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New Jersey's Gubernatorial Race, Part II: Governor Corzine's Challengers Call for Lowering Tax Burdens

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(See *Fiscal Fact* No. 171 for a discussion of Gov. Corzine's proposals and New Jersey's current economic crisis.)

Lonegan and Christie Debate Income Tax Cuts

The two major candidates for New Jersey's Republican gubernatorial nomination are former U.S. Attorney Chris Christie and former Bogota, New Jersey, Mayor Steve Lonegan. Polls show a close race between the two, and between each challenger and current governor Jon Corzine (D). Both Christie and Lonegan have made taxes a centerpiece of their platforms.

Lonegan's more defined tax proposal centers on a flat income tax rate with no exemptions or deductions at a rate of 2.9% beginning with the first dollar, falling to 2.5% in the second year, and 2.1% in the third year. Lonegan argues that the economic growth induced by the sharp cut in income tax and elimination of distortive tax preferences will enable revenues to remain stable after the first year even as the rate drops.

A flat income tax of the type Lonegan proposes is ambitious but attainable. Nine states have flat income taxes: Colorado, Illinois, Indiana, Massachusetts, Michigan, New Hampshire, Pennsylvania, Tennessee, and Utah. However, all of these states either incorporate some federal deductions by having state taxpayers use adjusted gross income or taxable income from the federal form, or provide a standard deduction or personal exemption. Both would have the effect of shielding some low-income individuals from paying income tax, providing all taxpayers with a minimal tax reduction, and making the system mildly progressive.

Lonegan's flat tax proposal is precisely that: flat in rate, in progressivity, and in the scope of things subject to taxation. On one hand, not offering a basic threshold below which one does not owe income tax could hurt poor workers disproportionately compared to the current tax system. Christie argues that 70% of households would pay increased income tax under Lonegan's flat tax plan. It is probably true that taxpayers currently in the bottom two tax brackets would pay more under the proposal, since Lonegan's flat rate exceeds the rates they currently pay (if they pay anything at all). Lonegan also states that the dramatic tax cut would produce long-term economic benefits that would exceed those costs.

Lonegan has also targeted the problematic *Abbott* ruling of the New Jersey Supreme Court, whereby the state is mandated to increase education funding under a dubious constitutional rationale. The Tax Foundation reviewed *Abbott* and other cases like it across the United States and estimated the tax impacts of the spending mandates, in its publication *Appropriation by Litigation.* ***[1]***

Table 1: Lonegan Flat Tax Idea Similar but not Identical to Existing State Flat Taxes

State	**Flat Tax Rate**	**Notes**
Lonegan Plan: New Jersey	2.90%	No deductions; tax applies on first dollar earned
Colorado	4.63%	Piggybacks on federal deductions by applying rate to federal taxable income
Illinois	3.00%	$2,000 personal exemption; piggybacks on some federal deductions by applying rate to federal adjusted gross income with modifications
Indiana	3.40%	$1,000 personal exemption; piggybacks on some federal deductions by applying rate to federal adjusted gross income with modifications
Massachusetts	5.30%	$4,400 personal exemption; higher rate applies to some earned investment income
Michigan	4.35%	$1,000 personal exemption; piggybacks on some federal deductions by applying rate to federal adjusted gross income with modifications
New Hampshire	5.00%	$2,400 standard deduction; tax applies to interest and dividend income only
Tennessee	6.00%	$1,250 personal exemption; tax applies to interest and dividend income only
Utah	5.00%	$2,625 personal exemption

Christie has been less definite about his tax proposal, but has emphasized that it would involve an across-the-board cut to all state taxpayers, and that it would retain many of the targeted tax credits that Lonegan's plan eliminates. (Christie has also noted that the timing of the cuts is dependent on the state's revenue situation.) Christie has also called for the reduction of New Jersey's corporate income tax, which at a top rate of 9.36% is one of the highest in the country.

The corporate tax cut would be an important move for New Jersey's competitiveness. In Fiscal Year 2007, New Jersey raised $332 per capita in corporate income taxes, behind only Alaska, New Hampshire, and Delaware. (Each of those states does not have one of the major taxes.) However, Christie's reliance on both tax cuts and tax incentives (credits or subsidies) as a way of encouraging business is in stark contrast to Lonegan's view that such incentives should be eliminated in favor of broad tax cuts.

A state that faces economic decline and an exodus of population has two choices. One is to ramp up state spending on education and infrastructure and offer targeted tax incentives for selected industries, and hope that these inducements will lure people back. All state governments do this to some extent, notwithstanding the risk. At best, however, these investments will take decades to pay off. At worst, the fate of Michigan could become more common: people take their degrees from the excellent state schools and use the excellent roads to drive to other states where there are jobs.

The other choice is to reduce reliance on burdensome and volatile revenue sources, prioritize state services and pare back on the non-essential, and set out a welcome mat of a simple, transparent, neutral, and stable state tax system for all. If tax increases have to occur, states should structure them in a way that spreads the burden and addresses spending growth.

Finally, both Lonegan and Christie support requiring a two-thirds vote by the legislature to increase taxes. And both candidates have referred to Tax Freedom Day, the day of the year when Americans have earned enough to pay taxes and can start working for themselves. Tax Freedom Day is calculated annually by the Tax Foundation for the nation as a whole and for each state. New Jersey's Tax Freedom Day this year fell on April 29, 16 days after the national Tax Freedom Day and second-to-last in the country.

Conclusion

New Jersey is facing a crisis in its state budget, tax system, and the economy as a whole. It is thus surprising to see significantly different approaches to addressing New Jersey's economic performance. Governor Corzine has proposed deferring some expenses, limiting eligibility for a troubling property tax rebate program, and hiking taxes on high-income earners. New Jersey was an early adopter of such a "millionaires' tax" several years ago, and its budget situation is now worse than that of other states.

Chris Christie and Steve Lonegan both aim to cut taxes, although Christie would preserve the bracket progressivity and the array of credits and deductions. Lonegan, while eliminating them, would create the nation's first completely flat tax (although several states have flat taxes with a standard deduction or personal exemption) and the one with the lowest rate. Christie would cut the state's high corporate income tax but also rely on tax incentives to spur development and employment, a policy that New Jersey has tried for years and that has not worked in other states.

Lonegan, on the other hand, hopes that favorable tax policy would be sufficient to bring jobs and business back.

Both plans are serious and attainable, with strengths and flaws. For those who deny that high tax rates and heavy tax burdens lead to a bad economy, one need only look at New Jersey. It remains to be seen which plan New Jersey residents think will make the Garden State bloom again.

Notes

1. *See* Chris Atkins, "Appropriation by Litigation: Estimating the Cost of Judicial Mandates for State and Local Education Spending," *Tax Foundation Background Paper No. 55* (Jul. 2007), at http://www.taxfoundation.org/research/show/22505.html

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