

R E P O R T

OF THE

LOCAL BUDGETARY LIMITATIONS REVIEW COMMISSION

CREATED BY JOINT RESOLUTION NO. 5, 1982

TRENTON, NEW JERSEY
NOVEMBER 1982

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Preface

This report of the Local Expenditure Limitations Technical Review Commission is the culmination of three months of diligent and concerted effort to review the history and address the future of the Municipal and County CAP law. The Commission is well aware that its report is being submitted well beyond the September 15, 1982 deadline fixed in the legislation by which it was created as well as the amendatory measure which extended the deadline to October 15. The Commission's failure to meet this deadline was unavoidable. The complexity of the task assigned it and the availability of resources made it impossible to comply with that date. The Commission was forced to exceed its deadline in the interests of producing the best possible report under the circumstances.

The Commission's work was hampered by the nonavailability of comprehensive statistical data at the outset of the Commission's study. Due to time and staff constraints the Commission was unable to assemble all information considered necessary for comprehensive study of the historical experience under the CAP law. The gaps in information resulting from this situation will be obvious to the reader of this report.

The Commission's charge consisted of mandatory responsibilities and discretionary duties. Again because of time and resource constraints, only the mandatory aspect of the charge has been met by the Commission.

The most difficult aspect of the Commission's chore, aside from time constraints, was to distinguish between technical and non-technical, i.e. policy considerations, and to confine itself strictly to technical matters. The lesson learned by the Commission is that the intertwining of technical and policy matters cannot be undone simply by decreeing that the two be divorced from each other.

This report should not be considered either the final or the authoritative source on the history of the CAP law to date. Meaningful review of the CAP law should continue in order to complete the task begun in this report and to expand it to include the future of the CAP law beyond 1982. Such review should be undertaken in proper scope and with the dedication of sufficient time and resources demanded by the importance of the issue to public officials and the people of New Jersey.

Acknowledgments

The Commission wishes to express its appreciation to the following persons for their invaluable assistance:

Frank W. Haines, III, Division of Local Government Services, Secretary to the Commission, for research, technical advice and assistance, and authoring the Report.

Terri Raney and Doris McVicar, New Jersey Taxpayers Association, and Phyllis Walker and Ester Toscano, Division of Local Government Services, for secretarial assistance.

Anthony Angelini and Joseph Scrivo, Division of Local Government Services, for technical assistance.

Carolyn Winters-Hazelton, Division of Local Government Services, for research assistance.

Dr. Laurence Falk, Office of Economic Policy, for technical assistance.

Jack Greenberg, County and Municipal Government Study Commission, for research assistance.

Jack Raney and Robert Johnston, Local Property Tax Section, Division of Taxation, for providing property tax data.

Dr. Ernest Reock, Bureau of Government Research, Rutgers, for information on school finance and caps.

SUMMARY OF RECOMMENDATIONS

(See Part IV)

1. REPLACE THE CURRENT 5 PERCENT FIXED CAP RATE WITH A FLEXIBLE RATE DETERMINED BY AN INFLATION INDEX. THE INDEX MOST APPROPRIATE FOR USE IS THE IMPLICIT PRICE DEFLATOR FOR STATE AND LOCAL GOVERNMENT PURCHASES OF GOODS AND SERVICES. THE ANNUAL CAP RATE SHOULD BE COMPUTED BY A TWO-YEAR MOVING AVERAGE OF THE RATE OF CHANGE IN THE INDEX; THE 5 PERCENT RATE SHOULD BE RETAINED AS A FLOOR OR MINIMUM CAP RATE.
2. PROVIDE A CAP EXCEPTION FOR DECREASES AFTER 1982 IN FEDERAL GENERAL REVENUE SHARING AND MUNICIPAL PURPOSES TAX ASSISTANCE AID.
3. PERMIT CARRYING FORWARD OR "BANKING" OF UNUSED CAP LEeway -- THE DIFFERENCE BETWEEN ACTUAL APPROPRIATIONS/TAX LEVIES AND THE MAXIMUM PERMITTED BY THE CAP CALCULATION -- FOR A TWO-YEAR PERIOD.
4. PROVIDE FOR ADJUSTMENT OF THE CAP BASE TO REFLECT TRANSFERS OF FINANCING RESPONSIBILITY IN A FUNCTION OR SERVICE FROM ONE GOVERNMENTAL UNIT TO ANOTHER. THE ADJUSTMENT WOULD BE UPWARD WHEN A FUNCTION IS ASSUMED FROM, AND DOWNWARD WHEN A FUNCTION IS SHIFTED TO, ANOTHER GOVERNMENTAL UNIT.
5. PROVIDE A CAP EXCEPTION TO COUNTIES FOR COST INCREASES IN MAJOR STATE-MANDATED COUNTY FUNCTIONS -- THE JUDICIARY, MAINTENANCE OF PATIENTS IN STATE INSTITUTIONS, CORRECTIONS AND PENAL, AND THE COUNTY PROSECUTOR -- THAT EXCEED THE ANNUAL CAP PERCENTAGE.
6. PROVIDE A CAP EXCEPTION TO MUNICIPALITIES FOR THE COSTS OF HOLDING REFERENDA TO EXCEED THE CAP.
7. REENACTMENT OF THE LOCAL CAP LAW, AS AMENDED TO INCLUDE RECOMMENDATIONS 1 THROUGH 6, SHOULD BE FOR A THREE-YEAR PERIOD EXPIRING ON DECEMBER 31, 1985, THEREBY ENCOURAGING FURTHER EVALUATION OF THE IMPACT OF THE LAW.
8. THE DIVISION OF LOCAL GOVERNMENT SERVICES, DEPARTMENT OF COMMUNITY AFFAIRS, SHOULD HAVE STAFF AND DATA PROCESSING CAPABILITY TO PERFORM NECESSARY ON-GOING, TIMELY ANALYSIS OF THE IMPACT OF THE LOCAL CAP LAW.

Later, the first legislative commission to evaluate the 1976 tax reform program noted that an objective of the CAP law was ". . . controlling increases in property tax levies by county and municipal governments" while again recognizing that constraints on local governments had to be reasonable.⁴ This group indicated that " . . . many legislators felt that to insure tax reform, a statutory constraint was required to insure a reduced dependency on the property tax to finance local government services."⁵ However, in a later discussion of the exemption from the CAP law for certain municipalities, they stated with emphasis a seeming inconsistency of this policy, i.e. that ". . . property tax rate control is not the primary objective of the expenditure limitations law. The primary objective of the expenditure limitations law is to control the rate of increased spending by local governments and by doing so the property owner is less likely to pay additional property taxes."⁶

While the statements quoted above are but a small sampling of statements by public officials on the CAP law, the Commission feels that they are a representative indication of legislative intent, and were instructive in shaping a perception of that intent. It is interesting to note some contradictions within the statements as to whether property tax levies or expenditures were the direct objective of restraints, and whether restraints were intended to cause a reduction in property taxes or spending, or merely slow their rate of growth.

Of key importance are references to increased state aid and tax reform in conjunction with the enactment of spending limitations. There is clearly a nexus here; the Commission is well aware, as are most parties familiar with State government over the past decade, that the CAP law was not a singular public policy, but was part of a tax reform package. This package or program involved

the first personal income tax ever enacted in New Jersey, the revenues from which were and are constitutionally dedicated to reducing or offsetting property taxes.

Another part of the political scenario at the time the CAP law and tax reform program were enacted was a widening dissatisfaction with government spending and a concomitant trend toward local tax and/or spending limitation reflected in the imposition of some form of such controls in 14 states and the District of Columbia between 1970 and 1977.⁷ This trend was characterized in the public mind by efforts in California resulting in approval of Proposition 13, and while not specifically alluded to in public statements contemporary with the enactment of New Jersey's CAP which were reviewed by the Commission, assumably had some influence on New Jersey policy-makers.

What, therefore, has the Commission synthesized from its consideration of background, circumstances and public statements as to the goals of the CAP law? It seems evident that no single statement will reflect unequivocally the goal(s) of the CAP law. This is so initially because the law applies differently to two different forms of local government, counties and municipalities. But of comparable importance is the lack of public statements or any other evidence from which to derive a concept of necessary or essential local services, which were to be immune to the CAP law.

Given these problems, the Commission has concluded that the goals of the CAP law are generally as follows:

- For municipal government, the CAP law should contribute directly to a reduction in the rate of growth of spending, and indirectly the rate of growth of municipal property taxation;

- For county government, the CAP law should contribute directly to a reduction in the rate of growth of property taxation, and should contribute indirectly to a reduction in the rate of growth of spending;
- For both levels of government, the CAP law was to reach a medium between constraints on spending and taxing growth and the ability to provide essential local services.

The effect on spending and taxing can be statistically examined and demonstrated. The same cannot be said for local government service impact. The Commission had neither sufficient time nor resources to undertake a new empirical study of local service provision to evaluate conclusively the CAP law's impact in this area. Indeed, the fundamental problem posed by the home rule tradition and multiplicity of municipal corporations which characterizes New Jersey may be an insurmountable obstacle to such a study even when undertaken in major proportion over time.

Recognizing that no uniform standards exist for all municipalities to measure the quality of service, the Commission concluded that evidence of the CAP impact on services would have to be obtained in a different way -- from available information and material that gives indications rather than conclusive findings. Accordingly the Commission turned its attention to extensive testimony by municipal and county officials both at various hearings in recent years and in response to questionnaires for information relating to the impact of the CAP on local services. The Commission has no problem or qualms about this approach, since it represents the only practical alternative open to it in its endeavors.

Equitability

In light of time and resource constraints the Commission did not deem it feasible to consider whether the CAP law has been equitable in the accomplishment of its goals. The matter of grouping or segregating local governments, especially municipalities, according to similarities or differences is such a massive undertaking, even assuming that a rational, acceptable methodology for doing so can be developed, as to be prohibitive. That a single policy imposed upon the wide variety of local jurisdictions and communities is likely to result in differing, perhaps unfair impact should be obvious; this has long been acknowledged as a fundamental problem in policy-making. It is questionable whether equity of impact was ever an important consideration of policy-makers at the time the CAP was enacted. The Commission thus avoided expending great time and effort to this consideration.

Part II

The County CAP

Overview: The County in New Jersey Government

A review of the role of county government in New Jersey is a necessary introduction to an assessment of the impact of the CAP law on counties.⁸ While county governments provide a vast array of services to citizens in New Jersey, a dichotomy exists between 'traditional' county services and services of a more locally-oriented nature that are a relatively new feature of county government. 'Traditional' services are services performed at the county level on behalf of, as a surrogate for, or as an extension of, state government. Examples of this type of service are welfare, criminal justice, the judiciary, and long-term care for mental illness. For all practical purposes, these services are state-mandated services, which the counties have little or no administrative control over and no choice but to fund.

That difficulties result from this competition for county resources between traditional, mandated functions and more recent discretionary, local-oriented services should be understood. That the CAP law as it affects counties has been a significant factor in the outcome of this competition will be addressed later in this section.

The County CAP - Rationale and Structure

The Commission has earlier noted the circumstances surrounding enactment of CAPS in 1976, and deduced a sense of the goals of the CAPS. That the county CAP is markedly different from the municipal CAP, and indeed from the state and local school CAP as well, is significant to note. The county CAP is the only CAP that directly limits raising revenue; the other CAPS are on the spending, rather than the revenue side of the budget in question.

The Joint Committee on Tax Policy recognized this distinction in its review of the local CAP law.⁹ Noting that county governments were more uniformly dependent on the property tax as a source of revenue than were municipalities, that group concluded a CAP on the county property tax levy to be reasonable when contrasted with the municipal CAP, when considered for equity of impact among counties, and presumably in evaluating intent and effectiveness.¹⁰

What was not commented upon, and what this Commission notes in passing, is the other distinction between the county and the other levels of government, particularly local, made by the policy makers of the time. Counties received no new or additional revenue as a result of the tax reform program with which to reduce or offset property tax demands. It seems that placing a CAP on counties was intended to prevent them from negating the property tax relief granted by direct payment of rebates to homeowners or aid payments to other

local units of government. That counties laid claim to only about 20% of all dollars raised by property taxation in 1976 was not sufficient reason to omit them from the budgetary limitations that were indispensable to tax reform.

The county CAP enacted in 1976 ¹¹ placed a 5% limitation on the increase in the county tax levy apportioned among a county's constituent municipalities above the previous year's levy, subject to modifications for growth in property tax ratables due to new construction; capital expenditures funded by any source other than property taxes; increases based upon ordinance adopted by two-thirds vote declaring an emergency; all debt service; and expenditures mandated after the effective date of the CAP law pursuant to state or federal law. The original law was amended early in 1977 ¹² to change the term "modifications" to "exceptions", to substitute "resolution" for "ordinance" in reference to emergency appropriations; and to provide an exception for contractual payments to other political subdivisions of the state with respect to use, services or provisions of any project, facility, or public improvement for water, sewer, solid waste, parking, senior citizen housing, or similar purposes or debt service therefore.

Attorney General's Formal Opinion 3 of 1977 set the general framework for the calculation of each county's limitation, after clarifying that the limitation was, in fact, placed upon the property tax levy and not budgeted appropriations. Using the terminology of the original statute, the opinion held that modifications were to be

considered exclusions from the act both in computing the base figure from the previous year upon which the 5% is applied to arrive at the CAP figure, and in determining the expenses to be included within that amount for the current fiscal year.

The county CAP calculation, as administered by the Division of Local Government Services, takes the following mathematical form:

Current year maximum allowable tax levy = 1.05 (previous year actual tax levy - previous year exceptions) + current year exceptions. Stated differently, the previous year's tax levy minus that year's exceptions equals the 'CAP base', or the amount on which 5% is applied; this base is increased by 5% and by the current year's exceptions, resulting in the current year's maximum permissible tax levy.

It must be noted that one exception, the amount of revenue generated from newly constructed real property at the previous year's county tax rate, is not subtracted with the rest of the exceptions to determine the base on which the CAP is applied. This results in a distinction among the enumerated exceptions between "add-on", amounts permanently added to the CAP base, and other exceptions which are not permanently included in the base and thus not augmented by the CAP percentage.

The county CAP and the calculation remained intact until 1981, when two existing exceptions were modified and two new exceptions were provided.¹³ The exception for capital expenditures was expanded to include all current capital expenditures provided that they could otherwise be financed by issuing bonds. The exception for emergency appropriations was modified to include emergency temporary appropriations and 'special' emergency appropriations (funded over 3 or 5 years) as well as 'regular' emergencies already excepted; however, limitations were placed on the aggregate amount of these emergencies which could be excepted from the CAP.

New exceptions were provided for appropriations made to participate in federal or state aid programs and funds received in reimbursement from federal, state or other funds; and for increases in utility and fuel costs above 10% of expenditures in the previous year for those items.

Two separate legislative acts of 1981 resulted in adjustments to the 1982 county CAP calculation in response to changes in state aid policies. The County Welfare Per Capita Cost Limitation Act of 1981¹⁴, which instituted state aid to eight counties in which per capita welfare costs exceed the statewide per capita cost of welfare, required a reduction in the base upon which the county CAP is determined equalling 70% of the funds received by each county in 1981.

The Fiscal Year 1982 Appropriations Law¹⁵ caused another adjustment to each county's CAP base, in this instance an addition. This was done in connection with the state's retaining tax revenue from the Corporation Business Tax Act and the Financial Business Tax Act, formerly paid to county governments, for state use.

Finally, two other exceptions were added by separate legislative acts early in 1982 (affecting counties as well as municipalities). The first act clarified that expenditure increases in collection or disposal of solid waste resulting from fees charged to sanitary landfill owners and operators by county health departments for solid waste enforcement activities were considered mandated by state law after the CAP law's effective date thereby excepted from the CAP. The second act excepted any portion of a lease payment made to a county improvement authority representing a proportionate amount for amortization of authority debt incurred in providing the facility being leased.¹⁶

Effect and Impact

As stated earlier, the Commission concluded that part of the intent of the county CAP was to contribute directly to reducing the rate of growth of county property taxation, and indirectly to reducing the growth of county spending. A review of county property taxation and spending is thus in order to begin an assessment of the effectiveness of the CAP law in accomplishing its goals.

Table 1 reports total county purpose property tax levies for the period 1970 to 1982. As demonstrated by that table, the annual rate of growth in county tax levies in each year since 1976 equaled or exceeded the lowest annual rate of growth between 1970 and 1976 only in the two most recent years (1973 rate of growth is excluded from consideration due to initial receipt of \$44.8 million of General Revenue Sharing that year). Furthermore, a comparison of overall growth for the two six-year periods before and after the CAP law shows a significant decline in the average annual rate of growth, 11.2% from 1970 to 1976 compared with 7.3% from 1976 to 1982.

This information clearly reveals that the CAP law has contributed to a reduction in the rate of growth of county purpose property tax levies on a statewide basis. It also shows that the initial indications of success reported by the 1979 Joint Committee on Tax Policy ¹⁷ were sustained beyond 1978, albeit at a lesser degree during 1981 and 1982.

