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The Government Affairs Group at Murtha Cullina LLP is pleased to provide information about current topics of interest.

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BUDGET WARS - CONNECTICUT PART II

Sticking to her word, Governor M. Jodi Rell wasted little time vetoing the \$35.5 billion biennial general fund budget passed by the General Assembly on June 26. In her July 1 veto message, Rell cited her strong disapproval of the \$2.5 billion in new taxes contained in the budget and the failure to reduce state spending during recessionary times as the main reasons for her rejection of the budget document. The Governor immediately issued an executive order to run the state for the next thirty-one days, limiting state spending “to those that are necessary for the provision of direct care, the administration of justice and the protection of the public health and safety.” Since this budget passed in both houses of the General Assembly with fewer votes than the two-thirds necessary to override the Governor’s veto, there is little likelihood the budget bill will be taken up during the legislature’s veto session on July 20.

Budget Negotiations

The Governor’s veto brings the development of a new state budget for FY10 and FY11 back to square one. The Governor and legislative leaders agreed to begin meeting at the governor’s residence starting June 28 to attempt to work out differences on a new budget package. All reports indicate these budget negotiations are not going well. After forty hours of discussions, the debate over tax increases versus spending cuts for the next two fiscal years continues. Rell is holding to a budget with no tax increases and the Democrat legislative leaders are holding their ground on further budget reductions which they believe will dismantle the state’s social safety net.

What is clear to most observers is that a compromise must be hammered out on four main elements of the budget - new taxes, additional spending cuts, the amount of deficit financing and the use of the state’s rainy day fund. What complicates this effort, however, are the large budgetary items which have been locked in either by federal or state requirements, thereby taking them off the table for fiscal review and adjustment. For example, \$556 million in local education aid and \$1.3 billion in Medicaid funds, both received under the federal stimulus program, cannot be used if the state attempts to lower both its core aid to K-12 education and its Medicaid eligibility standards. These two restrictions alone lock in a staggering \$1.9 billion in education aid to the state’s municipalities and hold harmless the state’s \$4 billion Medicaid program. Additionally, the recent labor agreement reached by the Rell administration and the state employee unions to save nearly \$700 million over the next two years places the

restructuring of the \$3 billion cost of the state employee salaries and benefit packages out of bounds for the same period of time. All of this reduces the spending cut flexibility of the budget negotiators in their efforts to achieve a compromise.

Connecticut Is Not Alone

Connecticut is not alone in experiencing an ongoing decline in revenues. It is one of forty-eight states that have seen tax revenues drop precipitously. Connecticut's expected shortfall in FY10 is projected to be \$4.1 billion. States like California and New York are confronting FY10 budget gaps of \$53.7 billion and \$17.9 billion, respectively. In the aggregate, according to the Center on Budget and Policy, states are facing budget gaps of \$166 billion in FY10. In Connecticut, the State Comptroller recently indicated collections from the state income taxes are down 15% from last year, the sales tax is down 11.3% and corporate taxes are off by 25.3% in a similar period.

Storm Clouds Remain

Since the "official" start of the current recession in December 2007, national unemployment has risen to 9.5%, housing permits have declined by 49% and real gross domestic product decreased by an annual rate of 6.1%. On the positive side, it appears the U.S. economy is no longer contracting. Economists are predicting a long, slow recovery for the economy, moving into positive territory by the second half of 2010. Traditionally, Connecticut's state revenues lag economic changes by two quarters.

If you have any questions about the issues addressed here, please feel free to contact David McQuade, Senior Government Affairs Consultant, at 860-240-6141 / dmcquade@murthalaw.com, or your attorney.