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## CT BUDGET BRIEFS

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### **On the General Fund Surplus: Years of Bounty, with What Result?**

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#### **Summary**

For the last several years, multimillion dollar surpluses have been reported in the state's General Fund.<sup>1</sup>

In Fiscal Year 1997-98, 60% of the \$460 million 1998 surplus was used for two purposes: to increase the Budget Reserve Fund and for income tax rebates.

The 1999 Budget Act directed the use of nearly \$552 million in 1999 General Fund surplus for a sales tax rebate, pre-paying some future expenses, keeping the Budget Reserve Fund at 5%, and funding for some on-going programs.

The SFY 2000 General Fund surplus of \$249.7 million, less than half last year's surplus, is to be distributed across dozens of programs and initiatives, from providing immediate tax cuts to hospitals to keeping the Budget Reserve Fund at 5%, paying cash for a number of infrastructure projects to avoid new bonding, and a variety of new and established initiatives, programs, and studies. The SFY 2000 surplus, however, is now expected to grow to as much as \$380 million, based on late-delivered tax returns with unanticipated additional revenue.

To spend surplus funds over the past three years, since such spending put the state over the spending cap, Governor Rowland issued a "Declaration" of "extraordinary circumstances," citing, among other things, eight consecutive years of General Fund surplus, a Budget Reserve Fund at 5% of General Fund appropriations, and that it "is prudent to expend certain state resources to avoid the issuance of debt as well as fund several projects which are primarily one-time in nature."

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<sup>1</sup> The Office of the State Comptroller repeatedly has urged that the eight consecutive years of General Fund "surpluses" not be viewed in isolation. Rather, the overall state financial position should be considered. For example, the decision to delay the implementation of Generally Accepted Accounting Principles (GAAP) means that the state's current system of reporting revenues and expenditures hides a cumulative General Fund deficit of \$602.7 million as of June 30, 1999. The conversion to GAAP again has been deferred, now to FY 04.

After three years of General Fund surpluses, which – when appropriated along with necessary deficiency appropriations -- have put Connecticut over its spending cap for the surplus year, it is appropriate to ask whether the rather *ad hoc* manner in which these funds have been used is the best investment of this bounty. Would it not be preferable to develop a more disciplined and strategic multi-year approach to the use of surplus funds? To make a variety of public investments that not only extend the state’s current prosperity to more of its citizens but also ensure its continued economic prosperity?

As background for dialogue, this short report briefly reviews the uses of General Fund surplus over the last three years and urges a more strategic and disciplined use of surplus funds.

**The Fiscal Year 1997-98 General Fund Surplus.** In Fiscal Year 1997-98, there was a \$460 million General Fund surplus. As shown in the following table, 35% of the surplus was transferred to the state Budget Reserve (“Rainy Day”) fund, while another 25% was used for an income tax rebate and 17% for Y2K compliance.

<b>Use of FY 1997-98 Surplus (in millions)</b>	
Transfer to the Budget Reserve Fund	\$161.7
Tax Rebate Program and Administration	116.5
Year 2000 (Y2K compliance) Funding	80.0
Medicaid Managed Care Capitation Payment	32.0
PILOT for State-Owned Property	28.0
Deficiency Appropriations	13.9
PILOT for Tax-Exempt Property	12.0
Supplemental Payments for Participants in the Circuit Breaker and Freeze Programs	8.0
School Library Books	3.0
U Conn Endowment Fund	1.8
Food Stamps for Legal Immigrants	1.7
Transfer to Debt Retirement	1.4
<b>Total</b>	<b>\$460.0</b>

**The Fiscal Year 1998-99 Surplus: The Governor’s Proposal.** The Governor’s proposal for the Fiscal Year 1998-99 surplus anticipated a total General Fund surplus of about \$482 million. Of this, \$80 million was to be used for the appropriation approved in December, 1998 for the Patriot’s Stadium complex in Hartford. Of the \$402 million in projected General Fund surplus that remained, the Governor proposed to use *about half* to “pre-fund” anticipated expenditures in FY 00 and FY 01. Specifically, the Governor proposed the following uses for \$402 million in projected General Fund Surplus that remained after the appropriation for the Patriots Stadium complex:

