BUDGET CONNECTION$

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Research Brief
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Connecticut's FY04 Budget: A Summary & Contextual Analysis

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I. Executive Summary

Since November 2001, Connecticut has been addressing its budget deficits by making deep cuts in an already frugal state budget, by using up available one-time revenues, passing today's fiscal obligations on to the next generation by borrowing and failing to fund adequately state pension funds, and – only as a last resort – delaying already enacted tax cuts and restoring some of the $2 billion in tax revenues that were cut in the late 1990s.

The FY 04 budget is now $1.2 billion (nearly 9%) under the FY 04 "Current Services" budget – the budget necessary to maintain state-funded services at current levels. Many programs and services integral to the well being of the state's children, youth and families are receiving *less funding in FY 04 than they did in FY 02* (even without adjusting for inflation). These cuts are also occurring despite an increase in Connecticut's population generally, and an increase especially among state residents who rely on state-funded services (including school children, seniors and the disabled, and persons who have lost their jobs).

Important actions were taken in the 2003 regular and special sessions to restore -- on an on-going basis -- some of the significant tax revenues cut in the late 1990s. Despite this, OPM estimates that Connecticut residents and corporations will still pay nearly a $1 billion *less* in taxes than they did when Governor Rowland took office.

This *net* reduction in revenues, coupled with a continued use of hundreds of millions of dollars of one-time revenues to balance the budget (e.g., $494 million in FY 05 alone), has created a structural deficit. OFA projects that even if the economy improves there will be a $606 million General Fund deficit in FY 06, and an even larger deficit in the years that follow.

Most would agree that Connecticut will remain competitive in this global economy only if it continues to maintain one of the nation's best educated workforces. This requires *current* investments in early care and education, K-12 education, and higher education, adequate health care for the uninsured, a well-functioning infrastructure, and other such essential services and programs. Yet, many of these investments have been reduced sharply. Indeed, many of the spending cuts in this FY 03-05 biennial budget are truly penny-wise and pound-foolish. Some result in a loss of federal matching funds while others markedly reduce services essential to averting far greater long-term costs.

Key facts about Connecticut's FY 04 budget include:

❖ *The FY 04 budget.* The FY 04 General Fund budget is $1.2 billion (nearly 9%) less than is necessary to maintain state-funded services at current levels. Estimated FY 04 General Fund *revenues* are expected to be about $2 billion *less than* the FY 04 current services budget.

❖ *Budget growth rate.* Connecticut's budget growth is not keeping up with population growth and need. Taking inflation into account, the FY 04 General Fund budget is just 0.8% greater than estimated FY 03 spending and *less than* the FY 03 budget as first adopted. The FY 03 General Fund budget grew 0.4% *less than* inflation (compared to FY 02).

❖ *Spending cuts.* The FY 04 budget makes a number of quite drastic, and ill-conceived, cuts in spending. They include cuts to HUSKY A and other health insurance programs for low-income families, cuts to need-based scholarship aid and other education funding, cuts to youth development and job training programs, cuts to programs and services that help families remain gainfully employed, and cuts in aid to towns. A number of the cuts will result in a loss of federal revenue, and many will, predictably, result in greater long-term costs and/or increased local property taxes.

❖ *Cumulative spending cuts.* The FY 04 General Fund budgets of all state agencies are *less than* necessary to maintain FY 04 current state services. For *many* state agencies, the FY 04 appropriation actually is *less than* FY 02 actual spending (not even taking inflation into account). For example, the OPM's FY 04 budget is 46% ($104.2 million) less than what was spent by OPM in FY 02. Other agencies similarly cut in the past two years include: State Library (42% cut); Office of Workforce Competitiveness (40% cut), Department of Higher Education (33% cut), Department of Labor (28% cut), Department of Public Health (17% cut), and Department of Environmental Protection (13% cut). For other state agencies, FY 04 budgets are less than FY 03 spending.

❖ *Spending cap constraints.* The FY 04 budget is $356 million under the state spending cap. This fact, coupled with the decline in the allowable budget growth rate (because of the recent weak economy), means that *even when the economy recovers* it will be difficult to restore funding for many of the programs and services cut over the last three years. In FY 03, the state spending cap allowed the budget to grow by $633 million. In FY 05, maximum growth can be just $478 million. The budget growth allowed under the spending cap *is less than half* the growth necessary to maintain current services. In fact, the gap between the FY 05 Current Services Budget and the FY 05 appropriation allowed by the spending cap is more than $1 billion.

❖ *Areas of greatest cumulative growth.* Overall, the FY 04 General Fund budget is about $551 million more than <u>FY *02*</u> actual spending (i.e., 4.6% more, not adjusting for inflation). By comparison, between FY 02 and FY 04, debt service payments increased by $172 million (17.4%), the Department of Correction's budget increased by $62 million (12%), and the Department of Children and Families' budget increased by $51 million (9.5%).

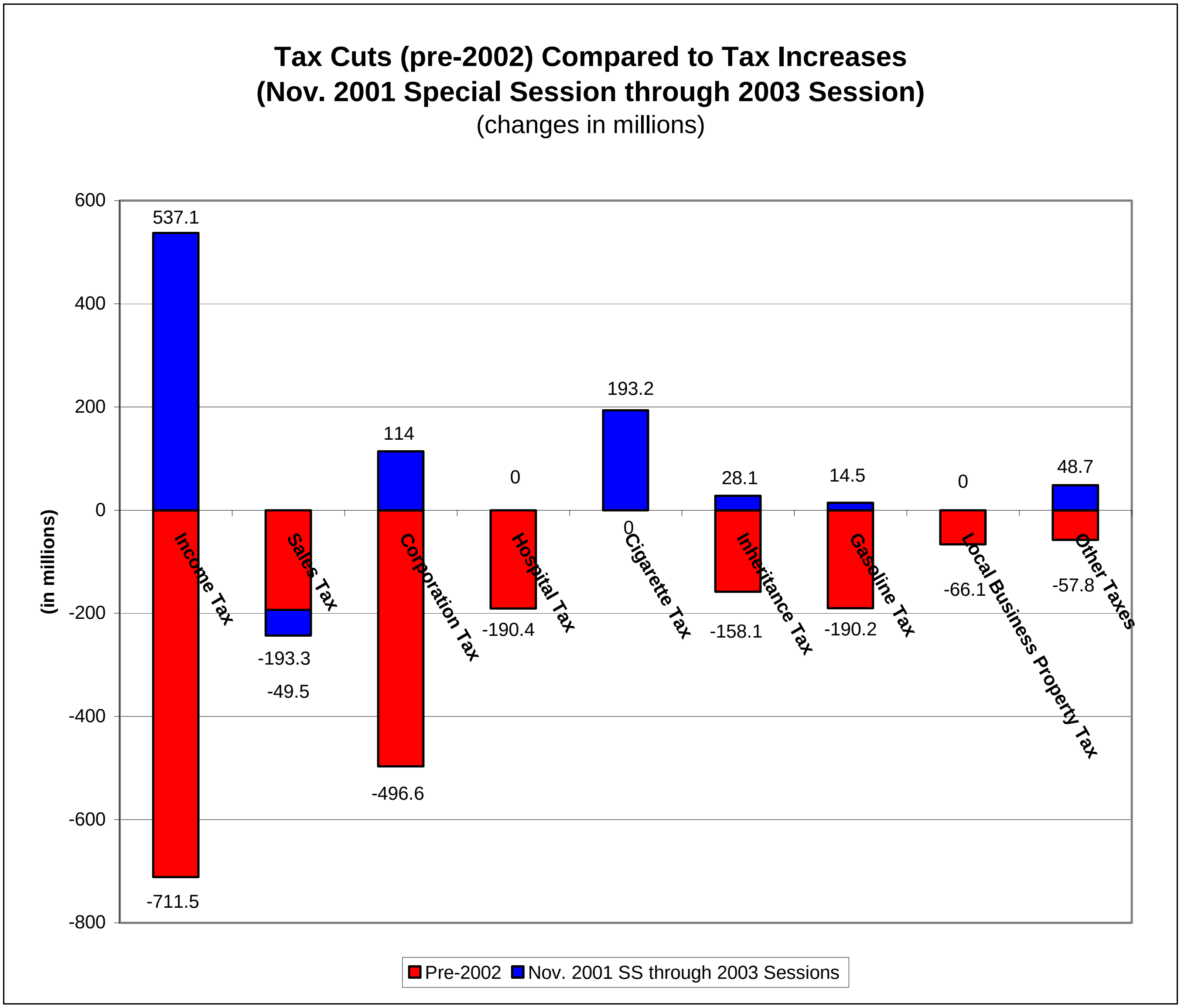
❖ *Revenue increases.* Deficit-mitigation in FY 02, FY 03 *and* FY 04 has relied on mid-year spending cuts, as well as a variety of revenue increases. A greater proportion of the new revenues in the FY 04 budget result from permanent tax and fee increases than was the case in FY 02 and FY 03. In FY 02 and FY 03, the majority of "new" revenues came from fund transfers and other one-time revenue sources, as illustrated in the table below:

Proportion of New Revenues from Various Sources: FY 02-FY 04

	FY 02	**FY 03**	**FY 04**
On-going Tax/Fee Increases	7%	31%	62%
Delay in Implementation of Already-Enacted Tax Cuts	0%	4%	1%
One-Time Revenues & Fund Transfers	93%	65%	37%

❖ *Tax increases in context.* Net permanent tax and fee increases enacted since the November 2001 special session are *less than half* the $2.1 billion in tax cuts made between the time Governor Rowland was first elected and the deficits began. That is, despite recent tax and fee increases, Connecticut taxpayers are still paying *a billion dollars less in state taxes* than they paid in 1995.

❖ *Continued shift in tax burden from corporations to individuals.* The new FY 04 revenues arising from permanent tax increases enacted in the last three years primarily come from tax and fee increases on individuals, rather than corporations. Now, a little more than three-quarters of the personal income tax cuts made since Governor Rowland was elected have been rolled back and the cigarette tax rate hike further increases taxes paid by individuals. By comparison, less than one-quarter of the corporate tax cuts made in the late 1990s have been rolled back permanently, and sales taxes on various business services continued to be cut even after deficits began.



❖ *Cumulative deficit mitigation.* From the November 2001 special session through the 2003 special sessions, Connecticut has mitigated a *cumulative* total of more than $3.62 billion in General Fund deficits through a combination of *mid-year* spending cuts, permanent tax increases, one-time revenues and fund transfers, delays in implementation of previously-enacted tax cuts, and borrowing, as follows:

Cumulative Deficit Mitigation: FY 02-FY 04	Amount	% of Total
One-time revenues/fund transfers	$1,456M	40%
Mid-year spending cuts (NOTE: *Additional* funding reductions were included in the revised FY 03 budget and the FY 04 & FY 05 budgets)	$953M	26%
Permanent tax increases	$849M	23%
Delays in implementation of enacted tax cuts	$37M	1%
Borrowing	$345M	10%

❖ *Structural deficit.* The FY 03-05 biennial budget continues to rely on many one-time revenues and fund transfers (rather than restoring more of the $2 billion in tax revenues that were cut in the late 1990s). As a result, the non-partisan Office of Fiscal Analysis predicts a $606 million General Fund deficit in FY 06 and a $770 million deficit by FY 08, *even if the economy improves.*

II. Overview

Net appropriations for *all* Connecticut's budget funds for the fiscal year ending June 30, 2004 (FY 04) are $13.52 billion ($13.8 billion in gross appropriations less an estimated $282 million in lapses and other savings).

Net FY 04 appropriations for the General Fund – the largest of the state's budget funds -- are $12.452 billion ($12.712 billion less estimated lapses and other savings of $260 million). This is $1.2 billion *less than* the net FY 04 Current Services General Fund budget of $13.63 billion. That is, the FY 04 General Fund budget is *nearly 9% less* than is necessary to maintain state services at current levels.

Notwithstanding these significant cuts, the non-partisan Office of Fiscal Analysis estimated on November 13, 2003 that FY 04 would end with a General Fund deficit of $38.1 million[1] On January 1, the State Comptroller estimated that the FY 04 General Fund budget would end up $84.8 million in the red.[2]

In addition, *this* biennial budget's use of one-time revenues (including, temporary corporate surtaxes, the securitization of tobacco revenue funds and energy conservation/clean energy revenue funds, and various fund transfers) results in a significant structural deficit in FY 06 unless action is taken to add permanent revenues and/or make further cuts to spending. *OFA projects a $606 million General Fund deficit in FY 06, even if the economy improves*.[3]

Grants to towns in FY 04 increase by about $27.4 million over OFA's estimate of FY 03 spending -- to $2.198 billion compared to estimated FY 03 expenditures of $2.171 billion. The FY 04 budget is under the state spending cap by $356 million. The budget growth rate for FY 04 (comparing the FY 04 budget to estimated FY 03 expenditures, with OFA adjustments for all appropriated funds) is 2.68%, or less than 1% if adjusted for inflation.

This short report first summarizes how FY 03 ended, then highlights key changes in spending and revenues in the FY 04 budget. This will be followed by several analyses that discuss specific budget changes in a bit more detail and examine the cumulative impact of state deficit mitigation actions on state expenditures and revenues since deficit-mitigation began in November 2001.

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1 OFA, *FY 04 General Fund and Transportation Fund Budget Projections* (November 13, 2003). OFA cautions that this estimate may change if there is further growth in state agency deficiencies, there are new deficiencies in budget accounts on OFA's "watch list," savings that are built into the budget from lapses or other programmatic changes do not materialize, and/or revenues are adversely affected by deterioration in economic conditions.

2 Office of the State Comptroller, "Wyman Sees Budget Deficit Rising to $84.8 Million" (January 2, 2004). The State Comptroller reported that corporation taxes were "substantially lower than estimated." Offsetting this was a $26 million increase in other revenues, including $22 million in additional federal revenues for the Department of Children and Families.

3 OFA, *Connecticut State Budget 2003-05* (December, 2003), p.17.

III. FY 03: In Closing

Expenditures. As reported in OFA's *Year-End Analysis of the FY 03 General Fund and Transportation Fund Budgets* (November 7, 2003), ***actual*** expenditures in FY 03 in the General Fund were $12.120 billion -- or about $28.2 million higher than originally budgeted. The *gross* General Fund appropriation for FY 03 had been $12.344 billion. A total of $93.8 million in FY 03 General Fund budget *increases* resulted from: a) agency budget deficiencies ($75.7 million)[4]; b) refunds of escheated property ($9.4 million) and c) adjudicated claims[5] ($8.7 million).

The FY 03 budget had assumed a variety of "savings." In total, $317.5 million in savings were achieved, as follows: a) lapses ($103.8 million)[6]; b) the Governor's November 2002 rescissions ($27.9 million); c) the Governor's January 2003 rescissions ($9.1 million); d) savings from state employee layoffs ($9.2 million); e) a reduction in the Reserve for Salary Adjustments account because the funds were not immediately needed ($29.3 million)[7]; f) a reduction in the agency Personal Services accounts for unsettled contracts ($18.7 million); g) spending cuts made in PA 03-2 (HB 6495)($70.7 million); and h) savings from union concessions/the Early Retirement Incentive Program ($18.7 million). It was anticipated that 4,300 state employees (funded from all funds) would take early retirement, and that 2,000 of these positions would be refilled in FY 04 and an additional 800 in FY 05. In fact, about 4,650 state employees chose to retire.[8]

Revenues. After adjusting for legislative and other revenue changes,[9] net FY 03 General Fund revenues were just 0.3% greater than FY 02 revenues.

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4 The source of these deficiencies was as follows: a) DSS - $67.7 million (primarily due to increased costs in Medicaid, ConnPACE and SAGA); b) Department of Administrative Services -Workers' Compensation Claims - $6.5 million; c) State Insurance and Risk Management Board - $1.3 million; and d) Military Department - $0.15 million.

5 NOTE: The General Assembly does *not* appropriate funds for adjudicated claims or for refunds of escheated property as part of the budget it adopts. As a result, the budget always has some built-in deficiency. Historically, over the past several years, spending in each account has averaged about $9 million. See comments by OFA at Fiscal Forecast presentation, Legislative Office Building, November 13, 2003.

6 The FY 03 budget had originally budgeted $157.9 million in lapses including $80.4 million in unallocated lapses, $24.5 million in "personal service" and "other expense" holdbacks, $7.0 million from a hiring freeze, $11.0 million for a wage freeze for managerial and confidential employees in executive and judicial, and $35.0 million from the Governor's "extraordinary" rescission authority. To this budgeted amount was added an additional $94 million in unspecified lapses, about $36.9 million of which was anticipated to be achieved through the Early Retirement Incentive Plan. The General Fund's year-end FY 03 lapse was far lower than the $251.9 million in total lapse anticipated in FY 03. The Office of Fiscal Analysis' report, *Year-End Analysis of the General Fund and Transportation Fund Budgets* (November 7, 2003), includes, as Exhibit C, a table showing agencies that lapsed $1 million or more in FY 03. Of the $229.8 million that lapsed in the General Fund, $34.7 million resulted from lapses in the General Fund debt service account, $32.3 million from the Department of Social Services (of which $18.5 million was a lapse in the Medicaid account), $29.3 million from the Reserve for Salary Adjustment account (resulting from OPM's removal of funding not immediately needed for various salary-related purposes), $23.1 million from the Judicial Department, and $15.9 million from the Office of Policy and Management.

