CONNECTICUT VOICES FOR CHILDREN

20 YEARS OF ADVANCING OPPORTUNITIES FOR CHILDREN AND FAMILIES

Testimony Opposing the Bond Lock
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Black and Puerto Rican Caucus
February 20th, 2018

Chairman Rosario, Vice-Chair McGee, and distinguished members of the Caucus:

I am testifying today on behalf of 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.

Opportunities for children in Connecticut today are not equal. The median Black and Latino workers make $10.08 and $8.98 per hour less than their white counterpart, respectively.[1] The poverty rate for Black and Latino children is 4.2 and 4.6 times that of their white peers, respectively—larger than national disparities.[2] Black children are disproportionately less likely to be enrolled in Gifted and Talented or Advanced Placement courses compared to their white peers.[3] These disparities in opportunity result in part from structural barriers, such as disparate zoning regulations and tax rates across our 169 municipalities. Connecticut must make strategic investments to ensure meaningful opportunity regardless of race, income, or location—investments all the more necessary now, as they will contribute to the long-term economic competitiveness of our state.

Four new fiscal restraints included in last fall's budget—a bond lock, spending cap, volatility cap, and bonding cap—threaten the legislature's ability to make strategic investments necessary to promote equitable opportunity and inclusive economic growth. These restrictions will disproportionately impact children of color by preventing Connecticut from taking action to redress existing inequities. We hope that the Caucus will consider prioritizing fixes to these fiscal restrictions this session, protecting the long-term viability of programs that benefit the communities it represents.

The Bond Lock Will Cement New Restrictions into Law Unless Changed by May
Section 706 of last fall's budget implementer stipulates that whenever Connecticut issues a bond for a two-year period beginning in May, it must vow not to change three spending and revenue restrictions for the life of the bond (typically 10 years) except in extraordinary circumstances.[4] Because bonds are considered contracts, Connecticut would be legally bound to maintain these spending and revenue restraints, despite what future Governors or legislatures might find to be in the state's best interest and despite policy changes at the federal level. Any effort to break the covenant could invite litigation, cost the state scarce dollars in immediate payment of principal, interest, and penalties, and give investors power over fundamental matters of governance. The precise impact of this provision depends on the details of the three restraints it seals into contract: the spending cap, volatility cap, and bond cap.

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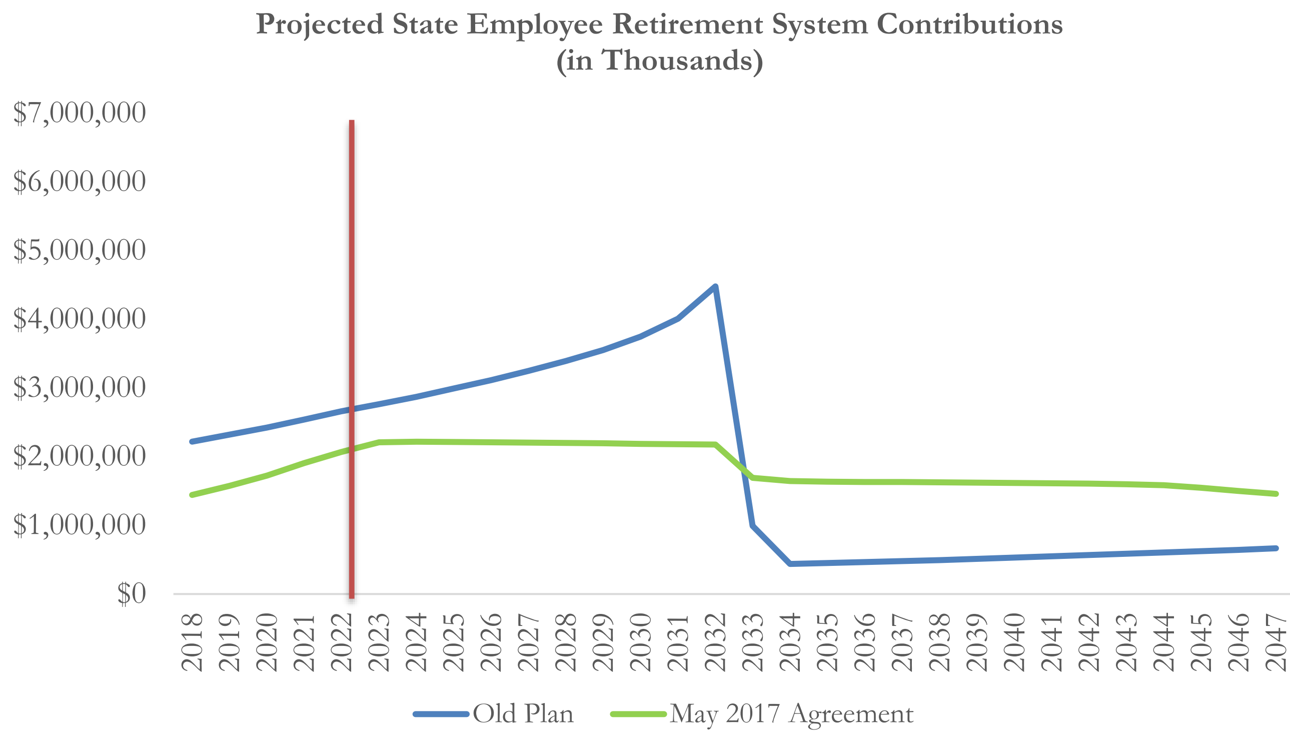
The Spending Cap Will Likely Pressure Supports for Children and Families

