

Budget CONNECTION\$

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Where *Really* Does Connecticut Stand?

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Connecticut, like other states, is grappling with how best to balance this year's budget and address next year's projected deficit. Some have raised concerns that further spending cuts will threaten our essential state investments in education, health, social services, economic development, and public infrastructure. Others raise concern that restoring some of the \$2 billion in tax revenues cut in the late 1990s will make Connecticut less competitive. This report summarizes where Connecticut currently stands on a variety of measures related to current budget deliberations. It includes state-by-state comparisons, as well as data about some important changes in Connecticut over the 1990s in the number of persons receiving state services and in who is paying for them.

State-by-State Comparisons

On the size of state and local government

On a variety of measures of government size, Connecticut is *very trim*. Indeed, a recent report published in *The Connecticut Economy*¹ compared all fifty states on five relative measures of government size and found Connecticut to be the second most frugal state in the nation. Specifically, it ranked Connecticut 49th in state and local governments' share of Gross State Product (GSP), 45th in state and local spending as a percentage of GSP, 48th in state and local spending as a percentage of personal income, 39th in the number of state and local full-time employees per 10,000 residents, and 43rd in state and local government employment as a percentage of total non-farm employment. Ranking the states based on the combined average of these five measures placed Connecticut 49th, second only to New Hampshire in leanness. The overall rank of neighboring states varied. Least frugal was New York (7th). It was followed by Maine (13th), Vermont (14th), Rhode Island (25th), New Jersey (42nd), Pennsylvania (43rd), and Massachusetts (46th).

On state spending overall

According to United States Census Bureau data on government spending,² Connecticut is:

- 50th (i.e. lowest) in state and local spending on education³

¹ D. Heffley, "My Big Fat State Government?" *The Connecticut Economy* (Fall 2002), pp. 4-5.

² Expenditure data are taken from the United States Census Bureau publication, *Government Finances, 1999-2000*, and are for fiscal year 2000. Spending levels are expressed either as a "share of income" or as "dollars per \$1,000 of personal income" (where comparisons based on "share of income" would have yielded exceptionally small figures). These measures are used to remove from multi-state comparisons the influence of the variation among states in population size, income, and the cost of living. State-by-state comparisons are included in J. McLynch & J. St. George, *Measuring Up* (Massachusetts Budget and Policy Center, January 2003). Available at: <http://www.massbudget.org/measuringup.pdf>

³ \$49.49 per \$1,000 of personal income goes to state and local spending on education. More specifically, \$38.41 per \$1,000 of personal income goes to spending on primary and secondary education (ranking Connecticut 4th lowest in the nation) and \$8.80 per \$1,000 on higher education (ranking Connecticut lowest in the nation).

- 49th in spending on transportation and on total wages and salaries for state and local government employees⁴
- 48th in spending on direct general expenditures (defined as combined state and local spending on programs, operations, and capital spending) and spending on housing and the environment⁵
- 46th on capital spending⁶
- 41st in public safety spending⁷
- 40th in public welfare spending.⁸
- 39th in social services spending⁹

Even on the measure on which Connecticut ranks highest – state and local hospital spending – Connecticut ranks 26th and is still below the national average.¹⁰

On Medicaid spending

The revised SFY 03 budget appropriates \$2.9 billion for Medicaid, the *single largest* expense in the General Fund budget. Because Connecticut receives 50% reimbursement from the federal government for its Medicaid spending, the amount of *state* funding for this program is about half this amount -- \$1.45 billion.

Though children constitute more than half of Connecticut’s Medicaid population, the health care costs of children constitute only 11% of Connecticut’s total Medicaid spending. By comparison, the elderly, blind and disabled constitute about 28% of Connecticut’s Medicaid enrollees and their health care costs are 70% of the total:

Distribution of CT Medicaid Enrollees and Spending (FFY 98)				
	# enrolled in Medicaid	% of CT Medicaid enrollees	% of CT Medicaid spending	% of All US Medicaid Spending
Children	207,306	51%	11%	15%
Adults	83,395	21%	6%	10%

⁴ \$9.36 per \$1,000 of personal income is spent on state and local transportation spending and 5.4% of state personal income on total wages and salaries for state and local government employees (down from 5.7% in 1999).

⁵ 15.8% of state personal income is spent on all direct general expenditures. \$10.85 per \$1,000 of personal income is spent on housing and the environment (i.e., conservation and development of state and local natural resources, parks and recreation, housing and community development, and sewers and solid waste management) (up from \$10.00 in 1999).

⁶ \$16.00 per \$1,000 of personal income is for spending on capital projects. This is much more than the \$13.48 per \$1,000 in personal income for capital spending in the preceding year (when Connecticut ranked 50th on this measure).

⁷ \$12.92 per \$1,000 of personal income is spent on public safety (i.e., police and fire protection and corrections facilities)(down from \$13.28 in 1999).