7 This figure is net of the $3 million in additional funds provided for 6-month extended health care coverage for laid off workers and the $1.3 million deficiency transfer for the State Insurance and Risk Management Board.

8 OFA, *Connecticut State Budget FY 03-05* (December 2003), p. 9.

9 PA 03-2 (HB 6495), adopted to address a projected FY 03 deficit of $660.7 million, increased FY 03 revenue by $439.8 million through: a) a top bracket personal income tax rate increase from 4.5% to 5% (FY 03 revenue increase of $207.4 million); b) imposition of sales/use tax on media and advertising, health and athletic clubs, and newspapers and magazines (FY 03 revenue increase of $10.4 million, though the FY 03-05 budget bill then *repealed* the sales/use tax on media/advertising and newspapers and magazines); c) cigarette tax rate increase from $1.11 to $1.51/pack (FY 03 revenue increase of $27.5 million); d) corporate tax surcharge of 20% imposed for 2003 tax year (FY 03 revenue increase

Personal income tax collections were 5.4% less than in 2002 (after adjusting for the rate change) and sales and use tax collections down 2.4%. By comparison, revenues from the public service companies tax grew 9.8% and from the oil companies' tax by 32.8% "due to higher than anticipated energy prices caused by concerns over Iraq and the Middle East," while the insurance premiums tax grew by 10.1% "due to higher insurance premiums resulting from the terrorist attacks of September 11, 2001 and health care costs."[10] Other taxes posting increases over FY 02 collections were the corporation tax (up 1.1%), the inheritance and estate tax (23.6%), the real estate conveyance tax (9.0%), the alcoholic beverage tax (1.8%), and the admissions, dues and cabaret taxes (18.0%). Cigarette taxes declined by 5.8%, after adjusting for rate changes. Tax refunds declined in FY 03 compared to FY 02 (from $830 million in FY 02 to $808 million in FY 03), and the amount of money Connecticut paid to companies claiming the refundable research and development credit also declined (from $21.9 million in FY 03 to $11.2 million in FY 03).

Among non-tax General Fund revenues, the largest gains from FY 02 to FY 03 were posted in Indian gaming payments (increasing from $369 million to $387 million), rentals/fines/escheats (from $47.6 million to $81.5 million), federal grants (from $2.142 billion to $2.318 billion), fund transfers to the General Fund (from $0 to $351.5 million), and transfers to the General Fund from the Tobacco Settlement Fund ($120 million to $138 million). There were declines in special revenues, licenses/permits/fees, investment income, and transfers from the General Fund to other funds (from $147.7 million in FY 02 to $93 million in FY 03), among others.

The General Fund -In Closing. Net FY 03 General Fund spending (but not counting spending through prior year's carry-forwards) was $12.12 billion. This was $96.7 million more than available revenue.

Because Connecticut is not allowed to run a deficit (unlike the federal government), PA 03-1 (September 8 Special Session) authorized the State Treasurer to issue 5-year, tax-exempt, General Obligation "Economic Recovery Notes" both to cover this $96.7 million deficit *and also* about $25-$30 million in retrospective reimbursements for the General Assistance medical program. The interest cost to bond this $122.9 million is about $12.9 million (assuming a 3.5% interest rate over the 5 year period).[11]

The FY 03 General Fund budget ended $363 million *under* the state spending cap.[12]

Transportation Fund – In Closing. The FY 03 Transportation Fund closed with an operating deficit of $56.8 million. This was largely attributable to a transfer of $52 million from the Transportation Fund to the General Fund and the retaining of $20 million in oil companies tax revenues in the General Fund (rather than transferring them to the Transportation Fund). These $72 million in revenue reductions, authorized by PA 03-2, were offset by $19.4 million *more* in "savings" than was originally budgeted ($15 million). This additional $19.4 million lapse resulted from a reduction in

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of $32.4 million) and various one-time revenue enhancements (FY 03 revenue increase of $70 million). It also made $129.4 million in General Fund expenditure reductions, of which only $70.7 million could be achieved according to OPM. To fill the gap, OPM cut $29.3 million from the Reserve for Salary Adjustments account and $18.7 million from various state agency Personal Services accounts. OFA, *Year-End Analysis of the General Fund and Transportation Fund Budgets* (November 7, 2003), pp. 2-3.

[10] OFA, *Year-End Analysis of the General Fund and Transportation Fund Budgets* (November 7, 2003), p. 3.

[11] OFA, *Year-End Analysis of the General Fund and Transportation Fund Budgets* (November 7, 2003), p. 2

[12] This will limit Connecticut's capacity to *restore* funding to programs that have been cut once revenues recover. If spending in FY 03 had been at the cap, growth could be greater in subsequent years.

Town Aid Road grants ($9 million), lower interest payments due to refinancing of Special Tax Obligation bonds at lower interest rates ($8.6 million) and savings from layoffs and early retirements. At the close of FY 03, the Transportation Fund had a cumulative *surplus* of $132.9 million (the $189.7 million balance at the end of FY 02 less the FY 03 operating deficit of $56.8 million).[13]

IV. The Long Road to the FY 04 Budget

When the 2003 General Assembly session began, the FY 03 deficit was $661 million, and OFA projected the FY 04 deficit to be $1.94 *billion.*[14] PA 03-2, enacted early in the 2003 session, not only addressed the existing FY 03 deficit, but also helped reduce the FY 04 projected deficit through new revenues and on-going spending cuts.[15]

OFA and the Governor differed in their estimates of how much new revenue PA 03-2 would generate in FY 04 ($624.1 million and $632.5 million, respectively). They also differed the impact in FY 04 of PA 03-2's spending cuts (with the Governor estimating $465.4 million in cuts and OFA questioning some of the Governor's assumptions about savings from layoffs and early retirements).[16] Using the Governor's estimates, PA 03-2 reduced the projected FY 04 deficit by a total of $1.118 billion, leaving a remaining FY 04 deficit of $889 million to be addressed in the FY 03-05 biennial budget deliberations.[17] By comparison, OFA projected a remaining FY 04 deficit of $903 million after PA 03-2's revenue increases and spending cuts.[18]

The Governor submitted his proposed FY 03-05 budget[19] to the General Assembly on March 4, 2005, delaying the release until after the General Assembly had passed PA 03-2 to help mitigate the FY 03 deficit. He proposed a $12.5 billion General Fund budget for FY 04, $1.2 billion less than the FY 04 Current Services budget. He also proposed $190.9 million in new FY 04 revenues, of which $147 million funds were transferred to the General Fund from other state funds.

What then followed were three attempts by the General Assembly to pass a FY 03-05 budget:

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13 OFA, *Year-End Analysis of the General Fund and Transportation Fund Budgets* (November 7, 2003), pp. 9-13.

14 The Governor estimated the FY 04 General Fund deficit to be $2.007 billion, and a $2.541 billion deficit in FY 05.

15 The General Assembly's first attempt to mitigate the FY 03 deficit, HB 6397, AAC State Expenditure and Revenue Adjustments (PA 03-1) was vetoed by the Governor on February 19, 2003 (www.cga.state.ct.us/2003/act/Pa/2003PA-00001-R00HB-06397-PA.htm). A week later, the General Assembly passed this second deficit-mitigation plan, HB 6495, AAC Modifications to Current and Future State Expenditures and Revenues (PA 03-2)(www.cga.state.ct.us/2003/act/Pa/2003PA-00002-R00HB-06495-PA.htm). This bill had Republican support in both houses and was signed by the Governor on February 28, 2003. CT Voices' summary of the vetoed bill, *The Vetoed Attempt to Address the FY 03 Deficit: HB 6397, An Act Concerning State Expenditure and Revenue Adjustments* (February 2003), and its summary of the bill signed by the Governor, *Addressing the Remaining FY 03 Deficit: PA 03-2 and How it Compares to the Vetoed Bill* (March 2003), are available at www.ctkidlink.org.

16 For CT Voices' summary of PA 03-2, see *Addressing the Remaining FY 03 Deficit: PA 03-2 and How it Compares to the Vetoed Bill* (March 2003), available at www.ctkidlink.org.

17 The Governor estimated the *FY 05* deficit was nearly $1.4 billion after PA 03-2 was enacted (projected FY 05 revenues compared to FY 05 current services spending). Governor Rowland's *FY 2003-05 Biennial Budget Introduction Supplement*, p. 8.

18 OFA, *Fiscal Forecasts* (November 13, 2003 PowerPoint), p. 3.

19 CT Voices' summaries of the Governor's proposed FY 03-05 biennial budget -- *Revenue Changes in Governor Rowland's Proposed FY 03-05 Budget: Who Are the Tax "Winners" and "Losers"?* (March 2003) and *Spending Changes in the Governor's Proposed FY 03-05 Budget: Toward a Connecticut We Won't Like, and a Connecticut We Can't Afford* (March 2003) -- are available at www.ctkidslink.org.

- *First FY 03-05 Budget.* On May 14, 2003, the General Assembly passed HB 6720, AAC the State Budget for the Biennium Ending June 30, 2005 and Making Appropriations Therefor, and Various Taxes and Other Provisions Related to Revenues of the State (PA 03-279).[20] This bill incorporated the budget bills adopted by the Finance and Appropriations Committees, with a few changes to bring them into balance. This budget, approved on a largely party line vote,[21] was vetoed by the Governor on May 15, 2003.

- *Second FY 03-05 Budget.* The General Assembly tried again to pass a budget on June 4, 2003 when it adopted HB 6721, AAC Expenditures and Revenues for the Biennium Ending June 30, 2005 (PA 03-185).[22] This budget, passed shortly after the Governor had released his revised budget proposal (because his original budget proposal had been nearly $300 million in deficit), also was vetoed by the Governor, on June 13, 2003.

- *Third and Final FY 03-05 Budget.* The budget bill adopted July 31, 2003 was the General Assembly's third attempt to pass a biennial budget.[23] Because FY 04 began July 1, 2003, when there was still no FY 03-05 budget, state spending was authorized through weekly Executive Orders that funded "essential" state services only.[24] Yet, because many programs that relied on state funds were not receiving funding through these Orders, many community-based providers were forced to take out lines of credit to maintain services.

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20 The text of this bill is at www.cga.state.ct.us/2003/act/Pa/2003PA-00279-R00HB-06720-PA.htm. CT Voices' summary of it, *PA 03-279 (HB 6720), AAC the State Budget for the Biennium Ending June 30, 2005 and Making Appropriations Therefor, and Various Taxes and Other Provisions Related to the Revenues of the State: A Summary* (May 2003), is available at www.ctkidslink.org.

21 In the House, the vote was 87-57 with six Democratic representatives voting no and one Republican representative voting yes. The Senate vote was 20-16, with one Democrat voting against the budget (Sen. Hartley) and no Republicans voting in favor.

22 The text of this bill is at www.cga.state.ct.us/2003/act/Pa/2003PA-00185-R00HB-06721-PA.htm. CT Voices' summary, *A Last Ditch Proposal? PA 03-185 (HB 6721), AAC Expenditures and Revenues for the Biennium Ending June 30, 2005: A Summary*, is available at www.ctkidslink.org. The bill was approved on a 84-65 vote in the House with nine Democratic representatives voting no and no Republican representatives voting yes. The Senate vote was 20-15 with no Democratic senators voting no and no Republican senators voting yes, and Sen. Hartley absent.

23 After the biennial budget was adopted, the General Assembly enacted a bill that would have modified this budget somewhat, by adopting a variety of concessions from the state employee unions that would have provided additional revenues that would then be used to partially restore the property tax credit against the income tax from a maximum of $350 to about $370 in FY 04 and to $420 in FY 05. OFA estimated that the package of concessions and the requirement that the state rehire 300 laid-off workers and establish a placement and training fund would have resulted in net savings, compared to the adopted budget, of $28.1 million in FY 04 and $70.3 million in FY 05. On August 8, 2003, the Governor vetoed this bill stating that is was "unconstitutional, creates illusory savings, and inappropriately borrows from the state pension fund" and directing that "the state continues to operate under Executive Order." [Letter from Governor to Secretary of State, August 8, 2003, available at www.state.ct.us/governor/bills/03veto11.htm].

24 The General Assembly's effort to appropriate funds for the first weeks of the new fiscal year (HB 6801, An Act Making Appropriations for Certain Expenses of the State for the Period Ending July 14, 2003) was adopted June 30, 2003, but vetoed by the Governor on July 1. The Governor's veto stated, "there is no authority in the Constitution or state for such a document." Senate President Kevin Sullivan thereafter asked the Attorney General to address the question whether the General Assembly has constitutional authority to adopt temporary appropriations. Attorney General Blumenthal, citing a 1980 Connecticut Supreme Court decision (*Eielson v. Parker*), opined that the General Assembly *does* have constitutional authority to adopt temporary appropriations, but that the Governor also has authority to veto them. Absent a veto override, the bills lack legal effect and the Governor has legal authority to issue an executive order to maintain essential state services. [Office of the Attorney General, *Letter to the Honorable Kevin Sullivan, President Pro Tempore, General Assembly*, July 16, 2003]. Just prior to the adoption of the final FY 03-05 budget, the Governor had issued an Executive Order to fund essential state services for the remaining 48 weeks of FY 04.

On July 31, 2003, a full month into State Fiscal Year 2004, the General Assembly approved HB 6802 – An Act Concerning Expenditures and Revenue for the Biennium Ending June 30, 2005.[25] The bill was adopted on a bi-partisan vote.[26] The Governor signed this bill (PA 03-1, June Special Session) on August 16, 2003, delaying his decision whether to sign or veto the bill until he had seen the budget implementer bills.[27] Continuing, but accelerating, a trend of prior years, the budget implementer bills were very long, contained many substantive programmatic changes, and provided little chance to have informed debate about some very significant changes included in the bill (such as the unprecedented charging of premiums on very low-income families as condition of receipt of HUSKY A benefits).[28]

Table A of this report summarizes the various budget bills in the 2003 Session and Special Sessions.

V. The FY 04 Budget: A Summary

The Net Budget. The following table compares the Connecticut's net FY 04 budget (and the net budgets of its key funds) with the net budgets for FY 02, FY 03 (as originally adopted), FY 03 (as revised for the second year of the biennium), and the FY 04 Current Services budget.[29]

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25 http://www.cga.state.ct.us/2003/act/Pa/2003PA-00001-R00HB-06802SS2-PA.htm

26 The House passed the budget on a vote of 87-56, with 6 absent and not voting. The Senate passed the budget by a 26 to 8 vote, with 2 absent and not voting.

27 Bills enacted to implement the FY 03-05 biennial budget are: a) HB 6806, AAC General Budget and Revenue Implementation Provisions (PA 03-6, June 30 Special Session)[JSS](www.cga.state.ct.us/2003/act/Pa/2003PA-00006-R00HB-06806SS2-PA.htm); b) SB 2001, AAC Public Health, Human Services and Other Miscellaneous Implementer Provisions (PA 03-3, JSS)(www.cga.state.ct.us/2003/act/Pa/2003PA-00003-R00SB-02001SS2-PA.htm); c) SB 2002, AAC the Connecticut Resources Recovery Authority (PA 03-5, JSS)(www.cga.state.ct.us/2003/act/Pa/2003PA-00005-R00SB-02002SS2-PA.htm); d) HB 6805, AAC the Recommendations of the Transportation Strategy Board (PA 03-4, JSS)(www.cga.state.ct.us/2003/act/Pa/2003PA-00004-R00HB-06805SS2-PA.htm); e) SB 2051, AAC Economic Recovery Notes and Revision to the Rate Reduction Bond Provisions of the Budget Implementation Act and Other Provisions to Implement the Budget (PA 03-1, September 8 Special Session)[SSS](www.cga.state.ct.us/2003/act/Pa/2003PA-00001-R00SB-02051SS4-PA.htm); f) HB 6901, AAC School Construction (PA 03-2, SSS)(www.cga.state.ct.us/2003/act/Pa/2003PA-00002-R00HB-06901SS4-PA.htm); g) SB 2050, AAC the Authorization of Special Tax Obligation Bonds for the State for Certain Transportation Purposes (SA 03-1, SSS)(www.cga.state.ct.us/2003/act/sa/2003SA-00001-R00SB-02050SS4-SA.htm); and h) HB 6902, AAC Bonds for Certain Revenue and Accounting Purposes (SA 03-2, SSS)(www.cga.state.ct.us/2003/act/sa/2003SA-00002-R00HB-06902SS4-SA.htm); The first four of these budget implementer bills were signed by the Governor on August 20, 2003. The last four were signed on September 10, 2003.

28 This change, which was *not* evaluated through public hearings and debate in the 2003 legislative session, could result in more than 86,000 children and parents losing health insurance benefits. CT Health Foundation & Anthem Foundation of CT, *Families at Risk: The Impact of Premiums on Children and Parents in HUSKY A* (November 2003).

29 OFA defines the Current Services budget to be the amount required to provide -- in the succeeding fiscal year -- the same services as in the current fiscal year plus any scheduled or required changes. Estimated expenditures are updated for inflation, annualization of partial year costs, projected increases or decreases in caseload, completion of projects, collective bargaining increases, costs mandated by statute or court order, and the scheduled opening of new buildings, for example. "FY 04 Current Services" thus represents OFA's estimate of the funding required to provide in FY 04 the same level of services as were provided in FY 03.

