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33 Whitney Avenue
New Haven, CT 06510
Voice: 203-498-4240
Fax: 203-498-4242
www.ctvoices.org

Implementing an Effective Spending Cap

Ellen Shemitz, J.D. and Ray Noonan

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Little discussed in this season's budget debates, spending caps play a prominent role in both the Republican and Democratic plans. While spending caps can be vital for preventing runaway spending in times of plenty, they can have a negative impact in times of slow growth if used to limit strategic investments necessary for long-term prosperity. Unfortunately, proposed changes to the definition of expenditures limited by the spending cap would have that effect, limiting the ability of the state to meet vital needs today or invest in success for tomorrow.[i]

As legislators continue to negotiate a budget, we urge them to put aside the question of the spending cap, waiting until the General Assembly has the votes to adopt a constitutional definition. Should the legislature feel compelled to amend the current statutory language, we would urge it to take the best from both proposals, guided by a commitment to meeting vital needs, investing in our cities and towns, and spurring equitable economic growth.

I. What is the Statutory Spending Cap?

As part of the grand bargain enacting an income tax in Connecticut, the General Assembly adopted what would be approved by the electorate in the 1992 election as Amendment 28 to the state Constitution. Amendment 28 had three parts:

- A **balanced budget requirement**, to ensure that Connecticut did not spend more money than it had collected;
- A **rainy day fund**, to ensure that we would be able to meet our financial commitments during difficult times; and
- A ***constitutional*** **spending cap**, to ensure that the existence of a new revenue source would not lead to unfettered growth in state government.

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." It also stipulates that defining these terms requires a three-fifths vote of each house in the General Assembly.

The same day that the General Assembly passed a resolution to enact a *constitutional* spending cap, it also passed a *statutory* spending cap.[ii] Just like any other law, the statutory spending cap required only a majority vote to pass and would require only a majority vote to be amended.[iii] The legislature intended the statutory spending cap only as a stopgap measure while it worked on definitions for the constitutional spending cap.[iv]

The statutory spending cap contained language similar to the constitutional one, except that it also defined "increase in personal income," "increase in inflation," and "general budget expenditures." The current statutory spending cap stipulates that "general budget expenditures" may increase by a percentage no greater than the percent "increase in personal income" or the percent "increase in inflation," whichever is greater. The statute has not changed since 1991.

II. What is happening to the Statutory Spending Cap?

In the fall of 2015, legislators sought a formal ruling on the legal effect of the constitutional and statutory spending caps in the absence of a three-fifths vote defining the three terms above. Attorney General Jepson issued an opinion finding that (a) until the legislature enacts definitions by a three-fifths vote, the constitutional spending cap has no legal effect and (b) until the constitutional spending cap became enforceable, the General Assembly could override or amend the existing statutory cap by simple majority vote.[v]

Legislators on both sides of the aisle are now attempting to do just that: to amend the existing statutory cap to make the terms more restrictive by changing what counts as a "general budget expenditure." If they enact such statutory changes by a majority vote but by less than a three-fifths majority, the new, tighter restrictions would stand until and unless amended by a simple majority vote. Depending on the specific terms adopted, this could limit the state's ability to meet vital needs, to accept federal funds, and to make strategic investments.

Moreover, if the General Assembly passes a budget with a three-fifths majority vote—a possibility if a compromise budget emerges from current negotiations—then the statutory changes to the spending cap definitions may have constitutional force.[vi]

III. What are problems with proposed changes to the Statutory Spending Cap?

Both budgets seek to change existing statutory language defining what line items are included as "general budget expenditures" covered by the spending cap. We examined all of the proposed changes, identifying potential benefits and hidden pitfalls.

State aid to distressed municipalities

As currently written, the statutory spending cap excludes "current or increased expenditures for statutory grants to distressed municipalities, provided such grants are in effect on July 1, 1991."[vii] In Fiscal Year 2017 (FY 2017), this amounted to $1.5 billion, including portions of the Education Cost Sharing formula and Payment in Lieu of Taxes, sent to 25 municipalities.[viii] The definition is imperfect—it does not include state grants created in the last quarter century and does not specify what counts as a distressed municipality.[ix] However, it represents policymakers' recognition that fiscal responsibility necessarily involves helping certain communities that often face structural barriers to succeed. Exempting such expenditures from the spending cap allows lawmakers to increase investments in the state's most challenged towns and cities without crowding out other important supports.