Impact on Spending

Table 2 reports total county expenditures, exclusive of CETA funds, for the period 1970 to 1982 (budgeted appropriations shown for 1982). CETA funds were excluded to avoid obscuring the overall trend in non-CETA expenditures, since the size of the program varied widely in proportion to total expenditures during the 12 years

TABLE 1

Change in County Purpose Property Tax Levies
1970-1982

<u>Year</u>	<u>Levy</u>	<u>Increase</u>	<u>Percent Increase</u>
1970	\$ 365,347,437	\$ —	—
1971	430,328,035	64,980,598	17.8
1972	472,788,995	42,460,960	9.9
1973	499,788,995	27,000,000	5.7
1974	546,534,809	46,745,814	9.4
1975	615,011,141	68,476,332	12.5
1976	692,199,668	77,188,527	12.6
1977	731,632,876	39,433,208	5.7
1978	764,925,168	33,292,292	4.6
1979	813,681,121	48,755,953	6.4
1980	874,410,256	60,729,135	7.5
1981	963,892,829	89,482,573	10.2
1982	1,054,061,419	90,168,590	9.4

	<u>Amount</u>	<u>Percent</u>	<u>Average Annual Increase</u>
Increase 1970-1976	\$326,852,231	89.5%	11.2%
Increase 1976-1982	361,861,750	52.3	7.3%

Source: Annual Reports of Division of Taxation, Dept. of Treasury, 1970-1981;
1982 State Abstract of Ratables, Div. of Taxation, Dept. of Treasury

TABLE 2

Change in Total County Expenditures
1970-1982
(excluding CETA funds)

<u>Year</u>	<u>Expenditures</u>	<u>Increase</u>	<u>Percent Increase</u>
1970	\$509,546,515	\$	%
1971	570,796,731	61,250,216	12.0
1972	665,917,309	95,120,578	16.7
1973	740,491,103	74,573,794	11.2
1974	806,264,849	65,773,746	8.9
1975	880,259,296	73,994,447	9.2
1976	961,684,610	81,425,314	9.3
1977	1,024,396,460	62,711,850	6.5
1978	1,107,779,017	83,382,557	8.1
1979	1,263,843,754	155,564,737	14.0
1980	1,351,720,116	88,376,362	7.0
1981	1,472,911,618	121,191,502	9.0
1982	1,579,723,852	106,812,234	7.3

	<u>Amount</u>	<u>Percent</u>	<u>Average Annual Increase</u>
Increase 1970-1976	\$452,138,095	88.7%	11.2%
Increase 1976-1982	618,039,242	64.3%	8.6

Source: Annual Reports, Division of Local Government Services, Dept. of Community Affairs, 1970-1980; Adopted county budget, 1981 and 1982

NOTE: 1982 represents budgeted appropriations, not expenditures

examined. Adjusted for CETA, this information shows a lower annual rate of growth in spending for the six-year period following the CAP law than the six-year pre-CAP period, results which expectedly coincide with the same comparison shown for county tax levies in Table 1. The smaller differential in pre-CAP and post-CAP spending growth rates compared with taxing growth rates is indicative of the CAP law's focus on taxing limitations while allowing free use of available non-property tax revenue.

The County CAP law therefore seems successful in achieving its direct and indirect control-oriented goals, contributing to reduced rates of growth in property tax levies and expenditures. However, the apparently diminishing success in meeting the direct goal of property tax levy control, demonstrated by rates of increase of 10.2% and 9.4% in 1981 and 1982 respectively, is important to note.

Effect on Services

The problems of evaluating the CAP law's success in facilitating, or not unduly hampering local government service provision despite taxing/spending control has been discussed earlier in this report. Nevertheless, information is available to suggest whether or not the county CAP has leaned too heavily toward control of taxing/spending at the expense of service provision. The Commission finds it appropriate to review this information on a primarily chronological basis, focusing on two time periods. The first period covers the years 1977-1980, the second period the two most recent years, 1981-1982.

Period One: 1977-1980

Initially, county service provision may not have suffered greatly in 1977 and 1978 under the limitations of the CAP law. The New Jersey Commission on Government Costs and Tax Policy noted in December, 1977 that the impact of the CAP was somewhat mitigated by the new infusion of counter-cyclical federal dollars in 1977.¹⁸ Also, appropriation of surplus funds by counties increased from an aggregate of about \$40 million in 1976 to \$50.3 million and \$59.6 million in 1977 and 1978 respectively, helping to offset limits on the ability to levy property taxes. Finally, as Table 3 demonstrates, counties as a group did not increase taxes to the maximum extent permitted by the CAP law. In 1977, \$11.4 million or 22.5% of the increase allowed by the CAP law, was not levied; in 1978 these figures rose to \$14.4 million and 29.8% respectively.

Nevertheless, warnings of adverse impact surfaced in 1978 when Hudson County, subsequently joined by 15 other counties, filed suit generally alleging that state agencies, particularly the Department of Human Services and the Judiciary, were required to abide by the CAP limitations when submitting budget demands or mandating annual expenditures in county budgets. (The Court did not agree with this argument).¹⁹ Although all counties party to the controversy had adopted 1978 budgets within the statutory requirements of the CAP law, they agreed that they were prevented or at least inhibited from using funds at their discretion for such necessary services as road maintenance, improvement of jails, and other services considered

TABLE 3

COMPARISON OF NEW JERSEY COUNTY TOTAL PROPERTY TAX LEVY,
ALLOWABLE CAP INCREASE AND UNUSED ALLOWABLE LEVY
FOR YEARS 1976 THROUGH 1982

<u>Year</u>	<u>Property Tax Levy</u>	<u>Increases in Levy Over Previous Year</u>		<u>Percent of Allowable Levy Increase Used</u>	<u>Allowable Cap Increase</u>	<u>Unused Allowable Levy</u>
		<u>Amount</u>	<u>Percent</u>			
1976	\$ 692,199,668					
1977	731,632,876	\$39,433,208	5.7%	77.5%	\$50,879,482	\$11,446,274
1978	764,925,170	33,292,294	4.6	70.2	47,440,638	14,148,344
1979	813,681,122	48,755,952	6.4	86.6	56,298,144	7,542,192
1980	874,410,255	60,729,133	7.5	97.8	62,066,535	1,337,402
1981	963,892,829	89,482,574	10.2	94.6	94,605,561	5,122,987
1982	1,054,061,418	90,168,589	9.4	90.3	98,806,602	8,638,013

SOURCE: County Abstracts of Ratables; County CAP calculation sheets, on file with
Div. of Local Government Services, Dept. of Community Affairs.

Note: Amount shown is that for financing general county budget. Excluded are levies
for county libraries and local health service districts.

necessary or desirable. Morris County noted that state-mandated expenses approximated 70% of its budget, while Union County complained that it was forced to utilize virtually all of its surplus to comply with the CAP law, violating good business practice.

This growing problem of state-mandated costs to county government was recognized by the Joint Committee on Tax Policy in its June 1979 report.²⁰ While finding the CAP law to be reasonably structured and rational, the Committee recommended a number of amendments designed to clarify legislative intent rather than expand or change the basis or structure of the law, to achieve a needed "fine-tuning" of the law.²¹ One recommendation, not changing the CAP law itself, but addressing a CAP-related issue, was the adoption of then-pending legislation placing a 5% limitation on increases in rates for Aid to Families with Dependent Children (AFDC), Supplementary Security Income (SSI), and county payments for maintenance of patients in state institutions. This proposal was not intended to directly limit increases in county appropriations for these purposes to 5%; rather, it was intended to shift to the state any costs resulting from rate increases exceeding 5%.

Among other recommendations pertaining to counties made by the Joint Committee at this time were excepting program expenditures reimbursed from federal, state or other sources from the CAP; and extending to counties the exception similar to that enjoyed by

municipalities for federal and state funds, to encourage and enable county governments to fully participate in such programs on a matching as well as reimbursement basis. The Committee noted that this recommendation was expected to place county welfare costs and programs reimbursed through Medicare, Medicare, Blue Cross or private insurers outside the CAP. ²³

Available information suggests that by 1980 the point was reached where the CAP law became a formidable if not prohibitive obstacle to accommodation of both local-oriented discretionary services at desirable levels and state-mandated services. This situation was examined at length and revealed by the County and Municipal Government Study Commission in its twentieth report. ²⁴ This report found that not only had state-mandated costs in 12 areas increased an average of 7% annually from 1975 to 1980, ²⁵ but since 1977, counties on a statewide basis had spent less than 50¢ for local services for every additional dollar consumed by mandates; the average for 1979 and 1980 was 40¢ for local services to every new dollar for mandates. ²⁶ Having compared the amount of state-mandated costs to the amount of the property tax levies, the most significant source of county revenue, the report concluded that flexibility, characterized by the marginal growth in county tax revenue, was consumed by the rising cost of state mandates. Clearly this indicated a declining ability to fund locally-oriented discretionary services. Furthermore, the report demonstrated that in counties of an urban character, such as Camden, Essex, Hudson Mercer, Middlesex, Passaic, and Union, the situation generally described was more serious.

The difficulties caused by the nature and extent of state-mandated expenses, and indications of difficulties in another area were highlighted in litigation involving Passaic County's 1979 budget. In the case of In re Local Finance Board ²⁷, Passaic County officials sought to fund judiciary costs ordered by the assignment judge as an exception mandated after the effective date of the CAP law. The outcome of this case (that such expenses could not be outside the CAP) is less significant than circumstances leading to the controversy. County officials, seeking to comply with the CAP law in the face of rising costs, particularly significant insurance and utility cost increases, and diminishing federal aid, found it necessary to reduce court-related costs through personnel reductions and other cost-cutting measures. The assignment judge interceded by ordering the county to restore court funding to previous levels.

The controversy therefore highlights several areas of increasing concern; the onerous and inflexible nature of state-mandated expenses, the increasing claim on resources by expenses that could be described as necessary costs of doing business or costs over which county officials have little or no control or discretion; and declining non-property tax revenues, particularly from the federal level.

Two other indications exist that suggest the ability of counties to cope with CAP constraints was worsening over time. First, Table 3 shows a rise in the extent to which counties increased taxes to the

maximum permitted by the CAP law, from the low point of 70.2% in 1978 to 86.6% and 97.8% in 1979 and 1980 respectively. By 1980 99.8% of total county property taxes allowed by the CAP were in fact levied. Second, Table 4 shows a disturbing trend regarding county surplus. From 1978 to 1979, counties in the aggregate increased appropriation of surplus by almost \$21 million, while holding the proportionate use of available surplus near by constant (72.6% to 72.1%). However, in 1980, at about the same rate of use (72.6% of available surplus) counties were able to increase aggregate appropriation of surplus by about only \$4 million. Furthermore, in 1980, for the first time since 1977, total appropriation of surplus exceeded the amount generated during the year (excess resulting from operations) and nearly equaled the amount generated the previous year. Indeed, at the beginning of 1981 total surplus available for appropriation was less than in 1979 and 1980 by about \$16.4 million and \$21.3 million respectively. Clearly the ability of counties to use surplus to offset the encroachment of the CAP law on the ability to raise property taxes had eroded by 1981.

TABLE 4
Analysis of County Surplus

	Balance January 1	Excess Resulting from Operations	Subtotal	Appropriated in Budget (\$ and % of balance available)	Balance December 31
1982	\$109,555,203	\$ N/A	\$ N/A	\$ 76,366,874 (69.7%)	\$ N/A
1981	95,499,457	78,642,467	174,141,924	64,586,721 (67.7%)	109,555,203
1980	116,802,650	63,560,860	180,363,510	84,864,053 (72.6%)	95,499,457
1979	111,851,672	85,557,681	197,409,353	80,606,703 (72.1%)	116,802,650
1978	82,158,929	89,334,909	171,493,838	59,642,166 (72.6%)	111,851,672
1977	67,203,049	65,311,376	132,514,425	50,355,496 (74.9%)	82,158,929

TABLE 5

Effective County CAP Rate

	<u>1982</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
Atlantic	18.2%	27.3%	13.4%	7.1%	6.3%	4.1%
Bergen	14.2	10.8	8.3	6.2	8.7	6.8
Burlington	12.1	12.6	12.9	5.7	8.1	14.1
Camden	9.4	15.4	7.2	7.7	7.1	4.7
Cape May	16.6	11.4	11.1	10.9	6.9	11.1
Cumberland	13.0	11.8	7.4	5.8	4.1	6.4
Essex	1.9	7.3	4.1	8.1	.6	5.7
Gloucester	19.6	10.5	7.2	14.5	8.3	5.5
Hudson	6.8	9.1	8.1	6.9	5.8	6.7
Hunterdon	21.6	22.2	10.5	12.7	11.1	5.0
Mercer	7.0	4.7	9.8	4.8	9.5	5.7
Middlesex	13.9	9.2	9.7	5.5	10.2	10.3
Monmouth	12.6	8.0	7.1	2.5	7.0	8.1
Morris	14.6	8.2	6.4	7.6	8.8	5.6
Ocean	12.7	18.4	11.8	9.3	11.1	12.1
Passaic	2.0	14.7	4.5	12.0	6.4	7.7
Salem	14.2	6.6	7.0	8.4	12.3	3.8
Somerset	14.8	10.9	8.1	9.9	9.2	10.4
Sussex	8.0	8.0	8.4	5.9	- 3.1	17.6
Union	12.2	11.3	5.7	7.1	6.2	6.9
Warren	17.3	6.4	7.6	8.3	4.6	6.4

21 County
Aggregate 10.3% 10.8% 7.6% 7.4% 6.5% 7.4%

$$\text{Effective CAP Rate} = \left[\frac{\left[\frac{\text{Current year's maximum allowable levy}}{\text{Previous year's actual levy}} \right] - 1}{\text{or}} \frac{\left[\frac{\text{Current year's allowable levy increase}}{\text{Previous year's actual levy}} \right]}{\right] \times 100$$

Period Two: 1981 - 1982

The final two years' experience under the CAP law can be distinguished from the preceding four years because the first significant amendments to the CAP law became effective in 1981, pursuant to Chapter 56, Laws of 1981. These changes appear to have provided some measure of relief to counties and initially resulted in a significant overall loosening of the CAP as it affected tax levy growth.

Table 1 shows that the first (and only) double-digit percentage increase in county property tax levies (10.2%) since the enactment of the CAP occurred in 1981. The second-highest percentage increase in county property tax levies since 1976 came in 1982, at 9.4%. Table 3 shows a reversal of the trend toward taxing to the maximum extent allowed by the CAP law, another indication that counties attained some belief beginning in 1981. Table 5, entitled "Effective County CAP Rates," again indicates the extent the 1981 amendments to the county CAP loosened the limits imposed by the pre - 1981 CAP law. This table shows the maximum percentage tax levy increase allowed by the CAP over each prior year's actual tax levy, based on information from CAP calculation sheets prepared by the Division of Local Government Services. It emphasizes that the restraining effect of the county CAP law on property tax levy increases diminished, largely as a result of the 1981 amendments, from a fairly stable effective rate of about 7.5% during 1977-1980 to an effective rate in excess of 10% in both 1981 and 1982.

Chapter 56, Laws of 1981 - A Closer Look

The above information reveals that the 1981 amendments resulted in a significantly different county CAP than had existed during the first four years. More detailed examination of those changes is necessary to understand these differences and to gauge the adequacy of this revised county CAP beyond 1982.

The important exceptions newly added to the county CAP law in 1981 were those for current capital appropriations; matching funds for grants; reimbursable expenditures (health care costs or appropriations to hospitals reimbursed by Medicaid); appropriations representing the portion of the county tax levy needed to participate in state or federal programs (welfare and county college costs); and utility cost increases above 10 percent of previous year's expenditures. The use of these new exceptions by counties and their integration into the CAP calculation as administered by the Division of Local Government Services is crucial to understanding the impact of this revision of the CAP law.

Counties did not take immediate advantage of all the new exceptions allowed in 1981 in that year, and as a group continued to be inconsistent in the use of those exceptions through 1982. Furthermore, the exceptions were not integrated into the CAP calculation in a uniform manner, as described in Attorney General Formal Opinion No. 3 of 1977. Of the new exceptions, capital appropriations and appropriation of matching funds for grants were not subtracted from the prior year's tax levy in arriving at the CAP base; but, beginning in 1981 current appropriations for those purposes were added in computing the current year maximum tax levy. Reimbursable expenses and appropriations to participate in state and federal programs were handled in the fashion described by the Attorney General Opinion No. 3 (utility cost increases need not be considered here, since only certain increases were CAP exceptions). Therefore, if capital and matching fund appropriations were included in a county's CAP base, the amount of those

appropriations became taxing leeway for other purposes, and future appropriations for capital and matching funds were excepted from the CAP.

This is not intended to be critical of the Division of Local Government Services. The Commission believes the Division acted correctly in applying Chapter 56 through its differential treatment of these new exceptions, for the appropriations handled to the letter of the Attorney General's opinion are considerably larger in size than the appropriations not so treated. Had all new exceptions been treated as 'true' exceptions, little CAP relief would have resulted from Chapter 56; had they all been treated as were capital and matching funds, the CAP law would have been far more liberal in 1981 and 1982 than could have been the intent of the Legislature.

The following tables 6 through 9 reproduce in slightly condensed form the county CAP calculations for 1981 and 1982. The column entitled Chapter 56, P.L. 1981 includes all the major exceptions added by that law except capital appropriations, which are stated in a separate column (this column also includes amounts appropriated as deferred charges to future taxation, representing funding of capital ordinances, formerly excepted as debt services prior to 1981). These tables illustrate two points: first, initially sporadic use of exceptions provided by Chapter 56, still not comprehensive in 1982; second, and more important, the impact that these exceptions had when used more thoroughly in 1982. In just two years, these new exceptions, exclusive of capital, displaced debt service appropriations as the most significant county CAP exception. In addition, Chapter 56 caused the county CAP base- the amount in which the CAP percentage is applied before including other exceptions - to decrease from an average of about 74% in 1981 to about 59% in 1982.²⁸

TABLE 6
1981 Preliminary County CAP Calculation

County	1980 Levy	Debt Service	Def. Charges (Capital)	Mandated After 1976	Vocational School	Ch. 56 PL 1981	Other	Total Exceptions
Atlantic	\$ 24,657,278	\$ 2,168,148	\$ -	\$ 10,000	\$ 1,392,000	\$ -	\$ -	\$ 3,570,148
Bergen	80,432,000	13,290,236	-	1,034,100	6,553,000	-	88,500	20,965,836
Burlington	32,797,593	2,776,350	-	201,476	3,470,863	-	-	6,448,489
Camden	69,295,977	7,030,022	172,939	420,963	3,871,555	11,058,648	152,311	22,706,439
Cape May	15,429,821	1,456,838	230,000	127,734	985,180	-	33,279	2,833,031
Cumberland	14,486,935	1,532,571	-	70,000	297,180	-	-	1,899,751
Essex	138,462,125	9,017,963	-	578,826	4,391,688	-	1,759,704	15,748,161
Gloucester	19,123,661	1,476,525	-	98,200	942,122	-	47,190	2,564,037
Hudson	63,236,632	4,050,110	-	365,000	3,235,873	-	-	7,650,983
Hunterdon	9,269,000	599,000	20,000	45,000	45,000	-	-	709,000
Mercer	47,211,951	5,340,271	18,000	139,541	1,899,141	-	1,489,257	8,886,210
Middlesex	75,301,537	10,621,815	2,314	754,035	6,895,227	-	97,600	18,370,991
Monmouth	52,727,067	4,223,555	-	219,555	1,975,317	-	-	6,418,427
Morris	42,953,815	5,986,722	-	171,240	445,600	-	155,740	6,759,303
Ocean	33,430,068	3,772,406	2,083,500	580,833	1,978,931	-	414,591	8,830,261
Passaic	47,706,186	3,135,342	-	578,819	2,500,541	-	2,500,532	8,715,234
Salem	8,333,021	348,634	-	204,111	697,500	-	52,000	1,302,245
Somerset	25,734,722	4,587,335	-	151,300	2,575,000	-	385,637	7,699,272
Sussex	12,258,959	651,833	2,183,200	137,898	-	-	-	2,972,931
Union	53,494,200	4,112,005	39,259	347,233	772,500	-	-	5,270,996
Warren	8,067,667	522,459	-	210,069	1,000	-	-	733,528
Total	\$874,410,255	\$ 86,700,140	\$ 4,749,212	\$ 6,445,933	\$ 44,925,018	\$ 11,058,648	\$ 7,176,341	\$161,055,293
of Total Exceptions		53.8	2.9	4.0	27.9	6.9	4.5	100

Source: County cap calculation sheets 1981.
Note: Detail may not add due to rounding.

