caps on school spending provide a mechanism for estimating school district budgets. However, we recognize that the existing cap, which is based on the growth in property values in the state, has fluctuated significantly since first implemented. We therefore propose that the cap formula be modified to dampen the fluctuations. Districts would be permitted to increase spending for each pupil by 6 percent, adjusted for the percentage change in property values in the State. Districts that spend below the State average would be permitted to increase spending more rapidly than high-spending districts (see Appendix A).

The Commission recommends that districts that do not meet performance criteria be required to spend at a level at least equal to the average per pupil expenditure for comparable districts that do meet the performance standards. The performance standards, which would be developed by the Department of Education, would center on student achievement, breadth of program, and adequacy of facilities. The required increases would become part of the district's regular budget, funded by both local taxes and state aid on a current-year basis.

The Commission recommends that the allocation of compensatory education aid be changed to reflect fully each area in which a student is deficient. The current additional cost factor of 0.18 should be retained for calculating the aid received by a district. The proposed formula will result in an increase of approximately $70 million, which will primarily benefit all districts confronted with a large number of students at risk of failure.

To meet the sizeable backlog of capital investment needed by school districts, we recommend that debt service aid be put on a current-year basis. Indeed, we recommend that state aid cover 100 percent of the debt service for the poorest school districts, those with resources less that 25 percent of the state average (see Appendix 3).

Finally, we recognize that public education must continue to attract quality teachers. The Commission recommends that a comprehensive survey of starting professional salaries should be authorized on a continuing basis. Consideration should be given to teachers' minimum salaries in relation to other starting professional salaries. We also encourage every elementary school district to provide a full-day kindergarten program and one year of pre-kindergarten. Enrollment would be voluntary, and the costs would be subsidized through general formula aid on a current-year basis.

Realignment of Service Responsibilities

The second component of our expenditure recommendations sorts out the proper role of state and local government in delivering several important services: the courts, public assistance, mental institutions, the office of the prosecutor and county colleges. State assumption of greater fiscal responsibility for these services will produce a permanent reduction in the tax burden required by the local government.

Public Assistance. Expenditures for public assistance can be divided into expenditures for benefits to recipients and expenditures for administration. We are proposing that the state assume full responsibility for financing the benefits portions of welfare services including Aid to Families with

Dependent Children, General Assistance, and Hospital Care. The Commission recommends that counties continue to administer the AFDC program and that they assume responsibility for administering General Assistance. Municipalities will no longer have any role in providing welfare services. To reduce differences in administrative costs among counties, we propose an administrative costs equalization program to offset a part of the administrative costs incurred by a county above the average costs for all counties. The proposed program would reimburse those counties whose administrative costs per capita exceeds the statewide average administrative costs per capita. Aid would equal the difference between the county costs and the state average costs multiplied by the county's population. The Commission recommends that the present public assistance system be restructured to reduce long-term dependency by providing incentives and support services to recipients. The Commission endorses the principles and objectives of the Realizing Economic Achievement Program (REACH) as a method of reducing long-term welfare dependency. The REACH program embodies many of the necessary reforms, including additional day care services, Medicaid coverage, education, and job training. The total cost of our welfare reform package to the state is $80 million. Finally, the Commission recommends that income data and other information that an individual or household is required to file to determine eligibility for public assistance, special programs or tax preferences should be consolidated in order to eliminate the need to provide duplicate information for each program.

Trial Court System. We propose that the state assume full financial and administrative responsibility for the trial court system. State takeover of financial responsibilities for the trial court system will result in greater accountability, more efficient allocation of resources, and reduced disparities in fiscal burdens among counties. This will involve the transfer to the state government of about 5,000 workers that are currently employed by counties, and will cost approximately $151 million. All trial court revenues will also be transferred to the state. Under the current system, counties pay 82 percent of the total costs of the court system but receive only 57 percent of the $39 million in revenues generated.

Office of the Prosecutor. The situation for the counties regarding the Office of the Prosecutor closely resembles that for the State's trial court system. The counties have no voice in determining the level or allocation of resources used in support of the activities of this constitutional officer. A prosecutor may petition an assignment judge for an order directing the county freeholders to provide additional funds. The Commission recommends that the responsibility for financing the Office of the Prosecutor be assumed by the State. This will increase state spending by $66 million. However, accountability will be enhanced as expenditure decisions and revenue-raising decisions are made at the same level of government. Again, fiscal disparities among counties will be reduced.

State Mental Institutions. Under the current system, county government are required to make significant payments for indigent patients receiving services at state institutions for the mentally ill or developmentally disabled. Counties have no control over these programs and often they have little opportunity to provide input into the operations of the programs. The Commission is recommending that the county payments to the state for these services be discontinued and that the full costs of providing these services be assumed by the state. This recommendation will increase accountability in the provision of these services and reduce disparities in fiscal burden among counties. The state Department of Human Services should also study the feasibility of state takeover of the five county-run facilities for the mentally ill. This recommendation will increase state spending by $105 million.

County Colleges. The state should fulfill its statutory obligation to support county colleges. The statute calls for the state to provide 43 percent of the operating costs of these institutions. Current support is about 27 percent. The cost of this proposal is $20 million.

Transition Period Concerns. The Commission is particularly concerned with the effect on employees of the transfer of service responsibilities to the State, such as the proposed judicial unification. Wages and benefits for employees differ among local governments and between the State and local governments. In addition, judiciary employees have not been afforded the same

rights as other public employees. The continuation of these practices creates the potential for dual personnel systems which may result in unnecessary costs due to bureaucratic duplication and differential treatment of comparably situated employees. Such treatment and unnecessarily inflated expenditures should be discouraged whenever practicable.

State Aid to Municipalities

The Commission's recommendations for reforming state aid will ensure an adequate local revenue base to finance essential local services, provide a more equitable system for compensating local government for tax-exempt state-owned property within their borders, and provide an incentive to local jurisdictions to serve as host communities for new utility installations.

Guaranteed Tax Base. The state assigns to local government the responsibilities for providing services such as public safety, public health, recreation and public works. However, local governments have access to only a few revenue instruments to finance these services. The property tax is the only broad-based tax available and, in many localities, the property tax base is inadequate to meet local service needs. While each of our proposed reforms will reduce the revenue-raising burdens on local governments, especially counties and school districts, the expenditure responsibilities facing municipalities will remain large relative to their resources. The problem will be particularly significant for many poor jurisdictions, which also tend to face above-average service needs.

The Commission considered three options to address this problem: reduce the service responsibilities of municipal government; expand municipal revenue-raising capabilities; or revise the current state aid system. The first option was not used extensively because of the value placed on local decision making in New Jersey. The Commission's goal was not to reduce home rule but to help home rule work better.

The option of local non-property taxes was rejected on three grounds. First, local non-property tax alternatives would not offer significant potential to reduce local resource disparities. Second, local-option taxes can

often have detrimental effects on economic growth and land-use management. Third, administrative difficulties and taxpayer compliance issues make local-option taxes problematic to employ efficiently and effectively.

The Commission believes that additional state aid will be necessary to redress these problems of inadequate local resources and fiscal disparities. However, the current system of unconditional state aid to municipalities is poorly targeted to need and does not reflect changes in state or local fiscal conditions. The Commission proposes that the state aid system freeze at 1986 levels the total amount and distribution of state aid from five programs: the Gross Receipts and Franchise Tax distribution, the Business Personal Property Replacement payments, the Corporation Business Tax on banks, the Financial Business Tax, and the Insurance Premiums Tax. In addition, a new Municipal Equalization Aid Program with a guaranteed tax base (GTB) formula would be implemented, patterned after the education aid equalization program. (See Appendix C for details on formulation and computation of the Municipal Equalization Aid Program.) Each municipality would annually have its aid calculated at the 1986 program levels for the five programs and under the GTB formula, and would receive the greater amount.

Under this new aid program, no municipality would receive less funding than it currently receives from the five aid programs. The impact of this new aid plan, coupled with the increased aid to school districts and counties, is that the number of municipalities with total equalized tax rates above $3 per $100 of true market value will decline from 78 to 13. Even in these 13 municipalities, the effective property tax rates will be significantly reduced. The added cost of the GTB plan is $351 million (see Appendix C). The Commission recommends that all aid received by a municipality under either component of the Municipal Equalization Aid Program be included in the Municipal Qualified Bond Program. This program enhances the credit worthiness of municipal bonds by authorizing the transfer of state aid monies from the State Treasurer directly to the paying agent for the municipal bonds.

Siting Future Utility Installations. Utility generating stations are generally considered undesirable by those who must live in close proximity to them. The present allocation formula for revenues from the utility taxes provides some incentive for municipalities to host such facilities. Indeed, it is this aspect of the formula that largely accounts for the present distribution of state gross receipts and franchise aid.

The Commission's recommendations to freeze the existing level and allocation of aid provides no incentive for a municipality to host a new utility installation. To provide such an incentive, we recommend that a host municipality receive revenues equal to a 3 percent tax on the original construction costs of the generating station, with the municipality's annual revenues limited to $700 per capita. (This limit corresponds to the limits contained in the present allocation formulas.) The revenues from this tax would be in addition to revenues from the municipal GTB plan and counted in the "Other Revenues" of the municipal budget, reducing the base budget for purposes of calculating aid under the municipal guaranteed tax base aid plan.

Payments In Lieu Of Taxes. We propose that the existing system of state payments in lieu of taxes (PILOTs) on state-owned real property to local governments be modified to compensate local communities more fully for the costs associated with serving state facilities. The proposed changes are that: 1) the formula to calculate state compensation use the municipal purpose tax rate and the assessed value of the state facility rather than the current practice of using the equalized local rate and assessed value; 2) the state fully fund the formula; and 3) the PILOT program be extended to cover property leased by the state from a state authority. The changes would eliminate current inconsistencies, and result in the state distributing $10-$20 million more to local communities.

Potential Versus Actual Property Tax Reductions

A major thrust of the Commission's recommendations is to reduce the revenue demands now placed on the property tax by the current allocation of functional and fiscal responsibilities and current state aid policies. The Commission proposes changes that will ensure that the potential property tax reductions

resulting from our expenditure reforms will be realized. Therefore, property tax reduction will be mandated upon local governments.

The Commission recommends that local school budget limitations be modified to reduce the permissible rate of school spending growth, which has in recent years been driven upward by increases in property value.

The county tax levy should be reduced for purposes of calculating the cap to ensure that the State assumption of costs currently borne by the county results in a reduction in the property tax levy. The county cap should be eliminated three years after the enactment of the Commission's recommendations on intergovernmental structural reform.

State assumption of municipal programs or functions will result in a reduced budget base for calculating permissible spending increases. Increases in state aid received through the Municipal Equalization Aid Program and through additional payments in lieu of taxes should be included within the municipal cap, in order to achieve the maximum reduction in the reliance on the property tax. Of course, when residents in a municipality feel that additional spending is necessary, the cap limit can be waived through referendum. The municipal cap should be eliminated three years after the enactment of the Commission's recommendations.

The proposed increase in state equalization aid to school districts and the new Municipal Equalization Aid Program will significantly increase the amount of state aid funds made available to local governments based on the distribution of property wealth across the state. This infusion of new state aid places an added premium on the accuracy of property assessments across local jurisdictions. We will discuss our proposals for improving assessment administration later on in this report.

REVENUE REFORMS

The Commission has reviewed each major tax imposed under state law in New Jersey and analyzed each tax using the revenue evaluation criteria previously agreed upon by the Commission. Similar criteria are commonly used in public

finance policy analysis and may be applied to a single revenue instrument or to the overall revenue system. The Commission revenue evaluation criteria are:

ADEQUACY refers to the ability of state and local revenue systems to provide revenues sufficient to meet current and anticipated state and local expenditure needs based on existing policies and programs.

CERTAINTY relates to the extent to which individual taxpayers can predict future tax liabilities or recipient units of government can predict the level of aid receipts. Certainty regarding the intricacies of the tax or aid system may facilitate financial planning and decision making by businesses, households and units of government alike.

COMPETITIVENESS refers to the advantages or disadvantages in attracting or retaining desired firms and households, which a state and local tax system has relative to tax systems in other comparable or neighboring states.

COMPLIANCE/SIMPLICITY indicates the ease with which individual taxpayer liability can be determined, by both the taxpayer and the collection agency, and provisions of the tax code can be enforced.

DIVERSITY measures the extent to which the base of the individual tax or the whole of the tax system is broadly defined so that it can withstand long-run declines in importance of some components while reflecting the importance of long-run growth in other components.

ELASTICITY measures the relationship between changes in measures of economic activity or population characteristics and changes in the revenue yield of the state and local tax system or selected taxes.

EQUITY/FAIRNESS refers to the extent to which the revenue burdens of the state and local revenue system are distributed fairly based upon either the individuals's or firm's ability to pay the tax or upon the benefits it receives from services financed by the tax.

NEUTRALITY/EFFICIENCY indicates the extent to which government financing influences private economic decision making and behavior. In general, the less the influence, the more neutral the individual tax or tax system. However, neutrality may not always be preferable, as government may decide to encourage some activities while discouraging others. Neutrality also refers to the extent to which local jurisdictions have their priorities distorted or restructured by the imposition of limits and by the form in which aid is received.

The revenue proposals will improve the efficiency and fairness of the state's tax system and offset the costs to state and local governments of lowering real property taxes. Although each tax change is discussed individually, these changes and the proposed reduction in property taxes are to be considered as a whole and not as a series of independent proposals.

Consumption Taxes

A sales tax is a tax on consumption. A sales tax can be general or selective. A general sales tax applies to a broadly defined, although not necessarily comprehensive, consumption base. A selective sales or excise tax applies only to a specific commodity or activity. General and selective sales taxes are often used simultaneously.

The Commission proposes a number of changes to the existing consumption taxes (the sales and use tax, utility taxes and other excise taxes). The proposed changes to the state's general and excise sales taxes will result in an increase of state revenues of approximately $428 million. The proposed changes to utility taxes on telecommunications firms will result in an increase in state revenues of approximately $189 million. The Gross Receipts tax rate on gas and electric bills will be reduced from 13 percent to approximately 8 percent and imposed on oil companies as well, with no change in total revenues. A consumption tax offset is proposed to reduce the regressivity of these taxes. The consumption tax offset will provide approximately $108 million in tax relief. The overall result of the proposed changes is to make this set of taxes more efficient and to distribute the tax burden more equitably.

Changes in General Sales and Excise Taxes. Of the 45 states with a general sales tax, 41 define their tax base more broadly than New Jersey. When a general sales tax base is defined too narrowly, consumers tend to change their spending behavior simply to reduce their tax burdens. The Commission believes that the extent to which government fiscal policies influence private consumption decisions should generally be kept to a minimum. The Commission proposes that the following items be included among the transactions covered by the state sales and use tax: 1) admission charges not currently taxed, 2) disposable paper products, 3) soap products, 4) non-prescription drugs, 5) cable television service, 6) cigarettes, and 7) telephone equipment. These changes will make the sales tax act simpler, more comprehensive in coverage, more equitable and neutral in relation to consumer choices. For example, under the proposal paper cups, plastic cups and all items that combine plastic and paper materials, such as plastic-coated paper cups, will be taxed at the same rate. By including paper products under the sales and use tax, the tax code will tax all plastic and paper items in the same manner. These disposable paper products were, in fact, subject to the State's sales tax prior to 1983.

Repealing the tax exemption on soap products will also simplify the tax. For example, shampoo and products that combine shampoo and hair conditioner are now exempt, but hair conditioner is not. Repealing the exemption on over-the-counter drugs will also eliminate confusing distinctions such as that between cough drops that are primarily candy and those that are considered medicine. The coverage of cable television service will ensure tax neutrality by taxing all forms of entertainment equally. Admission charges covered by the proposed change include boxing and wrestling matches, tennis court fees, golf club fees, and health club memberships. Currently, most activities in which the patron is not a participant are taxed, but activities in which the patron is a participant are not taxed. This change will make the tax system more equitable and simpler to administer. Lastly, the proposal to tax telephone equipment sales and use responds to recent organizational and technological changes in the telecommunications industry. Currently, all household and business appliances except phones are taxed. Now that phones can be purchased or leased from a number of providers, as opposed to leased solely from a public

utility, the exemption for telephone equipment is no longer equitable. In addition, recent product innovations such as combination telephone/clock radios and telephone/telephone answering machines make the current tax difficult to administer.

The Commission recommends that the sales tax exemption of supplies and material used to produce subsidized housing be codified into tax law and extended to all purchasers, including for-profit contractors. In addition, we recommend that the remaining tax on advertising services should be repealed. The use tax, however, should be applied to room occupancy, restaurant meals and amusement charges which are provided gratis.

The Commission also recommends that the existing statutory language of the sales tax exemption for equipment used in the manufacturing process should be clarified by 1) expanding the exemption to include the sale of supplies for use in the production of tangible personal property and 2) extending the exemption to machinery which is used to produce components of the production machinery itself. Further, the minimum useful life requirement for the exemption of parts used in connection with production apparatus should be repealed.

Excise tax changes proposed by the Commission include imposing the sales tax on alcoholic beverages consumed on premises, extending the excise tax to all tobacco products (such as chewing tobacco), increasing the wholesale excise tax on alcoholic beverages to 7.8 percent and imposing a unit-based excise tax on the possession or sale of controlled substances. Currently, non-alcoholic beverages such as milk are taxed in restaurants but alcoholic beverages are not. This is unfair and suggests the state is subsidizing the consumption of alcohol. The changes in taxation policy for tobacco products will tax all tobacco products in the same manner. Under present law, the excise tax imposed on cigarettes is four times higher than the (general sales) tax imposed on other tobacco products. The increase in the wholesale tax on alcoholic beverages will restore the parity between that tax and the general sales tax which was broken when the sales tax was increased to its current level. These changes in what are commonly called "sin taxes" would raise about $1.76 million in revenues for the state.

Public Utility Taxes. The Commission recommends imposing the corporation business tax on all public utilities, reducing the effective tax rate on electric and gas services from 13 percent to approximately 8 percent, imposing an 8 percent tax on heating oil and other fuels, repealing the existing franchise, excise and personal property tax on telecommunication public utilities, and imposing a 6 percent public utility gross receipts tax on all telecommunications services. These changes would promote a more neutral tax system while producing another $189 million in state revenues. Currently, consumers of heating oil pay no tax while consumers of gas or electric energy pay a 13 percent tax, resulting in an unjustifiable state subsidy of heating oil. By taxing all forms of energy equally, the overall rate can be lowered, encouraging consumers to select energy services without regard to the tax implications. Additionally, telephone services provided by regulated utilities, AT&T or New Jersey Bell, are taxed, while services provided by non-regulated utilities, such as MCI or Sprint, are not. These proposals would result in a more uniform tax treatment for all providers of telecommunication services. Lastly, the Commission recommends that public utility tax revenues no longer be earmarked for distribution to municipalities.