⁸ \$22.94 per \$1,000 of personal income is spent on public welfare spending (i.e., direct cash assistance payments to low-income families and individuals, vendor payments under Medicaid, and expenditures to administer these programs)(down from \$23.14 in 1999).

⁹ \$35.39 per \$1,000 of personal income is spent on social services (i.e., state and local public welfare programs, health programs, veterans’ services, hospitals, and payments to augment Supplemental Security Income benefits for the elderly and disabled) (down from \$36.00 in 1999).

¹⁰ \$8.44 per \$1,000 of personal income is spent on hospitals by state and local governments (down from \$9.05 in 1999). The average across states is \$9.41.

Elderly	55,244	14%	38%	27%
Blind & Disabled	54,602	14%	32%	39%
Disproportionate share hospitals	NA	NA	13%	9%
TOTAL	402,547	100%	100%	100%

Source: Urban Institute and Kaiser Commission on Medicaid and the Uninsured estimates based on data from HCFA-2082 and HCFA-64 reports filed by CT.

As the following chart shows, Connecticut's per capita spending on Medicaid far exceeds national averages for the elderly, blind and disabled, reflecting in part Connecticut's high cost of living but also suggesting the possibility for better cost control, particularly in long-term care.

Per Capita Medicaid Spending, CT v. US (FFY 98)			
	CT Medicaid Spending per CT Medicaid enrollee	US Medicaid Spending per US Medicaid enrollee	Ratio of CT Medicaid Spending/Enrollee to US Medicaid Spending/Enrollee
Children	\$1,516	\$1,225	1.24
Adults	\$2,046	\$1,892	1.08
Elderly	\$20,160	\$11,235	1.79
Blind & Disabled	\$16,898	\$9,558	1.77

Source: Calculations by CT Voices for Children, based on Urban Institute and Kaiser Commission on Medicaid and the Uninsured estimates from HCFA-2082 and HCFA-64 reports filed by CT.

On state and local government revenues

According to the United States Census Bureau data on state and local government revenues (for FY 1999-2000), Connecticut's state and local government revenues are relatively low compared to other states'.¹¹ Using "revenues as a percentage of total state personal income"¹² as the measure for comparing states, Connecticut ranks second to last (49th) in *total* revenue (at 19.0% of state personal

¹¹ This analysis comes from Center on Budget and Policy Priorities, *State and Local Government Revenue for Fiscal Year 1999-2000: State by State Census Data* (December 18, 2002).

¹² "State and local revenues as a percentage of personal income" is a standard form of measurement in public finance analyses as it shows the relative burden of state and local taxes on taxpayers and the relative effort states are making to fund public programs. An alternative measurement -- comparing revenues on a per capita basis -- is less useful as it does not take into account the differing abilities of states to raise revenues and fund programs (e.g., two states with large differences in average income levels could raise the same amount of revenue per resident, but the poorer state would be placing a greater tax burden on its residents). Also, the overall cost-of-living and wage levels may be higher in states with above-average incomes, so wealthier states may be required to spend more per resident than poorer states to provide the same level of services. Comparisons based on "revenues as a percentage of personal income" help to lessen the impact of such state variation. Also, these data look at combined state and local revenues, since there is great variation among states in the kind and extent of services provide by the state government as compared to local governments. Importantly, the measure of "personal" income used in these comparisons does *not* include capital gains income so the percentages overstate slightly the actual burden of state and local taxes on residents of a state, and particularly in states with significant capital gains income like Connecticut. See, Center on Budget and Policy Priorities, *State and Local Government Revenue for Fiscal Year 1999-2000: State by State Census Data* (December 18, 2002).

income).¹³ “Total revenue” is the broadest category for these revenue comparisons. Specific rankings on sub-categories of revenues are:

- 43rd in total general revenue¹⁴ (17%)
- 44th in federal revenue (2.7%)
- 41st in own-source revenue¹⁵ (14.3%)
 - 10th in total state and local taxes¹⁶ (11.5%)
 - 17th in personal income tax (2.9%)
 - 30th in corporate income tax (0.3%)
 - 9th in property taxes (4.0%)
 - 27th in general sales taxes (2.5%)
 - 25th in selective sales taxes¹⁷ (1.2%)
 - 43rd in all other taxes (e.g. motor vehicle, severance taxes, other taxes, 0.6%)
 - 50th (last) in charges, fees and miscellaneous revenue (2.8%).

