



# Crisis— A Terrible Thing to Waste

Connecticut's Budget Dilemma  
and the Opportunity for Reform

Prepared by  
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## Introduction

Connecticut is facing its greatest fiscal crisis since 1991. The national economy has had a dramatic impact on state budget revenues, thus driving the state into major deficits. We are paralyzed by many of the public policy challenges before us. Combined with the emergence of daunting demographic realities and unchecked growth in major programs, Connecticut is in the midst of a “perfect storm” that could be crippling in historic proportions.

However, our current fiscal state and our limited capacity to address it are, in many ways, self-imposed. This paper will reveal a history of policies and practices and a reluctance to make tough decisions that have exacerbated and contributed to our fiscal crisis. Our own actions—and inaction—have made us more vulnerable to the national recession, fueled the pace of our economic decline, and ensured that we will emerge from it long after the rest of the nation.

But this dilemma presents an opportunity to pursue a blueprint for change that, if pursued, will help the state endure and emerge more quickly from future economic downturns and embolden us with the resources and disciplined systems necessary to address our greatest public policy challenges.

***Most importantly, this blueprint argues that our future is a story for which we must be the authors.*** Our future is now written for us as we react to crises and external forces, while lurching from budget to budget and election to election. This crisis is an opportunity to set our state on a course of our own choosing. This crisis is a chance for leaders—in both parties and from both the executive and legislative branches—to exert courageous and visionary leadership to fundamentally change the way state government works.

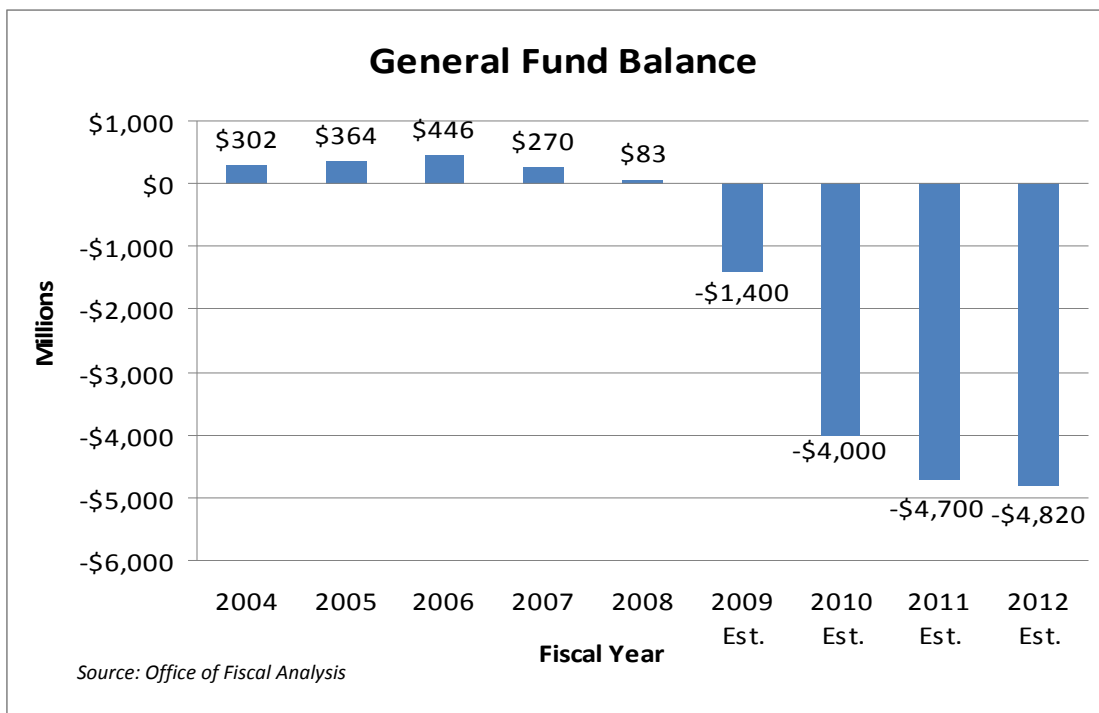
After all, a crisis is a terrible thing to waste.

## Background

The FY 2009 budget has a projected deficit of nearly \$1.4 billion. The FY 2010 budget has a projected deficit of \$4 billion (21.4% of the budget), and the FY 2011 budget deficit is estimated at \$4.7 billion (24.2%). Together this results in a projected deficit of \$8.7 billion for the next biennium.<sup>1</sup>

The sheer size of the FY 2010 - FY 2011 deficit is unprecedented in total dollars, although the combined FY 1991 and 1992 deficits that led to the income tax were larger as a percentage of the total budget.<sup>2</sup>

During the annual budget accountability report presented by the Office of Fiscal Analysis in November, 2008, the legislature learned that revenue declines—much of which can be attributed to the national recession—accounted for just over one-half of the projected FY 2010 deficit. The remaining one-half of the deficit was the result of increased spending on new and existing programs and structural holes created by using one-time revenues, such as surplus, for ongoing expenses.<sup>3</sup>



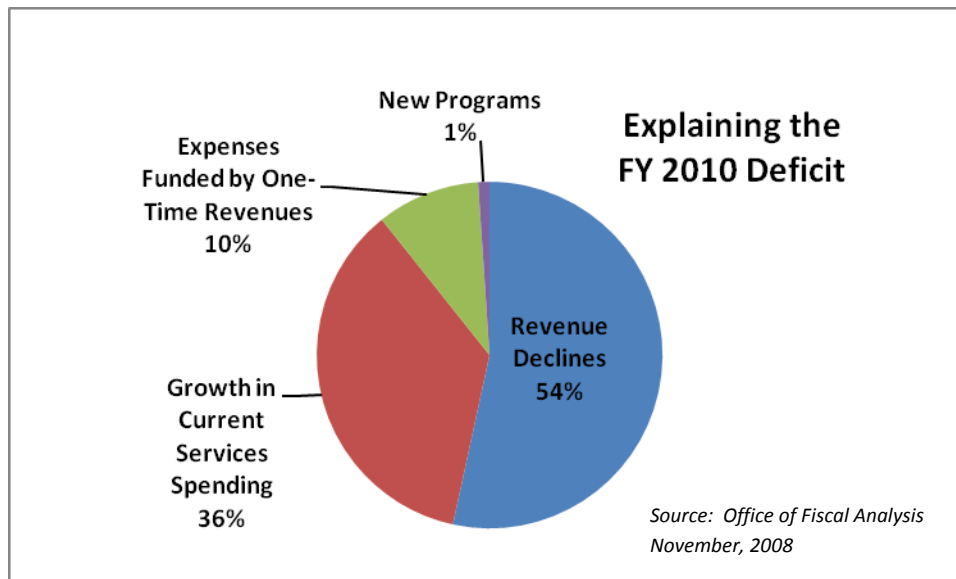
***In other words, our own decisions over many years—and not just the national recession—are responsible in a significant way for our current and projected deficits. Therefore waiting out the recession will not be enough. We must begin this session to advance long-term strategies for government, budget and tax reform.***

