Task Force Meeting

of

ASSEMBLY TASK FORCE ON FISCAL RESPONSIBILITY

"A review of the State revenue estimation and certification process"

LOCATION: Committee Room 11
State House Annex
Trenton, New Jersey

DATE: August 26, 2002
10:00 a.m.

MEMBERS OF TASK FORCE PRESENT:

Assemblyman Joseph J. Roberts Jr., Chair
Assemblyman John J. Burzichelli
Assemblyman Joseph Cryan
Assemblyman Jerry Green
Assemblyman Paul A. Sarlo
Assemblyman Paul R. D'Amato
Assemblyman Guy R. Gregg
Assemblyman Thomas H. Kean Jr.

ALSO PRESENT:

Diane Hansen
Office of Legislative Services
Task Force Aide

Mary Messenger-Gault
Assembly Majority
Task Force Aide

Beth Schermerhorn
Assembly Republican
Task Force Aide

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ASSEMBLYMAN JOSEPH J. ROBERTS JR. (Chairman): Ladies and gentlemen, if you could be kind enough to take a seat, we're going to get started. I welcome you to our Task Force meeting, and I'm happy that you could end your summer season with us.

I would ask that we could call the roll as we begin, please.

MS. HANSEN (Task Force Aide): Assemblyman Roberts.

ASSEMBLYMAN ROBERTS: Here.

MS. HANSEN: Assemblyman Burzichelli.

ASSEMBLYMAN BURZICHELLI: Present.

MS. HANSEN: Assemblyman Caraballo. (no response)

Assemblyman Green.

ASSEMBLYMAN GREEN: Present.

MS. HANSEN: Assemblyman Cryan, substituting for Assemblywoman Quigley.

ASSEMBLYMAN CRYAN: Here.

MS. HANSEN: Assemblyman Sarlo. (no response)

Assemblyman D'Amato.

ASSEMBLYMAN D'AMATO: Here.

MS. HANSEN: Assemblyman Kean, substituting for Assemblyman Doherty.

ASSEMBLYMAN KEAN: Here.

MS. HANSEN: Assemblyman Gregg.

ASSEMBLYMAN GREGG: Here.

ASSEMBLYMAN ROBERTS: Great, thank you.

Let me note that Assemblyman Sarlo is en route and is detained in traffic. Assemblyman Caraballo, unfortunately, sprained his ankle and that's the reason he is not with us. Assemblyman Doherty, in addition to having Assemblyman Kean here in his stead, has also sent a member of his staff, and we're grateful for that.

We have with us today three folks who will be appearing before the Task Force -- the first is former Acting Treasurer Peter Lawrance; the second will be Alan Kooney and Dave Rosen from OLS; the third is Corina Eckl, who is the Director of the Fiscal Affairs Program with the National Conference of State Legislators -- the goal being to look at some issues that were particular with respect to the last year or two, to have OLS give us an overview with respect to some of the revenue estimate and budget issues, and then, thirdly, to do what has been suggested by members of this Task Force, and that is to have the chance to get a sense of what other states do, so that that can be instructive in terms of where New Jersey is now and should go in the future.

It is my goal, because of time constraints, that some of our guests have to try and conclude no later than 1:00. Although we've had, sort of, a great deal of latitude with respect to peoples' questioning time and so on, that will continue, but I would just ask you to try and moderate your questions, recognizing that we do want to conclude early this afternoon.

At this point, it is my pleasure to welcome Mr. Lawrance and ask him to come forward.

Peter, good morning. It's a pleasure to have you with us.

PETER LAWRANCE: Good morning. Thank you, Mr. Chairman.

I had some talking points, and I believe I left them with Diane. I don't know if she's had a chance to pass them to the right or left.

ASSEMBLYMAN ROBERTS: She has not, but she will do that right now.

MR. LAWRANCE: As I said, thank you for the invitation. I appreciate being here. As on opening comment, I would tell you it was an error on my part, back in June, not to have been available to meet with the Assembly Appropriations Committee at that time. I believe the Assembly and the Legislature is entitled to an apology from the Acting Treasurer, and I so give it. I also thank you, as the Chairman of this Task Force, for affording me the opportunity to do that.

From the letter you sent me, I believe the real focus, though, today is on revenue forecasting. It affords me the opportunity to share my experience, which actually goes back to about 1972 and Governor Cahill, when I was legislative staff at that time. I should also tell you that revenue forecasting and estimating has been a significant issue throughout my career in state government. I can recall, be it Brendan Byrne, Tom Kean, Governor Florio, Governor Whitman, all dealing with the problems of coming up with accurate revenue forecasts.

We, in Treasury, when Whitman ran for re-election, underestimated revenues by over a billion dollars. It was rather frustrating after the election, and the closeness of that election, to realize the amount of money that might have been included in the original budget. I can also recall Governor Florio having a similar problem overestimating revenues, and having to come back with a variety of corrections after his tax increases. I should also tell you that, having been seven years in the executive branch, I really support the hard work that Treasurer McCormac has gone through to get the budget into balance, enacted, and so on and so forth.

One of the attachments that I gave you is a recent report from *Moody's*, where they rated the bonds, and it has some comments in there that -- it's basically there just to call to the Committee's (*sic*) attention. One of the references is that, when they were rating cash flows, they figured that, between the corporate tax and the gross income tax, there could be a variance of $300 million in either of those. They weren't predicting that the revenues were incorrectly certified. What they were saying, though, is that there is always a range of those sort of magnitudes in the normal revenue-estimating process.

Going back to last September, it became quite apparent to myself that we had overestimated revenues and that, obviously, today in hindsight, we had also underestimated the problem. There is an Attachment *B* that we had actually used with some rating agency presentations, and there's a graphic that we had shared with the transition team that said, on the basis of the estimate for the gross income tax we had -- and there's sort of this little dotted line going across on Attachment *B* -- and then showing that we had substantially, we thought at the time, corrected for the growth of income over $100,000. That number, probably with the closing of the books, should have been about a minus 15 percent. This morning I just, sort of, penciled in how dramatic that number, if you actually recreated that chart, graphically would have presented the gross income tax.

The other thing that has surfaced before this Committee was something that was referred to as the LLC loophole closing. I believe one of the members of the press, in January or February, came over and said that the actual LLC tax returns were significantly below the $420 million that was certified in June as the value of that estimate. The origin of that $420 million estimate was that, on an annual basis, it was forecasted that that tax should bring in about $300 million. As that bill was being negotiated and drafted, we in Treasury were aware of three corporations in New Jersey that, alone, we thought would pay over $100 million in additional taxes, as a result of that bill draft. They obviously did not. But with three corporations at that time telling us that that was probably what the tax burden would be on them, the underlying estimate of $300 million seemed reasonable.

Now that bill, which was debated for six months, when it was actually signed into law on June 30, had a retroactivity feature to it. So, in the first year, we picked up about 18 months worth of tax liability. So the higher number, or $420 million, used in the budget actually represented about a year and a half of revenue with the expectation that, going forward, there would be some truing up. As it turned out, the money did not come in under the LLC legislation.

There is the possibility, or the potential, that that may have, nevertheless, turned up in individual personal income taxes as they pulled money out of their corporations and into their personal income. There is also the potential that they just paid a normal business tax and never exercised the LLC thing. But in reality, it may also have been that, given the debate and the ability to anticipate this legislative change, the more sophisticated corporations took their shelters before the law was enacted, and the money left before it became a tax liability.

Now, as you know, this past spring there has been another attempt to close the corporate drain on revenues. I guess, next April 15 the bulk of those taxes will be paid, and, ideally and hopefully for the soundness of the State budget, that that estimate is correct.

If any of you had a chance to hear some testimony from New York state and from a taxpayers advisory group, the sophistication of corporations today, however, to -- for want of a better term -- game the system and move tax liabilities among the various states is fairly significant.

The other thing that happened in September, and in particular September 11, is all last -- and I say last spring, but it's actually the spring before that -- there was quite a discussion about a U-shaped shallow recovery, and that in December of 2002 we would see the economy come back; so that the anecdotal or preliminary economic data, that was being looked at in the last six months of the previous administration, was not necessarily an immediate cause for concern, because the expectation was the recovery would pick up in the spring of this year.

September 11, of course, changed those forecasts, but changed them in a way that the national forecasting groups were uncertain how to quantify and present that, and even to the extent they were starting to talk about these things. It was then very difficult to take their national forecast, and even some of the regional ones, and turn around and say: but for New Jersey this is potentially very good news, as jobs relocated to the north Jersey area, where high-income people that had previously paid New York City taxes would now be subject to a New Jersey tax liability. As you know, today there is continued concern that we may have a second downturn in the economy as stock prices and corporate profits are going lower.

The other item in one of the attachments is, as this happened, Acting Governor DiFrancesco basically directed that very aggressive and positive steps be taken. In the spring, we had -- when we first became concerned at the revenue estimates, and we went out and we actually hired *economy.com*. There's a professor called Dr. Mark Zandi, whose accuracy and hindsight has now made him something of a national star. But we have retained the services of that econometric service in addition to WEFA, who we were already using. We also went to Deloitte and Touche, who have taxpayer advisory services, and they had several professionals down in their Washington office that worked on the federal budget and actually had come from places like the GAO, the then-president's budget staff. We re-emphasized with the relationship we had with Rutgers University, also, to provide us with their forecasts.

In particular, the reaching out to Deloitte and Touche was that, in the spring and again in the fall, it was important, I thought, to have, looking over the shoulder of the professional team in taxation, people that would verify that we were asking the right questions, that we had the right methodology, that we had, sort of, the resources we needed in June to strike accurate revenue estimates. And again in the fall, we went back to these groups to see if they could provide us with updated forecasts and predictions.

Attachment *D* was the summary page from the Deloitte and Touche report that talked about the potential for, essentially, seeing revenues decline by only 680 million, and potentially the magnitude of about 1.6

billion. Now that was based on, essentially, the information and analysis that was available and unfolding in late September, early October. These reports were all shared with the transition team, and also became reviewed within Treasury. In addition to retaining these consultants, we began to put large amounts of money in reserve so that there would be flexibility in dealing with the problems. At various points in time, we went to the Wall Street community to borrow money. There was a very dry technical paragraph that presented what we saw, at that time, as the amount of risk. And, as you're also aware, if you were in the Legislature in the fall, we then also began a program of anticipating an increase in New Jersey Transit fares. We changed the phaseout of what we referred to as TEFA -- it's a transitional energy surcharge, which is built into the utility rates.

As a result of all of those things, the feeling was, as essentially we were exiting in December and January, that probably we would realize a net decline of about $1.4 billion. That was disclosed in the offering statement on a number of transactions, one of which I believe Treasurer McCormac shared with the Committee at the last meeting. At that point, we, and I anyway, were pretty much removed from what was going on.

Now, there is a tendency for taxpayers with a large tax liability to the Federal government to pay in advance, in December, their estimated payment, rather than the estimated payment that they would make on January 15. The opening of envelopes that last week in January did not produce the revenues that would be supportive of those estimates at the 1.4 billion amount. But it was really not until after the January 15 payments had come in and were trued up, that people in Treasury began to see a very, very significant problem that was much greater than what had been anticipated in the fall analysis.

I believe, last meeting, Treasurer McCormac shared a multicolored chart that showed how, in fact, the revenues from the big three taxes were on a downward slope and, as the time lines unraveled, came in significantly below.

In the world of budget administration, it is obviously very important to be able to estimate the revenues coming in. But, to do that, you have some other resources available to you, one of which is the surplus itself, the other of which is the ability to work with the Legislature in changing the laws -- the other of which is to have various different initiatives going forward, such as Tax Amnesty, and that you're-- When you're actually in Treasury, you are in a constant process of monitoring your revenues, monitoring your expenditures, and really working on a budget with about an 18- and sometimes 24-month horizon as to where we are today. But what do we really need to do over the next 18 months so that the '04 budget, in fact, is put in balance; and you work with the departments in coming up with various budget ideas and alternatives.

The money that we were able to put in reserve, and the initiatives that were brought to the Legislature, such as Tax Amnesty and some of the changes in the escheat laws, have their origins in a group of people, in particular over in OMB, but also from your own legislative staff, working on the budget to equip the Governor and the Legislature in keeping the budget in balance. To that point, New Jersey has always adopted a budget on time. It's always been in balance.

The rating agencies, I think, give the financial management of State government fairly high grades, and it is an important point of State pride. Given the charge of this Committee, and looking at this from a legislative perspective, and drawing on my 22 years of being in the legislative staff, one of the things that aids the Legislature is the fiscal note process. I have written them and I have reviewed them, and so on and so forth. But it is a reassurance that the fiscal note process equips you with adequate information. I will tell you, at one point in the prior summer, I had turned to a colleague of mine, Alan Kooney, and I said, "Gee, it was nice to read that the fiscal note on the LLC legislation was pretty much in agreement with our estimate." And he said, "Well, you didn't read it carefully. What we said is we really didn't have enough information to challenge your estimates, so we used your number." It was sort of like, "Oh."

It would have been, I think, helpful to Treasury and helpful to the Legislature had there been an opportunity to, essentially, get inside the numbers and a better estimate. Although, having used that as an illustration, I would be hard-pressed to say to legislative staff, "This is what you should have done differently." When we first saw the falloff of corporate taxes, we tried to pull individual tax returns to see if we could trace changes in corporate behavior and why were the revenue estimates down in the first instance. They were so complex that, basically, it was not readily doable. I was quite pleased to see, in the Governor's budget message, considerable analysis and effort had been put into documenting how corporate taxes had been changing in New Jersey.

The other thing that I will mention in my beginnings with the Legislature -- there used to be a Joint Appropriations Committee, and it had a subcommittee on revenues with both the Senate and Assembly participating. Those members would meet with the executive branch and with legislative staff and go through a dialogue and a discussion so, that when the time came for drafting the appropriations act, the members themselves had a sense of the numbers to present in the budget. It was probably a healthy part of the process, selecting a few legislators to work carefully and slowly with OLS and Treasury employees.

It's sort of what this Committee is doing at this point, academically, what might we do moving forward in the future. There's also a statutory reference here that monthly revenues be provided as a public reporting.

Lastly, there is something called the Revenue Forecasting Advisory Commission. This grew out of some of the difficulties in the early '90s. If it wasn't sponsored by Larry Weiss, who was then Chairman of the Appropriations process in the Senate, it was something that he strongly endorsed as a way to further supplement what the executive branch was doing and what the Office of Legislative Services were doing. That Committee probably never succeeded in achieving its full potential, but there is a tool there that would certainly assist the Legislature and the public in having a better understanding of revenues. It may be that that law is in need of amendment.

But, if I was to leave you with three thoughts, they would be: the fiscal note process, a subcommittee to look on revenues, and the Revenue

Forecasting Advisory Commission as three places you might want to head to enhance involvement of the Legislature.

To that point, I would conclude. I thank you for your attention. I always appreciated Senator Ewing's remarks, "It's the peoples' money." And, as I also said, it's important to try to enhance our bond rating as a worthy goal and to rebuild the surplus.

I thank you for your attention.

ASSEMBLYMAN ROBERTS: Mr. Lawrance, thank you very much. I appreciate the very concise and helpful presentation.

I think some of the members of the Committee have some questions. I'd like to begin with Assemblyman Cryan.

ASSEMBLYMAN CRYAN: Thank you, and good morning.

MR. LAWRANCE: Good morning.

ASSEMBLYMAN CRYAN: We've never met, so I was one of the folks who was on the Assembly Appropriations Committee that didn't get a chance to see you in June. So I thank you for the apology. It's a great pleasure to hear you today. Thanks for your insight and your comments. The candor is refreshing. I appreciate it very much.

I have some questions in regards to charts, and so on, as well as some background information that I'd like, because, quite frankly, I don't have the experience as some of my colleagues up here. Twenty-some-odd years, I think, in New Jersey government for you. Is that right?

MR. LAWRANCE: Twenty-two.

ASSEMBLYMAN CRYAN: You were Deputy Treasurer, Acting Treasurer? What else?

MR. LAWRANCE: I actually started as a budget analyst in what is now the Office of Legislative Services. For a while, Alan Kooney and I were both acting as legislative budget and finance officers. In the second year of the Whitman administration, I went to become the Deputy Director of the Office of Management and Budget in the executive branch. For Whitman's last year, I was the Deputy Treasurer, with Roland Machold as Treasurer. And then, the last year I was the Acting Treasurer -- I guess I went through four or five governors.

ASSEMBLYMAN CRYAN: I hope you go through a little less Assemblymen, but--

When did you become Acting Treasurer, exactly when?

MR. LAWRANCE: It was February 1, as Roland Machold and Governor Whitman left office.

ASSEMBLYMAN CRYAN: February 1 of '01, right?

MR. LAWRANCE: Right.

ASSEMBLYMAN CRYAN: Okay. So you know the process. You know well of the certification process. Is that a fair way to put it?

MR. LAWRANCE: Absolutely, sir.

ASSEMBLYMAN CRYAN: I appreciate the perspective that you share with us, and the background that you have. I understand Assemblyman Gregg may have had something to do with your appearance today, and I think the Committee owes a little thanks for that suggestion. I appreciate that.

My first comments and questions are on some of the charts. B1, Chart B1, could you take us back to that a little bit?

MR. LAWRANCE: Sure. The origin of this chart is actually after Governor Whitman left office, the *economy.com* forecast for the decline in capital gains became apparent to the Department of Treasury. The Office of Legislative Services, in March, I believe, briefed the Committee that, should the *economy.com* forecast be correct for the falloff in capital gains, we had overestimated our revenues. At that time, and this was part of the reason we did the hiring of consultants in the spring--

ASSEMBLYMAN CRYAN: Of '01?

MR. LAWRANCE: This would have been spring of '01, yes. And this -- these numbers, by the way, are calendar year, because it's done against tax liability as opposed to fiscal years. But, given year after year after year of this double-digit growth, we had essentially reduced the growth of personal income, of those individuals over $100,000, down to about 5 percent. At the time, we thought that that was a safe correction of the magnitude of the decline.

