A PLEA TO THE GENERAL ASSEMBLY

RE-EXAMINE THE 'BUDGET GUARDRAILS' AND REBALANCE CONNECTICUT'S STATE-LOCAL FISCAL SYSTEM

Property Tax Working Group of 1000 Friends

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A PLEA TO THE GENERAL ASSEMBLY: RE-EXAMINE THE 'BUDGET GUARDRAILS' AND REBALANCE CONNECTICUT'S STATE-LOCAL FISCAL SYSTEM

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INTRODUCTION

As a group of former state legislators, municipal officials and public policy analysts who offer recommendations on state fiscal issues, we issue this urgent plea to the General Assembly and Gov. Ned Lamont to reconsider the extension of the budget 'guardrails' that were enacted on February 9. Lawmakers and the public must have one last opportunity to review the fiscal impact of the 'guardrails' in order to make necessary revisions before an extra-legal device known as the "Bond Lock" renders the 'guardrails' irrevocable as soon as July 1.

What are the budget 'guardrails'? Enacted into law in 2017 and 2018—and extended on February 9 of this year for up to 10 more years-- they are a complicated interlocking set of restrictive revenue and spending controls that short-circuit the normal budgeting process for the purpose of limiting spending on programs and then transferring the "excess surplus" first to fill up the Rainy Day Fund and thereafter exclusively to retire outstanding state pension debt.

These 'guardrails' were cemented into state law by an extra-legal device called the "Bond Lock" which promises purchasers of state bonds that the General Assembly will not change any of the 'guardrails' for as long as 10 years except in a limited manner by a supermajority three-fifths vote.

In this series of five opinion articles, we look under the hood to review how the original 'guardrails' were changed during the adoption process; why the Bond Lock should be abolished; what new oversight process the General Assembly should apply before the renewed 'guardrails' take effect; and how the 'guardrails' should be revised for the purpose of reducing Connecticut's property tax burden while continuing to ~~chop~~ chip away at the unfunded state pension debt.

These essays don't take sides on the policy debates about the two-year budget beginning July 1 because we do not want to detract attention from the imperative to reopen and revise the 'guardrails' which will have an overriding impact on every policy debate underway now and in the future.

Section 1
The ‘Budget Guardrails’ Have Never Been Scrubbed by the Legislative Process

Connecticut is enjoying its most positive budget status in decades cushioned by historic high levels of federal aid. These conditions should give policymakers an unfettered opportunity during this legislative session to review the package of budget controls without the pressure of constricted revenues or imminent deficits.

Instead, we were stunned that the General Assembly on February 9 readopted the package of guardrails-- perhaps the most far-reaching fiscal legislation in Connecticut history, locking in the basic parameters of future state budgets for the next 10 years-- by using an “emergency certified” procedure that enabled legislators to vote on a bill with no public hearings, no Finance or Appropriations Committee review, no sufficient advance notice to rank-and-file lawmakers, no publication of advance texts for public scrutiny, and no opportunity to solicit or review any expert analysis.

We offer a grade of “B-plus” for the fiscal performance of the 2017-18 ‘guardrails’ because they successfully replenished the Rainy Day Fund and saved millions of tax dollars by significant prepayment of long-term debt. These savings have been used to fund important current line-item programs. But simply re-enacting the ‘guardrails’ on February 9 without re-examining and updating them was a missed opportunity that may not come again during the 10-year duration of the bond covenant.

Unfortunately, the failure to re-examine this complex set of budget controls before voting on them on February 9 was a repeat of the same problem from 2017-18.
There were no public hearings held before the new Bond Lock, Volatility Cap or Revenue Cap were enacted in October 2017 because the regular legislative session had adjourned in June and these new controls were adopted during an abbreviated special session in October.

When the new controls finally were subject to an after-the-fact public hearing during the 2018 regular session, serious concerns were expressed by witnesses but only modest revisions were made to the 2017 package, including reducing the Bond Lock duration from 10 years to 5 years.

Especially noteworthy for the current moment was the response of the Finance Committee in 2018 to concerns at the public hearing about the untested impact of the Bond Lock. The Committee approved a requirement that the Office of Policy and Management secretary, attorney general, comptroller, and treasurer study the use of bond covenants as a mechanism to control state spending and borrowing.

According to a published summary of the study provision: “The study must consider the covenants’: (1) legality; (2) potential long-term financial and economic effects; and (3) impact on state government operations, including the state’s ability to fund social service programs, public education, and workforce development programs.”

But sadly, this important study was never done. The requirement was stripped from the final bill before its passage on May 9, 2018.

Not only was an adequate review never conducted before the budget controls were adopted in 2017 and 2018, but there was never a review of any kind conducted by state fiscal experts while the controls were being implemented between 2019 and 2023, as the proposed study had required.