The most significant driver in the FY 2010 deficit is declining revenues. Historically, the state budget enjoyed average revenue growth of 3.8% per year (\$620 million). The revenue forecast for FY 2010 is -8.6%, a decline of \$1.4 billion—a total one-year drop of \$2 billion.<sup>4</sup>

Increased spending in four major areas is also a major driver in the FY 2010 deficit, accounting for a total of \$945 million or 25% of the deficit. These four areas of growth occurring between FY 2009 and FY 2010 are:

1. State Employee Wages & Benefits—increase of \$453 million
2. Medicaid—increase of \$245 million
3. Debt Service—increase of \$163 million
4. Local Education Grants—increase of \$84 million<sup>5</sup>

Connecticut’s ability to create jobs has only eroded over time. Business growth has been flat, while it increased nationally and in the northeast. The job growth we have enjoyed has occurred disproportionately in low-paying industries.<sup>6</sup>



Between 2000 and 2030 in Connecticut: The state’s population is expected to grow only 8%, while the nation will grow by nearly one-third. The elderly, intense users of health and human services will increase by nearly 70%. The population between age 18 and 64—those who will pay for these increased services—will shrink. The school age population will remain flat or decline.<sup>7</sup>

The state’s lack of success on the economic development front does not bode well for the immediate future. In the last recession Connecticut lost jobs sooner and took much longer to recover them than the rest of the nation. Connecticut lacks a long-term, innovative and visionary economic development strategy.

**Most Connecticut families are worse off now than at the start of the last recession.** Connecticut was the only state in which real income of the poorest 20% of families *fell* since the late 1980’s. Our middle income families had the second smallest gain in average income in the same period. However, our wealthiest 20% experienced a 45% increase in average real income, the second highest increase in the country.<sup>8</sup>

The economic success of our wealthy residents is not to be criticized. After all, many of our citizens aspire to such success and much of our income tax (including capital gains) revenue comes from these households. However, we need a strategic economic development plan that will ensure opportunity for the vast majority of our citizens who are not wealthy.

The national recession and resulting deficits, combined with these demographic and economic trends, and exacerbated by the policies and practices to be outlined below make for a “perfect storm.” This dilemma presents a unique opportunity to change business as usual.

# Agenda for Reform

The 2009 Session must be remembered for launching a new era of reform. The Governor and legislature can ensure that the coming decade fundamentally changes the way state government works.

We can dramatically alter our budget practices and policies. We can permanently change the dynamic between state and local government. We can enact historic and comprehensive budget and tax reform. We can enhance the legislature’s oversight role in a number of areas.

If we act boldly, we will address our greatest public policy challenges and successfully endure future recessions.

What is Connecticut doing—or failing to do—that has handicapped our capacity to address long festering public policy issues? What current policies and practices have exacerbated the budget crisis?

How can Connecticut fundamentally change the way state government works and embark on a new era of reform?

***The Agenda for Reform will review the origins of our budget dilemma and make recommendations for addressing them in the coming decade.***

The reform agenda proposes changes in ten major areas:

1. Long-Term Planning
2. Performance & Accountability
3. Spending
4. Spending Cap
5. Tax Policy
6. Tax Expenditures
7. Unfunded Liabilities
8. Indebtedness
9. Budget Reserve Fund
10. Accounting Methods

Some elements of this reform plan have been discussed for years. State Comptroller Nancy Wyman, State Treasurer Denise Nappier, and selected legislators from both parties have been sounding the alarm about many of these worrisome trends and the need for reform.

Now is the time to seize the momentum created by the crisis and these forward-thinking leaders and combine these varied strategies into a comprehensive reform agenda that will force a historic shift in the way state government works in Connecticut.

## I. Long-Term Planning

It has been decades since Connecticut was truly committed to comprehensive long-term and strategic planning. Long-term planning is a “comprehensive plan for five years or more that outlines broad long-range goals and objectives for the state.”<sup>9</sup> Strategic planning “measures progress and assesses how state agencies are meeting these broad goals.”<sup>10</sup>

Simply said, ***long-term and strategic planning represents a dynamic process of determining where we want to go as a state and how we will get there, and measuring progress towards achieving desired outcomes.***<sup>11</sup>

The Government Performance Project<sup>12</sup> grades the states on their performance and practices in management and governance. Connecticut is routinely rated one of the worst in the nation for comprehensive and long-term planning capabilities. In a recent study only two states had lower ratings than Connecticut.<sup>13</sup>

In a survey of 65 state agencies conducted by the Office of Policy & Management (OPM), it was found that only five agencies engaged in what could be truly described as strategic planning.<sup>14</sup>

The plans that were in force existed as “silos,” that is they were not developed in the context of a statewide vision and strategic plan and were not prepared in concert with agencies with overlapping public policy responsibilities.

When Connecticut engages in planning, it is:

- (a) lacking a singular vision for the state,
- (b) lacking overarching goals that the plan seeks to achieve,
- (c) compartmentalized, fragmented, single-agency, or focused on narrow policy areas,
- (d) inadequately staffed and resourced,
- (e) episodic and fails to endure with changes in leadership,
- (f) advanced without adequate and quality data,
- (g) lacking “teeth” to ensure implementation,
- (h) largely irrelevant to the budget process, or
- (i) fails to mandate performance measures to ensure accountability and results.<sup>15</sup>

The state budget has become Connecticut’s primary means of planning, but a budget is simply a tool to advance long-term strategic goals. In Connecticut the budget is the goal in and of itself.