Now, other than an untested econometric model that really had not been -- was known for less than a year, we thought that that was a fairly prudent thing to do and not to overreact, because it was basically the only place in the country that was making those forecasts. That forecast, by the way, was only recently acknowledged by the Federal government. States that were slow to acknowledge it continue today to have budget problems. But that was also a way to illustrate what we thought was the appropriate level of correction.

One of the difficulties in doing the gross income tax in New Jersey is that we are highly dependent on individuals earning over $250,000 a year as a taxable liability. And, unfortunately, those households you do not have turning up in your statistical series that you can work with it readily-- You can't look at unemployment filings and things like that. When the market turned down, there was a gentleman working in Treasury who had retired. I said to him, "When wealthy people undergo something like this, and the market turns down, what are they going to do?" And he just sort of smiled and he said, "Well, they're going to vote themselves more stock options." They obviously didn't. I can't walk next door to my neighbor and do even anecdotal discussions. It's a different circle of individuals.

ASSEMBLYMAN CRYAN: In Chart D, the Deloitte and Touche chart?

MR. LAWRANCE: Yes, sir.

ASSEMBLYMAN CRYAN: The timing on that chart, where it shows the optimistic shortfall of 680 million and pessimistic 1.6 billion.

MR. LAWRANCE: Just to get some sense of a time line--

ASSEMBLYMAN CRYAN: I appreciate your testimony, but there were some things that just went by a little quick.

MR. LAWRANCE: This report we asked to have concluded in time for transition. So, I want to say, the final draft was received in very late October. This is the 23rd page of a long write-up about tax trends and corporate models.

ASSEMBLYMAN CRYAN: You had this in late October?

MR. LAWRANCE: Correct.

ASSEMBLYMAN CRYAN: Okay. I guess, since I now understand some of the information we have, I just want to, kind of, talk for a couple minutes about the process. One of the things I'll use in particular is Treasurer McCormac's graph that you referred to in terms of a time line, a little bit.

Back in 2000, and in September of 2000, Treasurer Machold sent, I believe, the Chief Counsel in the Whitman administration a memo talking about a $15.4 billion revenue forecast. We know now that that 15.4 billion would have been accurate, but his forecast was 16.7. I know -- were you the Acting Treasurer then? You were the Deputy Treasurer.

MR. LAWRANCE: I was the Deputy Treasurer at the time.

ASSEMBLYMAN CRYAN: Rutgers came up with similar forecasts, similar-type warnings and problems in September 2000. Clearly, the administration was aware of them. I think that's a given.

MR. LAWRANCE: Right.

ASSEMBLYMAN CRYAN: Why were they ignored?

MR. LAWRANCE: It's sort of dangerous to speak for Roland. We had a long-term revenue forecast to build the '02 budget on, and we were seeing, in September, tax returns that were not consistent with that long-term forecast. I believe Roland wrote that memo to alert the Governor's Office on the fact that, as we proceeded through the budget process, we were probably going to have difficulties achieving the revenue standards.

Now in September, the amount of known information is before-Christmas sales, before this December-January payment of estimated taxes and--

ASSEMBLYMAN CRYAN: But clearly, these were alarming numbers. I mean, clearly they were ignored. Is that a fair way to put it?

MR. LAWRANCE: They became the context for shaping the final thing.

ASSEMBLYMAN CRYAN: Let me ask you--

MR. LAWRANCE: But I will tell you, every year coming up with a balanced budget is large numbers and quite difficult, but, yes.

ASSEMBLYMAN CRYAN: I saw that process this year. It can be pretty tricky.

Let me ask -- I guess it's kind of an obvious follow-up to that question -- whose numbers were used in the revenue forecast? Were they established by the Governor's Office or were they the Treasurer's Office's in the 2001 fiscal budget?

MR. LAWRANCE: I believe Treasury took to the Governor's Office our best estimate of what taxes would come in for the year. The Governor reviewed them with the Treasurer, and that became the basis for presenting to the Legislature the Whitman outgoing budget, with a billion-dollar surplus in it, plus, and so on. It was also revised slightly in late December, because the estimated payment of gross income tax was quite substantial and above some of the internal targets that had been prepared. It lead us to believe that, at that time, the gross income tax was coming in on track.

We also were looking at corporate taxes being off the mark, and when we talked to the experts in Treasury, we said, "Well, why is that?" They said, "We think it's the LLCs." It may be worth 100 million, it may be worth 200 million, it may be worth 300 million -- which was how we were missing the internal targets at that time. But that also led Governor Whitman to initiate a process in her budget recommendations to close the LLC loophole.

ASSEMBLYMAN CRYAN: Then she realistically, the way those numbers were -- the Governor's Office knew at that time. I should say it's the Governor's Office numbers in the 2001 budget, despite your warnings. Is that a fair way to put it?

MR. LAWRANCE: In fairness to the Governor, she followed the advice of Treasury of what we presented, but it--

ASSEMBLYMAN CRYAN: It's one of those things, though. You see, you look at a time line and I hear your testimony today. You were kind enough to-- You said, "Look, I underestimated the problem last September by a billion dollars." Came right out front and said-- When you look at the OLS information that we see monthly, clearly in the Treasurer's charts and so on, I go to February of 2001, revenue -- is it Richard Kaluzny I was looking at?

MR. LAWRANCE: It's Dr. Kaluzny, of the Division of Taxation.

ASSEMBLYMAN CRYAN: Clearly, there were problems there. Rutgers, again, saw forecast issues, as you're well aware of. Your own -- as Acting Treasurer, you said there could be an $800 million problem, I think, at that time. Is that correct?

MR. LAWRANCE: Yes.

ASSEMBLYMAN CRYAN: OLS had it at a billion. Is that about right? Does that enhance your recollection?

MR. LAWRANCE: My recollection was OLS initially thought the income tax estimate was a half a billion dollars too high, but I will defer to Alan later.

ASSEMBLYMAN CRYAN: But your numbers were 800 million?

MR. LAWRANCE: For?

ASSEMBLYMAN CRYAN: February of '01. You had numerous warnings in February of 2001, including your own numbers that indicated that you had revenue problems. I'm looking at a memo from 2001 that shows it's a half-a-billion bucks. It's a half-a-billion dollars off. Nine hundred million dollars when you total all out. Why certify the numbers? Why go through that process and certify, when, clearly there were problems then?

MR. LAWRANCE: I believe-- Well, there were a couple of things that were going-- I'm not sure exactly which memo you're looking at. But we revised downward the gross income tax revenue estimate and then sought the change in the LLC loophole closing which added about $420 million. The value of the LLC loophole closure did not really unfold until late June. That bill came together, I want to say, in the last two weeks of June.

ASSEMBLYMAN CRYAN: Last two weeks of June.

MR. LAWRANCE: And these numbers probably do not reflect that change, although they are--

ASSEMBLYMAN CRYAN: The memo I'm looking at is from Richard -- and I hate to--

MR. LAWRANCE: Dr. Kaluzny.

ASSEMBLYMAN CRYAN: Dr. Kaluzny, thank you. And it's to you, as the Acting Treasurer.

MR. LAWRANCE: Oh, this is in February?

ASSEMBLYMAN CRYAN: Right, February. But this memo states that costs had just returned to 1998 level of capital gains, which doesn't appear likely, will cost about 800 million in tax revenue for 2001. It's there. It's there in black and white.

MR. LAWRANCE: Yes. The origin of that memo, as I understand how and why Dr. Kaluzny was writing it, is that he read the December journal report on *economy.com*, with national forecasts for changes in taxable capital gains. And even though that article had been written in December, he didn't actually get around to reading it until February, and found it quite alarming and found it quite important to immediately, internally, write to Treasury that this had the potential for being fairly serious and significant.

ASSEMBLYMAN CRYAN: Did you have a sense of that importance when you read that memo?

It's not Governor Whitman calling, is it? (laughter) (referring to cell phone ringing)

MR. LAWRANCE: Sorry. Excuse me. I turned it off. (referring to cell phone)

This was the first national attempt to forecast capital gains, and it was done untested and became, I think, an important signal for all the states, and became the basis that basically encouraged us to lower, as shown in that other graphic, the growth of income over $100,000. But it was not supported by the other econometric forecast at the time.

ASSEMBLYMAN CRYAN: Okay.

MR. LAWRANCE: In hindsight, we probably all -- that we had known about it and its accuracy. But in hindsight--

ASSEMBLYMAN CRYAN: But with all candor, you did know about it. I mean, it was there.

MR. LAWRANCE: Well--

ASSEMBLYMAN CRYAN: It's pretty clear.

MR. LAWRANCE: It was-- It was--

ASSEMBLYMAN CRYAN: And you were candid enough to admit that you were underestimating the problem last September, which I'm grateful for being here. Then let me ask, I guess, which is the obvious question, did Governor DiFrancesco's office dictate to you what the certified revenues for FY 2002 must be, despite all these warnings, or did you recommend the figures?

MR. LAWRANCE: Absolutely no. I mean, the Governor basically, I believe, certified the revenue estimates that we recommended to him.

ASSEMBLYMAN CRYAN: And based on what you talked to us about earlier, that last September you underestimated the problem, and your earlier testimony here or--

MR. LAWRANCE: And then in September we began a process of damage control, after September 11.

ASSEMBLYMAN CRYAN: Damage control?

MR. LAWRANCE: Well, damage control in that we no longer had the PATH trains running in and out of lower Manhattan. We knew that we were about to undergo a significant economic shock, and that we'd better come up with options and solutions going forward.

ASSEMBLYMAN CRYAN: But pre-September 11, we knew--

MR. LAWRANCE: Pre-September 11, we felt that we were pretty much on course, and that we were on course in a context of a billion dollar surplus, an economic recovery anticipated for December, flexibility in the way we had structured state appropriations, so that it was quite manageable.

ASSEMBLYMAN CRYAN: First off, maybe I misunderstood, but one of the things I appreciated in your opening comments was the fact that last September -- and it says it here -- "I underestimated the problem by $1 billion." I believe, though, you overestimated revenues by $1 billion, that's your own comments here, just a little bit earlier on, correct? That doesn't include September 11. I mean, you knew ahead of time--

MR. LAWRANCE: No, that was after September 11 that we realized that we had overestimated revenues.

ASSEMBLYMAN CRYAN: So last September, in the 19 days between September 11 and 30, you had a sense that you underestimated by a billion bucks -- it magically came to light.

MR. LAWRANCE: No, after September 11, and then working with Deloitte and Touche and the other consultants, and talking to Treasury, that's when we realized the magnitude of the revenue loss. And that was basically a discussion on the gross income tax. The LLC issue really evolved much, much later.

ASSEMBLYMAN CRYAN: On the McCormac memo -- you have that graphic that you referred to, or that chart.

MR. LAWRANCE: I have the black-and-white edition.

ASSEMBLYMAN CRYAN: All right. And so do I. So we'll stay off colors. May of '01, your memo is -- shows a shortfall as well.

MR. LAWRANCE: Yes. The April ’01 memo would have been written against the numbers originally written in the Governor’s budget and not attributable to the June data.

ASSEMBLYMAN CRYAN: Doesn’t this chart consistently show a problem in this budget for FY 2002, even from the administration, and the clear differentiation between the administration’s numbers and OLS and Rutgers, and just about any other recognized economic group that would be analyzing the State of New Jersey?

MR. LAWRANCE: I think this report, or this bar graph, clearly illustrates why we’re here today -- the need to get a better handle on revenue estimating, and that it also shows, as the economic cycle is no longer linear, how rapidly and badly things fall off. And to end up at 13.8 billion from--

ASSEMBLYMAN CRYAN: Eighteen.

MR. LAWRANCE: Well, if you look at May of ’02--

ASSEMBLYMAN CRYAN: Right.

MR. LAWRANCE: --revenues were significantly off. I don’t know of anybody, 12 months earlier, who was expecting to see that number as the final tax collections on the big three.

ASSEMBLYMAN CRYAN: Well, let me summarize with this. I mean, clearly the warnings were there. Clearly, your own memos from February on, the warnings were there, and there were problems. Do you believe that the certified revenues for 2002 -- were they based on sound economic predictions in your view?

MR. LAWRANCE: At that time, absolutely. They were the -- basically the internally reviewed discussed numbers. They were what our tax policy people were telling us the LLC bill was worth. We knew that there was about a half-a-billion dollars variance between us and the Office of Legislative Services on the gross income tax, but we also knew that with a billion dollar surplus and other elements of flexibility, that that number could be certainly attainable. When we met with the Wall Street rating agencies over the summer, we explained that to them, and that that certification was in that context.

ASSEMBLYMAN CRYAN: I thank you, and I thank you for the apology. It was a pleasure to meet you. Thank you very much.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you.

Mr. Lawrance, I just have a couple of questions. I want to just explore, just for the purposes of history and going forward, the issue of your, if you will, failure to appear before the Assembly Committee in the past. I've been frustrated when there hasn't been the kind of dialogue that there needs to be between members of the administration and legislative committees. It was frustrating, candidly, when Governor Florio, in his first budget, had the Treasurer come in and present on behalf of all the members of the Cabinet. That was disrespectful to the Legislature. I think that, candidly, your unwillingness to appear on two occasions was disrespectful of the Legislature, as well. Was that a judgment that you made, or was that a judgment that was made by the administration in a directive that was given to you?

MR. LAWRANCE: I think it's important, when you meet with a Legislature, that you not only bring them a problem, but you bring them a solution, and I was not prepared in June to come before the Committee with the revenue issues at that time. We were still negotiating the LLC legislation, thought it would have been counterproductive to talk about it in early June, and, consequently, provided to the press and the Committee a fairly lengthy comprehensive report on revenue so you would have the advantage of that information. In hindsight, it was a huge mistake, and I should have appeared.

ASSEMBLYMAN ROBERTS: You've expressed that, and I appreciate that. I think one thing that we do need to take from this process is that we need to think through a mechanism that will, within what's permitted, give us some opportunity to compel people to engage in that dialogue. Because when the Legislature is deprived of information, even if it's incomplete information at a point in time, as I said, it's disrespectful to us, but the ultimate losers are our constituents, the citizens of this state. So I think we need to do everything we can to make sure that doesn't happen in the future.

I wanted to talk a bit about the LLC loophole issue, because that's one that I find to be very puzzling. You addressed it a little bit in your earlier testimony. And my understanding of the chain of events, if you will, is that when that was first proposed in January, by Governor DiFrancesco, that had a revenue price tag attached to it of about $100 million.

MR. LAWRANCE: Correct. He inherited that recommendation from Governor Whitman, but yes.

ASSEMBLYMAN ROBERTS: Did he support that recommendation?

MR. LAWRANCE: I believe that we testified in support of that. I mean, it was the budget he inherited, and it was needed to essentially balance the books for that year.

ASSEMBLYMAN ROBERTS: So the $100 million estimate went forward unquestioned. My sense is that it moved from 100 million to $420 million, roughly around the time frame of three days before the budget was signed into law.

MR. LAWRANCE: Well, you're basically correct. We did not have a bill draft on February 1, and when we had the bill draft in late June, it had a $300 million value. Then, when you put on top of that the accelerated year-and-a-half collection, you got to the 420.

ASSEMBLYMAN ROBERTS: There will always be a relationship and a measure of tension between the executive and the Legislature. The governor puts the budget together, will have what he or she wants to be their view of the world, and we will always have a different view. That's the reason that we need some mechanism that provides us with a measure of safety and certainty. This is, from my perspective, an egregious example of how badly things can go wrong. We go from $100 million, an unquestioned number, to 420 million, which is the number that's used when the budget is signed into law. We ultimately collect $71 million, which doesn't even meet the original target and falls woefully short of the $420-million number.

You testified earlier that your number was 320, 300 million, and you had the expectation that a few corporations would kick in the additional dollars. But it's very, very troubling that-- I could understand if there was a difference between 300 million and 420, but to have the gap be between 100 million and 420, and collect $71 million, I think it begs the question, wasn't that number created out of thin air, frankly, as a way to fill other gaps in the budget that had to be filled in order for the budget to go forward?

MR. LAWRANCE: I completely share your huge frustration that that number was not realized, but it was not an invented number -- it was a process of working with corporations and working with the Division of Taxation and relying on the best estimates of the experts at the time. Why that number was not achieved could have been the long lead time of enactment that let corporations beat us by doing early shelters. It may have been a flawed bill draft. It's sort of, at this point, water over the dam, but it was very troubling to see that only $71 million came in.

ASSEMBLYMAN ROBERTS: It is water over the dam. The difficulty is that we're dealing now, as we don't have enough money to provide school districts with more money and municipalities with more money -- we're dealing with the consequences of those decisions. And again, I think that revenue forecasting is as much of an art as it is a science, but to fall so short is really troubling.

You're a bright individual and an experienced individual and your colleagues are equally talented, and I frankly have trouble swallowing that the number could fall so far short. To have 420 be the anticipated number and 71 million be the realized number, really suggests that the budget is more a work of fiction than a work of fact. The consequences of those sorts of numbers, respectfully, that I think are created out of thin air, are consequences that really create problems for the people that we represent.

Let me leave that where it is for now and move on. Give me your thoughts about the Revenue Forecasting Commission and the value that that has had historically and can have in the future. It's my understanding that

that continues as an entity and there are people appointed to it. Is it not operating currently?

MR. LAWRANCE: I do not believe the Speaker, the Senate President, or the Governor has appointed new members, and I suspect the old members automatically went out of their term with the change of administrations. I will defer to the--

ASSEMBLYMAN ROBERTS: I understand. Now that you have the luxury of being an outsider, if you will, if you were to chart a course for that entity or one like it, to make it as meaningful as possible, what would you suggest?

MR. LAWRANCE: Probably one of the difficulties that committee (*sic*) had is that they did not have staff assigned to them. Things like the Pension Review Board has a full-time staff person and a consulting actuary. That helps make it work. I will probably get a lot of grief for this, but, sort of like, assigning the Office of Legislative Services to facilitate the work of that committee and staff, it would probably greatly assist it.

ASSEMBLYMAN ROBERTS: Thank you.

MR. LAWRANCE: But it does need a professional underpinning to--

ASSEMBLYMAN ROBERTS: Sure.