And under the “E-Cert” procedure, there was never even a minute of public hearing testimony or a page of expert fiscal analysis offered prior to the re-enactment of the controls on February 9.

The failure to subject the budget controls to serious scrutiny before they were adopted in 2017-18, during their operation from 2019-23, and prior to their re-adoption in 2023 runs counter to the “best practice” recommendations of state fiscal experts.

At the April 23, 2015 public hearing of the Finance Committee, for example, the state and local finance expert from the PEW Charitable Trusts praised the guardrail known as the 2015 Volatility Cap but recommended that policymakers “regularly evaluate the balance history an deposit and cap policies to ensure the fund is fulfilling its intended purpose.” This kind of evaluation has never happened here.

Regular evaluations are necessary for a “best practices” job of managing revenue stream volatility. According to a recent PEW recommendation, “Whether tax fluctuations are large or small, every state can benefit from a comprehensive and regular examination of volatility.” It pointed out that Utah’s executive and legislative fiscal agencies are required to produce a volatility study every three years “to measure the changes in all major revenue streams, identify the key factors influencing fluctuations, and present clear policy recommendations to mitigate future risk.” [2022]

A ”comprehensive” and “regular” examination of the performance of the guardrails has never been required in Connecticut. [In our final section, we advocate that Connecticut adopt a review similar to the Utah process described by the PEW report.]

A new statute requires that the 2024-25 budget now under legislative review must address “efforts to ensure equity in the state.” This project also necessitates a re-examination of the budget controls. A significant portion of the billions in long-term unfunded obligations covering pensions for state employees and teachers were accumulated when prior legislatures and administrations underfunded their pension obligations and kicked the pension can down the road.

How much of the financial burden of unfunded pension liability from the past 50 years is it fair to ask today’s taxpayers to pay? The answer to “how much” may come down to a matter of degree, but that is the kind of discretionary decision that should be made only after a public hearing and review by the General Assembly as part of the regular legislative process that would give taxpayers a chance to have their say.

Finally, rushing through the budget controls could have a negative impact on how the General Assembly may be tempted to pass bills in the future. Most legislative business is done as much by informal precedents as by formal rules. We fear there may have been damage to the long-term culture and practice of democratic lawmaking at the State Capitol when such a critically important budget bill was enacted on February 9 by leapfrogging over the normal legislative process.

Yes, we agree that the guardrails produced genuine benefits, but simply re-enacting them on February 9 without re-examining and updating them was a missed opportunity that may not come again during the 10-year duration of the bond covenant. That’s why in a nutshell the legislative process should be reopened.

Section 2
The 'Guardrails' Blocked Property Tax Reductions for Every Connecticut Resident

By causing the underfunding of property tax relief grants that are mandated by statute in favor of using "excess surplus" funds exclusively for debt prepayment, the 2017-18 guardrails produced an imbalance in state budget priorities. Rebalancing the priorities between debt retirement and property tax reduction is one of the principal reasons we urge the General Assembly in its current legislative session to review and readjust the allocation of "excess surplus" before the 2023 guardrail re-enactment becomes irrevocable.

Authors of the guardrails undoubtedly will claim it is "fiscally irresponsible" to challenge the budget controls. In response, we acknowledge again that these fiscal procedures enacted in 2017-18 succeeded in filling up the Rainy Day Fund and produced significant prepayments of future debt. We hope these positive fiscal practices continue at an appropriate level.

But the authors of the guardrails fail to acknowledge that these positive results came at a significant cost. Our primary concern, as we document in this article, is that making debt prepayments the sole and exclusive priority for using "excess surplus" budget funds has worsened a chronic shortfall in the funding of statutory property tax relief grants.

In this article we calculate the statewide cost of lost property tax reductions caused by the guardrails.

1. <u>How much "excess surplus" was available to fund statutory property tax reduction grants after the Rainy Day Fund had been filled?</u>

The guardrails operate at the end of the budget process primarily to manage what we call "surplus surplus" revenue or what the Office of Fiscal Analysis calls "excess surplus"—that is, fiscal surplus that remains unspent <u>after</u> the state budget has been funded and <u>after</u> the Rainy Day Fund has been filled to its statutory maximum—and divert all of it in an inflexible process exclusively to prepayment of unfunded pension debt.

After the guardrails took effect in 2018, it took several budget cycles to fill ~~up~~ the enlarged Rainy Day Fund to its new statutory maximum of 15% of net General Fund appropriations. By the end of budget year 2020, only $62 million could be labeled as "excess surplus" and be transferred to pension debt retirement.

Thus, it was not until the end of budget year 2021 that the Treasurer was required to transfer any substantial Rainy Day Fund balance in excess of 15%-- the "excess surplus"—to reduce long-term pension debt. As the chart below shows, the amounts of "excess surplus" to be transferred have been substantial: $1.619 billion in 2021, $4.1 billion in 2022 and $3.2 billion (est.) in 2023.