On the proportion of tax revenues from the corporate tax

Connecticut ranks 13th lowest among the 46 states with a corporation tax (i.e., 33rd) in the share of state revenues that come from that tax. Specifically, only 3.9% of Connecticut’s total state revenues came from its corporate tax in 2001. This was less than the average among all states (5.7%) and less than New York (7.1%), Massachusetts (7.0%) and New Jersey (6.8%). It was slightly more than Maine (3.6%), Rhode Island (3.5%), and Vermont (2.9%).¹⁸

State fiscal capacity

As Robert Tannenwald of the Federal Reserve Bank of Boston notes,¹⁹ readily available tax statistics can document the amount and mix of revenues that state and local governments receive, but it is far harder to measure a state’s fiscal capacity. That is, what is a state’s capacity to raise revenues (regardless of what the state actually collects)? To what extent does a state use that capacity? Is a state’s revenue capacity sufficient to meet the state’s needs for public services?

To answer this question of state fiscal capacity, Tannenwald measured states’ fiscal capacity, states’ fiscal need, and states’ “fiscal comfort” using a sophisticated model outlined in his study. “Fiscal comfort” is a measure that looks at the relationship between state fiscal need and state fiscal capacity to meet that need.

¹³ “Total revenue” is the broadest category for comparison. It includes the total of all intergovernmental revenue (e.g. federal funds) as well as all own-source revenue (total taxes, charges, and miscellaneous revenues) and utility, liquor store, and insurance trust fund revenue.

¹⁴ Defined as all state and local taxes, all charges and miscellaneous revenues (e.g., tuition at public universities, payments by private insurers to public hospitals, interest earnings, net lottery revenue, fines), and all federal revenue. Excludes employee retirement, insurance trust, liquor store, and utility revenues.

¹⁵ Defined as total taxes, charges and miscellaneous revenues. Excludes federal revenue and employee retirement, insurance trust, liquor store, and utility revenues.

¹⁶ Defined as all revenue from property, general sales, motor fuel, motor vehicle license, income (personal and corporate) and other taxes.

¹⁷ Defined as sales and gross receipts taxes on particular commodities or services (e.g., alcoholic or tobacco products).

¹⁸ OLR, *Corporation Tax Revenue in Connecticut and Other States* (2002-R-1002)(December 17, 2002).

¹⁹ R. Tannenwald, *Interstate Fiscal Disparity in 1997*, *New England Economic Review* (third quarter, 2002), pp. 17-33.

On *fiscal capacity* (states' capacity to raise revenues),²⁰ Connecticut ranked third highest in the nation (behind only Alaska and Hawaii). The next closest state in the region was New Jersey (#10), followed by Massachusetts (#11), New Hampshire (#12), New York (#13), Vermont (#19), Maine (#27) and Rhode Island (#38).

On *fiscal need*, Connecticut ranked 18th highest (just slightly over the national average). Connecticut's fiscal need *exceeded* that of all other states in the region except New York (#11). By comparison, New Hampshire ranked lowest (#51, since the District of Columbia is also ranked), while Maine ranked #49, Vermont #48, Rhode Island #43, Massachusetts # 36, and New Jersey #28.

On *fiscal comfort* (the relationship between tax capacity and fiscal need), Connecticut ranked 4th. That is, Connecticut was ranked the fourth most able among states to meet its fiscal needs given its tax capacity. On this measure, Connecticut fell behind only Hawaii, Nevada, and Delaware. Other states in the region were ranked as follows (in order of descending "fiscal comfort"): New Hampshire (#6), Massachusetts (#9), New Jersey (#10), Vermont (#11), Maine (#17), New York (#24) and Rhode Island (#25).

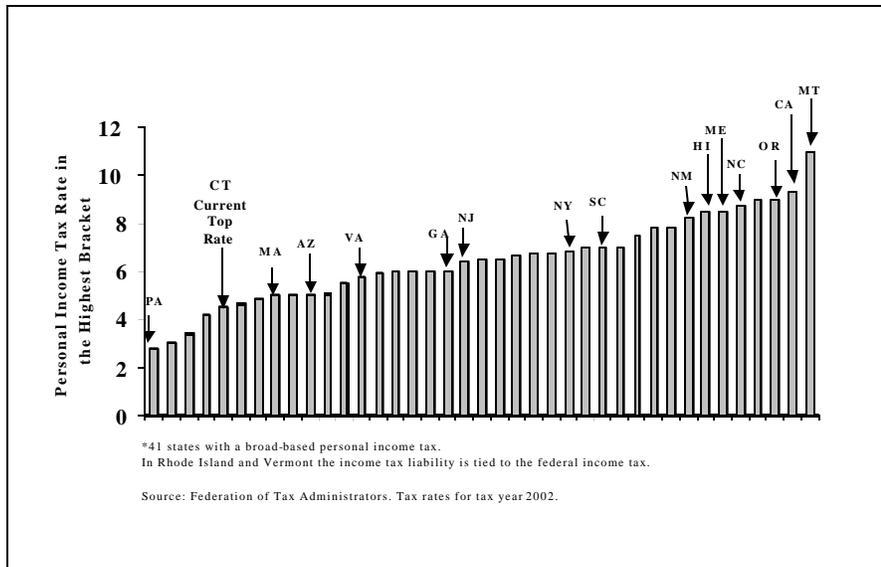
On tax rates

Connecticut's tax rates are competitive with and in some cases markedly below those of other states, including states in our region:²¹