MR. LAWRANCE: Because it's basically public members, and it's hard for them to take the--

ASSEMBLYMAN ROBERTS: Thank you.

As we go forward today, we're going to hear from the National Conference of State Legislatures and get the Legislatures -- and get a sense of what other states do. I think one thing, I sense, we would all agree on is that -- and we've talked about this in prior meetings -- the need to have something that is -- to have as much objective information as we can possibly have. Obviously, there's a balance between OLS and the administration, but if we could have an outside perspective, that's helpful as well.

Thank you very much. Those are all the questions that I have.

I would now call on Assemblyman Gregg.

ASSEMBLYMAN GREGG: Thank you, Mr. Chairman.

Good day, Peter. I won't call you the former Acting Treasurer -- it's got too many words in it -- so we'll just call you Peter, if that's okay?

MR. LAWRANCE: I appreciate that.

ASSEMBLYMAN GREGG: I want to thank you for coming. And I'd like to clear the air right up front that -- Peter is here because Peter wants to be here. I'd be happy to take credit for inviting him here, as our side of the aisle, but I think that the former Acting Treasurer wanted to be here to have an opportunity, one, to give this Committee insight as a past Treasurer, but also as an individual who can give us some thoughts about where we might want to go in the future. That's really the purpose of this hearing today. So I'm going to make the most of my time, Mr. Chairman, dealing with the future. Even though the past is always an important part of the future, I think it's important to look at where we have been and what occurred over our budget cycle and the new budget cycle, but I think we'll have an opportunity, when NCSL has an opportunity to come in front of us and tell us what's going on in the rest of the country. That's probably a more apropos time to review how New Jersey dealt in a pool of 50 states as we've gone through these difficult economic times.

Peter, you've outlined some thoughts about where you think we should be. I'd like to work, kind of, in order of things. In New Jersey, we have a very powerful Governor. Our Governor tends to have more rights given to them than many other states. Would you agree with that?

MR. LAWRANCE: Absolutely.

ASSEMBLYMAN GREGG: And with that power, of course, comes responsibility. But there also becomes an opportunity to get caught in a closed-door mentality, and perhaps forget that there are 120 other folks out here that are interested in how the State works, as well as 8.4 million people who care. Would you think part of the process might be improved if there was more openness on the part of -- and we'll call Treasury the administration at the same point -- in showing their books and giving information, not only to the Legislature, but also to the public on a more timely basis?

MR. LAWRANCE: Absolutely. I think it is very, very healthy to the process that the type of correspondence internal to Treasury about revenues was made available by Treasurer McCormac to this Committee, but it is that level of internal insight and working that I think is very important and healthy to the process. The book should always be open.

ASSEMBLYMAN GREGG: And moving forward with the legislative concept -- when you look at a budget bill, and this is something I didn't understand really until you shared it with me, but I think it's interesting -- the Committee may want to know -- that the budget bill has no statutorial power over revenue.

MR. LAWRANCE: Correct.

ASSEMBLYMAN GREGG: It is not certifying revenue when it is signed by the Governor and voted on by the Legislature.

MR. LAWRANCE: Correct. It's a bill making appropriations. It begins with a preamble that is a listing of the revenues, and then it says, "And there is hereby enacted." Then the surplus is the mathematical difference. But revenues is the constitutional duty of the Governor to certify funds that are available for appropriation, and that is looking at both the surplus and the revenue estimates, and that certification is not necessarily a forecast, but it is a certification of what's available to be appropriated. It is an ability of executive branch powers, in some ways, to call the tune.

ASSEMBLYMAN GREGG: So, in essence, when a legislator votes for the budget, they're really just voting for the spending, and they've really placed no seal of approval or denial on the actual revenue itself?

MR. LAWRANCE: Correct. And there have been years that the Governor has certified higher revenue estimates than the Legislature presented, and lower.

ASSEMBLYMAN GREGG: Number three, structurally balanced budget: it's a term that we hear and have heard for the past 10 years. We have never achieved one, even in the great years. Do you think that as we move forward in more difficult times, and, perhaps, more inconsistent times economically, that the goal of getting to a structurally balanced budget -- and for those of us who are not termed with that, basically that you're not supposed to spend any more than you take in, that your surplus from last year should not be a reserve that you use, and hoping that the new revenue created becomes the backstop for your budget -- do you think that that is an issue that should be discussed by the Legislature, as well as the administration, that moving towards that type of a goal should be very important as we go into the future?

MR. LAWRANCE: Yes. And that is the reason why I shared with you one of the rating agency comments. It's sort of the *Good Housekeeping* Seal of Approval, the direction you want to always be headed towards, and seeking structural balance is part of that. It's not the only thing, but it's very much-- It's not number one on the list.

ASSEMBLYMAN GREGG: Right up there?

MR. LAWRANCE: Right up there.

ASSEMBLYMAN GREGG: Thank you. The topic close to my heart is the term surplus. The surplus is, and I think we'll hear later, really the protection for a state for economic fluctuations. We all know that no matter how good we project, no matter how many good models we do, no matter how good our folks are, the economy quite often runs its own rules, and we can't be responsible for what occurs in the world. So we put a responsible package at the bottom, like a homeowner would and a citizen would do, keep some money in the bank for a rainy day.

There are some guidelines for states and *Moody's* and people like that. What do they think is a good surplus in a budget?

MR. LAWRANCE: Actually, I can't speak for them. I thought the 4 percent number served the Whitman years well, as that was the target that we constantly worked towards. It seemingly provided the cushion we needed. Within the context of that surplus, there was a $720 million "rainy day fund" that had half of the underestimation of revenues deposited in it. So that, if you looked at the history of the past eight years, revenues were underestimated by over $1.4 billion -- that generated a rainy day fund of $720 million that provided for the billion dollar surplus at the end.

I throw that out also to give some context to the volatility of revenues and what happens.

ASSEMBLYMAN GREGG: I think we're going to hear a lot about that later. I think we're going to hear a number closer to 5 percent as being a good number, with some states up to 10 percent, and unfortunately, many below. But watching what occurred to this State, specifically, as we have to deal in this State, as much as I'm interested in 49 others, do you think that as we move forward in this Committee that we should be looking into, perhaps, having a statutorial or even a constitutional requirement for a minimum surplus every year?

MR. LAWRANCE: Yes.

ASSEMBLYMAN GREGG: As a retired Treasurer?

MR. LAWRANCE: And as a retiree, I can harbor back to Pogo. (laughter)

That surplus is also a function of what's appropriated, so that not making the appropriation will generate the surplus as well.

ASSEMBLYMAN GREGG: We have a $100 million surplus, approximately, in this budget on a $23 billion, give-or-take, budget. Do you think that that is reasonable and prudent, even with the difficult economic times we have, as a former Treasurer?

MR. LAWRANCE: Every Treasurer wants as big a surplus as possible, and that surplus needs to grow going forward.

ASSEMBLYMAN GREGG: So I take that as it's not big enough.

MR. LAWRANCE: It was a successful surplus in enacting a balanced appropriations act last June. But going forward, I would hope that initiatives being taken now and in the future will let that surplus grow to what was originally recommended in this administration's budget. I believe if you start to book, for example, the recent tobacco securitization, the surplus today is larger than what was adopted in June.

ASSEMBLYMAN GREGG: Another topic that we discuss every year, one-shot revenues. I guess there will never be an administration that has not used that. Perhaps this budget we're in right now, probably, has the highest usage of one-shot revenues in the history of the State. I could be wrong, but I'd be happy to have that discussion occur. Do you think, again, as we move forward for a rationale process for the budget in the future, making recommendations to the administration, as well as the Legislature, that we should be telling them that the use of one-shot revenues should be limited -- used, perhaps, when we know the use of that one-shot revenue will be for a one-shot expenditure, so it will make sense, as opposed to a one-shot revenue that will have to be filled the next year.

MR. LAWRANCE: I always liked the expression, one-time revenues for one-time expenditures. And that basically flows into a good capital budget.

ASSEMBLYMAN GREGG: I'd like to thank you for your time, for coming today. I'd like to thank the Chairman for inviting you, and look forward to the rest of the questioning.

And thank you very much, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you very much.

Next is Assemblyman Sarlo.

ASSEMBLYMAN SARLO: Thank you, Mr. Chairman, and through you.

Good morning, Mr. Lawrance.

MR. LAWRANCE: Good morning.

ASSEMBLYMAN SARLO: And I also want to thank you for being here this morning, taking time away from your summer. As a new member of the Legislature and sitting on the Appropriations Committee, I've sort of been frustrated. I feel like my first six months I've spent balancing a previous budget prepared by others and voted on by others. But, as we continue to go through this, it is a good process, and I think it's a good learning process for a lot of people.

Previously, you had stated, to answering Mr. Cryan, that it was post September 11 that we began to realize that there was a significant shortfall. At last month's meeting, when our current Treasurer, Treasurer McCormac, was here, he had provided us with a memo -- and I apologize, you may not have it -- dated July 27, 2001, which came from your office and was regarding transition management, okay. And I commend you for, at that time, starting to think ahead. In the memo, it actually talks about Governor

McGreevey, Shundler, and a little bit of the politics behind the campaign. But it goes on to say that Fiscal '02 revenues could be significantly less than budgeted, and that the budget for Fiscal '03 could be substantial. This was back in July, from a member of your transition management team to your office. It went on to recommend that a crisis management team should be formed as part of this transition -- somebody will think outside of the box, get creative, think outside the box.

Do you know if that crisis management team, this group of people, would be thinking outside the box, creative, so that the incoming governor, whoever it may be, would've had an opportunity to have some idea as how to balance this shortfall, which actually was detailed, according to this memo, before September 11?

MR. LAWRANCE: It was never formally constituted with that type of a title, but we, each summer, in the Office of Management and Budget, begin to try to surface initiatives to control spending. We ask the departments to come up with percentage reductions. We have our own group of people internally, looking at initiatives that might be pursued so, that when the transition was actually done, we had briefing books that provided advice and guidance for consideration of the new administration on a tax amnesty program, on a tobacco securitization, on making other legislative changes. And that, in essence -- it was the recommendation of that gentleman that it get, maybe, a much more formal organization in that regard.

ASSEMBLYMAN SARLO: So it was, more, just done internally, not so formal as part of a special team.

MR. LAWRANCE: Yes. He typed it himself and probably printed it out and gave it to me one day.

ASSEMBLYMAN SARLO: The time between the election and, actually, the swearing-in of our new Governor -- at that point it was sort of painfully clear that the revenues were not going to materialize. During that lame-duck period, there was significant spending approved by the Legislature. Can you recall did your office or yourself, in any way, discouraged Governor DiFrancesco at the time to hold back on signing off on any of these lame-duck expenditures?

MR. LAWRANCE: There is a bill comment process that the various departments write up on legislation and provide it to the Governor's Counsel Office, and, I dare say, 99 percent of the time the Department of Treasury writes over, "We can't afford this." But it was also during that point in time that we fairly aggressively, always sort of, said, "If you are going to sign this piece of legislation, then this amount of money must go into reserve." I think that even continued into Acting Governor Bennett's term, where there were a few bill signings that he had done and then also directed additional money be put into reserve. And at that point in time, I think we were providing the press with inventories of funds that had been set aside in reserve. So it was a managed process of supplemental appropriations, but also, in essence, deappropriating other amounts.

ASSEMBLYMAN SARLO: Were you also sharing these particular concerns with the incoming Treasurer at the time, or the transition team coming in, of your efforts to hold back on some of these lame-duck spending?

MR. LAWRANCE: I was not personally involved in that, but we did make the Office of Management and Budget available to the transition office. I know that there was any number of communications between the transition team and the acting governors.

ASSEMBLYMAN SARLO: Just focusing in, as kind of a summary here, the chart that we've all referred to -- mine's black and white also. I guess only a few privileged people get the colored ones. In this chart, it basically shows that the outside agencies and OLS have always consistently been between 1 billion and $1.6 billion lower than the DiFrancesco's numbers or the Whitman's numbers back in 1/29/01. Through all your years of experience, when you look at something like this, the revenue estimation certification process, are you comfortable with it? Was this just some bad forecasting, or are you comfortable with the process?

MR. LAWRANCE: It's partly-- Well, as I said, there are three things that really need to get re-emphasized, and that is, legislative subcommittees looking at revenue collections; empowering the fiscal note process, or pushing it a little harder; and, also, the revenue Forecasting Advisory Commission is a way to further supplement. I deleted from an original draft of this -- there probably is a need to invest more in Treasury and more in OLS in their basic staff ability to forecast revenues.

The February memo talking about the *economy.com* report was read two months too late. That was probably attributable to the fact that Dr. Kaluzny is almost a one-man band. He needs additional resources around him as well.

ASSEMBLYMAN SARLO: Final question. Just looking back at the numbers, and we had talked about this, from 1994 to 2000, OLS has predicted within 3.2 percent of the actual certified, and Treasury has always been within 3.9 percent. Through this entire process, we were always off about 13 percent -- anywhere from 7 percent to 13 percent off. Any reason why? I mean, was it just-- How do we prevent this?

MR. LAWRANCE: It's the realities of the high marginal tax rates on the gross income tax, which makes it very volatile. It's also the nature of the science and the art. To get within 5 percent is probably pretty damn good.

ASSEMBLYMAN SARLO: We were successful from '94 to 2000. We were very successful. We were within 3.9 percent, okay.

Thank you, Mr. Lawrance.

I have no further questions, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you.

Next is Assemblyman D'Amato.

ASSEMBLYMAN D'AMATO: Thank you, Mr. Chairman.

Thank you, Mr. Lawrance, for being here.

What intrigues me about the charge of this particular Committee is that we're going to make, hopefully, some very profound recommendations to our colleagues in the Legislature as to how we can improve state revenue forecasting. I just want my colleagues to know that I've read, over and over again, the statutes that deal with the creation of the Forecasting Advisory Commission. I want to spend some time with you on that.

You said that one of your recommendations would be that the Commission would have the benefit of using the staff of OLS. Is there anything else that you can think of that would strengthen this particular Commission? And the reason I say this is, because, there's something very ideal about this Commission in that it is bipartisan. There can only be equal members of each party. And thus, there's none of this going back and forth, Republicans against Democrats and so forth. Is there anything else that we can do to improve this Commission, other than staff?

MR. LAWRANCE: You may take some of the routine appointments and turn around and say that the Secretary of Commerce or the cabinet officer for Commerce and Economic Development should be a de facto member. You may take someone -- the head of the-- I think there's a Governor's Economic Advisory Group that might automatically be an ex-officio member. There are ways you might identify people like that to also go on the board. It tended to be a group, last time that I recall their résumés, they were very much economists, really removed from State finances, and didn't quite see-- There's a lot of difference between forecasting personal income or jobs and forecasting sales tax and corporate business taxes.

ASSEMBLYMAN D'AMATO: Would you agree that, in a perfect world, this Forecasting Advisory Commission should have its own independent staff. Therefore, we have OLS, who is nonpartisan. If this Commission has its own staff, then you would get one more nonpartisan--

MR. LAWRANCE: Absolutely.

ASSEMBLYMAN D'AMATO: Okay. Now we're also charged with studying waste and mismanagement within state agencies. And again, I'm intrigued about some legislation that's been introduced in both the Assembly and the Senate, which would establish a general accounting office, which in part would review the performance reviews and program analysis of each state agency. It goes on and on and on. Do you have any thoughts about this particular type of legislation?

MR. LAWRANCE: That legislation and that concept, I think, has been discussed, if not for the past 15, for the past 20 years. The State Auditor, Rick Fair, I think would love to come and address that.

ASSEMBLYMAN D'AMATO: And any other recommendations with respect to the Treasury Department? You briefly said that they need more staff in order to assist them. Anything else?

MR. LAWRANCE: I think that Treasurer McCormac will bring you the better recommendations. I limited my comment, particularly, to the revenue-estimating staff as being two or three people that probably are overworked. I remember, at one point, we wanted to share a file between OMB and Taxation. They were still -- had like a Pentium I chip on their machines, when we were using Pentium IIIs in OMB. Things like that really inhibit quality staff work. It's penny-wise and pound foolish.

ASSEMBLYMAN D'AMATO: All right. Thank you, Mr. Lawrance.

Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you very much.

Assemblyman Kean.

ASSEMBLYMAN KEAN: Thank you, Mr. Chairman. Thank you for letting me substitute today on this important Committee.

Thank you, Mr. Lawrance, for appearing here today.

I've got a couple questions. The *economy.com* forecast -- that was only, as you were saying -- those had methodologies and things that were only recently accepted as fact. Is this the right methodology you're talking about, not as fact, but as good estimation?

MR. LAWRANCE: It was an attempt by their econometric team down there to take some national data, look at capital gains, desegregate it, and allocate it out to states. It was published, I believe, in December of '00 or '01. It was the first time that that had ever been done.

ASSEMBLYMAN KEAN: Okay. If we can get an idea around the numbers, and I just want to -- if you can state this is accurate. In our estimations, last year going forward, coming from the income tax, which is obviously what the capital gains or revenues would reflect, is an estimation of $8.6 billion in the budget?

MR. LAWRANCE: Yes. Actually I-- Which year were you talking about?

ASSEMBLYMAN KEAN: For the one, not this past June, but I guess Fiscal '02 -- the '02 budget numbers. If I can clarify, you can just -- maybe do a ballpark number. I'll put them out. My understanding, or my memory, was that we had 8.6 from an income tax revenue stream. Of that total, 6.8 were derived from individuals earning over $100,000; and 4.7 of that 8.6 total, jobs that were encapsulated within that 6-point number, as well, is the income earners over 250,000. Is that ballpark figure, your estimation about 47 percent, or whatever it is, of that amount is from wage earners earning over $250,000?

MR. LAWRANCE: It's been months since I've looked at that data. You're probably looking at good staff work, so I'll say I agree, but--

ASSEMBLYMAN KEAN: My memory is that the 6.8 billion was the certified numbers that actually came in, so a huge dropoff. It was, obviously, in that shortfall from the post-September 11 and the general economic downturn.

MR. LAWRANCE: Yes.

