CONNECTICUT VOICES FOR CHILDREN

Breaking The Stalemate: A Proposal for a Consensus Revenue Forecasting Process

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Connecticut's residents cannot afford to wait while its political leaders bicker over the size of the state budget deficit. Connecticut should establish a formal mechanism to forge consensus on the revenue forecast which helps establish the budgetary baseline for the upcoming biennium. If the relevant principals fail to reach consensus after a comprehensive, public process, then a respected non-partisan agency should be authorized to issue the official revenue forecast for both the executive and legislative branches.

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The Challenge. On February 2, 2009, Governor M. Jodi Rell delivered a televised address to the residents of Connecticut describing the grim budget outlook: "The red ink for the next two years – the period covered by my proposed budget – is nearly $8 billion."[1] On the same day, the non-partisan Office of Fiscal Analysis (OFA) released updated budget projections for the General Fund and Transportation Fund that pegged the impending deficit at $8.7 billion over two years.[2] While the Governor's and OFA's revenue estimates (and hence their projected budget deficits) differed, the size of the discrepancy was within the realm of reasonable disagreement. Modest differences in economic assumptions and technical details could easily produce this result.

Two days later, however, the Governor released a budget proposal that forecast a $6 billion deficit for the biennium.[3] Since that time, the state Capitol has assumed an "air of unreality."[4] Democratic leaders have argued publicly that the Governor revised her deficit projection downward to avoid specifying unpopular spending cuts or tax increases.[5] More than 98 percent of the divergence between the OPM and OFA deficit projections is attributable to differences in projected revenue.[6] The Governor maintains that the revenue forecast chosen by her Office of Policy and Management (OPM) is correct.[7] On February 18, the senior budget analysts from OPM, OFA, and the Comptroller's Office met to settle the dispute but failed to reach agreement.[8]

As a result of this impasse, Connecticut's political leaders have wasted weeks wrangling over the size of the deficit rather than the difficult policy decisions necessary to bring the budget into balance. Without structural change, this inter-branch conflict over the size of the deficit may not resolve itself in a reasonable, neutral fashion. Under current state law, the General Assembly's Committee on Finance, Revenue, and Bonding adopts official statements of estimated revenue.[9] The executive and legislative branches do not cooperatively develop and adopt an official consensus estimate of the budgetary outlook,[10] and there is no mechanism that requires the two branches to agree.

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Consensus revenue forecasting as a budgetary best practice. While taxing and spending are inherently political endeavors, the budget forecasting process can be designed to avoid partisan manipulation. Most states in the country have successfully adopted reforms that partially insulate the forecasting process from political pressure. According to the National Association of State Budget Officers, twenty-six states rely on a formal "consensus forecast process" which typically brings together the governor; legislature; non-partisan agencies, boards, or commissions; and outside consultants to develop an agreed-upon budgetary baseline before the more politically-charged budget discussions begin.[11] The federal government assigns the task of developing an official budgetary baseline to a respected non-partisan agency: the Congressional Budget Office.[12] Both mechanisms represent viable and intelligent alternatives to Connecticut's present system.

New York provides an excellent model for Connecticut. New York law requires the Chair and Ranking Member of the Senate Finance Committee, the Chair and Ranking Member of the Assembly Ways & Means Committee, and the Governor's Director of the Budget to annually convene a joint-legislative executive hearing at the end of February for the purpose of reaching consensus on the economic and revenue forecast.[13] By March 1, the Director of the Budget, the Secretary of the Senate Finance Committee, and the Secretary of the Assembly Ways & Means Committee are required to issue a joint report with a consensus forecast of the economy and receipts for the current and following fiscal year. If these parties fail to reach consensus, the State Comptroller is authorized and required to issue an official estimate of receipts by March 5.[14]

Massachusetts and Rhode Island both utilize consensus forecasting but omit an enforcement mechanism by an independent third party if the stakeholders fail to reach agreement. In Massachusetts, a joint legislative-executive hearing is convened by the governor's Secretary of Administration & Finance and the Chairpersons of the House and Senate Committees on Ways & Means. Following the hearing, the parties establish a consensus estimate regarding tax revenue that is then incorporated into both the Governor and Legislature's version of the budget.[15] In Rhode Island, a public revenue conference is held every six months that involves the Rhode Island State Budget Officer, the Senate Fiscal Advisor, and the House Fiscal Advisor. At this conference, the principals reach a consensus estimate for revenues for the current and following fiscal years. These estimates become the official estimate of anticipated revenue for the state.[16]

Connecticut should adopt the best practices from its neighboring states. Connecticut should establish a formal mechanism to forge consensus on the budgetary baseline for the upcoming biennium. If the relevant principals fail to reach consensus after a comprehensive, public process, then a respected non-partisan agency should be authorized to issue the official revenue forecast.