We stress that these enormous amounts were transferred after the Rainy Day Fund had been fully funded and after the state had already appropriated the Actuarially Determined Employer Contribution (ADEC) for the pension systems.

Three Years of "Excess Surplus" Budget Transfers to Pay Pension Debt:

- FY 21: $1.619 billion
- FY 22: $4.1 billion
- FY 23: $3.2 billion (est.)

- TOTAL: $8.919 billion

Our concern is that by sending all of this massive amount of "surplus surplus" to debt prepayment, even if we acknowledge it produces financial benefits, the result is that it imbalances the state's budget priorities because it comes at the cost of blocking state-funded reductions in property taxes by preventing surplus funds from going at least in part to funding tax relief grants to municipalities.

2. By How Much Were Existing Statutory Grants for Property Tax Reduction Underfunded During 2021-2023?

To document how this mandatory intercept of the "surplus surplus" blocks reductions in property taxes, the following are three statutory grant programs all impacted in the same negative way.

This article/White Paper may be the first time the amounts of these unfunded property tax reductions have been calculated and acknowledged as a consequence of the guardrails.

A. Special Education Excess Cost Grant

The cost of K-12 education, including education for students with special needs, is the largest expenditure in every municipal budget. Special education is an unfunded federal mandate on states and towns that increasingly consumes ever larger chunks of local budgets.

To help local boards of education offset a portion of these costs, the State Department of Education is required to assist towns in paying for services for students with extraordinary needs by providing the statutorily mandated Excess Cost Grant. This grant is intended to provide reimbursement for special education students who require services that in total exceed 4.5 times the district's average per-student spending for the previous year.

However, the state budget does not always appropriate the full amount of the grant. At times this was because of insufficient revenue, as was often the case prior to 2017. The grant has also been underfunded because the guardrails artificially restrict expenditures even if sufficient revenue has been collected.

The total amount of the grant for 2022 that should have reimbursed all 169 cities and towns was $207.4 million but the appropriation in the state budget was only $141 million. This meant that property taxes had to make up the $66.8 million difference in the same budget year in which the guardrails diverted $4.1 billion of surplus funds to prepay pension debt.

<u>This chart documents the underfunding of the Excess Cost Grant during the 3-year period 2021-2023 after the Rainy Day Fund had been filled:</u>

- FY 2021 $68.6 million
- FY 2022 $66.8 million
- FY 2023 $56.3 million

<u>Three Year Underfunding of Special Education Excess Cost Grant:</u>
- <u>TOTAL:</u> $191.7 million

Thus, the budget guardrails diverted $191.7 million in “surplus surplus” state funds during 2021-2023 from property tax relief that was legally due to cities and towns under the Excess Cost Grant.

B. <u>The PILOT Grants</u>

Much the same story can be told about the two major state-funded payment-in-lieu-of-taxes [PILOT] grants that reimburse municipalities for lost property tax revenue due to the exemption from local taxation of state property, private colleges, and nonprofit hospitals.

The state has been required by statute to reimburse municipalities for 77% of the lost revenue from private colleges and hospitals, 45% from most state-owned buildings and land, and 100% from land used as correctional facilities.

But as with the Excess Cost Grant, the PILOT grants have not been fully funded, leaving the towns to make up the difference in their budgets. In recent years, for example, the state property PILOT grant was funded at an effective reimbursement rate of only 24% and the colleges and hospital PILOT grant was funded at only 33%.

<u>The total general fund underfunding of both PILOT grants for the 3-year period of 2021-2023 when the ‘budget guardrails’ were in place was $187.6 million.</u>

<u>This chart shows the annual state budget PILOT deficits*:</u>

- FY 2021 $64.3 million
- FY 2022 $70 million

- FY 2023 $53.3 million

Three Year Underfunding of the Major PILOT Grants:

- TOTAL: $187.6 million

The “budget guardrails” diverted $187.6 million in “surplus surplus” state funds from property tax relief that were legally due under the two largest PILOT grants.

[*NOTE: The General Assembly for FY 22 and FY 23 approved shifting funds from the Municipal Revenue Sharing Account (MRSA) previously promised to municipalities to make up for General Fund deficits in the PILOT grants. These “rob Peter to pay Paul” MRSA amounts are not shown in this chart. The transfers are scheduled to end in FY 24.]

C. The Education Cost Sharing (ECS) Grant

The Education Cost Sharing Grant is generally the largest state grant sent to every municipality to help offset the costs of K-12 education. In 2019 the General Assembly adopted a progressive new ECS formula that increased funding to every city and town based on “student education needs” but delayed its full implementation until FY ~~20~~28 because of the additional expense. Instead, lawmakers adopted an annual “phase-in schedule” to reach full funding by 2028.