ASSEMBLYMAN KEAN: I guess the question is, as we're looking back-- The other question I've got, overall, is the administration has been off in its revenue forecasting for the last-- I should say, the prior administration is off in all of its forecasts for the preceding entire eight years or seven years of the Whitman administration, weren't they?

MR. LAWRANCE: Every administration has gotten it wrong. It's just a question of trying to get it as correct as possible.

ASSEMBLYMAN KEAN: I guess what I'm alluding to is, for five to seven budgets, the administration estimates were actually--

MR. LAWRANCE: Too low.

ASSEMBLYMAN KEAN: Yes. Or actually six of the seven, they were too low. And, actually, five of the seven, they were closer numbers than the OLS numbers. There's only in -- the last year that this disparity, when you actually overestimate revenue versus underestimated revenues.

MR. LAWRANCE: Correct.

ASSEMBLYMAN KEAN: And then the one question I guess I've got, through you, Mr. Chairman. I'm not sure. I guess I'm asking, because I don't-- It's not Peter's area of expertise-- His understanding was that this

Commission -- when we've been hearing a great deal about the need for fiscal accountability, and really being able to establish this and look forward and back about what we can do, going out here -- if I can ask, through you, Mr. Chairman, if we can get, through OLS or through the Governor's Office, have people been appointed to this Commission?

ASSEMBLYMAN ROBERTS: Assemblyman, when this issue was raised earlier, I looked at the current legislative manual, and I think that-- I don't know to what extent the members, who had been previously appointed, serve as holdovers. We need to clarify that, and we will do that. I think, as Mr. Lawrance said, I think the Senate President appointment has been made. I don't know that the Assembly appointee has been selected yet. So that's clearly going to be an area of focus of this Committee.

ASSEMBLYMAN KEAN: And the administration? I'm not sure, fully, of this Commission. Does the administration make appointees, as well?

ASSEMBLYMAN ROBERTS: They do. I believe that's been done, although I don't know that for sure.

ASSEMBLYMAN KEAN: Okay. If we could put that through you, Mr. Chairman, maybe we can find that out.

ASSEMBLYMAN ROBERTS: Assemblyman, absolutely. I think that, beyond just making sure that the Committee is populated, I think one of the things we're going to do, as Assemblyman D'Amato said, and others, is to make sure that it really has the resources to be able to be effective. So I think we'll continue our internal dialogue, and I think that would be one of our end products.

ASSEMBLYMAN KEAN: And I would be very supportive of that end.

ASSEMBLYMAN ROBERTS: Great.

ASSEMBLYMAN KEAN: Thank you, Mr. Chairman.

Thank you, Mr. Lawrance.

ASSEMBLYMAN ROBERTS: Thank you very much.

Assemblyman Green.

ASSEMBLYMAN GREEN: Thank you, Mr. Chairman.

I'm going to be real brief. I listened to the comments this morning, especially Assemblyman Cryan and also Assemblyman Roberts. My concern is that -- first of all, I've been a legislator now for 11 years, and I'm happy to know we're going to have a process where we can actually be able to talk to the different department heads when we have issues of this magnitude.

I must say that you did a very good job of apologizing. You did a very good job of making sure that you didn't point the finger, and you did a very good job of taking the blame. The reality is that, if we're going to move ahead, which we're trying to do with this particular Committee, when we talk about-- You have been part of the process for 30 years. You know the ins and outs of budgets. When the question was asked, in terms of the administration, did they have any input, and your response was that they took your recommendation -- I guess the bottom line is that you have to take the responsibility for some of the things that happened. Would you say yes or no?

MR. LAWRANCE: Absolutely, sir.

ASSEMBLYMAN GREEN: After 30 years, if you make a mistake and you're a professional in your field, I mean, it's obvious you don't want to make that mistake again. What steps would you recommend this Committee -- that we take to make sure the mistakes that you have made within the last two years do not happen again -- short and sweet?

MR. LAWRANCE: It's the three things that I mentioned earlier. But to this Committee in particular, encouraging your colleagues to meet periodically with OLS, with Treasury; looking at revenues and expenditures; and getting some appreciation for the budget.

ASSEMBLYMAN GREEN: All right. Again, I listened to those recommendations. I'm talking about the projections. It's obvious you had to use some type of format. You had to have some ability to understand. Like you said earlier, you looked down the road 18 months. There's a lot of stuff that happened, forgetting about 9/11, you were aware of. What can we do to make sure that this present administration not fall under the same pit holes, that's obvious, happened to the State of New Jersey the last two years? Let's forget about the Committee. We all understand that. I listened to you very carefully and that makes a lot of sense.

As a professional, you have the ability to project revenue coming in and revenue coming out, and for it to have been so far off, I'm asking you today, give us some idea how we can correct it, the current Treasurer can correct it, so we don't have the same problem again?

MR. LAWRANCE: Back when I worked for the Office of Legislative Services, we would work with the professional staffs in the Legislature and do internal briefing memos to the two appropriations committees outlining probable revenue growth and expenditure pressures, going forward. So, just as Treasury has an internal process of working against the future, so too, you probably should be working with Mary Messenger and the Office of Legislative Services on what are the issues coming up in the '04 budget.

ASSEMBLYMAN GREGG: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you very much.

I think there are no further questions.

Mr. Lawrance, let me thank you for coming in. This has been very, very productive. We spent some time talking about the past, but I think we spent a fair amount of time talking about the future, and your perspective has been valuable. I know, from my discussions with Treasurer McCormac, that you have been very, very helpful to him and generous with your advice. I want to thank you for that and for your continued commitment to the State of New Jersey.

Thank you very much.

MR. LAWRANCE: I appreciate your time. Thank you, all.

ASSEMBLYMAN ROBERTS: Thank you.

Next we will hear from Corina Eckl, who is here to make a presentation on behalf of the National Conference of State Legislatures.

Ms. Eckl is the Director of the Fiscal Affairs Program at NCSL. She has written extensively on state budget and tax issues. Her reports include the "State Fiscal Outlook for FY '02," "State Budget Actions," "State Tax Actions," "Legislative Authority Over the Enacted Budget," and many others. She also serves as editor of "State Budget and Tax News," a semimonthly newsletter on state fiscal issues.

Corina serves as a consultant on NCSL's evaluations of legislative organization and staff operations. She participated in the management studies of the Hawaii, Maryland, Louisiana, North Carolina, and Tennessee Legislatures. She has represented NCSL on assignments in Germany and South Africa. In addition to her research and management responsibilities, Corina is the NCSL liaison to the Hawaii Legislature.

An NCSL staff member since 1984, Corina has a bachelor's degree in political science and a master's degree in public administration from the University of Colorado. She is a 1993 graduate of the Legislative Staff Management Institute, a program cosponsored by NCSL and the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota.

Corina, it's either Hawaii or New Jersey, so we're happy that, at least for one visit, you've come to spend some time with us in New Jersey. As I said to you earlier, we had the opportunity to be visited by some of the leaders of NCSL earlier this year who reaffirmed their commitment as an organization to provide us with input and tackle tough issues as we go forward, and your presence with us today is reflective of that commitment.

So I thank you very much for being with us.

CORINA ECKL: Thank you, Mr. Chairman. It's my pleasure to be with you and the members of the Task Force today.

I've been asked to do a couple of things, as you had alluded to earlier, to talk about some of the revenue forecasting processes in other states, but NCSL also is a leader in collecting information on state fiscal commissions and what's going on around the country. When I was contacted to give the presentation today, I was also asked to provide some background information on what's going on around the country in terms of state fiscal conditions, and what has been going on in state revenues and revenue growths. I'll use that information and then lead into my discussion about revenue forecasting processes in other states.

We typically do one or two fiscal reports in the course of the year, but things have been changing so rapidly and so dramatically around the country, in terms of state finances, that we found ourselves doing six reports in the past eleven months, just trying to keep on top of what's going on around the country.

When we talked to states this past April -- to try to get a sense, what was the size of the budget gap they were trying to resolve -- the number was $27 billion. The budget gap we're defining, as both the sum of revenue shortfall as well as spending overruns, typically we were seeing spending overruns in the health-care related programs, most notably Medicaid. By the end of the fiscal year, which was June 30 for 46 states, that aggregate gap had increased to $37 billion. So, in the course of Fiscal Year 2002, you and your colleagues around the nation were struggling to close these gaps that had increased to $37 billion.

So far, most states have already taken care of Fiscal Year 2002. Connecticut, by the way, ended with a deficit. They are in the process of issuing revenue anticipation notes, short-term borrowing, five-year notes, to close that gap. California and North Carolina and Kentucky are three states that have yet to pass their budgets for Fiscal Year 2003. So they've not completely taken action and closed their current year budget gaps.

As we looked forward, we also asked states, "Please tell us what is the size of the gap you're trying to close for Fiscal Year 2003?" Like New Jersey, most states, in the course between January and the last few months, were working to close and pass their budgets for '03 and close those budget gaps. The amount had reached $58 billion. Let me note, though, that $23 billion of that is in the state of California.

And, also, I was just reading yesterday, on the flight here, that there is some consideration there of increasing the cigarette tax from $0.87 a pack to $3.00 a pack in an effort to try and close some of the budget -- the enormous budget gap facing the state of California.

The budget gaps were deep and widespread. This was a big problem around the country. It's not over yet. We had 12 states indicating to us that they had budget gaps in excess of 10 percent. This is in excess of 10 percent of their original budget. The largest here, Alaska -- there is somewhat of an aberration there. Alaska has a deep built-in structural deficit there, routinely turning to their reserve funds to try and close their budget gaps. But that is an accurate number, 31 percent budget gap in the state of Alaska.

The other states here (begins slide presentation), predominantly states that rely on personal income taxes -- and I have that information to share with the Task Force, in a few minutes, about what's going on with personal income tax collections. I know you've heard some of that from Mr. Lawrance this morning. But you can see that, across the country, this was certainly not east coast related. It wasn't central. It was all over the country we saw states reporting these big budget gaps.

California really should be listed on this, but their ’02 gap was relatively small vis-à-vis, relative, to their ’03 gap, and that’s why they don’t appear on this particular list of states. This is just a sense, again, a view around the country. The states here that are in blue hatch marks-- And by the way, I have provided members of the Task Force with a copy of this presentation so you can take notes or follow along in hard copy if you prefer.

You can see here 12 states -- indicating these are the states that had budget gaps in excess of 10 percent. There’s been a lot of interest expressed to us-- The 7 states that didn’t have a budget gap, why didn’t these 7 states have a budget gap? The characteristic that most commonly describes these 7, what they have in common, they have natural resource-based economies. So they had, early in the fiscal year, some strength in their revenues from oil, taxes, taxes on natural gas, coal, other sorts of severance taxes that really had bolstered their economies.

Delaware would be an exception here, but Delaware had an interesting development, where a single corporate income tax payment in the course of the year completely took care of their potential revenue shortfall. But, mostly, the states that did not have problems in Fiscal Year 2002 were really natural resource-based economy states.

We have been collecting for some years now, at NCSL, the state year-end balance data. And what this is is a combination of cash on hand, if you will, at the end of the fiscal year combined with rainy day fund balances. There had been a question, earlier, posed about the size of state balances that Wall Street suggests or recommends that states hold. That number has typically been 5 percent. I’ve heard a couple of the Wall Street analyst-types say that, “Well, it sort of depends on the nature of the state.” Maybe 3 percent to 5 percent is reasonable. But for years and years, we have used the 5 percent level as the prudent level, because Wall Street has told us that, that states need to maintain in their reserve funds.

So, again, this is a combination of rainy day fund balances and any sort of extra cash on hand, unobligated ending balance, the state may have had at the end of the fiscal year. If you look at this chart, you can see the last couple of national economic downturns. In the early 1980s, we had fairly substantial economic recession in this country. You can see that state balances fell -- this is the aggregate data -- fell below 2 percent. We had some recovery after that. Again, in the early 1990s, we had another economic downturn, potentially not as severe as the one in the early 1980s, although balances fell to their lowest level. You can see on the chart that we have been collecting data, but there had been some gradual improvement, and actually some fairly substantial improvement in the late 1990s. I have information to explain some of the numbers there.

Balances peaked at the end of Fiscal Year 2000. At the end of Fiscal Year 2001, they started to come down. At the end of Fiscal Year 2002, again, June 30 for 46 states, the aggregate balance is 4.9 percent. This, again, does not include states like California and North Carolina, as we expect that aggregate number to fall even further when those states report, and for the states that did report, a further decline to 3.6 percent for the ending balance at the end of Fiscal Year 2003. Again, that’s an estimate.

I’d like to point out that, nationally, states are predicting revenue growth of 3.7 percent for Fiscal Year 2003. There’s some question at this time

-- how reasonable is that number? Certainly, that's the actual average, and the state experiences differ, it varies from state to state. But we're going to be keeping a close eye on that 3.6 percent to see if that's a reasonable number.

In terms of just state revenues, this is a striking statistic, from my perspective, having followed this kind of information for some 18 years now. Nationally, Fiscal Year 2002 revenues were 1.4 percent lower than actual collections in Fiscal Year 2001. And in a staggering 29 states -- 29 states in this nation reported year-over-year revenue drops, and there's still a couple states that haven't reported. So we had a fairly unprecedented decline in state revenue collections around the country with, again, 29 states indicating that they did not collect as much in Fiscal Year 2002 as they have in the prior year.

We also had some states telling us now, notably Colorado, they don't even expect to collect in Fiscal Year 2003 as much as they've collected in Fiscal Year 2001. So they're having multiple year-over-year declines in revenue collections. Mostly the fiscal problems we've seen in the past year have been related to sluggish revenues, but, again, there have been some states indicating they had spending overruns, notably, again, in health-care related programs, especially Medicaid. Mostly this was a revenue problem, but there were some expenditure problems as well.

The reasons for the revenue problems: Well, most major categories are failing to meet the forecasted levels. I did some checking, just to make sure we had fairly good information on what was going on here. We had states all over the board telling us that it wasn't just the personal income tax. It was also the sales tax. It was also the corporation income tax. And various other states -- Nevada, for instance, has a lot of reliance on gaming tax revenues, and they were noticing big drops in some of their own state-specific sources. But, really, personal income tax collections faulted the most. We had, probably, the best information on what was going on with the personal income taxes compared with the other taxes.

In May of this year, the National Conference of State Legislatures partnered with the Federation of Tax Administrators and a couple of other groups to try to get a sense of what was going on this past year with personal income tax collections. We did a 50-state-- Well, actually, 41 states and the District of Columbia levied broad-based personal income taxes. We were surveying 42 jurisdictions to get this number. You can see, nationally, personal income taxes account for more than a third, 37.1 percent, of state tax revenues. New Jersey is 17th on the ranking, with personal income taxes accounting for 41.5 percent of state revenues.

Twenty states derive more than 40 percent, and five states -- they actually collect more than half, more than 50 percent, of state tax revenues from the personal income tax. The highest state, by the way, is the state of Oregon at about 72 percent of all state revenues coming from the personal income tax. They're one of the states with one of the biggest shortfalls, by the way.

From the data that we collected in this May's survey that we released in June, total personal income tax collections were 14.7 million, or 14 percent below Fiscal Year 2001 levels, in the period January through April. There's three principle categories of personal income tax collections that most people are looking at. There's final payments, and that's typically what people would make by April 15. Most states do have an April 15 deadline that corresponds with the Federal deadline. A couple states actually let their taxpayers go into May. But for the most part, they knew around April 15 what these numbers were going to be.

Final payments were down 26.3 percent, withholding was down 3 percent -- not devastating there -- and estimated payments were down 24.5 percent -- the estimated payments, again, people looking ahead at what they think they're income is going to be. These are people who make quarterly estimated payments. In looking ahead, they figured that they weren't going to be pulling in as much taxable income as they had in previous months or previous years. And so, their estimated payments were lowered accordingly. And those were down 24.5 percent. A lot of this information here helps explain why 29 states were reporting year-over-year revenue declines.

So what's behind the personal income tax numbers? Well, there was substantially lower income from capital gains. I want to make a mention here. Dr. Mark Zandi, who spoke at the NCSL annual meeting in Denver in July -- and we wanted him to do both an economic forecast, but give us a sense of what was going on with some of these numbers -- he provided us a slide of what was going on with capital gains, and I want to share some of this information with you. I mean, we're all aware, certainly from a public finance point of view and even our own personal portfolios, what was going on with capital gains, but the numbers here are fairly dramatic. I think it's important for the Task Force to know about this.

In 1995, realized capital gains were $164 billion. They increased to $427 billion in 1998, and they peaked in 2000 at $589 billion. So you can see there was this-- I wish I had this slide but it belongs to *economy.com*, I couldn't share it with you today. But there was this incredible increase, from 1995 of 164 billion; again, at the end of 2000, 589 billion realized capital gains. So there was this huge, huge increase, which helps explain some of those balances going up. States were having a difficult time trying to get into their revenue forecast exactly what was going on with this robust revenue growth. And, increasingly, states were ending with large balances.

Now 2000 was the peak. At the end of 2001, the number dropped to 293 billion -- that's an estimated number. At the end of 2002, the number is expected to be 220 billion. So that huge, huge capital gains bubble has burst, at this point, and state revenues, personal income tax collections in particular, are feeling the brunt of that.

The relative importance of capital gains in the state income tax systems varies, of course. The states that seem to be most dependent are Colorado, Oregon, New York, Connecticut, and California. Certainly New Jersey also has a high dependence on income generated from capital gains.

California did a study and found that their portion of taxable capital gains actually fell 62 percent in one year. They previously had $200 billion worth of taxable capital gains, and that had fallen quite substantially to 77 billion. So that's partly driving some of the numbers in California.

I also want to point out that there was an unpublished Federal Reserve report that was looking at capital gains and the importance of capital gains to state personal income taxes. They said, "Before 1995, capital gains and stock options accounted for about 4 percent to 5 percent of personal income tax collections." So this is pre-1995 -- about 5 percent of personal income tax collections. Just in the year 2000, that number had increased to about 15 percent. So you can see, nationally, all across the country, especially the states that have fairly high income citizens, they were getting a good proportion of their personal income tax collections from those fairly wealthy people who were realizing capital gains. So, as the market has been devalued, there's been a corresponding effect on state personal income tax revenues.