Through a disciplined and visionary planning process, led by the Governor and supported by the legislature, Connecticut can:

- (a) pursue a future of its own choosing,
- (b) avoid the cost of bad results,
- (c) reduce its vulnerability to external economic forces,
- (d) establish consensus on funding priorities and make uninterrupted progress on the most important issues,
- (e) encourage cooperation between different agencies and branches of government,
- (f) increase efficiency of spending and reduce duplication of services,
- (g) link budgets to outcomes and ensure accountability for results,
- (h) improve transparency and public confidence in government, and
- (i) in times of budget crisis provide a tool for making thoughtful budget cuts with a scalpel, rather than through uninformed and arbitrary across-the-board cuts.<sup>16</sup>

The Governor and legislature must act in the 2009 session to establish the foundation and infrastructure for a long-term planning process, and our leaders must commit themselves over the long-term—politically and statutorily—to the agreed upon process and all of its obligations.

We must establish in law a statewide long-term and strategic planning process. The process must consist of best practices outlined in the 2007 report of the Program Review & Investigations Committee and the Council of State Governments *State Governance Transformation* initiative.

We must establish an oversight body, the *Council on Connecticut's Future*, to oversee the planning process. The Council would be chaired by the Governor, provide for gubernatorial and legislative appointments, and be housed in OPM in a reconstituted Division of Planning & Government Performance.

We must give the Council, led by the Governor, unprecedented authority to articulate a vision for the state, to establish overarching goals consistent with that vision, to require agencies to develop strategic plans and budgets aligned with the state plan, and to make agency budgets dependent on compliance with planning obligations and established performance and accountability measures.

## II. Performance & Accountability

Most taxpayers are willing to pay their fair share. However, anger and resentment results if they feel they are sending “good money after bad.”

Connecticut largely uses “cost-based” budgeting in which agencies submit a modified version of the current year’s budget and then lobby the Governor and legislature for a percentage increase. There is no requirement that commissioners systematically justify what they already have, nonetheless the increase. There is no requirement that they demonstrate that the programs currently funded even work, and there is inadequate data to conduct such due diligence.

Therefore, the legislature is left to choose between approving unjustified budget growth, cutting services arbitrarily, raising taxes, or some combination of these poor choices. This leads to uninformed debate over what to cut, what to tax and what percentage to increase the budget—avoiding the truly necessary and more strategic decisions.

According to a report produced by the legislature’s non-partisan Program Review & Investigations Committee, “there is no link, analysis, or evaluation of how each agency’s spending is tied to overall state policy or how well each agency is performing in reaching any statewide goals.”<sup>17</sup> This makes it very difficult to build public and political support for major investments in key public policy areas.

If Connecticut adopted Results-Based Accountability (RBA) we could begin to change this. Use of RBA, in the context of a long-term, strategic plan, would drive decision-making and justify investments and reductions. Such a system would allow Connecticut to reprioritize its spending by investing in “high-value” spending and reducing “low-value” spending.<sup>18</sup>

***Connecticut must “budget for outcomes.”*** How much revenue will we have? What outcomes matter most? How much should we spend to achieve each outcome? How can we best deliver each outcome? How will we demand accountability in performance? How will we measure progress, success or failure?

Without such data, how will the Governor and legislature make informed decisions about what to cut to resolve the deficit? If compliance with RBA principles was mandated for all agencies, we would know what programs were working and which ones were failing to deliver the intended results.

Instead of spending cuts being across the board, uninformed and arbitrary to “share the pain,” our reductions would be strategic and we would avoid areas with a high return on the state’s investment.

Debating the false choice between reducing spending and cutting taxes rarely leads to concrete change. RBA would bring sanity and accountability to state budgets. It is an innovative model of planning, budgeting and monitoring to ensure government spending is efficient, effective, transparent, and accountable for results.

Over time RBA would help make state programs accountable for results, require agencies to collaborate, save taxpayers’ money, inform budget decisions, build confidence among voters, and better meet the needs of our fellow citizens.

We must adopt a multi-year plan to transition state agencies to mandated use of RBA, beginning with programs that are major cost drivers in the budget.

We must require all programs to have clearly articulated goals for the populations they serve, specific outcomes to be achieved, established benchmarks to measure progress towards the outcomes, and overall program performance measures.

We must charge the Governor, through a Chief Performance Officer in a re-chartered OPM Division of Planning & Government Performance with advancing this initiative.

We must enhance the state's capacity for data collection and analysis, and utilize the untapped potential of the state's CORE-CT system for linking spending with outcomes.

### III. Spending

Aggregate state spending has grown at startling rates in recent decades. Many of these investments were prudent and necessary. However, ***some major drivers in the state budget are growing at rates that are simply unsustainable with no concrete plan for addressing the unchecked growth.***

Nearly 75% of all General Fund spending in FY 2009 is in four areas:

