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Written Testimony
Comptroller Kevin Lembo
April 23, 2015

Concerning

SB 1135 An Act Establishing a Sustainable Path for Maintaining the Budget Reserve Fund and Reducing the Effect of Revenue Volatility on the State Budget.

Senator Fonfara, Representative Berger, Senator Frantz, Representative Davis and Members of the Committee:

Thank you for the opportunity to express my support for *Senate Bill 1135 An Act Establishing a Sustainable Path for Maintaining the Budget Reserve Fund and Reducing the Effect of Revenue Volatility on the State Budget.*

I would also like to thank Senator Fonfara for his leadership and work on this issue; as well as Representative Candelora for his continual legislative efforts related to the Budget Reserve Fund (BRF).

As you already know, Connecticut's high concentrations of individual wealth and significant number of corporate headquarters result in large fluctuations in revenue as economic conditions change. Revenue fluctuations result in significant revenue shortfalls when the economy is under-performing, requiring cuts in programs, reductions in aid to cities and towns, tax increases or all of the above.

The BRF also known as the Rainy Day Fund, can be used as an important tool for stabilizing the state's revenue stream to protect against large fluctuations in revenue.

This bill allows the state to fully realize the potential of the BRF as a mechanism to protect against revenue losses during economic downturns by increasing the cap on the BRF balance and making deposits into the fund a higher budgetary priority during good economic times.

(more)

Currently, deposits are made to the BRF at the close of the fiscal year with any unappropriated surplus being transferred to the BRF. Historically, this mechanism has resulted in limited deposits into the BRF. Anticipated surpluses have often been appropriated for other purposes during the budget process. In fact, since 1992, Connecticut has realized a total of $8.7 billion more in General Fund revenue than originally budgeted in years in which revenue outperformed expectations. However, of this excess revenue less than one third, $2.5 billion, has been deposited into the BRF[1]with the remainder used for other purposes.

The lack of consistent funding of the BRF resulted in insufficient balances for the state to weather either of the last two economic recessions. During the 2002 recession, General Fund tax revenue was $1.4 billion below 2001 levels over a two year period. In 2009, General Fund tax revenue took three years to recover to 2008 levels and shortfalls totaled $3.9 billion.[2] BRF balances were entirely insufficient to cover the revenue shortfalls of either recession. In 200 the BRF balance was $595 million and in 2008 the balance was $1.4 billion.[3] These inadequate reserve balances required cuts in services and increases in taxes in order to balance the state budget. Higher taxes and fewer government services placed additional downward pressure on the state's economy at the worst possible time. Greater BRF balances would have reduced or eliminated the need for such draconian measures.

To ensure better budgeting results in the future, SB 1135 makes BRF deposits a higher budgetary priority. It seeks to put Connecticut's budget on a more sustainable path by instituting a new formula to calculate required BRF deposits. The formula requires automatic deposits to the BRF each time the state's two most volatile major tax revenue sources, the estimated and final payments portion of the income tax, and the corporations tax, over perform in comparison to historical norms. Projected required deposits would be identified prior to the start of the legislative session and deposited into a special account outside of the General Fund. Identifying the projected deposits early will reduce the temptation of future legislators to re-appropriate the funds before they are certified as surplus by the Comptroller at the close of the fiscal year. But the bill is sensitive to abrupt changes in fiscal conditions by including provisions to return monies set aside for BRF deposit to the General Fund should revenue projections decline.

Placing a higher priority on BRF deposits will allow the state to build larger BRF balances prior to the next recession. However, the current statutory limit on BRF balances may be too low to provide adequate protection against declines in tax revenue associated with the next economic

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[1] See exhibit 1 attached for further detail
[2] See exhibit 2 attached for further detail
[3] Annual Report of the Comptroller - Budgetary Basis 2001, 2008

downturn. Current statute sets a cap on BRF balances of 10 percent of General Fund appropriations. Each of the last two recessions resulted in reductions in General Fund tax revenue of greater than 10 percent of net General Fund appropriations. In order for the BRF to act as a stop gap while tax revenues are depressed from an economic downturn, this legislation raises the cap on BRF deposits from 10 percent to 15 percent of net General Fund appropriations. A 15 percent cap will allow the state to build more adequate reserves in the BRF and is in line with the latest recommendations of the Governmental Accounting Standards Board (GASB).

