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Borrowing for GAAP gap makes sense

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Debt financing can be a prudent, reasonable and valuable fiscal tool for state government, much as it is for so many businesses, especially when rates to repay the debt are lower than in anyone's memory. Determining whether proceeding on such a course would be folly or fundamentally sound depends largely on how the funds will be used.

I couldn't agree more with the observation by the Connecticut Business and Industry Association (CBIA) that "Connecticut's failure to rein in the cost of government and more significantly reduce its long-term obligations has put the state in a precarious fiscal position." The question now is what actions can most effectively put us on firmer ground.

My longstanding adherence to the dual imperatives of exercising fiscal discipline regarding borrowing practices and meeting our obligation to adequately fund long-term liabilities hasn't changed. And it won't. That does not, however, preclude the prudent use of debt.

Debt should not be used as an easy way out, a substitute for tough budgetary decisions, or a roundabout way to fund programs that we really can't afford or don't really need. That said, the convergence of circumstances suggests there is a place for debt financing this year to effect the structural changes that are needed to improve the state's cash balances.

The virtual depletion of the state's Budget Reserve (Rainy Day) Fund and the accumulated effects of the state's past budgeting practices have strained the state's current cash position, even when budgets are balanced. To manage this situation, we have made more frequent use of internal transfers between accounts.

As businesses know well, revenues arrive unevenly, but bills must be paid on time. That is what we do at the Connecticut Treasury, and that is why such internal fund transfers are one element in the arsenal of effective cash management strategies.

The reasonable use of debt to drive structural changes also can help to alleviate the cash crunch. Here is how. The state is committed by law to implement Generally Accepted Accounting Principles (GAAP) for its budget beginning in 2014. Doing so - clearly in the state's long-term best interest - will further exacerbate the state's budget challenges in the near-term as revenues and expenses are accounted for on an equal basis.

GAAP is not just moving numbers on a balance sheet. The full transition will require paying down the current accumulated GAAP deficit of over $1 billion. (Not to be confused with the projected budget deficit of more than $1 billion beginning July 1, 2013.)

The plan was to use surplus dollars to fill the gap over the next decade. A surplus, however, is not on the horizon - leaving two realistic choices: put off the fiscally responsible funding of the GAAP deficit until well into the future or find an alternate means of funding the changeover.

Among those calling for accelerating the GAAP phase-in is CBIA. If that is to be accomplished - and I agree it should be - the money must come from somewhere. Debt can be used effectively to cover half of the GAAP deficit, in my view, committing the state not only to pay back what is borrowed - with the bond proceeds never to be treated as revenue - but also to a specific timeline to eliminate the remaining GAAP deficit.

We may also adjust the timing of repaying Economic Recovery Notes (ERN) - which now have three years of payments remaining - for an additional two years, which would create debt service savings in 2014 and 2015. Such an approach worked effectively in the 1990s under similar circumstances. And certainly, taking steps to re-establish the virtually-depleted Rainy Day Fund, a prudent fiscal measure recommended in Gov. Malloy's biennium budget, is highly advisable.

Proceeding with borrowing is not without downside, and each proposed instance should be weighed carefully.

The decision regarding whether, when and how to utilize debt may come down to this - pay now, or pay more later.

Denise L. Nappier is Treasurer of the State of Connecticut..