4/22/08

Budget Referendum Charge

I. The threshold question is should an automatic financial trigger or a petition signed by a requisite number of electors, or both, provide the impetus for a budget referendum?

II. If an automatic financial trigger is preferred, should it be a specific number or percentage of expenditures or tax increase presented by the local budget as adopted (with or without exclusions or other adjustments), or should it be a benchmark external to the local budget, such as one of the federally-generated CPI indexes?

III. It is my position that an automatic financial trigger, regardless of its design, fixed number or percentage, based on numbers from the local budget itself or from an external benchmark, can't work

- A. First, a specific number or percentage of increase in expenditures or tax increase as driven by the local adopted budget itself won't work
  - 1. An unadjusted number, whether an amount or percentage, cannot take into account the unusual increases in cost that often occur in sectors heavily impacting a municipal budget, and such an approach is, therefore, too inflexible. Some facts from the local budget will make my point:
    - a. Over 72 percent of Manchester's budget is currently comprised of employee salaries (at 53.1% of the budget) and benefits (another 19.1%)
      - 1) Connecticut law provides that once a public-sector labor agreement has been ratified by the municipality, it <u>must</u> be fully funded throughout its multi-year term, regardless of changed circumstances, though this does not preclude the possibility of lay-offs
      - 2) In the late 1970's and early 1980's, when I was in office, in a national economy inflating at a double digit rate, and at a time when public employee wages had historically been below those of comparable positions in private industry, employee compensation was growing at a rate of about 8% per year.
      - 3) If we were to enter into another such period of relatively high inflation, a cap based on perceptions of recent rates of inflation, such as the 3.5% that has been suggested by some, would not meet this fiscal reality.
      - 4) An additional example from this same category of expense would be that 13 percent of the municipal budget is comprised of health insurance costs, and the average annual increase in this area has been 9.07% since 2002/03.
    - b. Utility and energy costs comprise 2.8% of the General Fund budget. These costs escalated 37% in 2005/06, 35% in 2006/07, and 6.7% in 2007/08, thanks to the town having put electricity generation out to bid and saved roughly $300,000. All of these rates of increase are, of course, way out of range of the level of cap being contemplated by this approach's advocates.

c. Debt service, an area of the budget already approved by the electors in their support of bond issues, will represent about 5.7% of the budget for the next fiscal year, having grown from $4.34 million in 2006/07 to $9.07 million in 2008/09, an average annual rate of increase of 36.3%.

2. It was such considerations that compelled the Governor, in her 3.0% local tax cap proposal, to abandon the unadjusted figure approach and exempt employee health insurance, utility, and/or retirement fund cost increases of more than 8% over the prior year, the amount of decrease in certain State aid programs, debt service increases, and emergency expenditures, among others from the tax-cap calculations. Nonetheless, despite recognizing the futility of relying on an unadjusted-number cap, she recommends a percentage figure that is less than half the rate of increase in those areas that she would exempt, a percentage figure based on her perception of recent national rates of inflation that are suspect, as I will address shortly, and that may not have any relationship to reality going forward.

3. I feel compelled to note as well, that this tax cap proposal is made from the capitol city of a state that contributes one of the smallest percentages in the entire nation to that most expensive local service cost contained in any municipality's budget, that of educating our children.

4. Consistent with my concerns about fixed and inflexible benchmarks, this commission has several times already modified charter provisions that were based on specific numbers in favor of percentages of the over-all budget, but note as readily that the percentage approach we recommended was considered acceptable only as to certain relatively minor line items in the budget, not as an approach to limit the increase in total municipal expenditures in a given year, a much more serious matter.

B. Second, an external benchmark based on the readily-available CPI calculations of the Federal government won't work either.

1. First, the numbers are unreliable.

a. An article appearing in the Wall Street Journal of March 5, 2007 and written by an economist makes that point by reporting that "a series of methodological changes, redefinitions and gimmicks [in CPI reporting] have had the effect of sharply reducing reported inflation".

b. The foremost gimmick is the concept of "core inflation", regularly recited by the chairman of the Federal Reserve, in which food and energy increases are backed out of the CPI calculations. At the time this article was written in the Spring of 2007, these two items accounted for 23% of consumer spending. I'll leave to your own imagination what that percentage figure would be today what with sharply rising food and energy costs. In the first 8 months of 2007, the CPI rose at a rate 50% higher than the core rate utilized by the Fed in its calculations.

c. The credibility of CPI reporting began to decline when it was used to adjust Social Security payments annually for changes in the cost of living, thereby having a direct impact on the Federal budget.