The “phase-in” differentiates the shortfall in funding the full ECS formula from the failure to appropriate the full Excess Cost and PILOT grants, but it is similar in that the necessity of phasing in rather than fully funding the new ECS formula was due to fiscal constraints arising largely from the application of the budget ‘guardrails.’

But to the extent that full ECS funding for local education was not made available to municipalities due to fiscal constraints, it is appropriate to cite ECS underfunding and the resulting increase in local property taxes as a consequence of the spending constraints embedded in the budget guardrails that might have been surmounted under a more flexible set of controls.

~~This~~ The following chart shows the differences between what the new ECS grant formula promises to towns if “fully funded” with the actual~~ly~~ appropriated “phase-in” ECS grants for each of the fiscal years in which the budget controls have generated “excess surplus”:

- FY 2021 $270 million
- FY 2022 $221 million
- FY 2023 $145.3 million

- TOTAL: $636.3 MILLION

The total 3-year amount of ECS grant funding that was deferred as a result of the "phase-in" schedule and thus lost to towns for property tax relief is $636.3 million.

3. Sufficient "Surplus Surplus" Funds Were Generated in 2021-23 to Fully Fund the Three Major Property Tax Grants to Municipalities as well as to Make the Three Largest Unfunded State Pension Debt Reduction Payments in History

During the 2021-2023 period in which the combination of economic recovery and budget intercepts made available "surplus surplus" funds even after the RTainy Day Fund had been filled, a total of $8.819 billion was deposited in the state's unfunded pension accounts. During the same period, a total of $1.016 billion was not deposited in municipal accounts across the state for property tax grants as statutorily required.

Except for the restrictions on the use of "surplus surplus" imposed by the guardrails, there was sufficient revenue generated by the state's fiscal system during the 2021-23 period that could have been used both to fully fund the three largest property tax reduction grants for the first time in-state history and to make the largest 3-year deposit ever made of $7.803 billion to prepay unfunded pension debt.

The budget guardrails have not always been the cause of the underfunding of these grants because underfunding was a chronic problem even before the guardrails existed. Historically, both Democratic and Republican governors and state lawmakers have failed to fully fund the grants. Between 2006 and 2020, Connecticut raised only 95.5% of revenue needed to pay its expenses, making it one of only nine states with a 15-year deficit, as it engaged in unsustainable budget maneuvers that allowed pension debt to be deferred and property tax relief grants to go unfunded.

But once the "surplus surplus" revenue became available in 2021, the guardrails became the direct cause of the recent underfunding of the property tax reduction grants because they blocked using any of the "surplus surplus" to fulfill its grant funding obligations.

Section 3:
How the 'Guardrails' Were Transformed Into A Budget Austerity Device

In this article, we look under the hood to examine the legislative history of the budget cap system to demonstrate how it was transformed from a flexible mechanism designed primarily to refill the Rainy Day Fund and to manage volatile income streams into a new interlocking restrictive caps. The new caps were designed to impose austerity budgeting as the primary method of elevating pension debt prepayment as a higher priority than fully funding property tax reduction grants and other spending programs.

1. <u>The 2015 Lembo Volatility Cap</u>

Connecticut finance experts in the early 2000s were rightly concerned that the Rainy Day Fund [RDF] was insufficient to protect taxpayers from unbearable tax increases in the event of a disastrous revenue shortfall caused by an economic recession. Indeed, the RDF balance in 2011 couldn't have been worse-- it was zero! Positive balances grew slowly but by 2015 another budget deficit required a withdrawal from the RDF to balance the budget.

Fiscal experts agreed that the practice of funding the RDF by depositing only the leftover surplus at the end of the fiscal year was at fault. They agreed that such an ad hoc system was not sustainable as a long-term policy.

In response, then-Comptroller Kevin Lembo spearheaded a successful effort in 2015 to jettison the old ad hoc system and to replace it with three significant fiscal reforms.

First, he proposed the creation of a growth-adjusted Volatility Cap to intercept the most volatile sources of revenue -- the quarterly estimated and final payments portion of the personal income tax, and the corporation business tax—as revenue sources to fund the RDF. Second, he proposed increasing the required level of the RDF to 15% of the appropriated General Fund budget instead of 10%. Third, the RDF would be modified to require that surplus funding derived from the Volatility Cap intercept would be used first to build up the RDF to its new statutory level of 15% and thereafter be diverted to pay down unfunded pension debt.

At the April 2015 public hearing of the Finance, Revenue and Bonding Committee, the~~se~~ reforms were endorsed by fiscal experts. According to Robert Zahradnik, director of State and Local Policy at The Pew Charitable Trusts, "Pew's research ranked Connecticut 13th highest in the nation on tax volatility with a volatility score of 6.5, which means that revenues typically fluctuated by 6.5 percentage points from the 19-year average in any given year. By comparison, [the] 50-state tax revenue had a volatility score of 5.0. Connecticut is among the 29 states with volatility higher than the national benchmark."