Table 7

1981 Final County CAP Calculation

County	Amount on which CAP Applied	%	Ratables	Debt Service	Capital	Mandated After 1976	Vocational School	Ch. 56 Pl. 1981	Other	Total Add-ons/Exceptions	Maximum Levy	Percent of Levy Subject to CAP
Atlantic	\$ 21,067,130	\$ 1,054,357	\$ 2,574,113	\$ 4,181,437	\$ 1,800,000	\$ 167,486	\$ 2,326,000	\$ 562,768	\$ 327,000	\$ 10,303,393	\$ 31,390,523	71.1 %
Bergen	59,466,164	2,983,308	942,235	13,138,503	-	2,973,663	6,939,649	-	-	29,667,126	89,133,290	66.7
Burlington	26,349,104	1,317,455	490,665	4,738,475	-	528,162	3,512,856	-	-	10,587,613	36,936,717	71.9
Canden	46,589,539	2,329,477	1,222,220	7,955,292	324,500	2,661,846	4,188,521	12,834,365	1,841,724	33,357,944	79,947,483	58.4
Cape May	12,596,790	629,840	302,591	1,818,324	475,494	234,396	1,034,364	95,404	-	4,590,413	17,187,203	73.3
Cumberland	12,587,184	629,359	200,885	1,548,529	212,557	584,376	339,757	86,587	-	3,602,049	16,189,233	77.8
Essex	122,713,963	6,135,698	2,199,011	8,899,689	707,500	655,277	5,674,186	1,186,002	395,554	25,852,918	148,566,881	83.9
Gloucester	16,559,624	827,981	482,415	2,082,471	-	171,025	995,061	-	15,000	4,573,953	21,133,577	78.4
Hudson	55,585,649	2,779,282	663,277	4,138,602	534,000	560,000	5,290,941	-	134,121	13,432,103	69,017,752	80.7
Hunterdon	8,560,000	428,000	214,502	1,198,000	-	166,219	30,000	64,593	-	2,769,435	11,329,435	75.6
Mercer	38,325,741	1,916,287	500,965	6,272,673	18,000	258,694	2,131,349	-	22,010	11,119,978	49,445,719	77.5
Middlesex	56,930,546	2,846,527	1,636,234	10,935,146	1,102,000	1,141,549	7,987,358	-	-	25,323,814	82,254,360	69.6
Morristown	46,308,640	2,315,432	1,012,790	4,312,259	-	705,895	2,286,626	-	-	10,633,003	56,941,643	81.3
Morris	36,194,513	1,809,726	1,064,060	6,028,603	-	466,333	610,588	-	308,900	10,288,208	46,482,721	77.9
Ocean	26,599,806	1,229,990	824,274	6,056,213	2,948,900	915,283	2,167,000	250,100	590,309	14,982,069	39,581,875	62.1
Passaic	36,990,952	1,949,548	597,980	4,563,059	1,300,000	1,158,115	2,700,000	1,253,971	2,198,000	15,720,673	54,711,625	71.3
Salem	7,030,776	351,539	47,177	399,964	-	295,442	740,000	14,000	-	1,848,122	8,878,898	79.2
Somerset	18,035,450	901,773	626,657	5,467,152	200,000	242,480	2,780,000	273,491	-	10,491,559	28,527,009	63.2
Sussex	9,286,028	464,301	215,913	59,579	3,025,235	188,635	-	-	-	3,953,664	13,239,692	70.1
Union	48,223,203	2,411,160	388,443	5,777,726	650,000	441,875	1,252,500	395,750	-	11,317,455	59,540,658	81.0
Warren	7,334,159	366,708	116,436	746,100	-	13,213	6,550	-	-	1,249,008	8,583,167	85.4
Total	\$713,354,961	\$35,677,748	\$16,322,843	\$100,317,796	\$13,298,186	\$14,529,964	\$52,593,306	\$17,092,031	\$5,832,618	\$255,664,500	\$969,019,461	74.11%(a) 74.0 -(b)

Percentage of
Total Add-ons/
Exceptions

100

2.3

6.7%

20.6%

5.7%

5.2%

39.2%

6.4%

13.9%

(a) 21-county average
(b) 21-county aggregate

TABLE 8
1982 Preliminary County CAP Calculations

County	1981 Levy	Add Adjust. for Revenue Loss	Debt Service	Capital	Mandated After 1976	Vocational School	County Welfare Aid Adjust.	Ch. 56 PL 1981	Other	Total Exceptions
Atlantic	\$ 29,637,654	\$ 217,564	\$ 4,181,437	\$ -	\$ 167,486	\$ 2,326,000	\$ 685,262	\$ 20,297,055	\$ -	\$ 7,360,185
Bergen	89,129,645	1,148,111	13,138,503	1,800,000	2,973,663	6,939,649	-	-	327,00	45,475,870
Burlington	36,650,684	267,323	4,738,475	-	528,162	3,512,856	-	-	-	8,779,493
Camden	79,755,047	445,408	7,955,292	324,500	2,661,846	4,188,521	1,256,256	26,810,071	1,841,724	45,038,210
Cape May	17,187,194	89,835	1,818,324	475,454	234,396	1,034,364	-	1,742,064	-	5,304,642
Cumberland	16,189,233	118,616	1,548,529	212,557	584,376	339,757	315,042	5,316,040	-	8,316,301
Essex	146,316,143	1,305,514	8,899,689	707,500	655,277	5,674,186	4,964,463	7,121,375	395,554	28,418,044
Gloucester	21,133,577	134,964	2,082,471	-	746,175	995,061	-	5,657,079	15,000	9,495,786
Hudson	68,860,950	398,610	4,138,602	-	636,103	5,288,705	2,158,647	3,417,106	-	15,639,163
Hunterdon	11,329,000	90,831	1,198,000	534,000	166,219	30,000	-	1,345,069	134,121	3,407,409
Mercer	49,445,719	355,913	6,272,673	18,000	258,694	2,131,349	393,975	12,559,244	22,010	21,655,945
Middlesex	81,770,737	443,861	10,935,146	1,102,000	1,141,549	7,587,358	-	21,480,958	-	42,247,011
Monmouth	56,941,643	462,551	4,312,259	200,000	705,895	2,286,626	-	14,980,938	-	22,485,718
Morris	46,482,721	442,495	6,028,603	-	466,333	610,588	-	5,483,067	308,900	12,897,491
Ocean	39,581,875	289,228	6,056,213	2,948,900	915,283	2,167,000	-	3,155,850	590,309	15,833,554
Passaic	54,711,596	672,424	4,563,059	1,300,000	1,158,115	2,700,000	716,247	13,580,567	2,198,000	26,215,988
Salem	8,878,898	77,740	399,964	-	295,442	740,000	9,627	14,000	-	1,459,033
Somerset	28,527,000	181,863	5,467,152	200,000	242,480	2,780,000	-	3,393,291	-	12,082,923
Sussex	13,239,690	91,837	59,579	3,025,235	188,635	-	-	8,851,932	-	3,273,449
Union	59,540,658	509,058	5,777,726	650,000	441,875	1,252,500	-	-	-	16,974,034
Warren	8,583,167	98,096	586,100	160,000	1,063,560	6,550	-	273,880	-	2,090,090
Total	\$963,892,831	\$ 7,841,842	\$100,157,796	\$ 13,658,186	\$ 16,231,544	\$ 52,591,070	\$ 10,499,519	\$155,479,586	\$ 5,832,618	\$354,450,339

% of Total
Exceptions

100%

43.8%

3.0%

14.8%

4.6%

3.9%

28.3%

N/A

1.6%

Source: County cap calculation sheets 1982.
Note: Detail may not add due to rounding.

TABLE 9
1982 COUNTY CAP CALCULATION

	Amount On Which CAP Applied	Add-ons/Exceptions										Percent of Levy Subject to Cap
		%	Retables	Debt Service	Capital	Handated After '76	Vocational School	Ch. 56 P.L. 1981	Other	Total Add-ons/ Exceptions	Maximum Levy	
Atlantic	22,495,033	1,124,752	2,882,912	5,340,039	100,000	386,604	2,510,269	---	1,000	12,545,576	35,040,609	64.5%
Bergen	44,801,887	2,240,095	1,187,958	16,036,775	1,615,600	3,982,004	7,419,818	24,501,887	0	56,984,136	101,786,023	44.0
Burlington	28,138,514	1,406,926	497,402	6,438,910	448,515	628,144	3,512,856	---	0	12,932,753	41,071,267	70.3
Camden	35,162,244	1,758,112	1,724,836	10,591,004	1,066,492	1,598,127	4,865,752	30,317,840	131,000	52,053,163	87,215,407	40.3
Cape May	11,972,386	598,619	424,285	2,001,950	1,479,478	343,914	1,195,834	1,900,944	128,926	8,073,951	20,046,338	60.0
Cumberland	7,991,549	399,577	258,512	2,085,628	50,000	697,119	392,820	6,377,627	39,600	10,790,882	18,292,431	43.7
Essex	119,203,613	5,960,181	1,552,627	9,006,701	650,000	382,213	4,841,836	7,563,000	0	29,956,557	149,160,171	81.5
Gloucester	11,772,756	588,638	371,297	2,403,123	235,480	1,076,844	1,066,630	6,332,782	1,400,000	13,494,193	25,266,949	49.7
Hudson	53,620,396	2,681,020	1,040,109	4,955,327	350,000	1,008,592	5,560,132	4,323,199	0	19,912,380	73,532,776	73.0
Hunterdon	8,012,422	400,621	258,068	2,831,000	304,000	155,509	35,000	1,532,418	231,938	5,768,554	13,780,977	60.3
Maricopa	28,145,688	1,407,284	579,660	6,135,062	8,000	142,405	2,468,024	14,030,044	0	24,770,478	52,916,166	54.0
Middlesex	39,967,587	1,946,379	1,919,822	12,334,255	1,234,929	1,655,141	9,147,790	24,588,776	252,000	53,161,093	93,128,679	43.0
Norfolk	34,918,476	1,745,924	1,075,581	4,406,607	2,052,819	966,172	3,025,351	15,906,916	0	29,179,970	64,098,446	54.5
Warren	34,027,725	1,701,306	1,033,086	6,565,224	579,000	671,805	892,593	7,774,513	308,900	19,247,507	53,275,232	64.6
Ocean	24,037,549	1,201,877	718,335	5,958,146	585,000	817,634	2,700,000	3,960,571	250,000	20,171,563	44,209,113	54.4
Passaic	29,168,033	1,438,402	435,326	5,884,796	575,000	1,401,590	2,835,000	14,073,159	0	26,663,263	55,831,295	52.3
Salem	7,497,605	374,880	43,321	619,529	473,869	364,642	768,904	---	0	2,645,246	10,142,751	80.3
Somerset	16,525,939	831,297	763,878	6,439,215	640,000	317,392	3,025,000	4,083,970	0	16,120,752	32,746,692	50.8
Sussex	10,058,078	502,904	209,058	573,354	2,715,905	236,826	---	---	0	4,238,047	14,296,125	70.4
Union	43,075,683	2,153,784	454,362	6,088,431	1,550,000	884,092	1,378,000	10,519,000	690,000	23,717,670	66,793,352	64.5
Warren	6,591,172	329,559	60,447	965,658	277,757	1,251,040	8,000	585,000	0	3,477,460	10,068,632	65.5
Total	617,284,335	30,864,217	17,490,882	117,860,733	20,912,799	18,791,845	57,649,609	178,411,646	3,433,364	445,415,094	1,062,699,431	58.6%

% of Total
Add-ons/
Exceptions

6.9% 3.9% 26.3% 4.7% 4.2% 12.9% 40.1% 0.8% 100.0%

Source: County cap calculation sheets 1982.
Note: Details may not add due to rounding.

(a) 21 county aggregate, (b) 21 county average

The County CAP Paradox

The changes caused by Chapter 56, Laws of 1981 were certainly important to counties' ability to maintain service provision under the constraints of the CAP law in 1981 and 1982. The relief accorded them through exception of large areas of expenditures such as hospital, welfare and county college costs is significant, and contributed to a lessening of the problem caused by state-mandated costs discussed earlier in this report. However, despite these changes and the double-digit statewide property tax levy growth permitted as a result of them, the conclusion cannot be drawn that counties no longer have problems functioning under the CAP law.

Mention has been made earlier of the importance of non-property tax revenues in offsetting the CAP law's constraints on taxing ability to forestall service cuts. The availability of revenue from the state and federal government beyond 1982 is very much in question - many would claim the reduction in aid from both sources is a foregone conclusion. The county surplus situation, shown by Table 4, indicates some improvement since 1980-1981, but it cannot safely conclude that improvement will continue.

In addition to these key concerns, further analysis of the 1982 county CAP situation by the Commission raises more concern over the adequacy of the CAP law as presently constructed to allow service provision at desirable levels, notwithstanding the relative loosening of tax levy constraints in 1981 and 1982.

The Commission undertook a reconstruction of the county CAP as it relates to appropriations to better assess its current impact on county budgeting. This analysis attempts to compare the increase allowed counties in taxing ability to leeway allowed in incremental budget growth, and is shown in the following two tables, Tables 10 and 11.

This analysis stems from the concept that allowable CAP growth (leeway) can be divided into two categories: discretionary CAP leeway, or taxing growth which results from the percentage (5%) increment and the ratable growth add-on, and which may be appropriated for any lawful purpose; and non-discretionary leeway, or taxing ability which results only from appropriation of funds to purposes excepted from the CAP, i.e. debt service, capital, or costs of participation in state or federal programs. The analysis begins by subtracting appropriations for items excepted from the CAP from total budgeted appropriations for the year 1981; the result may be termed '1981 budget subject to (or not excepted from) the CAP.' This figure is then compared to the growth in taxing ability allowed in the following year by discretionary CAP leeway - 5% of the base on which the CAP is applied plus leeway resulting from ratable growth.

The analysis shows that for 1982 the 21 counties, in the aggregate, could have funded increases in all budgetary items not excepted from the CAP (78% of aggregate county budgets) by only about 4% by levying property taxes to the maximum permitted by the CAP law. That is, by using the largest

TABLE 10

County CAP Analysis: Discretionary CAP leeway
in relation to appropriations subject to CAP

County	(1)	(2)	(3)	(4)	(5)
	1981 Appropriations	1981 'CAP' Exceptions	1981 Budget Subject to CAP (Col.1-Col.2)	1982 Discretionary Leeway	Percentage Col.4÷Col.3
Atlantic	\$ 54,262,496	\$ 7,360,185	\$ 46,902,311	\$ 4,007,664	8.5%
Bergen	163,497,898	45,475,870	118,022,028	3,428,053	2.9
Burlington	58,251,325	8,779,493	49,471,832	1,904,328	3.8
Camden	119,841,933	45,038,210	74,803,723	3,482,948	4.7
Cape May	27,004,294	5,304,642	21,699,652	1,022,904	4.7
Cumberland	31,784,258	8,316,301	23,467,957	658,089	2.8
Essex	265,126,675	28,418,044	236,708,631	7,512,808	3.2
Gloucester	34,895,744	9,495,786	25,399,958	959,935	3.8
Hudson	130,389,106	15,639,163	114,749,943	3,721,129	3.2
Hunterdon	15,310,478	3,407,409	11,903,069	658,689	5.5
Mercer	68,901,700	21,655,945	47,245,755	1,986,944	4.2
Middlesex	124,519,850	42,247,011	82,272,839	3,918,201	4.8
Mommouth	94,322,001	22,485,718	71,836,283	2,821,505	3.9
Morris	70,412,490	12,897,491	57,514,999	2,734,472	4.8
Ocean	65,418,357	15,833,554	49,584,803	1,920,212	3.9
Passaic	86,411,099	26,215,988	60,195,111	1,893,728	3.1
Salem	17,347,624	1,459,033	15,888,591	418,201	2.6
Somerset	40,272,743	12,082,923	28,189,820	1,595,175	5.7
Sussex	21,811,973	3,273,449	18,538,524	711,962	3.8
Union	108,452,739	16,974,034	91,478,705	2,608,146	2.9
Warren	14,995,415	2,090,090	12,905,325	390,006	3.0
Total	\$1,613,230,198	\$354,450,339	\$1,258,779,859	\$48,355,099*	3.8%(a) 4.1%(b)
			(78.0%)		

(78.0%)

(a) 21-county aggregate
(b) 21-county average* CAP percentage increase: \$30,864,217
(2.4%), Ratable growth: \$17,490,882
(1.4%)

TABLE 11

County CAP Analysis: Discretionary CAP leeway
in relation to appropriations subject to CAP

(1)	(2)	(3)	(4)	(5)	(6)	
Budget	1982 Exceptions	1982 Budget Subject to CAP (Col.1-Col.2)	1981 Levy Minus Excep- tions: Amount on which 1983 CAP applied	5%	Percentage Col.5 ÷ Col.3 Allowable growth from levy before ratable add-on	County
\$ 54,468,428	\$ 8,537,912	\$ 45,930,516	\$ 26,349,784	\$ 1,317,489	2.9%	Atlantic
164,869,166	53,556,083	111,313,083	48,228,813	2,411,441	2.2	Bergen
59,582,097	11,028,425	48,553,672	28,979,864	1,448,993	3.0	Burlington
126,362,390	48,570,215	77,792,175	38,629,563	1,931,478	2.5	Camden
28,840,142	7,051,047	21,789,095	12,950,283	647,514	3.0	Cape May
32,147,886	9,642,793	22,505,093	8,649,638	432,482	1.9	Cumberland
264,527,746	22,443,749	242,083,997	123,859,438	6,192,972	2.6	Essex
37,080,382	12,534,258	24,546,124	11,169,385	558,469	2.3	Gloucester
129,293,829	16,191,251	113,102,578	57,309,264	2,865,463	2.5	Hudson
17,845,046	5,109,865	12,735,181	8,170,014	408,501	3.2	Hunterdon
73,375,691	22,783,534	50,592,157	29,304,700	1,465,235	2.9	Mercer
130,843,616	49,242,892	81,600,724	43,778,877	2,188,944	2.7	Middlesex
94,940,017	26,358,465	68,581,552	37,739,981	1,886,999	2.8	Monmouth
76,030,564	16,513,035	59,517,529	36,133,652	1,806,683	3.0	Morris
65,732,669	18,251,351	47,481,318	25,933,756	1,296,688	2.7	Ocean
81,548,043	24,769,535	56,778,508	31,046,756	1,552,338	2.7	Passaic
16,645,937	2,226,945	14,418,992	7,112,186	355,609	2.5	Salem
44,538,289	14,525,577	30,012,712	18,220,423	911,021	3.0	Somerset
23,297,908	3,526,085	19,771,823	10,770,040	538,502	2.7	Sussex
97,442,737	21,109,524	76,333,213	45,683,828	2,284,191	3.0	Union
17,141,628	3,087,454	14,054,174	6,981,178	349,059	2.5	Warren
\$1,636,554,211	\$397,059,995	\$1,239,494,216	\$657,001,423	\$32,850,071	2.7%(a) 2.7%(b)	Total

(75.7%)

(a) 21-county aggregate.