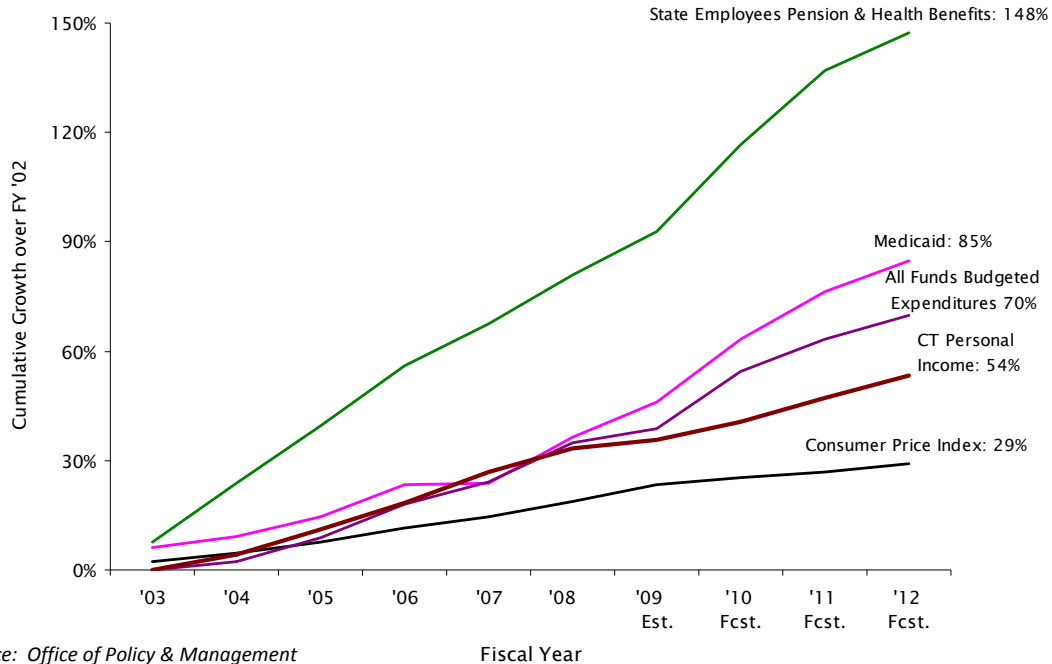
1. State Employee Wages & Benefits—\$4.9 billion (29%)
2. Medicaid—\$3.7 billion (22%)<sup>19</sup>
3. Local Education Grants—\$2.4 billion (16%)
4. Debt Service—\$1.5 billion (9%)<sup>20</sup>

Between FY 2003 and FY 2012 when the CPI is projected to increase 29%: Total state spending is projected to grow by 70%. Expenditures on state employee pension and health benefits are projected to increase nearly 150%—more than double that of the overall budget.<sup>21</sup>

Medicaid, which provides critical health care programs to the elderly and poor, is projected to increase 85%. Medicaid is one of the largest line item in the state budget at \$3.7 billion for FY 2009.<sup>22</sup> State health care costs for all programs increases by at least 10% per year with no plan to slow the growth.<sup>23</sup> State agency energy costs have risen 135% from FY 2000 to FY 2008, with no comprehensive energy plan underway.<sup>24</sup>

The Department of Social Services annual budget and the Department of Children and Families budget have grown quickly to over \$5 billion and nearly \$1 billion per year, respectively, without commensurate improvements in the lives of our neediest families and most vulnerable children and elderly.

## Growth in Significant State Expenditures



Source: Office of Policy & Management

We must develop and implement a long-term, strategic plan for the state and Results-Based Accountability for the budget, as discussed earlier, to prioritize funding, to justify the reduction or elimination of programs, to eliminate waste, and to improve efficiency.

We must mandate that major state programs be subject to independent review (similar to the Department of Social Services budget review now underway by a third-party secured by the State Comptroller) to advance agency reorganizations and program reform.

We must build a more diverse and complimentary strategy for providing human services in a more cost-effective manner by bringing together government, community providers, and philanthropic communities.

We must enact health care reform and adopt strategies for containing economy-wide health care cost increases.

## IV. Spending Cap

The Connecticut General Assembly adopted spending cap legislation in 1991 to garner political support necessary to enact the income tax. The cap allows state spending to grow from one year to the next by the greater of a five-year average growth in state personal income or the percentage increase in inflation during the preceding 12 months.

The spending cap applies to all appropriations, except: debt service payments, grants to distressed municipalities, first year expenditures on federal or court mandates, and transfers of unappropriated surplus to the Rainy Day Fund, state employee retirement fund, or debt service. The cap may be exceeded with an emergency declaration of the Governor and approval of at least 60% of members of both the House and Senate.

The voters approved a Constitutional amendment in 1992 adopting a spending cap and directing the legislature to define the key terms and definitions governing the cap. However, the legislature has never adopted updated definitions. Therefore, the statutory cap passed in 1991 contains the operative language defining how the cap will be calculated and implemented, which contributes greatly to the cap's structural weaknesses.

A spending cap can be good public policy, and it has slowed the growth in state spending in many areas. However, Connecticut's cap is poorly designed and increasingly unworkable. As a result, it is routinely ignored. For example, Governors Rowland and Rell issued "emergency" declarations, supported by the legislature, to exceed the cap in 8 of the last 11 fiscal years for a total of \$3.6 billion of spending above the cap.

What's more, the spending cap's flaws have resulted in additional "spending" through budget techniques that circumvent statutory restrictions, while giving the appearance of a "cap" on spending—leading to greater taxpayer obligations over the long-run.

For example, the cap has increased our dependence on borrowing for small projects and ongoing expenses, since debt service payments are exempt from the cap—costing taxpayers much more in the long-run. Total debt service as a percentage of the state budget has nearly doubled in the last two decades from 5.3% of state spending in FY 1988 to 10.4% in FY 2008.<sup>25</sup>

The current cap design encourages "outside the cap" spending through the use of revenue intercepts that restrict specific revenues to non-lapsing funds that provide funding for specific programs without the need for annual appropriations (e.g. Citizen's Election Fund).<sup>26</sup>

In the FY 2007 budget, nearly \$2 billion was in special, non-appropriated funds, nearly \$1 billion more than in FY 1997.<sup>27</sup> Ironically, the spending cap on the growth of "appropriated" spending has actually resulted in less of the state's spending being appropriated and subject to annual approval by the Appropriations Committee, thus reducing budget transparency and accountability.

The existing cap encourages a shift in the state's economic development incentives from grants and loans to tax credits, exemptions and deductions—tax expenditures that do not count as appropriations and are not annually reviewed or publicly scrutinized.

Our spending cap discourages the state from claiming all federal funds to which it is entitled, since most federal funds count towards the cap. Only 16% of Connecticut’s total state and local revenue comes from the federal government—the third lowest share among all states. The state’s relative wealth will always be a factor in our share of federal funds; however, the state has not maximized its full federal funding eligibility.

**Connecticut must live by its spending cap law or reform it so that it is workable and capable of achieving intended results.** Failure to do so will perpetuate the practice of routinely exceeding cap, increasing borrowing, leaving federal funds on the table, and using budget gimmicks to spend outside the cap. Collectively, these habits have led to a misleading representation of spending growth, less transparency, and greater obligations on the part of taxpayers.