Zahradnik recommended “that policymakers tie rainy day fund deposits to revenue volatility.” He noted that 13 states connected “the rules for when, how, and how much to deposit into their budget stabilization funds with underlying revenue or economic fluctuation.”

Lembo’s proposed reforms were adopted in 2015 as part of the 2016-17 budget bill with an implementation date for the Volatility Cap intercepts of 2019.

2. The 2017-18 Anti-Spending ‘Guardrails’

But a funny thing happened to the Lembo Volatility Cap between its approval in 2015 and its implementation in 2019: it was replaced in 2017 and 2018 by a different Volatility Cap and a much more severe set of anti-spending restrictions now known collectively as the ‘budget guardrails.’

The new controls transformed the Volatility Cap’s primary function from building up the RDF to interacting with the additional set of new caps to impose austerity budgeting on spending in order to generate more “surplus” funds. The new system would then automatically transfer the “excess surplus” funds to debt prepayment and away from programmatic budgeting, including property tax grants.

The anti-spending austerity budget ‘guardrails’ put in place in 2017-18 included:

- A new “Revenue Cap” that imposed a limit on the amount of estimated revenues that could be spent in any year. The Cap ratcheted spending downward from 99.5% of revenue in FY 20 to 98.50 in FY 24 to 98% in FY 26;

- A revised “Volatility Cap” that replaced Lembo’s flexible multi-year lookback to measure volatility with a “hard limit” of $3.15 billion for the appropriation of the personal income tax’s “quarterly estimates and finals” revenues (adjusted for inflation). All corporate tax revenue-- the most volatile of all revenues-- was excluded from the new cap. As we will discuss below, the changes to Lembo’s Volatility Cap played a major role in transforming the guardrails into an austerity budget device;

- A revised “Rainy Day Fund” that mandates “surplus surplus” funds be used only to retire pension debt after the RDF has reached its maximum required size of 15% of the state operating budget;

- A revised “Spending Cap” super-majority law that further constricted state spending by eliminating the prior Spending Cap exemption of $1.611 billion in statutory grants to distressed municipalities;

- A new “Bond Allotment Cap” that restricts the amount of General Obligation bonds that the governor may approve in any fiscal year; and

- An untested and bizarre "Bond Lock" law that requires the state treasurer to include a pledge to private bondholders who purchased state bonds between 2018 and 2020 that the state would not enact any laws taking effect between 2018 and 2028 that change any of the wording of the guardrails unless approved by a super-majority three-fifths legislative approval.

This collection of 2017-18 controls fundamentally altered the functioning of the 2015 Lembo Volatility Cap by creating an entirely new and untested state budget regimen.

How did the changes to Lembo's Volatility Cap contribute to transforming the guardrails into a spending restricting device? The change occurred because the focus of this Cap shifted away from the volatile character of the income stream in the Lembo Cap to the fixed amount of the volatile income in the adopted Cap. The Lembo Cap required the intercept of revenue "whenever the most volatile tax revenue streams produce revenue above historic norms" measured by a long-term multi-year lookback. In short, Lembo proposed a variable cap on using revenue from volatile income streams.

But the Volatility Cap adopted in 2018 that repealed the 2015 Lembo Cap enacted instead a hard limit of $3.15 billion of the quarterly and final payments from personal income tax filings that could be appropriated in the budget. The rest of such collected revenue is automatically deposited into the Rainy Day Fund. This dollar figure does not change except for an annual inflation adjustment.

The austerity budget function was implemented by the interlocking of the Volatility Cap's hard limit on appropriations to no more than $3.15 billion in "volatile" estimates and finals revenue (as adjusted); the Revenue Cap's hard limit on restricting spending to no more than 98%-99% of the estimated annual revenue; the Spending Cap's hard limit on annual state spending increases that now included aid to distressed municipalities; the Rainy Day Fund's required transfer to debt retirement; and the Bond Lock, which promised bond holders that none of the Caps could be altered by less than a super-majority three-fifths vote for a limited period of time.

The guardrails function as an "austerity" device because they prevent state spending on "programs" such as property tax reduction grants (or any other line-item "program") but they don't limit the amount of overall spending in the budget. Spending to reduce unfunded debt liability is still "spending" that is paid for by state taxes. But under the new regimen, debt prepayments are favored exclusively over property tax grants and other programs.

It is not irrelevant to inquire about the possible reasons why the fiscally flexible 2015 Lembo Volatility Cap was altered by the approval of strict spending limits and inflexible guardrails adopted in 2017 and 2018?

