FISCAL POLICY CENTER

At Connecticut Voices for Children

Where Should We Look to Fund Public Investment?
Mapping Connecticut's Revenue Landscape

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I. Introduction

Connecticut boasts a world-class workforce and close proximity to the center of the global economy, but over the past few decades we have suffered some of the Nation's slowest growth in jobs and fastest growth in inequality. Future-oriented investments, like quality early education and efficient public transit, are needed to sustain the high caliber of our workforce, capitalize on our proximity to New York City, and place Connecticut on a path to stronger, more broadly shared growth. However, the state has had a harder and harder time funding such investments in the face of depressed public revenues and rising health and pension costs. **Given these challenges, it is crucial we determine where our revenue system can support new investments that keep Connecticut as fine a place to find a job, start a business, and raise a family as it has always been.**

Compared to other states', Connecticut government spending is low and has remained so for years. The U.S. Census provides the definitive data on state and local finances, and by its measures,[1] Connecticut state and local government raises and spends less per dollar of personal income than almost any other state (a ranking that has not changed over the past decade). Simply put, Connecticut government has been consistently small.

At the same time, Connecticut's revenue system has two quirks that impact our capacity to raise revenue. First, while overall state and local revenues are comparatively low, total taxes rank fairly high. **Second**, while total taxes rank fairly high, factoring out the local property tax, taxes are relatively low. Understanding these quirks is crucial to generating investment funds without sparking a debate about the competitiveness of our revenue system. Broadly applicable tax increases may elicit considerable opposition, and also burden groups for whom taxes are already high, while targeted increases in revenue, either taxes or fees, may sustainably generate resources to fund investment by capitalizing on areas where Connecticut's revenues are comparatively low.

Overall, Connecticut's state and local revenues as a share of income rank lower than nearly every other state's. **Own-source revenues—those revenues governments raise from their own sources, rather than receive from the federal government—rank 8th lowest. However, state and local taxes as a share of income rank 13th highest, a quirk explained by Connecticut's lowest-in-the-country charges and fees**—the other component of own-source revenue. Charges are low for several reasons. Chief among them is that Connecticut enrolls comparatively few students in public colleges and treats comparatively few patients in public hospitals, relying instead on private institutions. Thus, combined state and local taxes can be moderately high while own-source revenues are quite low.

[1] Throughout this report, our analysis calculates Census *state and local* revenues and expenditures *as a share of personal income*, as reported by the Bureau of Economic Analysis (BEA). We report *state and local* data together for comparability's sake: each state divides responsibility differently among town, county, and state governments. We report revenues and expenditures *as a share of personal income* because it provides the most direct measure of government's affordability (revenues are chiefly paid out of taxpayer income) and because it removes much of the distortion caused by comparing states of different wealth. The latest year available for these Census data is fiscal year 2011.

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Looking more closely at tax revenues highlights one major driver: local property taxes, which rank 8th highest in the Nation. **Factoring out the property tax, Connecticut's state and local tax ranking falls from 13th to 29th.** Local property taxes differ considerably from town to town, imposing a heavier burden on struggling cities, while leaving many wealthy towns with tax rates among the lowest in the region. The effective rate in Hartford is more than five times higher than the rate in Greenwich, which is lower than the rate in towns across the New York border.[2] **The property tax may drive Connecticut's overall tax ranking higher, but it is low in many wealthy towns.**

