CONNECTICUT VOICES FOR CHILDREN

20 YEARS OF ADVANCING OPPORTUNITIES FOR CHILDREN AND FAMILIES

Testimony Supporting S.B. 465: An Act Concerning Finance
Nick Defiesta
Finance, Revenue and Bonding Committee
March 28, 2016

Senator Fonfara, Representative Berger, and distinguished members of the Committee:

My name is Nick Defiesta and I am testifying today on behalf of Connecticut Voices for Children, a research-based public education and advocacy organization that works statewide to promote the well-being of Connecticut's children, youth, and families.

We are testifying in support of S.B. 465, and respectfully offer recommendations to bolster the study, including:

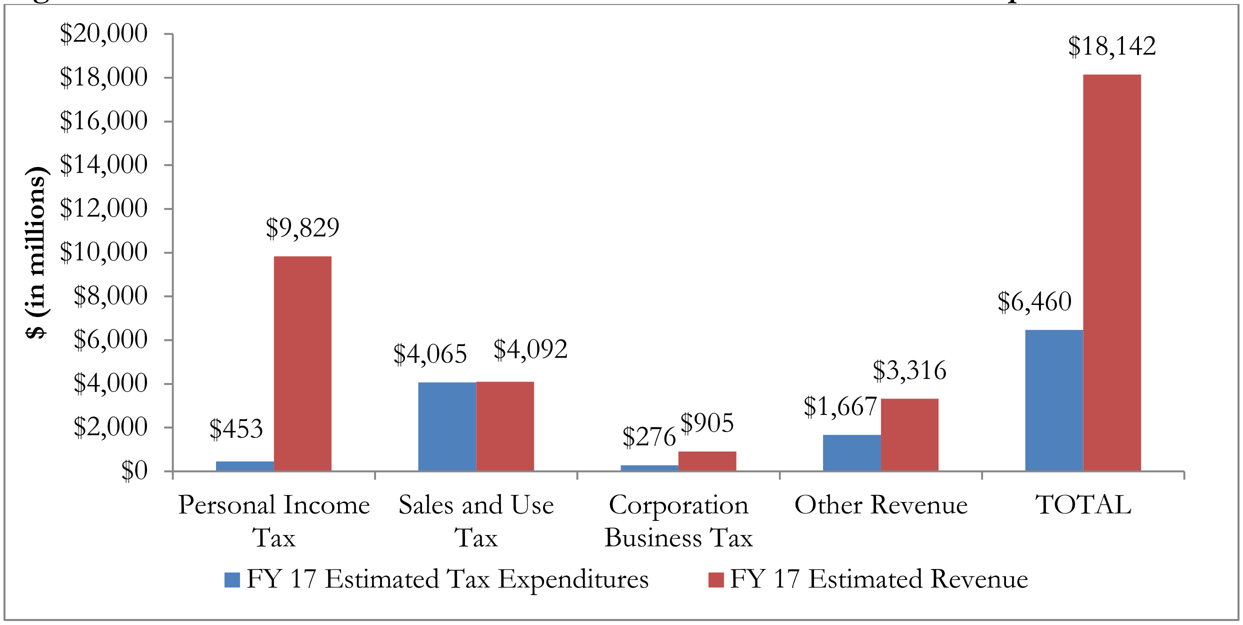
1. **Expanding the study to include all tax *expenditures*, instead of just tax credits;**
2. **Evaluating each tax expenditure to ensure it is meeting its goals in a cost-effective manner and issuing a recommendation; and**
3. **Integrating this study into the regular policymaking process by requiring a vote on its findings.**

1. We respectfully urge the Committee to expand the study to all tax expenditures, which are estimated to cost the state over $6.4 billion in revenue in the coming fiscal year. The tax credits proposed for study are only a subset of what are known as tax expenditures, which include exemptions in the sales tax, lower rates for certain corporations[1], and personal income tax deductions. Tax expenditures 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.

Despite these similarities, 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 are addressing critical state needs in a cost-effective way. Figure 1 shows the scale of the revenue lost to tax expenditures compared to the revenue estimated for FY 17.

[1] According to a report prepared by LeAnn Luna and Matthew N. Murray for the State Tax Panel in October 2015: "…the number of Connecticut corporate taxpayers claiming credits has declined over the last decade, falling to 3,639 in 2012. However, the value of credits has trended up from $93.1 million in 2003 to $151.4 million in 2012, an increase of 62.6 percent. The value of credits carried forward to the 2013 tax year was a staggering $2.5 billion."