On other things, here -- interest and dividends, stock options, employee bonus compensation -- those are all sort of interrelated here. I certainly saw a lot of employee bonus compensation, in several years with the dot-com economy and a lot of this, as well as stock options and a lot of that has just collapsed, as that sector of the economy has collapsed.

Missing the personal income tax target -- again, this is data that we collected in May. Thirty-nine states of the 42 jurisdictions -- 39 states reported that personal income tax collections were below projections. Now, states built their budgets, obviously as you know, based on their revenue forecasts. This is a fairly sizeable portion of state revenues. Thirty-nine states indicated that personal income tax collections were failing to meet the projections, failing to meet the level on which the budget was built. In 12 states, it was sizeable collections, or more than 10 percent below estimate.

Missing the overall revenue target -- again, it wasn't just a problem with personal income tax collections. We had that 39 states had revised their forecast at least one time, revised downward by the way, their forecasts at least one time in 2002. I can tell you, Iowa, for instance, revised. Colorado revised multiple times. Three and four times they were reducing their forecasts in the course of the fiscal year. Of the states that had revised their forecasts downward, those 39, 24 at the end of March were failing to meet their revised level. So it was a continuing downward problem. Fourteen states were on target, two were slightly above. Of the 11 states that had not revised their forecasts, 9 were below their original estimates.

So, again, I think this is just interesting information to demonstrate that this was a widespread problem and there was a fairly significant magnitude associated with it.

So let's move on now to talking more about revenue forecasting and economic forecasting. We have recently published, in *State Policy Reports*, an article on state revenue forecasting processes. Mr. Kooney, I know, has a copy of that. We could make photocopies and make that available to members of the Task Force, Mr. Chairman, if you're interested. But we recently wrote this because there is a lot of interest, right now, around the country about revenue forecasting processes. I can tell you that at least three other states have contacted us, and I don't want to say who they are, about the very same issues that you're looking at -- what can we do about our process and what do other states do?

I did talk to the fiscal director in Iowa. He gave me permission to talk to you about some of the discussions that are going on there, so I can do that in a moment. But we have collected information from around the country -- how are states going about this process? It really is a top-down process where the states start, as you do here, with an economic forecast. You're looking at economic assumptions to build estimates of your individual revenue sources. And the key determinants here are gross domestic product, employment, personal income, with some of the other variables being retail sales, wages and salaries, corporate profits, inflation, unemployment.

Some states have specific sectors of their economy that are important. In the state of Michigan, for instance, auto manufacturing is important to their overall economic forecast. They use that in terms of building their revenue forecast.

So the state economic forecast is the starting point. Then the states look at the trends in state revenues; what's happened, for instance, with sales tax revenues and perhaps the loss from Internet sales. There's been some good studies out of the University of Tennessee at Knoxville. Some professors there have done some good work on what's happening in sales tax collections and how they've declined as a result of more people doing their purchases over the Internet.

So, looking at trends in state collections, and then looking at recent tax law changes, I can tell you, prior to this year, when we have seen a net tax increase around the country in terms of taxes, the prior seven states had been reducing taxes. So some of the declines in state revenues have been expected and anticipated, because states were taking advantage of those robust revenue years to say, "Gosh, we don't really need to be collecting money at this rate. Let's cut taxes." And, in fact, the state of Colorado has an interesting provision where certainly taxes can be cut, but in order to increase them again, it goes to a vote of the people. It's our taxpayer Bill of Rights provision. So there is some concern in the state of Colorado that we, perhaps, have permanently reduced taxes, because it's hard to imagine that there's going to be a popular vote to increase them back again.

Looking at recent tax law changes, as part of this overall formula to find out what might be happening to revenues coming into the state in the coming years-- Now, in terms of the revenue forecasting process that exists in states, I want to just give you a little bit of background on some of these. As we looked at-- We try to category states to help make it easier for people to get a grasp of how do these things work. Sometimes that's a little difficult and a little arbitrary, because there are nuances attached with each of these processes. We have actually collected from 1998, and mostly there has not been any change, really good information from the states on what they do in terms of their revenue forecasting process.

One of the things that I want to point out is that we have information on all 50 states, but we probably have more information in footnotes. For every state that reported, it had to provide a footnote with the nuances and the detail that helps describe their process. I do have that table. I can certainly make copies of that available for members of the Task Force. But mostly, this is a summary, and I'll give you some background on some of these states.

The executive branch really drives the forecasting process in 17 states, but there are some variations among that. California, where it is, in fact, driven by the executive, the estimate is jointly approved by the governor and the Legislature. California has this Legislative Analyst Office, which does a lot of its own forecasting. So, in combination with some discussion between executive and Legislature, they do come together to jointly approve the forecast, but it really is an executive driven process there.

In Idaho, although the governor is responsible, the Legislature determines if it's reasonable. Is the forecast provided by the executive reasonable? In the state of Idaho, the forecast does not bind the budget, so that the budget is not determined on what that forecast is.

Let's see here-- In Texas, it's certainly driven by the comptroller, which is a statewide elected official. But the Legislature, with a four-fifths vote, can override what the executive says is the official forecast. It turns out they've never done that, but they do have the ability, with the majority vote, to override the official forecast provided by the executive.

In the state of Virginia, they have an interesting two-step process where a board of economists, appointed by the governor, reviews the economic forecast. That first starting point, the economic forecast, is reviewed by an outside board of economists. The second step is that business leaders then review the actual revenue forecast. So they're trying to have some external people looking at what the executive is doing, trying to find out if it's reasonable, if it's a good forecast.

In the state of Wisconsin, even though it is driven by the executive, it's not official. The governor submits the revenue forecast with his budget recommendation. The Legislature will work with its own legislative fiscal bureau to decide if that forecast was reasonable, and they will then use, typically, what the legislative fiscal bureau says is the revenue forecast.

Twenty-two states use a consensus estimating process. This is, typically, where they bring in a group of individuals typically representing the executive branch and legislative branch; and in seven states, they have a requirement that there is some kind of independent party included as part of the consensus group. Typically, these are university economists, professors of some sort, typically from the higher education community, but sometimes they can be outside.

In the state of Iowa, for instance, it just has to be a nonstate employee. It doesn't have to be someone from the university environment. But in 22 states, they do use some kind of a process where they're pulling people from various branches of government together. These groups range in size from three, in the state of Iowa, to twenty-five, in the state of Delaware. So the size of these groups varies considerably.

In North Carolina, they don't have any statutory guidelines governing the process, and in fact, it is a consensus process. But, if they cannot reach consensus between the group and members of the forecasting group, the Legislature typically has gone to the legislative forecast. That's what they use for building the budget.

In Vermont, even though it's a consensus forecast, they typically have two estimates, one from the executive and one from the Legislature. They merge that into a single forecast, and then they have an emergency board, which is the four legislative money committee chairs and the governor, determining: is this the number that we want to go with. So, again, it's a consensus process where they have legislative and executive participation.

In Massachusetts, both -- there is a legislative executive review of what the revenue forecast should be, but it is, in fact, certified by the Legislature. They have a public hearing process that, after they get these forecasts coming out, they hold public hearings, and it seems reasonable. People can come to the process and comment. And then the House and the Senate approve what the forecast will be, based on those forecasts.

Nebraska has an economic forecasting advisory board of nine members. It is a consensus process. Those nine members -- five are appointed by the Legislature and four are appointed by the executive branch.

We then have this category called "other." This was our attempt to try to at least say, okay, we have predominantly executive driven or consensus, then there's, sort of, all other. There's 11 states here. I've given a couple of examples on the slide. Let me go through a couple of these with you.

In Hawaii, it's the Council on Revenues. That's a group of economists. Typically, the Bank of Hawaii -- for example, would be one of -- the chief economists there is on the Council on Revenues. They are appointed by the governor, but they are independent from the governor, so we classify that as an "other."

In Colorado, the process is driven very much by the Legislature. The executive provides a revenue forecast, but the Legislature will look at both that forecast and the one done by their own fiscal staff, and decide which one they want of these. Typically, they do use the legislative forecast in that process.

In New Hampshire, they wait until they're at the conference committee process, and then the conference committee determines what the official forecast will be. Then they use that, because they're getting close to enacting their budget.

So the table that I have, that I'll provide to Al Kooney for distribution back out to the Task Force members, will have this kind of detail in it. You can look through that and see if there's anything in particular that stands out to you, if you're more interested in pursuing it. At a certain point, if you need to get more information on any particular state, we're happy to facilitate that for you by talking to people out there, fiscal directors or types, or others, who could provide you with additional detail and background information.

Let me keep going here. Is the forecast binding, essentially is this. This is a situation where the revenue forecast is the absolute cap for spending. It does bind the budget. In five states, though, and this is an interesting development, I think, appropriations are restricted to a percentage of the estimate. I've identified the five states here. I've spoken to the fiscal director in Iowa and in Delaware, and they're both pretty high on this procedure. So, after revenues are certified legally, the Legislature can only appropriate some percentage of the forecast.

So, in the state of Delaware, for instance, if revenues come in at 100 percent of forecast, that 2 percent difference goes right into the rainy day fund, because they're only allowed to spend 98 percent of the official forecast. Now, if the official forecast is too high, this doesn't do much good in the state. But, if the forecast comes in on target, if Delaware comes in on target with their revenue forecast, they can only spend 98 percent, and the other 2 percent again goes for the rainy day fund. We can talk about this more if there are questions about it.

I think it's an interesting development, and the people of these states are pretty high on this process. And we've not yet done a study in NCSL on this, but in view of, sort of, the recent developments with revenues and what's going on with state finances, I think it's probably a very good time to be contacting the states and getting some information about how successful they think this particular provision has been, especially in a declining economy.

Now risk factors to revenue forecast -- and this again is contained in the article that we recently prepared. There's just difficult-to-predict information. I mean, that's just pretty straight forward and not a surprise. Stock market performance -- no one can really accurately guess the performance of the equity markets. If we could, we'd probably all be very wealthy people, but it's difficult to predict certain kinds of information, and that's just part of a revenue forecast.

The volatile economy-- The states tend to underestimate revenues when the economy is booming -- we certainly saw that in '95, '96, '97, '98 -- and overestimate them when the economy is volatile or declining, which is exactly what we've seen in the past fiscal year. This is information that has historically proven to be true. It is difficult when the economy is changing. Another risk factor here is just simple timing issues. State revenue forecasts are made anywhere from a year to 24 months before the fiscal year begins. And when you think about it, at some point, you have to freeze your assumptions. You have to freeze the forecast, because you have to enact a budget. This is a particular problem for biennial budget states, where they have a two-year budget cycle.

In the state of Nevada, for instance, they initially had told us they thought they were going to end Fiscal Year 2002 with a nice little budget surplus. But they had made their forecast 24 months ago, and things have changed fairly dramatically, and they meet every other year in the legislative session. It's a biennial budget, so they know that they are pretty far off in some of their forecasts that they made so long ago. But again, these forecasts, these predictions, are made quite a bit in advance of when the actual information is going to be used in the budget process. So that's a big risk factor here.

To improve the process, we had looked at a report done by the Federation of Tax Administrators and the National Association of State Budget Officers, and these were their recommendations. We've made some adaptations to this, but developed state economic and revenue forecasts that have broader acceptance. And directly related to that is including the executive and the legislative branch in the development of both of those forecasts. I can tell you, having watched some of this development over the years, that the trend in the country has been moved to consensus forecasting. A lot of that is based on, again, trying to include the executive and the Legislature in developing the forecast.

There's been some concern, in a number of states, that the important thing is to come up with the policy around the numbers, but have some numbers in place that there's broad acceptance of and transparency. This whole transparency issue, that a lot of people are involved, if it's a legislative and executive, it perhaps has more credibility. It certainly has more transparency, and there's, perhaps, less finger-pointing if the estimate is off -- that everyone was contributing to the process through an open, transparent process.

Again, as we've seen different states talking and using the expertise of academic and business economists, increasingly you see that happening. I can tell you, in the state of Iowa, they have three members of their consensus forecasting group-- Iowa has been one of the states contacting us, and they've said I could talk to you about this. Very, very unhappy with the process they have there. They have one of the biggest -- they've been off target by one of the bigger percentages of any state, and they're very unhappy with the process there.

And some of the discussion now is to try to include some others from the community, someone from the banking community -- someone from the farming community -- and increase the number from three to, perhaps, five or even more. So they currently, as you are, are reviewing their forecasting process to see how they can improve it. I think what they're looking at now is to try to utilize the expertise of additional people and bring them into the process.

Additional steps to improve, assess, and understand the degree of uncertainly associated with the forecast-- I think, again, these are pretty straight forward. For instance, with the whole capital gains issue, there's a lot of uncertainly there. There's a lot of unknowns, and so trying to have a sense going into it, when you're looking at that forecast -- this is a volatile area, this is hard to predict. What percentage of our forecast is somehow extremely difficult to predict, and then, having that information in your minds as you're going forward, knowing that those numbers might not be met because of the uncertainly or the volatility.

Supplying the necessary data and personnel to generate the estimate -- we've had a couple of states tell us that they don't feel that they have sufficient resources, either through the executive branch or the legislative branch, to really delve into these issues, to really get good information, good solid information, because they're understaffed and they don't have the necessary resources to do the job they've been asked to do. So having the sufficient, necessary resources to do the job is important.

Reviewing revenue collections on a monthly basis, and comparing with the forecast, and trying to get a sense of the variance and the variation, and just having that information under your belt as you're moving forward to see how you have done, as you're moving forward to try to get better--

Maintaining flexibility to adjust the forecast -- always. Most states adjust their forecasts twice a year. Some states are quarterly. Others are, sort of, constantly monitoring. Others have indicated to us that they have the flexibility to call emergency meetings to make a modification in the revenue forecast.

In the state of Michigan, for instance, they've had a couple of emergency revenue forecasting meetings, because they knew they needed to adjust their forecast downward. And the sooner they did that, the earlier they did that in the fiscal year, the more months they had left to try to respond to the revenue shortfall through the spending side of the budget. So maintaining that flexibility is very important.

One final note I want to mention before I conclude my presentation, and everyone tells us this and I think it's important. A stable economy probably does more to ensure an accurate revenue estimate than any process improvements. And having said that, I don't want to say it's not important to look at process improvements. It's very important to look at process improvements, and I think over the years the states have tried to do that by moving to consensus forecasting, for instance. But again, in a stable economy, you don't have the moving target quite as much, so it's important to keep that in mind as you move forward. (end slide presentation)

Mr. Chairman, that concludes my presentation.

ASSEMBLYMAN ROBERTS: Thank you very much.

Your final observation that the stable economy is the best way to assure that the process will go forward in a smooth and meaningful way states the obvious--

MS. ECKL: Yes, it does.

ASSEMBLYMAN ROBERTS: --but it also is a framework for us to understand that, because we've had some particular problems in this state in the last couple of years, and because the macro economic factors have not been in our interest, we need to not throw out the entire system in a careless fashion. I think this Task Force is conducting itself very carefully and very thoughtfully. It's interesting to see that, when you look at this system that we use in New Jersey, it's one that 17 other states use. It's clear that two-thirds of the states in the nation have found a different way, and, I would submit, a better way.

Your comment that states are moving toward a consensus-based approach, I think, is the kind of recommendation this Task Force is ultimately going to make. The need for much stronger legislative presence in the process, the need for outside verifiers of the estimates that are determined by the executive, I think, are becoming clearer each time we meet and talk about where we've been and where we're going.

I'd ask you to share additional information on the issue of, what I'll term, midcourse corrections. You mentioned a couple of states that had the ability, through dialogue and through information-sharing, to assess the problem as they go along, whether it be through emergency session, or whether it be through some other process that allows them to take stock of the process as they go throughout the year. But your presentation was very, very helpful, and I thank you very much--

MS. ECKL: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: --for making it available to us, and also the other information which you've already provided to OLS and which you will be providing to us. I'll certainly make sure that it's made available to the other members of the Committee, as well.

MS. ECKL: Thank you.

ASSEMBLYMAN ROBERTS: Thank you.

Do any members of the Committee have questions?

Assemblyman Green.

ASSEMBLYMAN GREEN: Also, I'd like to congratulate you on your presentation. It's obvious you have taken a very professional direction in terms of the future. You mentioned New Jersey with 17 other states, and some of the recommendations that you are talking about -- in terms of, we need to bring more professionals into the process like bankers, people of that status who have a feel for the financial climate in those particular states of this country. When you talk about the 17 states -- that New Jersey has made with their process, would you say that the majority of time their estimates are politically driven or professionally driven?

MS. ECKL: You know, I'm sorry, I don't feel like I can really comment on that without having -- I haven't spoken to people in each of those states. I mean, even in the states that have executive--

ASSEMBLYMAN GREEN: The ones you have had some type of dialogue, the ones that you have looked at the pros and cons of their whole process--

MS. ECKL: Yes. My sense of it is that these are driven by the desire to get the forecast correct. I can't say that I'm aware of obviously politically driven forecasts. For instance, if we look at the state of Virginia, which is an executive-driven process and forecast there, they have that additional two-step process where they're bringing outside people in to look both at the economic forecast and the assumptions made there, and then a separate group of business people in to look at the revenue forecast. So, that is an executive-driven process, but their goal there is to try to get numbers that are solid, are sound, that can be used reasonably in developing the state's budget. So that's the kind of information that I'm aware of. In terms of strictly manipulation of the numbers for political gain, I'm not familiar through any of these processes. I just haven't looked at it that way. I haven't reviewed the information in that way.

Mostly, I think, the intent is to try to get the numbers right so that you can avoid some of the difficulty of trying to come up afterwards and clean up when the numbers aren't right.

ASSEMBLYMAN GREEN: I realize this.

MS. ECKL: Yes.

ASSEMBLYMAN GREEN: That's a tough question.

MS. ECKL: I'm just am not aware--

ASSEMBLYMAN GREEN: But the reality--

MS. ECKL: I would tell you if I've heard straight out, but I just really haven't.

