



Making Up for Lost Ground: 10 Key Points About Proposed FY 06 Budgets Executive Summary

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While much has been made of the proposed growth in the FY 06 budget, this report finds that both the Governor and the Appropriations/Finance Committee's proposed budgets are quite comparable in their efforts to play catch-up – with *both* adding more than \$1 billion in funding for essential programs that were cut in past budget deficit years and addressing neglected problems through long-overdue public investments.

#1: The Appropriations Committee's proposed budget for FY 06 is just 1.6% greater than the Governor's proposed budget for FY 06. The difference between them is about \$249 million in a more than \$15 billion FY 06 budget.

#2: The rates of growth in the Governor's and the Appropriations Committee's budgets both exceed the very slow budget growth in the recession years, though the Appropriations Committee's budget grows at a slightly faster rate. Compared to FY 05, the Governor's proposed FY 06 budget would increase spending by \$1.1 billion, or 7.6%. By comparison, the Appropriations Committee's proposed FY 06 budget would increase spending by \$1.35 billion, or 9.4%, 1.8 percentage points more. Growth in *both* proposed budgets is much less from FY 06 to FY 07 – 2.6% and 3.4%, respectively.

Viewed historically, both budgets reflect Connecticut's tradition of Yankee thrift, as evidenced by its rating by the *Connecticut Economy* as the second most frugal state in the nation *even before* deficit-mitigation began. Adjusted for inflation, growth in Connecticut's budget expenditures since FY 00-01 has averaged *less than 1%*, and between

FY 03 and FY 04 was *-0.5%* (i.e., less than the rate of inflation). Yet, over this same period, Connecticut's total population has grown by 2.9% and its public school population by 4.2%, increasing demand for state-funded services.

#3. Both the Governor's and the Appropriations Committee's FY 06 budgets would exceed the state spending cap. Both budgets agree that it is acceptable to go over the spending cap by \$244 million to gain additional federal Medicaid reimbursements through a nursing home provider tax. However, the Appropriations Committee's budget would exceed the cap by an additional \$190 million in FY 06. Many of its proposed restorations of health care coverage for low-income families and its expansions of mental health services would likewise increase federal Medicaid funding to Connecticut.

Both budgets also reveal some of the problems in Connecticut's spending cap as currently defined. The intent of the cap was to limit growth in state spending to growth in the state economy. However, because the statutory spending cap limits budget growth to the greater of the inflation rate in the last 12 months (which has remained relatively low) or the average growth in personal income in the last five years (excluding capital gains income, which is relatively high in CT), allowable growth in the state budget consistently *lags* growth in the economy and personal income in Connecticut. In addition, each year's cap is based on the state's actual spending in the prior year *rather than* the level of spending that was allowed under the cap.

The combined effect of these two aspects of the current cap is that there is a constant pressure to ratchet down public investment. *When times are lean, revenues are inadequate to maintain current levels of public investment, so spending is cut and the budget base reduced. However, when the economy recovers and revenues again begin to grow, the rate of allowable spending growth continues to decline because of the five-year averaging.* When this growth rate is then applied to a smaller budget base, it results in a decline in allowable spending growth even when the economy is growing. So, even though Connecticut's economy is improving, the amount the state budget can grow in a year is falling – from \$552.1 million between FY 04 and FY 05 to just \$371 million between FY 07 and FY 08. Under our current cap, even when we have revenues to restore spending that has been cut when times are lean, the time lag built into the cap and the reduced budget base restricts our capacity to do so. It's a trap, not only a cap.

#4: Despite proposals in both budgets to increase spending in FY 06 by more than \$1 billion, the budgets of many state agencies would remain less than actual spending in FY 02 (not even adjusting for inflation). We are still trying to catch up from the deficit years when very deep spending cuts were made. Comparing FY 02 actual spending to the Governor's FY 06 proposed budget reveals just how deep the cuts were for many state programs, including the Departments of Higher Education (proposed FY 06 would be 27.6% less than FY 02 actual spending), Economic and Community Development (-27.3%), Environmental Protection (-18.5%), and Public Health (-10.2%). Likewise, under both budgets *many* programs and services in other state agencies would be funded in FY 06 at levels less than FY 02 actual spending. To simply keep pace with inflation, the FY 06 budget would need to be 9% greater than the FY 02 budget.

#5. Under the Governor's and Appropriations Committee's budgets, funding for many state agencies in FY 06 would be less than is necessary to maintain current services. These agencies include SDE, DPS, DOC, the CSU, and the Judicial Department. For both proposed budgets, the total FY 06 General Fund

budget would be less than the FY 06 Current Services budget.