Last year's budget greatly expanded the reach of the constitutional spending cap, restricting the state's ability to meet vital needs and build thriving communities. Originally passed in 1991 as part of the compromise enacting the personal income tax, the constitutional spending cap requires that "general budget expenditures" not grow at a rate greater than the "increase in personal income" or "increase in inflation," whichever is greater. It leaves the definitions of those three terms to the legislature, stipulating that defining or amending them requires a three-fifths vote of each house in the General Assembly. Because of last fall's near-unanimous enactment, Connecticut now has a spending cap that broadly applies to almost all general budget expenditures.

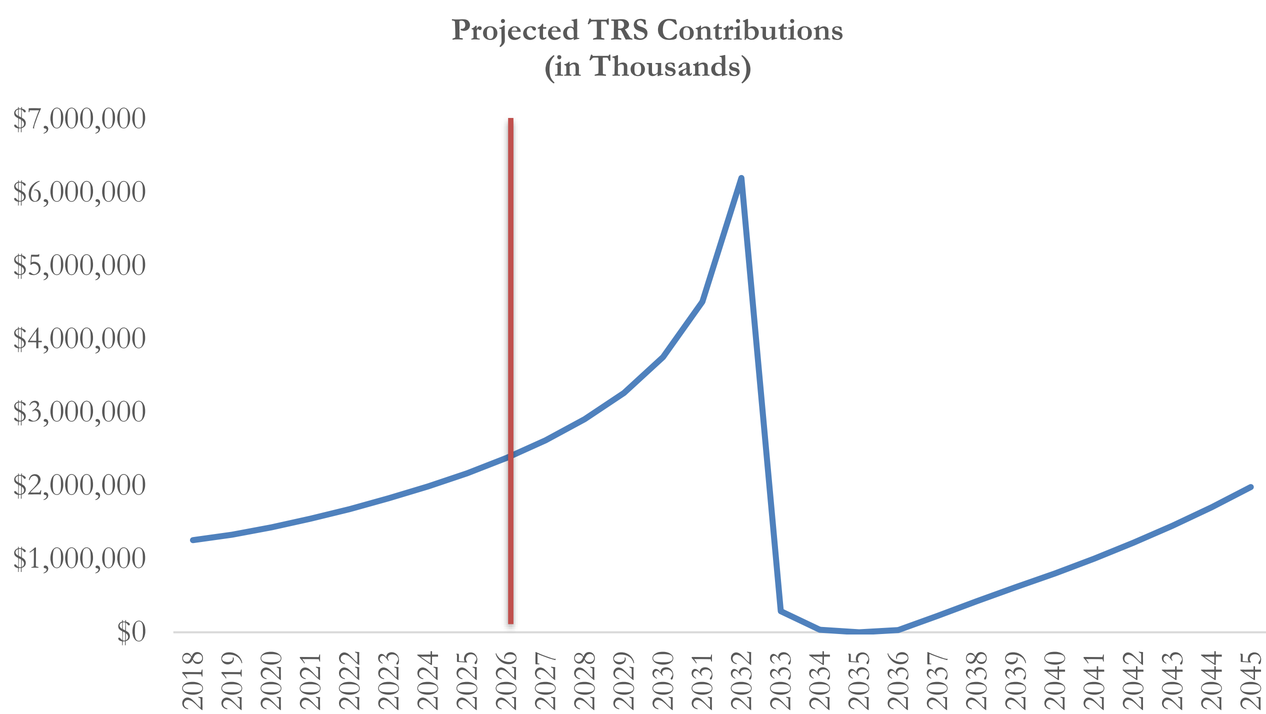
As a result of these changes, the Office of Policy and Management estimates that the spending cap prevents policymakers from investing more than an additional **$170.2 million** above Governor Malloy's proposed FY 2019 appropriations—not enough to support system-level investments in Connecticut's future or undo recent budgets' austerity. For example, restoring the Children's Budget to FY 2016 levels—a budget that eliminated Medicaid for 20,000 parents, reduced the property tax credit from $300 to $200, and cut more than $130 million from K-12 education—would cost $237.6 million, more than the room available under the cap. According to the most recent estimates, fully funding PILOT to support our cities would cost $270.8 million, more than $100 million above the cap.[5]