Since the late 1990s, the National Advisory Council on State and Local Budgeting has recommended that states establish a consensus revenue forecasting system.[17] The Council argues that "[a] process that provides for developing consensus on the revenue forecast is more likely to remove the forecast from ongoing dispute and keep the budget process on track." In 2003, Connecticut's Program Review and Investigations Committee completed an exhaustive evaluation of Connecticut's budget process and proposed the creation of a special budget committee comprised of the "majority and minority leadership of both chambers and the leadership of the appropriations and finance committees" that would meet prior to the start of the regular session to adopt "an estimate of revenue available under the existing tax structure…."

Consensus forecasting is viewed favorably by bond rating agencies. In connection with its 2003 report, the Program Review & Investigations Committee conducted interviews with representatives from the three major bond rating agencies: Fitch, Moody's, and Standard & Poor's. The rating agencies reported that states with the highest bond ratings typically exhibit structural balance, rapid responses to shortfalls, and *good forecasting*.[18] A simple review of the current ratings for general obligation bonds issued by each of the fifty states reveals a positive correlation between a state's use of consensus revenue forecasting and the quality of the rating received for its general obligation bonds. While mere association does not demonstrate causation, it "should come as no surprise that the states with the best credit ratings use [consensus revenue forecasting]."[19] The adoption of consensus revenue forecasting is consistent with a political system that is capable of confronting a realistic picture of its budget situation.

Table 1 provides the credit ratings assigned by Moody's Investor Services for the general obligation bonds of each state as of May 2008. Table 2 provides a description of Moody's credit rating scale. Only <u>nine</u> states were assigned Moody's highest quality rating ("Aaa"). According to the National Association of State Budget Officers, <u>eight</u> of those states had consensus revenue forecasting processes in place in 2008. States with consensus revenue forecasting featured an average rating slightly worse than Aa2, as compared to states without consensus revenue forecasting, which carried an average rating slightly worse than Aa3. Connecticut carries a rating of Aa3, which is the bottom rung of the second tier of "investment grade" bonds. This rating places Connecticut in the bottom third of all fifty states.[20] Moody's currently lists Connecticut as one of the twelve states with the largest projected budgetary gaps as a percentage of annual revenues for fiscal year 2010.[21]

A decline in a state's bond rating can have dramatic effects on its cost of debt service. Table 3 presents data on municipal general obligation bond yields as of March 3, 2009. Based on this market data, a state with a bond rating of A2 that issues a ten year general obligation bond for $100 million will face total interest payments that are $13.1 million dollars greater than the payments required by a state with a Aaa rating. Indeed, a state with an A2 rating (like Louisiana) will face interest payments that are $11.1 million dollars greater than the payments required by a state with an Aa2 rating (like Massachusetts).[22] A rather dramatic difference in yield requirements is observable between the second and third tiers (Aa1, Aa2, and Aa3 versus A1, A2, and A3).

The risk of poor credit ratings is not limited to higher interest payments. Given the fragility of the current credit markets, a lower credit rating may limit access to bonding altogether. As recently as this Fall, multiple states reported difficulty accessing the municipal bond market to obtain the short-term financing they required. The *New York Times* reported that Massachusetts "fell $170 million short of the $400 million it had sought in the credit market to make a routine quarterly aid payment to cities and towns. Louisiana and New Mexico both postponed multimillion-dollar bond sales in the face of the quivering market."[23] In October 2008, California's governor publicly contemplated requesting a loan from the federal government.[24]

Now is certainly not the time for Connecticut's leaders to play games with the size of the deficit. The stakes are simply too high. Connecticut's political leaders should act swiftly to enact a formal mechanism for adopting a revenue outlook that is binding on both the Governor and the General Assembly.