(b) 21-county average.

source of revenue available, to the greatest degree permitted by the CAP law, county governments could budget for a 4% increase for nearly four-fifths of their budget. Taxing leeway generated by the CAP percentage alone could fund about a 2.5% increase, with the ratable growth add-on funding about a 1.5% increase.

Projected forward, this analysis shows that in 1983 the CAP law will permit about 2.7% increase in about 76% of total county budgets, before add-ons for ratable growth are taken into consideration.

The problem of restricted budgetary growth available from the property tax will differ in extent depending on the proportion of categorical state and federal aid in each county's budget, and the purposes for which the aid is used. The greater the proportion of aid, the less serious the problem highlighted above will be, as long as the aid continues to be available. However, if the federal and state categorical aid decreases, the problem of limited budgeted growth allowed from the property tax intensifies if the need or demand continues for the services provided. The prospects for growth in non-property tax own-source revenues as well as categorical aid are not encouraging.

This analysis illustrates the effect the CAP law is likely to have on counties if continued as is beyond 1982. Despite permitting double-digit rates of property tax levy increase, the CAP law lacks the flexibility necessary to sustain both state-mandated service provision and locally-oriented discretionary service provision by counties beyond 1982 unless significant growth occurs in non-property tax sources of revenue.

Revisions are necessary to increase the flexibility of the CAP formula and to facilitate continued county provision of both state-mandated and locally oriented discretionary services.

Part III

The Municipal Cap

Rationale and Structure

The Commission's review of the general circumstances surrounding enactment of CAPS in 1976 and the goals of the CAP law can be found in the introduction to this report. Further emphasis of certain points highlighted by the Joint Committee on Tax Policy in its 1979 report is useful to gain a sharp focus and clearer understanding of the municipal CAP before proceeding with a detailed description of the municipal CAP structure.

The Joint Committee stressed the experimental basis on which the CAP law was first enacted, with an original expiration date of December 31, 1979. It stressed as well that the concept of imposing financial limitations on local government was a novel approach to controlling increases in the local property tax.²⁹ Presumably the Joint Committee meant the entire CAPS concept was new to New Jersey; both constitutional and statutory limitations on local property taxes were then and are now common in the United States. The more important novelty of New Jersey's approach to the concept was the imposition of restraints on municipal expenditures, rather than directly upon components of property taxation, i.e. base, rate, or levy.

The fact that the municipal CAP was imposed on spending rather than the tax levy was underscored by the Joint Committee in contrast to the county CAP. It concluded that the reason for this difference stemmed from the respective revenue structures of the two levels of government. The

local property tax then ranged from between 50 and 70 percent of total county revenue, while in the case of municipalities, it ranged from between zero and 90 percent of total revenue. Given this uniformity of county dependence on property taxes for revenue, and a desire for equitable impact, the CAP directly on the county property tax levy seemed reasonable. Given the dramatic difference among municipalities in reliance upon the property tax for revenue, a municipal CAP on the levy would be extremely harsh in some cases and without effect in others. Thus a CAP on municipal expenditures would be less inequitable and more appropriate.³⁰

The municipal CAP law enacted in 1976³¹ placed a 5% limitation on the increase in final appropriations of each municipality over the previous year subject to modifications for growth in property tax ratables due to new construction; capital expenditures funded by any source other than the local property tax; programs funded wholly or in part by federal or state funds; increases based on ordinances declaring emergency situations, approved by at least two-thirds of the governing body and approved by the Local Finance Board, not exceeding three percent of current operating appropriations and utility operating appropriations; all debt service; amounts required to fund a preceding year's deficit; amounts reserved for uncollected taxes; expenditures mandated after the effective date of the CAP law pursuant to state or federal law; expenditure of amounts derived from new or increased service fees imposed by ordinance, or derived from the sale of municipal assets;

and amounts approved by referendum. Municipalities having a municipal purposes tax levy of \$0.10 or less per \$100.00 were exempt from the CAP law.

The original law was amended early in 1977 ³² to change the term "modifications" to "exceptions", and to provide an exception for contractual payments to other political subdivisions of the state with respect to use, services or provisions of any project, facility or public improvement for water, sewer, solid waste, parking, senior citizen housing, or similar purpose or debt service therefore.

Attorney General's Formal Opinion No. 3 of 1977 set the general framework for the calculation of each municipality's limitation, as well as clarifying many unclear areas of the municipal CAP law. Using the terminology of the original statute, the opinion held that modifications were to be considered exclusions from the act both in computing the base figure from the previous year upon which the 5% is applied to arrive at the CAP figure, and in determining the expenses to be included within that amount for the current fiscal year. That is, the final line item of appropriations in a municipal budget, minus all expenses excluded as modifications (along with transfers to local boards of education, already subject to CAPS on local school budgets) equals the base amount to which 5% and modifications are added to determine the amount permissible for the new year's final appropriations.

The municipal CAP calculation, as administered by the Division of Local Government Services, takes the following mathematical form:

Current year maximum allowable appropriations = 1.05 (previous year total appropriations - previous year exceptions) + current year exceptions. Stated differently, the previous year's total appropriations minus the amount of that year's exceptions equals the "CAP base", or the amount to which the 5% is applied; this base is increased by 5% and by the amount of current year's exceptions, resulting in the current year's maximum permissible total appropriations.

It must be noted that as initially administered certain exceptions were not subtracted from final appropriations to determine the base on which the CAP is applied, notwithstanding Attorney General's Formal Opinion No. 3. These exceptions were the amount of revenue generated from newly constructed real property at the previous year's tax rate; amounts of revenue derived from new or increased service fees imposed by ordinance; amount of revenue derived from the sale of municipal assets; and amounts approved by referendum. This resulted in a distinction among the enumerated exceptions between "add-ons", amounts permanently added to the CAP base, and other exceptions which are not permanently included in the base and thus not augmented by the CAP percentage.

Except for an extension of the life of the statute through 1982, the municipal CAP and the calculation remained as enacted until mid-1980, when a number of developments occurred that will be discussed subsequently.

In the interim, a number of court decisions and Attorney General's formal and advisory opinions clarified different aspects of the municipal CAP. These decisions and opinions dealt primarily with controversy over what constituted expenditures mandated after the effective date of the CAP law pursuant to state and federal law. The three most significant court cases in this area each held that employee wage and benefit increases resulting from compulsory arbitration proceedings could not be considered CAP exceptions on the basis of being a post-CAP law mandate. ³³

Another case, that of City of Clifton v. Laezza ³⁴ clarified that the CAP add-on for new growth in ratables was properly computed by applying the local purposes tax rate, not the entire general tax rate, to the value of newly constructed improvements.

Another court decision of note held that a municipal altering its method of funding library costs from participation in a county library system to a joint municipal public library was entitled to an augmentation of its CAP 'base' to facilitate such change without sacrificing other municipal services. The court ordered that the amount generated in property taxes under the county system, not previously reflected in the municipal budget, could be added to the CAP "base", providing additional spending authorization within which to meet costs of the joint library which now had to be included in the municipal budget. ³⁵

In 1980, an amendment to the CAP law was made excepting from the CAP payments required by municipalities constituting the Hackensack Meadowlands

District to the intermunicipal account establishing for tax-sharing purposes.³⁶ This amendment, justified on the basis that this expense was beyond the control of the concerned governments, had no impact on municipalities outside the district and was thus of minor significance.

Late in 1980 the Attorney General rendered two opinions on the municipal CAP with serious implications for many municipalities. The first of these two opinions, Formal Opinion No. 21 applied to municipal recipients of Urban Aid and addressed the treatment for CAP purposes of moneys received as such by those municipalities. The Division of Local Government Services had required appropriation of Urban Aid funds within the CAP, not as an exception to the CAP. In Formal Opinion No. 21, the Attorney General ruled otherwise, finding that these funds clearly constituted state aid to be appropriated as an exception to the CAP beginning in 1981. This would necessitate deduction of the previous year's appropriation of these funds from final appropriations to determine the CAP "base", and a loss of the 5 percent increment on this amount for 1981, and would also involve deduction of the 5 percent increments of those funds added to CAP "bases" in prior years in which these funds were included in municipal budgets. In addition, this opinion would have the effect of overturning language in the state 1980-81 Appropriations Law which permitted these funds to be appropriated in 1980 as a CAP exception without deduction of the amount of such funds budgeted the previous year from final appropriations in computing the CAP "base".³⁷

The second opinion was Formal Opinion No. 23 of 1980, addressing the CAP exception for expenditures of funds derived from the sale of

municipal assets. The Division of Local Government Services had treated funds so derived as CAP "add-ons" rather than exceptions. In Formal Opinion 23, the Attorney General held this to be improper, ruling the sale of assets funds should be treated as exceptions not permanently added to the CAP "base". The opinion noted the contrary treatment of such amounts by the Division of Local Government Services since the inception of the CAP law, and the potential disruption in municipalities which relied upon the Division's past handling of the matter which would arise through corrective alteration of 1981 CAP calculations. Such alteration would involve deduction of proceeds from sale of assets added to CAP "bases" since 1977 from final appropriations, along with 5 percent increments thereon, in determining 1981 permissible final appropriations. The opinion expressed the expectation that redress would be sought in the Legislature.

Significant amendments were made to the municipal CAP law in 1981, some related to these Attorney General's opinions and some unrelated. In direct reaction to Formal Opinion No. 21 on Urban Aid funds, an amendment to the CAP law was enacted which required each municipality receiving such funds in 1981 to treat them in the same fashion as in 1980 for purposes of the CAP calculation. Municipalities receiving Urban Aid funds for the first time in 1981 or thereafter were allowed to appropriate them as a CAP exception in the first year of receipt only, with the amount received added to the CAP "base" in the following year and appropriated within the CAP from then on.

In reaction to Formal Opinion No. 23 on proceeds from sale of municipal assets, an amendment to the CAP law was enacted clarifying the method of computing the municipal CAP in light of differentiation between CAP "add-ons" and "true" exceptions. This amendment stipulated that proceeds of sale of municipal assets should be considered a "true" CAP exception, as per Formal Opinion No. 23, beginning in 1981. It provided that sale of assets proceeds previously treated as CAP "add-ons" should remain as such, thereby negating that portion of the opinion regarding corrective alteration in 1981 CAP calculations. In addition, the amendment formalized the treatment of other enumerated exceptions - those based on ratable growth, new or increased services fees imposed by ordinance, and referenda to exceed the CAP - as CAP "add-ons" rather than "true" exceptions for past, current and future years. This amendatory law also carried another substantive provision affecting the municipal CAP calculation. It required deductions in CAP "bases" after 1981 in situations where municipalities transfer functions or services funded in municipal budgets to municipal public utilities, authorities or special districts, which are unaffected by any spending or taxing limitations law. 39

Other substantive changes to the municipal CAP law were enacted in 1981 pursuant to Chapter 56, Laws of 1981. This law expanded the existing exception for capital expenditures to include all appropriations for current capital expenditures, provided the purpose for which a current appropriation is provided also be eligible for financing by issuance of

bonds. It revised the exception for emergency appropriations, eliminating the need for approval by ordinance and encompassing certain emergency temporary appropriations and emergencies funded over three-and five-year periods. Added as new exceptions were amounts received or to be received from federal, state or other funds in reimbursement for local expenditures, and amounts expended to fund increases in various public utility or energy-related costs exceeding a 10% increase over the previous year's costs. Also, a provision was added prohibiting transfers of funds otherwise allowed by law from line items of appropriations excepted from the CAP to line items subject to the CAP.

One further change in the municipal CAP law affecting 1981 municipal budgets was made under Chapter 155, Laws of 1981. This amendment related to treatment of Urban Aid funds, allowing municipalities receiving such funds in both 1980 and 1981 to appropriate 1981 funds as a CAP exception without deducting funds received 1980 from final appropriations in determining the 1981 CAP "base". Effective May 22, 1981, the provision was available to only a few municipal recipients of Urban Aid because most had already adopted their budgets for 1981.

Finally, two laws were enacted early in 1982 resulting in CAP exceptions for that year. The first law clarified that expenditure increases in collection or disposal of solid waste resulting from fees charged to sanitary landfill owners and operators by county health departments for solid waste enforcement activities were considered mandated by state law after the CAP law's effective date, thereby excepted

from the CAP. The second law excepted any portion of a lease payment made to a county improvement authority representing a proportionate amount for amortization of authority debt incurred in providing the facility being leased. 40

Effect and Impact

The Commission concluded earlier that part of the intent of the municipal CAP was to contribute directly to reducing the rate of growth of municipal expenditures, and indirectly to reducing the rate of growth of municipal property taxation. A review of spending and taxing trends is thus in order in beginning an assessment of the effectiveness of the CAP law in accomplishing its goals.

Impact on Spending

Table 12 reports total municipal expenditures for the period 1970-1982. As shown by that table, the average annual rate of spending growth for the six-year period following enactment of the CAP law (6.8%) is markedly lower than the average annual rate of growth for the six-year period preceding the CAP law (9.8%). Also notable is the absence of double-digit annual rates of increase since the CAP law's inception, whereas annual rates of increases of 12 percent or more occurred in three of the six years immediately preceding the CAP law's enactment.

Table 12

Change in Total Municipal Expenditures
1970 - 1982

<u>Year</u>	<u>Expenditures</u>	<u>Increase</u>	<u>Percent Increase</u>
1970	\$1,129,331,806	\$	- %
1971	1,269,071,467	139,739,661	12.4
1972	1,378,692,629	109,621,162	8.6
1973	1,543,840,491	165,147,862	12.0
1974	1,672,150,354	128,310,363	8.3
1975	1,884,190,783	212,039,929	12.7
1976	1,979,991,706	95,800,923	5.1
1977	2,110,662,616	130,670,910	6.6
1978	2,297,034,880	186,372,264	8.8
1979	2,380,136,327	83,101,447	3.6
1980	2,555,667,178	175,530,851	7.4
1981	2,772,113,054	216,445,876	8.5
1982	2,945,030,898	172,917,844	6.2
Increase 1970-1976	<u>Amount</u> \$850,659,900	<u>Percent</u> 75.3%	<u>Average Annual Increase</u> 9.8%
Increase 1976-1982	965,039,192	48.7	6.8

Source: Annual Reports, Division of Local Government Services, Department of Community Affairs, 1970-1980; 1982 Adopted Budgets; 1982 Abstracts of Ratables

Note: 1982 represents budgeted revenues (which equal budgeted appropriations), not expenditures

Impact on Property Tax Levies

Table 13 reports total property tax levies for municipal purposes for the period 1970 to 1982. As illustrated by that table, the average annual rate of growth in municipal purposes property tax levies has fallen dramatically comparing the six-year post-CAP law period to the six-year pre-CAP law period. The 6.2% decline in municipal property tax levies in 1977 reflects the institution of the \$50 million State Revenue Sharing Program funded by State personal income tax revenues as well as the first year of the CAP law. This downturn, followed by the two years of nominal increases of just over 1 percent, weighs heavily in depressing the six-year post-CAP average rate of growth, for in years 1980 through 1982 double-digit rates of increase occurred. Thus over the life of the CAP law the average annual rate of growth in municipal tax levies was significantly lower than in pre-CAP years; however, rates of growth in the three most recent years have assumed proportions more resembling pre-CAP days than the first three years under the CAP law.

The information above indicates that the results expected of the CAP law in spending and taxing restraint did in fact occur, viewing the period in which the CAP law existed as a whole. Isolating the contribution of the CAP law to these results, a difficult but better approach to ascertaining the "success" of the CAP law in meeting its goals, was an undertaking the Commission could not accomplish due to time and resource constraints. Lack of comprehensive and timely information prevented the Commission from evaluating capped and uncapped municipalities separately, and from distinguishing spending trends in areas subject to the CAP from areas excepted from the CAP.