Part of the reason that the new spending cap is so restrictive is that it includes expenditures to redress the structural inequities faced by families in our distressed municipalities. These grants include Education Cost Sharing grants to reduce disparities in education funding between towns, Excess Cost Grants to help provide special education services, and Priority School District funding to help improve student achievement.[6] The state's list of 25 distressed municipalities—including Bridgeport, New Haven, Hartford, New Britain, and New London—contain 61 percent of the state's Black population and 59.6 percent of the state's Latino population.[7] In effect, then, this provision of the spending cap discourages investment in the communities most populated by people of color.

One drastic change relates to how the spending cap accounts for pension payments. Under the new agreement, the spending cap will exclude payments for the unfunded portion of the state employee pension system (SERS) through FY 2022 and those for the teacher pension system (TRS) through FY 2026. Because SERS contributions peak in FY 2024 and TRS contributions peak in FY 2032, this essentially attempts to prevent unduly restricting spending in the short term while pressuring future legislatures to pay required contributions in the long term. However, its effect depends on how much the retirement systems actually earn. If SERS and TRS do not earn their expected returns, the required state contribution could increase by up to 500 percent, with much of that growth projected to occur after the dates that pension payments would be brought under the cap. This would force the legislature to cut billions of dollars of services from the budget, potentially including cuts to Medicaid, K-12 education, higher education, juvenile justice, and early childhood education.[8]



Source: Actuarial analysis of SEBAC agreement. Red line signifies when SERS comes under spending cap.



Source: Boston College Center for Retirement Research. Red line signifies when TRS comes under spending cap.

The New Volatility Cap Deviates from Best Practice

Before last fall, the legislature had already enacted a volatility cap set to go into effect in 2021.[9] This cap had bipartisan support and was responsive to market conditions, following national best practices.[10] However, last fall's budget not only expanded the constitutional spending cap, but also repealed this best-practice volatility cap, replacing it with a less nuanced one.

The new volatility cap essentially restricts the state's use of new funds from one of its most volatile but equitable sources. The state's personal income tax revenues are composed of two parts: "withholdings," from paychecks, and "estimates and finals," the typical means of paying for investment-related earnings. The new volatility cap requires the state to deposit any estimates and finals revenue in excess of $3.15 billion into the Rainy Day Fund, which it can use only during emergencies.

In FY 2017, Connecticut collected $3.12 billion in estimates and finals revenue, almost passing that threshold.[11] Because estimates and finals tend to be paid by wealthy individuals, the new volatility cap would likely dampen the effects of any income tax increase on the wealthy: the state could use only the withholdings portion of any new revenue raised for general expenditures, while it would be compelled to lock the estimates and finals portion away for another day. Furthermore, as the Connecticut economy grows, the new volatility cap would prevent Connecticut from reinvesting growing income tax revenues into its policy priorities; those dollars would instead also go into the Rainy Day Fund.