Consumption Tax Offset. General sales, utility and other excise taxes tend to be regressive in that low-income households pay a larger percentage of their incomes in taxes than do high-income households. To reduce the regressivity of these taxes, the Commission recommends a means-tested refundable tax credit to households on their state gross income tax for sales, utility and excise tax payments. The proposed consumption tax offset would reduce the average consumption tax burden to about 3.3 percent of family cash income by providing benefits that range from an average of $240 for households with incomes of less than $5,000 to an average of $50 for households with incomes of between $15,000 and $20,000. Households with incomes above $20,000 would not receive a consumption tax offset credit.

Currently, households with incomes under $15,000 pay approximately 3.7 percent of their incomes in consumption taxes and households with incomes over $50,000 pay approximately 1.7 percent. After the proposed consumption tax reforms and with the consumption tax offset, the tax burden on households with

Table 6

THE COMMISSON'S PROPOSED OFFSET FOR CONSUMPTION TAXES.

(Sales, Utility, Excise)

FAMILY CASH INCOME	HOUSEHOLDS NUMBER (000s)	HOUSEHOLDS AVERAGE INCOME	TAX BURDEN AVERAGE	TAX BURDEN RATE	AVERAGE BENEFIT PER HOUSEHOLD	TOTAL COST ($ mil.)	REVISED BURDEN RATE
Under $ 5,000	203	$ 1,740	$296	17.0%	$240	$ 49	3.2%
$ 5,000 - 10,000	192	7,400	365	4.9	130	25	3.2
10,000 - 15,000	198	12,540	532	4.2	115	23	3.3
15,000 - 20,000	225	17,540	630	3.6	50	11	3.3
20,000 - 30,000	457	24,720	782	3.2	0	0	3.2
Over 30,000	1,425	$67,080	$1,290	2.0%	$ 0	$ 0	2.0%
TOTAL	2,700					$108	

Source: Compiled by New Jersey Division of Taxation and Commission Staff.

incomes of under $15,000 falls to approximately 3.3 percent and the tax burden on households with incomes over $50,000 rises to about 2 percent. In addition to the consumption tax offset, the primary reason the state is able to increase consumption tax revenues without significantly affecting household tax burdens is that a substantial amount of the tax increases will be borne by businesses, such as the sales tax on telephone equipment.

The Gross Income Tax

The New Jersey Gross Income Tax was enacted in 1976 and designed as a broad-based tax with low tax rates. An additional bracket was added to the gross income tax rate structure in 1983 to respond to a fiscal emergency. The Commission proposes a number of changes in the New Jersey State Gross Income Tax.

Base Broadening. These changes will restore the broad base for the gross income tax, ensure that a household's total tax burden is based on an ability to pay, and ensure that taxpayers in like circumstances are treated similarly. The changes proposed by the Commission include: 1) a revision in the tax rates on gross income; 2) the replacement of the existing Homestead Relief Tax (i.e., Ford Bill) property tax deduction, the Homestead Rebate and the Homestead Tenant Credit with a means-tested circuit-breaker; 3) the repeal of the personal exemption for dependent college students and the regular exemption which may be claimed on a child's tax form when the child is also claimed as a dependent on the parent's income tax return; 4) a phase-out of the retirement income deduction for taxpayers who are 62 and over and have more than $50,000 in annual income; and 5) a more uniform tax treatment of retirement plans. To facilitate equity and compliance, the treatment of Keogh Plan contributions should conform to the federal tax system. Moreover, individuals who are not covered by an employer qualified retirement plan should be permitted to deduct contributions that they make towards their retirement. The increase in tax rates and a means-tested property tax circuit-breaker are discussed further below.

Table 7

THE COMMISSION'S PROPOSED GROSS INCOME TAX RATES

Marginal Tax Rates

TAXABLE INCOME	CURRENT LAW	PROPOSED	CHANGE
Under $ 20,000	2.0%	2.0%	0
20,000 - 50,000	2.5%	2.5%	0
50,000 - 100,000	3.5%	4.0%	0.5%
Over 100,000	3.5%	4.5%	1.0%

FAMILY CASH INCOME ($ 000s)	TAXABLE RETURNS (000s)	CURRENT TAX ($ Mil.)	PROPOSED TAX ($ Mil.)	CHANGE ($ Mil.)
$ 0 - 5	53	$ 3.3	$ 3.3	--
5 - 10	108	10.4	10.4	--
10 - 15	133	20.6	20.6	--
15 - 20	180	44.7	44.7	--
20 - 30	421	159.4	159.4	--
30 - 50	699	491.4	491.4	--
50 - 100	569	840.7	902.0	$ 61.3
100 - 200	105	381.1	455.3	74.2
Over 200	36	511.0	643.5	132.3
TOTAL	2,305	$2,463	$2,733	$268

Source: Compiled by New Jersey Division of Taxation and Commission Staff

Changes in the Tax Rate Structure. The proposed tax rates are the same as the existing law for all households with incomes under $50,000. For households with incomes of $50,000 to $100,000 the tax rate increases from 3.5 percent to 4.0 percent. For households with incomes above $100,000 the marginal tax rate increases from 3.5 percent to 4.5 percent. These rates are considerably lower than New York State rates and continue New Jersey's commitment to maintaining low tax rates on a broadly defined gross income base. The changes raise approximately $268 million in new revenues.

A Graduated Property Tax Circuit Breaker. We propose a graduated, means-tested circuit breaker to replace the present set of property tax relief programs for homeowners and tenants (the Homestead Tax Relief Act, the Homestead Rebate, and the Homestead Tenant Credit). Our goal is to ensure that low and moderate income households pay no more than a stated percentage of their total cash income in property taxes. The proposed circuit breaker is similar to the consumption tax offset proposed by the Commission, except that the circuit breaker takes into account differences in property tax burdens across jurisdictions as well as among income classes.

A household would determine its level of benefits from the circuit breaker program based upon its cash income and actual property taxes paid. Under our proposal, homeowners and tenants will receive a refundable income tax credit if the household's cash income is $50,000 or less. Homeowners will receive between 15 and 60 percent of the difference between their actual property taxes and five percent of their cash income. A homeowner who paid $1,000 or less in property taxes would receive $75, the minimum benefit level. If the homeowner's property taxes exceeded $1,000, the level of benefits received would be an increasing percentage of the difference between the actual amount paid and five percent of the homeowner's cash income. This group of homeowners would receive at least $135 in benefits. The maximum level of benefits would be $900. The percentage of the gap subsidized and the level of benefits are reduced as the homeowner's income increases (See Table 8).

Table 8

THE COMMISSION'S PROPOSED CIRCUIT BREAKER BENEFITS

HOMEOWNER CREDITS*

Actual Property Taxes Paid

Household Cash Income ($000)	$ 000 to $1000	$1000 to $1250	$1250 to $1500	$1500 to $1750	$1750 to $2000	$2000 to $2500	$2500 to $3000	$3000 to $4500	over $4500
under 10	$75	$135	$164	$198	$317	$772	$900	$900	$900
10 - 15	75	135	135	152	250	648	900	900	900
15 - 20	75	135	135	135	199	560	834	900	900
20 - 25	75	135	135	135	151	427	817	900	900
25 - 30	75	135	135	135	135	342	690	800	800
30 - 35	75	135	135	135	135	210	479	800	800
35 - 40	75	135	135	135	135	135	389	746	800
40 - 45	75	135	135	135	135	135	275	700	700
45 - 50	75	135	135	135	135	135	135	220	400

TENANT CREDITS*

Household Cash Income ($000s)	Credit
under 40	$100
40 - 45	80
45 - 50	50

* Credit amounts represent the average credit for the interval

Source: Compiled by New Jersey Division of Taxation and Commission Staff.

Tenants would also receive benefits under this circuit breaker program. Tenant households with incomes under $40,000 would receive a credit of $100. The credit would be phased out between $40,000 and $50,000. As in the case of homeowners, households with incomes above $50,000 would receive no benefits.

Currently, additional property tax relief benefits are provided through separate programs for veterans and for the elderly. Our proposals would not affect these programs.

Business Taxes

The business environment has changed significantly in recent years as a result of deregulation, technological innovations, and increased international competition. The Commission proposes several changes in business taxes to ensure that competing firms are treated fairly and uniformly by the state's tax system. The largest revenue change would result from taxing savings institutions under the nine percent Corporate Business Tax (CBT) and repealing the three percent Savings Institution Tax (SIT). This change results in more similar tax treatment of all financial institutions and generates a net increase in revenues to the state of $50 million. We recommend that the Legislature be sensitive to the financial circumstances of New Jersey's thrift industry when these reforms to the CBT and SIT are enacted.

The Commission also recommends eliminating health insurance premiums from the insurance premiums tax base. The present tax code does not tax health insurance premiums uniformly across all providers. This uniformity cannot readily be achieved by extending the tax to all purveyors of health insurance. Therefore, fairness is best achieved by eliminating any exposure to the tax.

The Commission recommends that the mechanism for dissolving corporations should be simplified. Moreover, the procedures for filing fees and information to the State by corporations should be consolidated to reduce unnecessary duplication and costs. This step could significantly reduce costs and increase compliance for corporations.

The Commission recommends repealing the earmarking to municipalities of corporation business taxes paid by banking and financial corporations and the insurance premiums tax. This results in a shift of $38 million in revenues from municipalities to the state. The current earmarking and distribution formulas are inappropriate state-aid programs because they do not reflect current local needs or circumstances. However, the proposed municipal equalization aid formula will guarantee to every municipality an amount of revenue at least equal to that received from the programs included in the GTB plan in the 1986 base year.

Federal tax reform of 1986 repealed accelerated depreciation for business investments. The Commission recommends recoupling to the federal system of depreciation as long as there is no substantial negative effect on the revenues generated. This recoupling will reduce the costs of compliance for state taxpayers. The Commission also recommends repealing the tax on business personal property purchased prior to 1977. Currently all business personal property purchased after 1977 is exempt from the tax. The revenues lost to the state from this change would be approximately $21 million in the first year and decline thereafter. The state should pay refunds, with interest, when an audit discovers an overpayment of taxes, even if the refund period has expired. The rate of interest should be derived from the rate of return on the state Cash Management Fund.

The Commission recommends several additional reforms to the CBT including 1) extending the CBT to investment companies that are chartered out of state and are wholly owned subsidiaries of banks operating in New Jersey, 2) prohibiting bank subsidiaries from electing to be taxed as investment companies, 3) developing a new income apportionment formula that places greater emphasis on deposits and receipts, 4) including leased property in the property factor of the allocation formula, 5) repealing the regular-place-of-business requirement in order to apportion less than 100 percent of income to New Jersey, 5) permitting interest deduction in accordance with federal law when the parent serves as a conduit for a loan received by its subsidiary, and 6) closing loopholes that arise from non-arms-length transactions.

Miscellaneous Taxes

New Jersey currently imposes an inheritance tax on the transfer of real property, with tax rates that vary by beneficiary class, and a "pick up" estate tax, that absorbs any of the federal tax credit that is not taken up by transfer taxes levied by New Jersey or some other state. The state Division of Taxation determines the tax liability and bills the taxpayer.

The Commission also examined two local option taxes. The Newark payroll tax is imposed upon private for-profit firms providing services in that city. This tax causes Newark to operate at a competitive disadvantage in terms of its ability to attract development. Also, under current law, state sales tax revenues are reduced when the tax is applied to a transaction already taxed under the Atlantic City Luxury Tax. The total tax imposed is not equal to the sum of the state and local rates.

The Commission recommends: 1) the repeal of the inheritance tax in favor of a self-assessed estate tax in order to reduce the costs of compliance for both the taxpayer and tax administrators; 2) the repeal of the Newark payroll tax with Newark's lost revenues offset by the Municipal Equalization Aid Program proposed by the Commission; and 3) increasing the state sales tax in Atlantic City to six percent, thereby raising the overall sales tax on items covered by the luxury tax in Atlantic City to 15 percent (nine percent would continue to go to the city).

Real Property Taxation

The Commission developed recommendations to improve the system of property assessment, reduce the pernicious effects of the property tax on development patterns, and strengthen the incentives to preserve farmland and open spaces.

Assessment Administration. The Commission proposes several reforms to reduce substantially the reliance on local government and therefore on the local property tax. These proposals will reduce fiscal disparities among local jurisdictions as well. Still, the current system of inefficient and

inequitable property tax assessment will continue to produce problems if left unattended. Because the apportionment of county taxes, state school aid and many forms of municipal aid is based on the distribution of property value among local jurisdictions, both tax apportionments and aid allocations become inequitable when those assessed values are flawed. Assessment problems are indicated by coefficients of deviation that are high and that differ greatly among taxing districts. While revaluation cycles average 7 to 8 years across the state, revaluation has not occurred for 20 years or more in some of New Jersey's largest urban areas.

The Commission proposes a separation of administrative function in real property assessment from appellate functions. The administrative functions required by law -- determining taxable status and taxable value, preparing tax lists and tables of aggregates and equalization respectively -- will be performed by a single state agency. The appellate function currently performed by the county boards of taxation will continue to be carried out by those boards, although the boards will be fully funded by the state.

The new agency in charge of real property assessment administration will be an independent board appointed by the Governor with the advice and consent of the Senate. The local property tax branch in the Division of Taxation, including its personnel, functions and responsibilities, shall be transferred to the new board. The board will consist of seven members serving staggered five-year terms, removable only for cause during those terms. It will be bipartisan, with no more than four members from the same political party. Board members will be paid salaries fixed by law, at levels commensurate with their duties. Except for the chairman, board members will be part-time. The board will be required to meet at least monthly.

The Governor will designate one of the seven appointees to be chairman and full-time chief executive officer. The chairman will appoint a district supervisor for each administrative district, subject to the approval of the full board . The 21 administrative districts will be coterminous with county boundaries. If the board deems it necessary, additional district offices could be established in any given county.

The board will prepare a budget request annually to be forwarded to the Legislature. After the annual budget is approved, the revenue requirements will be billed back to taxing districts based on apportionment value.

Each county district supervisor will make the annual tax list and property values available for inspection in every municipality at least once a year. At this time, district staff will be on hand to answer questions and address concerns that taxpayers have about values and other property tax-related matters.

With one very important exception, the state board's personnel policies will be governed by the Civil Service system. In its initial staffing, the state board must give hiring preference to certified tenured tax assessors and county tax administrators. Furthermore, the board's employment of certified tenured local assessment personnel should be achieved as far as practicable without decreasing the current compensation of those individuals. One practical limit on maintaining current pay scales is that compensation levels for assessors must be less than the chairman and district supervisors' salaries. Part-time salaries currently paid to assessors serving more than one district would be either aggregated or projected to full-time scale and averaged.

This reform will make the state board responsible for discharging all property tax assessment duties currently performed by municipal tax assessors and county boards of taxation. County boards of taxation will continue as appellate bodies of first resort, but will be independent of this new administrative agency. Resource deployment will no longer be limited by municipal and county boundaries, but will be centrally and comprehensively determined. Counties will continue to serve as administrative districts, and taxpayers will continue to have the benefit of annual review of tax lists and consultation with appraisers. The foundation of the system will continue to be the professional assessor.

Alternatives Considered. Because of the role of property tax assessment in county apportionment and school aid allocation, and because of the proposed new municipal equalization aid program, assessment was given careful consideration by the Commission. In addition to the reform approved by the Commission, several alternatives were also closely considered. One option was particularly attractive to a large number of Commission members and merits further discussion.

This option was recommended by the New Jersey Property Tax Assessment Study Commission, also known as the Glaser Commission, which proposed retaining the current system of municipal assessment with several notable modifications, including reconstituting the Local Property Branch of the Division of Taxation as a separate, independent division within the Treasury Department. This new division would have the authority to remove local assessment personnel and license and set performance standards for revaluation firms. The new division could set minimum sizes for tax assessment districts and order consolidations among existing districts. The Glaser Commission recommended that a new state aid program for subsidizing local assessment costs be established. The new Local Property Tax Division could then develop guidelines for tax assessor standards, compensation and support services, and withhold state aid if those standards were not met by a local assessment district. The Glaser Commission's report contained 37 conclusions and recommendations, a copy of which is attached to this report as Appendix D.

Other property tax administration reforms recommended by the Commission include 1) accelerating the existing timetable for tax sales in rem foreclosures for delinquent properties, especially vacant properties with building and safety code violations, 2) providing relief to municipalities with properties subject to foreclosure due to non-payment of taxes, and 3) changing from an annual to a semi-annual schedule for collecting Class II Railroad Property Taxes.

Property Tax on New Construction. Disparities in property tax rates pose a disincentive to economic development in high property tax rate jurisdictions. The purpose of a separate property tax on new construction is

first, to remove these disincentives of the present tax structure, and second, encourage development in accord with the proposed State Development and Redevelopment Plan. The draft State Plan has divided New Jersey into growth management tiers. Those municipalities with high tax rates tend to be located in those growth management tiers designated by the plan as most appropriate for redevelopment and new development. The two illustrative alternatives given in this report are based on the draft State Plan and are proposed by the Commission with the understanding that the recommendation will be studied further by the State Planning Commission.

Jurisdictions with lower tax rates impose a lower tax burden on new construction than jurisdictions with higher tax rates. To the extent that property taxes affect a builder's return on investment, otherwise desirable investment in distressed jurisdictions may not occur. Because jurisdictions with lower tax rates tend to be suburban or rural in character, this public policy encourages development to occur outside of existing urban areas. Growth in these low tax jurisdictions often exceeds the capacity of their public facilities to accommodate the increased demand. Construction of new facilities is discouraged in high tax jurisdictions and existing structures are often abandoned or allowed to deteriorate because of the high tax burden on these investments.

The Commission's proposals would significantly lower property taxes throughout the state. However, some differentiation between high and low-tax rate communities would continue. In addition, the proposed State Plan would encourage new development in municipalities with higher tax rates. The greater the preference for growth within a tier, the lower the rate of taxation on increments to the property tax base.