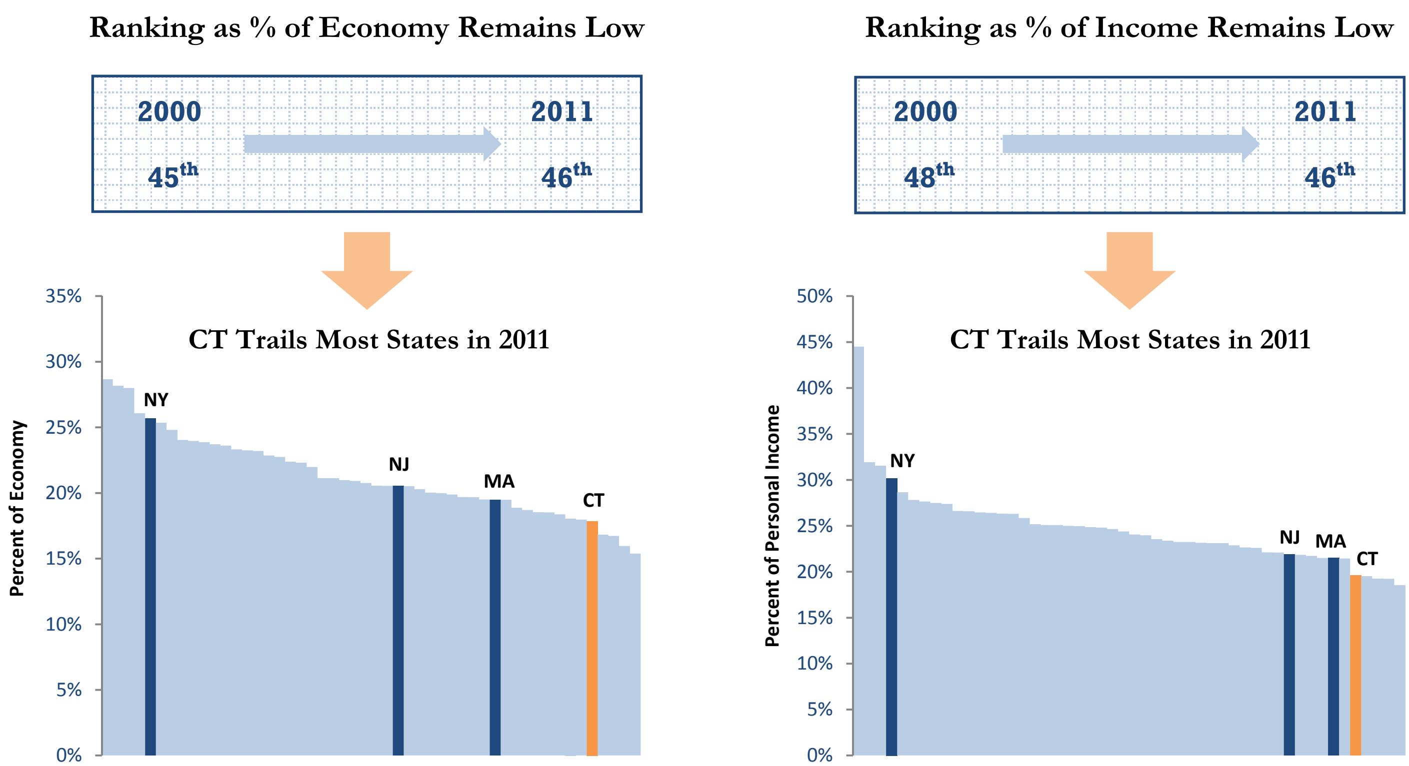
These quirks yield two indications of where Connecticut should look to fund additional public investment. First, Connecticut's low charges and fees are a potential source of revenue that could improve public services without affecting the state's tax burden. For instance, congestion-priced tolls on the state's interstate highways could fund transportation improvements while reducing traffic by charging drivers more at peak driving times.[3] **Second**, the inequality of the property tax means that residents of some wealthy towns benefit from not only the state's relatively low non-property taxes, but also low property taxes. These towns may have capacity to support investments in neighboring towns that have lower incomes and higher tax burdens.

II. Connecticut Government Spending Is Low[4]

Connecticut's government is comparatively small and has remained so for years. In FY 2000, Connecticut state and local government spending as a share of its economy (GDP) ranked 45th highest (6th lowest) among the 50 states; in FY 2011, it ranked 46th. Similarly, spending as a share of personal income ranked 48th in 2000 and 46th in 2011.[5]

Connecticut Government Spending Is Low

Ranks near Bottom of 50 States on State and Local Spending



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2 See, Office of Policy and Management, Municipal Fiscal Indicators FY 2007-11; Wade Gibson, Connecticut's Taxes Are Competitive with Tri-State Neighbors', Connecticut Voices for Children, April 2011.

3 See, Transportation Strategy Board, Office of Policy and Management, Electronic Tolling and Congestion Pricing Study, April 2009.

4 Unless otherwise indicated, data in this section, including figures, are derived from FY 2011 Census-reported state and local finance data and BEA-reported GDP and personal income metrics.

5 Going forward, the report will only cite figures as a share of income because total income and total size of the economy (GDP) track one another closely. In general, Gross Domestic Product, which measures the value of goods and services produced in a particular place, tracks measures of income, since dollars generated by production are income for residents of that place.

The comparatively small size of Connecticut's government translates into less spending on public services, even on such key investments in the future as education and transportation. According to Census and Bureau of Economic Analysis (BEA) data, from FY 2000 to 2011 Connecticut remained near the bottom of all 50 states in state and local spending as a share of personal income on education (45th in 2011), transportation (48th), public safety (47th), public salaries and wages (45th), housing and environment (49th), public welfare (42nd), and social services (42nd). Connecticut ranks substantially below average in public spending on hospitals as well, at 34th in FY 2011, down from 26th in 2000.

<u>Connecticut Spends Comparatively Less on Public Services</u>

Ranks near Bottom (50th) of States in Multiple Policy Areas

Education Ranking Has Risen[6]