- *Corporate tax.* Connecticut's 7.5% corporate tax rate is equal to the national average, and is now equal to or less than neighboring states (New York 7.5%, New Jersey 9.0%, Massachusetts 9.5% + surtax, Rhode Island 9.0%).
- *Sales tax.* Connecticut's 6% sales tax rate is 1% over the United States median (5%). It is less than Rhode Island's rate (7%), equal to New Jersey, and more than Massachusetts, Maine, Vermont (all 5%) and New York (4%, though local sales taxes can also be imposed and are as high as 4.5%).
- *Income tax.* Connecticut's 4.5% top bracket personal income tax rate is quite low compared to neighboring states (New York 6.85%, New Jersey 6.37%, Massachusetts 5.3%, Maine 8.5%). Among all states with a broad-based personal income tax, Connecticut's top bracket rate is fifth lowest, as illustrated in the following chart:

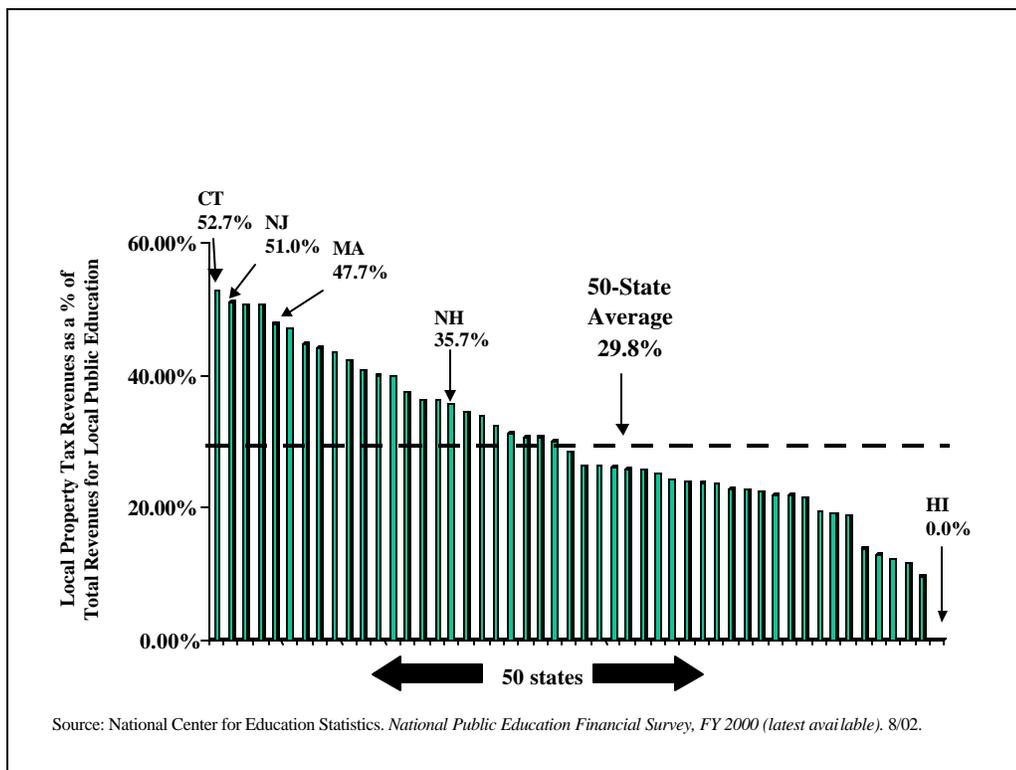
²⁰ "Tax effort," by comparison, refers to the proportion of tax capacity actually used – the ratio of revenues collected to tax capacity.

²¹ Tax Policy Center, *Tax Facts* (available at <http://www.taxpolicycenter.org/taxfacts/state/main.cfm>). Importantly, Connecticut, unlike many other states, does not have county government. In other states, counties may be responsible for public schools and for a range of health and human service programs. They also have taxing authority to fund these services. Therefore, comparing state tax *rates* across states can be deceptive, since the *state* tax rates do not include sales, income and property taxes that might be imposed by county or municipal governments. That is why the other comparisons in this report look at combined state and local taxes.



On state support for public education

As state support for education has fallen,²² Connecticut's average effective property tax (which is based on market, rather than appraised, value to allow town-by-town comparisons) increased by 41% (since 1991). Now, Connecticut's local public education system relies more on local property taxes than any other state.



²² From 46% of all K-12 public education spending in SFY 90 to 40% in SFY 03. By comparison, the average state contribution to K-12 education across all states is now about 51%.