To encourage development in areas that are designated by the proposed State Plan as most appropriate for redevelopment and new development, the Commission recommends that mandatory tax rates (not be confused with a statewide property tax) be imposed on new construction. These rates would differ according to the State Plan growth management tiers. The proposed new tax would be implemented as follows:

1. The value of new construction would be taxed exclusively at a rate established by the State regardless of the local property tax rate. The land value and the appreciation of the value of construction would be taxed at the locally determined property tax rate. The total tax on the property would be calculated as follows:

Total Property Tax Payment = [(Market Value of Property - Cost of New Construction) X (Locally Determined Property Tax Rate)] + [(Cost of New Construction) X (Mandatory Property Tax Rate)]

2. The mandatory rate on new construction would be automatically imposed at the time of initial assessment. Thus, unlike the Fox-Lance property tax abatement program, no local determination of applicability would be required. With the adoption of this program, Fox-Lance and other tax abatements designed to encourage non-subsidized new construction would be eliminated. Existing abatement contracts would be continued through expiration. Tax abatement programs for subsidized senior citizen and low-income housing would be continued.

3. The mandated rate on the costs of new construction would be imposed for a period of 15 years, after which the new construction would be taxed at the locally determined tax rate.

4. The state-imposed rate would apply to all new construction. The new agency in charge of property tax assessment administration will promulgate specific regulations that set the standards for defining new construction.

5. If the state-imposed tax rate is higher than the locally determined tax rate, the difference in revenues would be diverted to a state-operated infrastructure fund pool that would be used to finance infrastructure needs throughout the state. Specifically, the allocation of revenues would be as follows:

a. The revenues would be billed, collected and retained by the municipality up to the amount that would be raised from the locally determined municipal tax rate.

b. If revenues were not all absorbed by the municipality, the remaining revenues would be distributed to the school district up to the amount that would be raised from the school district tax rate.

c. If the mandatory tax rate was higher than the combined municipality and the school district tax rates, the excess revenues would be distributed to the county up to the limit of the amount that would be raised from the prevailing county tax rate.

d. If the mandatory rate on new construction was higher than the combined tax rate for the municipal, school district and county purposes, the excess revenue would be diverted to the state-operated infrastructure fund pool and used to finance infrastructure needs throughout the State.

The allocation of revenues would ensure that municipalities designated as growth areas were not financially penalized for securing new construction. Municipalities not targeted for growth would not receive any windfall from new construction.

The Commission discussed two illustrative rate structures. Both alternatives impose tax rates that vary by the State Plan Development Tiers. The rate structures are presented in Table 9.

Table 9
Illustrative Property Tax Rates on New Construction
(tax as a percent of property value)

Development Tiers Proposed by the State Planning Commission		Alternatives One	Alternatives Two
Tier 1	Redeveloping Cities and Suburbs	1.0%	2.0%
Tier 2	Stable Cities and Suburbs	1.5	2.25
Tier 3	Suburban and Rural Towns	2.0	2.5
Tier 4	Suburbanizing Areas	2.5	2.75
Tier 5-7	Limited Growth Areas	3.0	3.0

Source: New Jersey State Planning Commission, The Draft Preliminary State Development and Redevelopment Plan, Volume 1, January 1988, Trenton, N.J.

In both alternatives the mandatory tax rate is highest in areas less targeted for growth. These proposals would encourage development in designated growth areas, many of which already have adequate infrastructure. The major difference in the proposals is the concern that the tax rates in the first alternative for Tiers 1 and 2 are too low to pay for the costs imposed upon local jurisdictions in servicing the development. The two percent rate presented in the second alternative corresponds to the current Fox-Lance formula. The variation in the rate structure for new construction would violate the state's uniformity clause and would, therefore, require a constitutional amendment to implement the proposed plan.

Proposal for Farmland Preservation. The Farmland Assessment Act of 1964 provides for preferential assessment of land actively devoted to agricultural or horticultural use in order to reduce the marginal cost of farming and discourage the development of existing farmland. In 1987, over 25 percent of land area in the state qualified for farmland assessments.

The program has been an ineffective deterrent to the development of farmland because the penalty for development (payment of three years' worth of back taxes when the use as farmland ceases) diminishes relative to the tax subsidy received as the duration of the subsidy lengthens. The program thus subsidizes developer "land-banking," the acquisition and holding of parcels of land for eventual development. The penalty bears no relationship to the gain realized by developing the property. The Commission's proposal is intended to retain agriculture as a viable industry in the state and to preserve farmland and open space.

The Commission recommends the following approach:

1. Retain the existing differential taxation approach so that farmland is taxed at its value as farmland, rather than at market value.

2. Retain the three-year rollback period for payment of the differential between farmland taxes and market value taxes. Such funds would continue to be paid to the municipality.

3. Acquire equity in the property in exchange for preferential assessment. The acquisition of equity would compensate the state as a whole for the subsidy conferred.

Since the preferential taxation of farmland is authorized by the State Constitution, the imposition of the proposed plan for State accumulation of equity in property in the Farmland Assessment program would require a Constitutional amendment to authorize such legislative actions.

For each year that the property has been preferentially assessed, the state would acquire a one percent equity right in the difference at the time of change of use between assessed value as farmland and market value. Thus, the state would own 20 percent of the differential between farm value and market value on a property that was being developed after 20 years of preferential assessment. Several options are available to implement this new approach, including:

o Exercise of state option. In exercising its equity rights when property assessed as farmland changes use, the state could select an alternative among the following:

a. Accept a cash equivalent of the state's share of the difference in value.

b. Take the equivalent in value in fee simple ownership (a legal term that denotes land ownership of infinite duration and free of conditions or limitations) of a portion of the land itself.

c. Negotiate a lower density development in exchange for the state's share of ownership.

d. Purchase the remaining development rights in the land at fair market value. This would establish a state easement and would mean that the land would be permanently dedicated to agriculture. This concept

already exists in New Jersey State law under the Agriculture Retention and Development Program.

o Use of funds. The money acquired if the state elects to receive the cash equivalent of its equity right in farm property that changes use could be used in different ways:

a. Establish a state land bank, such as a natural resources trust, for purchase of development rights or park land. Funds could be allocated for use in the municipality or county of origin if farmland is available. Because the burden of the subsidy is borne by other taxpayers in the municipality, the municipality should receive priority in the use of the equity funds.

b. Contribute to the Agriculture Retention and Development Program, under which the state contributes matching funds to counties and municipalities to purchase the development rights to farmland permanently dedicated to agriculture.

VI. SAFEGUARDING THE BENEFITS OF THE NEW FISCAL SYSTEM

The recommendations discussed above will make substantial progress toward the goal of restoring balance, equity, efficiency, and accountability to the state's fiscal system. These reforms are aimed at producing results that are enduring, and not transitory. The Commission took steps to ensure that the restoration process, once begun, would be continued and preserved. These additional steps would first, facilitate orderly economic development, and second, reduce institutional impediments to effective public sector budgeting and planning activities.

ECONOMIC DEVELOPMENT STRATEGIES

Business climate refers to a state's willingness and ability to provide a productive environment in which businesses can operate. In addition to tax policies, several other factors influence a state's business climate including

the economic development programs offered, the adequacy of its infrastructure and stock of affordable housing, and the type of planning activity within the state.

New Jersey offers a variety of economic development programs to encourage firms to locate or expand in the state. The Commission recommends that all site-specific economic development programs be targeted to distressed areas. In addition, a systematic and independent evaluation of each of the current programs should be conducted. The limited resources of the state should be focused on the areas and programs with the greatest potential for success. The Commission recommends that the State continue its emphasis on science and technology programs. Moreover, a Challenge Grant program should be established to encourage cooperation between the State's colleges and its municipalities. Where the grants are provided to county colleges, they should be in addition to the full funding of the formula as prescribed and mandated by current law. An Industrial Development Zone program should be established to examine the efficacy of reducing public utility or business personal property taxes, targeting job training and infrastructure improvements, and establishing local business incubators for industrial users in distressed areas. Finally, the State should examine the interrelationships among the Departments of Commerce and Community Affairs, and the various other agencies regulating commercial activities, to streamline and simplify the regulatory process.

Continued economic development in New Jersey depends on the availability of affordable housing for workers in the State and on the ability of the State's infrastructure to handle growing demands. The shortage of affordable housing will severely limit New Jersey's economic growth. The State should develop a Housing Development Bank program to assist moderate-income households in purchasing homes.

A sound infrastructure is critical to the future prosperity of New Jersey. The Commission is particularly concerned with transportation, wastewater treatment, water supply and solid waste disposal. If major problems in these areas are not adequately addressed, they will increase in severity and the costs of corrective actions will cause a funding crisis at both the state and

local levels. The state should also ensure the adequacy of the infrastructure network to accommodate future demands. For example, additional grants should be provided to local governments to augment the funds made available through the Wastewater Trust Fund. Infrastructure needs in other areas must be quantified and financing options developed. A state-operated infrastructure fund pool, such as the one referred to in the Commission's proposed mandatory tax on new construction, would be a modest step in the right direction but more will be needed.

The Commission generally supports the objectives of the State Planning Commission's preliminary State Development and Redevelopment Plan for addressing the problems of imbalanced and uncoordinated growth. In addition, we encourage the State Planning Commission to promote the use of sub-state regional planning organizations to address planning issues that affect more than one municipality or county. Special improvement districts should be considered to address issues of local areawide planning, tax-base sharing, regulatory relief and the provision of infrastructure. Local use of development, impact, and linkage fees should be further examined with the aim of limiting, standardizing and regionalizing their use. All municipalities in the state that are categorized as distressed should be required to include as a part of their master plan a community and economic development element that would be subject to the State Planning Commission's cross-acceptance process. Finally, incentives should be provided to encourage the consolidation of selected services among local jurisdictions to achieve greater economies.

BUDGET PROCESSES

The purpose of the budget is to facilitate fiscal planning and control. To further these objectives, the Commission recommends several state budget reforms, including: the establishment of a contingency fund; the preparation of a tax expenditure budget; limitations on the dedication of revenues; fiscal notes for proposed policy changes; and a shared arrangement for financing state-mandated local activities. To assist local government budget planning and preparation, the Commission recommends that aid programs be funded at the

level embodied in the legislation. If it is necessary to reduce aid, the enabling legislation for the aid program should be changed.

Contingency Funds

While the general purpose of a contingency or Rainy Day fund is to increase the stability of a state's revenues and expenditures, three distinct goals can be enumerated. The first is to create a cushion to cover cash flow problems that a jurisdiction may experience. The second is to provide a reserve against unforeseen events, such as natural disasters, that cannot be anticipated in a budget but that may require an immediate response. The third is to provide counter-cyclical assistance by setting aside surplus revenues during times of prosperity and using them during an economic slowdown. The funding level, method, and drawdown procedures vary according to the specific purpose of the fund.

The Commission endorses the concept of a contingency fund. We recognize that the fund may not be of sufficient size to eliminate the need for tax increases or expenditure reductions in the event of a severe or sustained recession. However, the value of such a fund is to permit a more orderly response to the unanticipated shortfall in revenues or increase in expenditures due to recessions or emergencies.

Tax Expenditure Reporting

Tax expenditures or tax preferences are provided to an individual, organization, or activity through the tax code, rather than as a direct outlay. The tax preference may result from special exemptions, deductions, exclusions, credits, preferential rates, or deferrals. Every tax relief measure, differential tax rate, exemption or exclusion is not a tax preference. For example, the phase-out of the State's inheritance tax for certain classes of beneficiaries is not a tax preference because the benefits of the reduced rates are generally available to all taxpayers. An example of a tax preference in New Jersey is the reduced sales tax collected in designated Urban Enterprise Zones, which provides an indirect subsidy to businesses

located in the zone. At the local level, the Fox-Lance tax abatement program also provides an example of a tax preference. The presence of tax preferences does not presume a first claim by government on income or other resources within the state.

Like direct outlays, tax preferences affect the scope of government and economic activity in the state. However, there is currently no formal accounting or systematic review of tax expenditures, nor is there an ongoing estimate of the revenues foregone nor any analysis of the costs incurred and benefits provided.

To provide a comprehensive statement of New Jersey's budget, the Commission recommends that the Division of Taxation prepare an annual budget for those tax preferences provided by the state. The tax preference budget would be additional information included in the annual budget submitted by the Governor to the Legislature. The Commission further recommends that fiscal notes be required for changes to the tax code, particularly those changes that result in a tax preference.

Dedicating Revenues

Revenues are considered dedicated or earmarked when their use is restricted to the support of a particular program. The restriction may be narrow, such as requiring that fees from parking meters be used only for maintaining the meters and collecting the fees, or broad, such as New Jersey's constitutional requirement that revenues from the personal income tax be used for property tax relief. The restrictions may be constitutional or statutory.

The Commission believes that the constitutional dedication of revenues can distort budgeting and inhibit the flexibility of lawmakers to respond to changing needs or conditions. The Commission therefore recommends: 1) that there be no further constitutional dedication of revenues; 2) that the present dedication of the proceeds of the lottery, personal income tax, and tax on casino revenues be reconsidered; and 3) that where earmarking of revenues is appropriate, it be done by statute.

The Commission is aware that some revenues, such as user fees, may appropriately be used to support a specific service or program. When these fees cover the full cost of the service, they may operate as an indirect pricing mechanism for those who enjoy the benefits of the service. In those instances where the connection between the benefits and the fee is clear, the Commission believes that the revenues may appropriately be dedicated to providing the service. The Commission recommends that the dedication be by statute rather than embodied in the Constitution so that budgetary flexibility is preserved.

Fiscal Notes

New Jersey law currently requires that an estimate of the fiscal impact of proposed legislation, called a "fiscal note," be prepared whenever requested by the sponsor of the legislation, chairman of the reference committee, or presiding officer of either house. The fiscal note estimate covers the current year and the two succeeding years and includes the impact on local governments as well as the state.

The Commission believes that the present process for initiating a fiscal note is not comprehensive enough and that fiscal notes are not prepared in some situations where they would be appropriate. One such situation, the creation of tax subsidies, has been discussed above. Other examples include changes to sentencing policy as embodied in the criminal code, changes to pension legislation, and the imposition of regulations that affect the cost of delivering local services. The Commission also believes that the two-year horizon may not be sufficient, particularly for changes in services such as corrections or pensions.

The Commission therefore recommends that the process for initiating a fiscal note be changed to require a note whenever a potential fiscal impact is identified by the Legislative Budget Officer and that the Legislative Budget Officer be empowered to determine the scope of the estimates that will be required.

Payment for State Mandates

Most services provided at the local level are governed by state laws and regulations. In addition, the costs of many services are shared by the state and local governments. Many of the Commission's recommendations for service realignment will alleviate the local burden of many of these costs, but we are concerned that in the future new burdens may be imposed on local governments.

The Commission therefore recommends that the state share the costs of new or significantly enhanced services or regulations. The policy would distinguish between services or regulations that apply exclusively to local governments and those that affect all providers, public and private. For example, a requirement that there be two police officers in all patrol cars would fall within the scope of the requirement that the state participate in the cost of new or enhanced regulations. On the other hand, a change in the health or building code that affects anyone owning a building would not fall within the scope of this requirement.

For municipalities, state compensation will be made through the proposed guaranteed tax base formula. The budgets would be adjusted to reflect the cost of complying with the mandate, and state aid would be provided in proportion to the municipality's state support ratio. If a municipality receives aid from the frozen pool of programs (business and utility tax distributions), no additional aid would be forthcoming. State compensation for mandates imposed upon school districts can be made in a similar fashion.

Counties pose a different problem because there is no general formula aid program for counties. The Commission therefore suggests that the state develop a categorical aid program, which would be equalized according to the county's ability to pay, in the event that new or significantly enhanced service responsibilities or regulations are mandated upon counties.

Non-Fiscal Assistance to Localities

For many jurisdictions, the Commission's recommendations will result in a substantial infusion of additional funds. Concerns have been raised about the capacity of some jurisdictions to manage this increase effectively. The Commission shares these concerns and recognizes that some steps have already been taken in connection with the recent expansion of the distressed cities aid program. We recommend that the state offer technical and management assistance to local governments and school districts to help ensure that funds are spent efficiently and properly. The state is often in a better position than most local governments to identify state-of-the-art procedures for managing funds and implementing programs. That will ensure that residents receive maximum benefit from our recommendations and from other state and local services.

Permanent Tax Policy Commission

There is a long and variable cycle that characterizes the comprehensive analyses of tax policy in New Jersey. The New Jersey Tax Policy Committee (the Cahill Committee) issued its report in 1972, the New Jersey Commission on Government Costs and Tax Policy issued its report in late 1977, and now, in 1988, comes the report of the New Jersey State and Local Expenditure and Revenue Policy Commission.

The absence of an on-going independent analysis of the state's tax policy is troublesome for several reasons. First, the cumulative impact of a new tax or significant changes in an existing tax, when layered on top of the existing tax code, may not be obvious or anticipated. The new tax policy may produce effects that offset desirable features of the existing code or the effects of the tax policy change itself may be less than these anticipated when the policy was examined in isolation.

Second, the effects of a tax policy change may be difficult to evaluate in light of changes in the state's economic base, demographic characteristics, political institutions, or macroeconomic conditions. The absence of an on-going independent analysis of major issues in tax policy may mean that

simple problems become major concerns because they are not discovered in a timely fashion.

Comprehensive tax analysis and monitoring of tax policy effects are too important to be done sporadically. The Commission recognizes a need for a permanent, non-partisan commission, comprised of experts in the area of tax policy. This group would be available to advise the Governor and the leadership of the Legislature on matters of tax policy. More important, this group would be able to monitor the state's tax system and recommend changes in view of changing demographic, economic, or fiscal conditions. Such a body existed within state government until the late 1960s. The Commission feels that responsible tax policy decision making will be furthered if a new commission is established.

Permanent Pension Study Commission

State and local government expenditures for public employee retirement benefits are a large and growing component of public spending in New Jersey. Moreover, more than 100 bills to reform pension policy are considered during each legislative session. The fiscal consequences of many of these proposed changes in pension policy would not be fully apparent for several years. In addition, the impacts of pension policy changes made by one level of government often spill over to other levels. For example, since most county and municipal employees participate in the state retirement system, the changes in pension policies for state employees are automatically extended to local workers with local governments assuming the costs.

The Commission recommends that a permanent pension study commission be established to provide both technical and policy advice to the Governor, the Legislature, and to local policymakers on matters relating to changes in the benefits, funding, investments, and administration of retirement systems in the state. This pension commission would have an advisory role only, similar to that of the State's Capital Budgeting and Planning Commission, and would be comparable to the pension study commissions that have been established in 21 other states.