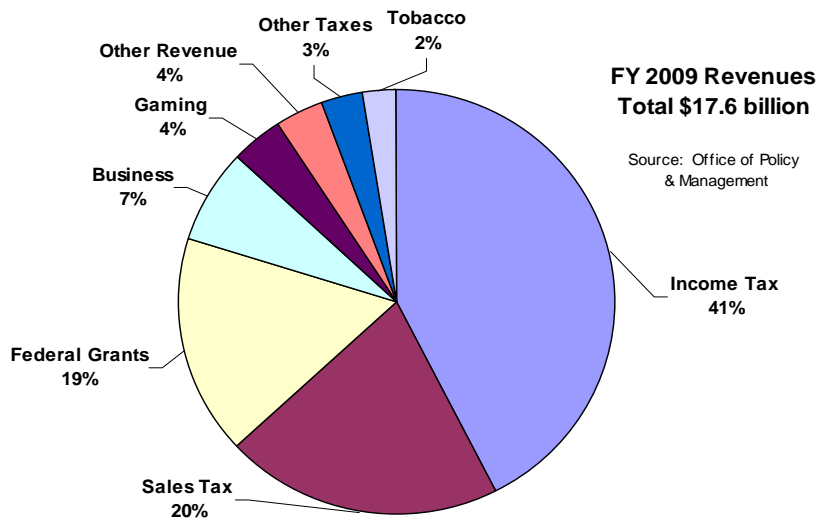
We must charge the Program Review & Investigations Committee to conduct a study of the impacts of the spending cap and its effectiveness in achieving its original purposes and to make recommendations for reform.

## V. Tax Policy

Connecticut’s tax system is antiquated and has failed to keep pace with the dramatic shifts in the economy. **We need a tax system that is modern, aligned with the new economy, less volatile, more reliable, more equitable and fair, and far less dependent on the property tax.**

The top five revenue sources in FY 2009, accounting for nearly 90% of total revenue, are:

1. Personal Income Tax—\$6.7 billion
2. Sales & Use Tax—\$3.4 billion
3. Federal Grants—\$3.1 billion
4. Businesses Taxes—\$1.1 billion
5. Gaming Revenue—\$677 million<sup>28</sup>



Given our dependence on income and sales taxes, which together account for two-thirds of all revenue, we must ensure that these taxes in particular are structured in a thoughtful, fair and more equitable fashion.

The income tax is relatively progressive for low income earners. However, it is essentially flat for all others and must be made more progressive. Also, it does not mitigate for the relative regressivity of the state's sales, property and other taxes.

The sales tax must be modernized to reflect our changing economy, which continues to move from product-based to service-based, from local businesses to multi-state and multi-national corporations, and from local stores to on-line sales. The sales tax rate could be lowered by eliminating some of the \$2.6 billion in exemptions that have little strategic public policy justification.<sup>29</sup>

In Connecticut the local property tax collects more revenue than any other tax—local or state. When accounting for all local and state tax revenue, the property tax accounts for \$7.8 billion (39%), income tax for \$6.4 billion (32%), and sales tax for \$3.5 billion (18%).<sup>30</sup>

Connecticut ranks second—at 31%—among all states in the share of its state and local own-source general revenues that come from the property tax.<sup>31</sup> This results in an unfair burden on low and middle income families and on businesses and incentivizes towns to make poor economic development decisions.

This dependence on the property tax has also crippled the capacity of our largest cities to attract businesses and families and to improve their schools and quality of life. However, enduring property tax relief can only be achieved if it is preceded by comprehensive tax reform and spending cap reform.

Comprehensive tax reform will not only achieve reliability, equity and fairness, but it will also make other objectives possible that will bring sanity and accountability to our budget process, while achieving savings over the long-term.

For example, tax reform and the resulting revenue stream could reduce unfunded liabilities, build the Rainy Day Fund, eliminate structural deficits by no longer using one-time revenues for on-going expenses, and reduce borrowing and the resulting debt service obligations—all of which would reduce taxpayer obligations in the long-run.

Most importantly, this reform and the enhanced revenue stream will make property tax relief an enduring reality. The state would finally be in a position to ensure full funding of the statutory formula grants to towns (e.g. Payment-In-Lieu-of-Taxes for state-owned property) and assume responsibility for major mandates, such as special education.

This major shift of responsibility from local to state government is necessary to reduce our dependence on the property tax, to achieve greater fairness and equity for taxpayers, to avoid

budget practices that cost taxpayers more in the future, and to provide fertile ground for new strategies in economic development, regionalization, and smart growth.

When new taxes are established, there is not always public policy justification for them. For example, the Business Entity Tax and the Real Estate Conveyance Tax were adopted more for their revenue generating capacity, rather than for their ability to advance strategic public policy objectives.

We must adopt tax policies that conform to principles of a high-quality state revenue system proposed by the National Conference of State Legislatures (NCSL):

- a. Aligned with state's long-term, strategic goals;
- b. Ensures stability, reliability and sufficiency;
- c. Improves equity and fairness and minimizes regressivity;
- d. Diversifies and balances revenue streams;
- e. Complements local government revenue systems;
- f. Responsive to interstate and international competition;
- g. Transparent and accountable to taxpayers;
- h. Broadens the tax base to reduce tax rates.

We must conduct and act on the findings of a Tax Incidence Analysis to examine the local/state tax system to evaluate how well it is conforming to the principles of a high-quality state revenue system, particularly adequacy, reliability, fairness, equity, transparency, and diversity.

We must adopt comprehensive tax reform to achieve the NCSL principles and to align the revenue infrastructure with the state's new long-term, strategic plan proposed earlier.

We must allow property tax relief to become a reality by fully funding grants to municipalities, adopting smart growth principles, making the state responsible for major mandates like special education, eliminating mandates where possible, and offering generous incentives for the regionalization of municipal services.

## VI. Tax Expenditures

Tax expenditures are tax credits, exemptions, and deductions that give preferential treatment to taxpayers through the tax code. Examples include the sales tax exemption on energy efficient products, the income tax deduction on contributions to the state's college savings plan, and tax credits for businesses.