<b>Governor’s Proposed Use of FY 1998-99 Surplus (in millions)</b>	

Funding for New England Patriot's Stadium Complex	\$80.0
Remaining Surplus	
Pre-fund the 27 <sup>th</sup> state employee payroll	\$90.0
Pre-fund Medicaid capitation payments (pre-fund one month's cost of about \$35 million for each of FY 00 and FY 01 and pre-fund Medicaid capitation "incentive" payments to be made over biennium at \$7.9 million)	\$78.0
Tax Rebate Program and Administration (to be augmented by \$13.3 million carried forward from Rebate 98 program)	\$70.0
State Employees Health Insurance (to convert to fully insured plan from self-insured plan and to pay off deficit in Rate Stabilization Fund with Anthem Blue Cross and Blue Shield)	\$65.0
Transfer to the Budget Reserve Fund	\$28.8
Pre-fund higher education endowment match for the biennium (\$9.1 million for FY 00; \$12.7 million for FY 01)	\$21.8
Fund additional Year 2000 (Y2K) costs	\$15.0
Fund some of school construction costs with surplus rather than bonds (2.4% of total FY school construction funding of \$424 million)	\$10.0
Pre-Fund School Library Books grant	\$6.0
Pre-Fund certain per diem costs of private providers in DMR, DMHAS, and DCF due to leap year (FY 00)	\$4.7
Fund payment of U Conn Educational Properties, Inc. developer's claim	\$2.5
Fund moving costs for portion of State Library	\$2.0
Fund automated forms and licenses ("e-government") through DoIT	\$1.7
Fund aerial photo survey in DEP	\$0.3
Fund electronic filing system in Ethics Commission	\$0.2
<b>Total (not including Patriot's Stadium Complex)</b>	<b>\$402.0</b>

**The Fiscal Year 1998-99 Surplus: The 1999 Budget Act.** The Budget Act adopted by the General Assembly in 1999, and signed by the Governor, directed the use of \$551.9 million of General Fund surplus (the amount projected by the Office of Fiscal Analysis when the budget was passed) over the next biennium budget. Of this, \$30.5 million was to be added to the Budget Reserve Fund (keeping it at the maximum statutory limit of 5% of the net General Fund appropriations). In addition, the budget act specified that any additional surplus beyond OFA's estimate of \$551.9 million was to be used for debt retirement.<sup>2</sup> The uses of the Fiscal Year 1998-99 projected surplus were as follows:

<sup>2</sup> . As of September 1, 1999, the Office of the Comptroller estimated the unappropriated surplus for SFY 99 to be \$69.3 million.

<b>Use of SFY 1998-99 Projected Surplus (in millions)</b>	
Transfer to the Budget Reserve Fund	\$30.5
Sales Tax Rebate Program and Administration	96.2
Fund state's 27 <sup>th</sup> Payroll for year	90.0
Pre-Fund Medicaid Managed Care Capitation Payment/Incentive Payments	78.0
State Employee Health Insurance Claims	60.0
School Construction Grants	55.0
Higher Education Endowment	21.3
Lawsuit Litigation and Settlements	20.2
Local Capital Improvement Funds (LoCIP)	20.0
Year 2000 (Y2K compliance) Compliance Funds	15.0
Reflectorized License Plates	12.9
Distressed Hospital Loan Funds	9.0
Private Provider Wage Increase	7.2
School Library Books Purchase	6.3
Public Works Capital Projects Revolving Fund	6.0
Arts Grants	6.0
Other items (including OPM Tall Ships, DECD Armistad, DOE Audit Hartford Public Schools, Ethics Commission electronic filing system, DEP aerial photo survey)	18.3
<b>Total</b>	<b>\$551.9</b>

As noted in the table above, about 17% of the 1999 surplus went to fund the \$109.5 million sales tax rebate program (\$96.2 from FY 99 surplus and \$13.3 million from the unexpended balance of the 1998 rebate program). The 1999 rebate program provided a smaller rebate to a larger group of Connecticut residents than the 1998 income tax rebate program. Specifically, it provided a \$50 rebate to individuals (or \$100 to married couples filing jointly) who either: 1) filed a 1998 resident CT income tax return or an extension; OR 2) were Connecticut residents and filed a 1998 federal income tax return; OR 3) were Connecticut residents that were eligible for the federal earned income tax credit in the 1998 income year; OR 4) were Connecticut residents that received Social Security benefits in 1998 under Title I of the Social Security Act.

In addition, 16% of the FY 1999 surplus was to fund the 27<sup>th</sup> state employee payroll (that occurs every 11 years), 14% was to pre-fund Medicaid managed care capitation payments and incentive payments, 11% was to be used to settle past state employee health care claims and complete the conversion to a fully-insured plan, and 10% was for upcoming school construction costs. The Office of Fiscal Analysis estimated that \$46.4 million of the surplus was to be used in FY 00 not for one-time expenses, but rather to fund *on-going programs*.