Pension policy is a specialized subject that requires a level of familiarity and understanding that cannot be acquired quickly or with only sporadic attention to the topic. A permanent study commission offers the ongoing perspective needed for the continuity of policy decisions that will best serve the short and long-run interests of workers and taxpayers. The pension commission would: 1) review bills and evaluate their impacts for both workers and employers; 2) prepare fiscal or actuarial notes for each proposed policy change; and, 3) monitor changes in economic, demographic or social conditions that are likely to affect retirement policies in the state adversely and suggest preventive or corrective actions for state and local policymakers.

Several Commission members thought that a permanent pension study group was unnecessary. They argued that the role outlined above for the panel is capably filled by the State's Division of Pensions, the Division of Investment, and the Office of Legislative Services. A permanent pension commission would, in their view, only add an additional layer of bureaucracy to State government and insulate policymakers. The opponents to the permanent pension commission also argue that pensions should not be singled out for closer scrutiny. First, several areas of state and local spending are larger and growing faster than expenditures for retirement benefits and yet no permanent commissions have been proposed to study these areas. In addition, the problems of inadequate fiscal notes or cost estimates are not limited to pensions. These procedures should be improved for all areas of state and local spending. Finally, the State provides several services aimed at retired or elderly residents. A permanent pension study commission will single out public retirees among all retirees for closer scrutiny.

All of the above points were presented and carefully considered by the Commission in recommending a permanent pension study commission.

VII. IMPACTS AND CONCLUSIONS

The Commission recommends that the revenue reforms proposed be implemented in January of the calendar year and that the expenditure reforms be enacted in July of that same calendar year. This phase-in schedule will minimize disruptions and reduce the adjustments required by taxpayers, service recipients, state aid recipients and state agencies. The one-time revenue windfall should be added to the state-run infrastructure pool and used to finance needed infrastructure investments throughout the state. This chapter will examine the impact of the Commission proposals on an illustrative sample of municipalities and households.

THE IMPACT OF COMMISSION PROPOSALS ON SELECTED MUNICIPALITIES

As a result of the Commission's recommendations, only 13 municipalities will have total effective tax rates above $3.00 per $100 of true market value. Here we discuss the impact of our recommendations on the fiscal situation in a representative sample of New Jersey's cities and towns. The changes highlighted in this summary are the state assumption of selected county and municipal costs such as courts, public assistance, prosecutors and mental health, and the increased state aid to cities, school districts and county colleges. The result of these changes is a state-wide reduction in local property taxes of $1.2 billion. The fifteen municipalities selected as examples include several of New Jersey's large cities and a representative sample of suburban, rural and shore communities. The sample cities are discussed alphabetically.

Atlantic City

Atlantic City is an older, redeveloping shore city with a 1986 population of 36,219 and a 1985 per capita equalized property valuation of $121,821. In 1986 Atlantic City had an actual effective real property tax rate of $2.02 per $100 of property value and received $8,164,468 in state aid.

Under the Commission's recommendations, Atlantic City would have received the same amount of state aid in 1986 ($8,164,468) and would have reduced its levy by more than $6,750,000 due to the state assumption of selected county and municipal costs and an increase of $206,782 in school aid. The effective property tax rate in Atlantic City would have been $1.902 per $100. This would translate into a $118 reduction in property taxes for the owner of a $100,000 home.

Beach Haven

Beach Haven is a developing shore community in Ocean County with a 1986 population of 1,812 and a 1985 per capita equalized property valuation of $168,082. In 1986, Beach Haven received $256,228 in state aid and had an effective tax rate of $1.241 per $100 of real property value.

Had the Commission's recommendations been in place in 1986, Beach Haven would have received the same amount of municipal state aid ($256,228), and would have reduced its levy by more than $213,083 due to the state assumption of selected county and municipal costs and an increase of $1,448 in school aid. The result of these changes would be a new effective property tax rate of $1.176 per $100. The owner of a $100,000 home would have received a property tax reduction of $65.

Bedminster

Bedminster is a rapidly growing rural suburban community with a 1986 population of 4,238 and a 1985 per capita equalized property valuation of $123,417. In 1986 Bedminster had an actual effective real property tax rate of $1.230 per $100 of property value and received $426,326 in state aid.

As a result of the Commission's recommendations, Bedminster, in 1986, would have received the same amount of state aid ($426,326) and would have reduced its levy by more than $449,000 due to the state assumption of selected county

and municipal costs and an increase of $17,107 in school aid. The effective property tax rate in Bedminster would have been $1.138 per $100. This would translate into a $92 reduction in property taxes for the owner of a $100,000 home.

Blairstown

Blairstown is a rural community with a 1986 population of 4,890 and a 1985 per capita equalized property valuation of $38,279. In 1986 Blairstown had an actual effective real property tax rate of $0.902 per $100 of property value.

As a result of the Commission's recommendations, Blairstown, in 1986, would have received the same amount of state aid ($2,961,698) and would have reduced its levy by more than $383,000 due to the state assumption of selected county and municipal costs and an increase of $107,227 in school aid. The effective property tax rate in Blairstown would have been $0.708 per $100. This translates into a $194 reduction in property taxes for the owner of a $100,000 home.

Camden

Camden is an older, redeveloping central city with a 1986 population of 83,265 and a 1985 per capita equalized property valuation of $6,021. In 1986 Camden had an actual effective real property tax rate of $5.884 per $100 of property value and received $9,431,694 in state aid.

As a result of the Commission's recommendations, Camden, in 1986, would have received $22,920,068 in state aid (an increase of over $13 million) and would have reduced its levy by more than $3,658,000 due to the state assumption of selected county and municipal costs and an increase of $623,335 in school aid. The effective property tax rate in Camden would have been $2.904 per $100. This translates into a $2,980 reduction in property taxes for the owner of a $100,000 home.

Elizabeth

Elizabeth is an older, redeveloping central city with a 1986 population of 106,656 and a 1985 per capita equalized property valuation of $14,257. In 1986 Elizabeth had an actual effective real property tax rate of $2.961 per $100 of property value and received $16,494,291 in state aid.

As a result of the Commission's recommendations, Elizabeth, in 1986, would have received $24,666,414 in state aid (an increase of over $8 million) and would have reduced its levy by more than $5,391,000 due to the state assumption of selected county and municipal costs and an increase of $2,258,797 in school aid. The effective property tax rate in Elizabeth would have been $2.136 per $100. This translates into a $855 reduction in property taxes for the owner of a $100,000 home.

Freehold Borough

Freehold Borough is an older, developing city with a 1986 population of 10,107 and a 1985 per capita equalized property valuation of $23,893. In 1986 Freehold Borough had an actual effective real property tax rate of $2.468 per $100 of property value and received $773,107 in state aid.

As a result of the Commission's recommendations, Freehold Borough, in 1986, would have received $1,455,373 in state aid (an increase of more than $682,000) and would have reduced its levy by more than $396,000 due to the state assumption of selected county and municipal costs and an increase of $87,587 in school aid. The effective property tax rate in Freehold Borough would have been $2.085 per $100. This translates into a $383 reduction in property taxes for the owner of a $100,000 home.

Hamilton Township

Hamilton Township in Mercer County is a growing suburban city with a 1986 population of 87,375 and a 1985 per capita equalized property valuation of $23,121. In 1986 Hamilton had an actual effective real property tax rate of $2.737 per $100 of property value and received $17,496,509 in state aid.

As a result of the Commission's recommendations, Hamilton, in 1986, would have received the same amount of state aid ($17,496,509) and would have reduced its levy by more than $5,056,000 due to the state assumption of selected county and municipal costs and an increase of $1,957,105 in school aid. The effective property tax rate would have been $2.507 per $100. This translates into a $230 reduction in property taxes for the owner of a $100,000 home in Hamilton.

Jersey City

Jersey City is an older, redeveloping central city with a 1986 population of 218,576 and a 1985 per capita equalized property valuation of $10,646. In 1986 Jersey City had an actual effective real property tax rate of $5.066 per $100 of property value and received $39,756,377 in state aid.

As a result of the Commission's recommendations, Jersey City, in 1986, would have received $58,567,200 in state aid (an increase of more than $18,810,000) and would have reduced its levy by more than $23,165,000 because of the state assumption of selected county and municipal costs and an increase of $9,692,219 in school aid. The effective property tax rate in Jersey City would have been $3.421 per $100. This translates into a $1,645 reduction in property taxes for the owner of a $100,000 home.

Montclair

Montclair is an older, stable suburban community with a 1986 population of 38,705 and a 1985 per capita equalized property valuation of $37,106. In 1986 Montclair had an actual effective real property tax rate of $3.518 per $100 of property value and received $2,721,904 in state aid.

As a result of the Commission's recommendations, Montclair, in 1986, would have received $3,858,019 in state aid (an increase of more than $1.1 million) and would have reduced its levy by more than $4,550,000 due to the state assumption selected county and municipal costs and an increase of $182,436 in school aid. The effective property tax rate in Montclair would have been

$3.135 per $100. The reduced property tax rate translates into a $383 reduction in property taxes for the owner of a $100,000 home.

Newark

Newark is New Jersey's largest city with a 1986 population of 316,345 and a 1985 equalized per capita property valuation of $7,188. In 1986 Newark had an effective property tax rate of $4.752 per $100 of property value and received $60,255,023 in state aid. In addition, Newark is the only city in the state to have a payroll tax.

As a result of the Commission's recommendations, Newark, in 1986, would have received $95,058,371 in state aid (an increase of more than $34 million) and would have reduced its levy by more than $36,922,000 due to the state assumption of selected county and municipal costs and an increase of $20,072,501 in school aid. The payroll tax would be eliminated and the state would provide the city with additional funding as part of the state aid package. The effective property tax rate in Newark would have been $2.711 per $100. This translates into a $2,041 reduction in property taxes for the owner of a $100,000 home.

Paterson

Paterson is an older, redeveloping city with a 1986 population of 139,453 and a 1985 per capita equalized property valuation of $9,594. In 1986 Paterson had an effective real property tax rate of $3.913 per $100 of property value and received $8,387,473 in state aid.

As a result of the Commission's recommendations, Paterson would have received $30,418,299 in state aid (an increase of more than $22 million) and would have reduced its levy by more than $5,054,000 million due to the state assumption of selected county and municipal costs and an increase of $1,276,752 in school aid. The effective property tax rate in Paterson would have been $2.055 per $100. This translates into a $1,858 reduction in property taxes for the owner of a $100,000 home.

Plainsboro

Plainsboro is a rapidly growing suburban community with a 1986 population of 10,656 and a 1985 per capita equalized property valuation of $63,420. In 1986 Plainsboro had an actual effective real property tax rate of $1.761 per $100 of property value and received $700,674 in state municipal aid.

As a result of the Commission's recommendations, Plainsboro would have received the same amount of state aid ($700,674) and would have reduced its levy by more than $689,000 due to the state assumption of selected county and municipal costs and an increase of $28,336 in school aid. The effective property tax rate in Plainsboro would have been $1.670 per $100. This translates into a $91 reduction in property taxes for the owner of a $100,000 home.

Trenton

Trenton, the state capital, is an older, redeveloping central city with a 1986 population of 91,746 and a 1985 per capita equalized property valuation of $9,308. In 1986 Trenton had an actual effective real property tax rate of $4.845 per $100 of property value and received $7,910,297 in state municipal aid.

As a result of the Commission's recommendations, Trenton, in 1986, would have received $24,354,803 in state aid (an increase of more than $16 million) and would have reduced its levy by more than $5,934,000 due to the state assumption of selected county and municipal costs and an increase of $3,524,563 in school aid. The effective property tax rate in Trenton would have been $2.440 per $100. This translates into a $2,405 reduction in property taxes for the owner of a $100,000 home.

Upper Saddle River

Upper Saddle River is a Bergen County suburban community with a 1986 population of 7,845 and a 1985 per capita equalized property valuation of

$77,480. In 1986 Upper Saddle River had an actual effective real property tax rate of $1.794 per $100 of property value and received $1,025,001 in state municipal aid.

As a result of the Commission's recommendations, Upper Saddle River, in 1986, would have received the same amount of state aid ($1,025,001) and would have reduced its levy by more than $408,000 due to the state assumption of selected county and municipal costs and an increase of $30,064 in school aid. The effective property tax rate in Upper Saddle River would have been $1.732 per $100. This translates into a $62 reduction in property taxes for the owner of a $100,000 home.

Summary

The sample of fifteen communities demonstrates that a major effect of the Commission's recommendations will be to reduce the reliance on local taxes. Every community in the State of New Jersey would have lower property taxes because no community would receive less state aid than currently, school aid would be increased substantially, and the state would assume the costs of county and municipal services such as the courts, welfare, prosecutors, and the care of indigent patients in mental institutions.

The attached table lists the fifteen communities and the impact of the Commission's recommendations on effective property tax rates. The actual 1986 effective real property tax rates range from $5.884 per $100 in Camden to $0.902 per $100 in Blairstown: a difference of $4.982 per $100 of market value or $4,982 in property taxes on a $100,000 home. As a result of the Commission's recommendations, the 1986 effective real property tax rates would range from $3.421 per $100 in Jersey City to $0.708 per $100 in Blairstown: a difference of $2.713 per $100 of market value or $2,713 in property taxes on a $100,000 home. The difference in the maximum and minimum property taxes paid in the selected cities is reduced by almost half.

In summary, the Commission's proposals would provide property tax relief throughout the state and significantly reduce property tax burdens in cities with high effective property tax rates.

Figure 10

IMPACT OF COMMISSION RECOMMENDATIONS IN MAJOR URBAN JURISDICTIONS

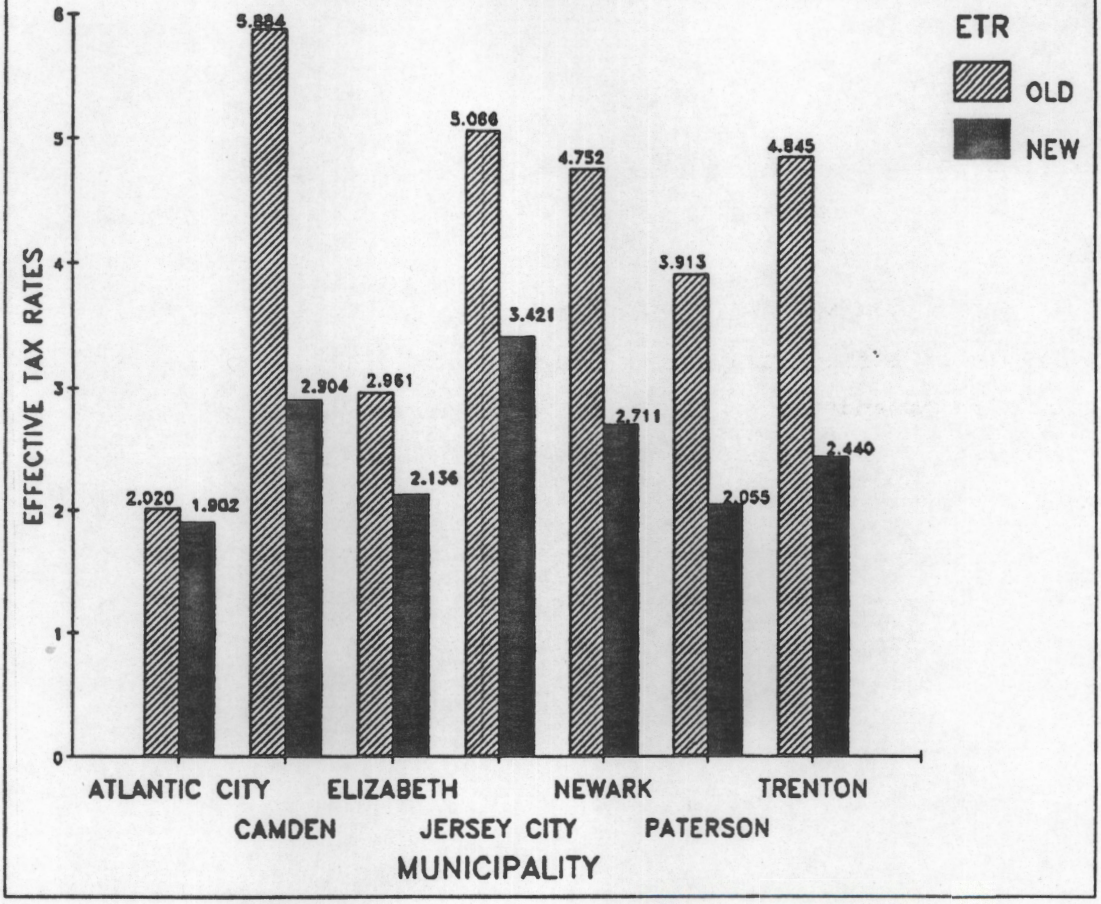


Table 10

IMPACT OF COMMISSION RECOMMENDATIONS ON SELECTED CITIES

Selected Municipalities	Existing Effective Tax Rate	Effective Tax Rate After Recommendations	Difference in Effective Tax Rates
Atlantic City	2.020	1.902	0.118
Beach Haven	1.241	1.176	0.065
Bedminster	1.230	1.138	0.092
Blairstown	0.902	0.708	0.194
Camden	5.884	2.904	2.980
Elizabeth	2.961	2.136	0.855
Freehold Borough	2.468	2.085	0.383
Hamilton Township	2.737	2.507	0.230
Jersey City	5.066	3.421	1.645
Montclair	3.518	3.135	0.383
Newark	4.752	2.711	2.041
Paterson	3.913	2.055	1.858
Plainsboro	1.761	1.670	0.091
Trenton	4.845	2.440	2.405
Upper Saddle River	1.794	1.732	0.062

Source: Compiled by Commission Staff, using data from State of New Jersey, Annual Report of the Division of Taxation in the Department of the Treasury for the Fiscal Year 1986, Trenton, New Jersey, 1987

THE IMPACT OF COMMISSION PROPOSALS ON SELECTED HOUSEHOLDS

The burden of the state's tax system falls disproportionately on the poor. Table 11 shows the average tax and taxes as a percent of income for the real property, general sales, and gross income taxes for different levels of income. Together, these three taxes account for most of the taxes paid directly by households. Homeowners with less than $10,000 in annual cash income devote more than 33 percent of that income to the three taxes. Conversely, homeowners with incomes over $200,000 in annual income pay an average of less than five percent of their incomes to these three taxes.