Changes in *Net* Appropriations (in millions)[30]					
	Net FY 02 (as originally budgeted)	**Net FY 03 (as originally adopted)**	**Net FY 03 (as revised by PA 02-1 (MSS))**	**FY 04 Current Services**	**Net FY 04 Budget**
General Fund	$11,893.951	$12,431.381	$12,091.804	$13,632.701	$12,451.955[31]
Transportation Fund	$840.747	$877.309	$903.162	$939.374	$897.565
Mash. Pequot & Mohegan Fund	$135.000	$120.000	$134.220	$135.000	$85.000
All Other Funds	$86.305	$89.285	$88.582	$92.449	$85.997
GRAND TOTAL	**$12,956.003**	**$13,517.975**	**$13,217.768**	**$14,799.524**	**$13,520.517**

As shown in this table, Connecticut's total net FY 04 budget is $1.28 billion *less than* the FY 04 Current Services budget. Net FY 04 General Fund appropriations are *less than* the FY 04 Current Services Budget by $1.18 billion. Moreover, estimated FY 04 General Fund *revenues* are expected to be *less* than the FY 04 Current Services budget by an every greater amount -- *by $2 billion*.[32] The budgets for the Transportation Fund, the Pequot Fund, and the total of all other Funds are also less than FY 04 Current Services. In fact, the net FY 04 budget is just slightly greater than the *FY 03* budget when it was originally adopted at the start of the 2001-2003 biennium, and *less* than this budget if one takes into account inflation.

Budget Growth. OFA reports that the FY 04 budget for all appropriated funds is 2.68% greater than estimated expenditures for FY 03, not adjusting for inflation. (Inflation-adjusted growth is just

30 This chart presents net *appropriations* for the years shown. The amount of funds actually spent in the corresponding fiscal year will differ. This is particularly true since November 2001 when mid-year reductions have resulted in cuts to various budget accounts. These reductions have occurred not only through normally-occurring lapses, but also through "forced" lapses and rescissions imposed by the Governor and by action of the General Assembly. In addition, deficiency appropriations result in funding at year-end that exceeds the originally-budgeted amounts in certain accounts. Actual General Fund spending in FY 02, for example, was $11.66 billion, not the $11.89 billion budgeted. Actual General Fund spending in FY 03 was $12.12 billion, or $28.2 million higher than the $12.092 billion originally appropriated.

31 The FY 03-05 budget bill included a total of $12.445 million in net FY 04 General Fund appropriations. Subsequently, however, in a budget implementer bill (PA03-6, JSS, s. 208), $7.1 million was appropriated to DPH for immunization services. This increase was supported by revenues from a new "health and welfare" fee to be assessed by the Insurance Commissioner on companies doing life and health insurance, with funds deposited in the General Fund (PA 03-3, JSS, s. 6). The sum shown in the table includes this $7.1 million increase in FY 04 net General Fund appropriations.

32 OPM Secretary Marc Ryan reports that the FY 04 General Fund Current Services Budget ($13.633 billion) exceeds estimated FY 04 General Fund revenues ($11.625 million) by $2.007 billion. M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation).

0.8%.)[33] By comparison, the Governor's recommended FY 04 budget reflected a 2.9% growth rate for all appropriated funds.[34]

Spending Cap. The FY 04 Budget is $356 million under the state spending cap. This is slightly less than in FY 03, when the budget was $376 million under the cap, but *further below the cap* than the Governor had proposed in his recommended FY 04 budget ($333 million).

NOTE: The fact that the FY 04 budget is substantially under the cap, coupled with a predictable decline in the allowable budget growth rate because of the recently weak economy,[35] means that *even when the economy recovers* it will be difficult to restore funding for many of the essential state programs and services that were cut so drastically over the last three years. In FY 03, the state budget could increase by $633 million and still remain under the spending cap. In FY 04, growth could be just $552 million, and in FY 05 just $478 million.

Importantly, the budget growth allowed by the spending cap is now *far less than* the budget growth needed to maintain current services. OPM Secretary Marc Ryan has reported that the growth rate currently allowed by the spending cap (just over 6%) is less than half the growth rate of the FY 04 current services budget (12.3%). As a result, the FY 04 Current Services budget is $763 million *more than* the FY 04 appropriation allowed by the state spending cap. In FY 05, this gap is even greater. *The gap between the FY 05 Current Services budget and the FY 05 appropriation allowed by the spending cap is more than $1 billion ($1.055 billion).* [36]

Impact of the Biennial Budget on the Out-Years. Taking into account the impact of already-enacted tax changes and historic spending trends, and *even assuming* a continuation of improving state economic conditions, OFA projects a $606 million General Fund deficit in FY 06, a $622 million deficit in FY 07 and a $770 million deficit in FY 08.[37] This is due in part to the continued use of one-time revenues to balance the budget.[38]

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33 By comparison, between FY 02 and FY 03, state spending grew just 1.7%, which was *less than* the rate of inflation over this period (which was 2.1%). M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation).

34 OFA, Connecticut State Budget 2003-05 (December 2003), p. 20.

35 Allowable "capped" growth is calculated by multiplying total "capped" expenditures by the 5-year average growth in personal income. The allowable growth rate using this 5-year average is falling – from 6.2% in FY 03 to 5.3% in FY 04 to 4.5% in FY 05. Because Connecticut relies on a 5-year average, the low growth in personal income in 2002 and 2003 (when the economy was floundering and unemployment relatively high) will continue to depress the average growth rate for some time to come. The result is that "allowable" budget growth is also falling.

36 M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation).

37 These projections assume that the state will convert to Generally Accepted Accounting Principles (GAAP) in FY 06 (resulting in an annual cost of $96 million in the following 15 years to amortize the existing GAAP deficit). However, conversion to GAAP has been postponed year after year. The projections also assume that the Early Retirement Incentive Plan Accrual payments that were delayed from this biennium will begin to be paid in FY 06 at an annual cost of $18.3 million. OFA, *Connecticut State Budget 2003-05* (December 2003), p. 17.

38 The FY 05 budget relies, for example, on $390.5 million in one-time revenues -- $300 million from securitizing the tobacco settlement revenues, $54.5 million from transfers to the General Fund from other funds (including quasi-public agencies), $19 million in revenues kept in the General Fund and not transferred to other funds (such as the Tobacco and Health Trust Fund) and $17 million in other one-time revenues. OFA, *Fiscal Forecasts* (November 13, 2003 PowerPoint), p. 9.

VI. The FY 04 Budget: Expenditures

A. An initial note of qualification and explanation. This analysis discusses FY 04 *appropriations*. What amount will actually be *spent* in FY 04 in the various budget accounts will differ – sometimes quite substantially –for at least three reasons:

Lapses and other Savings. The FY 04 General Fund budget includes about $260 million in anticipated "savings" through lapses and "other" savings.[39] These savings will be achieved (in whole or part) through normal spending patterns and/or through forced savings. Specifically, the $260 million in General Fund savings are to be achieved in the following ways: a) $2 million in legislative unallocated lapse; b) $75 million in unallocated (normal) lapse; c) $14 million in a OPM-determined personal services reduction; d) $11 million in an OPM-determined Other Expenses reduction; e) $153.3 million from the Early Retirement Incentive Plan; and f) $5 million from a fleet reduction. However, the precise amounts by which *specific* programs and services will be cut to achieve the savings built into this budget cannot be determined from the published state budget.

Carryforward Funds. The budget bill and various other statutes and bills authorize funds that were not expended by June 30, 2003 in certain budget accounts to be carried forward for use in FY 04.[40] The FY 04 budget includes a total of about $104.7 million of appropriations to be carried forward from FY 03 to FY 04 (and in limited circumstances into FY 05). This sum includes about $84.6 million in General Fund carry-forwards, $19.5 million in the Transportation Fund, $0.25 million in the Banking Fund, and $0.3 million in the Insurance Fund.[41]

In OFA's published budget book, these sums are *not* included in the individual lines of each agency's budget. That is, certain budget accounts actually have *more* funds available to them in FY 04 than is shown in the budget book. Importantly, however, while these carry-forward funds can help offset FY 04 expenditure reductions in the budget accounts to which they are credited, or provide some additional funds in FY 04, they do *not* provide funding *beyond FY 04*. That is, *they will only temporarily minimize the impact of a cut, or temporarily increase spending*.

Agency Deficiencies. OFA already projects net deficiencies in various FY 04 General Fund accounts, including in the Department of Public Works ($2.9 million), DMHAS ($1.1 million), and DCF ($16.18 million).[42]

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39 By comparison, the total amount of appropriated General Fund funds that lapsed in SFY 02 was $161.61 million. OFA, *Year-End Analysis of FY 02 General Fund and Transportation Fund Budgets* (October 22, 2002).

40 Specifically, PA 03-1 (June Special Session) authorized $91.7 million in carry-forwards, SA 03-15 authorized an additional $0.2 million in carry forwards, and existing statutes authorized an additional $12.8 million, for a total of $104. 7 million. OFA, *Connecticut State Budget 2003-2005* (December 2003), p. 8.

41 Major carry-forwards in FY 04 include: General Fund Reserve for Salary Adjustment ($21.9 million); DSS Work Performance Bonus ($9.9 million); PILOT for New Manufacturing Machinery and Equipment ($9.1 million); Transportation Strategy Board ($8.9 million); Transportation Fund Reserve for Salary Adjustment ($8.1 million); Litigation Settlement ($7.1 million); Priority School Districts ($3.2 million); Charter Oak Open Space Trust ($3.1 million); Reflectorized License Plates ($2.9 million); Workforce Investment Act ($2.7 million); and School Construction Grants ($2.6 million). In some cases, funds in one budget account are carried forward to be used for another purpose. For example, about $4.5 million of OPM funds are carried forward for use in FY 04 by the new Commission on Arts, Tourism. Other examples of this are included in Table B.

42 DCF's gross deficiency is $18.3 million. It was to be reduced to $16.18 million through a $2.1 million transfer to the Board and Care – Adoption account when approved by the Finance Advisory Committee. Contributing to the $18.3 million gross deficiency are: a) shortfalls of $4.8 million in personal services associated with the hiring of 110 durational

B. FY 04 Statewide Spending Reductions within Budgeted Agencies. The FY 03-05 budget implements six statewide reductions that reduce the appropriations of most state agencies. OFA's *Connecticut State Budget 2003-05* includes, as one of its financial schedules, a table that shows FY 04 and FY 05 reductions for various agencies resulting from these six statewide reductions. These six areas total $524.4 million in FY 04 cuts (including $442.4 in the General Fund) and $717.1 million in FY 05 cuts (including $627.8 million in the General Fund) and come from:

a) Eliminating funding for unsettled collective bargaining agreements ($67.0 million in FY 04 and $134.5 million in FY 05);
b) Cutting personnel service costs to reflect the roll-out impact of the FY 03 layoffs ($127.3 million in FY 04 and $134.3 million in FY 05);
c) Removing funds for the payment of accruals for sick and vacation leave days for retirees under the Early Retirement Plan (payment is to occur over a 3-year period beginning in FY 06)($14.8 million in FY 04 and $15.4 million in FY 05);
d) Annualizing FY 03 holdbacks and allotment reductions ($237.8 million in FY 04 and $302.6 million in FY 05);
e) Eliminating many inflationary increases ($57 million in FY 04 and $113.1 million in FY 05);
f) Moving many equipment purchases into the Capital Equipment Purchase Fund ($20.5 million in FY 04 and $17.2 million in FY 05).[43]

A second financial schedule in the *Connecticut State Budget 2003-2005* shows, by agency, FY 04 "actual holdback amounts" resulting in additional savings from the early retirement incentive plan (a total of $149.6 million in FY 04), from personal services reductions ($17.0 million in FY 04), from "other expense" reductions ($14 million in FY 04), and from fleet operations reductions ($2.3 million in FY 04).[44]

C. FY 04 Appropriations by Agency. The following table shows *General Fund* appropriation totals for the budgets of various state agencies of particular importance to children, youth, and families. Comparisons are made among actual spending in FY 02, the FY 03 budget as revised for the second year of the biennium (but *not* including any rescissions, holdbacks and other reductions), the FY 04 Current Services budget, and the FY 04 budget as enacted.[45]

Importantly, FY 04 appropriations for all accounts in the table below are less than FY 04 Current Services. Moreover, in many agencies, FY 04 appropriations are actually less than the funds spent in FY 02 and/or the funds appropriated for FY 03.

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and 65 permanent social work staff mandated by the federal court in Juan F. to reduce caseloads (145 social workers, 16 social work supervisors, and 14 social worker case aides); b) $2.3 million in Other Expenses attributable to costs to support this staff and higher than anticipated data processing needs; c) $1.9 million in Worker's Compensation claims; $1.15 million in the Board and Care –Foster Care account because of an "unexpected increase" of approximately 85 children/month in the number of children entering foster care; $8.2 million in the Board and Care-Residential account (of which $3.4 million is attributable to new residential beds created for female adjudicated delinquents since Long Lane's closure and $4.8 million to an "unanticipated increase" of about 75 children in the number of children in residential placements). OFA, *FY 04 General Fund and Transportation Fund Budget Projections* (November 12, 2003), pp. 5-6.

43 OFA, *Connecticut State Budget 2003-2005* (December 2003), pp. 52-54.

44 OFA, *Connecticut State Budget 2003-2005* (December 2003), pp. 55-56.

45 The FY 04 budget shows General Fund appropriations, rather than the net amount that will actually be spent after lapses, rescissions and the like. As noted earlier, the distribution of these savings across agency budgets, and within agency budget accounts, is not known currently.

As the table shows, some of the reductions in state agency budgets are very significant. For example, the FY 04 budget for OPM is 46% ($104.2 million) less than what was spent by OPM in FY 02. Other agencies with significant cuts in FY 04 appropriations as compared to FY 02 actual spending include: State Library (42%, $7.3 million cut); Office of Workforce Competitiveness (40%, $2.5 million cut), Department of Higher Education (33%, $20.6 million cut), Department of Labor (28%, $16.4 million cut), Department of Public Health (17%, $13.1 million cut), and Department of Environmental Protection (13%, $5.4 million cut).

Importantly, some reductions in agency budget accounts represent actual reductions in funds available, while others simply may reflect changes in *how* an account is being funded.

For example, the Legislative Management budget shows $0 for the CT Television Network in FY 04 and FY 05.[46] However, the General Assembly did not eliminate funding for CT-N. Rather, it changed *how* CT-N is funded. The 2003-2005 budget bill earmarked $2 million per year of revenues from the gross earnings tax on cable and satellite TV to support CT-N. The CT-N budget account, therefore, no longer receives funds through the *General Fund*, so the General Fund budget account shows "$0" and, because $2 million/year of funds are now earmarked for CT-N, General Fund revenues also were reduced by $2 million in the budget bill.

Such earmarked funds, as well as private contributions, many federal grants, and carry forward funds, are *not* included in the budget account total shown for each agency's General Fund budget. This is *truer* for some agencies (e.g. DPH, DECD) than for others.[47] That is, if a reduction in a General Fund budget account is offset by an increase in funding from some other source, there may actually be no reduction in the service or program funded.

In other agency budgets, certain expenditures may have been moved from the General Fund to the Capital Equipment Purchasing Fund (where purchases are financed with bond funds).

In the table below, agency FY 04 appropriations that are *less than* the amount spent <u>in FY 02</u> are underlined (and highlighted in red). The FY 04 appropriations that are more than FY 02 spending, but *less than* the <u>FY 03</u> appropriation are italicized (and highlighted in blue).[48]

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46 The account also showed $0 in funding in the revised FY 03 budget. FY 03 funds were provided from FY 01 surplus funds that were carried-forward for this purpose.

47 OFA's Budget Books for the years covered by this report provides agency total for "federal contributions," "carry-forward funding," "carry-forward-FY 01 surplus appropriations," "carry-forward-FY 02 surplus appropriations," "special funds-non-appropriated," and "private contributions." However, there is *no* breakout of how these funds are actually to be spent, limiting public understanding of how some quite significant sums of money are being used. For example, the revised FY 03 *General Fund* budget of the Department of Public Health was $75.528 million. The *total* budget of DPH that year, by comparison, was $165.126 million. Contributing to the difference was $85.9 million of federal contributions, $1.4 million of carry-forward funding, $1 million of carry-forward FY 01 surplus appropriations and $1.3 million of private contributions. The Budget Book does not reveal, however, how *all* of these additional funds are being spent (though there is some indication of the uses of federal contributions by the titles of the grants/contracts that *are* included in the Budget Book).

48 NOTE: the FY 02 and FY 03 amounts shown are *not* adjusted for inflation. Real (inflation-adjusted) reductions would exceed those shown in this table.