d. Prior to this, the CPI, designed to report the increased cost of maintaining a certain standard of living, was measured using the cost of a fixed basket of goods. The identical basket of goods would be tallied up at prevailing market prices for each period, and the period-to-period change in the cost of that market basket represented the rate of inflation, a fairly simple and straight-forward concept.

e. But the current administration's chief economist, together with then Fed chairman Greenspan, got the idea that if steak went up in price, for example, people would start eating hamburger instead, and so they substituted hamburger for steak in the basket, no longer reporting maintenance of the same standard of living.

f. Reflecting the bipartisan nature of this chicanery, early in the Clinton administration the Bureau of Labor Statistics had changed the arithmetical weighting of CPI components to a geometric weighting, so that any component that went up in price automatically got a lower weighting.

g. These moves were made on top of the Reagan administration's alteration of the component for housing costs, which was changed from a reflection of the cost of buying a new home to a government-imputed owners' equivalent rent.

h. I'm sure by now you have the picture. The author of the article reported that if the CPI methodology of 1980 were used to calculate inflation, the 2.1% increase reported by the government in January of that year would be pushing 10%, a rate he suggests most consumers would have estimated at the time on their own.

2. Second, the numbers reflected in the CPI aren't intended to and, in fact, don't relate to municipal expenditures.

   a. The CPI is intended to measure the impact of inflation on individual consumers, who neither employ large numbers of other people to serve them nor purchase the same goods and services as towns do.

   b. There is a municipal cost index that is produced privately by American City & County magazine. By way of comparison, the municipal cost index for March 2008 was published as an annualized rate of 4.8%, while the most-often cited CPI-U was reported for the same month at 3.98%, a difference in rate of just over 20%. Unfortunately, none of us has any experience with this privately generated index to know how reliable it might be as a benchmark for our town charter.

3. Third, at least in the current environment, the CPI and inflation are too volatile, even when annualized, to be used as a benchmark.

   a. Take the experience from August through November of 2007, for example, during which period the annualized rate of inflation more than doubled from 2.0% to 4.3%.

   b. If that same experience had occurred over the four months from December 2007 and March 2008, consider the difference in result you would have obtained in capping the current year budget based on whichever month in that sequence you had chosen to incorporate into the charter as the benchmark month.

4. For our purposes, let's adopt the annualized CPI number of March 2008, the latest figure available, and assess the impact of relying on the CPI to cap this year's proposed budget.

    a. If the CPI annualized number of 3.8% were applied to expenditures, it would require a reduction in the Manager's recommended budget of $1,609,064.

    b. If the CPI cap were applied to the tax levy, it would require a reduction of $2,716,417.

    c. Keep this 3.8% figure in mind as you bring back my comments about the escalators in the actual budget for employee costs and benefits, utilities, and debt service.

    d. And keep in mind too that the manager's proposed budget only provides $1,056,000 for capital expenditures.

C. Manchester's fiscal performance to date doesn't merit imposing a financial straightjacket on a process that's worked.

1. It seems to me that the need for a firm cap on municipal spending would be compelling if the actual Manchester experience was out of line with that of similarly sized or nearby towns.

2. At my request, Julian prepared a chart comparing the FY 2006 Manchester per capita expenditures and tax levy with those of towns typically used for comparison purposes with Manchester.

3. While I haven't studied the chart with a great deal of care, it seems to me that Manchester finds itself appropriately in the mix, and I would particularly call attention to its excellent bond rating since the rating agencies make an exhaustive review of a municipality's financial health before conferring any blessings on it.

4. In short, "if it ain't broke, don't fix it!"

5. All this said, I am not unmindful of the times we live in today, in which the public attraction to direct democracy makes a budget referendum proposal more attractive than it might once have been.

IV. What are the advantages of a petition approach?

A. The people decide when local taxes or spending warrant collective action, and they do it presumably taking into account the relative strength of the economy, so that in good times, they will be more likely to accept expenditures or tax increases that would strike them as excessive in difficult times. In other words, the same exact size of an increase in spending would be treated differently in one time than another, as arguably it should be, with no pre-determined artificial benchmark forcing an unwanted action.

B. As long as an appropriate number is chosen for the number of required signatures on a petition, the result would presumably be representative of the thinking of the entire community, and the taxpayers would not be forced to fund a vote that only an unrepresentative few, whatever their motives, desired.

C. A minimum turn-out required to ratify the vote, as is true with charter changes, would also assure that the result was truly representative.

D. The petition approach provides a vehicle for electors who feel that too little money is being applied to a critical service area to have the same vehicle for input as those who might feel that too much money is being spent over-all.