Concerns continued to grow about the state's poor fiscal standing and underfunded RDF. But the biggest change that preceded the transformation of the caps was the 2016 state election that produced an unusual 18-18 partisan tie in the State Senate. It strengthened the hand of both Republican and Democratic budget hawks who felt the Lembo plan and Malloy administration budgets did not go far enough to rein in programmatic spending.

The usual budget process was further disrupted when then-Gov. Dannel Malloy vetoed the Republican-led state budget well after the start of the 2017 fiscal year. Coincidentally, the State Spending Cap Commission submitted it recommendations in 2017 to the General Assembly where the newly-empowered bipartisan coalition of budget hawks adopted the Commission's Minority Report recommending aid to distressed municipalities be placed under the restrictive Spending Cap.

The conclusion seems inescapable that the new budget regimen that was defined by the imposition of inflexible guardrails was as much the product of a shift in political power as it was the outgrowth of attempts to better manage volatile fluctuations in revenues. Regrettably, it does not appear that the consequences of each new guardrail or of their interaction were given appropriate legislative study, review, or expert analysis prior to the adoption in 2017-18 or their re-adoption in 2023.

Section 4:
Dismantle The Undemocratic and Extra-Constitutional "Bond Lock"

The so-called "Bond Lock" is the most superfluous, undemocratic and possibly unconstitutional element of the budget guardrails.

The Bond Lock is a state law that requires the Treasurer to promise purchasers of state bonds that the General Assembly will not exercise its customary law-making process to alter any of the budget guardrails for the life of the bonds except by invoking an unusual super-majority three-fifths vote after an emergency declaration by the governor to suspend them temporarily for one budget year.

It is an axiom of parliamentary procedure that one legislature cannot bind a future legislature because each democratically elected legislative body is entitled to equal powers. Thus, a legislature elected in 2022 can pass a law declaring that "for the next 10 years pizza will be the official food of Connecticut." But the new legislature elected in 2024 can simply pass a superseding law: "Notwithstanding any other provision of law, lobster rolls are the official food for the next 10 years."

The Bond Lock attempts to prevent this outcome by promising purchasers of state bonds that no future legislature for the next five or 10 years will change the wording of the guardrails except by a super-majority three-fifths vote. Or to use the food example, the current legislature has enacted the Bond Lock to preempt legislators who will be elected in 2024, 2026, 2028, 2030 and 2032 from being able to exercise their constitutional law-making powers. They would not be able ~~to~~ under the traditional majority-rule legislative process to decide to replace pizza with a lobster roll~~.~~

As far as we can determine, no other state has enacted a Bond Lock because no other state legislators have voluntarily delegated to Wall Street bond purchasers their constitutional law-making powers to adopt and adjust their state budgets.

Despite our awarding of a grade of "B-plus" to the Rainy Day Fund replenishment and debt prepayment savings, the principal reason for our disappointment with the February 9 suspension of the regular legislative process to approve the guardrails was that the new Bond Lock will prevent any effective review, analysis, or alteration of the budget controls for as long as 10 years.

Returning to recent legislative history, ~~t~~here never was a public hearing on the "bond lock" concept held prior to it being inserted into the budget drafted by legislators after the regular 2017 budget deadline had passed.

When the Finance Committee finally held a public hearing in 2018, public finance experts who supported adoption of some form of a Volatility Cap expressed surprise and skepticism over the inclusion of a Bond Lock. Ellen Shemitz, Executive Director of Connecticut Voices for Children, summarized communications from Moody's Investor Service expressing concern that the Bond Lock "reduces budget flexibility" and from the

Standard and Poor's Rating Service that "a state might find itself locked into rigid financial practices should circumstances change."

Shemitz's testimony included a recommendation from Urban Institute economist Kim Reuben that Connecticut at least delay the Bond Lock, "arguing that it is 'not so much tying one's hands as tying one's hands and jumping off a cliff without knowing whether deep water or rocks lie below.' "

There is no doubt that Wall Street credit rating agencies have favored intercepting "excess surplus" funds to retire unfunded pension debt, but they have not similarly lauded the Bond Lock.

The Bond Lock should not have been renewed in February, especially in the absence of any review. In our view, there is more than enough justification to vote this session to dismantle the Bond Lock even by legislators who support the other 'guardrails.'

First, there is no evidence that the Bond Lock has had a positive impact on the state budget's fiscal performance over the past five years. The same production of "surplus surplus," the same huge transfer of funds into the Rainy Day Fund, and the same reduction in unfunded pension debt would have occurred even if the Bond Lock had never existed.

Second, the Bond Lock should be removed as a key obstacle to legislative adoption of financial measures that redirect more of the "excess surplus" revenue to property tax relief by fully funding state grants to municipalities.

The surplus money to fully fund these grants may not have existed in 2017-18. But as we have shown in the second article in this series, after new surpluses were generated during 2021-23 by the interaction of the national economic recovery and the state's revenue structure, the legislature could have pivoted to put more of the "surplus surplus" into the wallets of current taxpayers if they had not been handcuffed by the Bond Lock.