#6. The Governor and the Appropriations Committee propose to fund some agency budgets at levels just equal to their FY 06 Current Services needs. FY 06 funding proposed for the Commission on Children, Elections Enforcement Commission, and Freedom of Information Commission is *equal to* their current services budgets for FY 06.

#7. In those agency budgets in which the Appropriations Committee and/or Governor propose growth in FY 06 that exceeds FY 06 current services funding, the budget additions represent important public investments. Included among the increases in these budgets are the following:

- Increased funding for essential health services.
- Increased funding for education, and particularly for education that will address Connecticut's achievement gap.
- Increased funding for prevention and early intervention services that can reduce longer-term costs.
- Increased funding for home and community-based care to reduce reliance on more costly out-of-home and institutional placements.

Overall, the Appropriations Committee's budget provides a higher level of investment than does the Governor's budget in health care, education, aid to municipalities, and prevention and early intervention services that can help reduce longer-term costs.

#8. With the federal government cutting funding to the states, and also imposing unfunded or partially funded mandates on states, the Governor's and the Appropriations Committee's proposed budgets both include new state dollars to help make up the difference. Among the proposed increases in both FY 06 budgets are new state dollars to pick up funding for programs and services that had relied on federal funding (including judicial, public health, DCF), as well as new state dollars to help

comply with *partially* funded federal mandates (including No Child Left Behind).

#9. After years of coping with state deficits, the Finance Committee's Budget creates a more adequate long-term revenue stream than the Governor's proposed budget. Both would keep Connecticut's total state tax burden at overall levels less than 1995. The Governor's FY 06 budget includes \$582 million in net revenue increases. Less than half these proposed new revenues result from permanent changes in taxes and fees that can be expected to generate revenues beyond this biennium, and nearly half of these permanent revenues come from "sin" taxes that, while ongoing, do not grow with the economy. These proposed changes do not sufficiently address the structural deficit in Connecticut's budget, nor the increasingly outmoded nature of our revenue system, prolonging our state budget crisis.

While the Finance Committee budget includes some of the Governor's temporary or one-time revenues, it relies more heavily on on-going and progressive taxes than the Governor's budget does. It substitutes for the Governor's proposal to increase sin taxes a more graduated personal income tax that adds 4 new tax brackets starting at \$500,000 for married couples filing jointly. This would generate an estimated \$462.5 million in FY 06 (18 months) and \$345 million in FY 07 and years thereafter. In addition, it also includes a unified transfer tax on transfers of CT taxable gifts and estates that exceed a combined lifetime total of \$1 million that would replace our current succession and gift taxes. This would result in an estimated \$3.5 million net General Fund *loss* in FY 06 and a net General Fund gain of \$57.2 million in FY 07. Both changes would generate *on-going* revenues that would help address Connecticut's structural deficit.

Under *either* the Governor's or the Finance Committee's budget, total *net* state taxes increased since deficits began in 2002 would *remain less* than net state taxes cut between 1995 and 2001 (\$2.064 billion).

#10. The Finance Committee's proposed FY 06 budget imposes more responsibility on Connecticut's highest income taxpayers to help pay for essential public investments, while the Governor's proposed budget would put more tax-paying burden on our middle and lower-income residents. Connecticut's current state and local tax structure is regressive, that is, it requires families with lower and middle incomes to pay a substantially higher percentage of their income in taxes than the wealthiest families. Specifically, Connecticut's wealthiest taxpayers pay about 4.4% of their income in state and local taxes (after federal deductions), while middle and lower income taxpayers pay closer to 10% of their income in state and local taxes.

The new, graduated, high income tax rates included in the Finance Committee revenue bill, along with the long term impact of the new transfer tax, would reduce the regressive impact of the existing tax structure and make it fairer, while providing increased revenues to the state. By comparison, the Governor's budget places greater tax-paying burden on our middle and lower-income families by:

- Relying more heavily on sin taxes (which fall disproportionately on lower-income residents).
- Providing *less* funding than the Appropriations Committee's budget for municipalities, putting upward pressure on the local property tax (which falls disproportionately on middle-income families).
- Reducing a benefit to middle and lower-income taxpayers by keeping the maximum property tax credit against the personal income tax at its current level of \$350 for the next two years rather than allowing it to increase back to the \$500 credit, as the Finance Committee's budget does.

NOTE: To read the full report, see: <http://www.ctkidslink.org/publications/bud05tenthings04.pdf>.