Changes in Connecticut Over Time

On the sources of Connecticut's revenues & how this has changed

Since 1991, there has been a marked shift in the sources of Connecticut's revenues. Revenues from some taxes have *declined* as a share of General Fund revenues, while revenues from others have *increased*.

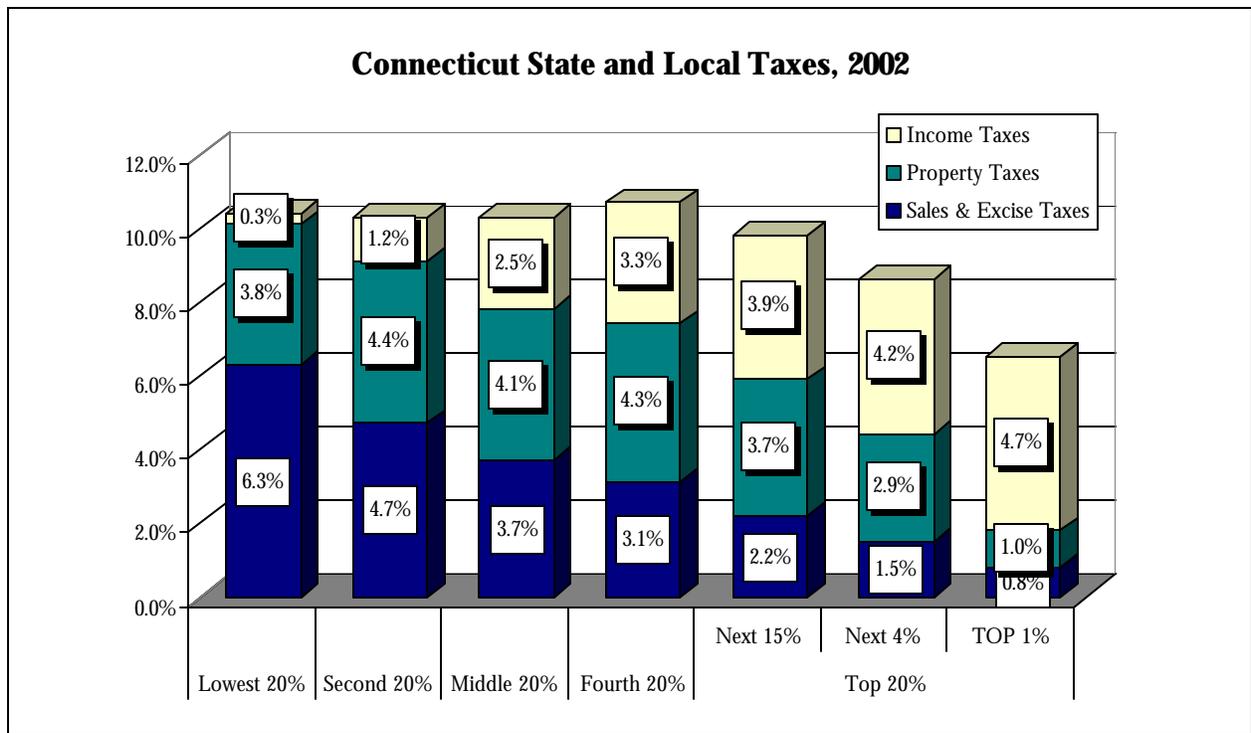
Specifically, revenues from business taxes have declined (from 18% of all General Fund revenues in 1991 to 8% in 2003),²³ as have revenues from sales and use taxes (41% to 27%), inheritance & estate taxes (5% to 1%), and cigarette & alcohol taxes (3% to 2%). By comparison, revenues from taxes on personal income have increased (from 9% generated by the tax on dividends, interest and capital gains in 1991 to 38% from the personal income tax in 2003), as have revenues from federal grants (from 17% to 20%).

On families' state and local tax burdens, and how this varies by family income

The proportion of income Connecticut families pay in state and local tax varies by their income level. The following table shows, by income grouping, what share of a family's income is paid in sales/excise, property, and income taxes²⁴, *without taking into account* the savings the family enjoys from being able to deduct income and property taxes on their federal income tax returns.

²³ "Business taxes" includes *all* business taxes, and not only taxes from the corporation tax (e.g., also public service companies gross earnings tax, petroleum companies gross earnings tax, insurance premiums tax). The corporation tax, alone, fell from 11.5% of all General Fund revenues in 1991 to 4% in 2002.

²⁴ "Income taxes" in the ITEP model includes personal income taxes, *as well as* attributed corporate income taxes.