Finally, SB 1135 seeks to assist in paying down unfunded liabilities by directing a small portion of excess revenues as identified by the new BRF deposit formula toward unfunded liability payments.

Had the BRF deposit mechanism proposed in this bill been in place since the inception of the income tax in 1992, the state would have been in a significantly better position leading into each of the last two recessions. Moreover, unfunded liabilities would have been reduced by approximately $800 million.

Rainy Day Fund Balance: Actual vs. New Formula (1992-2015)

FY	*Actual Balance*	***New Deposit Formula Balance***
2001	$595M	***$1,573M***
2009	$1,382M	***$2,534M***
2015	$519M	***$262M***
Total:	**$2,496M**	***$4,368M***
Total Payment Toward Unfunded Liability 1992-2014	**$776M**	

The higher BRF balances would have significantly limited the need for program cuts and tax increases in each of the two recessions experienced over the analysis period. In the absence of adequate reserves the program cuts and tax increases that were experienced further contributed to economic instability.

The proposed BRF deposit formula in this legislation combined with the proposed increase in the cap on BRF balances will enable the state to better manage the swings in revenue collections by storing money away in good economic times so that it is available when the economy slumps. Higher BRF balances in the run up to the next recession will hasten the state's economic rebound and avoid a slower recovery. It will also help prevent cuts in programs and services at a time when they are most needed and tax increases when least affordable. Better management of the BRF means a brighter future for Connecticut.

Thank you to the committee for its work on this important issue. I urge your support.

Attachment

Exhibit 1:

Excess Revenue is defined as the difference between actual General Fund revenue collections and Budgeted Revenue. Graph only displays Fiscal Years in which actual revenue outperformed budgeted revenue.

Source: Comptroller's Annual Report on a Budgetary Basis 1990-2014, schedule B2.

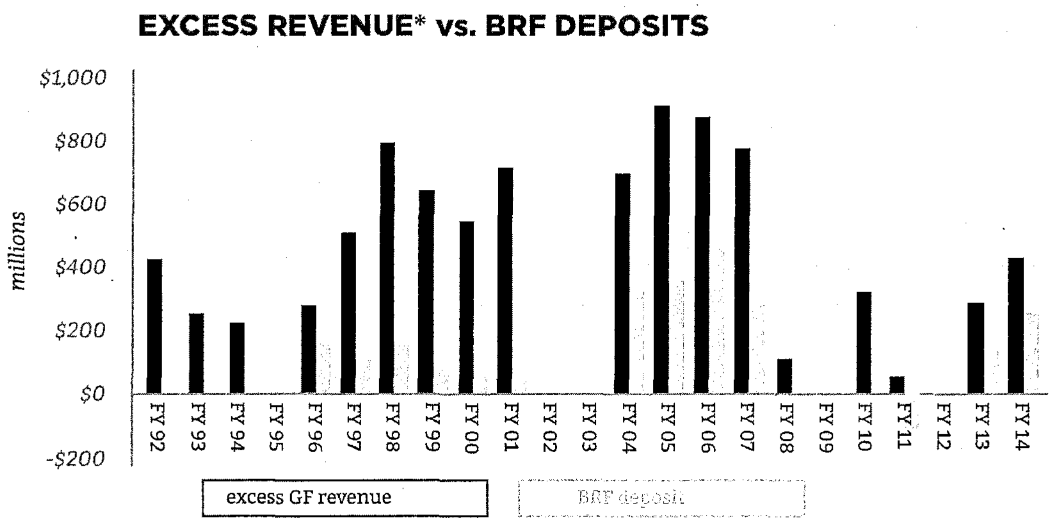

Exhibit 2:

Revenue Shortfalls are defined as the difference between the total General Fund tax revenue the fiscal year immediately preceding a recession (base year) and revenue collection in the ensuing fiscal years in which total general fund tax revenues remains below the base year.

Source: Comptroller's Annual Report on a Budgetary Basis 2001-2003 & 2008-2011, schedule B2.

FY	General Fund Tax Revenue
2001	$8,707,093,316
2002	$7,730,953,705
2003	$8,229,806,746
2002 Recession Total Revenue Shortfall:	*$1,453,426,181*

FY	General Fund Tax Revenue
2008	$12,523,911,045
2009	$10,708,262,539
2010	$10,894,132,455
2011	$12,049,466,814
2009 Recession Total Revenue Shortfall:	*$3,919,871,327*