Table 13

Change in Municipal Purposes
Property Tax Levies, 1970 - 1982

<u>Year</u>	<u>Levy</u>	<u>Increase</u>	<u>Percent Increase</u>
1970	\$ 453,837,828	\$ -	-%
1971	465,713,295	11,875,467	2.6
1972	525,351,851	59,638,556	12.8
1973	526,003,821	651,970	0.1
1974	583,719,724	57,715,903	11.0
1975	670,606,611	86,886,887	14.9
1976	783,479,526	112,872,915	16.8
1977	735,100,661	-48,378,865	-6.2
1978	744,766,122	9,665,461	1.3
1979	754,001,244	9,235,122	1.2
1980	829,855,956	75,854,712	10.1
1981	923,214,100	93,358,144	11.2
1982	1,027,924,892	104,710,792	11.3
Increase 1970-1976	<u>Amount</u> \$329,641,698	<u>Percent</u> 72.6%	<u>Average Annual Increase</u> 9.5%
Increase 1976-1982	244,445,366	31.2	4.6

Note: Levy excludes veterans and senior citizens deductions, 1970-1976, and Type I school levies included in municipal budgets (all years).

Source: Annual Reports, Division of Taxation, Department of Treasury 1970-1981; 1982 State Abstract of Ratables.

The Commission may therefore conclude that the goals of the CAP law in restraining municipal spending and taxing growth were met, and that the CAP law itself contributed to the outcome. Yet the importance or degree of the CAP law's contribution to these circumstances, which may vary according to trends in other factors, is not revealed by the above information. Thus the apparent success of the CAP law in meeting the goals oriented to financial restraint may at best be judged a qualified success.

The clear contrast in tax levy growth rates between 1976-1979 and 1980-1982 seems to suggest a diminishing success of the CAP law in controlling property tax levy increases. However, given the nature of the property tax as a residual tax, there are certainly other factors than the CAP law to be considered. The simple fact that annual rates of expenditure increases differ from annual rates of property tax increases, shown by comparing Tables 12 and 13, demonstrates the play of these other factors, particularly the availability of non-property tax revenue. The trends shown by comparing those two tables, i.e. rates of spending increase exceeding rates of property tax increase during 1976-1979, and rates of property tax increase exceeding rates of spending increase during 1980-1982 suggest a changing relationship between property tax revenues and other sources of revenue over the six-year period in question.

This changing relationship of revenues over the life of the CAP law is illustrated by Table 14, showing proportions of basic types of municipal revenues to total budgeted municipal revenues on a statewide basis. The table shows the proportion of property taxes to total budgeted revenue declining for the period 1976-1979, and growing for the period 1979-1982, while total budgeted revenues (and therefore appropriations) increased each year over the entire period.

Therefore, however successful the municipal CAP law may be in controlling expenditure increases, that degree of success may not coincide with the degree of success in controlling property tax levy increases.

Table 14

SHARE OF MAJOR REVENUE CATEGORIES IN NEW JERSEY
MUNICIPAL BUDGETS, 1976 - 1982

Revenue Categories	Year and Percentage of Total						
	1976	1977	1978	1979	1980	1981	1982
	%	%	%	%	%	%	%
Surplus	10.0	10.0	10.4	11.8	11.5	10.1	10.9
Miscellaneous	41.7	47.0	50.0	50.4	49.8	50.6	48.4
Delinquent Taxes & Liens	6.2	5.9	5.3	5.0	4.8	4.8	5.2
Subtotal	(57.9)	(62.9)	(65.7)	(67.2)	(66.1)	(65.5)	(64.4)
Property Taxes:							
Municipal	40.7	36.0	33.3	32.0	33.1	33.8	34.9
Type I School	1.4	1.1	1.0	.8	.8	.7	.7
Subtotal - Taxes	(42.1)	(37.1)	(34.3)	(32.8)	(33.9)	(34.5)	(35.6)
Total Revenue (Budgets)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
\$ (in millions)	1,926.0	2,044.5	2,233.3	2,355.4	2,505.6	2,733.3	2,945.0

Source: Annual County Abstract of Ratables

Effect on Services

The Commission has earlier noted the problems of evaluating the CAP law's success in facilitating, or not unduly hampering, local service provision despite the financial constraints it imposes. As in the case of the county CAP, the Commission's approach to this aspect of its charge was to review available information which is suggestive of whether the municipal CAP has tended to be imbalanced toward a constraint of service provision.

Those studies which have been conducted on the municipal CAP since its inception each contain elements suggestive of adverse impact on services and the causes thereof. Since each of these studies progressively encompasses more years of municipal experience under the CAP, a picture emerges which tends to portray the municipal CAP as increasingly constricting service provision over time.

The first study, done by the New Jersey Commission on Government Costs and Tax Policy, reviewed experience under the CAP in 1977, the first year of the CAP law. While finding that substantial service cuts were unnecessary in most communities in 1977, the report expressed three key concerns about the municipal CAP. The first concern was the disparity between the 5% CAP limit and the rate of inflation, as measured by the rise in the area's consumer price index. The disparity between the CAP percentage and recent rates of growth in municipal appropriations was also noted. The second concern was the rapid increase in certain basic operating costs (or "mandated costs", according to local

officials). A sample of 128 municipalities reviewed by the Commission showed pension cost increases averaging 9% and insurance cost increases averaging 21%. The third concern was a warning of potential adverse impact of police and fire wage increases under the recent binding arbitration statute exceeding the CAP percentage.

The timeliness of this warning was demonstrated in 1978 and 1979 as three communities sought CAP relief through the courts in response to wage settlements resulting from binding arbitration. Each of these communities cited negative impacts on municipal services if they were required to fund these wage increases within the CAP rather than outside the CAP.⁴²

The Joint Committee on Tax Policy studied the CAP law in 1979, focusing on the first two years of experience, 1977 and 1978.⁴³ While that committee thought the CAP law took sufficient cognizance of local needs in delivering essential services, it nevertheless cited indications of difficulty in maintaining services expressed by local officials. Three of these indicators were also cited by the first study. First, rates of inflation higher than the CAP percentage posed serious limits on consideration of new or expanded services, while spurring higher employee wage demands. Second, pension and insurance cost increases were found to consume in combination a range of about 25% to 50% of spending growth allowed by the CAP in a sample of 96 communities. Third, cost increases resulting from binding arbitration, as well as other cost increases in areas where Federal or State regulatory

actions or procedures were involved (i.e. pensions and utility costs) were frequently exceeding the CAP percentage. The committee's report cited two other important warnings about the municipal CAP in relation to service provision. First, it warned of losses of Federal Aid over the long run as adversely affecting service provision due to the CAP law being too tight to make up these losses with own-source revenue. Second, the inclusion of current capital costs within the CAP might be resulting in neglected maintenance, repair and replacement of capital plant.

The County and Municipal Government Study Commission undertook studies of the municipal CAP law by surveys of municipalities in both 1980 and 1981. The results of the Commission's research, some of which are set forth in its 1981 annual report, again disclose indicators of negative service impact found in the two earlier studies cited above.

The 1980 survey conducted by the Commission produced returns from 273 municipalities subject to the CAP. Of these respondents, 248 municipalities expressed problems in service delivery caused by the constraints of the municipal CAP. The occurrence of cutbacks in at least one area of expenditure was found in 103 municipalities in 1979, and 137 municipalities in 1980. Deferral of planned projects was revealed in 70 municipalities in 1979, and in 110 municipalities in 1980. Layoffs of personnel were reported by 48 municipalities in 1979 and by 47 municipalities in 1980.

Significant increases in basic operating costs were also disclosed by the survey. Increases in pension and benefit costs, which average perhaps 10% of total municipal functions, consumed over 5% of allowable spending growth in 80% of 232 municipal respondents studied; in over one-third of the sample, cost increases in this area used over 15% of CAP leeway. Similar results were found in insurance and utilities costs; about 55% of the sample reported insurance cost increases consuming over 15% of CAP leeway, with over 38% of the sample reporting utility cost increases exceeding 15% of allowable spending growth.

Binding arbitration resulting in police salary increases was reported in 89 municipal respondents, while 34 reported binding arbitration for fire salaries. Police salary increases consumed over 25% of CAP leeway in nearly two-thirds in these municipalities, while fire salary increases did the same in one-third of the cases reported.

The 1981 Commission survey, with 200 respondents, disclosed that the above conditions were essentially unchanged with the passing of another year. Reported cutbacks increase somewhat, while reported layoffs stayed about the same. Pension, insurance and utility cost increases as percentages of allowable spending growth assumed the same proportions as in 1980. The 1981 survey also disclosed an increase in the number of municipal officials favoring revision of the municipal CAP law by linking the CAP rate to an inflation index. In 1980, 21% of respondents cited this change as the most preferable change in the CAP law; in 1981, 29% of the respondents favored this change to other options.

The situation that emerges from review of this information, consisting largely of the viewpoints of municipal officials, is that of a municipal CAP law decreasing in flexibility under the pressures of inflationary trends and rapid escalation in certain basic operating costs, such that it inhibits maintaining former program and service levels to an increasing degree. The information does not offer uncontrovertible proof of wholesale cuts in municipal programs and services; although in light of the circumstances revealed it may be assumed that some significant cuts have been made. Rather, the information indicates a steady advance toward a point when retrenchment will assume major proportions and key programs and services will have to be terminated.

A review of the dynamics of the municipal CAP calculation reinforces the apparently declining flexibility of the municipal CAP law. Of particular significance is the "effective CAP rate", which is the percentage growth in that portion of the municipal budget subject to the CAP allowable under the calculation, taking into consideration growth allowed by the 5% CAP rate and by CAP "add-ons" for ratable growth, fee increases, referendum, and sale of municipal assets (the latter applicable through 1980 only).

According to research undertaken by the County and Municipal Government Study Commission, the statewide "effective CAP rate" for 1977, the first year of the CAP law, was 6.73%. For 1980, this statewide rate was 8.32%; for 1981, it was 7.11%. A 1982 sample of

118 municipalities studied by this Commission disclosed an aggregate effective CAP rate of 6.35%. This information indicates a decreasing effective CAP rate, hence decreasing flexibility for municipalities under the CAP law.

Because this information represents statewide aggregates in 1977, 1980, and 1981, and a sampling of municipalities for 1982, it must be viewed with some caution. The 1980 rate of 8.32%, for example, becomes 7.88% when one municipality, Atlantic City, is eliminated from consideration. Atlantic City has enjoyed tremendous ratable growth in recent years, greatly enhancing its CAP leeway. The 1980 statewide "effective CAP rate" was also enhanced by the add-on for proceeds from sale of municipal assets, no longer applicable in 1981 and 1982. Furthermore, in 1980 this CAP add-on disproportionately benefitted a small number of municipalities; the County and Municipal Government Study Commission found that nearly 75% of the aggregate \$20.6 million in CAP "add-ons" from sale of assets in 1980 applied to only 14 municipalities.

A more appropriate evaluation of "effective CAP rate" data is to examine frequency of this rate within ranges. Table 15 sets forth the results of this method of review for three most recent years of the CAP law (no earlier information available and reveals an increasing concentration of municipalities within ranges of low growth as measured by the "effective CAP rate". In 1980, 40.5% of all municipalities had an

Table 15

Effective CAP Rates 1980 - 1982

	5.00- 5.09%	5.1- 5.99%	6.0- 6.99%	7.0- 7.99%	8.0- 9.99%	10.0- 14.99%	Over 15%	Total
<u>1980</u> # of municipalities	27	157	93	48	53	37	39	454
% of total	5.9%	34.6%	20.5%	10.6%	11.7%	8.1%	8.6%	100%
<u>1981</u> # of municipalities	66	205	82	30	26	30	29	468
% of total	14.1%	43.8%	17.5%	6.4%	5.6%	6.4%	6.4%	100%
<u>1982</u> # of municipalities	10	63	23	10	7	4	1	118
% of total	8.5%	53.4%	19.5%	8.5%	5.9%	3.4%	.8%	100%

"effective CAP rate" of less than 6%; in 1981, this proportion increased to 57.9%, while in 1982, 61.9% of the sample municipalities had an "effective CAP rate" of less than 6%. While 61% of all municipalities had an "effective CAP rate" up to 7% in 1980, this proportion rose to 75.4% in 1981, and based on the 1982 sample, to 81.4% in the current year. This information clearly shows a trend of declining flexibility in the municipal CAP calculation.

A trend toward erosion of the portion of the municipal budget subject to CAP limitations could offset this decline in allowable rate of growth. Indeed, this trend might have occurred. A sample of 94 municipalities studied by the Joint Committee on Tax Policy showed that 70.6% of the municipal budget was subject to the CAP in 1977, and 68.5% in 1978. ⁴⁴ In 1980, the proportion of the municipal budgets subject to the CAP was 67.3%, while this Commission's sample analysis revealed this proportion to be 64.7% in 1981. However, this information is far from conclusive, since three of the years in question represent only a sampling of communities. Furthermore, the growth in the CAP-exempt portion of municipal budgets is most likely occurring in the two largest categories of exceptions, debt service and the reserve for uncollected taxes. The reserve for uncollected taxes is not a program or service-related appropriation, and debt service relates to capital plant and infrastructure rather than current operating expenditures. Thus

the decline in proportion of budget subject to CAP is probably not significant enough to offset the negative pressures upon programs and services from the decrease in CAP flexibility demonstrated above.

One other indication of the gradual tightening of the municipal CAP law exists in the extent to which municipalities utilize their allowable spending leeway. The Joint Committee on Tax Policy found unexpectedly that many of its sample municipalities were not budgeting to the extent allowed by the CAP law in 1977 and 1978. ⁴⁵ According to research performed by the County and Municipal Government Study Commission in 1980 statewide use of spending authorization under the CAP was 99.6%. Based on this Commission's research (118 sample municipalities) this percentage of use of CAP leeway was repeated in 1982.

Municipal Referenda

The local referendum was the principal discretionary method the Legislature gave municipal governing bodies to exceed their spending limit. Although the process may be viewed by some to be popular among voters, limited information indicates voter turnout for municipal budget referenda has varied greatly, yet may be somewhat higher than for annual school tax levy referenda in Type II school districts.

No continuing analysis of voter participation in municipal CAP referenda appears to have been undertaken, particularly for 1981 and 1982. Thus the above conclusion is based only on a sampling of data and testimony of elected officials.

Use of the referendum has been limited to 250 in six years, although the annual number did increase over the first 5 years from 3 in 1977 to 93 in 1981 as shown in Table 16. In 1982, the referendum number decreased over 50 percent to 40. Meanwhile the percentage of referenda approved declined to 34% in 1981 after rises from 29% in 1978 to 43% in 1980. The percentage of approvals rose to 45 percent in 1982, the highest since the first year of the CAP when 3 of 3 referenda received voter endorsement. After six years total referendum approvals number 99 -- 40 percent of all referenda during the period. The dollar amount of appropriations approved has not been significant as a proportion of statewide total budgets.

A summary of CAP referendum activity over six years by county indicates that there have been municipal referendums in 20 counties, with the largest number 37 in Monmouth and Bergen counties. (See Table 17.) This is to be expected since these counties have the largest number of municipalities within their boundaries. Sixty municipalities have resorted to referendum more than once; 47 municipalities have held a total of two referenda; 11 have held a total of three; one municipality held four, and another five. Of the 47 municipalities holding a total of two referenda,

TABLE 16
Municipal Referenda to Exceed the CAP
1977 - 1982

Year	No. of Referenda			% Appr'd	Appropriations	
	Total	Appr'd	Defeated		Approved	Defeated
1977	3	3	0	100%	\$ 124,452	\$
1978	14	4	10	29	584,640	1,708,415
1979	32	13	19	41	1,933,050	2,318,999
1980	68	29	39	43	4,387,358	5,790,251
1981	93	32	61	34	3,929,664	13,979,878
1982	40	18	22	45	2,470,923	3,687,224
Accumulated Total	250	99	151	40%	\$13,429,587	\$27,484,767

Source: Annual Budget Files, Division of Local Government Services,
Department of Community Affairs.

TABLE 17
Municipal Referenda to Exceed CAP by County
1977-1982

	1977		1978		1979		1980		1981		1982		Total	
	No.	App.	No.	App.	No.	App.	No.	App.	No.	App.	No.	App.	No.	App.
ATLANTIC					2	0	5	5	5	1	1	1	13	7
BERGEN			3	1	3	2	5	3	15	6	6	8	32	14
BURLINGTON					2	1	4	1	8	4	2	0	16	6
CAMDEN	1	1	3	1			11	3	10	3	4	3	29	11
CAPE MAY			1	1	1	0	2	1	2	1			6	3
CUMBERLAND														
ESSEX			1	0							1	1	2	1
GLOUCESTER	1	1	2	1	4	1	7	1	8	4	2	1	24	9
HUDSON							1	1	1	0			2	1
HUNTERDON							1	1	2	0	2	2	5	3
MERCER			1	0			2	0	2	2			5	2
MIDDLESEX							1	0	2	0	1	0	4	0
MONMOUTH	1	1	1	0	10	5	10	7	16	3	8	5	46	21
MORRIS			1	0	2	1	3	2	6	1	3	0	15	4
OCEAN					1	1	3	1	7	3	3	2	14	7
PASSAIC							4	1			2	0	6	1
SALEM					1	0	1	1	1	0	1	1	4	2
SOMERSET					3	1	1	0	3	2			7	3
SUSSEX					1	1	4	0	3	1	2	0	10	2
UNION			1	0	2	0	3	1			2	0	8	1
WARREN									2	1			2	1
TOTAL	3	3	14	4	32	13	68	29	93	32	40	18	250	99
# of counties where referenda occurred	3		9		12		18		17		15		20	

only 7 have been successful in both years, while 18 suffered defeats in both years. Of the 11 municipalities holding a total of three CAP referenda, none were successful every time; three were successful two out of three times, six were successful once, and two were unsuccessful all three times. The municipality holding four CAP referenda was successful only once, while the one holding five was successful three times.

Returns of a questionnaire sent to municipal officials for an executive study committee in 1980 indicated that half of them had considered use of the referendum but few had actually done so. Further, six of seven would not consider using referendum in the future.

One obstacle to use of the referendum is the requirement that the cost of the special referendum election be within the CAP. Other reasons given by officials for their opposition to the referendum are the general negative public attitude to tax or spending increases and the public lack of understanding of the CAP. Referenda have been rejected even though there would have been no direct impact on taxes or tax rates due to the planned use of surplus to finance the planned increase.

