CONNECTICUT VOICES FOR CHILDREN

20 YEARS OF ADVANCING OPPORTUNITIES FOR CHILDREN AND FAMILIES

Testimony Regarding H.B. 5086: An Act Concerning the Constitutional Spending Cap

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Appropriations Committee
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Senator Bye, Representative Walker, and distinguished members of the Committee:

Thank you for the opportunity to testify. I speak today on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to advance opportunity for Connecticut's children and families.

Connecticut Voices for Children supports the provisions of H.B. 5086 to redefine "increase in inflation" as the increase in the Consumer Price Index over two years. We also offer recommendations to improve the spending cap proposal in the bill to ensure the cap operates as intended. Specifically, we recommend:

1. **Define "general budget expenditures" as the amount *allowable* under the cap during the previous year, to ensure economic downturns do not irreparably harm public services;**
2. **Exclude the first year of federal funds from the cap, and then include them in the budget base the following year;**
3. **Expand the definition of "personal income" to include all *unearned* income such as capital gains and dividends, to properly estimate year-to-year economic growth; and**
4. **Establish a more robust and regular evaluation process for tax expenditures so that annual off-the-books spending through our tax code — over $6.4 billion in the coming Fiscal Year — is appropriately assessed.**

We support the provision in the bill to redefine "increase in inflation" as the increase in the Consumer Price Index (CPI) over two years. Such a change would capture an adequate length of time to ensure growth in the cap reflects Connecticut's economic reality. The Consumer Price Index, which measures changes in the prices of goods purchased by an individual or family, tends to underestimate the growth in the costs that state governments face. For example, health care makes up a larger share of a state's budget than of a family's budget and typically grows faster than other costs, and using one year of the CPI may not accurately capture this growth. Using two years of the CPI will help address this problem without the need to construct an alternative index.

Connecticut Voices for Children recommends the following regarding H.B. 5086:

First, we recommend defining "general budget expenditures" as the amount *allowable* under the cap during the previous year. In H.B. 5086, "general budget expenditures" is considered to be the amount of *actual* spending, just as it has been interpreted since its inception. While such a definition may

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appear to be sound policy at first glance, interpreting the spending cap as such in reality harms public investments in the programs and services that serve children and families.

Using actual spending as the base for the spending cap means that, following recessions that force budget cuts to health care, services for the disabled, education, child welfare, and other critical public programs can never fully recover, no matter how strongly state revenues grow during a recovery. Public services that Connecticut citizens rely on are cut, unless policymakers choose to exceed the cap. Using allowable spending as the base removes this barrier to reinvesting in the public good following recessions.

Second, we recommend excluding the first year of federal funds from the cap and then including them in the budget base the following year. Capped appropriations include some spending paid for with federal funds, rather than with Connecticut state taxes. Thus, as currently constructed, the spending cap can be a disincentive to pursuing additional federal money, as such funds could cause Connecticut to exceed the cap. Excluding such funding from cap calculations for one year, and then automatically including them in the following year's base calculation, solves this problem.

Third, we recommend expanding the definition of "personal income" to include all unearned income. Personal income, for the purposes of the cap, is currently calculated using United States Bureau of Economic Analysis (BEA) data. BEA defines personal income to include earnings, dividends, interest and various other sources of revenue, but does not include capital gains in the measure. Since taxing this source of income is an essential part of state revenue, including it in the spending cap personal income definition would lead to a closer fit between Connecticut's true year-to-year economic growth, and spending growth allowed under the cap. Substituting Connecticut "adjusted gross income" for the BEA measure is an option that could make this correction.

Finally, alongside H.B. 5086, we recommend that the Committee consider establishing a more robust and routine evaluation process for tax expenditures so that annual off-the-books spending through our tax code — over $6.4 billion in FY 2017 — is appropriately assessed. Using our tax code — tax credits, exemptions, deductions, reduced rates and the like — to achieve policy objectives rather than directly funding services through appropriations is one mechanism that Connecticut has used to avoid the spending cap's constraints.

Tax expenditures include exemptions in the sales tax, lower rates for certain corporations, and personal income tax deductions. They are akin to spending in that they cost the state money it would otherwise collect, lead to higher taxation or lower spending elsewhere in the budget, and can be used to achieve policy objectives. Yet, tax expenditures are not subject to the appropriations process that dictates – each and every year — precisely how state funds will be spent. Thus, tax expenditures – which in the coming fiscal year are estimated to amount to over $6.4 billion – persist year after year with *minimal* review as to whether they too are addressing critical state needs in a cost-effective way.

If the purpose of the spending cap is truly to limit the growth of Connecticut's budget to reasonable rates, then tax expenditures must also be considered. At present, tax expenditures are listed in a biennial report by the Office of Fiscal Analysis (OFA). In the "Connecticut Tax Expenditure Report,"[1] OFA describes each tax expenditure, the year it was enacted, its purpose, an estimated amount of revenue gained if the

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[1] For the most recent version, see: Office of Fiscal Analysis, "Connecticut Tax Expenditure Report," February 2016. https://www.cga.ct.gov/ofa/Documents/year/TER/2016TER-20160201_Tax%20Expenditure%20Report%20FY%2016.pdf

expenditure were to be repealed, and the number of taxpayers benefitting. While the report provides useful detail, it does not offer *evaluation* – that is, an appraisal of how well the tax expenditures are functioning, the extent to which they are meeting their policy goals, and ultimately, whether each tax expenditure should be continued, modified, or repealed.

In addition, no policymakers are ever obligated to take action on the findings of the tax expenditure report. By statute, the Finance, Revenue and Bonding Committee "…shall meet to receive and analyze the report."[2] While normal appropriations are subject annually to the rigor of public hearings, expert testimony, and legislative deliberation, $6.4 billion in tax expenditures in the coming fiscal year are virtually ignored by the General Assembly. Not only does this process fail to hold tax expenditures accountable for the policy goals they were intended to achieve (such as economic development), it harms transparency in our budgeting process by effectively keeping this spending out of the public eye without opportunity to assess their opportunity costs.

We propose that the Committee consider the following commonsense reforms to ensure spending via our tax code is held to a similar level of accountability as appropriated spending:

Expand the Tax Expenditure Report. The biennial OFA Tax Expenditure report is an important step in promoting budget transparency. We recommend the report:

- **Evaluate the extent to which each tax expenditure is meeting its policy goal**, including considerations of administrative cost, distributional impact, evolving fiscal climate, and expected change over time.
- **Submit a recommendation to continue, modify, or repeal each tax expenditure**, based on how well each tax expenditure is meeting its policy goal.

Bolster the legislative review process. Currently, the General Assembly is not obligated to act on the findings of the tax expenditure report. Requiring policymakers to treat over $6.4 billion in tax expenditures like normal appropriations will improve transparency and accountability.

- **Hold public hearings on the results of the Tax Expenditure Report,** so that taxpayers can weigh in on how public funds are used as they can during the regular appropriations process.
- **Require the General Assembly to vote on the recommendations of the tax expenditure report,** taking into account public testimony.

Thank you for your time. I would be happy to answer any questions.

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[2] Public Act 97-316