2000	2011
50th	45th

Public Salaries Ranking Has Risen

2000	2011
49th	45th

Transportation Ranking Has Risen

2000	2011
49th	48th

Public Safety Ranking Has Fallen

2000	2011
41st	47th

Housing/Environ. Ranking Has Fallen

2000	2011
48th	49th

Public Welfare Ranking Has Fallen

2000	2011
40th	42nd

Social Services Ranking Has Fallen

2000	2011
39th	42nd

Hospital Ranking Has Fallen

2000	2011
26th	34th

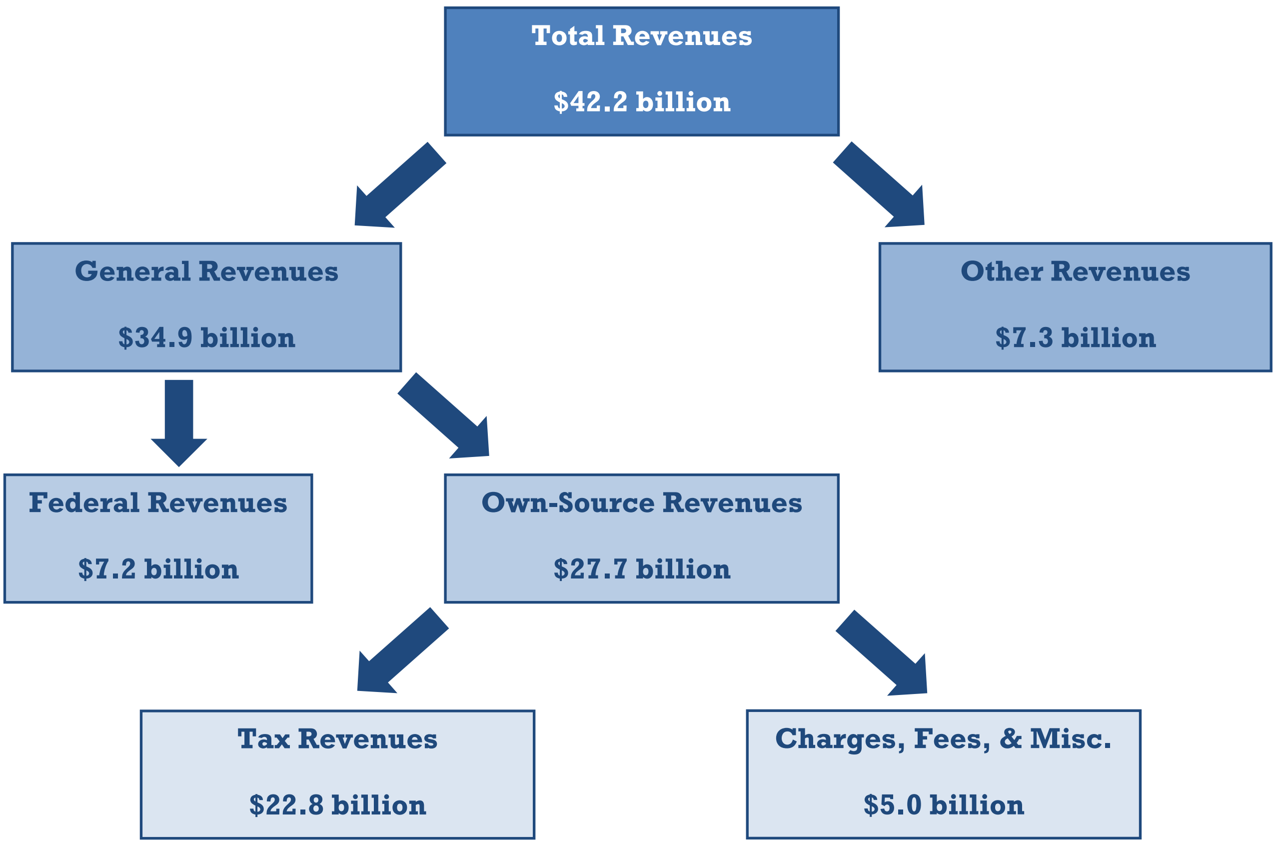
[6] Salaries and pension and healthcare costs for teachers and other education employees make up the largest part of the Census "Education" function and have been growing rapidly, helping explain why Connecticut's education ranking increased while most other categories decreased. Over this period, for instance, state contributions to the teacher pension fund nearly tripled from $215 million to about $600 million annually. Office of Fiscal Analysis budget books.

III. Connecticut Government Revenues Are Low[7]

Connecticut's revenues, like its spending, rank quite low compared to other states'. According to the Census and Bureau of Economic Analysis, total and general revenues for Connecticut state and local government rank 48th and 47th out of 50, respectively. Total Revenues, the broadest budget category, includes: a) Federal Revenues (federal contributions for education, Medicaid, and other programs); b) Own-Source Revenues (revenues generated by state and local governments themselves from taxes, charges, and fees); and c) state and municipal Other Revenues (revenues earned from operating public utilities, liquor stores, and trust funds that provide insurance, such as unemployment insurance and employee retirement funds).

Structure of Connecticut State and Local Revenues

Fiscal Year 2011



[7] Unless otherwise indicated, data in this section, including figures, are derived from FY 2011 Census-reported state and local finance data and BEA-reported personal income metrics.