ASSEMBLYMAN GREEN: The reality of my concern, and the reason why I asked that question first, is because of the fact that if we begin to look at it in terms of from a professional point of view, then we all should be somewhat comfortable in bringing outsiders, like bankers, professionals, who can more or less give us an independent approach to the problem, rather than in-house decisions that we, in the past, have used. It's obvious that, for a lot of different reasons, they have been off the mark. So, again, the reason why I initially asked that question was just to follow up on the concern that it should be easy for all of us to make sure that we don't fall into the same pit holes that we fell in here in New Jersey in the last two years, in terms of not having enough professional people helping us make those decisions, but depending on people whose jobs are at stake and who basically are going to look at it in terms of what's good for them and whether it's good for the state.

Again, thank you very much for your comments.

MS. ECKL: My pleasure.

ASSEMBLYMAN ROBERTS: Thank you.

Next is Assemblyman D'Amato.

ASSEMBLYMAN D'AMATO: Thank you, Mr. Chairman.

I, too, would like to thank you. I found your presentation most informative. Like our Chairman, once I was appointed to this Committee, I began to focus on other states that do their revenue forecasting process by consensus, as you've labeled it. By any chance, have you had an opportunity to study how Florida does it?

MS. ECKL: We have talked to Florida about their process, and I have some notes here that I can share with you about Florida. Do you have some specific questions about the process?

ASSEMBLYMAN D'AMATO: How's it working? According to the information I had, it was established in 1970 and, finally, in 1982 they took that process, which is a nonpartisan-type of approach, and they enacted it into law. The information I have is -- what I find so appealing about it is -- that they took the politics out of it. It's not productive when one party's banging another party about how they made a mistake. With this particular process, everybody is responsible for the forecasting. I was just interested as to whether you had any thoughts about it.

MS. ECKL: Well, according to our information, there's one representative each from the Governor's office, the House, the Senate, and the Joint Legislative Management Committee. So they have four members, and they must be professional staff with estimating experience. So they potentially have some political benefit. They do have professional qualifications and credentials to be conducting these estimates.

They have a very sophisticated process in the state of Florida, not only for revenue forecasting, but for economic and demographic forecasting, and have been held out as a leader in this nation for some of the ability they've had to do accurate forecasts. Florida has some other challenges. They're constitutionally prohibited from having a personal income tax. So they derive significant proportions of their revenues from the sales tax, which, based on consumer confidence levels and other issues, the sales tax can be quite a volatile source. I think the process they have in place has been widely accepted as being a high quality, credible process, but, then again, they're still dealing with the issues of having a tax base, a tax system that isn't particularly well balanced, vis-à-vis, a state that has a three-legged stool, if you will.

ASSEMBLYMAN D'AMATO: Has your organization done an analysis of the performance of those executive-agency estimate states versus the consensus estimate states, in terms of their success?

MS. ECKL: It's interesting you would ask that. We've not done a longitudinal study to try to get that information. But in preparation for this particular presentation today -- and in preparation -- I wanted to see how, in the past year, Fiscal Year 2002, how did states do vis-à-vis executive or consensus or other. And I prepared a chart, and I can make that available. I actually have 15 copies of that chart, and I'll give it to Alan Kooney to distribute to the members of the Committee. But interestingly, of the-- I should probably pull this out, so I'm not--

I wanted to know this information myself, but I think it's quite a fascinating issue. Of the states that have consensus, there were fewer that missed than states that have executive, if that's kind of the question, and I think it might be. Let me pull out this chart. I want to have this data in front of me as we're talking. Okay, here it is. All right. So, what I tried to do is look at what states had estimated Fiscal Year 2002 revenues would be and then what they actually were, and get the difference between those two numbers. Then I ranked the states, the top 10 states -- the states that had the biggest misses, if you will -- and the biggest miss was in Iowa. They had a 12 percent variation between what they thought they would get and what they actually collected. They have a consensus forecast.

Indiana was ranked third. They have a consensus forecast. They were off by 10 percent. Arizona was fourth. They were off by 10 percent. Of the 22 consensus forecasting states, those were the three that were off by the most -- in the top 10, if you will.

Looking at executive-driven, there were one, two, three, four, five states that were in the top ten. New Jersey is number two, by the way, off by 11 percent, according to our numbers. The others in that category are Alaska, off by 8.7 percent; Idaho, off by 7.5; Minnesota, off by 8; and the state of Virginia, off by 10. Those are executive-driven. Then the states that have some kind of other process that I had indicated, they varied fairly substantially, there were two states -- Colorado was ranked ninth and Montana was ranked sixth.

So really, this is interesting, and I am happy to provide this information to the members of the Task Force. I think it's really important, though, to point out that this isn't particularly scientific. It's more just illustrative of what's going on. I think it would be worthwhile for someone -- I don't know that we'd be able to do this at NCSL at any time very soon -- but to take a more longitudinal look at this sort of thing and try to get a sense of how far off states were and what kinds of process they use, and to see if there's any kind of correlation between those two. But that's really a fairly scientific study, and this information is not that.

ASSEMBLYMAN D'AMATO: Thank you.

Just one final question, Mr. Chairman.

Do you know of any pre-eminent experts that are advocates of the consensus-estimate approach that the Chairman might want to speak to?

MS. ECKL: You know, I don't, off the top of my head. I know that there are legislative fiscal directors around the country who are strong advocates of this, but I'm not aware, right this moment, of perhaps any academic types or someone who would have a broader view than just a single state. But I'm happy to try to investigate that for you. I'm happy to see if I could find some individuals who might be able to talk to you more about that.

ASSEMBLYMAN D'AMATO: Just pass that information on to the Chairman.

MS. ECKL: Certainly, my pleasure.

ASSEMBLYMAN D'AMATO: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you for excellent questions.

Assemblyman Gregg.

ASSEMBLYMAN GREGG: Thank you, Mr. Chairman.

Thank you. I had great expectations of your testimony, and they were surpassed. I'm glad that the Chairman agreed to bring someone like you to this hearing today, because I really think this testimony is what the hearing is supposed to all be about. Number one, I think it lays to rest an awful lot of the demons -- that New Jersey sits alone in its world of economic difficulties today. It is not nice to see, actually, that other states are living through the difficulties we are, but it does appear that we are having very similar problems to the rest of the country, dealing with economic difficulties that are brought to us in a way that we didn't have total control of. How we deal with it really becomes the issue. I think you bringing a lot of this information to us is very important.

I glean, from your testimony, that clearly states that have high dependency on income tax had a more difficult situation in their forecasting, because that's an area that fluctuated more because of all the issues you brought today. Would that be an accurate--

MS. ECKL: Yes, I think that's fair.

ASSEMBLYMAN GREGG: New Jersey, of course, is the richest state, at least this year. We, of course, rely tremendously on that. We have made that discussion in this Committee, as well as Budget and Appropriations, for years -- that our dependency on affluent people has been difficult and a benefit for our economy, because it allows other folks to get the benefits of that. But when things go south, it happens very quickly to us.

I really thank my colleague, Assemblyman D'Amato, for that question. I thank you for your response, because I had the same question about the methodology versus the accuracy of how states work. I think, whether it may be scientific or not, we'd like to think in the Legislature that, perhaps, consensus is a good way to do things because that's the business that we deal in more often. So I think that part of your testimony was also very important and excellent.

Your last comment, noted by the Chairman, about the best thing we could have going for us is a stable economy, is almost a understatement, but I think it has some truth to it. Something I may challenge you to go back and review for us, and come back to us on, is looking at the actions states have taken. I think that I have read -- and not your testimony, but other material that comes from NCSL -- some states have chosen to raise taxes, some states have chosen to cut spending, some states have chosen one-time revenue hits, some states have raided funds, some states have done any numbers of ways to find new revenue. New Jersey is one of the states that has done all of the above, one way or the other.

I think that the way -- and this is a philosophical question, and I hope you can give us some insight on it -- the way we act as a state with a poor economic forecast, and with the deficits that we're facing, may have something to do with creating the solution, which is a stable economy. The states that react in an aggressive way, perhaps too much in one way or the other, may actually create a less stable economy which will have them come out of this problem slower than other states. Could you comment on that?

MS. ECKL: That's a big question. It's a difficult one, of course. The actions that states took this past year were a combination of all the things that you said. We saw relatively few states increase taxes, and five increased taxes more than 5 percent of prior year collections. But those states, we think, are potentially ahead of the curve on this one, because there were just other factors in place. The general elections, that most states, unlike New Jersey, will be encountering in November, we think have a dampening effect on the number of states willing to raise new revenues to deal with their revenue shortfalls.

And, in fact, we already know the state of Maryland, the state of Nevada have special task forces looking at ways to increase revenues in a fairly substantial way. So the whole tax increase piece -- we think more of that is ahead of us than what we've seen so far. So, in New Jersey's instance again, I would say, perhaps, you’re ahead of the curve there. A lot of other states are going to follow suit starting next year. But a lot of states did depend on one-time revenues to deal with these shortfalls.

We had a meeting about this, a good discussion in Denver at our annual meeting, about these kinds of actions. There was some discussion that I thought was compelling about, perhaps, lawmakers were taking an unfair hit, if you will, for not having taken, necessarily, bold action. There’s some criticism that Legislatures didn’t take bold action to resolve these problems. But the counter to that has been, and I’ve heard this argued fairly persuasively, that we don’t know the scope or the depth or the duration of this particular downturn. It’s possible that the actions taken thus far by several states will be sufficient to deal with the whole. Now that’s when it’s important to bring in people like Mark Zandi from *economy.com* to say, “Well, here is what our forecast is, looking forward.” And, in fact, when we had him talk to our group, he said that he thought state revenues were set to rebound starting in 2003.

Now, it’s a forecast. It’s a crystal ball, but it is based on economic indicators and other factors, on whether or not that’s going to-- There is, obviously, downside risks to the accuracy of that forecast. But if that’s the case -- and we do see some kind of economic recovery that makes its way to the state level, so that state revenues rebound and benefit accordingly -- well, then, maybe it wasn’t necessary to take a lot of dramatic action this past year to deal with some of these shortfalls.

It’s hard for me, when I look around the country and see that states did raid funds, they did tap their rainy day funds and, in fact, that’s what those funds were there for. The whole host of actions that states took, it was the intention of lawmakers, I think, to do their best to try to make sure they both ended Fiscal Year 2002 with a balanced budget and enacted a balanced one for 2003.

It's difficult to know at this point in time, as we don't know how bad this current economic downturn is, whether or not those actions were sufficient. Now, there are people who will tell you, and I would concur, you don't want to use one-time revenue for ongoing spending. It's what Mr. Lawrance has said. That's important, and I think that's generally accepted around the country.

I don't think we know yet if the actions taken so far will have a long-term detrimental effect or not. It will depend on what happens with the economy and how quickly it rebounds. I'm not sure if I've answered your question.

ASSEMBLYMAN GREGG: Through the Chair, I think you were very insightful. I think reality shows us that stability is good. We need to move to stability and not be political. We've been trying not to be political here, but we did have the better part of a 15 percent shortfall in our budget in the State of New Jersey, and then we're the state that spent the most in the following year. There are a couple of us who continue to talk about spending, and I think it is part of the equation. It doesn't always get talked about in forecasting. Many have said, it's the spending, stupid, in other campaigns.

I think the states that have the ability to find the balance between the spending and the appropriate revenue forecasting are going to end up stabilizing the economy in their state, which is going to give them whatever number that comes out to be. Hopefully, it's a growing economy in the future so we can continue to provide the services we wish. I think that we need to watch both of them. I wanted to get your thoughts on that, and I hope you can help us as we move forward, because I'm intrigued to know, just like Assemblyman D'Amato, on next year, perhaps, or going into next year, the states that took certain actions, which one of the those actions, or combination of those actions, actually created a softer landing or a faster takeoff, depending on which way you want to look at it.

So I certainly appreciate your time in traveling all the way from Colorado. Your information has been, I think, probably the best -- no offense to OLS -- that we have had brought today -- or offense to Mr. Lawrance. So thank you for your time--

MS. ECKL: Thank you.

ASSEMBLYMAN GREGG: --and a safe flight back.

MS. ECKL: Thank you.

ASSEMBLYMAN ROBERTS: Thank you, Assemblyman.

Next, Assemblyman Cryan.

ASSEMBLYMAN CRYAN: Thank you, and thank you for coming.

MS. ECKL: It's a pleasure.

ASSEMBLYMAN CRYAN: It has been interesting. I have a number of questions, but time just doesn't allow. I think all of us do, when it comes right down to it.

Page 2 of your handout, the chart with the FY 2002 budget gaps -- we were flipping through it as the conversation was going. It looks like four of those particular states were executive-driven, unless I'm mistaken. Alaska, as you mentioned, Virginia, New Jersey, and Idaho, which, on a percentage, four-to-twelve, is a third, which kind of correlates to 17 out of 50. Would that be about right?

MS. ECKL: Yes. I've not looked at it that way, but it sounds right.

ASSEMBLYMAN CRYAN: The reason I asked is, really my question is, on consensus. A number of those, Arizona, Connecticut, and North Carolina, you wouldn't have any idea as to, on the consensus states, how many of those both the Legislature and the executive branch are the same political party, would you?

MS. ECKL: I can find that out, but I don't have that with me. But we have good information, in fact, on our Website about the partisan composition of each Legislature, and what the executive party is, too.

ASSEMBLYMAN CRYAN: It just, kind of, makes you curious--

MS. ECKL: Yes.

ASSEMBLYMAN CRYAN: --when the percentages are somewhat similar.

I'm going to flip over to Page 9, which is really the thing I just wanted you to expand upon a little bit--

MS. ECKL: Okay.

ASSEMBLYMAN CRYAN: --because I just found it extremely interesting, and that is the forecast-finding and the appropriations-restricted-to-percentage estimate. Could you, again, just one more time -- how do we go over that? I mean, so in Delaware, they can only spend 98 percent of the forecast?

MS. ECKL: That's correct. They have an official forecast. Once those revenues are certified as the official amount that is expected to come in -- again, they have a consensus forecasting process of about 25 people contributing to the numbers -- once they have the official forecast established, by law the Legislature can only appropriate 98 percent of that.

ASSEMBLYMAN CRYAN: Suppose-- Let's do the New Jersey scenario last year, where clearly we had the scenario -- you may have heard Treasurer Lawrance before -- we were under. We were well under our forecast. So how does that process work, when that happens?

MS. ECKL: Well, they will tell you that that doesn't really do them much good in that case. The point here is trying to make sure that you are leaving yourself some kind of a revenue cushion. If your revenues are way under what you expected, you're still faced with a fairly sizeable gap. In fact, the state of Delaware, even though they had that one-time appropriated income tax payment that really bailed them out, they did have some executive orders to reduce -- hold back spending between 1 percent and 2 percent -- because their revenues at one point were pretty shaky, and they knew they weren't going to even make the official forecast.

So really it's a measure that helps you in not spending everything that you come in. When revenues don't materialize as forecast, it's not really going to be-- If revenues came in substantially below what the forecast was, but they had appropriated 98 percent of what the forecast had been, there's really no fiscal discipline in there. There's no tool to help them in any way. They're still going to have to go through the same kind of cutbacks or other measures that we saw most states going through this past year. It's really when revenues are growing pretty rapidly that they're trying to contain spending, when revenues are growing fast.

ASSEMBLYMAN CRYAN: Which would have helped us in prior years?

MS. ECKL: In prior years, that's right. It helped Delaware get a 5 percent rainy day fund. They tell us now that they are unwilling to touch that, because the bond rating agency so much likes seeing Delaware with a 5 percent fund. But that's how they've gotten to that. They had that extra revenue cushion. They pushed that money for rainy day fund.

ASSEMBLYMAN CRYAN: So they built it in?

MS. ECKL: Yes.

ASSEMBLYMAN CRYAN: One of the reasons I asked that was because Assemblyman Sarlo was asking the Former Treasurer before about a specific lame duck period, where we went through an incredible amount of spending in a very short time frame. As a matter of fact, in two months we spent or appropriated in excess of a half-a-billion dollars.

When you're underforecast, like the situation we were in, and yet we continue to spend or to appropriate money, is there anything in this type of forecasting, other than what you have mentioned, that may help or would have helped, maybe, put the belt on some of that, or restricted that?

MS. ECKL: Well, separate from this -- and I have, in fact, a separate report that I brought with me in the event this question came up -- is there are states that have tax and expenditure limitations in place. In Colorado, for instance, spending can only increase 6 percent above the previous year's spending. So we have a good report on that. I'm happy, again, to make that available to your staff, and they can distribute that to you. I was not the author of that particular report, but there are measures that states have in place to try to contain the growth in spending year over year, by either tying it to inflation plus population growth or the previous year's spending level, some measure, some provision, some tool to try to restrain or constrain, to some level, spending from year to year. And then, again, we have a good report on that. I'm happy to make that available to the Task Force.

ASSEMBLYMAN CRYAN: Any strategies that, just from what you know so far in New Jersey, that you'd say, "Look, don't go down that path. It probably won't work for you." Anything?

MS. ECKL: No. I'm sorry. I really don't have any comment.

ASSEMBLYMAN CRYAN: I just wanted to ask because I was reading the note, about the stable economy does more to attract an accurate-- It's probably right. I mean, in this state, we saw, accurate revenue forecasting sort of went nowhere.

MS. ECKL: Right. Right. And again, I'm sorry. I didn't mean to suggest that process improvements aren't important. I think they're very important. But it's -- both things go hand in hand, I think. If you have a stable economy, that's good. But process improvements always, always, always, I think, are a good thing.

ASSEMBLYMAN CRYAN: Sure. Look, I learned a lot. I probably could spend hours. I really appreciate your time.

Thank you.

MS. ECKL: Thank you.

ASSEMBLYMAN ROBERTS: Thank you, Assemblyman.

Anyone else? (no response)

Corina, thank you very much.

MS. ECKL: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: This has been a long trip, but we are the beneficiaries of it.

Thank you very, very much.

MS. ECKL: Thank you. My pleasure.

ASSEMBLYMAN ROBERTS: Next, let me call on, last but not least, from OLS, Alan Kooney, who is the Legislative Budget and Finance Officer; and David Rosen, the Finance and Appropriations Section Chief.

Gentlemen, welcome. Good afternoon. A good afternoon it is.