Table 1. Moody's Credit Rating for State General Obligation Bonds (2008).[25]

States With Consensus Revenue Forecasting		States Without Consensus Revenue Forecasting	
State	**Credit Rating**	**State**	**Credit Rating**
Delaware	Aaa	Georgia	Aaa
Maryland	Aaa	Minnesota	Aa1
Missouri	Aaa	Nevada	Aa1
North Carolina	Aaa	Ohio	Aa1
South Carolina	Aaa	Texas	Aa1
Utah	Aaa	Alabama	Aa2
Vermont	Aaa	Alaska	Aa2
Virginia	Aaa	Arkansas	Aa2
Florida	Aa1	Hawaii	Aa2
Indiana	Aa1	Idaho	Aa2
Iowa	Aa1	Montana	Aa2
Kansas	Aa1	New Hampshire	Aa2
New Mexico	Aa1	Oregon	Aa2
Tennessee	Aa1	Pennsylvania	Aa2
Washington	Aa1	Arizona	Aa3
Kentucky	Aa2	**Connecticut**	**Aa3**
Massachusetts	Aa2	Illinois	Aa3
North Dakota	Aa2	New Jersey	Aa3
Maine	Aa3	Oklahoma	Aa3
Michigan	Aa3	West Virginia	Aa3
Mississippi	Aa3	Wisconsin	Aa3
New York	Aa3	California	A1
Rhode Island	Aa3		
Louisiana	A2		
Nebraska Wyoming	No general obligation debt	Colorado South Dakota	No general obligation debt

Table 2. Moody's Credit Rating Scale.[26]

Aaa	Issuers or issues rated Aaa demonstrate the strongest creditworthiness relative to other US municipal or tax-exempt issuers or issues.
Aa1 Aa2 Aa3	Issuers or issues rated Aa demonstrate very strong creditworthiness relative to other US municipal or tax-exempt issuers or issues.
A1 A2 A3	Issuers or issues rated A present above-average creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Table 3. Municipal General Obligation Bonds Yields (March 3, 2009).[27]

Years to Maturity	Aaa	Aa2	A2
1	0.57	0.67	1.92
5	2.24	2.44	3.60
10	3.20	3.40	4.51
15	4.10	4.29	5.24
30	4.84	4.98	5.72

Table 4. Total Additional Debt Service Required for $100M General Obligation Bond Relative to States with Aaa Rating (2009).[28]

Years to Maturity	Aa2 relative to Aaa	A2 relative to Aaa
1	$0.1 M	$1.4 M
5	$1.0 M	$6.8 M
10	$2.0 M	$13.1 M
15	$2.9 M	$17.1 M
30	$4.2 M	$26.4 M

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[1] M. Jodi Rell, Governor of Connecticut, Remarks to Residents of Connecticut (Feb. 2, 2009), *available at*: http://www.ct.gov/governorrell/cwp/view.asp?A=3675&Q=433172.

[2] CONN. GENERAL ASSEMBLY, OFFICE OF FISCAL ANALYSIS, FY 09 - FY 12 GENERAL FUND AND TRANSPORTATION FUND BUDGET PROJECTIONS (2009) [hereinafter OFA PROJECTIONS], http://www.cga.ct.gov/OFA/Documents/Statements/2009/Feb_2_2009_Statement.pdf.

[3] *See* GOVERNOR M. JODI RELL, CONNECTICUT FY 2010- FY 2011 BIENNIUM GOVERNOR'S BUDGET (2009), *available at*: http://www.ct.gov/governorrell/cwp/view.asp?a=1317&Q=433326.

[4] Mark Pazniokas, *Lawmakers, Rell, Struggle Over Public Opinion; State Budget Crisis*, HARTFORD COURANT, Feb. 20, 2009, A5.

[5] Christopher Keating, *Exactly How Big of a Hole Are We In?; Projected State Deficit: How Many Billions?*, HARTFORD COURANT, Feb. 19, 2009, A3.

[6] Author's calculations based on: GOVERNOR M. JODI RELL, *supra* note 3, at part I, 2-12, *available at:* http://www.ct.gov/opm/lib/opm/budget/2010_2011_biennial_budget/bigbook/bigbookpart1_fob_final_schedules.pdf; FY 2010-FY 2011 Governor's Budget Slide Presentation (2009), *available at*: http://www.ct.gov/opm/lib/opm/budget/2010_2011_biennial_budget/final_budget_ppt_2010_2011.pps; OFA PROJECTIONS, *supra* note 2, at 3.

[7] Pazniokas, *supra* note 4.

[8] Keating, *supra* note 5.

[9] CONN. PROGRAM REVIEW & INVESTIGATIONS COMM., CONNECTICUT BUDGET PROCESS 59 (2003) [hereinafter CONN. BUDGET PROCESS], *available at*: http://www.cga.ct.gov/2003/pridata/Studies/PDF/Budget_Final_Report_Digest.PDF.