The declining flexibility of the municipal CAP formula is a product of several factors. First and foremost, the fixed CAP rate of 5% has not reflected inflationary trends both in general and in certain basic municipal operating costs since its inception. Second, the much-publicized slowdown in the construction industry has probably diminished the frequency and extent of budget growth from ratable construction. The tendency of rejection of referenda to exceed the CAP limit has reduced the potential of that avenue of CAP relief. The 1981 amendments to the law changing proceeds of sale of assets to a one-year CAP exception and tightening CAP loopholes, advisable as they may have been, have further contributed to inflexibility. In view of these factors and the potential cutbacks in aid from higher levels of government, the municipal CAP law seems in need of revision, if extended beyond 1982, to instill added flexibility in pursuit of its goal of blending financial restraint while allowing for the maintenance of adequate service levels.

Part IV.

Conclusions and Recommendations

Overview

The information presented in the preceding two sections of this report shows that the CAP law has been successful in contributing to reduced rates of increase in county and municipal government expenditures and tax levies. The six-year period in which the CAP law has been in effect compares favorably with the preceding six-year period when experiences in spending and tax levy growth are evaluated. However, rates of increase in county and municipal property tax levies have risen in the most recent years of the post-CAP period, resembling pre-CAP law rates of increase more than those experienced in the earlier years under the law.

The information previously presented also depicts an apparent decline in the flexibility of the CAP formula over time, a paradoxical finding in light of rising rates of property tax increase. This declining flexibility has coincided with and contributed to increasing difficulty for counties and municipalities to sustain program and service delivery. The initial impact of the CAP law in this area was mitigated by the ability of local governments to streamline operations and eliminate waste without significant reduction in services. In most recent years, retrenchment has had a growing impact on service delivery.

The purpose of the CAP law was to achieve a balance between two potentially conflicting goals - financial restraints and maintenance of needed services. On the whole this balance was maintained; low rates of increase in spending

and taxing growth occurred, but not at the expense of wholesale curtailments or elimination of local services. However, when viewing the six-year history of the CAP law, a trend is revealed toward an undoing of the balance between the two goals. The balance seems to have shifted against service provision, but curiously enough the balance has also shifted against that aspect of financial restraint that centers upon the local property tax.

Focus: The County CAP

In fulfilling their traditional role as extensions or surrogates of state government, counties are required to fund services provided as such on a priority basis. When costs increase dramatically in these areas, as they have over the life of the CAP law, counties must meet these costs within their resources as limited by the CAP law at the expense of discretionary, i.e. local-oriented services.

The amendments made to the county CAP calculation in 1981 partly reflected this situation by excepting county financial shares of programs undertaken with the financial assistance of the state and Federal government, whether that financial assistance was provided on a current or a reimbursement basis. The key state-mandated program area excepted from the CAP by this change was welfare; other key appropriations excepted were those for hospital costs and county colleges. The impact of these amendments on the growth in county property tax levies in 1981 and 1982 was demonstrated in Part II of this report, and contributed significantly toward the recent resurgence in the rate of growth in county property tax levies.

Part II of this report also demonstrated that the county CAP does not provide enough flexibility to relieve continued pressures from cost increases in other State-mandated areas. Counties still face a situation where discretionary local-oriented services will suffer as cost increases occur in State-mandated programs and services despite the significant annual rates of increase in county property tax levies.

Focus: The Municipal CAP

The point that must be emphasized about the municipal CAP is that its effectiveness in controlling increases in spending does not directly result in effective control of property tax levy increases. If the municipal CAP were constructed to allow no growth in spending, it still would not prevent property tax levy increases if non-property tax revenues declined. It does not follow that recurrence of double-digit rates of increase in municipal purpose property tax levies in the years 1980 to 1982 means the municipal CAP is not restrictive enough and should be made tighter. The correlation between spending control and taxing control in the municipal CAP is dependent upon fluctuations in non-local property tax revenues.

There is one factor in the municipal CAP calculation that has perhaps contributed to growth in property tax levies that might not have otherwise occurred. The practice of allowing a CAP "add-on" for proceeds from sale of municipal assets, followed from 1977 through 1980, in effect resulted in permanent increases in spending authorization based on a one-time source of

revenue. While this practice enhanced the flexibility of the CAP formula, it theoretically resulted in property tax increases to maintain that spending level in each year following the year in which the add-on was taken, assuming that proportions of non-property tax revenues held constant.

This factor notwithstanding, the resurgence in the rate of increase in municipal property tax levies while spending flexibility declines under the municipal CAP is not as striking a paradox as it is at the county level.

Related Factors

Omitted from this consideration of trends in property tax levies during the life of the CAP law are elements of the 1976 tax reform program not reflected in municipal and county budgets and property tax levies that balance these budgets. These elements are the State's assumption of the full cost of veterans' and senior citizens' property tax deductions, and property tax relief accorded directly to homeowners by the Homestead Rebate Program. It is beyond the scope of this Commission to evaluate all components of the tax reform package of which the CAP law was a part. However, it is important to recognize that from the taxpayer's viewpoint, these two programs serve to offset increases in property tax bills caused by rising local budgetary demands on property tax revenues.

Conclusion: Need for Flexibility

The Commission concludes that the basic structure of the local CAP law remains appropriate and represents a reasonable policy for restraint of growth

in local expenditures/tax levies while making sufficient allowance for local service provision. However, the Commission also concludes that if the CAP law is to be extended beyond its December 31, 1982 expiration date, it is in need of changes to improve the flexibility of the respective CAP formulas, to make them more responsive to short-term changes in fiscal and economic conditions and local needs. The Commission strongly believes these changes are essential if the CAP law is to be successful in attaining its two-fold goal of financial restraint without undue impairment of service provision capability. If the CAP law is extended beyond 1982 without these alterations, the Commission is apprehensive that financial restraint will result in reductions in local services exceeding the original intent of the law.

Problems of Flexibility

There are three elements of the CAP formula common to counties and municipalities which have worked to inhibit flexibility for service provision:

- 1) A nominal CAP rate, fixed at 5 percent, which by nature cannot adjust to, and by circumstance has failed to reflect, general inflationary trends which reached double-digit proportion;
- 2) A key component of flexibility based on ratable growth from new construction, which is adversely affected by broad factors restricting economic growth and is sometimes only loosely reflective of local needs and conditions;

- 3) The reliance which the formula encourages on use of non-property tax revenues, particularly Federal and State aid, to fund basic services, while failing to provide the flexibility to react to reductions or eliminations through use of own-source revenue.

Flexible Rate Alternative

To address the problem of a CAP rate which does not reflect inflationary trends, the Commission believes that the 5 percent fixed CAP rate should be changed to a flexible percentage limitation based on an inflation index while retaining the current 5 percent rate as a minimum or floor percentage.

The Commission reviewed several inflation indices, including the formula used to determine the expenditure limit on State government in New Jersey, growth in per capita personal income (see Appendix for detailed information presented on this subject by Dr. Adam Broner). Emphasis was placed on the relevance of what the indices measured to the nature of local government expenditures in New Jersey.

Based on this review, the Commission concluded that the inflation index most relevant to local government expenditures is the Implicit Price Deflator for State and Local Government Purchases of Goods and Services, computed and published quarterly by the United States Department of Commerce in the Monthly Survey of Current Business. Although there is no similar inflation index exclusively applicable to local governments in New Jersey, this index offers

several advantages over a fixed 5 percent CAP rate, the most important being that the index better reflects changing economic conditions than a fixed rate in general, and the 5 percent rate in particular.

Use of a flexible CAP rate should also reduce pressures for additional exceptions to the CAP law to compensate for cost increases above the fixed rate in specific areas. The existing exceptions to the CAP law are well-reasoned and appropriate. New exceptions have been suggested frequently, most of which relate to specific program areas, i.e. police, fire, insurance, legal costs, and so on. Proliferation of exceptions will not only increase the complexity and administrative difficulty of the CAP formula; it may also tend to confer competitive edges in demands for budget increases, encouraging inefficient allocation of resources and discouraging those economies which have been a positive by-product of the CAP law.

A flexible CAP rate based on an inflation index will also establish a closer relationship between the State CAP formula, which includes both real growth and inflation components, and the local CAP formulas, which hitherto have included only a real growth component.

A reasonable concern over a CAP rate based on an inflation index is the potential of drastic annual upward or downward fluctuations. To address this concern, the Commission recommends that the current 5 percent rate be retained as a floor or minimum CAP rate if the rate of change in the Implicit Price Deflator falls below 5 percent, and that a two-year moving average of the rate of change in the index be used as a basis for computing the annual CAP rate.*

*Dr. Broner dissents with the recommendation for a floor or minimum CAP rate. See Appendix.

The Commission therefore recommends that the local CAP rate be computed annually as the rate of change in the Implicit Price Deflator for State and Local Government Purchases for Goods and Services, averaged for the two years immediately preceding the current year, rounded to the nearest one-half percent, but in no case to be less than 5 percent.

For purposes of administrative practicality, the rate of change should be measured using the index reported for the second quarter of each year in question, as is the State CAP. The rate thus computed should be certified by the Director of Local Government Services, Department of Community Affairs, by October 1 of each year, a date by which the necessary data are published and which is timely within the local budget cycle.

Table 18 sets forth the State and Local Government Implicit Price Deflator for the period 1975 to 1982, and demonstrates the annual rate of change in the index and the computation of the two-year moving average proposed for determination of annual CAP rates.

Adjustment For Aid Losses

The problem of the inflexibility of the CAP formula to losses of non-categorical Federal or State aid currently excepted from the CAP and used for basic services also needs to be rectified. Federal aid of this nature currently received by counties and municipalities is Federal General Revenue Sharing. State aid of this nature is Municipal Purposes Tax Assistance aid, received only by municipalities. The Commission recommends that a CAP exception be provided for decreases after 1982 in Federal General Revenue Sharing and Municipal Purposes Tax Assistance aid. This will allow counties and municipalities to maintain basic services funded by this aid with own source revenues if they opt to do so.

Table 18

IMPLICIT PRICE DEFLATOR FOR STATE AND LOCAL GOVERNMENT
PURCHASES OF GOODS AND SERVICES
FISCAL YEARS 1976-1982

Year	Quarter II, Implicit Deflator and State and Local Government Purchases	Annual Percentage Growth-- Second Quarter To Second Quarter	Two-Year Moving Average	
			To Two Decimal Places	Rounded To Nearest Half-Percent
1975	128.7	--	--	
1976	136.8	6.28%	--	
1977	147.2	7.60	6.95%	7.0%
1978	157.6	7.07	7.34	7.5
1979	171.3	8.69	7.88	8.0
1980	189.6	10.68	9.69	9.5
1981	206.3	8.81	9.75	10.0
1982	221.5	7.37	8.09	8.0

SOURCE: "Survey of Current Business, July 1982"; Bureau of Economic Analysis, U. S. Dept. of Commerce, Washington, D.C. 20230.

Allowance For Unused Leeway

The nature of the CAP formula, in which current year spending or taxing growth is based on the previous year's level, may produce the undesirable side effect of imprudent budgeting. Spending or taxing to the maximum extent permitted may occur in a given year when it is not essential to do so, for fear that permissible growth needed in subsequent years will be forfeited. This could be characterized as a "use it or lose it" syndrome in budgeting under the CAP law. To discourage this practice, the Commission recommends carrying forward or "banking" of unused CAP leeway on a limited basis.

Under this recommendation, any spending or taxing leeway allowed by the CAP formula but not budgeted for in that given year could be used in either of the next two succeeding years. This should encourage realistic and prudent budgeting and better short-term service and program planning.

Adjustment For Transfer Of Functions

New Jersey is characterized by an unusually large number of governmental entities in a small geographical area; a strong tradition of home rule; a movement toward service provision on broader regional bases, and a State government increasing its role in the governmental structure. In this dynamic political scenario, roles and responsibilities of governmental units in funding and delivery of services may change frequently and dramatically. It is important that laws imposing financial constraints take cognizance of this situation and contain provisions to reflect changes in patterns of funding and

delivery of services. These provisions should be designed to encourage sensible changes as well as to discourage changes motivated by other less desirable considerations.

The State CAP law reflects these considerations by providing for adjustment of the State spending base when local funding responsibilities are assumed by the State and when State funding roles are transferred to local levels. However, the local CAP law currently provides for such adjustments only when funding responsibility is shifted out of municipal budgets to other special-purpose local entities not bound by statutory spending limitations, a 1981 amendment enacted to prevent circumvention of the CAP. Elaboration is needed to address assumptions of funding responsibilities as well as termination of those responsibilities in the CAP formulas for both municipal and county governments.

Therefore, the Commission recommends that the local CAP law be brought into agreement with the State CAP law, by providing for an adjustment to the CAP bases if transfers of functions or services and responsibility for funding occur between governmental units. These adjustments should be based on expenditures of the most recent year preceding the transfer, and should result where applicable in base increases for the entity newly assuming the function or service and base decreases for the entity formerly funding the function or service.

* * * * *

The previous four recommendations apply to both counties and municipalities. The following recommendations are specifically exclusively to only one of these two levels of government.

Municipal CAP Referendum

The potential flexibility of the municipal CAP formula, provided by allowing the spending limitations to be exceeded if approved by referendums, has not been fully realized. Many reasons for this, such as lack of public understanding, insufficient publicity, and voter apathy, cannot be addressed in the CAP law itself. However, one factor inhibiting the use of this avenue of CAP flexibility is that the cost of holding a CAP referendum, being within the CAP, uses up needed spending leeway regardless of the outcome of the vote. This discourages municipal officials from seeking this approach to CAP relief, and may be addressed by amending the CAP law.

Therefore, the Commission recommends that an exception be provided for the costs of holding a referendum to exceed the CAP.

County Referendum

The policy of allowing the CAP to be exceeded, if approved by referendum, is generally sound and appropriate for municipalities, and has been advocated for counties as well. The Commission carefully considered this issue, and concluded that it is not appropriate to provide for county referenda to exceed the CAP.

County government tends to be the least visible level of general government in New Jersey. Citizens do not usually identify with the county in which they reside as closely as the municipality and State, and they tend to be unfamiliar with many functions and services performed by county government. Furthermore,

since success of municipal CAP referenda seems to be based largely upon proper publicity of the issues involved, counties would be at a serious disadvantage in mounting an adequate publicity campaign. Costs of county-wide referenda would be much greater than municipal referenda. Finally, there is sparse historical experience with county-wide special elections, at which CAP referenda would be held. Therefore, the Commission has concluded that a referendum to exceed the County CAP is not a practical flexibility provision. If, however, this option is extended to counties, the Commission recommends that the cost of referenda be excepted from the CAP.

The County CAP and State Mandates

The growth of county government as a regional provider of local services, while maintaining the traditional role as an extension of State government, is thwarted by the restraints of the CAP law. When drastic cost increases in State functions performed by counties occur, retrenchment in discretionary areas of county expenditure must occur, for by law counties cannot shun their duty as surrogates of the State.

The change from a fixed CAP rate to a flexible inflation-based CAP rate will help to relieve fiscal pressures against maintaining discretionary services. However, the nature of cost increases in State-mandated functions is such that they cannot be expected to consistently reflect inflationary pressures. Requirements that counties provide certain levels of staff support, for example,

could result in cost increases that in no way represent rates of inflation. Furthermore, if an inflation-based CAP rate produces a significantly more liberal CAP than the current 5 percent, there may be a tendency on the part of State officials to view the allowable growth in property tax levies as a substitute for scarce State funds. They may thus demand an expansion of the county role in providing those services which are more reflective of State than local functions; and county officials will have no choice but to comply.

The possibility is still strong that increases in costs of State-mandated county functions will be disproportionate to revenue growth allowed by the CAP law. In the interests of allowing counties to continue their dual role as State and locally-oriented service providers, the Commission believes that the county CAP formula should contain an additional element of flexibility.

Therefore, the Commission recommends that an exception be added to the county CAP for cost increases in major State-mandated functions and services which exceed the annual CAP percentage.

The County and Municipal Government Study Commission categorized State-mandated functions performed by counties, the average cost proportion of each function over the period 1975 to 1980 and their 1980 total dollar cost. (See Tables 19 and 20). The major categories are welfare services; the judiciary system, including probation and judicial functions of the sheriff and county clerk; maintenance of patients in State institutions; corrections and penal system; and prosecutorial services. The county CAP already provides an exception

Table 19

RELATIVE COST OF MANDATES -- 1980

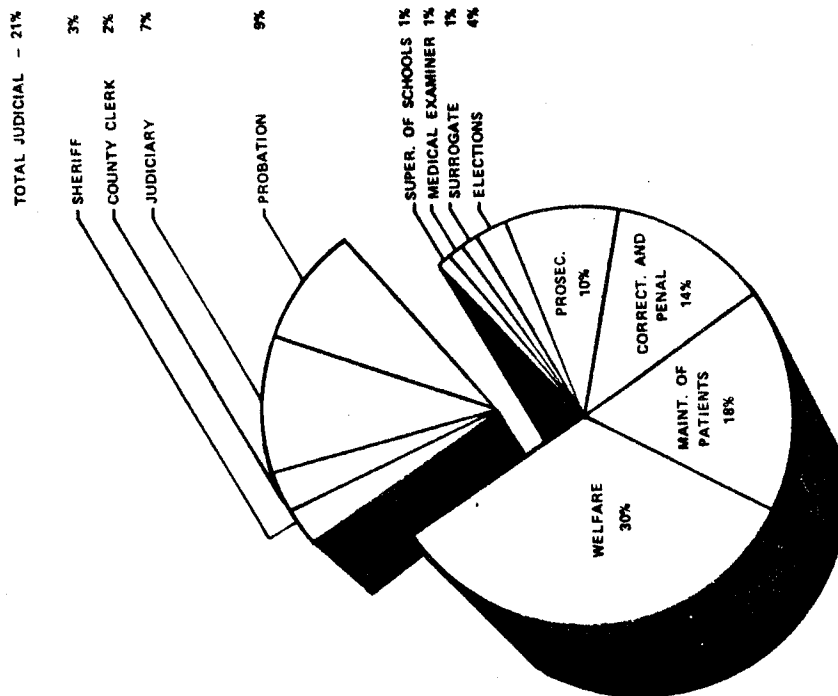


Table 20

RELATIVE COST OF MANDATES

Average Percent of Total Costs 1975 to 1980	Dollar Costs 1980
WELFARE 31%	116M
MAINTENANCE OF PATIENTS IN STATE INSTITUTIONS 18%	66M
CORRECTIONS AND PENAL 13%	56M
PROSECUTOR 9%	39M
JUDICIARY 8%	28M
PROBATION 8%	34M
ELECTIONS 4%	14M
SHERIFF 3%	13M
COUNTY CLERK 2%	9M
SURROGATE 1%	4M
MEDICAL EXAMINER 1%	3M
SUPER. OF SCHOOLS 1%	2M
	388M TOTAL

Reproduced from The Impact on Mandates on Counties: The Need to Balance State and Local Service Roles in New Jersey.
Twentieth Report of the County and Municipal Government Study Commission.

for the bulk of welfare costs. Cost increases which exceed the annual CAP percentage in the remaining major State-mandated functions listed above should be excepted from the CAP.