Many tax expenditures advance worthy public policy goals. However, unlike appropriated expenditures, tax expenditures are rarely revisited and become permanent revenue losses for the state. ***Rarely do these tax policies get re-examined in light of changing economic conditions and evolving public policy needs, and most never receive a routine assessment of their strategic value to the state relative to the revenue lost.***<sup>32</sup>

Total “spending” through tax expenditures exceeds \$5 billion per year.<sup>33</sup> If tax benefits are to be offered, resulting in an erosion of the tax base, then there must be greater accountability and transparency.

Our dependence on tax expenditures has grown dramatically, often as a means of “spending” while avoiding the spending cap. The number of credits against the corporation tax has increased from 11 when the cap was passed to 29 now. The amount claimed has increased nearly 100-fold.<sup>34</sup> Of the 116 exemptions to the sales tax, nearly 50 (42%) were added since the spending cap was adopted. Nearly a quarter of state “spending” is now through preferential tax expenditures.<sup>35</sup>

We must conduct a cost-benefit analysis of all tax credits, exemptions, exclusions, and deductions and sustain only those that advance critical interests as articulated in the state’s strategic plan.

We must not approve future new tax expenditures without a formal analysis of the costs and benefits.

We must require measures, like Results-Based Accountability with appropriations, to determine if the economic impact and benefit to the state justifies the lost revenue.

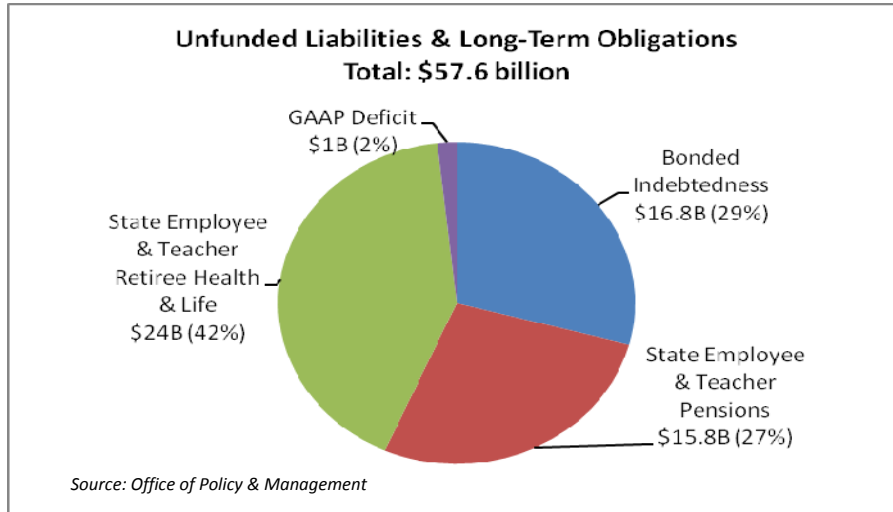
We must make the distribution of tax benefits more transparent and publicly reported and make more tax expenditures subject to caps on the total amount that may be claimed each year.

## VII. Unfunded Liabilities

Unfunded liabilities represent what the state is obligated to pay in the future in the form of pensions, health insurance, and other benefits for teachers and state employees. Connecticut’s unfunded state pension liabilities for teachers and state employees are nearly \$16 billion. Compared to all other states, we are dead last at only funding 56% of this obligation.<sup>36</sup>

Our unfunded liability for “other post-employment benefits” (OPEB) like health and life insurance for teacher and state employee retirees is \$24 billion. Again, we rank dead last among all states by funding almost nothing towards this obligation.<sup>37</sup> Together this is a total unfunded liability for pensions and other retiree benefits of \$40 billion—more than our entire biennial state budget.

***This trend in future obligations is simply unsustainable.*** Unfunded liabilities represent claims against future state revenues. We can phase in funding for these obligations now or prepare for increased taxes or program reductions in future years. Given the rising cost of health care, it is reasonable to expect these obligations to increase well beyond the rate of inflation if no action is taken.



We must increase annual contributions to the OPEB Trust Fund for health insurance obligations for state employee and teacher retirees using funds from future surpluses.

We must adopt a 25-year plan to address the unfunded liability of state employee pensions.

We must avoid early retirement incentive programs if they exacerbate the state’s pension liabilities.

We must adopt and honor a stricter policy of directing budget surpluses to the Budget Reserve Fund and unfunded liabilities.

We must work with the unions to consider changes to pension and retiree health plans for new hires in future contracts.

We must adopt health care cost containment strategies to reduce OPEB liabilities.

## VIII. Indebtedness

The Connecticut Constitution requires that we have a balanced budget. Unlike the federal government, the state cannot ignore a deficit. However, this does not mean that we cannot—like the federal government—take on crippling debt.

Connecticut's bonded indebtedness now totals \$17 billion—ranking Connecticut third highest among all states in per capita state debt. ***Debt service is now one of the largest line items in the state budget*** after only state employee wages and benefits, Medicaid, and Local Education Grants.

Debt service is projected to grow \$156 million between FY 2009 and FY 2010, adding greatly to projected deficits.<sup>38</sup> In 1988, 5.3% of state spending was spent on debt service. By 2007 it had more than doubled to 11.4%.<sup>39</sup> In FY 2007 Connecticut spent \$1.8 billion on debt service. By 2010, debt service could approach \$2.2 billion per year or over 12% of the budget.<sup>40</sup>

If the same share of the budget went to paying off debt now as in FY 1990, there would be nearly \$1 billion more today to build the Rainy Day Fund, pay off debt, reduce unfunded liabilities, or make strategic program investments.<sup>41</sup>

School construction grants often account for one-half of total bonding in a given fiscal year. Although such investments are “high value,” the generosity of the program relative to other states and the lack of accountability and controls by the legislature and State Department of Education have led to crushing debt for state taxpayers.