Agency (General Fund Budget)	**FY 02 (Actual Spending)**	**FY 03 (Budget As Revised)**	**FY 04 Current Services**	**FY 04 Gross Budget**
	[$M]	[$M]	[$M]	[$M]
Legislative Management	$48.621	$49.953	$56.964	$50.449
Permanent Commission on the Status of Women	$0.549	$0.573	$0.662	**$0.511**
Commission on Children	$0.572	$0.566	$0.695	**$0.534**
Latino & Puerto Rican Affairs Commission	$0.366	$0.381	$0.436	**$0.360**
African-American Affairs Commission	$0.279	$0.329	$0.346	***$0.284***
DCF	$539.882	$573.678	$627.486	$591.314
Children's Trust Fund	$5.318	$5.772	$5.945	***$5.534***
Office of the Child Advocate	$0.548	$0.693	$0.733	***$0.608***
State Dept. of Education	$1,995.545	$2,004.786	$2,145.296	$2,017.494
Dept. of Higher Education	$62.696	$45.788	$57.730	**$42.243**
University of Connecticut	$190.560	$193.667	$204.182	$197.097
CT State University	$139.276	$138.947	$145.902	$140.432
Regional Community-Technical Colleges	$129.262	$125.484	$131.774	**$126.146**
Teachers' Retirement Board	$217.762	$194.042	$286.117	**$200.528**
State Library	$17.439	$13.926	$16.156	**$10.135**
DSS	$3,589.653	$3,687.360	$4,045.721	$3,766.679
DPH	$77.752	$75.528	$81.458	**$71.732**
DMR	$701.326	$724.733	$769.377	$737.827
DMHAS	$411.486	$438.065	$475.092	$439.918
U Conn Health Center	$74.293	$74.290	$76.726	$74.894
Office of Protection & Advocacy	$2.579	$2.839	$2.899	**$2.505**

Office of Policy & Management	$226.079	$157.940	$166.841	**$122.287**
Dept. of Public Safety	$129.566	$145.328	$151.103	***$137.726***
Military Department	$6.669	$6.200	$8.058	**$6.279**
Judicial Department	$343.767	$361.396	$392.790	***$356.544***
Public Defenders Services	$32.838	$34.530	$37.338	***$33.710***
Dept. of Correction	$513.374	$542.002	$592.602	$575.200
Dept. of Labor	$59.421	$49.681	$50.434	**$43.070**
Office of Workforce Competitiveness	$6.772	$4.112	$4.273	**$2.651**
Dept. of Economic & Community Development	$23.631	$18.861	$25.322	**$21.179**
Dept. of Environmental Protection	$42.585	$40.271	$42.689	**$37.218**
Elections Enforcement Comm'n	$0.789	$0.857	$0.895	***$0.816***
Ethics Commission	$0.995	$0.904	$0.922	**$0.690**
Freedom of Information Comm'n	$1.262	$1.340	$1.411	**$1.189**
Debt Service –State Treasurer	$992.071	$1,023,378	$1,202,483	$1,164.218
TOTAL GENERAL FUND (if *all* agencies are included)	**$11,662,265**	**$12,091.804**	**$13,632.701**	**$12,712.266**[49]

As shown in the table above, the agencies in which FY 04 gross appropriations *exceed* the amounts budgeted in FY 02-03 were Legislative Management, the Department of Children and Families, the State Department of Education, the University of Connecticut, the Department of Social Services, the CT State University, the Department of Mental Retardation, the Department of Mental Health and Addiction Services, the University of Connecticut Health Center, the Department of Correction, and Debt Service –State Treasurer. Even for all these agencies, however, FY 04 appropriations are still *less than their FY 04 Current Services budgets*. Also, the growth in the budgets of these agencies was far from uniform.

The table below compares FY 04 gross appropriations to actual spending in FY 02 (*not* adjusted for inflation), and ranks the agencies by the percentage increase in their budgets over this two-year period. Among the agency accounts reviewed, State Treasurer-Debt Service, the Department of Correction budget, and the Department of Children and Families budget had the largest percentage increases:

[49] The FY 04 *General Fund* budget reduces this $12,712.266 million appropriation by $2 million for unallocated legislative lapses, $75 million for estimated unallocated lapses, $14 million for a general "personal services" reduction, $11 million for a general "other expenses" reduction, $153 million for the Governor's Early Retirement Incentive Plan, and $5 million for a fleet reduction. The *net* FY 04 General Fund budget after these reductions is $12,451.955 million.

Growth in Appropriations from FY 02 (actual) to FY 04 (appropriated) Selected State Agencies Ranked by Percentage Increase				
Agency	**FY 02 (actual)**	**FY 04 (budgeted)**	**Increase** (in millions)	**% Increase**
General Fund (Total)	**$11,892.951**	**$12,444.855**	**$550.9**	**4.6%**
Debt Service - State Treasurer	$992.071	$1,164.218	$172.147	17.4%
Department of Correction	$513.374	$575.200	$61.826	12.0%
Department of Children & Families	$539.882	$591.314	$51.432	9.5%
DMHAS	$411.486	$439.918	$28.432	6.9%
DMR	$701.326	$737.827	$36.501	5.2%
Department of Social Services	$3,589.653	$3,766.679	$177.026	4.9%
Legislative Management	$48.621	$50.449	$1.828	3.8%
University of CT	$190.560	$197.097	$6.537	3.4%
State Dept. of Education	$1,995.545	$2,017.494	$21.949	1.1%
U Conn Health Center	$74.293	$74.894	$0.601	0.8%
CT State University	$139.276	$140.432	$1.156	0.8%

D. Significant Changes. Upcoming CT Voices' reports will highlight in greater detail the changes made in the FY03-05 budget, and cumulatively since deficits began in 2001, in key health, education, and human service programs that help children, youth and families. This summary will simply list a number of changes with particularly significant budgetary impacts. The funding changes noted (cuts or additions) compare FY 04 appropriations to the FY 04 Current Services budget.

1. Education

- SDE. Reduce funding for education equalization ($68.3 million cut from FY 04 current services, and $132.3 million cut in FY 05)[50]
- DHE. Reduce need-based scholarship aid through CT Independent College Student Grant Program (CICSG) and CT Aid for Public College Student Grant Program (CAPCS) (total FY 04 cut: $1.266 million to CICSG and $2.966 million to CAPCS); defer higher education matching grant ($10.1 million cut)
- U Conn. Cut block grant increase to reflect layoffs ($4.9 million cut)
- U Conn Health Center. Cut block grant increase to reflect layoffs ($1.3 million cut)
- Teachers' Retirement Fund. Reduce contribution, funding at 69% of actuarial requirement for FY 04 ($85.2 million cut)

[50] Formula changes include not fully eliminating capped funds, eliminating the density supplement, and distributing a portion of the funds based on priority or transitional school district status.

2. Health

Reductions:

- DSS. Reduce HUSKY A and fee-for-service benefits and implement premium and co-payment requirements ($10.37 million net cut);[51] reduce school-based child health reimbursements ($1.2 million cut); increase HUSKY B premiums ($2.4 million cut); eliminate Medicaid presumptive eligibility ($2.8 million cut); institute $15 co-payment fee for ConnPACE ($5.1 million cut); reduce disproportionate share payments ($15 million cut); phase-in preferred drug list ($12.5 million cut); revise durable medical equipment acquisition policies ($2.52 million cut); implement program of care enhancement/disease management for high cost patients ($2 million cut); implement liquid asset test for ConnPACE ($0.8 million cut); implement dose optimization ($0.5 million cut)
- DMHAS. Delay PILOTS initiative ($0.57 million cut)
- DPH. Reduce per capita subsidies to local health departments (0.8 million cut)
- DMR. Reduce funding for Birth-to-Three program ($2.7 million)[52]; reduce funding to reflect net savings in conversion of public services to private ($1 million cut); reduce funding to reflect residential closures/reconfiguration ($2.39 million cut)

Additions:

- DSS. Fund continued coverage for HUSKY A adults (100-150% of poverty level) as required by current court order ($14 million addition); caseload and utilization update and 2.5% rate increase eff. 1/1/04 for Medicaid managed care ($49.98 million addition); revise Federally-Qualified Health Center payment system ($0.3 million addition)
- DMHAS. Reallocate General Assistance managed care funding ($14.4 million addition); restore funding for substance abuse beds ($1.4 million addition); fund Traumatic Brain Injury (TBI) placements ($0.4 million addition)
- DPH. Expenditure update for local health departments ($0.81 million addition)
- DMR. Provide funding for new placements ($4 million addition); provide funding for cooperative placements ($2.3 million addition)
- DCF. New staffing costs ($3.9 million addition)

3. Family Economic Well-Being

- DSS. Eliminate benefit standards' increase ($3.58 million cut);[53] eliminate safety net services ($2.22 million cut); provide funds to re-open child care certificate program for only up to 400 slots only ($11.8 million cut);[54] restructure State Administered General Assistance ($20.1 million cut); enhance housing/homeless services ($0.55 million addition)

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51 Many of these changes are truly penny-wise and pound-foolish. The change to HUSKY A alone not only would result in a *loss* of federal matching funds equal to 50% of the funding cut (the "saving"), but also is projected to result in more than 86,000 children and parents losing health insurance coverage because they cannot afford the premiums. See *Families at Risk: The Impact of Premiums on Children and Parents in HUSKY A* (CT Health Foundation, 2003), available at: http://www.cthealth.org/matriarch/d.asp?pn=policybrief1%2Epdf.

52 State costs are to be reduced in part by requiring parents with a gross annual income over $45,000 to now pay a monthly fee for Birth-to-Three services.

53 Although mandated by statute, the annual increase in standards has been eliminated each fiscal year since FY 92. Consequently, the cash benefits provided to Connecticut's poorest children and families are far less now than they were a decade ago in inflation-adjusted dollars.

54 Intake into the Child Care Certificate program for low-income families was closed in FY 03. As a result, this budget account is projected to have a $25.5 million "surplus" in FY 04 that will lapse, despite the fact there are 8,800 low-wage families on a waiting list for this program who need subsidies for their child care expenses so they can continue to work. *DSS SFY 2005 Technical Adjustment Budget Request.*

- OWC. Reduce funding for CT Employment and Training Commission (CETC)($1.05 million cut, though budget also allows carryforward of $1 million of FY 03 CETC funds for use in FY 04)

4. Public safety / corrections

- DCF. Fund new residential treatment beds for juvenile girls ($1.02 million addition); continue support for forensic evaluations ($0.7 million addition); savings from closure of Long Lane School ($3.76 million cut)
- Judicial Department. Provide funds for Hartford Juvenile Detention Center Expansions ($2.45 million addition); provide funds for drug courts ($0.55 million addition); provide funds for additional adult probation officers ($0.44 million addition)
- DOC. Additional overtime expenses ($6.88 million addition)[55]; funding for increased inmate population ($6.05 million addition)[56]; funding to relieve prison overcrowding ($1.95 million addition)[57]; send more inmates out of state to achieve savings ($5 million cut)[58]; transfer Board of Parole to DOC ($10.1 million addition to DOC and $10.3 million cut to Board of Parole—net savings of $0.24 million)
- OPM. Reduce funding for drug enforcement program grants to towns ($1 million cut); reducing funding for justice assistance grants ($1 million cut); carry-forward $1 million of FY 03 funds for drug enforcement grants to towns and transfer to Hartford Police Department; eliminate various state grants (e.g., Drugs Don't Work grants for after school programs, neighborhood youth centers, summer camps; grants to neighborhood youth centers; grants to Boys and Girls clubs)($1.97 million cut)

5. Aid to Towns. NOTE: The state provides funding to towns through a variety of grants. These include:

a. Payment in Lieu of Taxes (PILOT) to compensate towns for some of the property tax lost when the state exempts certain types of property from local property tax (e.g. state-owned property; colleges & hospitals; certain new machinery and equipment; certain vessels)
b. Mashantucket Pequot and Mohegan Fund
c. Town Aid Road Fund
d. Local Capital Improvement (LoCIP) Program
e. Education Cost Sharing (ECS)
f. Public school and non-public school pupil transportation
g. Adult education
h. Various other education programs (e.g. child day care, early childhood program, early reading success program, school-based health clinics, school-based child health, excess

55 In FY 03, DOC's estimated expenses for overtime were almost $37 million. Because the FY 04 budget removes $8.4 million in funding to reflect layoffs of nearly 180 DOC staff, it should not be surprising that increased funding for overtime will be needed.

56 DOC's total inmate supervised population is expect to increase from the current 21,000 to 22,067 by July 2004 and to 22,692 by July 2005. The budget also includes funding to expand the Somers Correctional Institution by 720 beds in FY 05.

57 These funds are for the Justice Reinvestment "Building Bridges" project.

58 This authorizes 2,000 inmates to be sent out-of-state in addition to the 500 currently in Virginia. There is a $20/day difference in the average inmate cost per day to house a CT inmate in Virginia.

special education costs, OPEN choice, magnet schools, extended school hours, school accountability, youth service bureaus, priority school districts)

i. Drug enforcement program.

In FY 04, funding for all of these programs is $2.168 billion. This is $16.2 million *less than* the $2.184 billion in funds provided to towns in FY 03, and an even greater reduction from FY 04 Current Services needs. Among the areas in which funds were cut to below FY 04 Current Service levels are:

- SDE (see above). Reduce funding for education equalization ($68.3 million cut from FY 04 current services)
- DOT. Reduce Town Aid Road grants ($35 million cut). There is also a $12.5 million addition resulting from transferring the program to the Transportation Fund
- OPM. Modify Payment in Lieu of Taxes (PILOT) grants to eliminate eligibility for the property tax exemption for new equipment related to direct and indirect mailings ($16.9 million cut).

6. Other

- Downsize Elections Enforcement Commission ($0.11 million cut); downsize Ethics Commission ($0.17 million cut); downsize Freedom of Information Commission ($1.6 million cut); Commission on Human Rights and Opportunities ($0.16 million cut)
- OPM. Eliminate non-income qualified veterans from additional property tax exemption for veterans ($2.7 million cut)
- Department of Banking. Fund re-location of agency to different building ($3.6 million cut)
- DECD. Eliminate funding for cluster initiative ($0.87 million cut)
- Transportation Strategy Board. Provide carry forward funds for TSB ($8.9 million addition)

D. **January 2004 Allotment Reductions.** The Governor's January 2004 allotment reduction plan[59] cuts $12.489 million in FY 04 funding primarily in agency "personal service" and "other expense" budget accounts. These cuts are not shared equally, however. For example, $3.345 million of the allotment reductions are in DSS' budget -- 27% of the total (note, however, that DSS' budget is 29% of the total FY 04 General Fund budget). There are *no* cuts to personal services in some agencies (e.g. Governor's Office, Lieutenant Governor's Office, Secretary of State's Office, DPS, DPH, DMR, SDE, DOC, DCF) and the magnitude of cuts to personal services in other agencies varies. For example, personal services cuts in the OPM budget total $484,368 (3.5% of total personal services FY 04 funds), at DAS $659,167 (3.6% of total), at DOL $293,477 (4% of total), at CHRO $245,605 (4%), at DMHAS $1.55 million (1%), and at DSS $1.5 million (1.5% of total).

Some agencies have no or very small cuts to their "other expense" budget account, while others have larger ones, including Department of Public Safety ($411,020, or 2%), DMR ($427,047, or 1.9%), DMHAS $160,000, or 0.6%), DSS ($1 million or 1.1%); DOC ($400,000 or 0.6%), and Judicial Department ($200,000 or 0.3%).

Cuts *other than to personal services and other expenses accounts* that exceed $40,000 are: OPM-Leadership, Education, Athletics in Partnership program ($42,500 cut in FY 04 appropriation); OPM-Justice

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[59] *FY 2004 Allotment Reduction Plan* (January 2004).

Assistance Grants ($175,583); DAS-Workers' Compensation Claims ($995,557); Department of Public Safety-Fleet Purchase ($171,000); DMHAS –Grants for Substance Abuse Services ($95,000); DMHAS-Grants for Mental Health Services ($67,000); DSS-Healthy Start ($63,045); DSS-Services to the Elderly ($150,000); DSS-Services for Persons with Disabilities ($41,603); DSS-Employment Opportunities ($62,749); DSS-Community Services ($61,811); DOC-Other of State Beds ($1 million). The $350,00 allotment reduction in the DSS Housing/Homeless Services account was rescinded after an outcry about the impact on those needing shelter services.

Importantly, these allotment reductions ought not be viewed in isolation, but rather as a continuation of a pattern of reductions in budget accounts that, over the last several years, have cumulatively grown to be quite significant. To give one example, the Leadership, Education, Athletics in Partnership program (an award-winning program that had served at-risk urban youth in five Connecticut cities through a summer and after-school program) received $2.33 million from OPM in FY 01. Its funding was reduced to $2.1 million in FY 02, and to $1.8 million in the revised FY 03 budget. The Governor had proposed to eliminate all funding for LEAP in FY 04. Although the General Assembly approved $0.85 million in FY 04, the Governor's January 2004 allotment reduction will reduce this by another 5% -- to $0.81 million. That is, in just three years, funding for this program has been cut by two-thirds; it operates now only in New Haven.