Both budgets eliminate this recognition by including grants to distressed municipalities under the spending cap. This would force policymakers to make unnecessary tradeoffs between essential building blocks for thriving communities, such as between state education grants and child care supports or between payments in lieu of taxes for tax-exempt property and transitional services for incarcerated youth. Although including these grants under the cap may allow additional flexibility if they do not grow significantly over the coming years, it also limits the state's ability to invest in workforce development and other essential services during more prosperous times. Thus, if the legislature passes a consensus budget with at least a three-fifths majority and the statutory spending cap definitions have constitutional force, the General Assembly may inadvertently hamstring its ability to invest in a more prosperous tomorrow.

A better definition, supported by a majority of the Spending Cap Commission, would continue to exclude from the cap "expenditures for statutory grants to distressed municipalities."[x] This would allow the state to support quality education in its more disadvantaged towns and cities without fear of displacing other essential services.

Federal funds

The statutory spending cap currently specifies that "general budget expenditures" include only *appropriated* funds. Although some federal dollars, such as those for Medicaid, are not currently appropriated, others are.[xi] Thus, the statutory spending cap, passed to limit *state* spending, can also limit our ability to accept some *federal* funds, incentivizing legislators to transfer federal funds to off-the-books non-appropriated accounts in order to avoid the cap.[xii] In doing so, it makes the state budget less transparent and less accountable.

The Republicans' budget addresses this problem by explicitly excluding all federal funds from the spending cap, as a majority of the Spending Cap Commission supported.[xiii] The Democrats' budget does not exclude all federal funds from the spending cap, perpetuating the problems of the current language. Although including federal funds under the cap may allow for additional flexibility if these grants do not grow significantly during the coming years, we are concerned that the lack of transparency it encourages makes our government less accountable. We urge the legislature to follow the Republicans' lead and exclude all federal funds from the cap.

Federal mandates

While the Republican budget appropriately excludes all federal funds from the spending cap, it undermines this exclusion by proposing a different, harmful change. The statutory spending cap currently excludes the first year of state expenditures to implement "federal mandates or court orders," defining "federal mandates" as either (1) programs in which the state must participate or (2) programs in which the state participated on July 1, 1991.[xiv] The Republican budget would eliminate the second part of the definition, bringing under the cap any state spending to implement federal programs that are not mandatory. For example, although expanding Medicaid services under the Affordable Care Act is not mandatory, Connecticut chose to do so by creating HUSKY D, thereby providing 190,730 low-income adults with health insurance.[xv] This cost Connecticut almost $50 million in FY 2015, leveraging more than $1.3 billion in federal funds.[xvi] The Republican provision would include Connecticut's $50 million under the cap as well as the additional funds Connecticut would have to provide to maintain coverage as the federal government reduces its share.

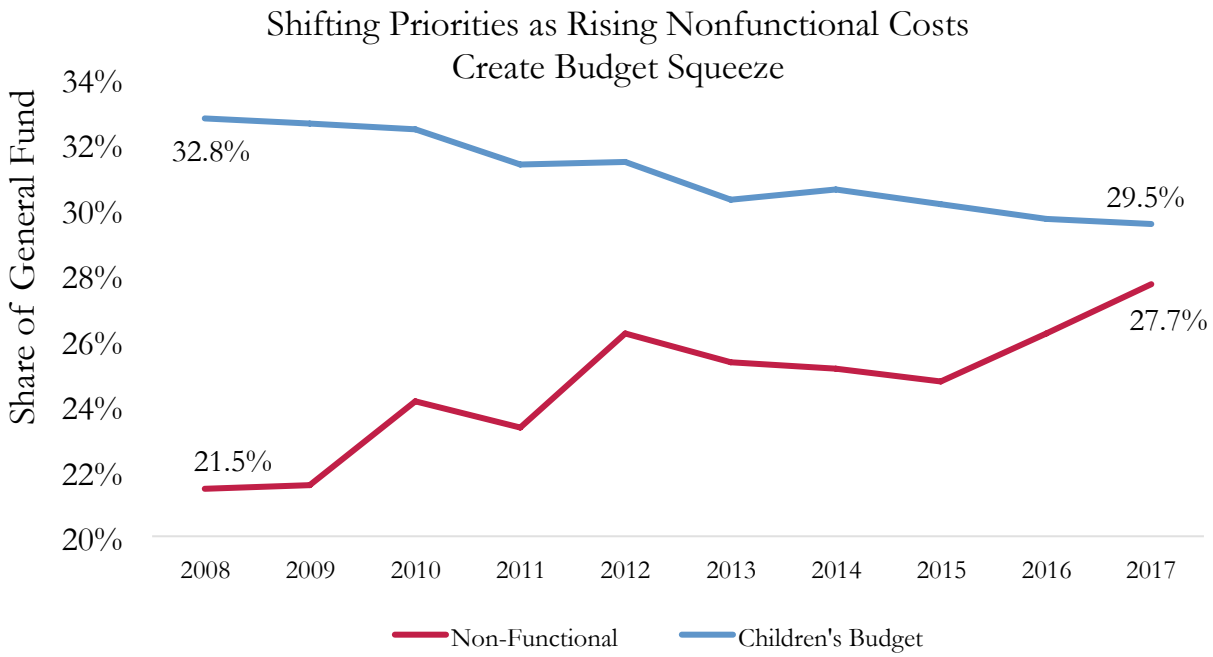
This is unwise for two reasons. First, it limits our ability to accept federal funds because if we accept federal funds then we must cut state funding to remain under the spending cap. Second, federal funds multiply the impact of state dollars—for example, in Fiscal Year 2016, nearly sixty percent ($4.59 billion) of Connecticut's Medicaid spending came from the federal government.[xvii] The Republican provision would move the state's share of Medicaid funding ($3.3 billion) under the cap, risking huge cuts to state services.[xviii] These cuts' effects would be multiplied by the corresponding loss of matching federal dollars. We urge the legislature to adopt language that allows the state to continue its commitments to children and families as effectively as possible.