Impact of the cost of one of the most expensive State-mandated functions on county governments has been recognized in at least two other major studies over the past ten years.

The New Jersey Tax Policy Committee created by Governor Cahill proposed in its 1972 Report that full cost of judicial operations borne by the counties as well as salaries of prosecutors and their assistants be assumed by the State as a technique for relieving property taxes.

The more recent 1982 "Final Report of the Supreme Court Committee on Efficiency in the Operation of the Courts of New Jersey" recommended that the Trial Court System be financed completely at the State level.

The Technical Review Commission recognized, as did the County and Municipal Government Study Commission in its June 1981 Report, "The Impact of Mandates on Counties: The Need to Balance State and Local Service Roles in New Jersey", that the problem which counties have in financing mandated State costs is not entirely attributable to the county CAP law. Indeed, the previously cited Report on mandates suggested a variety of alternative solutions, including State assumption of costs of mandated services, State take-over of mandated functions, restoration of State aid revenues, and providing State revenue sharing to counties.

In the absence of any hope for legislative action on any of the above alternative actions, the Commission proposes this procedure for providing CAP relief in county financing of discretionary services.

Extend Cap For A Short Period

The Commission recommends that the local CAP law be reenacted, as amended by the recommendations previously set forth, for a three-year period, with an expiration date of December 31, 1985. This recommendation follows the precedent established when the CAP law was first enacted. A short extension will provide opportunity for further evaluation of the impact of the law on both municipalities and counties.

Need For On-Going Cap Data And Analysis

The work of the Commission was hampered by the lack of comprehensive data, particularly on 1981 municipal expenditures, 1982 municipal budgets, and details of municipal CAP calculations, despite a recommendation for an improved data system in the January 9, 1981 "Interim Report of the Committee to Study Municipal and County Spending Limitations" and a special study by a small committee later in 1981 aided by a grant from the Fund For New Jersey.

Accordingly, the Commission's final recommendation repeats one made in that January 9, 1981 Interim Report that the Division of Local Government Services should have staff and data processing capability to perform necessary on-going, timely analysis of the impact of the local CAP law.

FOOTNOTES

1. Joint Resolution #5 of 1982, section 3.
2. N.J.S.A. 40A:45.1.
3. Van Wagner, Richard. "The New Jersey Gross Income Tax: An Analysis from Background to Enactment". Seton Hall Legislative Journal, Volume 2, No. 2, (Summer) 1977; pg. 121.
4. "Report of The Joint Committee on Tax Policy", Legislature, State of New Jersey, pursuant to Senate Concurrent Resolution No. 64 of 1978; pg.22.
5. Id. pg. 79.
6. Id. pg. 138.
7. Advisory Commission on Intergovernmental Relations. "State Limitations on Local Taxes and Expenditures". Washington, D.C. February 1977. Pg. 2.
8. The primary source for this review is The Impact of Mandates on Counties: The Need to Balance State and Local Service Roles in New Jersey. Twentieth Report of The County and Municipal Government Study Commission, Trenton, New Jersey, June 1981.
9. Op. Cit.
10. Op. Cit. Pg. 85, 88
11. P.L. 1976, c.68.
12. P.L. 1977, c.10, sec. 2.
13. P.L. 1981, c.56, sec. 2.
14. P.L. 1981, c.60.
15. P.L. 1981, c.190.
16. P.L. 1981, c. 438, sec. 3; P.L. 1981, c.460, sec. 5.
17. Op. Cit. Pg. 92-94.
18. "The Report of The New Jersey Commisson on Government Costs and Tax Policy", Trenton, New Jersey. December 8, 1977. Page A-17.
19. Clark v. County of Union, 163 N.J. Super. 344 (1978); modified and affirmed by Clark v. Degnan, 83 N.J. 393 (1980).
20. "Report of The Joint Committee on Tax Policy", Op. Cit.

21. Id. Page 145.
22. Id. Page 146. The legislation in question was Assembly Committee Substitute for A. 32227 of 1979, and was not enacted. The same proposal is pending in 1982 as Assembly Bill 427.
23. Id. Pages 147-151.
24. The Impact of Mandates on Counties: The Need to Balance State and Local Service Roles in New Jersey. Op. Cit.
25. Id. Page 17.
26. Id. Page 25.
27. 83 N.J. 389 (1980)
28. The Joint Committee on Tax Policy (op. cit., pg. 107) reported that in 1977 and 1978 the percent of county purpose levy within the CAP averaged about 82% and 85% respectively. The Commission cannot be sure whether it computed this statistic in the same manner.
29. Op. cit. Pg. 79.
30. Id. Pg. 85.
31. P.L. 1976 c.68.
32. P.L. 1977 c.10, sec. 1.
33. New Jersey State Policemens' Benevolent Association local No. 16 v. City of East Orange, 164 N.J. Super. 436 (1978); City of Atlantic City v. Laezza, 80 N.J. 255 (1979); New Jersey State Policemens' Benevolent Association Local 29 v. Town of Irvington. 80 N.J. 27 (1979). Attorney General formal opinions and advisory opinions on this exception were formal opinion No. 16 of 1979 (re Solid Waste Management Act), and advisory opinions M77-3160 (support of free public libraries), M77-3543 (law enforcement costs in Atlantic City) and M79-3913 (police training costs). These opinions all found the statutory exception to be inapplicable to the situations addressed.
34. 149 N.J. Super. 97 (1977).
35. Township of Hopewell v. State of New Jersey, 156 N.J. Super. 225 (1978).
36. P.L. 1980 c.66, effective July 10, 1980.
37. P.L. 1980 c.56. Because of the lateness of the effective date of this law, June 30, 1980 in relation to the timetable for adoption of municipal budgets, only two municipalities were able to exercise this optional treatment of Urban Aid funds in their 1980 budgets.

38. P.L. 1981 c.61.
39. P.L. 1981 c.64.
40. P.L. 1981 c.438 sec.3; P.L. 1981 c.460 sec. 5.
41. "The Report of the New Jersey Commission on Government Costs and the Policy", op. cit.
42. N.J. State PBA Local 16 v. City of East Orange, 164 N.J. Super. 436 (1978); City of Atlantic City v. Laezza, 80 N.J. 255 (1979); N.J. State PBA Local 29 v. Town of Irvington, 80 N.J. 271 (1979).
43. "The Report of the Joint Commission on Tax Policy", op. cit.
44. Id. pg. 100-102.
45. Id. pg. 104.

APPENDIX

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JOINT RESOLUTION NO. 5

(Approved July 28, 1982)

Assembly Joint Resolution No. 12 (*Official Copy Reprint*)

A JOINT RESOLUTION establishing a commission to study the local spending limitations formulas imposed on local governments of this State and to make recommendations thereon.

1 WHEREAS, The Legislature in 1976 established by statute limitations
2 upon the expenditures of the counties and municipalities of this
3 State in order to protect homeowners from the spiraling cost of
4 local government; and

5 WHEREAS, These expenditure limitations were imposed on an ex-
6 perimental basis in order to provide for the orderly and periodic
7 review by the Legislature and the Governor of their effects upon
8 the local governments and the taxpayers of the State; and

9 WHEREAS, The expenditure limitations imposed upon counties and
10 municipalities by P. L. 1976, c. 68 (C. 40A:4-45.1 et seq.) is
11 scheduled to expire on December 31, 1982 and the Legislature
12 will be considering whether the expenditure limitations should be
13 continued; and

14 WHEREAS, It is essential that the current statutory formulas be
15 studied to determine if, from a technical point of view, they are
16 accomplishing their intended goal in an equitable way and if
17 they are flexible enough to accommodate changes in municipal
18 development and economic trends; now, therefore,

1 BE IT RESOLVED *by the Senate and General Assembly of the State*
2 *of New Jersey:*

1 1. There is established a commission to be known as the Local
2 Expenditure Limitations Technical Review Commission. The com-
3 mission shall consist of the Director of the Division of Local
4 Government Services, the Executive Director of the County and
5 Municipal Government Study Commission, the Executive Director
6 of the New Jersey State League of Municipalities, the Executive
7 Director of the New Jersey Conference of Mayors, the Executive
8 Director of the New Jersey Association of Counties, the Executive
9 Director of the New Jersey Taxpayers Association, the Director
10 of the Economic Policy Council, and three academicians with ex-
11 pertise in municipal finance who do not hold elective office, one of
12 whom shall be appointed by the Governor, one of whom shall be
13 appointed by the President of the Senate, and one of whom shall
14 be appointed by the Speaker of the General Assembly.

- 1 2. The commission shall select from among its members a chair-
2 man and a vice chairman and also shall select a secretary, who need
3 not be a member of the commission.
- 1 3. The commission shall review the formulas governing the
2 spending limitations set forth in P. L. 1976, c. 68 (C. 40A:4-45.1
3 et seq.) to determine whether, from a technical point of view, the
4 formulas are accomplishing their goals in an equitable way and
5 whether the formulas are flexible enough to accommodate changes
6 in economic trends and local needs. The commission may recom-
7 mend any changes which will make the formulas more equitable
8 and responsive to changing needs and economic circumstances.
9 To the extent possible, the recommendations shall be designed to
10 avoid any significant liberalization or tightening of the spending
11 limitations on a Statewide basis, although it is recognized that the
12 recommendations may result in liberalization or tightening of the
13 spending limitations for individual municipalities and counties.
14 The commission may note ways that the spending limitations could
15 be further liberalized or tightened if the Legislature is so inclined.
16 The commission shall report its findings, conclusions and recom-
17 mendations to the ***[Governor and the Legislature]*** **Local*
18 *Budgetary Limitations Review Commission established pursuant*
19 *to Joint Resolution No. . . . of 1982 (now pending before the*
20 *Legislature as Assembly Joint Resolution No. 46 of 1982)** as soon
21 as practicable, but no later than ***[October 1]*** **September 15**,
22 1982. **Upon receipt thereof, the Local Budgetary Limitations*
23 *Review Commission shall transmit the findings, conclusions and*
24 *recommendations of the Local Expenditure Limitations Technical*
25 *Review Commission to the Governor and the Legislature.**
26 **The commission shall, after reporting its findings, conclusions*
27 *and recommendations, remain available to provide such technical*
28 *assistance and services as the Local Budgetary Limitations Review*
29 *Commission may deem appropriate and necessary.**
- 1 4. The commission shall be entitled to call to its assistance and
2 avail itself of the services and assistance of such officials and
3 employees of the State and its political subdivisions and their
4 departments, boards, bureaus, commissions and agencies as it
5 may require and as may be available to it for said purpose and
6 may expend such funds as may be appropriated or otherwise made
7 available to it for the purposes of its study.
- 1 5. The commission may meet and hold hearings at such places
2 as it shall designate.
- 1 6. This joint resolution shall take effect immediately.

**EXPLANATION—Matter enclosed in bold-faced brackets [thus] in the above bill
is not enacted and is intended to be omitted in the law.**

Matter printed in italics thus is new matter.

Matter enclosed in asterisks or stars has been adopted as follows:

***—Assembly amendments adopted June 28, 1982.**

PRELIMINARY COUNTY CAP CALCULATION

COUNTY OF _____

County Purpose Tax \$ _____

Less Exceptions:

Vocational School	\$ _____
Out of County Vocational School	\$ _____
Debt Service	\$ _____
Deferred Charges to Future Taxation Unfunded	\$ _____
Emergency Authorizations	\$ _____
Unemployment Compensation Insurance	\$ _____
Capital Improvements (N.J.S. 40A:2-2) and (N.J.S. 40A:2-22)	\$ _____
Utility Costs per (Chapter 56, P.L. 1981)	\$ _____
Child Placement Review Act (Chapter 125, P.L. 1978)	\$ _____
Local Health Services Act (Chapter 329, P.L. 1975)	\$ _____
Environmental Health Act (Chapter 443, P.L. 1977)	\$ _____
County Board of Elections (Chapter 111, P.L. 1980)	\$ _____
Compensation Increase Board Members (Chapter 186, P.L. 1980)	\$ _____
Social Security Mandated Increases	\$ _____
Matching Funds for State and Federal Grants	\$ _____
Expenditure Mandated per 2A:158-1.1 (Prosecutor Office Salaries)	\$ _____
Judicial Salary Increase (Chapter 127, P.L. 1980)	\$ _____
Pension Increase Fund (Chapter 306, P.L. 1977)	\$ _____
Municipal Utilities Authority Share of Costs	\$ _____
County Welfare Board	\$ _____
County College	\$ _____

_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____
_____	\$ _____

Total Exceptions	\$ _____
Amount on Which 5% CAP is applied	\$ _____
5%	\$ _____
Allowable County Purpose Tax Before Additional	\$ _____
Exceptions per (N.J.S. 40A:4-45.4)	\$ _____

FINAL COUNTY CAP CALCULATION

COUNTY OF: _____

Allowable County Purpose Tax Before Additional
Exceptions Per N.J.S. 40A:4-45.4

§ _____

ADD:

New Construction 198 Added List (Rate_____)

New Construction 198 Partial Assessments (Rate)

Emergency Authorizations

Vocational School

Out of County Vocational School

Debt Service

Deferred Charges to Future Taxation - Unfunded

Municipal Utilities Authority - Share of Costs

Unemployment Compensation Insurance

Social Security Mandated Increases

Pension Increases Fund (All Pension Funds)

Allowable County Purpose Tax After All Exceptions

\$ _____

County Local Purpose Tax Per Budget

\$ _____

PRELIMINARY MUNICIPAL CAP CALCULATION

MUNICIPALITY

COUNTY

Total General Appropriations for 198

Exceptions:

Less:

Total - Mandated Expenditures per N.J.S. 40A:4-45.3g

Excluded from 5% "CAPS"

Total All Other Operations - Excluded from 5% CAPS

Total State and Federal Programs Off-Set by Revenues -
Excluded from 5% CAPS

Total Capital Improvements - State and Federal

Programs Off-Set by Revenues - Excluded from 5% CAPS

Total Capital Improvements - Excluded from 5% CAPS

Total Municipal Debt Service - Excluded from 5% CAPS

Deferred Charges to Future Taxation - Unfunded

Emergency Authorizations - Excluded from 5% CAPS:

By Ordinance

By Resolution

Transferred to Board of Education for the Use of Local
Schools (R.S. 40:48-17.1 and 17.3)

Cash Deficit of Preceeding Year

Deficit in Dedicated Assessment Budget

Amount to be Raised by Taxation - Funded by
Assessment Bonds

Total of Type I District School Debt Service -

Excluded from 5% CAPS

Total of Deferred Charges and Statutory Expenditures -

Local School - Excluded from 5% CAPS

Reserve for Uncollected Taxes

Sale of Municipal Assets - Added to base in 198

Service Transferred to LPU, LPA, or SPD in 198

Other:

Total Exceptions

Amount on which 5% CAP is applied

5% CAP

Allowable Operating Appropriations before additional
Exceptions per (N.J.S. 40A:4-45.3)

FINAL MUNICIPAL CAP CALCULATION

MUNICIPALITY _____ COUNTY _____

	CAP
Allowable Operating Appropriations Before Additional Exceptions per N.J.S. 40A:4-45.3	\$ _____
Add:	
REFERENDUM - Approval Conditional - Note on Approved Budget	\$ _____
New Construction 198 Added List (Rate _____)	\$ _____
New Construction 198 Partial Assessments (Rate _____)	\$ _____
Increased Fees	\$ _____
Prior Year's Increased Fees	\$ _____
_____	\$ _____
Allowable Operating Appropriations After All Exceptions	\$ _____
Approved Budget:	
(H-1) Sheet 19	\$ _____
Adjustments to (H-1):	\$ _____
_____	\$ _____
Total General Appropriations for Municipal Purposes Within 5% "CAPS"	\$ _____

AMENDED BUDGET

Amended - Int. _____ CAP _____

Allowable Operating Appropriations Approved Budget	\$ _____
_____	\$ _____
_____	\$ _____
Allowable Operating Appropriations Amended Budget	\$ _____
Amended Budget (H-1)	\$ _____
Total General Appropriations for Municipal Purposes Within 5% "CAPS" - Amended Budget	\$ _____

OFFICE OF ECONOMIC POLICY

CAPS BASED ON INFLATION INDICES -- BACKGROUND INFORMATION

This paper is a brief outline of the content of various available price indices that might be applied in formulas determining caps on local government budgets.

The cap on State expenditures is currently determined by the growth of per capita personal income applied to base year expenditures. It should be realized that personal income growth in nominal dollars (meaning in current dollars of each year) is determined by a real growth component (i.e., nominal personal income adjusted for price changes) and an inflation component. When we see statistics that say, for example, that New Jersey personal income in 1981 increased over the previous year by 10%, we should realize that such a large percentage increase is due mainly to an 8.6% price increase and only 1.4% is real growth of personal income. The remainder of this paper presents historic data showing the relationship between these two components and reviews the applicability of the various available indices of inflation to local caps.

It will be instructive at this point to review the actual relationship between the inflation and real growth component of nominal personal income growth in New Jersey for the last ten years.

The inflation component of nominal personal income growth is revealed only by applying an inflation index to the growth of nominal personal income. There is no unanimity as to what index should be applied. The federal government applies three indices to personal consumption expenditures -- the overwhelming part of personal income. The three indices are: 1) the implicit price deflator; 2) the chain price index and 3) the fixed-weight price index (1972 weights). One can also apply the various Consumer Price Indices when justified. Without further discussion of the reasons, the most appropriate is the implicit price deflator of personal consumption expenditures -- an inflation measure similar to the one applied to Gross National Product in nominal dollars.

The following table provides data for New Jersey personal income growth, adjusted by the national implicit price deflator for personal consumption expenditures and annual rates of real personal income growth. It should be remembered that personal income is determined originally in current dollars and only by applying an inflation index is it possible to reveal the real growth and therefore the two components of nominal personal income growth.