IV. Revenues Are Low, but Taxes are Relatively High[8]

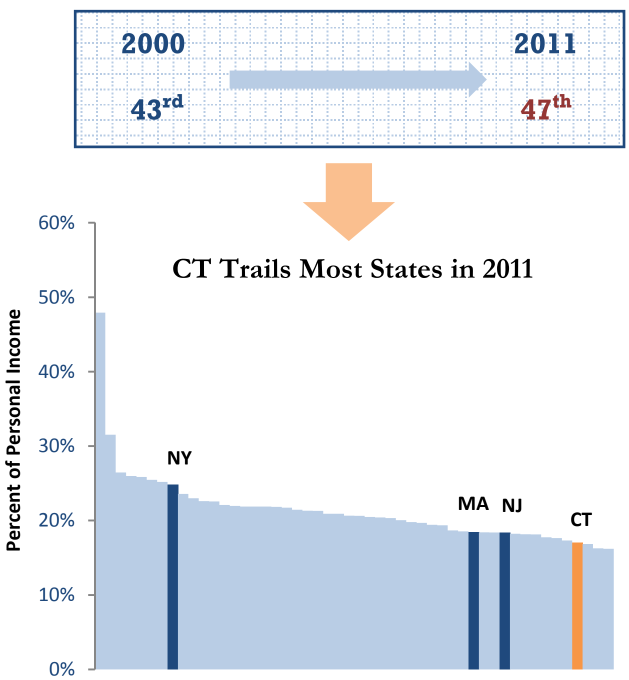
While Connecticut general revenues ranked 47th highest (4th lowest) among states in FY 2011, and own-source revenues ranked 43rd, tax revenues ranked 13th among states. How can Connecticut have comparatively low own-source revenues but high taxes? It has the country's lowest charges, fees, and miscellaneous revenue, the other component of own-source revenue. While nationally, charges such as tolls and public college tuition equal 4.9% of personal income, in Connecticut they constitute just 2.5%.

These revenues are low for several reasons. Chief among them is that Connecticut enrolls comparatively few students in public colleges and treats comparatively few patients in public hospitals.[9] Nationally, public colleges enroll 82% of students; in Connecticut, they enroll 65%.[10] Across the country, many states and cities operate large public hospital systems. Connecticut, by contrast, has only one major public hospital; the state's largest hospitals are all private.[11] As a result, Connecticut's government collects less in tuition and medical charges than most states', contributing to its low ranking on charges and fees, which in turn contributes to its low ranking on own-source revenue.

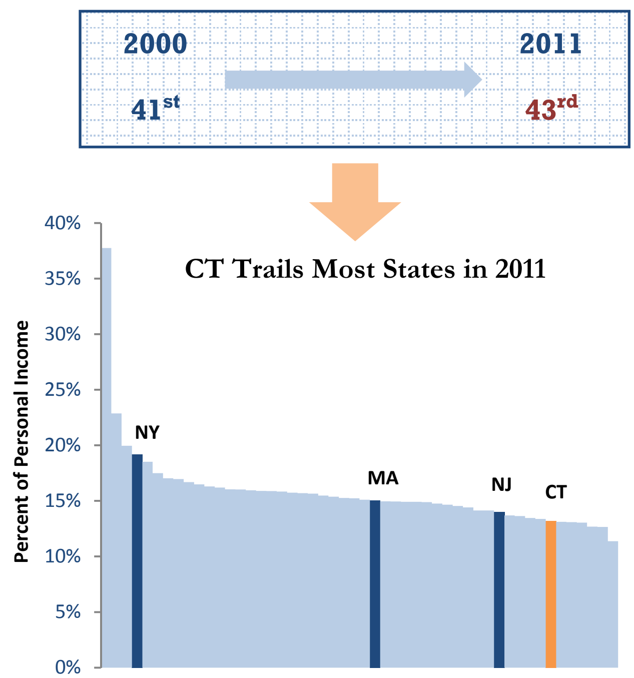
<u>Connecticut's Overall Revenues Are Low, but Tax Revenues Are High</u>

- *Connecticut's General and Own-Source Revenues Rank near Bottom of 50 States*

General Revenue Ranking Has Fallen



Own-Source Revenue Ranking Has Fallen



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8 Unless otherwise indicated, data in this section, including figures, are derived from FY 2011 Census-reported state and local finance data and BEA-reported personal income metrics.

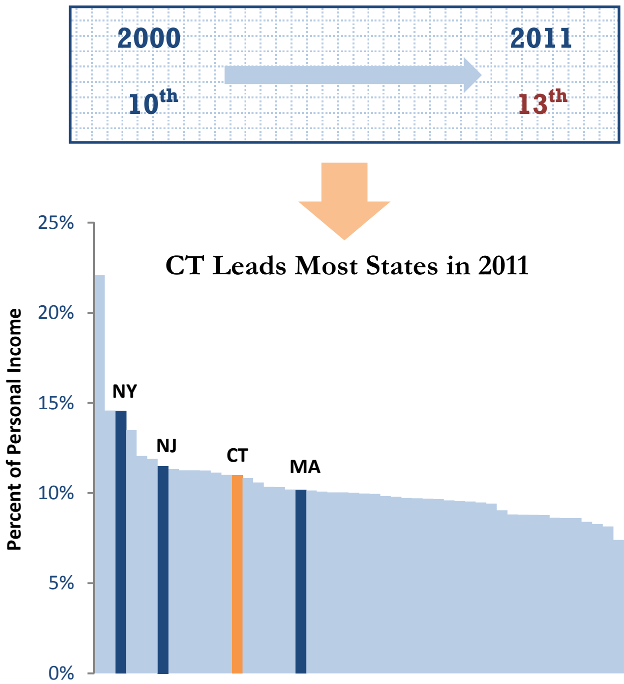
9 Connecticut state and local spending on other charges and fees ranks very low as well: revenues from tolls, sewerage, interest, and miscellaneous charges, fees, and revenues are all in the bottom ten nationally. Education and hospital charges, however, make up the lion's share of non-tax own-source revenues by the Census's definition.