A L A N R. K O O N E Y: It is. Good afternoon. We're well aware of that, Mr. Chairman, and aware of your statement about leaving here on time.

ASSEMBLYMAN ROBERTS: Well, we would like to, but by no means do I want you to abbreviate your participation. It's our fault that we have too much to say, I guess.

MR. KOONEY: Well, I think it's been a very productive morning and early afternoon, both from Mr. Lawrance and from Ms. Eckl, who I thought gave an excellent presentation to the Task Force.

You've asked us basically to speak on the Legislature's role in revenue forecasting and certification and whether there are possible ways to improve it. I think, also, all of the things that we would say have been mentioned in some context here already, by either yourselves or by prior speakers.

What I wanted to do, just briefly -- I'm going to allow Mr. Rosen to speak of specifics about any questions you might have about what did or didn't happen in terms of actual revenues. But in terms of process, I'd like to frame the discussion just around two themes. I think things fall into place that way, at least from my perspective.

Number one is that revenue forecasting and revenue certification are two very different things. Revenue forecasting is a skill or an art or, some of you might even call it, a voodoo art, depending on your point of view. But, whatever you call it, it's an exercise you go through. Revenue certification, on the other hand, is a power or a responsibility that's delegated by law. In some cases, the certification of the availability of revenues has very little to do with forecasting in the usual sense. That distinction, I think, will become important when you talk about things like commissions with possibly binding revenue certifications.

The second point I wanted to make, and I think this is really extremely important to understand in this state, is that revenue forecasting is essentially an adjunct to the budget process in New Jersey. Unlike some other states, and unlike the congressional budget office in Washington, we have no requirement that anyone in New Jersey give long-range revenue forecasts. I have to say, given some of the inaccuracies of some of those forecasts, I'm not so certain I would agree that they're necessary. But, as a result of that, our revenue forecasts tend to be limited to the budget horizon, which is generally the remainder of the current fiscal year and the next fiscal year. And, because the purpose of these forecasts is to guide the budget, they tend to be very specific, which means we don't make forecasts with ranges in them. We make forecasts that have point numbers in them.

In many cases, most economists who do forecasts, do forecasts with ranges. Well, that doesn't work when you're doing budgeting. They also tend to be very inclusive. They have to be, if they're there to balance the budget, and they take into account many technical factors and types of revenues that would be ignored in broader forecasts. For the same reason, the so-called accuracy of the revenue forecast might be evaluated differently by the people doing the forecasts themselves than by the recipients of the forecasts. What I mean by that is, if a forecaster sees his or her revenue forecast as being 98 percent accurate, they might pat themselves on the back and say they did a pretty good job.

If we're off by 2 percent, or 98 percent accurate, on a tax like the gross income tax over the course of a couple of years, that could turn into about $300 million, $320 million in shortfalls. The so-called accuracy of your forecasts, as an academic exercise, takes on much different ramifications when it's actually dollars that you don't have to spend in the budget.

Now, looking at these issues in these contexts, there's a couple of points I would want to make and one of them was touched upon especially by Assemblyman Gregg, earlier, here. I think it's really something -- that, when the Task Force gets down to business, the process in New Jersey has to be acknowledged. It's a truism that the Governor in New Jersey exercises enormous power over the state budget. Based on the State Constitution and, quite frankly, a 58-year-old, and I would say, obsolete budget statute, the Governor presents the budget proposal, certifies the revenues and all other resources available to support the budget, has expansive line-item veto authority, and is authorized to restrain state spending during the course of the year if problems develop, notwithstanding the levels of appropriation that the Legislature has put into the budget.

In addition, the constitutional provision of a single general appropriation act for a fiscal year tends to strengthen executive power, at the expense of legislative committee influence, over multiple appropriation bills, as you might see, for instance, in Washington, D.C. or in some states. Now, I'm not saying that's a recommendation for multiple appropriations bills, but it's a fact that legislative authority is enhanced when different appropriation bills go to different committees.

And finally, the absence of any modern financial standards, about what actually is part of the budget and isn't part of the budget, means that the Governors can make budget proposals appear smaller than they really are, by declaring some revenues to be dedicated, and therefore what we call off-budget, and then charging expenditures against those revenues, effectively removing them from the part of the budget that gets counted. We have recent examples and long-term examples of this. It happens every year. It's happened in every administration.

One recent one is the $2-a-day car rental surcharge that was added. That, believe it or not, is not a revenue in the State budget. It's off-budget, and so are the expenditures that are being charged against it. We have a much longer 20-year-old example -- the taxes that we collect on energy corporations. These would be corporate business taxes and sales taxes. The same corporate business taxes and sales taxes paid by everybody else are collected here in New Jersey by the State, distributed to municipalities, but not considered part of the State budget.

Again, I just bring this to your attention, because while there's a consensus that this is how we do business here, that is how the reality of the power of the Governor is in this state. As far as the Governor's power to certify revenues, it stems from one very brief provision in Article 8, Section II, of the State Constitution. I'll just read this very briefly. "No general appropriation law, or other law appropriating money for any state purpose, shall be enacted if the appropriation contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of revenue on hand and anticipated, which will be available to meet such appropriations during such a period as certified by the Governor." That's the basis for the authority for the Governor to make the declaration of revenue.

We have some State law on the books that requires the Governor to state what the anticipated revenues will be when they present the budget, but this is the certification power that's in the State Constitution. And, in fact, when the Governor signs the budget every June 30, there is a statement appended to that which is a certification of revenue.

Despite that, despite this vast power and despite that constitutional authority, I would argue that the Legislature certainly has, or can assert, a role in the deliberations of the amount of revenue available to support the budget. There's no law or rule that says a Legislature, either in whole or through its budget committees, has to agree with the Governor's revenue estimates. By the same token, the Governor may very well change his or her own estimates between the time the budget is introduced and when it's enacted into law. This happens quite often, in fact happened with the Fiscal 2003 budget, as you all know.

But the reality here, again, getting back to the relationship of revenue forecasting to the budget process here, the reality of the budget process, at least in New Jersey, is that once the Governor's budget is proposed, that becomes the game plan, that becomes the basis from which changes are made. Every subsequent decision about revenue expectations after that is not made in the context of an academic exercise, except in the case when it's made by OLS, who basically just comes in and says, "We either agree or we disagree." But, for the legislative and executive participants in the process, every decision made subsequent to the introduction of the budget about revenue expectations is seen not only as an expectation, but what does this mean for spending levels and what does this mean for the size of the State's surplus. So, it gets mixed up, quite frankly, and maybe, properly, with a lot of other legitimate concerns that the budget-makers might have at that time.

I want to say-- I'll let David speak a little bit about what we do, if you're interested in how we do it. It's remarkably untechnilogical and unsophisticated. I want to say one thing, because it was brought up here earlier by the members of this group, because I'm fairly familiar with this. The State Revenue Forecasting Advisory Commission is an entity that we in OLS have had, at least we had while it was still active, fairly regular contact with. And it wasn't because we were assigned as staff to it. We weren't assigned as staff to it. The Treasury actually was. But we dealt closely with them. We helped them set up their meetings, we knew the members.

That Commission was created in the summer of 1992, out of a situation that wasn't terribly different from the situation we're now facing. I believe it was Senator McNamara's legislation; I can't remember for certain. I must be very candid with you, and maybe too candid. I think the Commission was a concept that looked good on paper but did not work out so well in practice. I know the Chairman is familiar with that Commission, from having sat on the budget committees.

The problem with it, quite frankly, from my perspective, and this will be Alan Kooney talking, not OLS, is that it suffers from the same disabilities, as many other advisory commissions suffer from, when you appoint public members. They're all very good at what they do. They're all distinguished members, but they do not have continual time or continual access to the kind of information that's necessary to do this kind of work. This is an information-driven process. These people who come together -- maybe once a month, maybe once every two months -- they would listen to people like us, or people like Treasury representatives, say stuff and then, the expectation was, they would then issue revenue forecasts four times a year.

It was a difficult task, notwithstanding the fact that there were some prominent economists on there. But one of the things I would point out is that so many of our revenues have nothing to do with the economy. There are much more mundane things. In some cases, there are funds that are taken by the Treasurer from other state funds. They have nothing to do with forecasting whatsoever.

So the Commission hobbled along without all of its members for maybe a year-and-a-half, and it hobbled along with its members for maybe three or four years, and, sort of, became somewhat irrelevant to the process. I guess it is arguable about why that happened, but I think if there were-- It's still on the books. The members, I think, their terms have all expired. If this group were to look more carefully at that, I think they might do well to bring in one or two members of that Commission and see, from their perspective, what they thought was right and not right about it.

I think I'll stop right now. I've probably talked a little too long, and see if you have any questions. I believe David might have a word or two he wants to say.

DAVID J. ROSEN: Thank you. I agree with everything Alan said, particularly the fact that we're untechnilogical and unsophisticated. (laughter)

What I'd like to do is, sort of, explain briefly why I think there was a $3 billion revenue forecasting error, too, from our perspective, and what the different pieces of that are. I mean, clearly, there's a national problem and New Jersey was part of that.

Last year ago, May of 2001, when we came before you, we were projecting $1.6 billion less in revenue available for the '02 budget than the administration had proposed in their budget. About a quarter of that had to do with Fiscal Year '01 revenue, and that, sort of, goes into the opening balance for '02, but that's not part of the forecasting error for '02. So, there are really three components, three pieces, each of which was worth about $400 million in '02.

The first was, we thought the base from the prior year was lower. Simply, that when you do revenue forecasting, you grow from one year to the next, and if the first year is lower, all things being equal, that lower amount of money flows through. That was about $400 million. We thought the administration had adopted overly aggressive growth rates on some of the major taxes, and that was worth about $400 million. Separate from that, we thought they had overestimated capital gains by about $400 million. So this is the three pieces that made up about a $1.2 billion revenue difference at that point.

This morning I went back and I found our testimony from that time. I just want to read a couple of lines from the very end of it. It said, "All revenue forecasts are wrong to some degree. I certainly acknowledge these numbers will need to be revised again in the future. But as you formulate this budget, I need to reiterate that this forecast, which was $1.6 billion below the administration, rests on relatively optimistic assumptions. We're assuming that stock prices will rise for the rest of the year. We're assuming there will be no national recession, and we're assuming that New Jersey will fair better than our neighbors in the nation as a whole. If these assumptions prove incorrect, our forecast is likely to be too high." And, in fact, they were, and it was.

It appears now that, while we were viewed as being alarmists -- we raised the capital gains issue last spring -- that, in fact, we probably overestimated capital gains by $500 million. We were projecting a 25 percent decline. It probably was as much as a 50 percent or 60 percent decline. So that was an additional $500 million.

I forgot to mention the LLC forecast. When we testified in May, the Treasurer had not yet raised the forecast to 420, so that was not built into our number. So that would be another $300 million of money at risk. Incidently, I pulled out the fiscal note. OLS did not agree to the 420. We said the administration says 420. We have no access to their data, and we can't make a judgment. We never endorsed that number. So there was about a one-five difference on July 1, based on what we knew between our forecast and the administration forecast.

We were off by about $500 million more on the capital gains. We had overestimated that. And then there was probably another billion dollars because of the poor economic performance. Part of it may be attributable to September 11, although we now know, from economic data that were not available in May or June that year, that the recession had already started, and economic performance had generally been very poor.

So those three things really make up the $3 billion shortfall we ended up with for the year. A forecast difference between us and the administration of 1.5 billion. The capital gains being $500 million, worse than we were expecting, and we were pretty pessimistic by general standards, and then the general underperformance of the economy added another billion dollars.

So, if you had gone with our revenue forecasts, I mean, you still would have had a shortfall, it would have been a smaller shortfall.

We'd be happy to answer any questions.

ASSEMBLYMAN ROBERTS: Thank you very much.

Let me start with Assemblyman Burzichelli.

ASSEMBLYMAN BURZICHELLI: Thank you, Mr. Chairman.

Good afternoon, Alan, and good afternoon, David. It's nice to see both of you again. You're frequent visitors with us, and we appreciate your input and guidance. I remember meeting you as a freshman as part of our orientation day.

MR. KOONEY: I remember.

ASSEMBLYMAN BURZICHELLI: And when you looked me in the eye and said, “You’re not going to like what you see in respect to these numbers,” and you were straightforward then, and you’ve been straightforward all along.

Alan, if I may direct it to you first. You can help us along. You mentioned, and helped us along, because you’re hearing this Task Force honestly discuss ways to do things better-- You heard mentioned about the Commission, forecasting Commission, estimating four times a year. In sober language you told us, it’s not the best place to put good citizens of New Jersey at, because they don’t have the access to resources that would be necessary to be effective. Can you help us with a suggestion, in lieu of that Commission? Have you a thought?

MR. KOONEY: I think-- Well, let me start off by saying that I’m not disparaging the Commission or the concept of it or the ability, perhaps, to have a Commission that would be more effective. Whether that group is to remain as an advisory commission, or whether, in fact, this body and the Legislature and the Governor’s Office have something else in mind in purpose, by way of changing the process, to make the certification a function of this entity -- in other words, make their recommendations-- There wouldn’t be a recommendation or decision binding. There’s a very big decision and one that would take a lot of discussion.

In the absence of that, I would just say, I don't have any magic bullet for this situation. I do happen to think that some of what happened last year was somewhat of an aberration. And I say that also acknowledging that every year we're going to be wrong to some extent. When you're wrong on the other side, nobody comes back and yells at you because we have too much money. We may kick ourselves around a little bit in the back room, but basically you're not going to get a lot of grief if you underestimate revenues.

The problems happen, and the risk factors happen, when they come in situations like we just had and, quite frankly, like we had in 1989, '90, and '91, when the economy turns. Corina made a very good point there, which was greatly discussed, about how you always miss the estimates when the economy turns.

I think, in general, I would just suggest that there be a fuller and more open discussion of the factors that go into making these forecasts. As I said, they come out in the context of the State budget. They just show up one day, and there they are. And yes, it's true that the Treasurer will show up at a press conference, or not, depending on what happens, and talk about them. But by that time, they're there. We will come along a month or two later and we'll have the benefit, at that point, of some extra time to look at things, which I think is an advantage to us, and say, well, this may be overstated, or whatever. But I think the process is one that needs to take place more regularly during the year.

The reporting of revenues that go on as we collect them, for instance, is a very important piece of the work that we do in OLS. We try very hard to track what's actually happening at the time that it's happening, and then try to figure out what's going on from that. There is a requirement that the Treasury report every month on what's going on with revenues, and they do that through the mechanism of a release to the legislative leadership and a press release, generally. I don't think there is, probably, as much discussion of those things as there might be.

We provide, at least the members of the Budget Committee, something the Chairman has referred to, which is a revenue snapshot, which basically attempts to analyze what's going on contemporaneously. We're dependent on the data we received from the Treasury Department, because they collect the money for us to produce that thing. We send that out. We occasionally get questions about what we think is going on. But I think a more public process, leading up to the numbers that would go into the budget, is certainly one that would be advantageous to all. How it's formally structured -- there's many ways to skin that cat.

ASSEMBLYMAN BURZICHELLI: From the earlier testimony, Mr. Lawrance speaking to us, one of the things for me was the Treasurer's Office, at that time, their inability to understand what was going on around them. The thought that information, that could have been helpful to them, sat on someone's desk for two months, was not read because that person was overwhelmed -- that's a great concern. The fact that his office -- and I don't mean this directed at him personally -- I mean, the office and its resources could not interpret how tax returns were coming in and what trends it may indicate. It's got to be very disturbing to you, as professionals, to myself as a lay person representing people of the 3rd District. It shakes my confidence, because if the Treasurer doesn't know, and can't read, and can't understand tax returns that are being sent in, and they can't glean from them what trends we may be seeing, then we have some great, great issues that we have to discuss internally.

I'd like you to help us along here, and I'm going to keep my questions brief, because we're trying to bring this to a conclusion in a shorter time than it took to do the budget. But maybe you can give us some insight into your relationship with the DiFrancesco administration and their numbers. Did you meet with the executive branch when it was very clear that you had a great difference, to reconcile the differences between what your office was projecting and what they were working with?

MR. KOONEY: I'll let David answer that.

MR. ROSEN: We generally carry on as much of a dialogue as we can with the administration, with any administration. We were having conversations. In fact, the article to which Pete Lawrance referred -- Mark Zandi's article about capital gains -- was one that we brought to their attention, that we were concerned about this issue, and we weren't aware of anybody else who was talking about it. We found the Zandi article, and we shared that with them. We had conversations with them throughout the budget process and shared our perspective on--

ASSEMBLYMAN BURZICHELLI: Can you share with us your initial reaction when the mysterious $320 million appeared on the LLC tax discussion without corresponding legislation? I mean, obviously, it happened in a short period of time, but--

MR. ROSEN: Well, let me clarify, there was legislation. The legislation had been moving as early as January. The actual bill that passed, I believe, was a reintroduction, for technical legislative reasons, that happened in late June, and the bill didn't move in late June. Throughout the process of negotiation on the bill, there were a series of increases in the forecast for the value of this piece of legislation. We never had access to any of the data. It was based essentially on, as we understood, anecdotal information available to the Treasurer. We were unable to make a judgment as to whether or not that was valid. It certainly seemed like a big number, and we certainly expressed that view informally, but we had no data on which to come out with a forecast.

ASSEMBLYMAN BURZICHELLI: Now, Al, you mentioned at the beginning of the testimony, you were clarifying for us the roles of the certification process. This was my first time around in this budget process, and it was enlightening. I don't want to just say interesting and to dismiss it as being interesting. It was an experience, and it was a good experience. For the people of New Jersey, we would have preferred it had been a better experience. Could we have worked with different numbers? I mean, our sitting Governor now presented numbers to us, as did the previous Governor to the previous legislative body. Could we have changed those numbers? Could we have said, "We don't believe your forecast, we don't believe that that number is the right number?"

MR. KOONEY: Well, I would argue that, yes. I'm a legislative junkie. I've worked with the Legislature for 28 years. I believe the Legislature-- There's no question that the "certification" rests with the Governor, that's the way it is. When the Legislature considers the Governor's budget, they can do everything from accept it wholesale to throw it in the nearest garbage can.

