Impact of Connecticut’s Constitutional Spending Cap on Connecticut’s Future

Connecticut Voices for Children Budget Forum

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More Than Half of States Have Tax or Spending Limits

Public capital and economic growth: a critical survey

1. Introduction


IS PUBLIC EXPENDITURE PRODUCTIVE?*

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This paper considers the relationship between aggregate productivity and stock and flow government spending. The empirical results indicate that (i) the nonmilitary public capital stock is more important than the stock of military capital, (ii) government spending on infrastructure, education, and other public services increases productivity, and (iii) the flow of public capital has a negative effect on productivity.

What Have We Learned From Three Decades of Research on the Productivity of Public Capital?*

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October 8, 2009

Abstract

This paper reviews the research on the productivity of public capital and discusses the evidence on the relationship between public capital and productivity. The author argues that public capital is not a direct contributor to productivity, but that it plays an important role in the economy by providing goods and services that are essential for productivity. The paper also reviews the evidence on the relationship between public capital and productivity and discusses the implications for policy.
Research on Effectiveness of Tax and Spending Limits Provides Lessons

• Little evidence that limits improve state economies, especially in high-income states

• Results on whether limits reduce size of government are mixed and inconclusive

  • Underlying preference for smaller government can be attributed to limits

• When needs exceed limits, there are ways to evade or relax limits
But Research and Experience Reveals Serious Side-Effects. Limits Can

• Squeeze budget when investment is needed most

• Make government less accountable by reducing transparency

• Reduce efficiency

• Undermine democracy
Spending Cap Growth Rate is Lowest During Economic Recoveries

Allowable percent growth current cap, 1993 - 2017

Complex Rules Can Result in Less Public Oversight
Many Decisions are Made Without Public Oversight

• Non-appropriated funds do not receive as much scrutiny

• Tax expenditures are not reviewed every year

• Budgeting by emergency declaration is less open
States With Limits Look for Alternative Ways to Meet Needs

• New non-appropriated accounts funded directly

• Borrowing for programs previously supported by general fund spending

• Costs and responsibilities shift to local governments
The Volatility Cap – What is it?

• All revenues from Estimates and Finals portion of income tax above a **threshold** are deposited in Budget Reserve Fund before budget deliberation starts

• **Threshold** is determined by adjusting FY2017 Estimates and Finals collections ($3.15M) annually for personal income
The Advantages of a Volatility Cap in Principle

• Prospective deposits build the reserve fund

• Has potential to smooth out ups and downs of business cycle

• Does not affect spending priorities the way spending limits do
Problems With the Volatility Cap As Designed

- Stifles growth in income tax not just one-time spikes (see graph)

- Can require deposits in years when deficits are projected

- Creates preference for taxes on wages and non-income taxes?
Current formula captures more than surplus above trend growth

Source: OPM Fiscal Accountability Report, Consensus Review Report
Does Connecticut need all these caps and limits?
Connecticut Revenues are not high compared to other states

• Connecticut ranks 14th in state/local taxes as share of state income

• BUT ranks SECOND-LOWEST in state/local own-source revenue as share of state income because of low use of user fees

• Tax Foundation ranking showing 2nd highest tax levels misleading;
  • Doesn’t include fees and charges
  • Includes taxes paid to other states such as income taxes to New York, property taxes on second homes, sales and fees paid while traveling, severance taxes included in energy bills
Connecticut’s spending is not high compared to other states

- Connecticut ranks 2\textsuperscript{nd} from bottom in state/local expenditures as share of state income

- Ranks low compared to other states on state and local spending as share of state income in important areas:
  - 40\textsuperscript{th} on state and local education spending
  - 41\textsuperscript{st} on higher education spending
  - 41\textsuperscript{st} on public welfare spending
  - 47\textsuperscript{th} on spending on highways

Source: US Census State and Local Government Finances 2016
Tax and Spending Limits are Not The Way to Build Economic Prosperity

- Public in other states have recognized shortcomings of tax and spending limits

- Colorado suspended TABOR for five years; 29 other states considered TABORs and did not adopt them
Fiscal Policy Blueprint for Economic Prosperity

• Invest in Education and Health

• Launch Public Infrastructure Projects

• Boost Household Incomes

• Improve Budget Planning and Modernize Tax Code
Conclusion

• Changing Connecticut’s caps to more accurately reflect reality of state’s economy and spending needs would

  • result in greater ability to meet those needs and a more transparent and accountable budget process

  • without tying the hands of future legislators before the state’s economic and fiscal circumstances are known.

• Other more effective ways to improve budget process include the budget stabilization fund with revised deposit rules that fix the volatility cap, improved tax expenditure oversight, and consistent current services budgeting
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