For example, municipalities are allowed to return to the state for up to three times for increased bond funds for the same project. The Commissioner of Education is given inadequate statutory authority to require that municipalities meet basic requirements in enrollment projections, educational merit, and local approvals before grants are approved by the legislature. Lastly, the system encourages growth in deferred maintenance on the local level and an emphasis on new construction rather than renovation and expansion—leading to increased dependence on bonding at the state level.

We must develop a long-term, statewide capital improvement plan that is aligned with the state's long-term, strategic plan proposed earlier.

We must evaluate and approve bonding requests based solely on how they will advance the strategic goals and most critical needs identified in the above plans.

We must establish the State Comptroller's proposal to establish a Debt Affordability Committee to review bond requests and make recommendations to the Bond Commission.

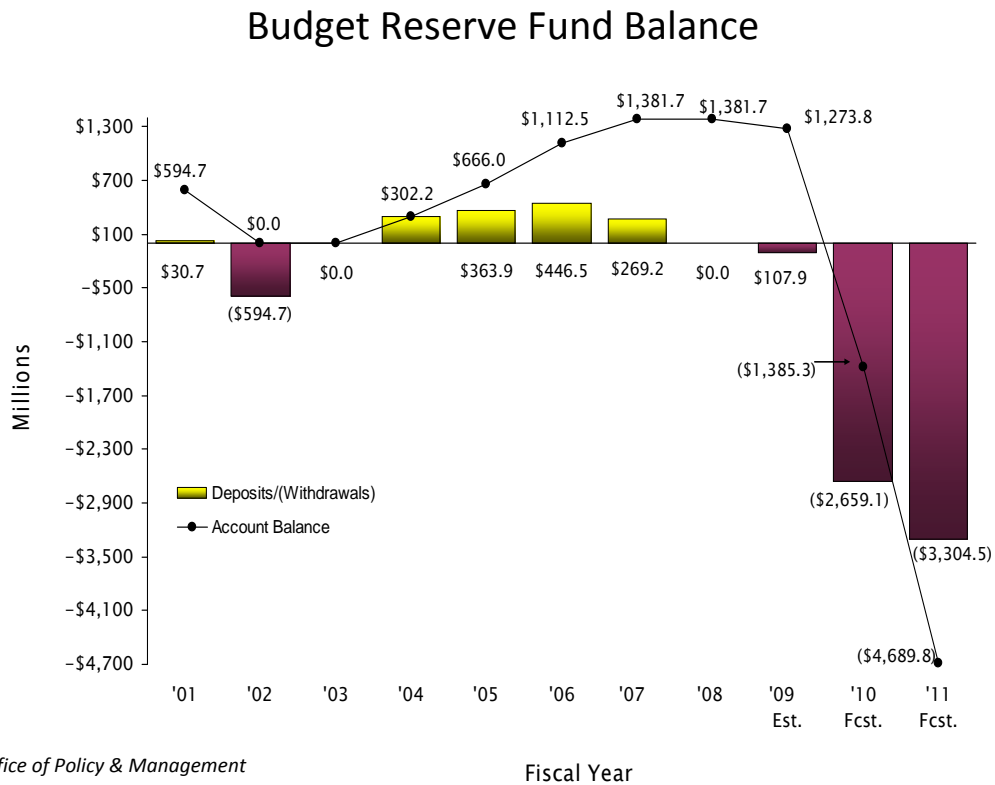
We must enhance the Commissioner of Education's authority over school construction grant requests to increase scrutiny of projects and to focus on school projects of greatest need.

We must cease the practice of using bonding for small amounts that are more appropriately funded through the budget appropriations process.

## IX. Budget Reserve Fund

The state’s Budget Reserve Fund (BRF), sometimes called the “Rainy Day Fund,” exists to help the state endure economic downturns and avoid reacting to them in ways that may exacerbate the decline.

State law allows the BRF to equal up to 10% of net General Fund appropriations. The Rainy Day Fund now has a balance of nearly \$1.4 billion, which is 81% of the full statutory capacity or \$330 million short.<sup>42</sup> The state’s failure to meet this statutory threshold is largely the result of using surpluses in good years to fund ongoing programs, rather than for building the Rainy Day Fund.



Source: Office of Policy & Management

For example, \$290 million in FY 2007 surplus, \$480 million in unspent FY 2008 funds and another \$16 million of FY 2008 transferred revenues are now funding ongoing expenses in the FY 2009 budget. This leads to structural deficits that must be addressed in subsequent years. As a result, nearly \$800 million of the projected FY 2009-11 deficits is a result of these “budget gimmicks” that only delay the need to address revenue shortfalls.<sup>43</sup>

***This session we are forced to not only address the impact of declining revenues as a result of the national recession, but we must also address the structural deficits created by our own budget choices.***

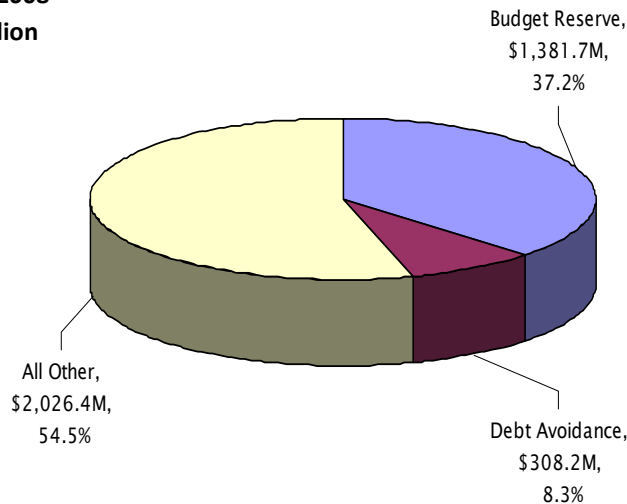
Between FY 2004 and FY 2008 the state enjoyed cumulative surpluses of \$3.7 billion. However, only one-third of it was deposited into the Rainy Day Fund and only 8% to reduce debt. More than half of it was used for future program expenditures and other purposes.<sup>44</sup>

We must mandate by law that all surplus funds be used to build the Rainy Day Fund and, when the statutory threshold is reached, all remaining surplus be used to reduce unfunded liabilities or debt.

We must amend state law to allow the Budget Reserve Fund to grow to an amount equal to 15% of net General Fund appropriations.