Pension contributions

The constitutional and statutory spending caps both exclude "payment of bonds, notes, or other evidence of indebtedness" from the cap. Multiple authorities, including the Governmental Accounting Standards Board (GASB), Moody's, and Federal Reserve Bank of Boston, treat pension liabilities as evidence of indebtedness, that is, money that the state owes to pensioners.[xix] This suggests that the cap should exclude unfunded pension liabilities.

However, while Democrats explicitly exclude pension liabilities from the spending cap, Republicans do not. Republicans' proposed language not only runs contrary to many fiscal authorities but also would make it more difficult for legislators to address the state's unfunded liabilities. Under Republicans' proposed language, increasing pension contributions to make up for previous mismanagement could displace funding for other services currently under the cap. Already, the share of the budget devoted to children has decreased over the last nine years while the share devoted to our pension liabilities has increased. Republicans' proposed policy would likely accelerate this

trend. We urge policymakers to incorporate in their final budget Democrats' language concerning the spending cap's treatment of pension contributions.



Connecticut Voices for Children analysis of state budgets. Non-functional costs include pensions, retiree health costs, teachers' retirement costs, and debt service.

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[i] While this brief focuses on proposed changes to the definition of "general budget expenditures," we note two other concerning aspects in the Republicans' and Democrats' proposals.

First, the Republicans' proposal neglects to specify the "increase in personal income" as the *compound* annual growth rate of personal income. This comports neither with the majority of the Spending Cap Commission nor with best practice in economic analysis. Widlitz, P., & Cibes, W., Jr. (2017, January). Report of the Chairpersons (Rep.). Retrieved September 28, 2017, from Spending Cap Commission website: https://www.cga.ct.gov/app/tfs/20160330_Spending%20Cap%20Commission/Complete%20Set%20of%20Reports%20and%20Separate%20Statements%20Produced%20by%20Spending%20Cap%20Commission%20Members.pdf. Pages 14-15. Sec. 329 of Senate Schedule B LCO# 10072 at https://www.cga.ct.gov/2017/amd/H/2017HB-07501-R00SB-AMD.htm.

Second, the Democrats' proposal interjects a new concept into the spending cap debate, one not required by the Constitutional amendment. Specifically, it requires appropriations to the General Fund and Special Transportation Fund to be less than expected revenue. Presumably, this is to guarantee that the state will deposit some estimated revenue into the Rainy Day Fund, an admirable goal. However, it is out of place in this provision. See Sec. 272 subsection (b)(1) of Senate Schedule A LCO# 10069 at https://www.cga.ct.gov/2017/amd/H/2017HB-07501-R00SA-AMD.htm.

[ii] Jepsen, G. (n.d.). Letter written November 17, 2015 to Senator Leonard A. Fasano. Retrieved September 28, 2017, from https://www.cga.ct.gov/app/tfs/20160330_Spending%20Cap%20Commission/20160330/Letter%20from%20Attorney%20General%20Jepsen%20to%20Sen.%20Fasano%20re%20Spending%20Cap%20(November%2017,%202015).pdf. Page 3.