Third, the Bond Lock places the legislature in a straitjacket by making it impossible to respond to new economic conditions. A major unforeseen contingency came to pass after the Bond Lock was adopted in 2017-18 when the COVID pandemic struck in late 2019. Fortunately, Connecticut and other states were rescued by an unprecedented avalanche of federal spending. Connecticut's "lock" of budget inflexibility was mitigated largely by federal funds. But will the end of federal budget support necessitate an adjustment in the guardrails? That will be ~~practically~~ impossible when the first bond is sold after July 1.

By freezing the budget status quo, the Bond Lock may also prevent the state from launching important new initiatives. Gov. Lamont in March announced the appointment of a Blue Ribbon Panel to produce by the end of the summer "a data-driven, actionable, strategic plan that supports optimal child development, family needs, business needs, and prioritizes equitable access to early care and education." Gov. Lamont should be applauded for addressing the childcare crisis. But as the Volatility Cap, the Spending Cap, the Revenue Cap and the Budget Reserve Fund as enforced by the Bond Lock automatically divert "excess surplus" revenue to pension debt prepayment, will there be enough funds available for a significant new statewide childcare initiative?

<u>Fourth and most importantly, the Bond Lock is an affront to democratic values and a highly questionable evasion of the constitutional order of state government.</u> The Connecticut Constitution places all budgeting powers in the elected legislative and executive branches. The state should offer purchasers of bonds its customary covenant promising to pay principal and interest on its bonds. But there is no conceivable reading of the Constitution that authorizes lawmakers to offer bondholders a special covenant granting them the right to bring an injunction or other judicial action under the authority of the Bond Lock to prevent our elected legislature from exercising its constitutional budget powers.

While we view laws requiring super-majority votes to approve legislative action to be inconsistent with democratic rule by majority, nonetheless there is a right way and wrong way to enact them. For example, Connecticut voters amended the state constitution in 1992 by adopting a new Spending Cap that requires a super-majority vote of three-fifths of legislators to suspend it.

The Bond Lock is an attempt to negate legislative majority rule not by the "right way" adoption of a constitutional amendment that is approved by voters but rather by the "wrong way" questionable legal device of a "covenant" or special promise given to bond purchasers that the General Assembly will not "unlock" the guardrails except by a legislative super-majority.

The Bond Lock was an improper end run around the constitutional amendment process. Even worse, it is a heavy-handed attempt to disenfranchise Connecticut voters by denying a majority of duly elected legislators the authority to exercise their constitutional budget-making duties. It should not be perpetuated.

Section 5:
A Proposal to Restore Legislative Oversight for ‘Budget Guardrails’

There is still time left before the end of this legislative session-- and prior to the “locking in” of the new bond covenants-- for lawmakers by majority vote to restore legislative oversight and review the budget guardrails that were sidestepped by the “E-Cert” process on February 9.

The budget controls enacted in 2017 deserve praise for producing a positive budget outlook based on fully funding the Rainy Day Fund and paying down future debt. But their unnecessary lack of flexibility has caused distortions in the state budget and produced inequitable underfunding of current needs even during this period of robust budget surpluses.

We urge lawmakers to amend the budget guardrail system to build in flexibility safeguards that could lead to legislative adjustments in response to changing budgetary needs or economic conditions.

To be sure, we are NOT recommending that lawmakers turn back the clock and terminate all of the budget controls. Rather, we propose a legislative re-examination before the current re-enactment is locked in to determine whether revisions are needed to improve budget operations, tax fairness and policy equity.

It should not be forgotten that the original justification for adopting the Volatility Cap and other controls to build up Connecticut’s Rainy Day Funds has been extraordinarily successful. By one recent measure, Connecticut had $5.59 billion in its RDF at the end of 2022, the 5th most successful RDF in the country, according to the PEW Foundation. Similarly, billions of “surplus surplus” funds have been intercepted to pay down unfunded debt during 2021-23 even after the state has paid its required regular contribution, known as the “Actuarily Determined Employer Contribution” or ADEC.

Thus, it is time for legislators to carry out what has not been done previously: submit the budget guardrails to an on-going and data-driven comprehensive review that the Bond Lock has effectively blocked during the past five years. Unfortunately the “E-Cert” procedure used on February 9 shielded the guardrails from a thorough review prior to their re-adoption.

Here is our recommended plan for a comprehensive review and reform:

First, we petition lawmakers to create a meaningful ad hoc legislative process to substitute for the normal bill review procedures that were skipped on February 9. This could include a joint informational forum held by the Finance and Appropriations Committees with commentary from the nonpartisan Offices of Fiscal Analysis and Legislative Research and invited fiscal experts.