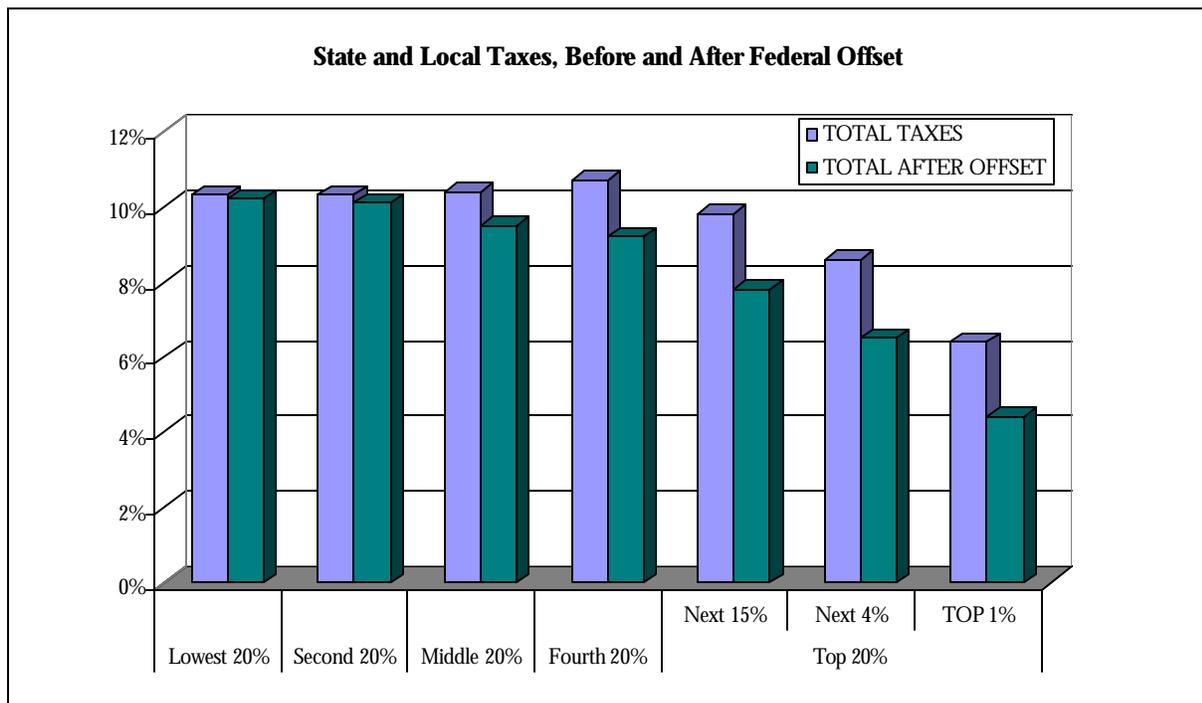
Taking into account the savings reaped from deducting state income and property taxes on the federal income tax return, the disparity in share of income paid in state and local taxes is even greater since the benefit of the federal deduction is greatest for those subject to the highest federal marginal tax rates.²⁵ As illustrated in the following table, *after the federal deduction offset*, Connecticut's middle and lower-income families (all but the wealthiest 20%) pay *over twice* as much in state and local taxes than the wealthiest 1%, as a percentage of their income.²⁶

²⁵ The poorest 20% of families in Connecticut have their share of income going to state and local taxes reduced by 0.1 percentage point -- from 10.3% to 10.2% -- while the wealthiest 1% of families see their share reduced by 2 percentage points -- from 6.4% to 4.4%.

²⁶ Robert S. McIntyre et al., "Who Pays? A Distributional Analysis of Tax Systems in All 50 States," Institute on Taxation and Economic Policy (Washington, D.C., 2003).

CT Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
CT Income Range	Less than \$21,000	\$21,000 – \$37,000	\$37,000 – \$60,000	\$60,000 – \$97,000	\$97,000 – \$220,000	\$220,000 – \$471,000	\$471,000 or more
Average Income in Group	\$13,800	\$28,300	\$47,800	\$75,300	\$131,500	\$285,800	\$2,405,500
Total Sales & Excise Taxes	6.3%	4.7%	3.7%	3.1%	2.2%	1.5%	0.8%
-General Sales—Individuals	2.7%	2.2%	1.9%	1.6%	1.2%	0.9%	0.5%
-Other Sales & Excise—Ind.	1.4%	0.9%	0.6%	0.5%	0.3%	0.1%	0.0%
-Sales & Excise on Business	2.2%	1.6%	1.2%	1.0%	0.7%	0.5%	0.3%
Total Property Taxes	3.8%	4.4%	4.1%	4.3%	3.7%	2.9%	1.0%
-Property Taxes on Families	3.7%	4.4%	4.1%	4.3%	3.6%	2.8%	0.7%
-Other Property Taxes	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%	0.3%
Total Income Taxes	0.3%	1.2%	2.5%	3.3%	3.9%	4.2%	4.7%
-Personal Income Tax	0.3%	1.2%	2.5%	3.3%	3.8%	4.1%	4.5%
-Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
TOTAL TAXES	10.3%	10.3%	10.4%	10.7%	9.8%	8.6%	6.4%
Federal Deduction Offset	-0.1%	-0.3%	-0.8%	-1.5%	-2.0%	-2.1%	-2.0%
TOTAL AFTER OFFSET	10.2%	10.1%	9.5%	9.2%	7.8%	6.5%	4.4%