In Washington, the President's budget is pronounced dead on delivery from the time it comes. Now, that's unrealistic, politically. I'm nonpolitical and apolitical, but I work in this environment. That's not going to happen. But there is no reason why the Legislature, either relying on our advice or somebody else's advice -- it doesn't have to be our advice -- cannot craft a budget that is based on different revenue estimates. The question is, is this really something that they want to do, and what's in it for them?

As I mentioned, once the Governor's budget is presented, that becomes the 800-pound gorilla. If you come along two months later -- and you, I'm using that generically -- if the Legislature comes along two months later, either based on our advice or somebody else's advice, and says, "It looks like we're going to have \$500 million less in revenue," then somebody says, "Fine, where are you going to cut \$500 million from the budget?"-- If the Legislature adopts a revenue estimate that's higher, and, then, either puts that money in surplus or spends the money, then when the Governor comes along later on June 30 and certifies the revenues, if there hasn't been a mutual agreement reached between the branches of government, than either there's going to be spending vetoed or the surplus is going to be reduced.

So the answer to your question isn't an abstract answer. The Legislature certainly can, and, I would argue, should, take a more independent view of the revenue, certainly a more interested view of the revenue situation. Is it realistic to expect that they will produce a budget based on different revenue estimates? Maybe. That might depend on the political makeup, quite frankly, of the Governor's office and the Legislature. It's happened before in rare instances, but it's really, I think, and probably more likely, a process of negotiation.

ASSEMBLYMAN BURZICHELLI: And the process of negotiation is politics. So it's not a bad thing. We elect people, and we engage accordingly.

Two other quick questions, if I may, either Alan or David, or whoever cares to answer. I don't know if this crosses any policy discussion lines, or how free you feel you are to speak, but how would you change the forecasting process? I know you said earlier you don't have a silver bullet. You must have some thoughts.

MR. KOONEY: One of the things that, quite frankly, I've yet to become a major fan of, in terms of the forecasting process, is the reliance on heavy-duty outside economic forecasting consultants and firms. I know a lot of states do this. I know some of them speak very highly of it. I remain a skeptic of it for a variety of reasons. Number one, their own economic forecast hasn't been anything to write home about, and number two, so much of what influences the revenues that we get is specific -- almost inside baseball kind of stuff -- so there could be no reason for anybody, whether they're from Deloite and Touche or anywhere else, to be expected to understand that. They can provide parameters.

In terms of our process in-house, here, as I indicated, it's remarkably low tech. It's some guys who I think do a lot of work in following what's happening and attempting to make estimates from it, but it doesn't rely on econometric forecasting models or anything else. Treasury, I think, has a little bit more sophisticated models going, and has access through consultants that they've hired to do that. I would argue that the results, at the best, are a toss-up in that regard. That gets to the actual forecasting methodology. The process, in terms of should it continue to be done the way it's done, I really-- I think we have discussed that. I don't have any particular policy recommendations for how this should be done. I will work, obviously, with whatever you folks thinks is a better way to do it.

MR. ROSEN: I agree with Alan. To take up on something that Treasurer McCormac said when he spoke to you last month, early this month: In some sense, it's irrespective of the particular structure you set up for doing revenue forecasting, whether it's a consensus forecast or some other, and that is, if there is a significant difference of opinion between the estimates of whoever is making estimates; and in our current structure, it's Treasury and the OLS staff. If there's a significant difference, it seems to me it's incumbent upon policy makers to find out why and try to make a judgment; and whether the process to do that is the current process, and to the Legislature becoming engaged in looking at that dispute, or some kind of consensus body or some outside body, that's really your call. I'm not sure it makes a lot of difference, as long as you set up a mechanism for dealing with the years in which there's some significant disagreement, for years in which, and there have been plenty of years, in which there's a 1 percent difference. We're not going to get better than 1 percent in revenue forecasting. If either of us is right, and there's a 1 percent difference, both sides feel pretty good about it. But, it seems to me, it serves your interest of a mechanism to resolve the situation in those years where there appears to be a significant difference and one that's significant in budgetary terms. I think there are different structures that might do that.

ASSEMBLYMAN BURZICHELLI: Very good.

Thank you, both of you, for taking time and being patient and most informative.

Mr. Chairman, thank you.

ASSEMBLYMAN ROBERTS: Thank you very much, Assemblyman.

Next is Assemblyman Green.

ASSEMBLYMAN GREEN: Thank you, Mr. Chairman.

I'm going to be rather quick. My colleague just about asked all the questions I was going to ask, except the fact that I just want to congratulate you, coming before this Committee, being upfront, being honest. My concern is that some of your comments in terms of the previous administration-- Your numbers were a little more to the center than their numbers were, yet still seem like they were not supporting what you were saying. In fact, they went in the opposite direction. My concern is that -- was there a reason for this, especially when Mr. Lawrance said earlier it was his decision, because the administration, basically, followed his decision? And what formula were you able to use to be so close to the center? It's obvious his formula was totally different. Here we're all supposed to be in the same game together, moving in the direction of looking out for the taxpayers dollars.

MR. ROSEN: Let me try to answer that. I think there are a couple of pieces. One of the differences I pointed out was the issue of capital gains. There was a legitimate and serious difference of opinion, nationally, about how to forecast. It was really an unprecedented situation. We had had, for about four or five years, a stock market bubble that drove income tax revenues. The stock market values had dropped precipitously, and we had to guess what was going to happen next. There were no historical models to look at for doing that.

Some of us took the view that capital gains revenue was going to drop significantly. We didn't have the full courage of our convictions to go public with our most pessimistic view of what that might be, but we still projected a fairly sharp decline. There were revenue forecasters across the country, other than Pete Lawrance, who didn't think that was going to happen, as well. I remember, we called the Congressional Budget Office at one point that spring to talk to them, to sort of bounce our ideas off of them, as we did with our colleagues in other states. And CBO's expert on capital gains said, "Oh, no, we think capital gains are going to be flat." We strongly disagreed, but the point I'm making is -- there are people who honestly took a different position.

In terms of the rest of the revenue forecast, there's always a range of variation among what's possible, and we have the advantage -- that is, we, OLS have the advantage -- of not having to worry about the implications of the numbers we pick. We can just say this is what we think. Other people are selecting numbers in the context of a policy document that they're presenting, and that's more complicated.

ASSEMBLYMAN GREEN: For the record, I would just like to feel that, in the future, that you feel comfortable in being more open. If you were more open, we might not be sitting here today. I'm hoping that the current

Treasurer would want to accept some of the knowledge that, basically, you have, because it's obvious that you were right in a lot of different issues that, basically, other people decided to go in a different direction.

And also, I'd like to congratulate the Chairman, because, it's obvious, in this room we started with this Committee, and some people might have questioned it, but it shows that sometime all of us are supposed to be working together. In reality, we are not. The more open we are about these particular issues, the better off the State of New Jersey would be.

So again, please be comfortable, in the future, if you feel something -- be able to feel comfortable that you're going to say it. Because, again, we could avoid some of these problems that would have allowed you, two years ago, to come before a committee of this nature to express your concerns.

Thanks, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Thank you, Assemblyman.

Next, Assemblyman Gregg.

ASSEMBLYMAN GREGG: Thank you, Mr. Chairman.

Following on the heels of Assemblyman Green, we'd love you to be honest, but we think you're always honest. And, quite frankly, people don't listen. That is part of the process of why we're here today, I think, Mr. Chairman -- is to create a system that some people have to listen, as opposed to determine; that there's a better opinion than they perhaps want to listen to. But we do thank you for your candor.

I had an opportunity to speak with Ms. Eckl just a couple seconds ago, to ask a question that I didn't ask before. The question was, are there states that have their revenue forecasted prior to the budget? This came from your testimony because I thought it was interesting, Alan -- that you were testifying, basically, that the system is as it is, that the Governor, whoever it is, whether it's Republican or Democrat, puts their budget forward, and that becomes the structure for the budget. It sets the tone. It sets the ultimate goals. It sets the framework together that it's going to look something like this when the day is over. That happened simultaneously with the revenue, virtually prior to the revenue being certified.

So we already have this picture out there. Every department having a feeling that they're going to get this money, every citizen feeling that they're going to get this piece. It's done before anybody bothers to see whether or not the money is going to come in. So, I asked her the question, do other states do revenue certification first? Lo and behold, the answer was yes. Apparently, it's in some of the paperwork we have received, so we'll be able to go through that. Do you think that could add something to the process, if we have some form of a program, and a revenue certification that precedes the executive branch's idea or framework of what a budget is, the way we work today?

MR. KOONEY: Well, at the very least, a process like that would keep in front of policy makers, and in front of the public, the revenue situation; whether, eventually, it was more correct or not, who knows. But, as Ms. Eckl indicated, there are states where they have, basically, continually functioning revenue-estimating bodies. They meet *X* number of times a year and, basically, what they do is, they meet and revise what they've said the last time they say. Now, could that become confusing? Maybe, but that's the nature of what this is. So that, if they're good at what they do, by the time it comes time for a Governor to present a budget, presumably, there has been reached some kind of agreement or consensus on at least the major types of revenues that would be available to support that budget, up to that point. And yes, I've talked to some of my counterparts from other states where these groups meet six times a year, or something like that, to do this kind of a thing.

ASSEMBLYMAN GREGG: I would hope that the Task Force pretty much concurs with the concept of having openness in getting numbers from the Treasury, and having it be accurate and quick. We get yours, but yours are coming after theirs.

MR. ROSEN: If I might add to that: Both in the administration and in the OLS staff, we're looking at revenues every week, every day. It's a question of where in the process you want to make that a public discussion. Because, in a typical budget cycle, the first time numbers pop up is when the Governor presents his or her budget in January. And then we respond later on. Depending on the mechanisms you look at, you could have other times of the year in which those discussions are made public.

ASSEMBLYMAN GREGG: Thank you.

Ms. Eckl also brought forth some states that had that formula of a certain percentage of revenue that is certified -- could then be used for appropriations. How did that bounce off as a concept? In other words, some states have 97 percent. So, if the revenue certification was 20 billion, for argument's sake, however that's certified, whether it's consensus or whatever, that that certification now creates, for argument's sake, whatever 98 percent of 20 billion is, and that becomes your maximum appropriation level.

MR. KOONEY: Well, if it works right, that's one method for building up a rainy day fund, as some of the states have done. If it doesn't work right, it doesn't happen that way.

I think the decision -- that would be a major policy decision here, for either the Legislature or the Governor or the people, if it went to a referendum, as to how that would work. And, of course, it would be as good as your revenue estimates were. I mean, you wouldn't want to have a situation like that and then have somebody jack up the revenue estimates, so that you'd end up in the same situation you would be in before. But, I know of some states that do that, and they do seem fairly satisfied that it works well. They seem to take it very, very seriously.

ASSEMBLYMAN GREGG: Well, you have the same evil mind I do, because that's the same thought I had, which is, just change the revenue projection. So, I think you come back full circle, and you have to have an accurate revenue forecast that's done through consensus that people can agree upon. And specifically, in a state like New Jersey, where we are starting with such an abysmal surplus in 2003, that having that kind of a 97 percent, 98 percent of certified revenues next time, could then help build that surplus that, I think, virtually everyone has testified in front of us, has said, that without a surplus, you're walking a very, very thin line in the event the economy doesn't turn around.

With that, I thank you for your presentation.

Thank you, Mr. Chairman, who now is you.

ASSEMBLYMAN CRYAN: Thank you, Assemblyman.

Assemblyman.

ASSEMBLYMAN D'AMATO: Mr. Kooney, I thought I heard you say that we have a 50-year-old, out-dated budget process. Was I correct?

MR. KOONEY: I think what I said was we have a 58-year-old budget statute that governs the delivery and contents of the State budget, and then I ventured my unsolicited opinion that it was somewhat obsolete. (laughter)

ASSEMBLYMAN GREGG: Which will appear in the papers. (laughter)

ASSEMBLYMAN D'AMATO: Well, what can we, as the State Legislature, do to amend that statute, to improve it? What are your specific recommendations?

MR. KOONEY: Well, that statute, which was a 1944 statute, actually predated our State Constitution, and, in fact, was itself, I think, a post-depression era attempt to bring some order to State finances. It was probably pretty forward-looking in its time. There's some things that are perfectly fine with it. It governs the date that the budget will be delivered, and there's no problem with that kind of stuff. It governs, in some cases, the content of the budget in terms that are so obsolete.

It talks, for instance, about a highway fund that we haven't had for 35 years. In my mind, it does not require two things. Number one, it doesn't govern the contents of, what I would call, the State budget, very specifically. As one of the points I've made here, which again was somewhat gratuitous, was that it does not define that the funds that comprise, what I would call, the State budget, here-- As a result, we have a budget that looks like it's $23.4

billion, but is really much higher than that, except that that's sort of an unacknowledged aspect.

I think a statute that was brought more up to date in that regard, as to what funds or part of the State budget, would be advantageous. I think a statute that, perhaps, spelled out a little more what information would be provided along with the budget, by the way of documentation or displays, might be a good idea as well.

In terms of process, the budget statute mentions nothing, essentially, about the Legislature at all, other than that the Legislature receives the budget from the Governor and that, at some point, it produces a bill. There's no mention of budget committees. Everything that happens in the budget process right now happens as a result of custom or of rules. That's not necessarily bad, because it seems to function pretty much on its own. But, again, I see many states where there's a lot more specific application to those types of things, which isn't to say you would want to be hamstrung in those situations. But it's actually amazing how much of our budget process is just, sort of, just sort of happens.

ASSEMBLYMAN D'AMATO: What data does the executive branch have access to, when it comes to revenue forecasting, that OLS does not?

MR. ROSEN: Tax returns. Tax returns are confidential, and we don't have access to them. In terms of the income tax data, a lot of that is aggregate data, which is made available to us, because it doesn't disclose who the individual taxpayers are, although there's still some of that that we can't get. Corporate tax data is much more difficult for us to access, or to get in a useful form, because so much of that is company-specific. There are a smaller number of large taxpayers who really matter.

In the LLC case, for instance, we had no access. We didn't know who the taxpayers were who were supposed to be bringing in this extra money. We had no way to evaluate whether or not that was true.

ASSEMBLYMAN D'AMATO: But if tax returns are confidential, then how is it that the executive, whether it's Republican or Democrat, has access to it? I mean, I'm sure--

MR. ROSEN: They are confidential to the Division of Taxation, and they do the analysis. In other words, they're allowed to use the data. There are very limited instances in the statutes -- I can get the specifics for you -- on who else has access to them. But the people who do the revenue forecasting in the Division of Taxation have access to that data.

ASSEMBLYMAN D'AMATO: In a perfect world, would you like to have the same access that the Division of Taxation has in order for you to do your revenue forecasting?

MR. ROSEN: That would be nice to have. It's a trade-off, for somebody else to make, as to whether the value of us having that, against expanding the world of people who have access to confidential tax information -- what the proper balance is in those trade-offs, but we'd always like more data, rather than less.

ASSEMBLYMAN D'AMATO: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you.

I think Assemblyman Sarlo has a question.

ASSEMBLYMAN SARLO: Yes. Thank you, Mr. Chairman.

One quick question. It could probably be a yes or no answer. We talked about this Revenue Forecast Advisory Commission. Former Treasurer, Mr. Lawrance, stated that he would like to see, going forward, that we re-establish, reinvent, whatever you'd like to call it, and I agree with the part that you had said earlier, that in order for that Commission to be successful-- There's a lot of numbers here. There's a lot of data. It's a very data-driven business, this revenue forecasting. At any time, between OLS and the Treasury, where we were off about $1.6 billion, did anybody come up from Treasury and say, "Hey, maybe it's a good idea to bring in this Advisory Commission. Let's reinstate them, and let's have them come in as a third party to look at this"?

MR. ROSEN: No.

ASSEMBLYMAN SARLO: Okay. Thanks.

ASSEMBLYMAN ROBERTS: Thank you.

Assemblyman Kean.

ASSEMBLYMAN KEAN: Thank you, Mr. Chairman.

Sorry for missing the first half of your testimony. This question may have been asked already. How can we, as a Legislature, working with the executive branch, make your jobs easier, in terms of-- As I sat through the Budget Committee process this year, and I understand this has happened in prior years as well, there are some black holes or assumed numbers when you came before the Committee and said, well, because the administration said this is how much they're going to derive, and we've got nothing substantiating more or less, and that was included this year, whether it was CBT or tobacco bonds-- You just talked about the LLC. The prior years -- what, I guess, in terms of getting accountability into the process, what can we do, as a Legislature, to help that, from your perspective?

MR. ROSEN: Oh, I don't know. Propose new ideas three or four years in advance and let us study them. (laughter)

I mean, realistically, when new ideas are being advanced during the budget process, it's difficult to get information in a timely way to analyze it. In this particular budget cycle, the tobacco bonds number was literally a plug number. That wasn't a revenue forecast, it was a policy decision to be made. And so whatever number was decided upon between the Governor and the Legislature was what was going to happen.

In terms of the corporation tax, I think when we testified before you, there wasn't a full-blown proposal out there, so we simply, as is our custom, we say, okay, assuming they get what they propose, that's the number that gets plugged in there. Ultimately, we got information from Treasury on the basis for their forecast, once the bill was flushed out and moved through committee and got amended. We were able to present to you some -- if not a full-blown revenue forecast, a fairly serious reaction to some of those numbers.

ASSEMBLYMAN KEAN: Right.

MR. ROSEN: And, in fact, there was some dialogue that then went on with the administration as a result of that. But, clearly, the sooner that an idea is flushed out, the better chance we have of giving you some useful information.

ASSEMBLYMAN KEAN: Thank you, Mr. Chairman.

ASSEMBLYMAN ROBERTS: Assemblyman, thank you.

I think we are concluded.

Gentlemen, thank you very much for your participation and, in particular, your patience.

And to the members of the Task Force, thank you very much for taking a day in August and being here, not that you had a whole lot of choice. But we will be reconvening in September on a day that's, hopefully, more convenient; but thank you very, very much.

(MEETING CONCLUDED)