It is often argued that state and local government cap formulas should be treated equally, that is if state caps are based on personal income, so should local government caps be. This "fair approach" cannot be implemented

ANNUAL PERCENTAGE OF:

<u>Year</u>	<u>Nominal Personal Income Growth</u>	<u>Inflation (Implicit Price Deflator)</u>	<u>Real Personal Income Growth</u>
1972	8.05	3.63	4.27
73	8.72	5.70	2.86
74	8.47	10.03	-1.42
75	6.83	7.65	-0.76
76	8.50	5.11	3.23
77	8.69	6.00	2.54
78	10.07	6.88	2.98
79	11.25	8.85	2.20
80	12.33	10.28	1.86
81	11.01	8.60	2.22

directly since no data on personal income for municipalities exist. Nevertheless, a very good approximation can be found by combining inflation and real growth -- the two components which ultimately determine personal income. How to find a proper measure of real growth for individual municipalities will be discussed in a separate paper. Presently we deal only with the inflation component.

An inflation index can be easily applied if one is willing to disregard variations between baskets of goods and services for the local community and for the nation as a whole. In this approach, the national inflation rate is

treated as the norm against which the ceiling on expenditures or taxes is set. But which of the several available indices is most appropriate for local caps will have to be determined after briefly reviewing the way various price indexes are constructed.

We turn now to a closer examination of this issue. It will be useful to introduce some basic concepts which will help us understand better the nature of inflation measures. Essentially, we are striving to express a very complex economic phenomenon in one single number, namely a number that will reflect the change of prices of all goods and services over some period of time. In the case of a single good, the task is relatively easy: we register the price of that good in two periods (say, in two months) and express them in the form of an index. For example, the price of a pound of beef was \$1.50 in July 1972 and \$3.00 in July 1982. The price index for July 1982 in comparison with July 1972 equals 200. If the price was \$2.97 in June of 1982, its index compared with the 1972 base period was only 198. Hence, between June and July of 1982, the index increased from 198 to 200 which is slightly over a 1% growth over a month. We then annualize that monthly increase by compounding monthly for 12 months and we get an annual price increase of 12.8%. This is what we normally read in the papers about monthly and annual price changes except that the index discussed is an overall index of many commodities (including services), not just a single good. Even in the case of a single item, it is not that easy because we have to determine the place we registered the price change. Was it in Lawrenceville's shopping mall; in all stores of New Jersey; or in all stores of the U.S.? We see immediately that we have to select some stores and places in order to make it manageable and to reduce costs of collecting information. Actually, prices are collected for about 85 large areas, and in those areas the stores are selected scientifically according to a survey where consumers are most frequently buying.

We now move to the more complex issue of many goods and services. It is clear without any elaboration that we can deal only with a sample of commodities. But how do we select them? Without going into details, suffice it to say that the items to be included in an overall index are determined by a survey of consumers; in the case of the Consumer Price Index by about 20,000 urban consumers. The latest such survey was conducted in 1972-1973 and it still is the basis of the current CPI. Again, more frequent surveys; say, for each year, are very costly and difficult to obtain.

There are many complicated issues to be resolved in selecting the items to be included in the index, such as the proper representation of the major expenditure components. If, for example, in the goods category, we include bread, then what kind of bread should be selected? This question applies to all groups. At present, about 250 general categories are selected with some flexibility to choose from among the various kinds of brand names, etc. Once an item is chosen, its price has to be observed and recorded over the entire period, until a general revision of the entire procedure.

Having selected the items and recorded the prices over time, we proceed to calculate the overall price index by multiplying the price change by the quantity of the particular category purchased. Let us assume that the price index in July 1982 for rye bread was 180 and for beef, as previously given, 200. Then if beef is representing all meat and rye bread is representing all baked goods, we determine that in the base year of the last survey (1972) expenditures for meat were, say, 1.5% and for baked goods, 1.2% of total consumer expenditures. Multiplying 200 by 1.5 and 180 by 1.2 and dividing the total by the sum of $1.5 + 1.2$, we obtain the average price index, which in our example equals 191. It is now easy to understand that, in reality, exactly this procedure is applied to a larger number of items to obtain the overall price index. But before we jump to this conclusion, we have to look at some further complications.

One complication is the question of changes in consumption patterns that result from changes in prices. We all know that the increases in energy prices caused dramatic changes in our consumption of fuel but also resulted in requiring a different, more efficient, automobile; in better insulated houses, etc. Thus, the shares of expenditures of many items change over time and we may question whether expenditure patterns established in 1972 (before fuel prices increased more than fourfold) are still valid.

Maybe we can build an index in which new, more current, expenditure patterns are reflected. Such indices are actually calculated. Instead of, say, 1972 weights, we can use 1981 weights in calculating an inflation index for 1982. The CPI, however, is based on reference year weights (currently 1972) while the so-called Implicit Price Deflators for Personal Consumption Expenditures are based on current year weights. Statisticians call a price index which is based on reference year weights the "Laspeyres formula" and on current year weights, the "Paasche formula."

The distinction between these two types of price indices is very important in considering which type is more appropriate for our purposes. It is not a matter which index is 'better' (they are both good for different purposes) but rather which is proper for the particular purpose at hand. The 1972 weighted CPI index answers the question: "How much would it cost in the current period to buy the average living standard of 1972?" However, if we ask what was the price change between 1980 and 1981, a 1981 weighted index would better measure the change of the 1980 consumption level, not 1972 consumption level. For our purpose, it seems more relevant to consider the cost change of the more recent consumption bundle. Hence, we may question the validity of using the CPI which is based on 1972 consumption weights. As already mentioned, the government also calculates indices based on 'current' consumption weights. One of them is the Implicit Price Deflator for State and Local Government purchases.

But we are a little ahead of our story. First, we must examine what kind of expenditures are included in the index or, in other words, for whom they are calculated.

The CPI is calculated in two versions: a) For All Urban Consumers and b) For Urban Wage Earners and Clerical Workers. The former index includes about 80% of the U.S. population; while the latter, about 50% of all urban population. Naturally, the distinction is introduced in order to reflect better the consumption patterns of these two groups of consumers. Still, rural households and expenditures specific to other consumer groups are probably not reflected well in the CPI. On the other hand, the Implicit Price Deflators in the National Accounts published by the Bureau of Economic Analysis are more comprehensive and specific. There is available a personal consumption expenditures index with subdivisions for durable goods, and services; for gross private domestic investment with a breakdown for nonresidential and residential fixed investment. Finally, exports and imports and government purchases indices are also provided with the latter divided between Federal and State and local government purchases of goods and services.

We will concentrate here on the distinction between the Consumer Price Index and the Implicit Price Deflator for State and Local Government Purchases.

According to the CPI, the major expenditure categories had the following shares in 1972:

	<u>1972-73</u>
Food and beverages	18.8%
Housing	42.9
Apparel	7.0
Transportation	17.7
Medical Care	4.6
Entertainment	4.5
Personal care and others	<u>4.5</u>
	100.0

A cursory review of these items reveals that they may be quite irrelevant for a typical budget of a local government. An expenditure of almost 43% on housing is probably exaggerated even for a typical consumer, but certainly not applicable for a government budget. Within that major category we find such items as home purchase (9.97%); rent of residential shelter (5.62%); household furnishings and operation (8.22%); fuel and other utilities (6.52%). Except the latter, and to some degree rent, the other items are typically not bought in an operational local budget. Similarly, entertainment, food and beverages, personal care, educational expenses and even medical care expenses are not typical for a local government.

Instead, such items as wages and salaries of government employees, transportation, energy, etc. are typical costs for government agencies. Some of the price indices for these items may differ considerably from those included in the CPI. Therefore, it is preferable to choose among the available indices the one that responds better to expenditure categories of the public sector. From this viewpoint, the Implicit Price Deflator for State and Local Government Purchases clearly exhibits the preferred characteristics.

The following table compares the State and Local Purchases Index with several broader indices for the years 1971-1982.

Table 1

COMPARISON OF IMPLICIT PRICE DEFLATORS (IPD) and CPI

	GNP IPD	Personal Consumption Expenditures IPD	State and Local Government Purchases IPD	Consumer Price Index for All Urban Consumers	
				U.S.	N.J.
1971	96.01	96.5	94.7	96.8	96.3
1972	100.00	100.0	100.0	100.0	100.0
1973	105.69	105.7	106.9	106.2	106.5
1974	114.92	116.3	117.4	117.9	118.3
1975	125.56	125.2	128.3	128.7	127.6
1976	132.11	131.6	137.0	136.1	134.7
1977	139.83	139.5	146.0	144.9	141.9
1978	150.05	149.1	156.9	155.9	150.3
1979	162.77	162.3	169.8	173.5	164.3
1980	177.36	178.9	184.7	197.0	183.8
1981	193.71	193.7	200.3	217.4	201.4
1982:1	201.99	201.7	209.7	225.9	208.4
σ	34.55	34.48	37.29	42.87	36.64
v	.244	.243	.255	.286	.254
<u>ANNUAL PERCENT CHANGE</u>					
1972	4.16%	3.63%	5.60%	3.31%	3.84%
1973	5.69	5.70	6.90	6.20	6.50
1974	8.73	10.03	9.82	11.02	11.08
1975	9.26	7.65	9.28	9.16	7.86
1976	5.22	5.11	6.78	5.75	5.56
1977	5.84	6.00	6.57	6.47	5.35
1978	7.31	6.88	7.47	7.59	5.92
1979	8.48	8.85	8.22	11.29	9.31
1980	8.96	10.23	8.78	13.54	11.89
1981	9.22	8.27	8.45	10.36	9.58
1982:1	4.27	4.13	4.69	3.91	3.48

On the average for the 11-year observation, the highest inflation rate is measured by the U.S. CPI followed by the State and Local Government IPD, the New Jersey CPI, the GNP Implicit Price Deflator and the Personal Consumption Expenditure IPD. Although we cannot choose an index simply because it gives a higher value, the highest reading for the CPI is known to be influenced by the way housing costs are treated. Since the housing component with its very high weight is the least relevant for the expenditure mix of local government, there are good reasons to discard the U.S. CPI.

An even more important observation than the average inflation rate measured by the various indices is their variation over time. All indices show acceleration of inflation up to 1975, then a period of deceleration between 1975-1977 followed by the next period of acceleration up to 1981-1982. Again, the most volatile changes are shown by the U.S. CPI. The latter started with the lowest inflation rate among all indices analyzed here (3.31% in 1972) and reached the highest annual increase of 13.54% in 1980. A statistical expression of these annual variations of each index is the so-called standard deviation (σ) and the coefficient of variation (V). These statistics, provided in Table 1, clearly show the largest deviation and variation for the U.S. CPI.

The following table compares the state and local government inflation rate with three other inflation rates, namely, the Implicit Price Deflator of Personal Consumption Expenditures and the Consumer Price Indices for the U.S. and New Jersey. (see Table 2)

TABLE 2

COMPARISON OF IMPLICIT PRICE DEFLATOR (IPD) AND CPI

	State and Local Gov't.	Difference Between SLG and:		
		Personal Consumption Expenditure	CPI for the U.S.	CPI for New Jersey
1971	--	--	--	--
1972	5.60	+1.97	+2.29	+1.76
1973	6.90	+1.20	+0.70	+0.40
1974	9.82	-0.21	-1.20	-1.26
1975	9.28	+1.63	+0.12	+1.42
1976	6.78	+1.67	+1.03	+1.22
1977	6.57	+0.57	+0.10	+1.22
1978	7.47	+0.59	-0.12	+1.55
1979	8.22	-0.63	-3.07	-1.09
1980	8.78	-1.45	-4.76	-3.11
1981	8.45	+0.18	-1.91	-1.13
1982:1	4.69	+0.56	+0.78	+1.21

The conclusion one can reach from this review is that from the viewpoint of the content of the inflation indices, the most relevant is the Implicit Price Deflator for State and Local Government Purchases of goods and services. This index is published monthly in Economic Indicators, prepared for the Joint Economic Committee by the Council of Economic Advisers. The least appropriate is the U.S. CPI.

Uncapped Municipalities

The Committee considered the provision of the municipal cap law which creates a special class of municipalities exempt from the cap if the municipal purposes tax rate is \$.10 or less per \$100 of assessed value.

While the Committee recognized the rationale for the recommendation in the 1979 Report of the Joint Committee on Tax Policy which called for deletion of the exemption, in the absence of a near-unanimous position by Commission members, the Commission makes no recommendation for changing that section.

The following table shows the total number of uncapped municipalities by county for each year since enactment of the cap law and the number of municipalities which had no local purposes property tax rate.

Names of municipalities included in the summary are available in the Commission's files at either the Division of Local Government Services or the New Jersey Taxpayers Association.

The Commission considered the desirability of having a uniform budget format for all municipalities so that comparable analysis of cap impact on both capped and uncapped municipalities would be available. However, a change for such uniformity, without changing basic provisions of the cap law, did not appear to be practical. The Commission does urge continued research and analysis on spending growth in uncapped municipalities to develop information for future evaluation as to whether the exemption provision should be retained.

**NUMBER OF UNCAPPED MUNICIPALITIES AND NUMBER WITH NO TAX RATE
BY COUNTY, BUDGET YEARS 1977 TO 1983**
(Based on municipal purposes tax rate of \$.10 per
\$100 ratables or less in previous tax year.)

County	No. of Municipalities	1977*		1978		1979		1980		1981		1982		1983	
		No	Un- Rate capped	No	Un- Rate capped	No	Un- Rate capped	No	Un- Rate capped	No	Un- Rate capped	No	Un- Rate capped	No	Un- Rate capped
Atlantic	23	3	3	5	6	3	5	3	5	3	6	4	6	4	5
Bergen	70	1	2	1	4	3	3	3	4	2	3	1	1	1	2
Burlington	40	7	7	7	17	8	14	9	15	9	14	8	14	6	13
Camden	37	2	2	2	2	2	3	2	3	1	1	1	1	1	1
Cape May	16	2	2	2	3	2	3	2	3	2	2	2	2	2	2
Cumberland	14	5	3	7	9	7	9	8	10	7	8	7	9	8	8
Essex	22	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Gloucester	24	5	3	5	6	4	7	2	5	1	3	1	4	1	4
Hudson	12	1	1	1	1	2	2	1	1	1	1	1	1	2	2
Hunterdon	26	6	6	6	12	7	12	5	13	5	9	4	9	5	10
Mercer	13	0	0	1	2	1	2	1	2	1	1	1	1	1	1
Middlesex	25	3	3	2	5	2	5	1	5	2	7	1	5	2	5
Monmouth	53	1	1	2	2	3	4	2	5	1	4	1	3	2	4
Morris	39	0	0	0	0	0	1	0	1	0	0	0	0	0	0
Ocean	33	2	2	2	2	2	3	2	3	2	2	2	3	1	2
Passaic	16	0	0	0	0	0	0	0	1	0	0	0	0	0	0
Salem	15	7	8	8	10	8	10	8	10	8	10	10	10	10	10
Somerset	21	1	2	1	4	1	4	2	2	2	2	2	3	2	3
Sussex	24	3	2	4	5	6	8	7	8	6	7	6	7	4	5
Union	21	0	0	0	1	0	1	0	1	1	1	0	1	1	1
Warren	23	9	7	13	17	13	17	10	16	8	12	8	15	8	12
Total	567	58	54	69	108	74	113	68	113	62	93	60	95	61	90

* Note: 1977 (Actual 1976 rates). Municipalities in the "no rate" column were calculated without inclusion of the tax levy for one-half the cost of senior citizens' deductions and full cost of the veterans' deductions, which deductions were fully reimbursed by the State beginning in 1977. Calculation for the "uncapped" municipalities includes the levy for senior citizens' and veterans' deductions in 1977 only.

Source: All figures based on data on Annual County Abstracts of Ratables. Years 1977 to 1979 from "Report of the Joint Committee on Tax Policy", Trenton, June 1979. Years 1980 to 1983 adapted from "General Tax Rates and Effective Tax Rates", Studies by the Local Property and Public Utility Branch, N.J. Division of Taxation.

Statement of Adam Broner

I suggest that the calculation of "add-ons" be modified to take into account not only new ratables, but also lost ratables during the year. This way the "add-ons" will be calculated as a net quantity instead of a gross quantity. There are two reasons for this suggestion. First, as was mentioned in the paper discussing the inflation indices, the cap on State expenditures is based on personal income growth in current dollars which encompasses two components: the inflation rate and real net growth. The postulate that local expenditure caps be similar to the State cap would therefore require that, for municipalities too, net real growth be added to the inflation rate. The Commission has accepted an inflation rate but retained the current "add-ons" which reflect rather gross, not net, real growth. Actually, this way real growth is exaggerated and results in somewhat higher caps than those on the State level.

Second, there is even a more fundamental reason why I recommend that a net growth of ratables should be considered. In municipalities where the tax base is declining, i.e., the decline in ratables is greater than the increase in ratables, a situation prevalent in some cities of the State, the current and Commission-accepted method would allow tax rates to increase much more than the inflation rate in order to cover the decline in property tax revenues due to losses in ratables. This leads us to an ever-increasing property tax rate which, in turn, leads to further erosion of the tax base and, consequently, new increases in tax rates. The end result of such a process can only be a continuing decline of the urban economy to the detriment of the entire State. For this particular reason, I strongly recommend the Commission accept a method of calculating municipal caps which adds only net increases in ratables.

Under this method, property tax rates will be allowed to increase at the rate of inflation and include net growth of ratables. The adoption of this method is essentially equivalent to limiting property tax increases even though the caps are expressed in terms of expenditure limitation. A direct property tax rate limit proposal is available from the Office of Economic Policy.

Statement of Adam Broner

By adopting the implicit price deflator for state and local government purchases we introduce flexibility to the local government caps. In order to prevent difficulties in expenditure adjustments following abrupt and large declines in the rate of growth in that index, it has been agreed that a two-year average of growth in the index should be applied. Under these conditions, I do not see any need for putting a 5% floor under the inflation index to be applied to local caps.

This is the reason why I could not vote for the entire solution adopted by the majority of the Commission even though I full-heartedly agree with the basic concept of applying the inflation rate as expressed in the implicit price deflator of state and local government purchases.

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