CONNECTICUT VOICES FOR CHILDREN

20 YEARS OF ADVANCING OPPORTUNITIES FOR CHILDREN AND FAMILIES

Testimony Regarding the Constitutional Spending Cap

Bills: S.B. 51, S.B. 151, S.B. 153, S.B. 155, S.B. 160, S.B. 390, S.B.466, H.B. 5004, H.B. 5005, H.B. 5217, H.B. 5219, H.B. 5401, H.B. 5700, H.B. 5702, H.B. 5777, H.B. 5779, H.B. 5836, H.B. 5844, H.B. 6511, and H.B. 6734

Testimony Regarding Current Services Budgeting

H.B. 5839

Ellen Shemitz, J.D.

Appropriations Committee

April 3, 2017

Senator Osten, Representative Walker, Senator Formica, Representative Ziobron, and distinguished members of the Committee:

My name is Ellen Shemitz, and I am testifying today as Executive Director at Connecticut Voices for Children, a research-based child advocacy organization working to ensure that all Connecticut children have an equitable opportunity to achieve their full potential, and as former member of the General Assembly's Spending Cap Commission, tasked by the legislature to propose language for the statutory implementation of the constitutional spending cap.

At Connecticut Voices for Children, we believe that the work of this Committee, that is the work of creating the state budget, provides the single best statement about the priorities we hold as a state. We fund what we value. Whenever changes to the rules or procedures that govern the creation of state budget are proposed, as with the bills before you today concerning the spending cap and current services budgeting, we believe the budgeting principle of neutrality is essential: that is, no proposal should unintentionally advance certain priorities or burden others. The values we believe should guide budget setting, that is the values that should not be unintentionally impaired by changes to budget setting rules, are:

1. **Equity** - meaning that our fiscal system should advance responsible long-term planning by encouraging Connecticut to create a strong foundation of excellent schools, good roads, and other public services necessary for equitable opportunity and economic competitiveness.
2. **Adequacy-** meaning that our fiscal system has enough resources to continue to provide the level of public services that society desires in the near- and long-term. This includes allowing the state to meet its long-term obligations in a stable and predictable way so that there remain sufficient resources for other essential services.
3. **Transparency -**meaning that residents can easily understand the consequences of particular fiscal policies.

Today I will testify on bills addressing two essential components of our fiscal system: the spending cap and current services budgeting.

SPENDING CAP

As part of the grand bargain enacting an income tax in Connecticut, the General Assembly passed Amendment 28. Amendment 28 had three parts: a balanced budget requirement, to ensure that Connecticut did not spend more money than it collected; a rainy day fund, to ensure that we would be able to meet our financial commitments during difficult times; and a spending cap, to ensure that the existence of a new revenue source would not lead to unfettered growth in state government.[1] The legislature did not intend the spending cap to solve all of Connecticut's fiscal woes; rather, the spending cap was to work together with the balanced budget requirement and rainy day fund to make Connecticut more fiscally responsible. Fiscal responsibility implies more than setting boundaries on government spending—it also means creating an equitable, adequate, and transparent fiscal system that makes Connecticut economically competitive in the 21st century. Thus, the spending cap must advance these principles to be consistent with what the legislature intended.

Amendment 28 asks the legislature to define three terms used in the definition of the spending cap: "increase in personal income," "increase in inflation," and "general budget expenditures." This presents an opportunity to ensure that the spending cap truly fulfills the legislature's intent. Below we comment on how the spending cap bills before this Committee define each of these terms.

The definition of "increase in personal income"

We support using the compound annual growth rate of return to calculate "increase in personal income" as done in H.B. 5004, H.B. 5217, H.B. 5219, H.B. 5401, H.B. 5700, H.B. 5777, H.B. 5779, H.B. 5884, H.B. 6551, H.B. 6734, and S.B. 785. Using the compound annual growth rate of return is a best practice of economic analysis and codifies what OPM and OFA have already done for 25 years.[2]

The definition of "increase in inflation"

We oppose the definition of "increase in inflation" included in all spending cap bills before this Committee. These bills define "increase in inflation" using the consumer price index for urban consumers (CPI-U). Since the government is not an urban consumer, the CPI-U's rate of inflation will not align with the rate of inflation that state and local governments actually face. Thus, over time, the spending cap will limit expenditures not because of growth in spending but because of faulty measurement.

To illustrate, major components of the CPI-U include food, beverages, housing, apparel, and recreation.[3] The government purchases relatively little food, beverages, housing, apparel, and recreation, so it makes little sense to use an index that includes these expenditures.

A more appropriate measure would be the U.S. Bureau of Economic Analysis price index for state and local government expenditures. This would account for spending on roads, police, fire protection, and other services that build foundations for thriving communities.

The definition of "general budget expenditures"

Many of the definitions of "general budget expenditures" in bills before this Committee explicitly include or exclude certain types of spending from the cap. We address whether the legislature should include three types of spending under the cap and recommend additional language to ensure adequate supports for children and families.