10 Connecticut Department of Higher Education, College Enrollment Database; National Center for Education Statistics, College and Career Tables Library.

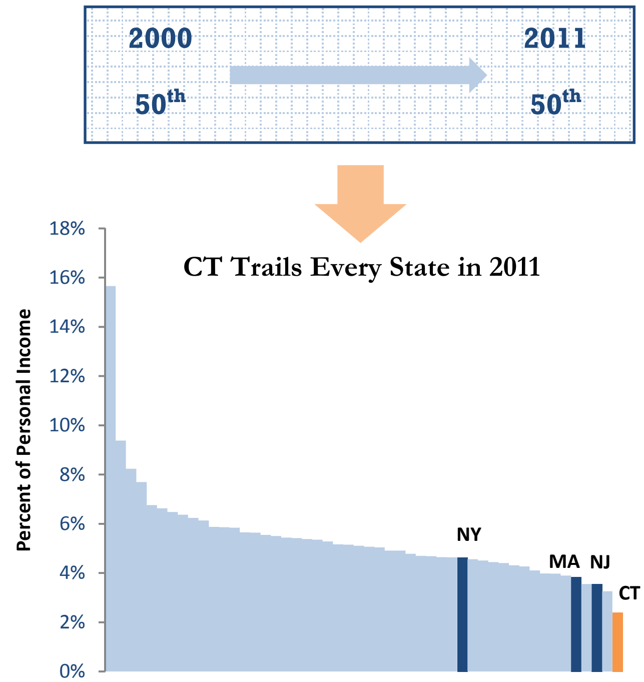
11 Yale-New Haven Hospital, Hartford Hospital, and St. Francis Hospital—all private—are the state's three largest hospitals; UConn Health Center, the state's main public hospital, has a fraction of the beds of these larger hospitals.

➢ *Tax Revenues Rank near Top of 50 States; Charges and Fees Rank near Bottom*

Tax Revenue Ranking Has Fallen



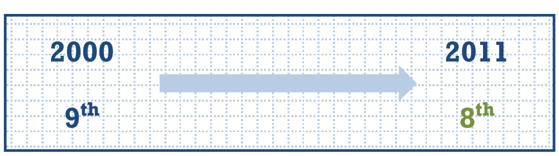
Charges, Fees, Misc. Ranking Remains Low



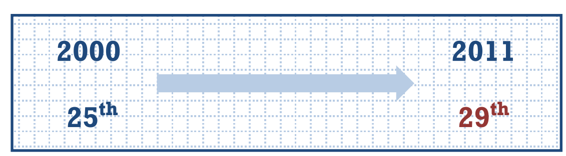
V. Factoring Out the Property Tax, Taxes Are Low and Increasingly Progressive[12]

Although Connecticut state and local taxes rank fairly high, factoring out the property tax, Connecticut's ranking falls from 13th to 29th highest. While the state's property taxes—raised by municipalities—rank high, the sum of all other taxes—largely state-level—ranks comparatively low. Connecticut's local property tax, then, is what drives its relatively high tax ranking.

Property Tax Ranking Has Risen



Ranking of All Other Taxes Has Fallen



Over the past decade, the comparative mix of state taxes has changed in favor of progressive income taxes rather than regressive sales taxes. Connecticut's personal and corporate income tax rankings have both risen since FY 2000: the personal income tax rank increased from 17th to 7th in FY 2011, while the corporate tax rank increased from 30th to 22nd. Over the same period, Connecticut's sales tax rankings fell: the general sales tax rank decreased from 27th to 41st highest in FY 2011, while the selective sales tax rank (e.g., the cigarette tax) fell from 25th to 32nd.

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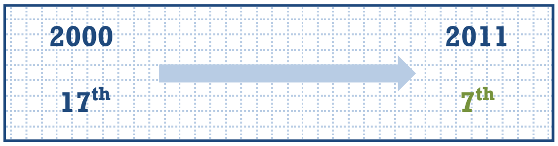
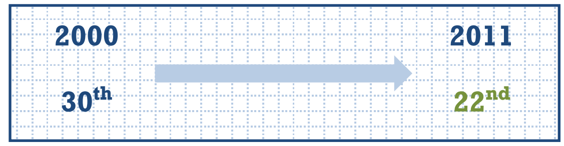
[12] Unless otherwise indicated, data in this section, including figures, are derived from FY 2011 Census-reported state and local finance data and BEA-reported personal income metrics.

