

THE #ASE AND POLICY / OPTIONS FOR IMPROVING CONNECTICUT'S BUDGET

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This report has two primary, related objectives: the first objective is to build the case for improving Connecticut’s fiscal year 2024 and fiscal year 2025 biennial budget so that it provides more support for low- and middle-income families, and the second objective is to develop policy options. Throughout the report, the term “budget” means both the tax system and the spending system, and “low income” (the bottom 50 percent) and “middle income” (the next 40 percent) means tax filers or families in the bottom 90 percent of the income distribution.

The first section of the report begins to build the case for improving Connecticut’s budget so that it provides more support for low- and middle-income families. The section proceeds in three parts:

The first part provides an overview of Connecticut’s pre-tax income inequality and racial and ethnic income gaps. The key finding is that pre-tax income inequality and racial and ethnic income gaps decreased in Connecticut last year, but the state still has the third highest level of pre-tax income inequality during a period of historic income inequality in the U.S. as a whole, and the state also still has substantial pre-tax racial and ethnic income gaps that tend to result in higher levels of income inequality for families of color. A related, major finding is that a high level of income inequality contributes to poverty, especially for families of color due to the addition of substantial racial and ethnic income gaps, and poverty negatively impacts children in “virtually every dimension.”

The second part provides an overview of Connecticut’s unfair tax system. The key finding is that Connecticut’s tax system is unfair because it disproportionately burdens low- and middle-income families, especially families of color, and thereby increases post-tax income inequality and racial and ethnic income gaps, offsetting in part the recent, important reduction in pre-tax income inequality and racial and ethnic income gaps. Another major finding is that Connecticut has a low overall tax burden compared to most states and the U.S. as a whole, further supporting the case that the primary problem with Connecticut’s tax system is not the overall burden but rather the unfair distribution.

The third part provides an overview of Connecticut’s unfair spending system. A major finding is that compared to most states and the U.S. as a whole, Connecticut has a high level of long-term obligations comprised primarily of bonded debt, unfunded pensions, and unfunded other post-employment benefits. Relatedly, the key finding is that Connecticut’s spending system is unfair because the high level of spending required to service long-term obligations past generations insufficiently funded limits spending on public services and investments that support the current generation of low- and middle-income families. Moreover, although Connecticut should certainly make the required full pension debt payments each year, *additional* payments increase the unfairness of Connecticut’s budget and are not necessary to fully fund the state’s pension systems on a set schedule. The limited spending on public services and investments to support the current generation becomes even more concerning when considering the high level of pre-tax income inequality and racial and ethnic income gaps harming the current generation of Connecticut’s low- and middle-income families and the unfair tax system exacerbating the problem.

The second section of the report continues to build the case for improving Connecticut's budget in the process of developing policy options. The section proceeds in five parts:

The first part provides an overview of and policy options for reforming Connecticut's tax revenue restrictions. The key finding is that in addition to the estimated \$490 million to \$735 million in newly available revenue annually due to past and projected additional pension debt payments, policymakers could generate an average of \$1.5 billion a year in revenue during the next budget cycle by reforming the use of funds from two major tax revenue restrictions, the volatility cap and the revenue cap.

The second part provides an overview of and policy options for eliminating or reducing Connecticut's tax gap. The key finding is that policymakers could potentially generate up to \$2.6 billion a year, largely from high-income and wealthy tax filers, by providing additional funding for the Department of Revenue Services to eliminate or reduce the state's income tax gap. Another major finding is that "tax incidence" and "tax gap" analyses differ and both are essential for creating a fairer tax system.

The third part provides an overview of and policy options for eliminating or reducing Connecticut's high cost, high growth tax expenditures. The key finding is that policymakers could generate up to about \$770 million a year by eliminating or reducing six of the state's high cost, high growth tax expenditure programs, one of which is for film production. Another major finding that even according to the state's own broader economic impact analysis, Connecticut loses an average of nearly \$80 million a year from its film production tax expenditure program alone, which more than offsets the average total gain from the other major business assistance tax credit programs.

The fourth part provides an overview of and policy options for increasing Connecticut's taxes on the wealthy. The key finding is that policymakers could generate several hundreds of millions of dollars or more a year by reasonably increasing the top income tax rate, by reasonably increasing the estate and gift tax, and/or by establishing a reasonable statewide property tax on high value homes. Another major finding is that Connecticut recently lost low- and middle-income tax filers to net migration and gained high-income tax filers, potentially further supporting the case for creating a fairer tax system, which requires generating revenue to fund tax cuts for low- and middle-income families.

The fifth part provides a summary of policy options to improve Connecticut's budget, which involves generating revenue to fund the creation of a fairer tax system and a fairer spending system. To generate revenue, policymakers could pass legislation that incorporates one, some, or all of the proposed broad approaches: reforming Connecticut's tax revenue restrictions, eliminating or reducing Connecticut's tax gap, eliminating or reducing Connecticut's high cost, high growth tax expenditures, and increasing Connecticut taxes on the wealthy. To create a fairer tax system, policymakers could use a portion of the newly generated revenue to fund major tax reforms, such as adding a cost of living adjustment to Connecticut's income tax, creating the Connecticut child tax credit, increasing and expanding the Connecticut earned income tax credit, and improving the Connecticut property tax credit. And to create a fairer spending system, policymakers could use a portion of the newly generated revenue to fund major spending reforms, such as increasing funding for early care and education, increasing funding for public sector jobs, and ensuring funding for CT Baby Bonds.