VII. The FY 04 Budget: Revenues

A. A Bit of Context. The Governor reports that between the time he first took office and 2002, $2.064 *billion* in permanent tax cuts were enacted that have been fully implemented. These include: $711.5 million in personal income tax reductions; $496.6 million in corporation business tax reductions; $193.3 million in sales tax reductions; $190.4 million cut from the hospital tax; $190.2 million cut from gas and petroleum taxes; $158.1 million cut from the inheritance tax; $68 million cut from taxes paid on machinery and equipment, and $57.8 million in other tax cuts.[60]

Since then, budget bills enacted to address the FY 02, 03 and 04 budget deficits have included a total of more than $900 million in net permanent tax increases.[61] In short, the *total* of all recent permanent tax increases – including those enacted in the 2003 regular and June special session -- is still *less than half* of the $2 billion in taxes cut in the prosperous late 1990s when a temporary surge in capital gains taxes generated state budget surpluses.[62]

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60 Governor's *2003-2005 Biennial Budget Introduction Supplement* (p. 34). OPM Secretary Marc Ryan reports that tax cuts fully implemented over this period have resulted in a total $2.08 billion cut in taxes. Secretary Ryan reports a total of $72.3 million in "other taxes" cut, compared to the Governor's $57.8 million total cut in this category. M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation), p. 43. Note, moreover, that there were significant tax cuts in the 1990s even *before* Governor Rowland was elected.

61 During this period of time, there also have been some tax reductions, notwithstanding the existence of deficits. PA 02-1 (MSS), for example, exempted business analysis, management, consulting, and public relations services furnished "in connection with an aircraft" retroactive to 1/1/94 ($0.8 million revenue loss in FY 03 and $0.2 million each year thereafter), while PA 02-4 (MSS) extended and expanded various tax breaks for clean fuels (a $1.3 million revenue loss in each of FY 03 and FY 04).

62 The spending cap's measure of personal income growth does *not include* capital gains income. Thus, when capital gains income surged in the late 1990s, budget surpluses resulted. In 1994, Connecticut residents reported $2.547 billion in capital gains income. By 2000 this had increased to $15.435 billion. In 2001, however, the capital gains income reported by Connecticut residents fell by to $8.435 billion. Although this 45% drop in a single year was very significant,

B. FY 04-05 General Fund Revenue Changes, In Short. According to OFA, the 2003-05 biennial budget bill increased *net* General Fund revenues in FY 04 by $391.3 million -- $621.7 million in various revenue increases offset by $230.4 million of revenue reductions.[63] OFA reports that General Fund revenues in FY 05 increased by a net $248.9 million -- $509.8 million in revenue increases offset by $260.9 million in revenue reductions.[64] I

In addition, a number of bills enacted earlier in the 2003 legislative session have (or could have) impact on General Fund revenues, including PA 03-2.[65] *In total*, according to OFA, revenue changes enacted during *both* the 2003 regular and June 30th special session will result in an anticipated increase of $935.6 million in General Fund revenue in FY 04 and $1.132 million in FY 05.[66] These net new revenues, according to OFA, come from the following general sources:

	FY 04 ($M)	FY 05 ($M)
Structural, on-going tax & fee changes	$628.5	$608.0
Delays in previously-enacted tax reductions	$11.9	$30.5
One-time revenue enhancements and fund transfers	$295.2	$493.8
TOTAL	$935.6[67]	$1,132.3

C. A Closer Look at the FY 04-05 Biennial Budget's Revenue Changes. The Governor's FY 03-05 budget proposed to increase FY 04 *tax* revenues by a net $52.9 million ($179.1 million in tax increases offset by a $115.7 million reduction in the sales tax resulting from the elimination of the 5.75% tax on hospital patient care services and a $10.5 million earmarking of General Fund tax revenues for the emergency spill response account). The Governor's proposed changes would have increased FY 05 tax revenues by a net $126.6 million ($253.5 million from tax increases offset by a $116.4 million tax cut and a $10.5 million transfer of tax revenues out of the General Fund to the emergency spill response account). For a summary of these proposed changes, see CT Voices' report, *Revenue Changes in Governor Rowland's Proposed FY 03-05 Budget: Who Are the Tax "Winners" and "Losers"?* (March 2003)(available at www.ctkidslink.org).

capital gains realizations reported by Connecticut taxpayers in 2001 still exceeded gains reported in 1997 and the three years before that. M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation), p. 34.

63 OFA Fiscal Note on HB 6802. This includes the additional $7 million in new revenues for immunizations generated by a new fee on various insurance companies that had been included in one of the budget implementer bills. By comparison, the FY 03-05 budget results in a net revenue *loss* in FY 04 and FY 05 in both the Transportation Fund and the Conservation Fund. FY 04 Transportation Fund revenues are reduced by a net $17.2 million and in FY 05 by a net $6.9 million. *Connecticut State Budget 2003-05* (December 2003), p. 27. The revenue loss to the Conservation Fund is $1 million in both years.

64 OFA Fiscal Note on HB 6802, available at www.cga.state.ct.us/2003/fn/2003HB-06802-R01-FN.htm.

65 These bills include: PA 03-85, AAC Eligibility for Benefits to Veterans; PA 03-107, AAC Certain Administrative Procedures of the Department of Revenue Services; PA 03-120, AAC the Research and Development Tax Credit Exchange Program; PA 03-147, AAC Sales Tax Bond Requirements for Non-Resident Contractors; PA 03-225, AAC Various Taxes Administered by the Department of Revenue Services; PA 03-269, AAC Municipal Grant Lists etc.; and PA 03-271, AAC the Unlawful Delivery of Cigarettes.

66 OFA, *Connecticut State Budget 2003-2005,* p. 27. Note, OFA reports the FY 04 net revenue gain to be $937.6 million, but the total of the component parts of the gain (recurring taxes and fees, delays in tax reductions, and one-time revenue enhancements and fund transfers) is actually $935.6 million.

67 In addition to OFA's arithmetic error, CT Voices' analysis shows that total one-time revenues and fund transfers as reported by OFA for FY 04 are actually less than the total reported in all the budget bills and implementers adopted in the 2003 regular and special sessions. This is discussed more fully in Section VIII of this report.

The approved biennial budget, as amended by its implementing bills,[68] makes the multiple changes to FY 04 and FY 05 General Fund tax and other revenues:

KEY GENERAL FUND REVENUE CHANGES IN THE 2003-05 BIENNIAL BUDGET BILL AND ITS IMPLEMENTERS: FY 04-05 IMPACTS[69]	**FY 04** (in millions)	**FY 05** (in millions)
TAXES		
Personal Income Tax [70]		
- Reduce maximum property tax credit from $500 to $350 & phase out $100 residual credit at higher income levels [PA 03-1, JSS, § 101]	$112.0	$112.2
-Delay scheduled reductions for single filers [PA 03-1, JSS, § 101, 115-116][71]	$0.9	$3.5
-Increase Alternative Minimum Tax from 5% to 5.5% of taxpayer's adjusted federal AMT [PA 03-6, JSS, §72]	$0.0	$0.0
Sales & Use Tax[72]		
-Repeal phase-out of remaining 1% tax on computer/data processing services[73] [PA 03-1, JSS, §§ 95-96]	$0	$10.8
-Eliminate 5.75% tax on hospital patient care services[74] [PA 03-1, JSS, §§ 95-96]	($115.7)	($116.4)
-Restore exemption for advertising/public relations services for media and cooperative direct mail (exemption had been repealed and 3% rate set by PA 03-2). Exemption applies to sales on or after 7/1/03. [PA 03-1, JSS, §§ 95-97]	($7.7)[75]	($7.8)
-Restore exemption for sales of newspapers & magazines (exemption had been repealed in PA 03-2). Exemption effective 7/1/04 so no revenue loss in	$0.0	($15.0)

68 Because some provisions of the budget implementers *amend* the budget bill, this summary includes *both* the changes made by the budget bill *and* those made by the implementers.

69 The table in the text reports only changes made in the budget bill and implementers. Changes made earlier, in PA 03-2, are highlighted in the footnotes so that the full extent of 2003 changes is documented in this report.

70 In addition, the Governor had indicated that enhanced audit collections resulting from a new computer system would result in a $30 million gain in FY 05. NOTE: PA 03-2, enacted in the regular 2003 session, increased the tax rate on the upper bracket of the income tax from 4.5% to 5%. The increase applied to taxable income over $20,000 for joint filers, $10,000 for single filers and married people filing separately, and $16,000 for heads of household, effective January 1, 2003. Estimated revenue gain is $403.9 million in FY 04 and $393.0 million in FY 05.

71 The budget bill delays the scheduled income tax reductions for single filers by stretching out the timetable for increases in the amount of income exempt from tax and by delaying scheduled increases in income thresholds for reducing the personal exemption and credits (including the property tax credit). The Governor proposed to repeal the scheduled reductions.

72 In addition, the Governor had indicated that enhanced audit collections resulting from a new computer system would result in a $15 million gain in FY 05. In addition, PA 03-2 – enacted early in the 2003 Session -- imposed the sales tax on health an athletic club services unless provided by a non-profit organization or a municipality (effective April 1, 2003). The revenue gain was estimated at $7.5 million in FY 04 and $8.5 million in FY 05. PA 03-2 also reduced the sales tax exemption for clothing and footwear from $75/item to $50/item effective April 1, 2003. The revenue gain was estimated at $30 million in FY 04 and $32 million in FY 05.

73 The 1% tax was scheduled to be phased-out effective July 1, 2004. The 1% tax will apply to sales on and after that date.

74 This tax had been suspended from July 1, 2001 through June 30, 2003. Without this change, the sales tax would again have been applied to hospital patient care services after July 1, 2003.

75 Note: When PA 03-2 repealed this exemption and imposed a 3% sales tax on these services, OFA estimated at the time that the revenue gain would be $20 million in FY 04 and $22.5 million in FY 05. The budget bill restores the exemption, and OFA now estimates that this will result in a *loss* of $7.7 million in revenue in FY 04 and $7.8 million in FY 05.

FY 04 but $15M revenue loss in FY 05 [PA 03-1, JSS, § 98][76]		
-Require out-of state vendors w/ state contracts to collect/remit the sales/use tax due CT[77] [PA 03-1, JSS, § 105]	$2.5	$5.0
-Eliminate sales tax free week,[78] effective July 1, 2004 [PA 03-1, JSS, § 120]	$0.0	$3.3
-Create new sales tax exemption for tangible personal property purchased by *for*-profit hospitals for patient care ($0.4M revenue loss in FY 06, since exemption is effective 7/1/05) [PA 03-6, JSS, §54]	$0.0	$0.0
-Make sales tax permits issued after 10/1/03 valid for 5 years rather than 3 [PA 03-6, JSS, §73]	$0.1	$0.1
Corporation Business Tax[79]		
-Impose 25% surcharge for income year 2004 on any corporation with a tax liability greater than the $250 Alternative Minimum Tax)[80] [PA 03-1, JSS, §§ 87-88]	$49.4	$33.6
-Extend the Research & Development tax credit exchange to capital-base reporting corporations for 2002-2004 income years[81] [PA 03-1, JSS, §§ 89]	($12.5)	($12.5)
-Impose, *then repeal in the budget implementer*, a requirement that certain multi-state corporations report income of related companies in a combined tax return.[82] [PA 03-1, JSS, §§ 90-91; PA 03-6, JSS, §244]	$0	$0

[76] Note: This exemption was *repealed* in PA 03-2. In its fiscal note, OFA estimated the revenue gain from the repeal to be $68 million in FY 04 and $66 million in FY 05. Reinstatement of the exemption, OFA estimates, will result in a $15 million revenue loss in FY 05 only (because the exemption is again effective beginning 7/1/04).

[77] Specifically, the bill requires *new* contracts for state agency purchases of supplies, equipment, and similar items from sellers with no taxable relationship ("nexus") with Connecticut to include an agreement that the contractor and its affiliates will collect use tax on all Connecticut sales during the term of the state contract. This requirement applies to affiliates that control, are controlled by, or are under common control with, the contractors. The contractor (and affiliates) is required to collect use tax only on items subject to the 6% tax rate.

[78] During the "sales tax free week" (the 4th week of August) items of clothing costing more than $50 but less than $300 were exempt from sales tax. While the budget eliminates the tax free week, articles of clothing costing less than $50 each remain exempt from sales tax.

[79] The Governor estimated $4 million in increased revenues in FY 05 from enhanced audit collections. For a comprehensive look at Connecticut's corporation business tax, see S. Geballe & D. Hall, *Connecticut's Corporation Business Tax: It's Time for Repair* (CT Voices for Children, July 2003), available at www.ctkidslink.org.

[80] Corporations subject to the surcharge must calculate the surcharge based on tax liability *before* credits. Note: PA 03-2 (HB 6495) imposed a 20% temporary corporate tax surcharge in income year 2003.

[81] The budget bill (section 89) temporarily reinstated eligibility for research and development tax credit refunds for companies that pay the alternative capital base tax for a year in which they report no net income. PA 03-120 had reinstated eligibility for these companies for income year 2002. The budget bill extends eligibility to the 2003 and 2004 income years allowing these companies with no net income to sell back these unused tax credits at partial value and get a cash refund.

[82] The budget bill, when passed, required a group of related corporations that meet certain criteria to determine the tax liability of the group's members that are doing business in Connecticut as if the group were a single company (known often as "unified" or "combined" reporting). By requiring a group of related corporations and business entities to combine and apportion their income or capital base as if it were one company rather than many, the bill could subject more of the group's income to the Connecticut corporation tax. Unified reporting has been called, by some tax experts, the single most effective way to prevent large multi-national corporations from avoiding paying Connecticut corporation tax by creating subsidiary or related corporations in other states or nations and transferring otherwise taxable income *out-of-state* to them. While OFA estimated that this change would generate $40 million in additional corporation business tax revenues each year, the press reported Republican legislators' claims that the revenue gain would have been closer to $400 million. The provision was quickly repealed in one of the budget implementers. M. Jacklin, "State's Poor, Middle Class Left to Pick Up the Slack," *Hartford Courant* (August 20, 2003). These estimates of revenue gain if mandatory unitary reporting is enacted demonstrate how successfully many corporations have been in reducing the tax owed to Connecticut through these mechanisms.

-Require corporations to add back, when determining net income for tax purposes, certain otherwise deductible interest expenses w/ related companies [PA 03-6, JSS, §78]	$10.0	$10.0
-For income years between January 1, 2003 and December 31, 2004, create a "safe harbor" from interest penalties for underpayment of corporate tax for taxpayers affected by add-back requirements [PA 03-6, JSS, §79]	No OFA estimate	No OFA estimate
-Increase from $25,000 to $250,000 the "preference" tax corporations must pay when they elect to file a combined report [PA 03-6, JSS, §80]	$30.0	$30.0
-Increase maximum investment for which *certain* investors can get tax credits under the Urban Site Program[83] (estimated $5-$10M revenue loss/year after FY 06) [PA 03-6, JSS, §77]	$0	$0
Succession & Estate Tax		
-Delay by two additional years each remaining step of the phase-out of inheritance tax[84] on Class B and Class C heirs and roll-back 1/1/03 rate reduction. Succession tax would now be eliminated for Class B heirs on 1/1/06 and for Class C heirs on 1/1/08. Effective for transfers after 3/1/03. [PA 03-1, JSS, § 94]	$11.0	$26.0
-Adopt contingent, temporary estate tax on estates of over $1 million of people who die between July 1, 2004 and January 1, 2005 (a one-time revenue gain, if implemented, in FY 05 only) [PA 03-1, JSS, §§ 59, 502][85]	$0.0	$55.0

[83] Under current law, the maximum investment for which a credit can be claimed is the amount of *state* revenue that will be produced by the project. Now, if the project involves a firm in one of four manufacturing industries that is relocating from out of state and the relocation will result in the development of at least 725,000 square feet in a state-sponsored industrial park, the maximum investment is increased to the *combined* projected new state and local revenue. The industries are pharmaceutical preparations, unclassified food preparation, lubricating oils and greases, and miscellaneous manufacturing industries. The bill also creates a non-lapsing "Connecticut Impact and Analysis Account" in the General Fund to hold proceeds the state realizes in connection with the urban sites program (with investment earnings staying in the account). DECD is authorized to use the funds in the account for the costs of the urban site program (including its own administrative costs) and carry-forward unexpended balances to the next fiscal year.

[84] This affects estates of people who die on or after March 1, 2003 that exceed certain amounts and that pass either to collateral descendants (e.g. brothers, sisters, nephews, nieces – class B heirs) or more remote heirs (Class C). The bill increases tax rates for taxable estates of those who die between March 1, 2003 and December 31, 2004 but applies tax rates that were in effect in 2002 (reversing a rate reduction that took effect January 1, 2003). No tax is imposed on estates of $600,000 or less that pass to class B heirs and of $200,000 or less that pass to Class C heirs. There remains no tax on estates *of any size* that pass to heirs that are closer in relationship to the decedent (e.g. spouses, children, grandchildren, parents).

[85] A tax, set at 1.3 times the maximum credit allowable against the federal estate tax for state estate tax purposes (excluding the 75% reduction in that credit applicable under federal law in 2004), is imposed on estates over $1 million of persons who die between July 1, 2004 and July 1, 2005. The tax must be paid within 6 months of death (rather than current 9 months). Section 61 of the budget bill specifies that this estate tax is *contingent* on Connecticut failing to receive a certain specified amount of "extraordinary" federal financial assistance. "Extraordinary" federal assistance is defined as extra federal medical assistance and other aid similar to that which Connecticut received for FY 03 and FY 04 under the federal Jobs Growth, Tax Relief and Reconciliation Tax of 2003. If the amount of extraordinary additional federal funds Connecticut receives in FY 05 is more than $110 million, this temporary estate tax is repealed.