Income Taxes Have Risen in Rank while Sales Taxes Have Fallen

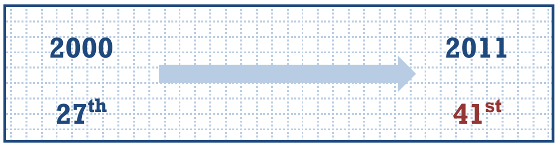
Personal Income Tax Ranking Has Risen



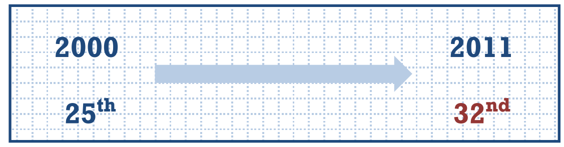
Corporate Income Tax Ranking Has Risen



General Sales Tax Ranking Has Fallen



Selective Sales Tax Ranking Has Fallen



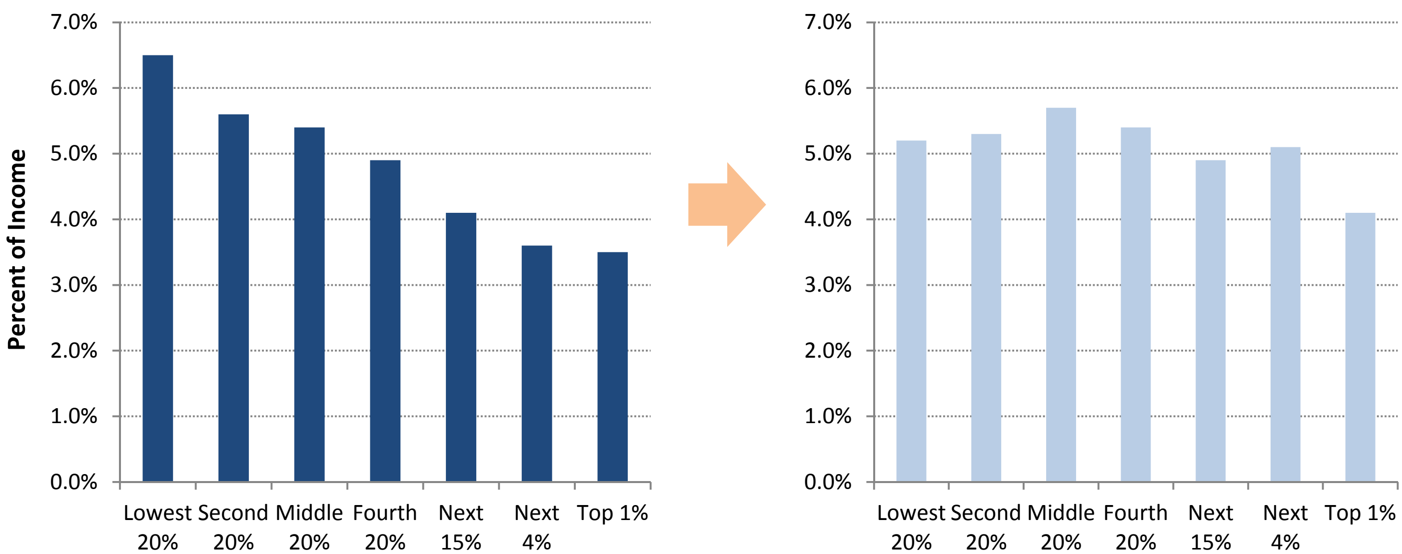
These trends bode well for the fairness of Connecticut's state tax code. The personal income tax is one of the most progressive taxes, and Connecticut has increased rates on high incomes on several occasions since 2000, at a time when other states have been moving in the opposite direction. At the same time, the more regressive sales tax has remained relatively low, with few increases on low-income families and businesses alike.

These findings are consistent with the following Institute on Taxation and Economic Policy analysis,[13] which shows that Connecticut's tax code—excluding property taxes—has grown more progressive over the last decade. In 2002, Connecticut's non-property taxes were almost perfectly regressive, with the poorest 20% paying 6.5% of their income, most of the top 40% paying 4 to 5%, and the richest 1% paying 3.5%. By 2013, the burden on the poorest 20% had fallen to 5.2%, while the burden on the top two quintiles had increased nearly to equal the burden on the poorest 20%. The top 1% of taxpayers enjoyed a lower burden, however, at 4.1%: since much of their income goes to saving and non-sales taxed purchases, they enjoy a lower rate overall, despite paying a higher income tax rate.