The Commission's proposals will redistribute state and local tax burdens among households. The changes result from proposals to broaden the general sales and gross income tax bases, to increase the gross income tax rates for high-income households, and to provide refundable tax credits to reduce the regressive burden on low-income households of the real property and consumption taxes. The poorest households will have their average tax burden reduced by 25 percent as a result of the Commission's recommendations, while households with incomes over $200,000 will experience a 20 percent tax increase. More generally, most households with cash incomes of $50,000 or less will benefit from declining tax burdens, while households with incomes above $50,000 will pay more in taxes. Some part of this increase in New Jersey tax liability will be used to offset federal tax liability through itemized deductions. Therefore, the increased tax burdens are probably overstated for households with over $50,000. Nevertheless, the poorest households will continue to pay a greater share of their cash income in taxes than the more well-to-do households even after the Commission's proposals are enacted. Households with incomes of $10,000 or less will pay 24 percent of their income in taxes, compared to 5.3 percent of income that will be paid by households with income greater than $200,000.

The information in Table 11 reflects average incomes, tax burdens, and benefits from policies proposed by the Commission. The actual taxes paid and the effects of proposed changes will, of course, depend on household size, spending patterns, source of income, and place of residence. To demonstrate

Figure 11

AVERAGE IMPACT OF THE COMMISSION'S PROPOSALS, BY HOMEOWNER INCOME CLASS

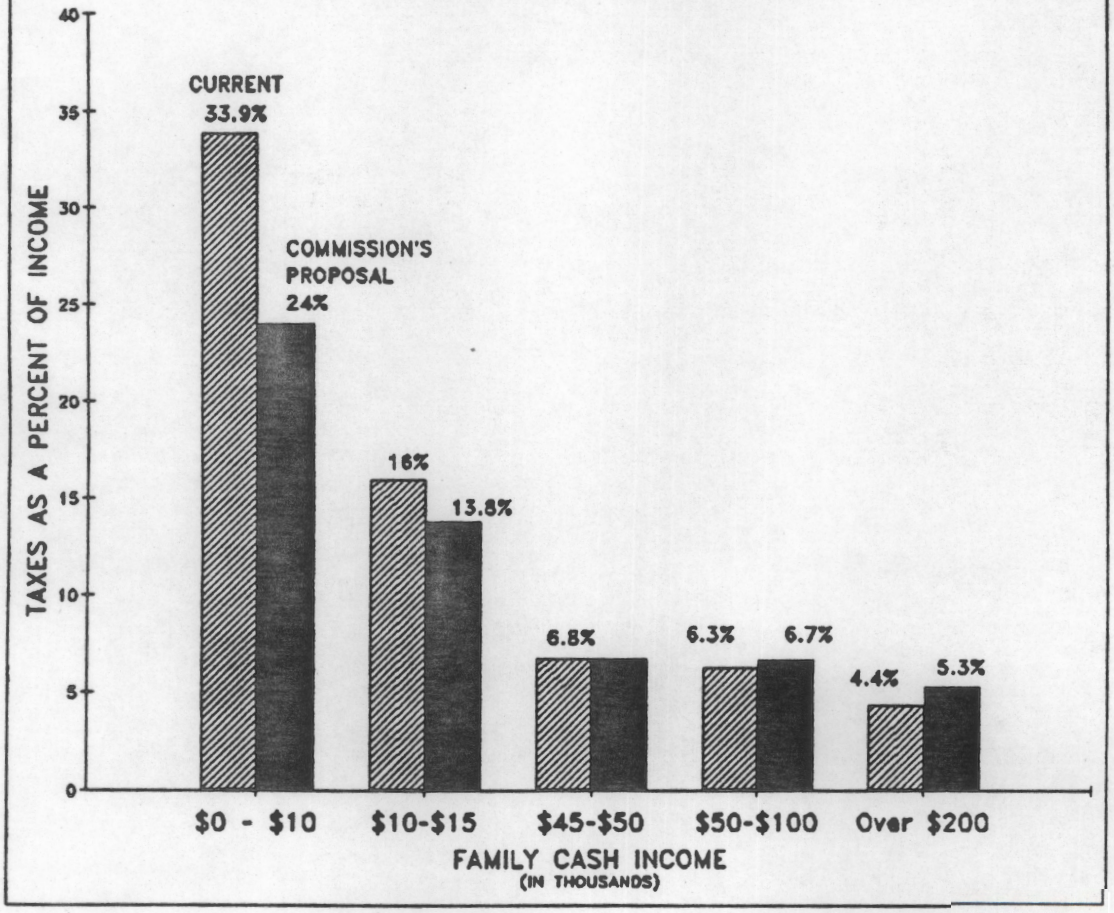


Table 11

ESTIMATED AVERAGE IMPACT OF COMMISSION'S PROPOSALS ON HOMEOWNERS

INCOME CLASS (000s)	NUMBER OF FAMILIES (000s)	AVERAGE INCOME	CURRENT TAXES		PROPOSED CHANGES							PROPOSED TAXES		
					SALES TAX		INCOME TAX		PROPERTY TAX					
			AVG TAX	TAX as % INCOME	BASE CHANGES@	CONSUMPTION CREDIT	BASE CHANGES*	TAX RATE	STATE AID#	REPEAL REBATE	CIRCUIT BREAKER	CHANGE IN TAXES	TOTAL TAX	TAX as % INCOME
UNDER $10	99.5	$5,320	$1,803	33.9%	$21	($185)	$67	$0	($384)	$200	($246)	($527)	$1,276	24.0%
$10 - 15	83.3	$12,609	$2,013	16.0%	$40	($115)	$71	$0	($265)	$207	($217)	($279)	$1,734	13.8%
$15 - 20	91.2	$17,547	$2,004	11.4%	$49	($50)	$72	$0	($211)	$206	($199)	($133)	$1,871	10.7%
$20 - 25	109.6	$22,586	$2,053	9.1%	$57	$0	$72	$0	($213)	$205	($182)	($61)	$1,992	8.8%
$25 - 30	102.4	$27,515	$2,277	8.3%	$60	$0	$72	$0	($213)	$199	($181)	($63)	$2,214	8.0%
$30 - 35	124.4	$32,491	$2,541	7.8%	$62	$0	$74	$0	($230)	$197	($170)	($67)	$2,474	7.6%
$35 - 40	110.6	$37,409	$2,734	7.3%	$76	$0	$74	$0	($230)	$195	($161)	($46)	$2,688	7.2%
$40 - 45	110.3	$42,596	$2,969	7.0%	$84	$0	$75	$0	($230)	$195	($160)	($36)	$2,933	6.9%
$45 - 50	97.0	$47,364	$3,240	6.8%	$93	$0	$75	$0	($230)	$192	($130)	$0	$3,240	6.8%
$50 - 100	462.1	$68,061	$4,273	6.3%	$122	$0	$88	$107	($245)	$187	$0	$259	$4,532	6.7%
$100 - 200	95.5	$130,822	$7,679	5.9%	$211	$0	$137	$706	($297)	$188	$0	$945	$8,624	6.6%
OVER $200	33	$427,320	$18,608	4.4%	$296	$0	$174	$3,685	($379)	$191	$0	$3,967	$22,575	5.3%

@ Assumes 50% of estimated change is paid directly by households.

* Repeal of Ch. 304 and college and pension exemptions for taxpayers with taxable income over $50,000.

Includes state assumption of local responsibilities, increased school aid, and Municipal Equalization Aid Program.

SOURCE: Compiled by New Jersey Division of Taxation and Commission Staff

the effects of the recommendations on different households and in different locations, we have estimated the change in tax burden for six illustrative households: 1) a low-income retired couple with no dependents; 2) a low-income single parent with two dependents; 3) a moderate-income single individual who works out of state; 4) a moderate-income couple with two dependents; 5) a middle-income retired couple with one dependent; and 6) and upper-income couple with two dependents. The effects of the recommendations are discussed for four municipalities chosen to illustrate the results of property tax changes in an urban jurisdiction (Newark), a suburban jurisdiction (Hamilton Township, Mercer County), a shore community (Beach Haven, Ocean County) and a rural community (Commercial Township, Cumberland County).

The Commission also estimated the average market value of the home each household would own, using data on the number of households in each income level, actual property taxes, and effective tax rates. The homestead rebate for the illustrative households represents the average rebate received by a homeowner in the income class in each of the selected municipalities. (See Appendix E for a detailed explanation of the methodology.) The effects for each household type in each municipality are discussed in turn. The reductions in property taxes are a result of increased state aid to local governments, including state assumption of responsibility for services currently provided by counties or municipalities, increased school aid, and the Municipal Equalization Aid Program.

Low-Income Retired Couple

This household consists of an elderly couple with no dependents, two additional tax exemptions because of their age, and total cash income of $12,000, primarily from social security income. Because social security income is not taxed, they currently receive a refundable tax credit of $57. They also pay $212 in sales taxes. As a result of the Commission's recommendations to broaden the income tax base, this couple would still pay no income taxes but it would lose the refundable tax credit. Sales taxes would increase to $252. However, they would be eligible for a refundable consumption tax credit of $130, decreasing the actual amount of the sales tax burden by $90 from the current amount.

This couple would also be eligible for the graduated property tax circuit breaker, which depends upon the property taxes that they actually pay as well as their income. The effect of these proposed changes will vary because benefits of the reduction in property taxes and the circuit breaker depend upon the jurisdiction in which they live.

If the couple lives in an urban jurisdiction, such as Newark, they own a home with a market value of $31,320. With an effective tax rate of $4.75 per $100 value, their yearly property tax bill would be $1,488. After the increase in state aid, the effective tax rate would decrease to $2.71 per $100. This tax rate would result in a yearly property tax bill of $849, a reduction of more than 40 percent. In addition, they would receive a circuit breaker credit of $75 against their gross income tax liability, for an effective reduction of $774 in property taxes. Even with the elimination of the homestead rebate, this couple would experience an overall reduction of $542, or 33 percent, in state and local taxes.

If the retired couple lived in a suburban jurisdiction, such as Hamilton, they would own a home with a market value of $58,675 and have a yearly property tax bill of $1,608, based on an effective tax rate of $2.74 per $100 value. Their homestead rebate would be $205. After the proposed changes, the effective property tax rate would decrease to $2.51 per $100 value. This rate would result in a yearly property tax bill of $1,471. Based upon this property tax bill, their circuit breaker credit would be $135. Overall, the couple would have a $98 reduction in state and local taxes in this community.

If the retired couple lived in a shore town, such as Beach Haven, the market value of their home is $133,580. With an effective tax rate of $1.24 per $100, their yearly property tax bill would be $1,656. Their homestead rebate would be $198. With the adoption of the Commission's proposals the effective tax rate would decrease to $1.176 per $100. The new rate would result in a property tax bill of $1,571. Based upon this bill, the circuit breaker credit would be $152. The couple would have a $41 reduction in taxes as a result of all our recommendations.

If the retired couple lived in a rural community, such as Commercial, the market value of their home would be $21,635, and the effective tax rate would be $2.823 per $100. This rate results in a yearly property tax bill of $611 and a homestead rebate of $188. As a result of our proposals, the effective tax rate would be reduced to $1.872, and the couple would be billed for $405 in property taxes. The circuit breaker credit would be $75. The changes in state and local taxes would result in a $126 reduction in the couple's state and local tax burden in the rural community.

Low-Income Single Parent with Two Dependents

A single parent with two dependents and wage income of $7,500 pays $156 in sales taxes and $49 in income taxes. With the recommended changes, the amount paid in sales taxes would rise by $29 to $185. However, the actual amount of payments in sales taxes would be completely offset by the refundable consumption tax credit of $185. The income tax burden of this household would increase to $131 as a result of the recommendations to broaden the tax base. The effect of the sales and income tax recommendations would result in this household paying $129 less in state taxes.

To determine the total impact of the Commission's recommendations on this household's state and local tax burdens, the value of the homestead rebate and the change in property taxes in each of the four municipalities must be determined. In addition, this household is eligible for a property tax circuit breaker credit, which will vary according to the property taxes actually paid.

In the urban jurisdiction, this single-parent household would own a home with a market value of $28,275 and pay $1,343 in property taxes, the result of an effective tax rate of $4.75 per $100 value. After the proposed changes, the tax rate would be reduced to $2.51 per $100 and the property tax would be reduced by $577 to $767. The household would receive a circuit breaker credit of $75, partially offsetting the elimination of the homestead rebate of $220. The overall result of our recommendations is thus a reduction of $506 in this household's state and local tax burden in the urban jurisdiction.

In the suburban jurisdiction, the market value of their home would be $50,790. At an effective property tax rate of 2.74 per $100, their property tax bill would be $1,392. After the proposed changes, the effective property tax rate would be $2.51 per $100 and this household would pay $1,273 in property taxes. This is a $118 reduction in property taxes. They would lose $223 as a result of the elimination of the homestead rebate but receive a circuit breaker credit of $164. The overall result would be a reduction of $132 in this household's state and local tax burden.

The market value of this family's home in the shore community would be $109,855. They would pay $1,362 in property taxes, reflecting an effective rate of $1.24 per $100. Their homestead rebate would be $207. This household would pay $1,292 in property taxes after the proposed changes, a reduction of $70, and receive a circuit breaker credit of $164. The overall reduction in state and local taxes would be $101.

This family in the rural community would own a home with a market value of $17,545 and pay $495 in property taxes at an effective rate of $2.823 per $100. Their homestead rebate would be $178. After the proposed changes, this household's property taxes would be reduced by $167 to $328. Overall, this household would receive a circuit breaker credit of $75 and experience a $138 reduction in state and local taxes.

Moderate-Income Single Individual Working Out of State

A single person with no dependents who works out of state, has a wage income of $34,400 and other investment income of $1,400 currently pays $286 in sales taxes and receives a refundable tax credit of $45. The Commission's proposals would result in a $57 increase in sales taxes and an $71 increase in New Jersey income taxes. This individual's income is too high to be eligible for the consumption tax offset. The taxpayer's out-of-state tax burden is assumed to remain constant. The effect of the base-broadening proposals is to increase this individual's state tax burden by $128.

This individual would be eligible for a circuit breaker credit. The amount of the credit, the value of the eliminated homestead rebate, and the reduction in property taxes vary according to the municipality in which the taxpayer resides.

In the urban jurisdiction, this individual's home would have a market value of $32,855. The property tax bill would be $1,561, based upon an effective rate of $4.75 per $100 value. The homestead rebate would be $201. After the proposed changes, this individual's property taxes would be reduced by $670. The circuit breaker credit would be $75, giving this individual an overall reduction of $416 in state and local taxes.

The market value of this individual's home in the suburban jurisdiction would be $64,715. The property taxes would be $1,773, based upon an effective rate of $2.74 per $100. The homestead rebate would be $187. The Commission's recommendations would reduce the effective rate to $2.52, lowering the property taxes to $1,622. With a circuit breaker credit of $135, this individual would find his overall tax burden increased by $31 in the suburban jurisdiction.

In the shore community, this individual would own a home with a market value of $140,835 and pay $1,746 in property taxes at an effective rate of $1.24 per $100. The homestead rebate would be $174. After the proposed changes to state aid and local services, this individual's property taxes would be reduced to $1,656. The circuit breaker credit would be $135. Overall, this individual would experience an increase of $77 in state and local taxes.

The market value of this individual's home in the rural community would be $25,455. The property taxes would be $719, based upon an effective rate of $2.823 per $100, and the homestead rebate would be $184. After the proposed changes, this individual's property taxes would be $477. This would be partially offset by a circuit breaker credit of $75. Overall, this individual would experience an decrease of $5 in state and local taxes.

This individual would be eligible for a circuit breaker credit. The amount of the credit, the value of the eliminated homestead rebate, and the reduction in property taxes vary according to the municipality in which the taxpayer resides.

In the urban jurisdiction, this individual's home would have a market value of $32,855. The property tax bill would be $1,561, based upon an effective rate of $4.75 per $100 value. The homestead rebate would be $201. After the proposed changes, this individual's property taxes would be reduced by $670. The circuit breaker credit would be $75, giving this individual an overall reduction of $416 in state and local taxes.

The market value of this individual's home in the suburban jurisdiction would be $64,715. The property taxes would be $1,773, based upon an effective rate of $2.74 per $100. The homestead rebate would be $187. The Commission's recommendations would reduce the effective rate to $2.52, lowering the property taxes to $1,622. With a circuit breaker credit of $135, this individual would find his overall tax burden increased by $31 in the suburban jurisdiction.

In the shore community, this individual would own a home with a market value of $140,835 and pay $1,746 in property taxes at an effective rate of $1.24 per $100. The homestead rebate would be $174. After the proposed changes to state aid and local services, this individual's property taxes would be reduced to $1,656. The circuit breaker credit would be $135. Overall, this individual would experience an increase of $77 in state and local taxes.

The market value of this individual's home in the rural community would be $25,455. The property taxes would be $719, based upon an effective rate of $2.823 per $100, and the homestead rebate would be $184. After the proposed changes, this individual's property taxes would be $477. This would be partially offset by a circuit breaker credit of $75. Overall, this individual would experience an decrease of $5 in state and local taxes.

Moderate-Income Family of Four

This is the average household in the state, with the median household income for New Jersey of $33,500. This family currently pays $392 in sales taxes and $434 in income taxes. The Commission's proposals would result in a $60 increase in sales taxes and an $81 increase in income taxes. The household income is too high to be eligible for the consumption tax offset. The effect of the Commission's recommendations to broaden the income tax base would be to increase this family's state taxes by $141.

To determine the total impact of the Commission's recommendations on this household's state and local tax burdens, the value of the homestead rebate and the change in property taxes in each of the four municipalities must be determined. In addition, this household is eligible for a property tax circuit breaker credit, which will vary according to the level of household income and the property taxes actually paid.

In the urban jurisdiction, the market value of this family's home would be $31,300. They would pay $1,487 in property taxes and receive a homestead rebate of $201. After the proposed changes, the property taxes on their home would be reduced to $849. Their circuit breaker credit would be $75. Overall, this family would experience a $372 reduction in state and local taxes.

In the suburban jurisdiction, this family would own a home with a market value of $62,375 and pay $1,709 in property taxes. Their homestead rebate would be $190. After the proposed changes, this family's property taxes would be reduced by $145. They would also receive a circuit breaker credit of $135. Overall, this family's state and local taxes would be increased by $53 as a result of these changes.

In the shore community, this family's home would have a market value of $119,300. They would pay $1,479 in property taxes, which would be reduced by $76 as a result of changes recommended by the Commission. They currently receive a homestead rebate of $187, which would be eliminated. Based upon their income and property tax, this family would receive a circuit breaker

credit of $135. Overall, they would experience an increase of $117 in state and local taxes in the shore community.

In the rural community, the market value of this family's home would be $22,970 and they would pay $648 in property taxes based upon an effective rate of $2.823 per $100. They would receive a homestead rebate of $184. The proposed changes would reduce this family's property taxes by $218. Their circuit breaker credit would be $75, increasing their overall tax burden by $32.