The following table shows how the deductibility of state income and property taxes preferentially benefits Connecticut's wealthier households:



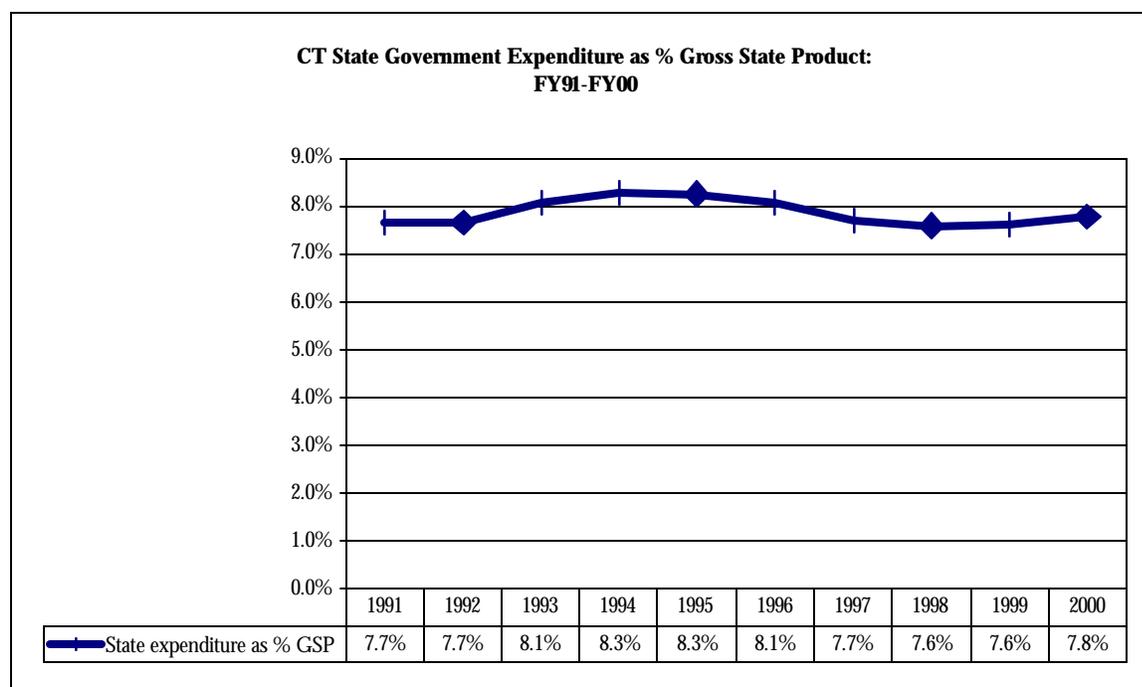
Source: ITEP, Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition, 2003.

On the growth in state spending

Since the mid-1990s, Connecticut's growth in state spending has been less than national averages and less than in prior years.

Overall, Connecticut's state budget grew about 4.5% per year since 1995. Connecticut's budget growth since 1995 has been *less than* the average rate of growth for all states (5%-6%/year). It was also far less than Connecticut's budget grew in prior years (10.8%/year on average between 1987-1991 and 6.4%/year on average growth between 1991-1995).²⁷

Adjusted for inflation, state growth in spending has averaged about 2% per year since 1995. Importantly, this growth has not out-stripped overall growth in Connecticut's economy. The following chart illustrates that General Fund spending as a share of Gross State Product in FY 2000 was nearly the same as it was in FY 1991, *less* than it was in FY 1995, and has remained between 7.6% and 8.3% throughout the 1990's.²⁸