Gift Tax: Delay for two years gift tax phase-out (i.e., maintain current rate until 1/1/06)[86] Provides $1M in FY 05. [PA 03-1, JSS, § 99]	$0	$1
Insurance Premiums Tax: Limit the total value of tax credits an insurance company or HMO may take against the 1.75% premiums tax owed to no more than 70% of the pretax tax liability. Effective for income year beginning 1/1/03. [87] [PA 03-1, JSS, § 86]	$2.5	$2.5
Public Service Companies Tax –Total		
-Extend 5% gross earnings tax currently imposed on cable TV to satellite TV provided to CT subscribers, eff. 9/1/03. [88] [PA 03-1, JSS, §§ 92-93, 501]	$2.5	$3.0
-Earmark $2M/year of cable & satellite TV gross earnings tax revenues for CT Television Network's (CTN) coverage of state government [PA 03-1, JSS, § 106] [89]	**($2.0)**	**($2.0)**
Oil Companies Tax:		
Reduce from $21M to $10.5M in FY 04 (and to $13M in FY 05) the amount of tax transferred to the Transportation Fund. Sums remain in General Fund.[90] [PA 03-1, JSS, §65]	$10.5	$8.0

[86] This maintains the current gift tax rates on gifts between $25,000 and $1 million until January 1, 2006, then resumes the phase-out of the tax on gifts this size with the phase-out complete January 1, 2010. Under prior law, the phase-out would have been complete on January 1, 2008. There remains no tax on gifts of $25,000 or less.

[87] Prior changes to the corporation business tax had imposed a similar limit on the use of tax credits to extinguish *all* corporate business tax. This provision extends the limit on the use of tax credits to extinguish all tax liability to companies liable for the insurance premiums tax.

[88] As with the cable TV tax, the satellite TV companies are to pay tax on a quarterly basis. The Comptroller is authorized to count as revenue for the previous fiscal year satellite TV tax payments postmarked by the end of July.

[89] NOTE: OFA characterizes the earmarking of funds as a revenue loss to the General Fund. Previously, the CT Television Network (which broadcasts state government proceedings) has been funded through the General Fund. With this earmarking of funds, there is no longer a budget line in the Legislative Management General Fund budget for CT-N (since it no longer needs a General Fund appropriation) and overall General Fund revenues are reduced by the $2 million/year of earmarked funds.

[90] The Department of Revenue Services is to deposit in the Special Transportation Fund $2.625 million per quarter in FY 04 and $3.25 million per quarter in FY 05 of the state's motor fuel tax revenues. (Current law requires DRS to deposit $5.25 million for the quarter ending 9/30/03). Reducing funds transferred to the STF results in an increase in General Fund revenues of $10.5 million in FY 04 and $8 million in FY 05, and cuts Special Transportation revenues by the same amount.

Earmark revenues from petroleum gross earnings tax for DEP emergency spill response account [PA 03-1, JSS, §45][91]	**($10.5)**	**($10.5)**
Misc. Taxes[92]		
-Explicitly apply controlling interest transfer tax to additional transfers of real property[93] [PA 03-1, JSS, § 100]	$2.5	$5.0
-Extend alcohol sales for an additional hour (to 9 pm) on weekdays/Saturdays [PA 03-1, JSS, § 103]	$2.1	$2.1
FEES[94]		
-Increase various other court fees and repeal provision of PA 03-2 that had earmarked to the Judicial Department's Other Expense account specified court and program fees and attorney taxes that PA 03-2 had increased (up to a maximum of $4.9 million in FY 04 and after)[95] [PA 03-1, JSS, §119]	$5.43	$5.43
-Impose $0.50 per report fee on towns when town reports delinquent property taxes to DMV (so DMV can w/hold registration) [PA 03-1, JSS, § 102]	$0.5	$0.5
-Double land use application fee from $10 to $20, increasing revenue to Environmental Review Teams, the Council on Soil and Water Conservation, and the Water Conservation Districts [PA 03-6, JSS, §108]	$0.28	$0.28
-Increase various environmental quality permit fees w/ revenue to	$4.95	$4.95

91 NOTE: OFA characterizes the earmarking of funds as a revenue loss to the General Fund.

92 In addition, the FY 03-05 budget bill earmarks revenues from the 12% hotel occupancy tax in FY 04 and FY 05 for the newly-constituted CT Commission for Arts, Tourism, Culture, History and Film. PA 03-1, JSS (sec. 85) specified that $20 million in funds from this tax were to be earmarked and provided to DECD for arts, culture and tourism. PA 03-6, JSS, specified that the funds were not to be credited to DECD, but instead to the new Commission. Concurrently, PA 03-1, JSS (sec. 107-112, 119) eliminated the Tourism Account and transferred revenues earmarked to the account (from the $1 day/rental car surcharge on cars rented for 30 days or less, from payments on advertising, etc.) to the General Fund – resulting in an off-setting $24.2 million revenue gain to the General Fund – or a net gain to the General Fund of $4.2 million. PA 03-6, JSS, §243 provides an additional $4.48 million in revenue for the new Commission through the carry-forward of funds that had previously been appropriated to OPM. Total funding for the new Commission in FY 04 is therefore $24.48 million. In addition, in PA 03-2 the General Assembly increased the tax on cigarettes by another 40 cents (from $1.11/pack to $1.51/pack) effective March 15, 2003 (with estimated revenue gain of $70.9 million in each of FY 04 and FY 05).

93 Under current law, the tax is applied to the sale or transfer of a controlling interest in an entity that has an interest in real property worth $2,000 or more. The bill expands the tax to several other types of property transfers. For example, the tax applies whether the entity holds the property directly or indirectly, whether the transfer occurs in one transaction or a series of transfers, and whether it involves one seller or a group acting in concert. It exempts from the tax transfers of controlling interests in entities owning real estate located in an enterprise zone.

94 Other provisions in the budget implementers shift costs of some currently state-funded services *to families* by imposing new fees on receipt of services. PA 03-3 (JSS), section 55 imposes cost-sharing fees of up to 5% of family adjusted gross income on HUSKY B families, resulting in these families paying a combined total of about $2.4 million in FY 04 and $3.9 million in FY 05 to maintain coverage and receive benefits. In addition, PA 03-3 (JSS) authorizes imposition of premiums and co-pays in HUSKY A and fee-for-service Medicaid (sections 72-73, 96) which, if implemented as written, represents the imposition of a combined total of $15.9 million in fees in FY 04 and $22.2 million in FY 05. The elimination of presumptive eligibility (PA 03-3, JSS, s. 56) will also result in an estimated "savings" of $2.8 million in FY 04 and $3.0 million in FY 05 by shifting additional costs to families and providers. In addition, PA 03-3, JSS, section 9 amends the Birth-to-Three program to impose fees on parents of children eligible for services if family income is $45,000/year or more. OFA estimated that families would, through this fee, pay a combined total of $1 million/year toward the cost of this program.

95 NOTE: Since OFA characterizes such earmarking as a revenue loss to the General Fund, the repeal of the earmarking is shown as a revenue gain to assure consistency. A total of $5.42 million in fees was expected in FY 04, but $4.9 million of it was earmarked.

Environmental Quality Fund at DEP. Increase solid waste fee from $1/ton to $1.50, w/ revenue to DEP Solid Waste Account [PA 03-6, JSS, §§109-139, 151-153]		
-Earmark funds from newborn genetic testing fees for new DPH newborn screening account [PA 03-3, JSS, §4]	($0.345)	($0.345)
-Impose new "health & welfare" fee (assessed by Insurance Commissioner) on each domestic insurer or HMO that does any life or health insurance in CT to pay for DPH's child and adult immunization program, TB and communicable disease treatment & data collection re immunization status of Medicaid children [PA 03-3, JSS, §6]	$7.1	$7.1
OTHER REVENUES[96]		
-Increase from $20 to $35 the surcharge for various motor vehicle infractions and related charges[97] [PA 03-1, JSS, §104]	$1.6	$1.6
-Allow DRS to contract with outside collection agencies to collect unpaid tax and interest [PA 03-6, JSS, §75]	Unknown gain	Unknown gain
-Credit any funds CT receives from "Wall Street Settlement" to General Fund [PA 03-1, JSS, §46(g)]	$4.2	$0
-Implement DRS Integrated Tax Administration System (expected to increase collection of various state taxes)[SA 03-2, Sept. SS]	Unknown gain	Unknown gain
ESCHEATS		
-Reduce time limits for property to be considered abandoned (i.e. can be claimed by state); dormancy period cut from 5 to 3 years [PA 03-1, JSS, §§ 66-84][98]	$21.3	$17.3
TRANSFERS *TO* THE GENERAL FUND FROM OTHER FUNDS[99]		
-Require OPM/State Treasurer to propose a plan to secure an additional	$0.0	$300.0

[96] Other "revenues" included in the budget bill and implementers (if one defines "revenues" as new sources of funds that allow state expenditures to be reduced) include: a) amending the insurance company statute to require insurers to cover Birth-to-Three services provided by qualified professionals up to a maximum of $3,200 year (a reduction from $5,000 per child per year) with a total maximum per child of $9,600 (a part-year FY 04 revenue gain to the Birth-to-Three program of $2.1 million)[PA 03-3(JSS), s.7]; b) reducing the town's share of federal reimbursements under Medicaid for services provided in school-based health programs (and thereby increasing state's share from 40% to 50%, or $1.2 million in FY 04)[PA 03-3, JSS, s. 54]; and c) imposing the cost of urine testing of race track dogs on facility owners rather than on the Division of Special Revenue, saving Connecticut about $0.486 million in FY 04 [PA 03-6, JSS, §§179-180].

[97] The surcharge is increased to $35 when an accused is found to have committed any infraction with a $35 fine, or pleads no contest and pays the fine by mail.

[98] Most property held or owned in Connecticut that is unclaimed by its owner is presumed abandoned after a specified amount of time passes (the dormancy period). The state treasurer is authorized to assume custody of such abandoned property. The bill changes current law in a number of ways, including reducing the amount of time that must pass for various types of property to be presumed abandoned, providing more specific rules about certain property (e.g. gift certificates), and changing some of the requirements for the presumption of abandonment.

[99] Additional changes not noted in the table above include the earmarking of funds from the Commercial Recording Account for 5 positions at the Secretary of State's Office and $0.617 for computerized voting [PA 03-1, JSS, s. 44)[revenue gain to General Fund of $1.0 million in each of FY 04 and FY 05] and the transfer of 14 DEP General Fund Air Bureau staff positions to Title V funding (generated by permit fees on large stationary pollution sources that are increased by the implementer) [PA 03-6, JSS, s.149-150)[results in a transfer of an expense of $1.12 million in FY 04 and $1.156M in FY 05 from the General Fund].

$300M in revenues in FY 05 through securitizing tobacco settlement revenues [PA 03-6, JSS, §43]		
-Transfer to the General Fund all other revenues credited to Energy Conservation and Load Management (ECLMF) and Clean Energy Fund from 7/1/03 to 6/30/05 *or* generate an equivalent sum by securitizing $144M in funds from the Energy Conservation and Load Mgmt Fund and $25M/year from the Clean Energy Fund. The $194M in securitization bonds are to be backed by the Competitive Transition Assessment (CTA) on utility bills.[100] Interest costs if such bonds are issued is projected to be $28.1 million. [PA 03-6, JSS, §44-50; PA 03-1 (Sept. SS) §2-7].	$169.0	$25.0[101]
-Transfer $1M/mo. from the Energy Conservation & Load Mgmt Fund to the General Fund [PA 03-2; PA 03-1, JSS, §47(a); PA 03-6, JSS, §248; PA 03-1, September SS, §9)] [102]	$12.0	$12.0
-Transfer to General Fund from CT Housing Finance Authority [PA 03-1, JSS, §46(e)]	$2.5	$2.5
-Transfer to General Fund from CT Innovations [PA 03-1, JSS, §46(d)]	$5.0	$5.0
-Transfer to General Fund from CT Development Authority [PA 03-1, JSS, §46(b)]	$10.0	$10.0
- Transfer to General Fund from Banking Fund [PA 03-1, JSS, §46(f)]	$5.0	
-Transfer from Banking Fund to Department of Banking to fund office relocation [PA 03-6, JSS, §196][103]	Up to $3.6	
TOBACCO SETTLEMENT FUNDS		
-Eliminate transfer of $12M in each fiscal year from General Fund to Tobacco Health Trust Fund [PA 03-1, JSS, §46(a)]	$12.0	$12.0
-Eliminate transfer of $2M in each fiscal year from General Fund to Biomedical Research Fund [PA 03-1, JSS, §46(c)]	$2.0	$2.0

Special Transportation Fund. Section 117 of PA 03-1 (June Special Session) increases various DMV fees to $20, resulting in a revenue gain in the Special Transportation Fund (STF) of $7.3 million in FY 04 and $10.1 million in FY 05. Sections 113-114 of the budget bill create the Transportation

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[100] The budget bill and implementers specify that *all* revenues from the conservation and renewable energy charges raised in FY 04 and FY 05 are to be transferred to the General Fund *unless* DPUC authorizes, by October 30, 2003, the issuance of new securitization bonds, the proceeds of which must provide the General Fund with an equivalent amount in revenues. Bonds are to be paid off with revenues derived from the utilities' competitive transition assessment charge on utility bills. The budget bills authorize the sale of $144 million in bonds to replenish funds in the Energy Conservation and Local Management Fund (at 3.5% for 7 years, resulting in an interest charge of $120.9 million) as well as another $50 million in bonds to restore funds to the Renewable Energy Investment (Clean Energy) fund (at 3.5% for 7 years, resulting in an interest charge of $57.2 million)(see note below).

[101] The $25 million in each of FY 04 and FY 05 are from securitizing the Clean Energy Fund.

[102] PA 03-2 required DPUC to authorize a disbursement of $1 million/month from the Energy Conservation and Load Management Fund until July 1, 2005 and deposit the funds into a separate, non-lapsing account in the General Fund to be used by state agencies for electrical utility costs, including conservation projects. PA 03-1 (JSS), §47(a) maintains the required transfer, but directs that funds are to be deposited in the General Fund, rather than in this non-lapsing fund. PA 03-6 (JSS)(section 248) "inadvertently" repealed the transfer. PA 03-1 (September SS)(section 9) restored the requirement that $1 million per month of revenues be transferred from the ECLMF to the General Fund.

[103] NOTE: The net balance in the Banking Fund as of June 30, 2003 was $30.5 million. The transfer of up to $3.6 million from the Banking Fund to the Department of Banking is to fund a relocation from their current office as 260 Constitution Plaza to 960 Main Street. This relocation results in a one-time cost of $3.2 million in FY 04 for facility modifications, furniture and fees. It also results in an estimated cost of $236,448 per year *in increased rend.* Department of Banking lease costs have increased from $39,504/month prior to 2002, to the current $59,246/month and will increase after the move to $78,950/month.

Strategy Board Projects Account as a non-lapsing account in the STF, and allocates $5 million of these new fees to the account in FY 04 and half the increased fees to the account in FY 05 and thereafter. It also transfers funds from the STF to this new TSB Projects Account: $10 million in FY 04, $5 million in FY 05 and $5 million on July 1, 2005 (FY 06). This results in a $15 million revenue loss to the STF in FY 04 and corresponding gain of $15 million for the TSB, and a $10 million loss to the STF in FY 05, and a corresponding gain to the TSB. Section 118 delays the increase (from $2 million to $3 million) in funds transferred from the STF to the Conservation Fund generated by the tax on the sale of motor fuel by distributors to boatyards and marinas. This results in a gain of $1 million in FY 04 and in FY 05 in the STF and a corresponding loss to the Conservation Fund. Fees are more than doubled for the ferry service to cross the Connecticut River by section 40 of PA 03-3 (with a FY 04 revenue gain of $90,000 and a FY 05 gain of $154,000). Section 8 of PA 03-1 (September Special Session) allows DOT to establish discounted commuter rates for riding the Rocky Hill and Chester-Hadlyme Ferries, resulting in a revenue loss of $5,000-$15,000 annually.

Local Taxes. Section 58 of PA 03-6 (June Special Session) allows towns to impose a $5 fee on any person who is delinquent in the payment of property tax. This could collectively generate about $0.8 million if all municipalities participate.