[10] *Id.*

[11] NAT'L ASSOC. OF STATE BUDGET OFFICERS, BUDGET PROCESSES IN THE STATES (2008), Table 7, *available at*: http://www.nasbo.org/Publications/PDFs/2008%20Budget%20Processes%20in%20the%20States.pdf.

[12] Congressional Budget and Impoundment Control Act of 1974, 2 U.S.C. §§ 601–688 (2000).

[13] N.Y. STATE FIN., § 23 (McKinney 2009).

[14] While Connecticut's fiscal year begins on July 1, New York's fiscal year starts on April 1. N.Y. STATE FIN., § 3 (McKinney 2009). While New York's consensus revenue forecasting process represents an excellent

model for Connecticut, the abbreviated timeline in New York between the submission of the governor's budget in January and the start of the fiscal year should not be replicated. *See, e.g.*, N.Y. STATE COMPTROLLER, FISCAL REFORM FOR NEW YORK STATE: IMPROVING ACCOUNTABILITY, TRANSPARENCY, AND FISCAL RESPONSIBILITY 25 (2006) ("New York State's budget timetable is too short to allow sufficient time for deliberation, solicitation of public comment, legislative debate and consideration of alternatives. The Governor submitted the 2006-07 Executive Budget on January 17, 2006, a total of 73 calendar days (29 scheduled legislative workdays) before the fiscal year begins on April 1."), *available at*: http://www.osc.state.ny.us/reports/budget/fiscalreform.pdf.

[15] MASS. GEN. LAW. ANN., ch. 29, § 5B (West 2009); *see also* MASS. BUDGET CTR., CREATING A TRANSPARENT BUDGET FOR MASSACHUSETTS 12 (2006), http://www.massbudget.org/file_storage/documents/Creating_a_Transparent_Budget.pdf.

[16] R.I. GEN. LAW. § 35-16-1 to -6 (2009).

[17] GOV'T FINANCE OFFICERS ASSOC. , NAT'L ADVISORY COUNCIL ON STATE & LOCAL BUDGETING, RECOMMENDED BUDGET PRACTICES: A FRAMEWORK FOR IMPROVED STATE AND LOCAL GOVERNMENT BUDGETING 48 (1998), http://www.gfoa.org/services/dfl/budget/RecommendedBudgetPractices.pdf.

[18] CONN. BUDGET PROCESS, *supra* note 9, at 51.

[19] Diana Fortuna, *How to Fix Albany; Real Numbers, True Accounting*, N.Y. TIMES, July 11, 2004.

[20] MOODY'S INVESTOR SERVICE, OUTLOOK REMAINS NEGATIVE FOR U.S. STATES: FEDERAL FISCAL STIMULUS MAY MODERATE RECESSION'S EFFECTS ON U.S. STATES; IMPACT FROM RECESSION WILL NOT BE EQUAL 4 (2009).

[21] MOODY'S INVESTOR SERVICE, *supra* note 20, at 14.

[22] Author's calculations based on *Municipal Market Data General Obligation Yield,* THE BOND BUYER, March 4, 2009.

[23] Randal C. Archibold, *California May Ask U.S. for Loan*, N.Y. TIMES, Oct. 3, 2008.

[24] Marc Lifsher and Evan Halper, *Financial Crisis: Ripple Effects; State Pins Its Hopes On Credit Easing; Officials Are Counting On Resuming Bond Sales to Pay Bills. But They Don't Rule Out Seeking a Loan From the U.S.*, L.A. TIMES, Oct. 4, 2008, A12. With a rating of A1, California has the second-worst bond rating in the country.

[25] MOODY'S INVESTOR SERVICE, RATING CHANGES FOR THE 50 STATES FROM 1973 TO DATE (2008); NAT'L ASSOC. OF STATE BUDGET OFFICERS, *supra* note 11, at Table 7.

[26] MOODY'S INVESTOR SERVICE, MOODY'S RATING SYMBOLS & DEFINITIONS 15 (2008).

[27] THE BOND BUYER, *supra* note 22.

[28] Author's calculations based on THE BOND BUYER, *supra* note 22. Calculations assume that a S&P or Fitch rating of AA converts to a Moody's rating of Aa2 and that a S&P or Fitch rating of A converts to a Moody's rating of A2. Calculations reflect a general obligation bond that pays simple interest; that is, the bonds pay a fixed amount of interest each period to the holder and then repay the principal at the end.