CONNECTICUT VOICES FOR CHILDREN

State Budget Challenges Facing Connecticut

CANDIDATE BRIEFING
JULY 2010

A lack of long-term strategic state budget planning, combined with short-sighted fiscal choices and the declining economy, present unprecedented budget challenges for Connecticut. As more Connecticut families struggle during the current economic downturn, the role of state government is critical. Not only must the state provide adequate funding for programs that maintain our quality of life and economic competitiveness — including education, health care, public safety, environmental protection, and transportation — it must also increase its help to families struggling to make ends meet. Unfortunately, just as needs are rising, Connecticut's flawed revenue system is failing to provide the resources to meet those needs.

Connecticut's fiscal house can and must be repaired. Fortunately, Connecticut has the financial capacity to meet these challenges. What is missing is a commitment to long-term strategic state budget planning.

Connecticut's state revenues are falling short of what is needed to maintain current services. In May 2010, the Office of Fiscal Analysis projected General Fund deficits for the next four years: $371.7 million in FY 2011, $3.37 billion in FY 2012, $3.17 billion in FY 2013 and $3.15 billion in FY 2014. Factors contributing to this structural deficit include new tax exemptions, credits, and rate reductions that reduce the state's revenue base; dramatic declines in state tax revenues resulting from the weak economy; rising energy and health costs; and increased demand for programs that help families in need. Resolving the state deficit while maintaining essential services will require a balanced approach that includes a thorough review and reform of our state and local revenue system.

Short-sighted budget gimmicks have exacerbated the state's budget challenges. The biennial budget adopted for Fiscal Years 2010 and 2011 plugged the deficit hole with the sale of future revenue streams ("securitization"), an ill-conceived retirement incentive program, unspecified forced savings ("lapses"), transfers from the Budget Reserve ("Rainy Day") Fund and budget accounts designated for other purposes ("fund sweeps"), and federal stimulus funds. The non-partisan Office of Fiscal Analysis estimates that 70% of the FY 2012 projected deficit is a result of the use of the one-time revenues and new borrowing to balance budgets in preceding years, rather than permanent revenue increases or spending cuts.

Connecticut's current budget is under-funded in multiple ways. According to the Connecticut Conference of Municipalities, the state's share of local public education funding has fallen to 36.8%, the lowest level since FY 1983. State payments to cities and towns to compensate them for the property taxes they cannot collect on their tax-exempt property (PILOT payments) are woefully under-funded. The reimbursement rate for state government property has fallen from 41% in FY 2002 to 33% in FY 2010, and the rate for private colleges and hospitals fell from 73% in FY 2002 to 54% this year. What's more, even in healthier economic years, public investment did not keep pace with growth in the state's economy, despite the widely-acknowledged need for increased investment in transportation, education, housing, health care, and environmental protection.

Connecticut has been shifting current fiscal obligations onto the next generation. Connecticut has $15.8 billion in unfunded pension liabilities in the State Employees

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Retirement Fund and the Teachers Retirement Fund, as well as $29.6 billion in unfunded post employment benefits, such as health, dental, and life insurance. Connecticut's pension systems were only 59% funded in 2009, ranking us the fourth worst in the nation.

A history of excessive borrowing even in good economic times also constrains our ability to cope with the current economic crisis. Before the crisis hit, Connecticut already was 10th highest among states in bonded debt ($18 billion) as a share of the state's economy. If debt service in FY 2010 (11.0% of the budget) were the same proportion of the budget as it was in FY 1990 (5.4%), there would now be more than $1.0 billion of additional revenues available for vital public investments.

Connecticut has the capacity to solve these fiscal problems but is failing to meet the challenge. In 2006, the Federal Reserve Bank of Boston ranked Connecticut highest among all states in "fiscal capacity," our ability to meet our state's spending needs given our revenue capacity. Yet we lag behind other states in how much we invest as a percentage of our state's personal income (according to 2007 data from the U.S. Census and U.S. Bureau of Economic Analysis):

- On state and local *total* direct spending, Connecticut ranks 2nd lowest (49th);
- On state and local spending on all education and on higher education, Connecticut ranks 4th lowest (47th);
- On assistance to Connecticut's most vulnerable populations, Connecticut's state and local spending on public welfare ranks 5th lowest (46th); and
- On investing in Connecticut's infrastructure through state and local spending on highways and natural resources, Connecticut ranks lowest (50th).

Failing to put Connecticut's fiscal house in order and invest in programs with proven results is harmful to our state's future. Connecticut's structural and investment deficits will persist until the state has a revenue system that reliably meets its investment needs and grows with the economy. The alternative is short-term "savings" with serious long-term costs, such as:

- Cuts in state funding for education that would result in a less skilled workforce and higher property taxes, making the state a less desirable place for businesses.
- Inadequate investments in our transportation system and housing stock, which would deter families and businesses from locating here.
- Weaker front-end supports for our most at-risk families (e.g., to avert homelessness, reduce child abuse and neglect), which could result in increased numbers of children placed into foster care.
- Reduced investments in mental health and substance abuse treatment that would reduce worker productivity, endanger family cohesiveness, and increase prison costs.

We can put Connecticut's fiscal house in order by:

- Adopting a comprehensive, long-term strategic state plan that prioritizes all our needs for public investment and identifies how best to finance that investment.
- Pursuing a balanced approach to deficit reduction that includes streamlining government *and* raising revenue to compensate not only for recession-related losses and increased public needs, but also to address the structural deficit that has arisen in the state's budget over the past several years as Connecticut came to rely on one-time revenues and borrowing to balance its budget.
- Raising sufficient revenues to meet current and future state needs in a manner that emphasizes adequacy, fairness, and accountability. This includes enacting a more progressive personal income tax.
- Closing corporate tax loopholes — flaws in our tax code that enable many large, multi-state or multi-national corporations to avoid paying their fair share of tax, thereby shifting the responsibility for funding public investment in the goods and services on which we all rely onto our in-state businesses and families.
- Requiring greater transparency and accountability in how state dollars are spent, including a thorough cost-benefit evaluation of the state's growing use of tax credits and exemptions.
- Meeting our current state obligations by fully funding current pension and health care costs and reducing our state debt.
- Spending smarter by investing more in preventive programs that avert longer-term costs.
- Maximizing the collection of federal funds to which Connecticut is entitled, and more effectively competing for federal stimulus funds and other competitive grants.

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