Middle-Income Retired Couple

This household consists of a retired couple with a total cash income of $58,700, including $17,000 in wages. They have one dependent. This couple currently pays $682 in sales taxes and $685 in income taxes. The Commission's proposals would result in a $100 increase in sales taxes. The household's income is too high to be eligible for the consumption tax offset. The couple's income taxes would increase by $100 as a result of broadening the base. The effect of these Commission proposals is to increase this couple's state tax burden by $200.

The total effect of our recommendations will depend upon the value of the homestead rebate, which will be eliminated, and the reduction in property taxes that results from the increase in state aid. Each of these varies by municipality.

The market value of this household's home in the urban jurisdiction would be $34,400. Their property tax bill would be $1,634, based upon an effective rate of $4.75 per $100. The Commission's recommendations would reduce the rate to $2.74 per $100, increasing the property tax bill to $933. Because their cash income exceeds $50,000, they would not be eligible for the circuit breaker credit. Their homestead rebate of $204 would be eliminated. Nevertheless, the overall effect of the recommendations would to decrease this couple's tax burden by $297 in the urban municipality.

Table 12

IMPACT OF COMMISSION'S PROPOSALS ON SIX HOUSEHOLDS*

Household Type and Location	Current Taxes**	Property Tax Changes			Sales Tax Changes		Income Tax Changes		Total Impact	
		State Aid Increases***	Homestead Rebate	Circuit Breaker	Base Broadening	Consumption Credit	Base Broadening	Rate Increases	Proposed Taxes	Increase or (Decrease)
Low-Income Retired Couple										
Urban	$1,643	($639)	$205	($75)	$40	($130)	$57	$0	$1,101	($542)
Suburban	$1,763	($135)	$205	($135)	$40	($130)	$57	$0	$1,665	($98)
Shore	$1,811	($85)	$198	($152)	$40	($130)	$57	$0	$1,739	($72)
Rural	$766	($206)	$188	($75)	$40	($130)	$57	$0	$640	($126)
Low-Income Single Parent with Two Children										
Urban	$1,548	($577)	$220	($75)	$29	($185)	$82	$0	$1,043	($506)
Suburban	$1,597	($117)	$223	($164)	$29	($185)	$82	$0	$1,465	($132)
Shore	$1,567	($70)	$207	($164)	$29	($185)	$82	$0	$1,466	($101)
Rural	$700	($167)	$178	($75)	$29	($185)	$82	$0	$562	($138)
Moderate-Income Individual Who Commutes Out of State										
Urban	$1,802	($670)	$201	($75)	$57	$0	$71	$0	$1,386	($416)
Suburban	$2,014	($149)	$187	($135)	$57	$0	$71	$0	$2,045	$31
Shore	$1,987	($90)	$174	($135)	$57	$0	$71	$0	$2,064	$77
Rural	$960	($242)	$184	($75)	$57	$0	$71	$0	$955	($5)
Moderate-Income Family of Four										
Urban	$2,313	($638)	$201	($75)	$60	$0	$81	$0	$1,941	($372)
Suburban	$2,535	($143)	$190	($135)	$60	$0	$81	$0	$2,588	$53
Shore	$2,305	($76)	$187	($135)	$60	$0	$81	$0	$2,422	$117
Rural	$1,474	($218)	$184	($75)	$60	$0	$81	$0	$1,506	$32
Middle-Income Retired Couple, One Dependent										
Urban	$3,001	($701)	$204	$0	$100	$0	$100	$0	$2,704	($297)
Suburban	$3,376	($169)	$186	$0	$100	$0	$100	$0	$3,594	$217
Shore	$3,309	($100)	$184	$0	$100	$0	$100	$0	$3,593	$284
Rural	$2,307	($317)	$186	$0	$100	$0	$100	$0	$2,376	$69
Upper-Income Family of Four										
Urban	$7,333	($851)	$214	$0	$244	$0	$143	$719	$7,802	$469
Suburban	$7,756	($202)	$189	$0	$244	$0	$143	$719	$8,849	$1,093
Shore	$7,525	($112)	$178	$0	$244	$0	$143	$719	$8,697	$1,172
Rural	$7,573	($749)	$205	$0	$244	$0	$143	$719	$8,135	$562

Notes to Table: * Based upon statewide average tax liability for households having stated characteristics.
Does not include proposed utility tax changes as these will vary depending upon energy consumption patterns.
** Property, personal income, sales and selective sales taxes only.
*** Includes state assumption of local service responsibilities, increased school aid, and the Municipal Equalization Aid Program.

Source: Compiled by New Jersey Division of Taxation and Commission staff.

In the suburban jurisdiction, this household's home would likely have a market value of $73,330. Based upon an effective property tax rate of $2.74, their property tax bill would be $2,009. They would receive a homestead rebate of $186. This couple's property tax bill would be reduced to $1,838 after the proposed changes. Living in a suburban jurisdiction, this household would experience an overall increase of $217 in state and local taxes as a result of the Commission's recommendations.

In the shore community, this household would own a home with a market value of $156,625 and receive a property tax bill of $1,942. The couple's property tax bill would be reduced by $100 to $1,842 after the proposed changes. With no circuit breaker credit and the elimination of a $184 homestead rebate, this household would experience an overall increase of $284 in state and local taxes in the shore community.

In the rural community, this household's home would have a market value of $33,290. They would receive a property tax bill of $940 and a homestead rebate of $186. The proposed changes would reduce the couple's property tax bill by $317, resulting in an increase of $69 in state and local taxes in this community.

Upper-Income Family of Four

A family of four with a taxable income of $146,900 currently pays $1,548 in sales taxes and $3,802 in income taxes. Broadening the base of these two taxes would result in increases of $244 in sales taxes and $143 in income taxes. The rate increase would result in an increase of $719 in income taxes, for an increase in state taxes of $1,106.

In the urban jurisdiction, the market value of this family's would be $41,740, and they would pay $1,983 in property taxes. Increases in state aid would reduce their property taxes to $1,132. After accounting for this reduction in property taxes and the loss of their $214 homestead rebate, this family's total state and local tax burden would increase by $469 in the urban jurisdiction.

In the suburban jurisdiction, their home would have a market value of $87,800. Based upon an effective tax rate of $2.74 per $100, they would pay $2,406 in property taxes and receive a homestead rebate of $205. Implementing the Commission's recommendations would reduce their property taxes by $205. This family would then experience an increase of $1,093 in state and local taxes.

The market value of this family's home in the shore community would be $175,440. The effective property tax rate would be $1.24 per $100, resulting in $2,175 in property taxes and a $178 homestead rebate. After the proposed changes, this family's property taxes would be $2,079. As a result of the Commission's recommendations, this family's state and local tax burden would increase by $1,172.

In the rural community, this family would own a home with a market value of $78,745 and pay $2,223 in property taxes, an effective rate of $2.823. They would receive a homestead rebate of $205. The Commission's recommendations would reduce the effective property tax rate to $1.872, resulting in a property tax bill of $1,474. Overall, this family would experience an increase of $562 in state and local taxes if they lived in the rural community.

Summary

The greatest reductions in state and local taxes will occur in urban jurisdictions. These areas will benefit most from the increases in state aid and the state assumption of local service responsibilities that we have recommended. Indeed, property tax reductions in these jurisdictions will offset tax increases in the sales and income taxes and the elimination of the homestead rebate for all but the wealthiest family in our illustrative set of households. In addition, our recommendations consistently benefit the poorest households, primarily because of the consumption tax offset, reduced property taxes, and the circuit breaker credit.

The impact of our recommendations on the moderate-income households depends upon where they live. In municipalities with low or moderate property tax burdens, these households may experience a slight increase in state and local taxes. This increase is a result of broadening the sales and income tax bases and eliminating the homestead rebate, changes which are not offset by the reduction in property taxes stemming from increases in state aid and the state assumption of local service responsibilities. However, in municipalities where property taxes still exceed $2,000 per year, moderate income households would receive a significantly higher circuit breaker credit. This higher credit would offset the base changes and the elimination of the homestead rebate.

VIII. SUMMARY OF COMMISSION RECOMMENDATIONS

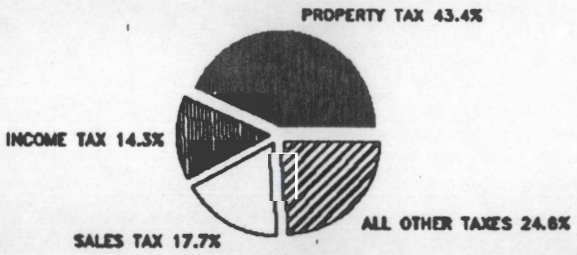
These individual recommendations are part of a comprehensive program to create a balance in New Jersey's state and local government structure, reduce the reliance on local taxes, and level the playing fields upon which residents, taxpayers, and communities compete. The expenditure recommendations will result in an immediate improvement in the balance between local responsibilities and local resources and in the quality of services delivered to the state's residents. The revenue recommendations will make the state tax system fairer and more responsive to the present and future economy of the state, while raising the revenues needed to reduce the reliance on local taxes. Finally, several recommendations ensure that New Jersey remains a dynamic, desirable place in which to live and work, with a healthy fiscal system. The page number shown after each recommendation indicates the location of the text discussion. Many of these recommendations will be expanded upon in supplemental reports to be issued soon by the Commission.

EXPENDITURES

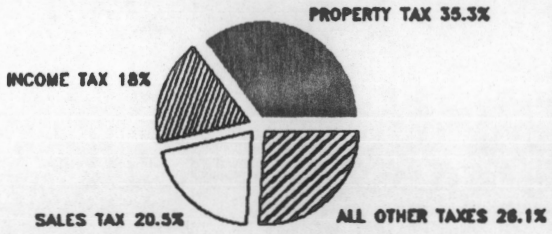
The goals of the Commission's expenditure recommendations are first, to improve the delivery of essential public services; and second, to improve the balance between local service responsibilities and the resources available to finance those services. Recommendations for expenditure reforms are proposed in the areas of local school finance, intergovernmental structure and state aid to municipalities.

Figure 12

NEW JERSEY STATE TAXES
CURRENT AND PROPOSED



CURRENT



COMMISSION'S PROPOSALS

1986 DATA

Table 13

SUMMARY OF MAJOR EXPENDITURE PROPOSALS

Expenditures	(in millions) additional state costs	cumulative total
A. Education Finance Reform		
1) current-year funding	181	181
2) minimum budgets and certification	32	213
3) compensatory aid	71	284
4) debt service	84	368
5) phase out of minimum teachers' salary program	25	393
B. Intergovernmental Structure Reforms		
1) public assistance		
a) state assumption of AFDC, GA and SSI benefits costs	86	479
b) eliminate county (benefit equalization aid	15	464
c) initiate county administration cost equalization aid	9	473
2) judicial unification	151	624
3) patients in mental institutions		
a) mentally ill facilities	45	669
b) facilities for mentally retarded	60	729
4) prosecutors	66	795
5) full funding for county colleges	20	815
C. State Aid		
1) guaranteed tax base municipal aid	351	1166
2) payments in lieu of taxes	10	1176

Source: Compiled by Commission Staff and the Bureau of Government Research, Rutgers University.

LOCAL SCHOOL FINANCE

The Commission is convinced that significant improvements in educational performance will not occur until we reduce spending disparities among school districts. Our recommendations will reduce disparities among districts and improve student performance, improve the quality of physical facilities, continue teaching as an attractive profession, and address the need for early childhood education.

Current-Year Funding:

(1) Current Expense Equalization Aid should be paid as a percentage of the current year's budget (p. 52).

(2) The budget cap formula should be changed to provide for a 6 percent annual growth, plus or minus an inflation factor based on the annual growth in state equalized valuation (p. 52) (see also Appendix A).

Minimum Budgets and Certification:

(3) School districts which fail to meet specified standards regarding performance, breadth of program, and capital facilities should be required to budget at least at the average per-pupil level for all other districts which do meet those standards (p. 52).

Compensatory Education Aid:

(4) Compensatory Education Aid should be calculated by counting each element of the testing program on which a student is deficient and multiplying by the full additional cost factor of 0.18 and the prior year's state average adjusted Net Current Expense Budget (NCEB) (p. 53).

Debt Service:

(5) Funding of Debt Service Aid should be placed on a current-year basis (p. 53).

(6) The formula for Debt Service Aid should be revised to provide for a higher state share and, upon certification of need by the state, for full state funding of all debt service requirements in school districts having less than 25 percent of the guaranteed valuation (p. 53) (see also Appendix B).

Teachers' Salaries:

(7) Full state funding of the teachers' minimum salary program should be phased out gradually between 1988-89 and 1992-93, with local school district costs for the program becoming a portion of the NCEB on which Current Expense Equalization Aid is paid (p. 53).

(8) A comprehensive survey of starting professional salaries should be authorized on a continuing basis and consideration should be given to teachers' minimum salaries in relation to other starting professional salaries (p. 53).

Early Childhood Education:

(9) Full-day kindergarten programs and one year of pre-kindergarten should be encouraged in every elementary school district, with enrollment to be on a voluntary basis and the costs to be subsidized through Current Expense Equalization Aid on a current-year basis (p. 53).

INTERGOVERNMENTAL STRUCTURAL REFORMS

The Commission's intergovernmental structural reforms define the proper role for the State and local governments in delivering and financing several important services including the courts, public assistance, institutions for the mentally ill and developmentally disabled, the office of the prosecutor and county colleges.

Public Assistance:

(10) The state should assume the full costs of benefits for all recipients of Aid to Families with Dependent Children, Supplemental Security Income, and General Assistance, including the municipal share of hospital costs for recipients of General Assistance where applicable. With state assumption of these benefit costs, the existing Welfare Equalization Aid program will be eliminated (pp. 53-54).

(11) The administration of General Assistance should become a county function, thereby consolidating the administration of public assistance programs at the county level. In addition, the Department of Human Services should explore administrative solutions to the potential duplication of services between its Division of Youth and Family Services and the County Welfare Agencies (p. 54).

(12) The state should implement an aid program to offset county administrative costs for public assistance in excess of the statewide average cost per capita. This program must be accompanied by greater accountability for management efficiency and error reduction on the part of counties (p. 54).

(13) The present public assistance system should be restructured to reduce long-term dependency by providing incentives and support services to encourage recipients to become more self sufficient. The objectives of the Realizing Economic Achievement (REACH) program embody many of the necessary reforms, including additional day care services, medical coverage, education, and job training (p. 54).

(14) Income and other information filed by a taxpayer to determine eligibility for public assistance, special programs, or tax preferences should be consolidated to eliminate the filing of duplicate information for each program (p. 54).

Judicial Unification:

(15) The state should assume the full financial and administrative responsibility for the trial court system (p. 54).

Maintenance of Patients in State Mental Institutions:

(16) The state should eliminate the present system whereby counties are forced to subsidize the care of indigent county residents who are patients in state institutions for the mentally ill and the developmentally disabled (p. 55).

Prosecutors:

(17) The state should assume the full financial and administrative responsibility for the Prosecutor's Office (p. 55).

County Colleges:

(18) The state should fulfill its statutory obligation to provide financial support for the county colleges (p. 55).

STATE AID TO MUNICIPALITIES

The resources available to municipalities are generally not adequate to meet their expenditure responsibilities. The problem is particularly significant for many poor jurisdictions, which also tend to face above-average needs. Local option non-property taxes would not adequately address the problem and may have adverse consequences for economic development in many jurisdictions. The Commission's recommendations will guarantee that each municipality has an adequate revenue base to finance essential services.

Guaranteed Tax Base for Municipalities:

(19) The state should guarantee that each municipality has an adequate property tax base to meet its residents' demands for essential services. State aid will compensate municipalities for the difference between the revenue they can raise from taxing their actual property tax base and the revenue that would be raised from taxing the guaranteed base.

To assure that no municipality receives less aid than it currently receives, the present level and distribution of revenues from the Gross Receipts and Franchise taxes, the Business Personal Property Tax, the Corporation Business Tax on banks, the Financial Business Tax, and the Insurance Premiums Tax should be frozen. Each municipality would have its aid calculated according to the guaranteed tax base and the frozen programs and would receive whichever amount is greater (pp. 56-57) (see also Appendix C).

All aid received by a municipality under either component of the Municipal Equalization Aid Program should be included in the Municipal Qualified Bond Program.

(20) A municipality should receive revenues equal to the yield of a three percent tax applied to the construction costs for a new generating station, up to a limit of $700 per capita, as an incentive to serve as the host community for the facility (p. 58).

Payments in Lieu of Taxes:

(21) The formula used to calculate state compensation to municipalities in lieu of property taxes on state-owned real property should be changed to use the municipal general tax rate and the assessed value of the state facility (p. 58).

(22) The payments-in-lieu-of-taxes formula should be funded in full (p. 58).

(23) The program of payments in lieu of taxes should be extended to cover property leased by the state from a state authority (p. 58).

POTENTIAL VERSUS ACTUAL PROPERTY TAX REDUCTIONS

The Commission proposes changes that will ensure that the potential property tax reductions resulting from our recommended expenditure reforms will be realized.

Adjustment of the County Levy Cap:

(24) The county tax levy should be reduced for purposes of calculating the cap to ensure that the state assumption of costs currently borne by the county results in a reduction in the property tax levy (p. 59).

(25) The county cap should be eliminated three years after the enactment of the Commission's recommendations regarding intergovernmental structural reform (p. 59).

Adjustment of the Municipal Budget Cap:

(26) The state assumption of municipal programs or functions should result in a reduced budget base for calculating permissible spending increases under the municipal budget caps (p. 59).

(27) Increases in state aid received through the Guaranteed Tax Base formula and through additional payments in lieu of taxes should be included within the municipal cap, in order to achieve the maximum reduction in the reliance on the property tax (p. 59).

(28) The municipal cap should be eliminated three years after the enactment of the Commission's recommendations (p. 59).

REVENUES

The Commission has evaluated each major tax imposed under state law in New Jersey using a set of criteria agreed upon by the Commission and commonly used in public policy analysis. These revenue proposals will improve the efficiency and fairness of the state's tax system and offset the costs to state and local governments of lowering real property taxes.

SALES AND USE TAX

The Commission recommends that the list of transactions covered by the State sales and use tax be expanded. These proposals will make the sales tax act simpler, more comprehensive in coverage, more equitable and more neutral with respect to choices made by individual households.

(29) The state should repeal the present exemptions for admissions charges a) to boxing, sparring, or wrestling matches or exhibitions and b) to facilities for sporting and entertainment activities in which the patron is to be a participant (p. 62).

(30) The state should repeal the sales tax exemption for purchases of disposable paper products (p. 62).