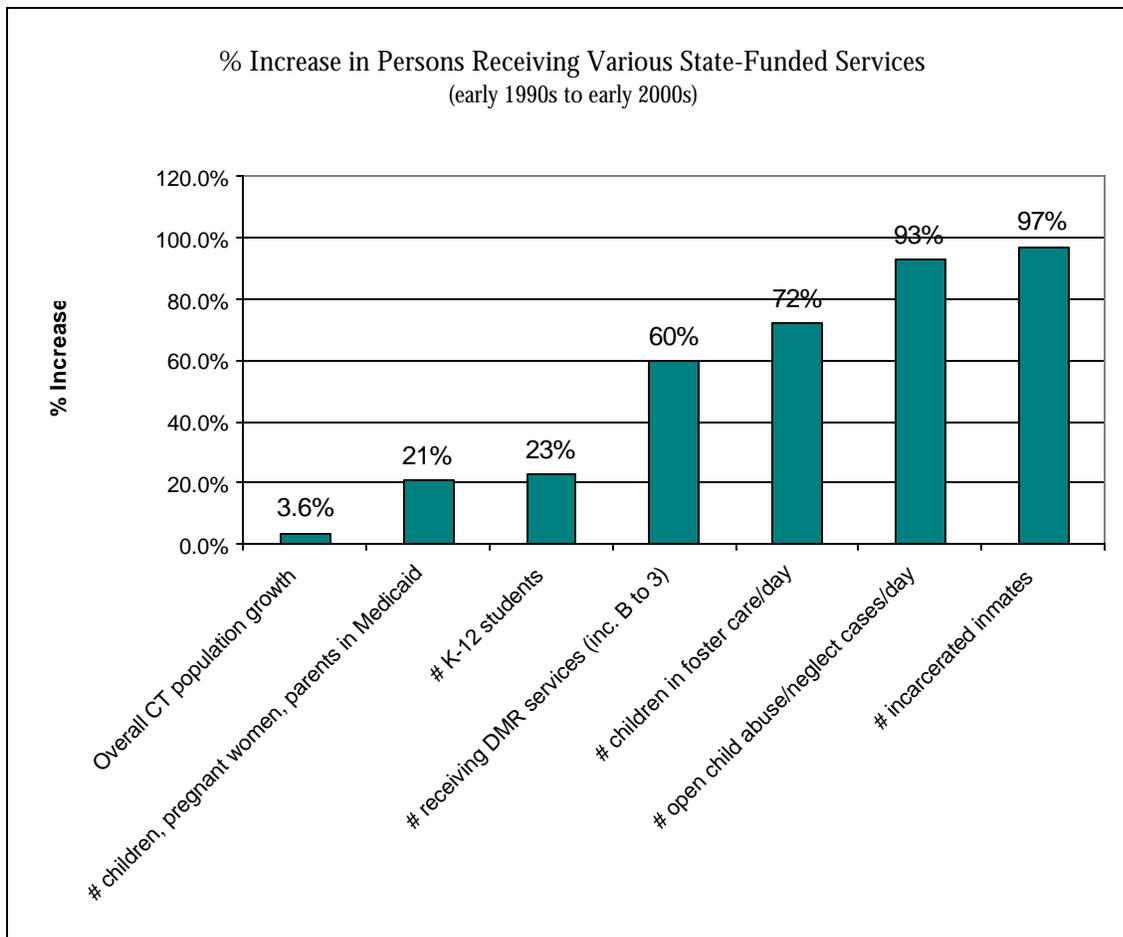
On the growth in Connecticut populations needing state services

Some of Connecticut's 2%/year growth in state spending over the 1990s can be attributed to expansion of Connecticut populations who require state services (and particularly relatively *expensive* state services).²⁹ Growth in a number of these populations has exceeded overall state population growth over the 1990s, as illustrated in the following chart:

²⁷ OPM Secretary Marc Ryan, *Challenges Facing the State* (a PowerPoint presentation to the Governor's Council on Economic Competitiveness and Technology, September 26, 2002).

²⁸ OFA, *Connecticut State Budget*; Bureau of Economic Analysis, Regional Accounts Data, Gross State Product Data. Available at: www.bea.doc.gov/bea/regional/gsp/

²⁹ Growth in spending on health care, and particularly on prescription drugs, has also greatly exceeded overall growth in the state budget, as it has in the private sector.



Conclusion

Connecticut is not unique among states in facing severe budget challenges. The National Governors Association and National Association of State Budget Officers recently reported that states “face the most dire fiscal situation since World War II.”

Fiscal 2003 total state balances “have plummeted by a spectacular 70% since they peaked in fiscal 2000” -- from \$48.8 billion in FY 2000 to \$14.5 billion in FY 2003.³⁰ Projected state budget deficits for FY 2004 (as a percentage of the state budget) range from a low of 3.8% in Rhode Island to a high of 20-33% in California.³¹ Connecticut’s projected deficit for SFY 04 is mid-range.

The good news for Connecticut is that it has ample fiscal capacity to address its budget challenges without further eroding an already very lean governmental sector *or* jeopardizing its economic competitiveness. In Connecticut, the budget challenge is really not a matter of wealth, but of political will.

³⁰ National Governors Association, National Association of State Budget Officers, *The Fiscal Survey of the States* (November 2002).

³¹ I. Lav & N. Johnson, *State Budget Deficits For Fiscal Year 2004 Are Huge and Growing* (Center on Budget and Policy Priorities, December 23, 2002). The lower estimate is from California’s Legislative Analysts’ Office, the higher from the Governor’s Office.