Unfunded liabilities: **We recommend excluding the unfunded liability of the state's actuarially determined employer contribution to its retirement systems from the spending cap** for two reasons:

- **It aligns with commonly accepted definitions of "evidences of indebtedness."** The constitutional spending cap excludes "payment of bonds, notes or other evidence of indebtedness." Multiple authorities, including the Governmental Accounting Standards Board (GASB), Moody's, and Federal Reserve Bank of Boston, treat pension liabilities as evidence of indebtedness.[4] This suggests that the cap should exclude unfunded pension liabilities.
- **It gives the legislature the flexibility to pay for future obligations more predictably without crowding out essential investments.** Under the most recent labor agreement, annual pension costs will increase by about $600 million over the next 16 years, then remain stable through the 2030s and 2040s.[5] If the legislature includes unfunded liabilities under the spending cap, then there will be $600 million less available per year for schools, roads, health care, and other essential services. This would contradict the principle of adequacy since building strong foundations for children and families today prepares us effectively for the future.

  S.B. 785 explicitly excludes payments for unfunded liabilities from the spending cap, so we support that provision of the bill.
  H.B. 5401, H.B. 5700, H.B. 5779, and H.B. 6511 explicitly include payments for unfunded liabilities under the spending cap, so we oppose those provisions of the bills.

Federal funds**: We recommend excluding the first year of federal funds from the spending cap and then including them in the following year's base calculation**. Including the first year of federal funds under the cap would cause two problems:

- **It would make our fiscal system less adequate and equitable**. Limiting opportunities to accept federal funds available to promote thriving communities would make our state less able to provide the excellent schools, roads, health systems, and other public services necessary for an equitable society.
- **It would make our fiscal system less transparent.** Including appropriated federal funds under the cap would incentivize the legislature to move them to off-the-books non-appropriated accounts, which are exempt from the cap. Not only would including federal funding under the cap be unusual—only two out of 24 states with spending caps include federal funds—but it would likely make it more difficult for Connecticut residents to understand how their government works.[6]

  H.B. 5004, H.B. 5217, H.B. 5219, H.B. 5777, H.B. 5844, H.B. 6734, H.B. 5401, H.B. 5700, H.B. 5779, and H.B. 6511 exclude all federal funds from the spending cap, so we support those provisions of the bills.

Business tax expenditures: **We recommend including business tax expenditures under the spending cap.** If the cap will apply to some types of spending intended to promote economic growth—such as spending on schools, hospitals, and transportation—it should also apply to the hundreds of millions of dollars in business tax expenditures that Connecticut spends annually to promote economic growth. Doing otherwise violates the principle of neutrality since it incentivizes the legislature to favor some kinds of economic growth strategies (business tax expenditures) over others (building excellent schools, roads, and other public services) solely to avoid the cap.

Preventing "ratcheting down": **We also recommend defining general budget expenditures as the amount *allowable* under the cap during the previous year**. In previous interpretations, "general budget expenditures" was considered to be the amount of *actual* spending. While such a definition may appear to be sound policy, 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. Using allowable spending as the base removes this barrier to reinvesting in the public good following recessions.

CURRENT SERVICES

Current services estimates are a budgeting best practice that increases transparency and helps account for routine changes like inflation and caseload adjustments. Each year, when crafting a budget, state officials use the previous year's spending as a baseline. Then, policymakers adjust that spending for how much it will cost to provide the same level of services this year, given more people on the program or cost increases.

For a hypothetical example, say it cost $10 million in 2015 to provide developmental disability services for Connecticut families. In 2016, more families need those services, and inflation has raised the cost of providing services, so it costs a little more to keep offering the program — say, $2 million more. The new baseline for the program is the previous cost ($10 million) plus current services changes ($2 million), totaling $12 million.

In other words, current services estimates tell us how much Connecticut would have to spend on a given program — developmental disability services for family, economic development assistance for businesses, health care for children — in order to maintain the program at its current level, in the absence of any policy changes. This has helped policymakers and the public compare spending year over year and track how budgets affect the programs and services we care about.

Current services are critical for budget transparency and accountability because they provide an honest assessment of what our budget really does and help us hold elected officials accountable for those changes.

Thank you again for the opportunity to submit testimony. I am happy to answer any questions and can be reached at eshemitz@ctvoices.org or 203-498-4240 (x 108).

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[1] Spending Cap Commission. *Complete Set of Reports and Separate Statements - Report of the Chairpersons.* January 2017. Retrieved from: https://www.cga.ct.gov/app/taskforce.asp?TF=20160330_Spending%20Cap%20Commission. Page 15.
[2] For more on using the compound annual growth rate in person income, see Spending Cap Commission, *Report of the Chairpersons*, pages 14-18.
[3] William Cibes. *Separate Statement of William Cibes.* January 2017. Retrieved from: https://www.cga.ct.gov/app/taskforce.asp?TF=20160330_Spending%20Cap%20Commission. Pages 2-7.
[4] Spending Cap Commission. *Report of the Chairpersons.* Page 24.
[5] Keith Phaneuf. CT Mirror. *Budget Panel Backs Deal to Stretch Out Spiking CT Pension Costs.* January 2017. Retrieved from: https://ctmirror.org/2017/01/24/budget-panel-backs-deal-to-stretch-out-spiking-ct-pension-costs/.
[6] Daniel Liston. OLR. *OLR Backgrounder: State Spending Caps Analysis.* 2013. Retrieved from: https://www.cga.ct.gov/2013/rpt/2013-R-0244.htm.