KEVIN LEMBO
STATE COMPTROLLER

MARTHA CARLSON
DEPUTY COMPTROLLER

STATE OF CONNECTICUT
OFFICE *of the* STATE COMPTROLLER
55 Elm Street
Hartford, CT 06106

Written Testimony
Comptroller Kevin Lembo
March 27, 2015

Concerning
SB 294 An Act Increasing the Cap on the Budget Reserve Fund

Senator Bye, Representative Walker, Senator Kane and Representative Ziobron:

Thank you for the opportunity to express my support for Senate Bill 294 An Act Increasing the Cap on the Budget Reserve Fund.

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 Budget Reserve Fund (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.

In order for the state to fully realize the potential of the BRF as a mechanism to protect against revenue losses during economic downturns, deposits into the fund must become a higher budgetary priority during good economic times and the cap on the BRF balance must be increased.

Currently, deposits are made to the BRF at the close of the fiscal year with any un-appropriated 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 caused its balance to be insufficient 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

[1] See exhibit 1 attached for further detail

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 2001 the BRF balance was $595 million and in 2008 the balance was $1.4 billion.[3] Inadequate 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.

In order to ensure better results in the future, the state should consider making BRF deposits a higher budgetary priority. The current practice of waiting until an un-appropriated surplus is certified at the close of the fiscal year to fund the BRF is not maximizing the capability of this important tool. A new mechanism that identifies potential surplus revenue prior to the budget process is needed. However, any early identification of potential surplus revenues should allow enough flexibility to permit such funds to return to the General Fund if financial conditions change as the fiscal year progresses. A policy that removes projected surplus from the General Fund in the middle of the fiscal year in the absence of a mechanism to return those dollars in the event financial conditions change could require painful cuts to programs mid-fiscal year, even when revenues are performing as originally budgeted.

Such strict policies are unnecessary. Historical data indicates that adequate BRF balances can be built by only making deposits when revenue is performing well. Still, it is important that such excess revenues be identified early and not be appropriated for other purposes through the budget process. A balanced approach that identifies excess revenues prior to the budget process, but allows for their return should financial conditions change is needed to ensure consistent and adequate deposits to the BRF while avoiding the potential for requiring mid-year budget cuts when revenues are performing as budgeted.

Placing a higher priority on BRF deposits will allow the state to build higher 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 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, the 10 percent cap should be raised to at least 15 percent of net General Fund appropriations as recommended by the Governmental Accounting Standards Board (GASB) and supported by my office for many years.

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

In the past, raising the cap has never been a high priority as we have never had a BRF balance of greater than eight percent; however, the pain of the most recent recession has made it exceedingly clear that past practices have not served us well. Moving forward, I would respectfully recommend making BRF deposits a higher budget priority, and raising the cap on BRF balances to accommodate the additional deposits.

The BRF has the potential to 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. This will hasten the state's rebound from the next recession 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.

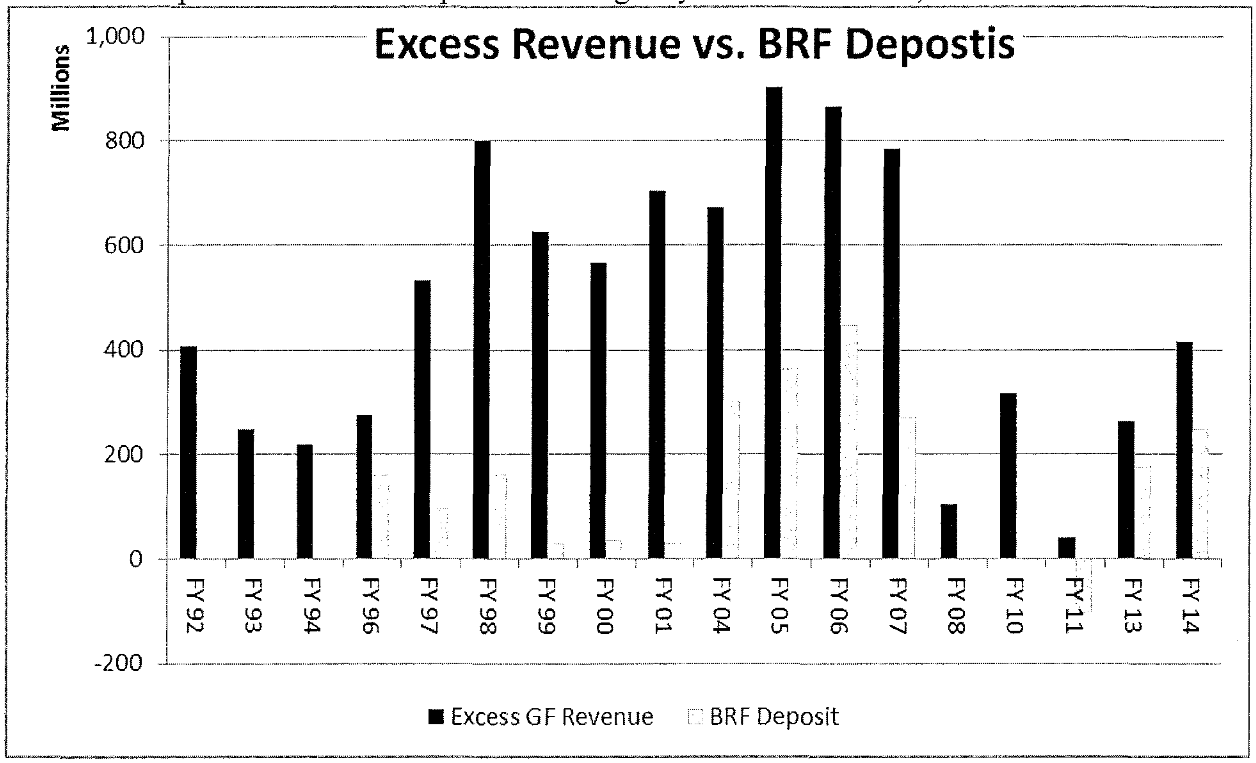

Exhibit 2:

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*