(31) The state should repeal the sales tax exemption for purchases of soap products and cleaners for household use (p. 62).

(32) The state should repeal the sales tax exemption for purchases of over-the-counter drugs (p. 62).

(33) The state should repeal the sales tax exemption for purchases of alcoholic beverages for on-premises consumption (p. 62).

(34) The sales tax should be applied to the purchase of cable television service (p. 62).

Table 14

SUMMARY OF MAJOR REVENUE PROPOSALS

	Change in State Revenues	Cumulative Total
A) Sales/Use and Excise Taxes		
1) admissions	36	36
2) disposable paper products	32	68
3) soap products	27	95
4) non-prescription drugs	38	133
5) alcoholic beverages		
a) increase wholesale excise tax to 7.8%	6	139
b) on-premises consumption	155	294
6) cable television	29	323
7) telephone equipment	37	360
8) tobacco		
a) sales tax on cigarettes	70	430
b) extend excise tax to all tobacco products	20	450
B) Gross Income Tax		
1) repeal Ford property tax deduction	170	620
2) repeal Homestead Rebate Program	305	925
3) repeal Homestead tenant credit	56	981
4) repeal college exemption	6	987
5) phase out deductions for age 62 and over	6	993
6) change in tax rate structure	268	1,261
7) consumption tax offset	(108)	1,153
8) property tax circuit breaker		
a) homeowners	(169)	984
b) tenants	(97)	887
C) Public Utilities Taxes		
1) telecommunications		
a) six percent gross receipts tax on all services	213	1,100
b) extend corporate business tax to all providers	65	1,165
c) repeal franchise tax on utilities	(57)	1,108
d) repeal excise tax on utilities	(15)	1,093
2) energy utilities (impact of change to be revenue neutral)		
D) Corporation Business Tax		
1) extend to savings and loans institutions	76	1,169
2) repeal business personal property tax	(21)	1,148

Table 14 (Continued)
SUMMARY OF MAJOR REVENUE PROPOSALS

E) Miscellaneous Taxes		
1) repeal savings institution tax	(26)	1,122
2) eliminate insurance premiums tax on health insurance premiums	(10)	1,112
3) repeal earmarking of financial business tax revenues	18	1,130
4) repeal earmarking of insurance franchise tax revenues	20	1,150

Note: ( ) = decrease in state revenues.

Source: Compiled by Commission Staff and New Jersey Division of Taxation

(35) The present exemption for sales of telephone and telegraph equipment should be repealed, except for purchases made by providers of telecommunications services (p. 62).

(36) The sales tax exemption for purchases of cigarettes should be repealed (p. 62).

(37) The use tax should be applied to room occupancy, restaurant meals, and amusement charges which are provided gratis (p. 63).

(38) The sales tax on advertising services should be repealed (p. 63).

(39) The purchase of building materials to be used to construct state-financed housing should be exempt from the sales tax, regardless of who makes the purchase. This exemption should be codified in the Sales and Use Tax Act (p. 63).

(40) The existing statutory language of the sales tax exemption for equipment used in the manufacturing process should be clarified by: a) expanding the exemption to include the sales of supplies for use or consumption directly and primarily in the production of tangible personal property by manufacturing, processing, assembling or refining; and b) extending the exemption to machinery which is used to produce production equipment, parts or other features of the production machinery itself. Further, the one year minimum useful life requirement for exemption of parts and the exception for tools and supplies used in connection with the production machinery, equipment or apparatus should be repealed (p. 63).

SELECTIVE SALES OR EXCISE TAXES

The Commission proposals for what are frequently referred to as sin taxes will result in similar tax treatment for similar commodities.

(41) The Alcoholic Beverages Wholesale Sales Tax rate should be increased from 7.3 percent to 7.8 percent to restore its original relationship to the sales tax (p. 63).

(42) The cigarette excise tax should be extended to all tobacco products and imposed at the wholesale level (p. 63).

(43) A unit-based excise tax should be imposed on the possession or sale of controlled substances (p. 63).

(44) The Departments of Treasury and Transportation should further review and make recommendations regarding the imposition of a weight-distance tax on heavy trucks for highway use.

GROSS INCOME TAX

The Commission's recommendations for the gross income tax will ensure that the taxpayer's burden is based on an ability to pay and that taxpayers in similar circumstances are treated similarly. The Commission proposals will broaden the base for the gross income tax, change the rate structure and increase the progressivity of the state's overall tax system.

(45) The Homestead Rebate, Homestead Tax Relief Act (Ford Act), and Homestead Tenant Credit should be repealed (p. 65).

(46) The state should implement a targeted property tax circuit breaker for homeowners and tenants, according to which a) homeowners with incomes under $50,000 would receive a rebate based upon the percentage of their income paid in property taxes; b) tenants would receive a refundable credit which would be phased out between $40,000 and $50,000 of gross income (pp. 66-68).

(47) The additional personal exemption for dependent college students should be repealed (p. 65).

(48) There should be a phase-out of deductions for retirement income for taxpayers aged 62 and over whose incomes exceed $50,000 (p. 65).

(49) The rate structure should be changed, so that the rates are: 2 percent on income less than $20,000; 2.5 percent on income between $20,000 and $50,000; 4 percent on income between $50,000 and $100,000, and 4.5 percent on income in excess of $100,000 (p. 66).

(50) The state should implement a means-tested refundable credit against gross income tax liability to offset consumption taxes (i.e., sales, excise, and utility) paid by households with cash income below $20,000 (p. 64).

(51) The treatment of Keogh Plan contributions should conform to the federal tax system (p. 65).

(52) Individuals who are not covered by an employer qualified retirement plan should be permitted to deduct contributions they make towards their retirement. Specifically: a) deductions of contributions made under Section 401(k) of the Internal Revenue Code should be allowed only if no other retirement plan is available to the taxpayer; b) this treatment of Section 401(k) plans should be extended to Section 403(b) plans, which cover employees of non-profit corporations; and c) the treatment of contributions to Individual Retirement Accounts should more closely conform to the federal tax system (p. 65).

(53) The state should repeal the regular exemption which may be claimed on a child's tax form when the child is also claimed as a dependent on a parent's income tax return (p. 65).

(54) The state should review the Reciprocal Personal Income Tax Agreement between the Commonwealth of Pennsylvania and the State of New Jersey to determine the present effects of the agreement.

PUBLIC UTILITY TAXES

The Commission proposals for reforming public utility taxes will result in a more uniform tax treatment for all providers of telecommunication services and all energy providers as well.

Telecommunications Utilities:

(55) The public utility taxes on telecommunications utilities should be changed to: a) impose a 6 percent gross receipts tax on all telecommunications companies; b) impose the Corporation Business Tax on all providers of telecommunications services, including regulated utilities; c) repeal the existing franchise tax on regulated utilities; d) repeal the existing state excise tax on regulated utilities; and, e) repeal local property taxes on the personal property of regulated utilities (p. 64).

Energy Utilities:

(56) The public utility taxes on energy utilities should be changed by: a) repealing the existing gross receipts, franchise, and excise taxes on gas and electric utilities; b) imposing the Corporation Business Tax on gas and electric utilities; and, c) applying a gross receipts tax to sales of electricity, gas, oil and other fuels at a rate to preserve the yield from the current set of taxes (p. 64).

REAL PROPERTY TAX

The Commission's recommendation will improve property tax assessment administration, reduce the pernicious effects of the property tax in areas where further development is desired, and strengthen the incentives to preserve farmland and open spaces in the state.

Assessment Administration:

(57) The assessment of real property should be consolidated under a State Board of Equalization, with at least one office in each county, and financed through state-levied administrative fees. The administrative functions of the present county Tax Boards should be eliminated and the Boards placed under the jurisdiction of the Tax Court to hear appeals of assessments (pp. 70-73).

(58) The existing timetable for tax sales and in rem foreclosures for all delinquent properties should be accelerated (p. 73).

(59) An accelerated timetable should be enacted for foreclosure against vacant properties with building and safety code violations (p. 73).

(60) Relief should be provided to municipalities with properties subject to foreclosure due to non-payment of taxes by: a) granting adjustments to municipal property valuations for state aid apportionments; b) granting adjustments to municipal property valuations for previous and current county tax apportionments; c) granting credits against the municipal reserve for uncollected taxes; and, d) accounting for the portion of the municipal reserve for uncollected tax attributable to the school levy in the computation of state school aid (p. 73).

New Construction:

(61) A mandatory system for taxing the value of new construction should be implemented, in concert with the State Development and Redevelopment Plan, with a lower rate in areas targeted for growth. To the extent that the revenue yield from the imposition of the mandatory tax rates exceeds the yield from the tax rates for local purposes, the state would use the excess revenues to finance infrastructure (pp. 73-77).

Farmland Assessment:

(62) The Farmland Assessment program should require program participants to yield a percentage of the development rights of the property for each year of preferential taxation (pp. 77-79).

BUSINESS TAXES

The Commission recognizes the changing business environment brought about largely by deregulation and technological innovations. These changes have blurred traditional distinctions among industries, especially those providing various financial services. Commission recommendations will respond to these changes to ensure that competing firms face similar tax treatments.

Corporation Business Tax (CBT):

(63) The CBT should be expanded to include financial institutions currently subject to the Savings Institution Tax. The Legislature should be sensitive to the financial circumstances of New Jersey's thrift industry at the time that the CBT reforms are enacted (p. 68).

(64) Subjectivity under the CBT should be extended by definition to investment companies that are chartered out-of-state and are wholly owned subsidiaries of banks operating in New Jersey (p. 69).

(65) Banks subsidiaries should be prohibited from electing to be taxed as investment companies (p. 69).

(66) The earmarking of the CBT paid by banking and financial institutions should be repealed (p. 69).

(67) A new income apportionment formula should be developed for bank corporations to place greater emphasis on deposits and receipts and less emphasis on tangible property. The State Supreme Court, in the Metromedia decision, 97 N.J. 313 (1984), has found that the Division of

Taxation has broad rights to regulate statutory apportionment and the division may find it appropriate to issue regulations on this matter (p. 69).

(68) The CBT should be amended to include leased property in the property factor of the three-factor formula. It is recognized that the Division of Taxation already incorporates this concept by regulation but it is deemed important enough to reflect such a concept in statutory form (p. 69).

(69) Repeal the present CBT requirement that a corporation must maintain a regular place of business outside New Jersey in order to apportion less than 100 percent of its income to New Jersey under the existing three-factor allocation formula. The Division of Taxation should monitor the effect of this repeal and it should consider adoption of regulations to prevent a taxpayer unduly benefiting therefrom. The present statutory provision in Section 8 of the CBT should be adequate authority for the Division to adopt such regulations (p. 69).

(70) The state definition of depreciation should be recoupled to the present federal definition (p. 69).

(71) The CBT should be changed to permit an interest deduction in accordance with federal law when a parent corporation serves as a conduit for a loan to a subsidiary (p. 69).

(72) Loopholes which arise from non-arms-length transactions between affiliated corporations should be closed (p. 69).

(73) The state should pay refunds to taxpayers when an audit discovers an overpayment of taxes, even if the normal refund period has expired (p. 69).

(74) The state should pay interest on refunds of overpayment of taxes, in conformity with the Federal Tax Code, with rates of interest derived from the rate of return on the state Cash Management Fund (p. 69).

(75) The unitary combination taxing procedure was considered and rejected.

Financial Business Taxes:

(76) The Savings Institution Tax should be abolished. The institutions covered by this tax will now be subject to the CBT (p. 68).

(77) The Financial Business Tax paid by unincorporated financial businesses should no longer be earmarked (p. 69).

Insurance Taxes:

(78) The Insurance Premiums Tax should not be applied to premiums from health insurance (p. 68).

State Railroad Taxes:

(79) The Class II Railroad Property Tax should be collected semi-annually rather than annually (p. 73).

Business Personal Property Tax:

(80) The Business Personal Property Tax, which applies to property purchased prior to 1977, should be repealed (p. 69).

Tax Administration:

(81) The mechanism for dissolving a corporation should be simplified (p. 68).

(82) Corporate filings of information and fees to the State should be consolidated to eliminate multiple annual filings (p. 68).

MISCELLANEOUS TAXES

Commission recommendations in this area will simplify the administration of taxes imposed on bequests. In addition, the Commission proposes reforms for several local option taxes.

Inheritance and Estate Taxes:

(83) The legal incidence of the tax should be shifted from inheritances to estates, with a federal tax base modified to include deductions for spouses and Class A beneficiaries comparable to those under the existing inheritance tax, retaining the present pick-up estate tax (p. 70).

(84) The deductions in the estate tax code should be expanded to incorporate the current system of exemptions of transfers found in the inheritance tax code (p. 70).

(85) The administration of the tax should be converted from a billed system to a self-assessed system (p. 70).

Local Option Taxes:

(86) The Newark payroll tax should be eliminated. The authorization for local taxes on parking fees should be retained and all other unexercised local option taxes should be repealed (p. 70).

(87) The Atlantic City Luxury Tax should be modified so that future extensions of the state sales tax to transactions also taxed under the Luxury Tax do not result in a loss of revenue to the state (p. 70).

SAFEGUARDING THE BENEFITS OF THE NEW SYSTEM

The Commission developed recommendations to ensure that the balance created in the state's fiscal system would be permanent. These proposals will facilitate desirable economic growth and reduce institutional impediments to effective public sector budgeting and planning activities.

ECONOMIC DEVELOPMENT STRATEGIES

The Commission has proposed recommendations to aid the orderly and balanced economic development within the state. These recommendations will call for better evaluation and targeting of existing economic development programs, ensure an adequate infrastructure and the availability of affordable housing, and encourage better planning and coordination of development activities, especially among local governments.

Economic Development Programs:

(88) Site-specific economic development programs should be targeted to distressed areas (p. 80).

(89) The state should develop and implement systematic and independent evaluations of each of its current economic development programs (p. 80).

(90) The state should develop an Industrial Zone Program to slow or reverse the decline in manufacturing activity in the state (p. 80).

(91) A challenge grant program should be established to encourage cooperation between the state's colleges and municipalities (p. 80).

(92) The state should continue the emphasis on science and technology programs (p. 80).

(93) The state should examine the interrelationship of economic development programs operated by the Departments of Commerce and Community Affairs as well as the various agencies regulating commercial activities (p. 80).

Adequacy of Housing and Infrastructure:

(94) The state should establish a Housing Development Bank to ensure an adequate supply of affordable housing (p. 80).

(95) The state should ensure the adequate provision of infrastructure, including transportation, water supply, wastewater treatment, and solid waste disposal facilities (pp. 80-81).

(96) The state should continue to provide grants to local governments for the construction of wastewater facilities to augment the Wastewater Treatment Financing Program (p. 81).

State and Local Planning:

(97) The efforts of the State Planning Commission to foster orderly development should be encouraged as a method to reduce infrastructure and service costs and as a useful tool to promote economic development. To further encourage orderly development, the State Planning Commission should develop mechanisms to promote sub-state regional planning and coordination (p. 81).

(98) The State Planning Commission should encourage the establishment of regional special improvement districts to address issues of local area planning, tax base sharing, regulatory relief, and the provision of infrastructure to promote orderly economic development (p. 81).

(99) The State Planning Commission should review the local use of development, impact, and linkage fees with an eye toward limiting, standardizing, and regionalizing their collection, distribution, and use (p. 81).

(100) The County and Municipal Government Study Commission should study the development and funding of incentives to encourage the consolidation of selected services among jurisdictions or the transfer of selected services to counties (p. 81).

(101) The Municipal Land Use Law should be expanded to include a requirement that all municipalities that are categorized as distressed by the state include as part of their master or comprehensive plan a community and economic development element that would be subject to the State Planning Commission's cross-acceptance process. The costs associated with the preparation of this plan should be paid by the state (p. 81).

BUDGET PROCESS ISSUES

The Commission recommends several budget reforms to facilitate fiscal planning and control, including setting up a contingency or rainy day fund, preparation of an annual accounting of the costs of tax preferences provided, establishing limits on the dedication of revenues, the preparation of fiscal notes for proposed legislation, state government sharing of costs for state-mandated local activities, state non-fiscal assistance to improve local management efficiencies, and the establishment of permanent tax and pension study commissions.

Contingency Funds:

(102) The Commission endorses the concept of a state contingency fund to permit a more orderly response to an unanticipated shortfall in revenues or increase in expenditures due to recessions or emergencies (p. 82).

Tax Expenditure Reporting:

(103) The Division of Taxation should prepare an annual estimate of revenues foregone for those tax preferences provided by the state (pp. 82-83).

(104) Fiscal notes should be required for all changes to the tax code (p. 83).

Dedication of Revenues:

(105) There should be no further constitutional dedication of revenues. The present dedication of the proceeds of the Lottery, personal income tax, and tax on casino revenues should be reconsidered. Where earmarking of revenues is appropriate, as with some user fees, the earmarking should be accomplished by statute (p. 83).

Fiscal Notes:

(106) A fiscal note should be required whenever a potential fiscal impact is identified by the Legislative Budget Officer. The Legislative Budget Officer should further be empowered to determine the scope of the estimates that will be required (p. 84).

Payment for State Mandates:

(107) The state should share in the cost of new or significantly enhanced services or regulations mandated upon municipalities or counties. The sharing of the cost with municipalities should be through the Guaranteed Tax Base aid formula. For counties, the state should develop a categorical aid program which would be equalized according to the county's ability to pay (p. 85).

Full Funding of State Aid Programs:

(108) Aid programs to local governments should be funded at the levels embodied in the law. If it becomes necessary to reduce aid for any reason, the law establishing the program or formula should be changed. These funding levels should not be determined on an annual basis through the budget process (p. 81).

Non-fiscal Assistance to Localities

(109) The state should take a more active role in providing technical and management assistance to local governments to ensure that funds are expended efficiently and properly (p. 86).

Permanent Commissions

(110) A permanent, non-partisan tax policy commission should be established. This commission would advise the Governor and Legislature on matters of tax policy and would monitor the tax system and recommend changes in light of changing demographic, economic, or fiscal conditions (pp. 86-87).

(111) A permanent pension study commission should be established to provide technical and policy advice to the Governor, the Legislature and local policymakers on matters relating to changes in the benefits, funding, investments, and administration of retirement systems in the state (pp. 87-88).