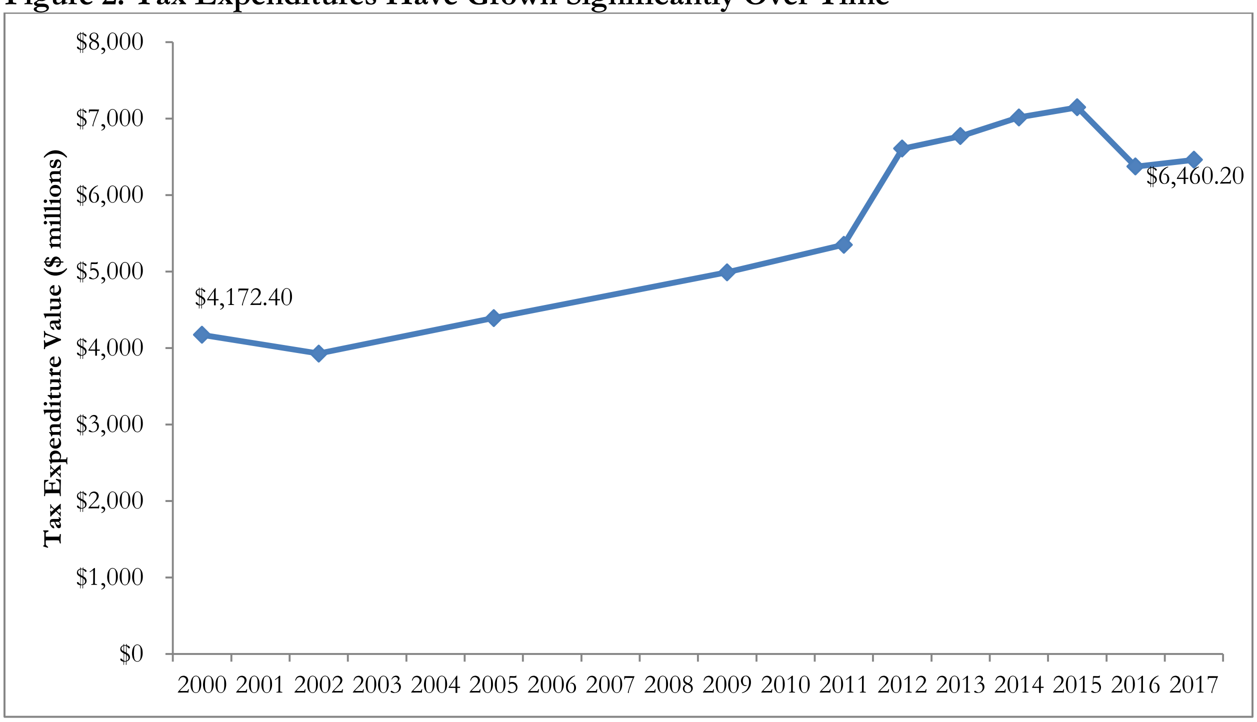
Figure 1: FY 17 Estimated Revenue Collection vs. Revenue Lost to Tax Expenditures



Sources: Office of Fiscal Analysis 2016 Tax Expenditure Report, Governor's FY 17 Midterm Budget Proposal. "Other Revenue" includes the Cigarette Tax, Motor Fuels Tax, Health Provider Tax, and all other revenue sources.

Moreover, as seen in Figure 2, the total estimated value of these tax expenditures has only grown over time, from $4.2 billion in FY 2000 to $6.5 billion in FY 2017 — growth of over 50 percent. This trend has directly contributed to the state's declining revenue that has led to the difficult fiscal situation we find ourselves in today.

Figure 2: Tax Expenditures Have Grown Significantly Over Time



Sources: Historical Office of Fiscal Analysis Tax Expenditure Reports. "Miscellaneous Revenue" includes the Cigarette Tax, Health Provider Tax, and all other revenue sources. Note that no data is available for FY 2001, 2003, 2004, 2006, 2007, 2008, or 2010.

While tax credits are one part of tax expenditures, any study of tax credits would miss a significant portion of spending through our tax code. In order to have a holistic picture of our tax code, we urge the Committee to expand the study to study all tax expenditures.

2. Within the study, we urge the Committee to fully evaluate each tax expenditure to determine whether tax incentives are achieving their policy objectives in a fiscally responsible manner. At present, tax expenditures are listed in a biennial report by the Office of Fiscal Analysis (OFA). In the "Connecticut Tax Expenditure Report,"[2] OFA describes each tax expenditure, the year it was enacted, its purpose, the estimated amount of revenue that would be gained if the expenditure were 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.

We propose that the Committee assess each tax expenditure by requiring that the study include evaluations of all tax expenditures, including a description of the tax expenditure, its beneficiaries and its goals; an analysis of its fiscal and economic impact alongside administrative costs; and a recommendation, based on the evaluation, as to whether to continue, modify, or repeal each tax credit.

These evaluations will provide accountability and transparency to a part of our tax code that too often goes unexamined. During a time of fiscal austerity, it is incumbent that the state analyze all types of spending, including spending through tax expenditures, to ensure all spending is meeting its goals in a cost-effective manner. If tax expenditures are evaluated to be operating efficiently, they should be continued or expanded; if they are found to be an ineffective use of scarce taxpayer resources, they should be ended. An expanded, robust study by DRS would help bring the state closer to this goal.

3. Finally, we urge the Committee to integrate this study into the regular policymaking process by requiring a vote on its findings. Currently, no policymakers are ever obligated to take action on the findings of the OFA Tax Expenditure Report. By statute, the Finance, Revenue and Bonding Committee is merely charged to "… meet to receive and analyze the report."[3] 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 hold public hearings and vote on the findings of the DRS study to ensure this spending is properly assessed through the legislative process. Holding public hearings so that taxpayers can weigh in on how public funds are used – as they do during the normal appropriations process – will ensure this spending remains accountable. And requiring the General Assembly to act on the findings, by agreeing with the recommendations offered in the report or by modifying them based on public testimony, will ensure that spending through our tax code reflects the public will – instead of remaining on the books with no regular evaluation.

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[2] 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
[3] Public Act 97-316

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

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