CONNECTICUT VOICES FOR CHILDREN

Connecticut's Volatility Cap: Frequently Asked Questions

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What is the volatility cap?

The volatility cap imposes a threshold for certain types of revenue, above which any excess must be deposited into the Budget Reserve Fund (BRF) and excluded from general appropriations. The goal is to smooth out unstable revenue streams and reduce the state's reliance on one-time cash influxes.

Which types of revenue fall under the cap?

The cap applies to revenue from the Estimates & Finals portion of the personal income tax, which has high year-to-year variance, as well as revenue from the pass-through entity tax. Any revenue from these combined taxes above $3.1968 billion for Fiscal Year 2019 must be deposited into the BRF. The threshold is indexed to average income growth over the previous five years.

How will the current volatility cap affect future budgets?

The cap requires the deposit of revenues in the BRF even when the state faces deficits, causing unnecessary cuts to essential programs like education and municipal aid. The Office of Fiscal Analysis predicts required deposits of about $550 million in FY 2020-2021, despite deficit projections of about $3 billion. Because the threshold is set too low, it will divert ordinary revenue growth into the BRF, preventing needed investments.

How can the cap be changed and improved?

As a result of the Bond Lock, there are heightened requirements to change the volatility cap:

- The legislature votes with a three-fifths supermajority to revise the threshold amount, "due to changes in state or federal tax law or significant adjustments to economic growth or tax collections."
- The Governor declares the existence of a "fiscal emergency" or "extraordinary circumstances" and the legislature votes with a three-fifths supermajority to change or suspend the cap. In this circumstance, the change is in effect for one year only.

A better cap would incorporate the following elements of the volatility cap adopted with bipartisan support in 2015 that had been set to take effect in 2021:

- Raise the volatility threshold;
- Index the threshold to grow with average revenue, rather than average income;
- Increase the look-back period from five years to ten years; and
- Remove the requirement of BRF deposits in years with projected deficits.