We must adopt the State Comptroller's proposal to require minimal mid-year deposits to the Rainy Day Fund when surpluses are projected.

**Use of General Fund Surpluses**  
**FY 2004 – FY 2008**  
**Total \$3.7 Billion**



## X. Accounting Methods

Connecticut does not abide by Generally Accepted Accounting Principles (GAAP) established by the Governmental Accounting Standards Board (GASB). GASB is an independent organization that establishes standards of accounting for state and local governments, collectively referred to as GAAP.

GAAP standards are used by the state for federal auditing purposes, bond issuances, and selected reports by the State Comptroller. However, the standards are not honored in the budget process. Connecticut develops budgets and prepares financial statements based on a modified cash basis, rather than a modified accrual basis required by GAAP. This leads to a less than honest and transparent system of reporting the state's true financial state and future obligations. It also leaves the state budget vulnerable to manipulation.

According to the Government Performance Project, “(Connecticut’s) unusual way of keeping its books has made it somewhat easier to hide from the truth. Connecticut accounts for . . . revenue streams as quickly as possible, while taking the opposite approach with its expenses.”<sup>45</sup> Abiding by GAAP would likely reveal millions of dollars in artificially buoyed funds.<sup>46</sup>

**GAAP is necessary to rebuild public trust and to enhance accountability and transparency.** Businesses and municipalities are already required to abide by these principles. State government should hold itself to the same high standards. Conversion to GAAP was mandated in state law in 1993, but has been repeatedly postponed by the Governor and legislature because of the impact on the budget. GAAP would, in essence, decrease any year-end surplus and increase any deficit. Over the past three fiscal years the annual GAAP deficit has averaged \$1 billion per year.<sup>47</sup>

We must enact legislation mandating a multi-year conversion to GAAP for development of the budget and preparation of financial statements.

## XI. Conclusion

The unprecedented budget deficit projected for FY 2010 – FY 2011 will ultimately be addressed with deep cuts in programs, delays in new programs, state employee layoffs and concessions, depleting the Rainy Day Fund, increased taxes and fees, agency eliminations and consolidations, budget gimmicks, borrowing, use of one-time revenues for ongoing needs, federal stimulus funds, and other strategies.

However, if this is the sole result of the 2009 session, we will have “wasted” a crisis. Let this be the year we act with courage and foresight by getting serious about these structural issues. Let this be the year we accept that local and state government as we know it can never be the same again. **Let this be the year we launch a decade of reform** by advancing many of the strategies proposed previously.

The importance and magnitude of these strategies require that the legislature enhance its oversight role. **The legislature must assume greater responsibility for oversight, monitoring, evaluation, and legislative remedy** in the areas discussed above. This can begin by requiring the Appropriations and Finance Committees to meet quarterly, throughout the year, to fulfill these roles outside the pressure and narrow focus of a legislative session.

The Governor and legislature have an unprecedented opportunity to make their mark on state history for which future generations will be grateful. Let the 2009 session launch a new and historic era of reform in Connecticut. **Let the change begin with us.**

## End Notes

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- <sup>1</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>2</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>3</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>4</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>5</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>6</sup> *Connecticut 2020*, Connecticut Economic Resource Center, November 2008
  - <sup>7</sup> *2008 Fiscal Accountability Report*, Connecticut Office of Policy and Management
  - <sup>8</sup> *Follow the Money*, Connecticut Voices for Children
  - <sup>9</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>10</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>11</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>12</sup> The Government Performance Project is independently conducted and financed by *Governing* magazine and the Pew Center on the States
  - <sup>13</sup> Government Performance Project, 2005
  - <sup>14</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>15</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>16</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>17</sup> *State Long-Term Planning*, Program Review and Investigations Committee, December 2007
  - <sup>18</sup> *Transforming Government*, David Osborne, The Public Strategies Group
  - <sup>19</sup> The Medicaid line item includes both state and federal funds. When federal reimbursements are received, they are counted as General Fund revenues.
  - <sup>20</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>21</sup> *2008 Fiscal Accountability Report*, Office of Policy and Management
  - <sup>22</sup> Office of Policy and Management, State of Connecticut
  - <sup>23</sup> *Transforming Government*, David Osborne, The Public Strategies Group
  - <sup>24</sup> Connecticut Office of Policy and Management
  - <sup>25</sup> *State Spending Cap Needs Some Repair*, Connecticut Voices for Children
  - <sup>26</sup> *State Spending Cap Needs Some Repair*, Connecticut Voices for Children
  - <sup>27</sup> *Coping with the Cap*, Connecticut Voices for Children
  - <sup>28</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>29</sup> *Building a Reliable, Fair and Accountable 21<sup>st</sup> Century Revenue System*, Connecticut Voices for Children
  - <sup>30</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>31</sup> *Follow the Money*, Connecticut Voices for Children
  - <sup>32</sup> *Follow the Money*, Connecticut Voices for Children
  - <sup>33</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>34</sup> *Coping with the Cap*, Connecticut Voices for Children
  - <sup>35</sup> *Coping with the Cap*, Connecticut Voices for Children
  - <sup>36</sup> *Beware Those Sleeper Taxes*, The Connecticut Economy
  - <sup>37</sup> *Beware Those Sleeper Taxes*, The Connecticut Economy
  - <sup>38</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>39</sup> Office of Fiscal Analysis, Connecticut General Assembly
  - <sup>40</sup> *Coping with the Cap*, Connecticut Voices for Children
  - <sup>41</sup> *Follow the Money*, Connecticut Voices for Children
  - <sup>42</sup> *2008 Fiscal Forecast*, Office of Fiscal Analysis
  - <sup>43</sup> *Building a Reliable, Fair and Accountable 21<sup>st</sup> Century Revenue System*, Connecticut Voices for Children
  - <sup>44</sup> *2008 Fiscal Accountability Report*, Connecticut Office of Policy and Management
  - <sup>45</sup> Government Performance Project, 2005, independently conducted and financed by *Governing* magazine and the Pew Center on the States
  - <sup>46</sup> Government Performance Project, 2005
  - <sup>47</sup> Office of the State Comptroller, State of Connecticut