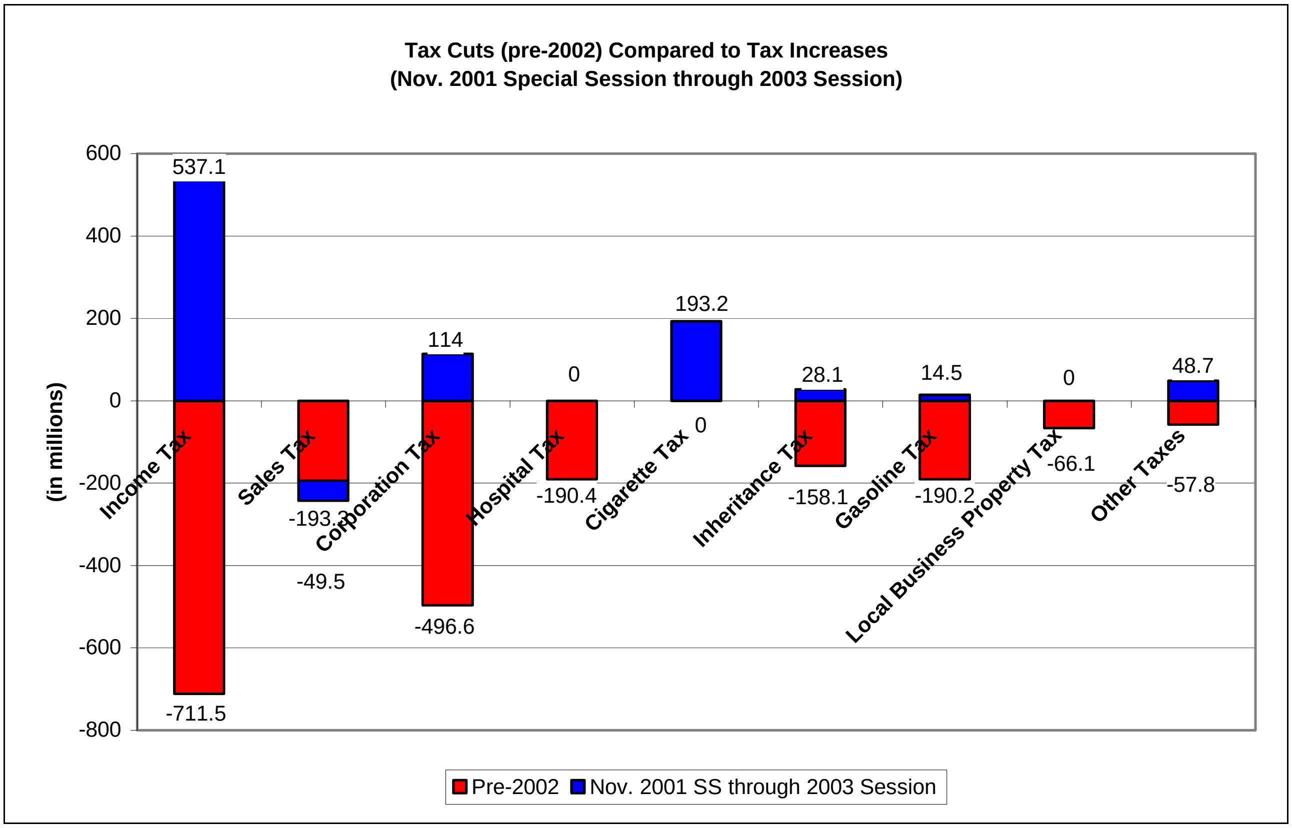
D. FY 04-05 Tax Changes: In Context. As shown in the table below, net tax increases enacted since the November 2001 Special Session are less than half the total tax cuts made between the time Governor Rowland was first elected and deficits began. Moreover, Connecticut did not simply roll-back each of the various taxes that were cut in the late 1990s. Rather, there is significant variation among the taxes that were *increased* since General Fund deficits emerged in FY 02 and the taxes that were *cut* when there were General Fund surpluses in the late 1990s.

	Tax Cuts in Rowland Tenure, Pre-November 2001 Special Session[104]	Total Net On-Going Tax & Fee Increases[105] (FY 04 revenue)	*Net* Change in Taxes & Fees (net increases since 11/02 less cuts prior to 11/02)
Income Tax	-711.5	537.4	-174.1
Sales Tax	-193.3	-49.5	-242.8
Corporation Tax	-496.6	114.0	-382.6
Hospital Tax	-190.4	0	-190.4
Cigarette Tax	0	193.2	193.2
Inheritance Tax	-158.1	28.1	-130.0
Gasoline/Diesel/Petroleum Tax	-190.2	14.5	-175.7
Local Business Property Tax	-66.1	0	-66.1
Other Taxes & Fees	-57.8	48.7	-9.1
TOTAL	**-2,064.0**	**886.4**	**-1,177.6**

104 *Governor Rowland's Budget Proposal FY 2003-2005 Biennium* (March 4, 2003 Powerpoint), p. 46.

105 The table does not include revenues from temporary surtaxes since fail to address the structural deficit in a permanent way. The table *does* include revenues resulting from delays in implementation of tax cuts. Because OFA reduces General Fund revenues whenever funds are earmarked, this table assumes the same. NOTE: taxes and fees shown in this table include not only General Fund fees and taxes, but also Special Transportation Fund fees and taxes.

The following chart shows graphically how the *net* tax *increases* enacted through, and including, the FY 03-05 budget compare to the tax *cuts* from the time Governor Rowland took office and the time that deficits emerged, by type of tax.[106]



As shown on the chart above, in the late 1990s the personal income tax was reduced by a total of $711.5 million (largely because of the property tax credit). To date, deficit-mitigation efforts have *increased* the personal income tax by $537.4 million, primarily from the rate increase from 4.5% to 5% (resulting in $403.9 million in additional FY 04 revenue) and the reduction in the maximum property tax credit and elimination of the residual $100 credit for high-income taxpayers (resulting in a $112 million in additional FY 04 revenue). That is, a little more than ¾ of the personal income tax cuts made in the late 1990s have been rolled-back since deficits began.

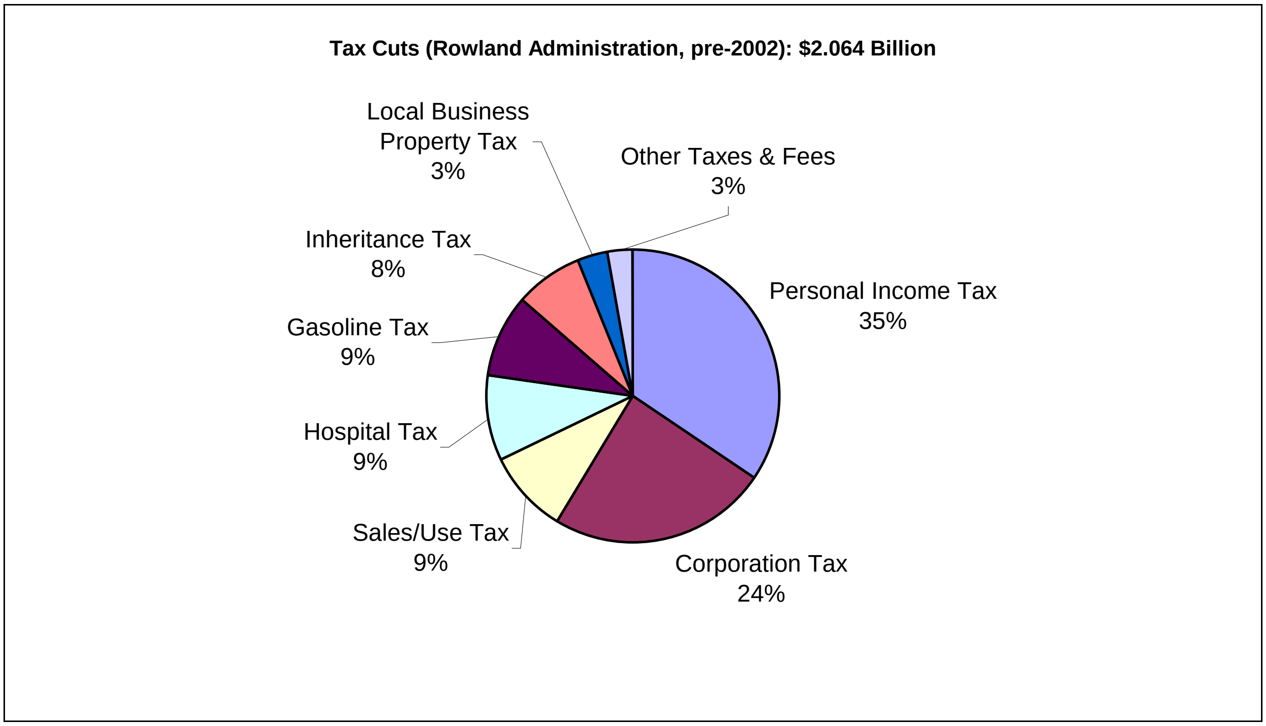
By comparison, the corporation business tax was cut by nearly $497 million between the time the Governor was first elected and the November 2001 Special Session. Since then, structural changes to the corporation business tax have resulted in $114 million in net new FY 04 revenues. That is,

[106] The chart includes only those net tax increases (and reductions) that are *not temporary*. Excluded as tax cuts, for example, were Connecticut's two tax rebates in the late 1990s (a total of $219.2 million for an income tax rebate in FY 99 and a sales tax rebate in FY 00). Similarly excluded as tax increases are the 20% surcharge on the corporation tax for income year 2003 (in PA 03-2) and the 25% surtax for income year 2004 (in the FY 03-05 budget bill) that together add a projected $82.4 million to FY 04 revenues (since they do not result in permanent changes in the corporation business tax). *Included*, however, are revenues from *delays* in the implementation of tax cuts already enacted (such as the delay in the phase-out of Connecticut's inheritance tax).

23% of the corporate tax cuts made in the late 1990s have been rolled back permanently. Sales taxes were cut by $193 million pre-2002, and have been cut another $49 million (net) since.

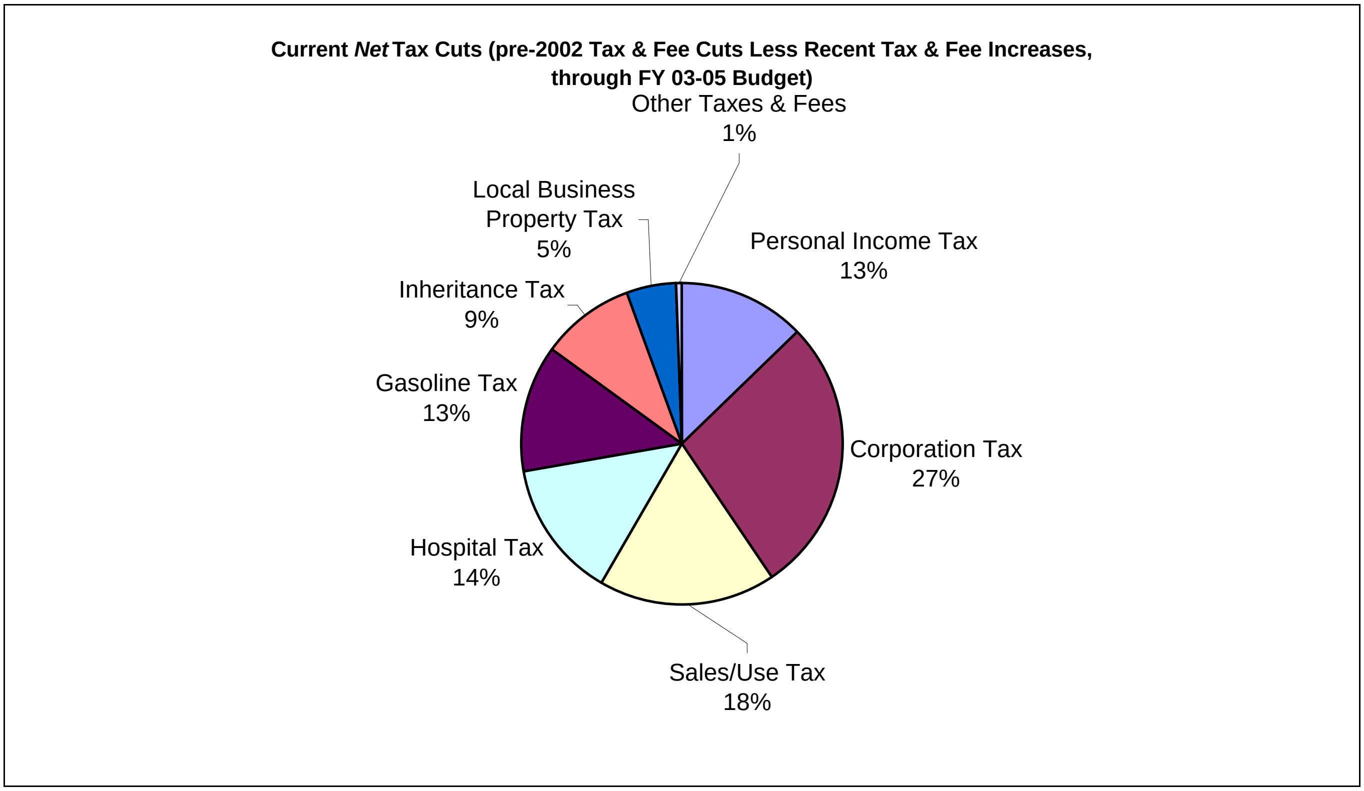
E. The Impact of Tax Changes on Who Are the Tax "Winners" and "Losers." As OPM Secretary Marc Ryan has reported,[107] even after the recent state tax increases discussed in this report, state taxes are still more than $1 billion less than they were when Governor Rowland first took office. Importantly, however, *which taxpayers* are benefiting from the net reduction in state tax has changed. The final charts illustrate who are the winners and losers of the permanent state revenue changes from the pre-FY 02 tax cuts *through* the FY 03-05 biennial budget.

The first chart shows the distribution of the $2.064 billion in tax cuts enacted after Governor Rowland took office but before deficits began, by type of tax.



The second chart shows the distribution of the $1.178 billion in *net* tax cuts over the period since Governor Rowland was elected through the 2003 legislative sessions (i.e., the $2.064 billion in tax & fee cuts enacted before the November 2001 special session less the non-temporary *tax and fee increases* enacted since that time), by type of tax.

107 OPM Secretary Marc Ryan, *The State Budget and the Economy* (PowerPoint presentation, October 15, 2003), p. 44.



Comparing the two charts, it is evident the net "winners" are corporate, rather than individual, taxpayers. For example, while 27% of the tax cuts enacted between the time Governor Rowland took office and the November 2001 special session directly benefited corporations (both through savings in the corporation tax and property tax reductions), 32% of the *net* tax cuts as of this date directly benefit corporations. By comparison, 35% of the pre-2002 tax cuts were to the personal income tax. Now, only 13% of the *net* tax cuts now are to the personal income tax. Also, not shown on these charts (because the tax was not *cut* in the late 1990s) is the increase in the cigarette tax ($193.2 million in additional FY 04 tax revenues), which also falls on individual taxpayers.

VIII. Trends in State Budget Deficit Mitigation

Since the General Assembly began deficit-mitigation efforts in the November 2001 special session, the manner in the deficits have been addressed, and in which new *revenues* have been generated, has changed. This report concludes with a quick summary of deficit-mitigation actions taken to date.

FY 02 Deficit. As monthly General Fund deficit projections increased in FY 02, deficit mitigation began. All together, about $353 million in FY 02 appropriations were cut mid-year.[108] In addition,

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108 Specifically, the Governor ordered rescissions ($29.5 million in September, and $28.1 million in December, 2001), the General Assembly cut FY 02 spending both in the November 2001 special session ($128.8 million in cuts to accounts funded with FY 01 surplus funds, $35.3 million in reductions to FY 02 appropriations, and $7.0 million in reductions to FY 02 carry forward funds) and also in the May 2002 special session ($28.4 million), and an additional $96

in the November 2001 special session, the phase-out of Connecticut's inheritance tax was delayed by one year (FY 03 revenue gain of $11 million). Other actions taken early in the 2002 legislative session also resulted in some increased revenues in FY 02. For example, the tax on cigarettes was increased by 61 cents (from $0.50 to $1.11/pack, effective April 3, 2002) resulting in a FY 02 revenue gain of $30.2 million from the increased tax on sales and another $9.5 million in one-time FY 02 revenues from imposing the increased tax on inventory (PA 02-1). The repeal of the credit against the insurance premiums tax for managed care organizations providing HUSKY coverage also resulted in a FY 02 revenue gain of $14 million (although this was offset by a higher appropriation for increased fees to the managed care organizations)(PA 02-3).[109]

Notwithstanding these changes, the General Fund ended FY 02 with a deficit of $817.1 million—the first General Fund deficit recorded since 1991. To address the deficit, Connecticut drained its Budget Reserve ("Rainy Day") Fund ($594.7 million) and issued 5-year Economic Recovery Notes ($222.4 million). Without the mid-year spending cuts and modest tax changes, however, the FY 02 deficit would have been more than $1.2 billion.

FY 03 Deficit. In the 2002 legislative sessions, anticipating growing deficits in the FY 03 budget, the Governor and General Assembly took actions to reduce spending mid-year by a projected additional $340 million,[110] but also made a number of changes to generate new revenues. In total, there were about $739 million in additional revenues generated for FY 03, as follows:

- 31% ($231 million) from structural changes to taxes or fees that result in new revenues on an on-going basis;[111]
- 4% ($25 million) from delays in previously-enacted tax cuts;[112] and
- 65% ($483 million) came from one-time revenue enhancements (fund transfers, re-allocated funds, the tax amnesty, and other one-time revenue sources).[113]

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million in FY 01 "surplus" funds also was cut. OPM Secretary Marc Ryan, *Governor's Council on Economic Competitiveness & Technology: Challenges Facing the State* (September 26, 2002), p. 11.

109 A one-time $18 million revenue loss also resulted in FY 02 from a change in when the sales tax exemption for patient care services applied (PA 02-3).