Non-Property Taxes Have Grown More Progressive

Taxes as % of Income by Income Quintile 2002

Taxes as % of Income by Income Quintile 2013



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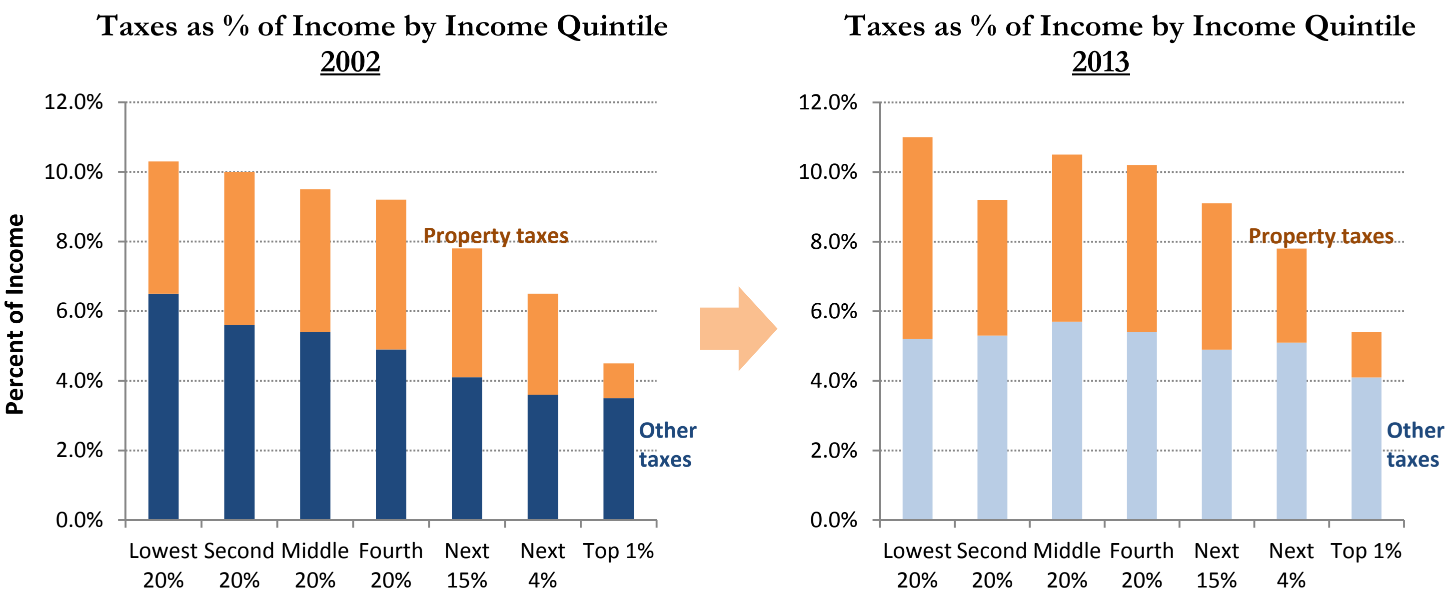
[13] "Who Pays" reports from the Institute on Taxation and Economic Policy, available at www.itepnet.org. ITEP's analysis adjusts each quintile's tax burden by the amount of federal taxes offset by the deduction for state and local taxes on the federal income tax in order to provide a clearer picture of the burden of state and local taxes.

However, if one includes property taxes as well, the progressivity breaks down. In fact, regressive property tax increases over the last decade have swamped progressive improvements in the rest of the tax code. Because of disparate tax rates in towns across the state, with the highest rates in communities with the lowest incomes, the overall impact of property taxes is regressive. The top 20% of earners, especially the top 1%, enjoy a proportionately lower property tax burden (in orange below) than do the other 80% of taxpayers. Meanwhile, residents of poor cities like New Haven face considerably higher property taxes, taxes that have generally risen over the past decade.

Property Taxes Keep Taxes Regressive

The Wealthy Enjoy Substantially Lower Property Tax Burdens



As the map below demonstrates, effective property tax rates vary greatly by town wealth. According to the Office of Policy and Management,[14] Greenwich, Darien, New Canaan, and Westport had equalized mill rates (taxes owed per $1,000 of property, equalized over assessment cycles) between 6.69 and 10.95 in FY 2011. Hartford, New Haven, Waterbury, and Bridgeport, meanwhile, had equalized rates between 27.97 and 34.84.[15] At the same time, property tax rates in wealthy towns in Westchester County are often more than double those in Fairfield County.[16] The wealthiest towns in Connecticut, in other words, enjoy property tax rates substantially lower than in neighboring Connecticut cities and New York suburbs, while the non-property taxes they pay in Connecticut are comparatively low as well. On both counts, then, they benefit from low state and local taxes.