## The Fiscal Year 1999-2000 Surplus: Governor's Proposed Use

In SFY 2000, the General Fund surplus was projected to be less than half the surplus in the prior year. Even with the additional projected revenues, it will still like fall short of last year's surplus. This is due, in part, to the phasing in of various revenue reduction measures adopted in prior legislative sessions (including an increase in the property tax credit against the personal income tax, phasing out of the inheritance tax, and continued rate reductions in and expanded credits against the corporation tax), as well as General Fund expenditures in excess of SFY 2000 budgeted amounts.

Governor Rowland proposed to use the SFY 2000 surplus, anticipated in early February, 2000 to be \$241.3 million, as shown in the table below. Note that the Governor did *not* propose a third year of rebates, nor the pre-payment of expenses such as Medicaid managed care capitation payments:

<b>Governor's Proposed Use of FY 1999-2000 Surplus (in millions)</b>	
SDE/DoIT/DOC/Legislative Management: Avoid issuing debt by paying cash for: -school construction projects (\$90M); CT Education Network (\$10M); School Wiring (\$20M), Core Financial Systems at DoIT (\$7.5M); move DoIT to new facility (\$3.5M); storage lockers for prisoners (\$750K); Capitol Security requirements (\$400K)	132.15
Budget Reserve Fund	33.4
OPM: U Conn Health Center Deficit and funding of strategic initiatives	20.0
DRS: Phase-in elimination of hospital gross receipts tax eff. 4/1/00	17.5
DMHAS: Community programs	8.2
OPM: Operation Sail (Tall Ships)	5.5
DCF: Transition staff and clients from Long Lane to new Juvenile Training School	4.95
DCF: Community-based systems of care transition services	3.5
State Library: Arts Enhancement (Festival for Arts and Ideas; Greater New Haven arts strategic planning study and endowment)	2.0
State Library: Digital Library	2.0
Charter Oak College: CT Distance Learning Consortium	2.0
DSS: Offset SSBG FY 01 cuts	1.0
DSS: Outreach for HUSKY A & B	1.0
DHE: Establish Gov. O'Neill Chair in Public Policy at CCSU	1.0
DEP: Mosquito-transmitted diseases defense (West Nile virus)	1.0
DEP: Digital area photo project	0.9
Attorney General: Litigation Account	0.8
OPM: Hire consultant for health insurance	0.75
DSS: Fatherhood Initiative	0.5
DSS: Teen Pregnancy and Domestic Violence Prevention	0.5
DOL: Hartford Jobs Funnel	0.5
DECD: Job Incentive Grant	0.4
DOL: Individual Development Accounts	0.4
Judicial: Aid re takeover of courthouse security	0.4
Other (e.g. DMH early intervention longitudinal study, DCF regional office moving expenses)	1.5
<b>Total</b>	<b>241.3</b>

## **The FY 1999-2000 Surplus: The 2000 Budget Act**

The budget approved in early May, 2000 appropriates the then-projected \$250 million surplus as detailed in the table that follows.

However, estimates of the true surplus for SFY 2000 have now been revised upward dramatically, based on the late delivery of state tax returns with tens of millions more in revenue. It is now estimated, as of mid-May, that the SFY 2000 surplus may be as high as \$380 million. Section 72 of the Budget Bill (sHB 5216) specifies that notwithstanding other provisions of law if, when SFY 2000 closes on June 30, the Comptroller determines that there are unappropriated surplus funds in the General Fund “after any amounts required by provision of law to be transferred for other purposes have been deducted,” then the amount of the surplus is to be appropriated as follows: “(1) \$10,000,000 to the Department of Information Technology, for School Wiring, and (2) the balance to the Department of Education, for avoiding the issuance of debt for school construction grants.”

Given the dramatic increase in SFY 2000 surplus projections, however, it is likely that in the Special Session that must be called to finish legislative business there will be continuing dialogue about use of surplus funds. According to press accounts, Republican leadership is urging that no changes be made, while Democratic leadership has expressed interest in using some of this additional surplus to continue the freeze on tuition at Connecticut’s public colleges and universities and provide more aid to local municipalities.