APPENDICES

APPENDIX A

The Commission's Proposed School District Budget Cap Formula:

$$\text{Permissible Increase in Budget} = \text{Base Budget} \times \text{Basic Cap Rate} \times \text{Equalization Factor} \times \text{Enrollment}$$

Where:

$$\text{Base Budget} = \text{The larger of: (Prior Year School District Adjusted NCEB per Pupil) or (Prior Year State Average Adjusted NCEB per Pupil)}$$

$$\text{*Basic Cap Rate} = 6\% \pm \left(\text{Deviation of the Annual Percentage Growth in State Equalized Valuation from 6\%}\right) \left(\frac{5}{\text{Deviation} + 5}\right)$$

$$\text{Equalization Factor} = \frac{\text{Prior Year State Average Adjusted NCEB/Pupil}}{\text{Prior Year School District Adjusted NCEB/Pupil}}$$

Enrollment = Prior Year School District Resident Enrollment

APPENDIX B

The Commission's Proposed Formula for State Debt Service Equalization Aid to School Districts

$$\text{State Share} = 1.33 \left(1.000 - \frac{\text{School District Equalized Valuation per Pupil}}{\text{Guaranteed Valuation per Pupil}} \right)$$

(But never a negative figure
and
never more than 1.0000)

Where:

$$\text{Guaranteed Valuation} = \left(1.344 \times \text{State Average Equalized Valuation per Pupil} \right)$$

APPENDIX C

THE COMMISSION'S PROPOSED MUNICIPAL EQUALIZATION AID PROGRAM

The Municipal Equalization Aid Program is intended to replace five existing programs in which payments are made by the State to municipal governments:

	1986 Amount
Gross Receipts and Franchise Taxes	$685,000,000
Business Personal Property Replacement	158,703,834
Corporation Business Tax on Banking Corporation	16,233,550
Financial Business Tax	1,602,934
Insurance Franchise Tax	20,224,731
	$881,765,049

and one special local tax:

Newark Payroll Tax	15,201,126

Municipal equalization aid is calculated for each municipality through three formulas, with the municipality receiving the largest of the three amounts calculated. Two of the formulas use a guaranteed tax base approach, in which the State guarantees to each municipality that it will be able to tax its own property owners as though it had a stipulated level of property tax ratables, with the State making up the difference if the municipality does not have that level of taxable property. The third formula assures each municipality that it will never receive less in equalization aid than it received in the base year from the sum of the five State payment programs which are being replaced by this Program.

BASIC MUNICIPAL EQUALIZATION AID

Guaranteed Tax Base Per Capita

Under this formula, the guaranteed tax base per capita is set at 1.74 times the state average equalized valuation per capita in the prior year. Only civilian (non-military base) population is used in this calculation.

State Support Ratio

The guaranteed tax base is used to calculate a percentage which the State will pay of each municipal budget; this is known as the state support ratio. The state support ratio varies inversely with the actual property tax base of the municipality. Places with large amounts of taxable property have low state support ratios; places with little taxable property have large state support ratios. The ratio is calculated by the following formula:

$$\text{State Support Ratio} = 1.00 - \frac{\text{Municipal Equalized Valuation per Capita}}{\text{Guaranteed Tax Base Per Capita}}$$

Base Budget

The state support ratio is multiplied by the base budget of the municipality to find the dollars of municipal equalization aid to which the municipality may be entitled. There are three ways of calculating the base budget, with the smallest of the three calculations being used. The three are the projected net municipal budget, the actual net municipal budget, and the maximum support budget.

The net budget of a municipality is defined as:

(a) that total municipal budget,

minus

(b) all revenues anticipated other than:

(1) the amount levied in property taxes, and

(2) the amount of municipal equalization aid received,

plus

(c) all special district taxes levied within the municipality,

plus

(d) a sum equal to the amount received from any local tax which is discontinued under this program (Newark payroll tax),

plus

(e) in those municipalities where the cost of garbage and trash collection and disposal is not covered in the municipal budget or by a special district tax, a per capita amount equivalent to the statewide average cost for these services in places where they are financed publicly.

Projected Net Municipal Budget - The projected net municipal budget is found by multiplying the net municipal budget of the prior year by 1.00 plus the annual growth rate of the sum of the state gross income tax and general sales tax in the most recently completed state fiscal year.

The use of the growth rate tied to state revenue is intended to permit state aid to be based on some growth in local budgets, while preventing rapid increases which place an unreasonable burden on State revenue sources.

Actual Net Municipal Budget - The second way of determining the base budget is through calculation of the actual net municipal budget for the current year using the same definition described above. This can only be done after the municipal budget has been adopted. If a municipality should adopt an actual budget which is less than its projected budget, its aid will be based on the lesser figure.

Maximum Support Budget - If a municipality could gain as State aid a percentage of an unlimited local budget, this would constitute a blank check on the state treasury. Therefore, a limit has been placed on the size of the base budget on which state aid will be paid. Two additional considerations have been taken into account in establishing this limit.

1. The limit has been linked to state revenue flow, so that a downturn in the economy will be less likely to be accompanied by an increase in municipal aid entitlements. This is done through the calculation of a state per capita revenue factor.

   The state per capita revenue factor is defined as 51% of the total amount received from the gross income tax and the general sales tax in the fiscal year ending on June 30 prior to the start of the municipal budget year, divided by the most recent total estimated state population.

2. The second consideration is a recognition that some municipalities may need to spend more money per capita than others because of the characteristics of the community. It has been assumed that the single factor -- other than the gross size of the municipality -- which most affects the need to spend is population density in persons per square mile. A state support limit per capita is calculated, therefore, incorporating both the state per capita revenue factor and the relative density of the municipality:

State Support Limit Per Capita	=	.99	State Per Capita Revenue Factor	+	.01	State Per Capita Revenue Factor	Municipal Density / State Density

Finally, the maximum support budget is calculated by multiplying the state support limit per capita by the most recent estimated population of the municipality.

Where a special local tax has been eliminated (Newark), it is necessary to increase the maximum support budget by the amount realized from this source in the prior year, multiplied by the growth percentage used in calculating the projected net municipal budget.

FIXED MUNICIPAL AID

Under the second aid formula -- Fixed Municipal Aid -- every municipality will be entitled in every future year to the same amount of State funds which it received in the base year under the programs replaced by the municipal equalization aid program -- the gross receipts and franchise tax, the business personal property replacement payments, the corporation business tax on banking corporations, the financial business tax, and the insurance franchise tax.

MINIMUM MUNICIPAL EQUALIZATION AID

Minimum municipal equalization aid is intended to provide a lower level of State support for those municipalities which are above the guaranteed tax base per capita used in basic equalization aid. This formula has little impact at the present time, since most of these places receive more in fixed municipal aid than they would be entitled to under either the basic or the minimum equalization aid formulas. However, as time passes, municipal budgets will grow, while fixed municipal aid will remain unchanged, and the minimum equalization aid program will become more important. This aid is calculated in a manner similar to basic equalization aid:

Minimum Aid Guaranteed Tax Base per Capita

This secondary guaranteed tax base is set at 10 times the state average equalized valuation per capita.

Minimum Aid State Support Ratio

The formula for calculating the minimum aid state support ratio is:

$$\text{Minimum Aid State Support Ratio} = (.30)\left(1.00 - \frac{\text{Municipal Equalized Valuation Per Capita}}{\text{Minimum Aid Guaranteed Tax Base}}\right)$$

Minimum Aid Base Budget

The base budget for minimum equalization aid is the same as for basic equalization aid; that is, the smallest of the projected net municipal budget, the actual net municipal budget, or the maximum support budget.

FINAL AID CALCULATION

The final step in the calculation of municipal equalization aid is to determine which of the three formulas produces the largest amount of aid - basic municipal equalization aid, fixed municipal aid, or minimum municipal equalization aid.

1986 COST

A simulation of the Municipal Equalization Aid Program for 1986 indicates an estimated total cost of $1,232.6 million, of which $881.8 million would be available from the five programs eliminated under this plan, with $350.8 million of new funds being required.

The basic municipal equalization aid formula would provide the aid for 256 municipalities, fixed municipal aid would be operative in 291 places, and 20 municipalities would receive their aid under the minimum municipal equalization aid formula.

APPENDIX D

CONCLUSIONS AND RECOMMENDATIONS OF THE PROPERTY TAX ASSESSMENT STUDY COMMISSION (PTASC)

(The page numbers indicate the location of discussion in the PTASC's final report.)

1. New Jersey is a high property tax state (p.10).

2. The property tax burden is lower in New Jersey than it was in the early 1970's, but in the last few years the tax, in constant dollars per capita, has increased steadily, and the reliance of counties and municipalities on the property tax has grown (p.28).

3. The property tax is most burdensome in urban areas, where there are concentrations of low income homeowners, and where the largest part of the tax goes for municipal services (p.38).

4. The property tax is highly regressive (p.47).

5. Significant State action is appropriate and necessary:

   (1) to alleviate the immediate conditions which provide the potential for fiscal shock, and

   (2) to prevent the development of similar conditions in the future (p.67).

6. The present property valuation standard of value should be retained, as well as the State constitutional provisions which require that all property should be assessed uniformly (p.68).

7. Classification of real property is rejected as an approach to the mitigation of fiscal shock (p.69).

8. Site value taxation is rejected as a solution to the immediate problems of fiscal shock (p.70).

9. Every municipality in the state should be given the option of implementing revaluation programs on a four-year schedule, rather than requiring immediate and full implementation (p.71).

10. There should be a limited program of State financial assistance for the purpose of easing the phase-in of a revaluation program for those municipalities which demonstrate the potential for severe fiscal shock (p.75).

11. Any legislation enacted to authorize optional locally-funded phase-ins of a revaluation program should have an effective life of no more than five years, and no municipality should be permitted to implement a phase-in more than once. Application for a State-aided phase-in should be accepted only within a period of two years following enactment of enabling legislation (p.77).

12. No phase-in will provide sufficiently for the property tax relief necessary to mitigate fiscal shock (p.78).

13. As part of an overall tax reduction program, legislation should be enacted requiring municipalities to impose on all property, taxable and non-taxable, a user fee sufficient to cover taxes levied for public safety purposes, with municipal property taxes paid to be considered a credit against such a fee (p.85).

14. A goal of property tax reduction should be that no property tax exceeding 3% of property value would have to be levied in any community in order to provide adequate public services. This should not be done through a tax rate limit (p.85).

15. A State-funded circuit breaker should be enacted that would insure that no taxpayer in New Jersey need pay more than a reasonable percentage of gross income in property taxes (p.97).

16. The Local Property Branch of the Division of Taxation should be reconstituted as a Division of Local Property Tax Assessment (p.115).

17. A five-member Assessment Administration Review Board should be established within the Division of Local Property Tax Assessment to adopt standards developed by the Division to hear appeals from actions to remove assessment personnel or to revoke the license of a revaluation firm (p.118).

18. An office of county property assessment supervisor should be established in every county, to be filled by a State employee of the Division of Local Property Tax Assessment, with all costs to be paid by the State (p.199).

19. The Division of Local Property Tax Assessment should develop standards for the minimum size of a tax assessment jurisdiction, and the director of the Division should be empowered to order a consolidation of the tax assessment function in municipalities which do not meet the standard (p.120).

20. A new program of State aid for local assessment administration should be enacted, to cover one-third of the statewide cost of local assessment administration, but with larger amounts of State aid going to places with smaller property tax bases on a per capita basis (p.121).

21. The Division of Local Property Tax Assessment should develop standards for tax assessor salaries and benefits, staff, office space, equipment, and other resources in taxing jurisdictions of varying size (p.122).

22. State aid for local assessment administration should be withheld from any municipality which does not meet specified standards for tax assessor salaries and benefits, staff, office space, equipment, and other resources required by the tax assessor's office (p.122).

23. Where a municipality fails to meet State standards for salaries, staff, office space, equipment, and other resources for the tax assessment office, and where performance standards are then not met, the director of the Division of Local Property Tax Assessment should be empowered to provide for adequate funding of the tax assessment office, with costs to be covered by withholding any State aid to which the municipality is otherwise entitled (p.123).

24. County boards of taxation should become strictly tax appeal boards, and their administrative duties should be divided between the county property assessment supervisor and the central staff of the Division of Local Property Tax Assessment (p.124).

25. The CTA certificate should be a requirement prior to appointment for municipal tax assessors and county property assessment supervisors (p.125).

26. New instructional courses should be developed in tax appeal procedure and required of county board of taxation members early in their first term of office (p.125).

27. The CTA certification should be placed on a five-year renewal cycle, with renewal to be based on either the completion of instructional programs or passage of a State examination (p.126).

28. The Division of Local Property Tax Assessment should develop standards of performance for municipal tax assessors, county tax board members, and other assessment personnel, and the director of the Division should be empowered to remove from office a person who does not meet those standards (p.127).

29. The administration of tax deductions and Homestead Rebates should be handled centrally by the Division of Local Property Tax Assessment, but the administration of tax exemptions should remain a duty of the municipal tax assessor (p.127).

30. The Division of Local Property Tax Assessment should provide assistance to municipal tax assessors in the appraisal of complex properties and in the defense of tax appeals (p.128).

31. The Division of Local Property Tax Assessment should develop standards for computer-assisted mass appraisal systems, and all municipalities should be required to obtain permission from the Division before purchasing such a system (p.128).

32. The full responsibility for all equalization of aggregate assessed values should be concentrated in the Division of Local Property Tax Assessment (p.128).

33. The deadline for filing tax appeals with the county board of taxation should be moved up from August 15 to a date in the late Spring of the tax year (p.130).

34. Every property owner should be notified of any change in the assessment on his or her property by mail early in January of the tax year (p.130).

35. Tax assessors should be given the right to file tax appeals to correct errors in assessments (p.130).

36. The Division of Local Property Tax Assessment should be empowered to determine the need for revaluations and to order that they be conducted an implemented, with the cost to be covered, in part, by the new State aid program for assessment administration (p.131).

37. The Division of Local Property Tax Assessment should be empowered to license revaluation firms, establish standards for their performance, monitor their performance, and revoke their licenses if this appears justified (p.131).

APPENDIX E

METHODOLOGY FOR ESTIMATING THE IMPACT OF COMMISSION RECOMMENDATIONS ON HOUSEHOLDS

The estimates of the current sales, income, and property taxes paid by different income classes were prepared using a simulation model developed by the Policy Economics Group of Peat Marwick. The model combines tax and income data from the Internal Revenue Service, household data from the Current Population Survey by the Bureau of the Census, and information on income sources, spending patterns, and asset holdings from various independent surveys. These data are extrapolated and weighted to represent New Jersey residents in 1986. The estimates represent the mean values for the observations in the income interval.

The estimates of the current and proposed income and sales tax burdens for the illustrative households represent the mean value for observations of similar households. Estimates of the property taxes paid by the illustrative households were made by multiplying the estimated value of their home in each municipality by the current and proposed effective property tax rates. The effective tax rates for 1986 were obtained from the Abstract of Ratables table in the Annual Report of the Division of Taxation. The proposed effective tax rates were calculated by adjusting the local levy to reflect the Commission's recommendations regarding increases in state aid and the state assumption of local service responsibilities. The adjusted levy was divided by the "Net Valuation on Which County Taxes are Apportioned" (Column 11) from the Abstract of Ratables. The Net Valuation was also adjusted to reflect the Commission's recommendation to remove telephone personal property from the property tax base.

The market value for residential housing in individual municipalities was derived from unpublished data from the Homestead Rebate-Income match used to by the Division of Taxation to produce their report on Owner Occupied Housing Statistics. The formula used to calculate the values is as follows:

$$\text{Market Value} = \frac{a}{b \times c}$$

where:

- a = The total property tax payments claimed by all households in the income group of the illustrative household in the selected municipality who filed a 1986 state income tax return and claimed a homestead rebate.
- b = The 1986 effective tax rate per $100 value for each selected municipality, as obtained from the Abstract of Ratables table in the 1986 Annual Report of the Division of Taxation.
- c = The number of households in the income range of the illustrative household who lived in the selected municipalities and who filed 1986 a state income tax return and claimed a homestead rebate.

The property tax payments are net of property tax credits for the elderly or veterans, whereas the effective tax rates are based upon the overall levy and do not account for these credits. These differences may result in market values being understated.

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NEW JERSEY STATE AND LOCAL EXPENDITURE AND REVENUE POLICY COMMISSION

MINORITY REPORT

The Commission's final report includes a recommendation for a permanent pension study commission. We strongly object to this proposal on the grounds that such a move:

- o is unnecessary;
- o duplicates activities already being completed by state bodies and, as a result, wastes taxpayers' monies;
- o promotes inefficiency by increasing the bureaucracy and delaying an already lengthy review process of pension measures; and
- o singles out one expenditure -- public employee pensions -- for increased political manipulation.

Matters related to public employee pensions already undergo an extensive and intricate system of scrutiny, review, analysis, and checks and balances involving the legislative and executive branches of state government.

Pension issues are monitored, examined, and evaluated for their fiscal impact and effect on employees and employers by the Division of Pensions and the Office of Legislative Services. The State Investment Council invests the funds to ensure their solvency and to obtain the best return. These experts already keep a careful eye on public employee retirement benefits.

In addition, pension bills are reviewed by several Assembly and Senate committees. These include: the Senate State Government, Federal, and Interstate Relations and Veterans Affairs Committee; the Assembly State Government Committee; the Assembly Veterans Affairs and Defense Committee; the Senate Revenue, Finance, and Appropriations Committee; and the Assembly Appropriations Committee. Each committee holds extensive public hearings on proposed pension bills.

The Division of Pensions does address legislative proposals. The division is a part of the New Jersey Department of Treasury, the Governor's fiscal arm.

Any bill approved by both houses of the Legislature goes to the Governor, who has the power to approve, veto, or conditionally veto the measure.

Adding a commission to this process would not be efficient or constructive. Permanent commissions were not recommended to deal with any other areas of public spending, many of which require specialized knowledge and understanding.

In addition, the inference in the final report that a permanent commission will offer the on-going perspective needed for the continuity of policy decisions that will best serve the short and long-term interests of workers and taxpayers undermines the Legislature and ignores the political reality that commissions are appointed bodies.

Finally, we question the method by which the recommendation for a pension commission was pursued repeatedly by some SLERP commissioners, despite continued rejection of various forms of this proposal by the Commission's Task Force on Expenditures and Financing of Local Government, the Task Force on State Government and Expenditure Activities, and twice by the full Commission. Only a last-minute, surprise motion on this issue -- not previously disclosed on any agenda and introduced only towards the end of the meeting when several Commission members were not present -- was passed by a slim margin.

For these reasons, we urge rejection of the proposal to create a permanent pension commission.

Larry Cohen
Sen. John H. Dorsey
Joseph P. Galluzzi
Dennis N. Giordano
Assemblyman Alan J. Karcher
Stephen J. Kessler