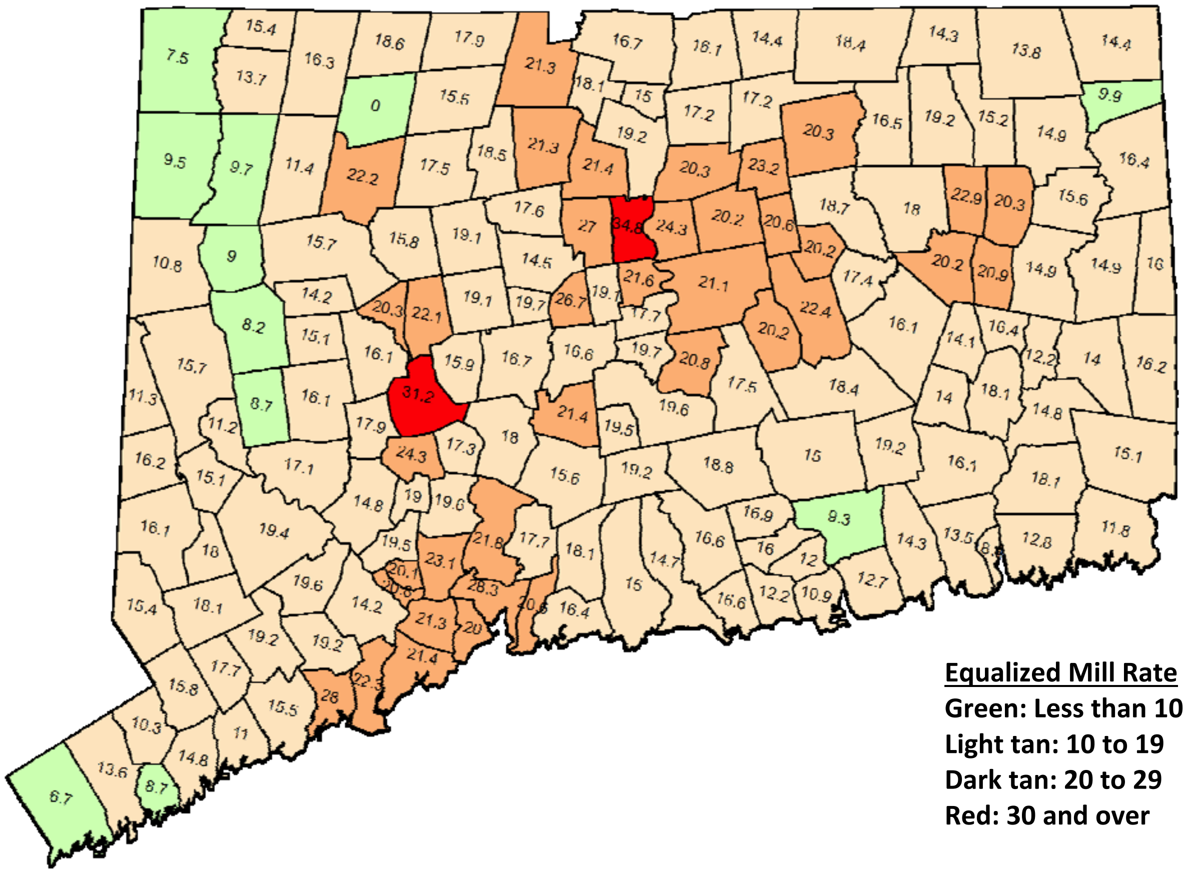
[14] Office of Policy and Management, Municipal Fiscal Indicators, FY 2007-11.

[15] Cities like Hartford and New Haven have substantially smaller per capita property tax bases than towns like Darien and New Canaan. In large part, this is because close to half of Hartford and New Haven property is tax exempt: universities, hospitals, train stations, and courthouses all tend to be located in cities, although they provide services to entire regions. Cities also have smaller per capita property tax bases because their average residents are poorer than those in surrounding suburbs, a consequence in large part of exclusionary zoning that prevents affordable housing construction in wealthy suburbs.

[16] Wade Gibson, Connecticut's Taxes Are Competitive with Tri-State Neighbors', Connecticut Voices for Children, April 2011.

<u>Property Taxes Are Low in Many Wealthy Towns</u>

2011 Equalized Mill Rate by Town



VI. To Fund Public Investment, Where Is There Capacity?

The analysis above suggests two areas Connecticut may have capacity to raise revenues to fund public investments without altering the competitiveness of our revenue system.

The first is charges and fees, an area of public revenue Connecticut relies on less heavily than any other state. Connecticut's charges and fees are low in large part because we provide less extensive public universities, hospitals, tolled highways and bridges, and other functions than do most states. Should Connecticut decide, for instance, to expand public investment in transportation, charges such as tolls would generate additional revenue in a domain where Connecticut charges less than most states; an increase in the gas tax, on the other hand, would raise Connecticut's comparatively high taxes further. Congestion-priced tolls, which could be raised and reinvested the most heavily-trafficked areas, would have the added benefit of reducing traffic by charging motorists more if they travel at peak times and less if they elect to save and drive at non-peak hours. In so doing, these tolls would not only save drivers precious hours but also reduce pollution from stop-and-go autos in our most densely populated corridors.

The second area of potential capacity involves wealthy towns that benefit from both low property taxes and low non-property taxes. As the tax incidence graphs and map above illustrate, residents of many of Connecticut's wealthiest towns benefit from a comparatively low state and local tax burden, driven by Connecticut's relatively low non-property taxes and those towns' low property taxes. These comparatively low rates, coupled with towns' wealth, may signal a capacity to raise revenue through the property tax, revenue which could be kept close by and used to benefit children in neighboring cities with greater need and lower revenue capacity. Such a program may be preferable to a progressive increase in the state income tax, which would affect wealthy residents both in low-property tax towns like Westport and in high-property tax cities like New Haven.

As the state contemplates public investments to speed travel along key transportation corridors or provide quality early education for vulnerable children, it is important Connecticut look to funding areas where it can raise revenues without significantly altering the competitiveness of our revenue system. Any proposal to raise and make substantial investments will generate opposition. By focusing on areas where Connecticut revenues are comparatively low, we can reduce the potential for conflict, while also minimizing any adverse effect raising additional revenues may have. By tailoring our revenue solutions carefully, we can ensure public investments deliver maximum benefit to the state.