<b>Approved Use of FY 1999-2000 Surplus (in millions)</b>	
SDE/DotT/DOC/Legislative Management: Avoid issuing debt by paying cash for: -school construction projects (\$43.632); Education Technology Initiatives as follows: a) CT Education Network (\$5M); b) School Wiring (\$10M), c) Tech Ed E-Commerce (\$2.5M), d) CT Distance Learning Consortium (\$1.2M), e) Technology Teacher Training (\$3.3M); f) Digital Library (\$2M)], Core Financial Systems at Comptroller (\$7.5M); move DotT to new facility (\$6M); storage lockers for prisoners (\$750K); Capitol Security requirements (\$2M); Flag Restoration (\$100K), Capitol Child Development Center Playground (\$5K)	84.4
Budget Reserve Fund	34.9
One-time surplus revenue sharing with towns	34.0
OPM: U Conn Health Center Deficit and funding of strategic initiatives	20.0
DRS: Phase-in elimination of hospital gross receipts tax eff. 4/1/00	17.5
DEP: Charter Oak Open Space Trust Account	10.0
OPM: Arts Grants	6.0
SDE: ECS-Hartford Supplemental School Aid	5.7
OPM: Operation Sail 2000	5.5
SDE: Magnet School	5.0
OPM: Contingency account for litigation/settlement only	3.75
SDE: School Accountability initiatives	2.8
DCF: Transition Staff and clients from Long Lane to new Juvenile Training School	2.7
DCF: Link computer system	2.1
OPM: Greater New Haven arts strategic planning study/endowment	2.0
OPM: International Festival for Arts and Ideas expansion to other towns	1.0
DEP: Mosquito control (West Nile)	1.0
DSS: Offset SSBG cuts	1.0
DSS: Elderly Nutrition	1.0
DHE: Endowed chair in public policy at CCSU in honor of Gov. O'Neill	1.0
DECD: Amistad Dock	0.75
DSS: Fatherhood Initiative	0.6
DSS: Teen Pregnancy and Domestic Violence Prevention	0.5
DOL: Hartford Jobs Funnel	0.5
DECD: Central Tourism Account	0.5
DECD: Job Incentive Grant	0.4
DOL: Individual Development Accounts	0.4
Legislative Management: Study of Hospitals in CT	0.4
Judicial: Aid re takeover of courthouse security	0.4
Other (e.g., OPM census and health insurance consultants, Film Commission, Freedom Trail, DMR early intervention longitudinal study, Judicial Department Juvenile Justice Accountability Study, DPH nursing study, DPH Hospice relocation)	
<b>Total</b>	<b>\$249.7</b>

**Uses of General Fund Surplus Over the Past Three Years.** The combined total of the surpluses for SFY 1997-98 and SFY 1998-99 was more than \$1 billion (\$1,011,900,000). Forty percent of the total surplus over these two years was used for either tax rebates (21%) or transfers to the Budget Reserve Fund (19%). In addition, nearly 11% of the surplus over these two years was used to pre-pay Medicaid managed care capitation payments, and another 9.3% was used for Y2K compliance problems.

Unlike in the prior two years, the \$250 million SFY 2000 surplus, as currently appropriated, will *not* be used for tax rebates. Rather, about a third (\$84.4million) will be used on such projects as school construction and other capital improvements to avoid issuing debt, another 14% will be put into the Budget Reserve Fund to maintain its 5% statutory level, 7% will be used to speed up the elimination of the hospital gross receipts tax (\$17.5 million in lost revenue for the end of SFY 2000), and the balance (\$92.9 million) will be used for literally dozens of other projects, initiatives, and studies.

**Toward a public investment plan for more strategic and disciplined use of General Fund surpluses.** Assuming that the economy continues strong and the General Fund continues generating surpluses, Connecticut should develop a plan to use the funds in a more disciplined and strategic manner.

This year, surplus funds were devoted to a greater extent than in prior years in some one-time higher return investments – including renovating aging schools, putting more computers in classrooms, and preserving open space. Of particular note is the new Charter Oak Open Space Trust Account, to be funded with \$10 million of surplus funds. This account will provide on-going funding for the preservation of open space in the state.

This year, however, surplus funds also were far more widely scattered across a range of arts, tourism, and other on-going programs, some receiving almost token support. In addition, other important investments –such as in the Housing Trust Fund to increase affordable housing – were not made.

Now, when times are good and the treasury is full is the time to make well-targeted public investments that can ensure the state's continued economic prosperity and quality of life. The recent discovery of tens of millions of additional SFY 2000 surplus funds, after the Budget bill passed, only emphasizes the importance of developing a strategic plan for investing this bounty in ways that promote long-term economic security and stability for all of Connecticut:

Government investment in education and training, infrastructure, and research and development has a proven track record. Well-directed spending in these areas can increase the economy's productive capacities. Furthermore, many of these expenditures will have additional benefits not even picked up in standard economic accounts. For example, an individual's gains from education extend beyond just getting a higher wage on the job. And the benefits from a well-planned infrastructure will include a cleaner environment and livable cities.

*The Public Investment Deficit* (1998)

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