110 Cuts in the budget included $94 million in additional lapses, a $36.8 million reduction in anticipated debt service payments, a $35 million cut to the town aid road appropriation, $35 million in cuts through the Governor's "extraordinary" rescission authority, a $34.9 million reduction to the contribution to the Teachers' Retirement account and $21 million in other education cuts, and a total of $190.9 million in other appropriations reductions of various sorts. These cuts were to be offset by additional spending of $108 million through "technical" changes, result in net spending cuts of $339.6 million. OPM Secretary Marc Ryan, *Governor's Council on Economic Competitiveness & Technology: Challenges Facing the State* (September 26, 2002), p. 13. As noted earlier in this report (Section III), $317.5 million in savings actually were achieved.

111 E.g., limit the use of tax credits to offset a maximum of 70% of pre-credit corporate business tax liability and prohibit use of credits to avoid paying the $250 Alternative Minimum Tax ($30.5 million revenue gain in FY 03), impose a new $250 annual tax on the LLCs, LLPs, and S corporations that had earlier been totally exempted from the 7.5% corporation business tax ($28.0 million in FY 03), place new restrictions on the Research and Development tax credit exchange program ($13 million revenue gain in FY 03), and increase the cigarette tax ($122.3 million in FY 03, as well as $30.2 million in FY 02).

112 E.g., defer the scheduled phase-out of 1% tax on computer and data processing services ($10 million in FY 03), delay for two years scheduled phase-out of tax on gifts of between $25,000 and $1 million ($2.6 million in FY 03), and delay for two years scheduled increases in the personal exemption for single tax filers on personal income tax ($12 million in FY 03).

113 E.g. liquidate Anthem stock for $127 million, transfer $85 million of funds from the CT Housing Finance Authority to the General Fund, transfer $68.8 million in funds from the tobacco settlement to the General Fund, grant a tax

Notwithstanding these new revenues, and the very significant spending cuts, FY 03 ended with a deficit of $96.7 million that also was addressed through 5-year Economic Recovery Notes. However, total borrowing totaled $122.9 million -- $96.7 million to cover the FY 03 deficit and the balance to cover unpaid General Assistance medical claims. Total deficit mitigation for FY 03 was, again, more than $1.2 billion.

FY 04 Deficit. During the 2003 regular and special sessions, the General Assembly enacted provisions that resulted again in a significant net increase in revenues. The FY 04 budget also includes about $260 million in mid-year cuts. However, unlike in FY 02 and FY 03, many of the new FY 04 revenues come *not* from one-time sources, but rather from permanent revenue changes that begin to address Connecticut's structural deficit. In FY 04, new revenues will be coming from the following sources:

- 62% ($574.5 million in *net* new revenues) from structural changes to taxes or fees that will result in new revenues on an on-going basis;[114]
- 1% ($11.9 million) from delays in previously-enacted tax cuts;[115] and
- 37% ($348.3 million) from one-time revenue enhancements.[116]

In Summary. Since the fall of 2001, Connecticut has addressed a *cumulative* General Fund deficit of more than $3.6 *billion.* Throughout their deficit-mitigation efforts, the General Assembly and Governor consistently, and continually, cut spending. While total *mid-year* spending cuts total more than $950 million, spending *also* was reduced when the FY 03 budget was revised and the FY 04 budget adopted. As noted earlier in this report, FY 04 spending is *less than* the FY 04 current service needs by more than $1 billion.

In generating *new* revenues over this three-year period, the Governor and General Assembly at first relied, primarily, on one-time revenues and fund transfers. It was only in the 2003 regular and special sessions that the General Assembly and Governor began to restore, *in a permanent way*, some of the hundreds of millions of dollars of tax revenues cut in the late 1990s. According to OPM Secretary Marc Ryan, only about a fifth of the new tax revenues in FY 04 come from changes enacted in the 2002 legislative session (in large part from the increase in the cigarette tax). The

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amnesty ($109.0 million collected, much more than the $22 million originally projected), change the timing of accrual of certain tax revenues.

114 E.g., increase in top personal income tax rate from 4.5% to 5% (FY 04 revenue gain of $403.09 million); reduce maximum property tax credit against personal income tax from $500 to $350 and eliminate residual $100 credit for high-income taxpayers (FY 04 revenue gain of $112.0 million); repeal sales tax on hospital patient care services (FY 04 revenue *loss* of $115.7 million); increasing from $25,000 to $250,000 the "preference" tax due on corporate taxpayers who elect combined reporting (FY 04 revenue gain of $30 million); requiring corporations to add back otherwise deductible interest expenses and costs arising from transactions with related companies (FY 04 revenue gain of $10 million); increasing cigarette tax from $1.11/pack to $1.51/pack (FY 04 revenue gain of $70.9 million).

115 E.g., delay for two years the remaining phase-out of Connecticut's inheritance tax (FY 04 revenue gain of $11 million).

116 E.g., securitizing the Energy Conservation and Load Management and Clean Energy Funds ($169 million in FY 04 and $25 million in FY 05), revenues from the 20% corporate tax surtax in income year 2003 and the 25% corporate tax surtax in income year 2004 ($33.0 million and $49.4 million in FY 04, respectively), and changes in the escheat law ($21.3 million in FY 04). NOTE that the FY 05 budget includes $300 million in revenues from securitizing tobacco settlement funds.

balance of these new tax revenues result from structural changes made in the 2003 Session and special session.[117]

The following tables illustrate these trends, showing – in the first table - the proportion of new revenues that came from various sources (*not* including borrowing), and in the second, the distribution of all deficit-mitigation in the last three years:

Proportion of New Revenues from Various Sources: FY 02-FY 04			
	FY 02	**FY 03**	**FY 04**
On-going Tax/Fee Increases	7%	31%	62%
Delay in Implementation of Already-Enacted Tax Cuts	0%	4%	1%
One-Time Revenues & Fund Transfers	93%	65%	37%

	FY 02	**FY 03**	**FY 04 (budgeted)**
***Mid-Year* Spending Cuts**[118]	$353.1M	$340.0M[119]	$260.0 (proj.)
On-going Revenues[120]	$44.2M	$230.6M	$574.5M
Delay of Enacted Tax Cuts	$0M	$24.6M	$11.9M
One-Time Revenues & Fund Transfers	$604.2M[121]	$483.4M	$348.3M
Borrowing	$222.4M	$122.2M	TBD
TOTAL	**$1,223.9M**	**$1,200.8M**	**$1,194.7M (to date)**

From the November 2001 special session through the 2003 special sessions, Connecticut has mitigated a *cumulative* total of more than $3.62 billion in General Fund deficits through a combination of *mid-year* spending cuts, permanent tax increases, one-time revenues and fund transfers, delays in implementation of previously-enacted tax cuts, and borrowing. Nearly 40% of this deficit-mitigation ($1,456 million) has been through one-time revenues and fund transfers and a little more than 26% through *mid-year* spending cuts ($953 million). Permanent tax increases have accounted for a little more than 23% of cumulative deficit mitigation ($849 million), and delays in enacted tax cuts for another 1% ($37 million). Borrowing has closed the resulting gap – contributing thus far nearly 10% of all deficit mitigation ($345 million)

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117 OPM Secretary Marc Ryan, *The State Budget and the Economy* (PowerPoint presentation, October 15, 2003), p. 44.

118 *Additional* cuts were made when the revised FY 03, FY 04, and FY 05 budgets were adopted. For example, the FY 04 budget includes $442.4 million in cuts to the General Fund from elimination of funding for unsettled collective bargaining agreements, cutting personnel service costs to reflect the layoffs, removing funds for the payment of accruals for sick and vacation leave days for retirees under the early retirement plan, annualizing FY 03 holdbacks and allotment reductions, eliminating many inflationary increases, and moving many equipment purchases into the Capital Equipment Purchase Fund. In addition, there were other agency-specific cuts (as noted earlier in this report). As a result of these reductions, the FY 04 budget is more than $1 billion less than necessary to maintain current services.

119 As noted earlier in this report, the savings actually achieved in FY 03 were somewhat less than this budgeted figure.

120 Revenues in the years following enactment may differ from the first year. For example, a tax increase effective in FY 03 may generate more revenue in FY 04 if economic conditions change, or if the original effective date of the tax change means FY 04 is the first *full* year for the increase.

121 Includes $594.7 million in funds from the Budget Reserve (Rainy Day) Fund, as well as $9.5 million in one-time revenues from imposing the increased cigarette tax on existing inventory.

IX. Summary

Since November 2001, Connecticut has been addressing its budget deficits by making deep cuts in an already frugal state budget, by using up available one-time revenues, by passing today's fiscal obligations on to the next generation by borrowing, and – only as a last resort – delaying already enacted tax cuts and beginning to restore some of the $2 billion in tax revenues that were cut in the late 1990s.

The FY 04 budget is now $1.2 billion under the FY 04 Current Services budget and many programs and services integral to the well-being of the state's children, youth and families are receiving *less* funding in FY 04 than they did in FY 02, even without adjusting for inflation. These cuts are also occurring despite an increase in Connecticut's population generally, and an increase especially among state residents who rely on state-funded services (e.g., school children, seniors and the disabled, and persons who have lost their jobs).

Important actions were taken in the 2003 regular and special sessions to restore -- on an on-going basis -- some of the significant tax revenues cut in the late 1990s. Despite this, OPM estimates that Connecticut residents and corporations will still pay $961 million *less* in taxes than they did when Governor Rowland took office.[122]

This *net* reduction in revenues, coupled with the continued use of one-time revenues to balance the budget (the FY 05 budget includes $493.8 million in one-time revenues and Fund transfers), has created a structural deficit. OFA projects that even if the economy improves there will be a $606 million General Fund deficit in FY 06, and an even larger deficit in the years that follow.

Most would agree that Connecticut will remain competitive in this global economy only if it continues to maintain one of the nation's best educated workforces. This requires *current* investments in early care and education, K-12 education, and higher education, adequate health care for the uninsured, a well-functioning infrastructure, and other such essential services and programs. Yet, many of these investments have been reduced sharply in the last three years. Many of Connecticut's spending cuts are truly penny-wise and pound-foolish. Some result in a loss of federal matching funds. Other cuts markedly reduce services that are necessary to avert far greater long-term costs.

There IS an option.

If Connecticut were to restore the *remaining* $1 billion or so in tax revenues that were cut in the late 1990s, when Connecticut's economy was strong (and high capital gains taxes, coupled with very modest spending growth, resulted in significant budget surpluses), there would be sufficient revenue to restore our state investments in essential education, health, and human service programs and services. Yet, our *total state* tax burden would be no more than in the mid-1990s and, taking into account recent federal tax cuts, our *total state and federal* tax burden would remain *less.*

Any other decision will, in the long run, short-change Connecticut's economic growth, impair the health and well-being of many state residents, and jeopardize the high quality of life Connecticut enjoys.

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[122] M. Ryan, *The State Budget and the Economy* (October 15, 2003 PowerPoint presentation), p. 45.

						TABLE A
Budget Actions in 2003 Session and Special Sessions						
Bill Title	**Bill #**	**Public Act #**	**Gov. Action**	**Senate Vote, House Vote**	**Spending Changes**	**Revenue Changes**
2003 Regular Session						
AAC State Expenditures and Revenue Adjustments	6397	PA 03-1	Veto 2/19	17-16, 86-63	GF (-$121M) STF (-$7.5M) PF (-$20M)	FY 03: $473.4M FY 04: $832.3M
AAC Modifications to Current and Future State Expenditures and Revenues	6495	PA 03-2	Sign 2/28	18-15, 79-68	GF (-$129M) STF (-$9M)] PF (-$21.5M)	FY 03: $439.8M (inc. $300M one-time) +$11.7 earmarked; FY 04: $634.3M
AA Transferring Funds to Agencies With Deficiencies for the Fiscal Year Ending June 30, 2003	6589	SA 03-15	Sign 6/12	36-0 143-0	Transfer $74.4M to cover deficiencies	
AAC the Budget for the Biennium Ending June 30, 2005 and Making Appropriations Therefor, and Various Taxes and Other Provisions Related to Revenues of the State	6720	PA 03-279	Veto 5/5	20-16, 87-57	FY 04 GF Budget $12.897B less $291M lapse=net $12.606B. Net new revenues: FY 04: $655.5M FY 05: $721.6M	
AAC Expenditures and Revenues for the Biennium Ending June 30, 2005	6721	PA 03-185	Veto 6/13	20-15, 84-65	FY 04 GF Budget $12.818B less $333M lapse=net $12.485B. Net new revenues: FY 04: $543.8M FY 05: $577.9M	
June 2003 Special Session						
AA Making Appropriations for Certain Expenses of the State for the Period Ending July 14, 2003	6801	PA 03-2 (June SS)	Veto 7/1	19-12, 84-49	Appropriates $399.5M to allow for continuation of state spending for first 2 weeks of FY 04	
AAC Expenditures and Revenues for the Biennium Ending June 30, 2005	6802	PA 03-1 (June SS)	Sign 8/16	26-8, 87-56	FY 04 GF Budget $12.712B less $260M lapse=net $12.452B. Net new revenues: FY 04: $391.3M; STF $17.7M; CF: $1M	

AAC State Employee Contracts	6803	SA 03-1 (June SS)	Veto 8/8	21-11, 76-49	Net cut from employee concessions of $28.1M in FY 04 and $70.3M in FY 05 Revenue loss from restoring max. property tax credit from $350 to $370
AAC Recommendations of the Transportation Strategy Board	6805	PA 03-4 (June SS)	Sign 8/20	23-8, 86-33	New revenues to TSB=$8.6M
AAC General Budget and Revenue Implementation Provisions	6806	PA 03-6 (June SS)	Sign 8/20	24-6, 87-32	Implements the budget
AAC Public Health, Human Services and Other Miscellaneous Implementer Provisions	2001	PA 03-3 (June SS)	Sign 8/20	24-8, 73-47	Implements the budget
AAC the CT Resources Recovery Authority	2002	PA 03-5 (June SS)	Sign 8/20	29-0, 95-23	Authorizes CRRA to borrow up to $22M in FY 04 and up to $93M in years thereafter to support debt repayment
September Special Session					
AAC Authorization of Special Tax Obligation Bonds of the State for Certain Transportation Purposes	2050	SA 03-1 (Sept SS)	Sign 9/10	29-0, 133-2	Authorizes $199.7M in Special Tax Obligation Bonds in FY 04 (% cost of $120.8M)
AAC Economic Recovery Notes and Revisions to the Rate Reduction Bond Provisions of the Budget Implementation Act and Other Provisions to Implement the Budget	2051	PA 03-1 (Sept SS)	Sign 9/10	29-0, 96-39	Authorizes Treasurer to issue Economic Recovery Notes for FY 03 deficit ($96.7M) & for retrospective SAGA reimbursements ($25-30M). Allows Treasurer to issue revenue bonds to securitize future revenues from Energy Conservation and Load Management and Clean Energy Funds (% cost to bond $122.9M=$12.9M)
AAC School Construction	6901	PA 03-2 (Sept SS)	Sign 9/10	34-0, 118-0	Authorizes between $544.5-605M in bonds (%=$314.4-$349.4M)
AAC Bonds for Certain Revenue and Accounting Purposes	6902	SA 03-2 (Sept SS)	Sign 9/10	34-0, 121-0	Authorizes $44.1M in GO bonds in FY 04 and $27.1M in FY 05 (%=$22M and 14.2M)

			TABLE B
A Sampling of FY 03 Carry-Forwards Directed to Other Purposes in FY 04 (in millions)			
Agency	**Account From**	**Account To (if Different)**	**Amount**
OPM	PILOT New Manufacturing Machinery and Equipment	Adriaen's Landing Convention Center	4.200
OPM	Local Aid Adjustment	DSS: Hsing/Homeless for Home for the Brave	0.250
OPM	Town Grants for Drug Enforcement	Grant to Hartford Police Department	1.000
OPM	Local Aid Adjustment Grant	OWC: CETC Workforce	0.200
OPM	Other Expenses	Actuarial Services	0.150
OPM	PILOT New Manuf Mach/Equipmt	Grant to Nutmeg Games for State Games of Am.	0.100
OPM	$4.78M from PA 02-1(MSS), s.19's purpose	Commission on Arts, Tourism	4.480
		Institute for Municipal & Regional Policy CCSU	0.125
		Council on Environmental Quality	0.050
		Washington DC Center for UConn & CSU students	0.100
		OPM (unspecified)	0.025
Dept. of Labor	Personal Service	Opportunity Industrial Centers in Bridgeport & Waterbury ($0.1@)	0.200
Dept. of Higher Education	National Service Act	National and Community Service	0.085
Dept. of Motor Vehicles	Reflectorized license plates	Upgrade registration, license data system	2.9
Dept. of Transportation	Transportation Strategy Board	Up to 0.64 can be transferred to OPM	9.000
Dept. of Transportation	Transportation Strategy Board	OPM; Local Aid Adjustment (PA 03-6, sec. 27)	1.300
Dept. of Mental Health & Addiction Services	Pre-Trial Alcohol and Substance Abuse	Regional Action Councils	0.250
Dept. of Public Safety	Personal Service	Match for federal $ for trooper class	0.750