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COMPTROLLER LEMBO PROPOSES MEASURES TO USE SPENDING CAP AS TOOL FOR BUDGET STABILITY AND PREDICTABILITY

Comptroller Kevin Lembo, testifying before the state Spending Cap Commission today, proposed a new approach to the state spending cap formula in order to better stabilize future state budgets.

The existing spending cap formula is based on only short-term performance of volatile personal income growth or inflation measures, Lembo said.

Lembo presented a data analysis by his office demonstrating that, rather than rely on short-term lookbacks, the state should base the spending cap formula on a smoother, long-term measure of personal income growth and/or inflation growth. For example, measuring growth over a 10-year average, rather than one-year or five-year averages, will result in a more stable spending cap formula.

"This proposed new approach to our state spending cap has the potential to ensure that our budgets are more stable and predictable – and will alleviate the need for future crisis-driven tax increases, service cuts or layoffs during economic recessions," Lembo said. "It would also allow us to build up greater reserves – establishing a robust recessionary seawall – and to pay off state debt and liabilities at a greater pace.

"For the sake of state residents and businesses, budget stability and predictability must be the focus of any conversation about Connecticut fiscal policy."

Today's proposal harmonizes with the Budget Reserve Fund deposit rules that Lembo proposed and the state legislature adopted two years ago (effective in 2020). The new Budget Reserve Fund – or "rainy day fund" – rules will ultimately reduce state revenue volatility by diverting windfalls from the General Fund's most volatile revenue sources into the rainy day fund.

"These Budget Reserve Fund rules are designed to restrain spending during good economic times by diverting revenues that would otherwise have encouraged increased expenditures and, instead, puts more money aside to provide the funding necessary to maintain government services during economic downturns," Lembo said.

"The Budget Reserve Fund rules target revenue – but the policy considerations are very similar to those the Spending Cap Commission faces in defining the expenditure cap. A key consideration for both policies is their effect on reducing volatility in state budget expenditures over time.

"The new Budget Reserve Fund deposit rules and a well-designed spending cap are complimentary tools that, if adopted and adhered to, can help to reduce annual volatility in state expenditures."

Historically, Lembo said the state has not adhered to the spending cap when revenues are available to exceed it – indicating that state spending growth has been driven primarily by the availability or scarcity of revenue, rather than by disciplined financial planning.

"Too often, spending levels during the peak of economic expansion have exceeded levels that are sustainable long-term, leading to budgetary cuts and crisis-driven tax increases when the economy inevitably turns south," Lembo said.

Currently, the state constitution requires that appropriations be capped based upon an annual growth rate of either personal income or inflation (the greater of the two).

Lembo's office provided an analysis of what happens when the state bases the spending cap formula on personal income growth over one year, five years and 10 years. His office also analyzed what would happen when the state changes the inflation measure – one that better reflects the market basket of goods generally purchased by state government (the Government Consumption Expenditures and Gross Investment measure or "price deflator"), rather than those purchased by the typical consumer (the urban consumer price index or CPI-U).

By applying both changes in combination, particularly when you lengthen the average growth measurement of each over a longer time period (10 years instead of one or five years), the spending cap formula would be less volatile, making it easier for future legislators and governors to plan for budgets and adhere to the cap.

"The commission should consider defining personal income and inflation under the constitutional spending cap in a manner that reduces annual fluctuations in allowable growth," Lembo said. "A less volatile limit is likely to elicit greater compliance by future governors and legislatures by requiring less drastic and difficult adjustments to the budget in order to comply with the cap.

"Combined with the Budget Reserve Fund deposit rules, the spending cap will help the state build larger budget reserves to weather future economic downturns. Larger reserves will reduce the need for service cuts and tax increases during future economic downturns – speeding the state's economic recovery and ensuring state services are available when they are most needed."

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