The benefit of holding even a truncated legislative review now is that if lawmakers re-examine and decide to adjust the budget controls, there would still be time to enact changes by a majority vote as long as they can be voted on prior to July 1 when the new Bond Lock will become operative.

As we have noted previously, PEW and the other leading state fiscal resource centers highly recommend an ongoing review of automatic budget controls.

Second, we urge that the renewed 5-to-10-year duration of the Bond Lock be deferred or suspended for at least one year to provide sufficient time for further legislative evaluation and expert review. Although we oppose any extension of the Bond Lock, a covenant of only one-year duration while the fiscal re-evaluation is taking place is preferable to an unamendable 5-to-10 year covenant.

If action to defer the Bond Lock is not taken prior to July 1, another opportunity may not come until 2028 at the earliest-- and perhaps not until 2033. The purpose of the legislative review is to review revisions and improvements to the guardrails. But unless the Bond Lock is suspended (or abolished) no changes could be made.

Third, we call on the General Assembly to establish a statutory Budget Controls Review Commission to issue regular reports prior to enactment of a new biennial budget. The Commission would evaluate and report on the impact of the major budget ‘guardrails’ on the state budget and economy, funding for state programs and services, pension debt obligations, local government operations, and state and local tax burdens.

The study questions approved by the Finance Committee in 2018 but not enacted into law still need to be answered regarding the legality and use of Connecticut’s bond covenant as a mechanism to control state spending and borrowing.

We advocate that Connecticut adopt a regular review similar to the Utah process described by the PEW report that requires the~~ir~~ executive and legislative fiscal agencies to produce a volatility study every three years “to measure the changes in all major revenue streams, identify the key factors influencing fluctuations, and present clear policy recommendations to mitigate future risk.”

The commission would make recommendations and report back to the legislature and Governor on whether to restructure the budget controls or revise any individual element of the guardrails. Membership of this review commission should include the Finance and Appropriations Committee chairs and ranking members; appointments by legislative leadership and the Governor's office, representatives from organizations specializing in state and local public finance—such as the PEW Foundation, NCSL and NLC; analysts from OFA and OPM; and local government representatives from relevant interest groups, such as CCM and CABE.

<u>Fourth, revise the Guardrails to make Funding of Property Tax Grants a Priority Comparable to Prepayment of Pension Debt.</u>

We urge a major reordering of priorities for use of the "surplus surplus." As advocates for property tax reform and relief, we recommend that the General Assembly and Gov. Lamont elevate property tax reduction to the same preferred status under revised budget controls that is now accorded to unfunded debt prepayment.

For a state that has always enjoyed one of the highest per capita income ranks in the country, Connecticut's fiscal status often attracts national attention for two budget anomalies: it has had one of the highest unfunded pension liabilities and it suffers from one of the highest property tax burdens.

The budget guardrails deserve credit for making an impressive start addressing the first problem by fully funding the state's Rainy Day Fund and sequestering "excess surplus" funds to pay down the state's massive unfunded pension liability.

But the guardrail system has failed to address the state's "highest in the nation" property tax burden and indeed may have worsened it by locking the state into retreating from fully funding municipal grant programs that provide critically important property tax relief.

The property tax deserves renewed legislative attention. Most of the proposals for using surplus funds for tax reduction have focused on cutting the personal income tax, which accounts for 32.4% of Connecticut's overall state-local tax burden. But the property tax accounts for 43.2% of the overall state-local tax burden and is a much more regressive tax than the income tax because it is not based on ability to pay.

According to an analysis of the 2022 Tax Incidence Report done by Connecticut Voices for Children, "The property tax is still the most unfair component of Connecticut's tax system, and it increased the most (between 2011 and 2019) for working-class and lower-middle-class families."

We recommend setting up a statutory Property Taxpayers Relief "Excess Surplus" Fund to receive a substantial percentage of "excess surplus" funds to supplement the appropriated grant amounts. Its goal would be to fully fund the key property tax-related grants, including PILOT, Excess Cost and ECS. The process to fund these grants should be established in the same manner as the Volatility Cap and Budget Reserve Fund now intercept "excess surplus" to fund debt payments as a supplement to the customary appropriated line-items

Dedicating a portion of the “surplus surplus” to property tax relief would make the implementation of the budget guardrails more equitable because it would reduce the weight of prior debt on taxpayers while reserving more of the benefit of their tax payments for services they need and have been promised by statute.

It is important to emphasize that using “surplus surplus” revenue to fund property tax reduction grants would not diminish in any way the deposits going into the Rainy Day Fund pursuant to the current guardrail law because the amount of “surplus surplus” is calculated only after the RDF has been filled to its statutory maximum.

By reopening the budget guardrails to include surplus funding for municipal tax reduction grants, Connecticut for the first time in its recent history would be equipped to tackle both of its major fiscal liabilities of unfunded pension debt and underfunding of municipal property tax grants.

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