As a result, the new volatility cap limits the types of policies the state's policymakers could feasibly enact to protect or expand programs that redress barriers to opportunity for Connecticut's Black and Puerto Rican communities. In order to invest in Education Cost Sharing grants, the Care 4 Kids program, increased Payments in Lieu of Taxes, expanded Medicaid coverage, or other critical programs, policymakers could not rely on increased income tax rates on the wealthy or on all of the dollars from Connecticut's growing incomes. Rather, the new volatility cap would incentivize them to rely on taxes, such as on property and sales, that demand more from low-income residents than from wealthier ones.

The Bond Cap May Threaten Ability to Attract Business

Last fall's budget also imposed various restrictions on state bonding, often used to build schools and stimulate economic development. Additional work is necessary to map how these bonding caps will impact the state's ability to facilitate equitable economic growth. Any bond restrictions that limit Connecticut's ability to attract new business, such as through investments in critical transportation or information technology infrastructure, would likely undermine the state's long-term prosperity.

Thank you for this opportunity to testify. Please feel free to contact us if you have questions or need additional information. You can reach me at rnoonan@ctvoices.org or (203) 498-4240 x113.

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[1] Noonan, R. (2017.) *State of Working Connecticut 2017*. Retrieved from http://www.ctvoices.org/sites/default/files/State%20of%20Working%20Connecticut%202017%20Final.pdf.

[2] Noonan, R. and Siegel, K. (2017.) *Reductions in Poverty, Uninsurance at Risk due to New Budget*. Retrieved from http://www.ctvoices.org/sites/default/files/Census%20brief%20FINAL.pdf.

[3] Stokes Hudson, C. (2018.) *The Black-White Education Gap in Connecticut: Indicators of Inequality in Access and Outcomes.* Retrieved from http://www.ctvoices.org/sites/default/files/New%20Edits%20-%20NG%20-%20The%20Black-White%20Education%20Gap%20In%20Connecticut%20-%20Indicators%20of%20Inequality%20in%20Access%20and%20Outcomes%20Final%20-%20Copy%20(1).pdf.

[4] Public Act 17-2 Section 706.

[5] Office of Fiscal Analysis. (2015.) *PILOT Grants*. Retrieved from https://www.cga.ct.gov/ofa/add-budinfo1617final.asp.

[6] Fiore, Tom. (October 2017.) *E-mail correspondence with Tom Fiore at Office of Policy and Management*.
[7] Analysis of 2016 Census 5-year population numbers. Distressed municipalities list from Department of Economic and Community Development. Distressed Municipalities List 2017. Retrieved from http://www.ct.gov/ecd/cwp/view.asp?Q=251248&A=1105.
[8] Although TRS's assumed rate of return is 8 percent, over the last decade, the fund earned 5.3 percent returns (see http://publicplansdata.org/quick-facts/by-pension-plan/plan/?ppd_id=17#investments). Furthermore, over the same period, rather than its assumed 6.9 percent, SERS has realized a 5.1 percent return. Boston College Center for Retirement Research. (n.d.). Plan Data: Connecticut SERS. Retrieved November 13, 2017, from http://publicplansdata.org/quick-facts/by-pension-plan/plan/?ppd_id=16#investments. Boston College's Center for Retirement Research estimates that if TRS's investments earn similar returns as they have over the last decade, then the state's contributions to TRS will increase almost 500 percent ($4.9 billion) from FY 2018 to their peak in FY 2032. http://crr.bc.edu/wp-content/uploads/2015/11/Final-Report-on-CT-SERS-and-TRS_November-2015.pdf, page 65, Table A9. From FY 2026, the last year that the spending cap excludes these contributions, to FY 2032, they are predicted to increase by $3.8 billion (260 percent).
[9] H.B. 7061 Session Year 2015 Sec. 164. *An Act Concerning the State Budget for the Biennium Ending June 30, 201, and Making Appropriations Therefor, and Other Provisions Related to Revenue, Deficiency Appropriations and Tax Fairness and Economic Development.* Retrieved from https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&bill_num=HB07061&which_year=2015.
[10] For more information, see Lembo, K. (2015.) *Stabilizing Connecticut's Revenue Stream with the Budget Reserve Fund.* Retrieved from http://www.osc.ct.gov/brf/docs/BudgetReserveFund_policybrief.pdf.
[11] Connecticut Office of State Comptroller. Personal Income Tax Estimated and Final Payments. Retrieved from http://openbudget.ct.gov/#!/year/2017/revenue/0/fund_type/General/0/revenue_category/Personal+Income/0/account_descr?vis=barChart.