[iii] *Ibid,* page 3 and 8, footnote 5.

[iv] The legislature passed the statutory spending cap before Connecticut's voters approved the constitutional spending cap. See *Ibid,* page 3-4.

[v] *Ibid.*

[vi] Blumenthal, R. & Cohn, H. (n.d.). Letter written April 14, 1993 to Representative Edward Krawiecki, Retrieved October 5, 2017, from https://www.cga.ct.gov/app/tfs/20160330_Spending%20Cap%20Commission/20160330/Letter%20from%20Attorney%20General%20Blumenthal%20to%20Rep.%20Krawiecki,%20Jr.%20re%20Spending%20Cap%20(April%2014,%201993).pdf. Page 3.

[vii] Connecticut General Statutes Sec. 2-33a. Limitation on expenditures authorized by General Assembly. Retrieved from https://www.cga.ct.gov/current/pub/chap_016.htm#sec_2-33a.

[viii] Office of Fiscal Analysis. (2016). Connecticut State Budget FY 2017 Revisions (Publication). Retrieved October 2, 2017, from https://www.cga.ct.gov/ofa/Documents/year/BB/2017BB-20161101_FY%2017%20Connecticut%20Budget%20Revisions.pdf. Page 7. The economic indicators included in the calculation include per capita income, percent of population in poverty, unemployment rate, share of housing stock built before 1939, and percent of population with high school degree and higher. Department of Economic and

Community Development. (n.d.). Distressed Municipalities Criterions. Retrieved October 02, 2017, from http://www.ct.gov/ecd/cwp/view.asp?a=1105&q=251248. Cain, S., Wetzel, C., & Fiore, T. (2016, May 9). Calculating the Expenditure Cap. Presentation. Retrieved October 2, 2017, from https://www.cga.ct.gov/app/tfs/20160330_Spending%20Cap%20Commission/20160509/Calculation%20of%20the%20Spending%20Cap%20Presentation.pdf. Slide 7.

[ix] OPM and OFA have interpreted "distressed" to mean "25 most distressed" and defined distressed using criteria calculated by the Department of Economic and Community Development. Statute does not stipulate this nor any other manner of implementing the definition of "distressed." Cain et al., slide 7. Spending Cap Commission. Report of the Chairpersons. Page 33.

[x] Spending Cap Commission. Report of the Chairpersons. Page 30. The Commission Chairpersons also noted that there were good reasons to allow the General Assembly to limit the number of distressed municipalities and to specify the criteria by which they were defined. Spending Cap Commission. Report of the Chairpersons. Page 33.

[xi] Gibson, W. (2013, October). (Issue brief). Retrieved October 02, 2017, from Connecticut Voices for Children website: http://www.ctvoices.org/sites/default/files/bud13federalfunds.pdf. Page 1.

[xii] *Ibid.*

[xiii] Spending Cap Commission. Report of the Chairpersons. Page 27.

[xiv] Technically, the law excludes these dollars in the first year and then counts them as "general budget expenditures" for the purposes of calculating the allowable percentage of growth in the following fiscal year.

[xv] Office of Legislative Research. Medicaid Overview. (2017, February 6). Retrieved October 05, 2017, from https://www.cga.ct.gov/med/committees/ACM/Connecticut%20Medicaid%20Overview.pdf. Slide 34.

[xvi] Kaiser Family Foundation. Medicaid Expansion Enrollment. (n.d.). Retrieved October 05, 2017, from https://www.kff.org/medicaid/state-indicator/medicaid-expansion-spending/?currentTimeframe=0&selectedRows=%7B%22states%22:%7B%22connecticut%22:%7B%7D%7D%7D&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D.

[xvii] Kaiser Family Foundation. Federal and State Share of Medicaid Spending. (2017, May 11). Retrieved October 02, 2017, from https://www.kff.org/medicaid/state-indicator/federalstate-share-of-spending/?dataView=1¤tTimeframe=0&sortModel=%7B%22colId%22%3A%22Location%22%2C%22sort%22%3A%22asc%22%7D.

[xviii] *Ibid.*

[xix] This issue was discussed by the Spending Cap Commission in their Report of the Chairpersons, page 24. The Commission did not conclude whether or not the language of "evidence of indebtedness" included unfunded pension liabilities.