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The Governor's Proposed FY 07 Midterm Budget Adjustments: Highlights & A Contextual Analysis

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March 2006

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I. Introduction

While it is easier -- and tempting -- to think about state budget issues on a year-to-year basis, this perspective has two fundamental limitations: a) it fails to take into account the cumulative impacts of past budget choices; and b) it does not address the impact of proposed budget choices in the years to come, particularly in the context of changes in the state's demographics and economy.

This summary of the Governor's proposed adjustments to the FY 07 budget provides a more comprehensive perspective. It gives not only a brief overview of key changes in spending and revenues proposed by the Governor, but also places her budget proposal in the context of longer-term trends in state budget choices. This report reveals that the Governor's proposed FY 07 adjustments do little to reverse some very troubling budget trends that Connecticut *must* address if it is to preserve its economic competitiveness, its quality of life, and its fiscal stability. These challenges are discussed more fully in a recently-released report by Connecticut Voices for Children, *Getting Connecticut's Fiscal Ship in Order: Seven Reasons Connecticut's Budget Still Has Problems, Despite Its Surplus & How to Address Connecticut's On-Going Budget Problems (2006)*.²

This report on the Governor's proposed FY 07 Midterm Budget Adjustments has two parts. The first looks at the Governor's proposed FY 07 spending revisions, overall as well as in key agencies impacting the lives of Connecticut's children and families. It places proposed spending in some historical context, comparing proposed spending to spending in the current fiscal year (FY 06) and to the fiscal year when Connecticut's most recent recession began (FY 02). It also reports on OFA and OPM's estimates of state spending in the three years *after* this biennium overall. The second part of this report reviews proposed changes in revenues over the same time periods.

¹ Description of the Governor's proposed revisions to the FY 07 budget is drawn from *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006); OPM, *FY 2006-07 Governor's Midterm Budget Adjustments* (PowerPoint Presentation, February 8, 2006); Office of Fiscal Analysis, *Synopsis of the Governor's FY 07 Midterm Budget Adjustments* (February 10, 2006); Office of Legislative Research, *Governor's Business Tax Proposals (SB 51)* (February 14, 2006); and Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006). Discussion of the impact of the current budget on the years to come benefits greatly from the passage of PA 05-262 (§1) that requires the Secretary of the Office of Policy and Management and the director of the legislative Office of Fiscal Analysis to each provide to the Appropriations Committee and the Finance, Revenue and Bonding Committee no later than November 15 a report with data about the state's estimated revenues, expenditures, tax credits, bond authorizations, and Budget Reserve Fund balances for the current biennium and the ensuing three fiscal years, as well as the "major cost drivers" affecting state spending (e.g., OPM, *Report to the Appropriations and the Finance, Revenue and Bonding Committees: An Act Concerning Fiscal Accountability of State Government* (November 15, 2005); OPM, *Fiscal Accountability of State Government: Presentation Prepared for the Appropriation and Finance, Revenue and Bonding Committees by the Office of Policy and Management* (November 15, 2005); OFA, *FY 06 Projected General Fund and Transportation Fund Deficiency Information* (November 15, 2005); OFA, *FY 06-FY 10 General Fund and Transportation Fund Budget Projections and Fiscal Information* (November 15, 2005)). The historical part of this report is based on CT Voices' analysis of past expenditure data as reported by the Office of Policy and Management, the Office of Fiscal Analysis and the State Comptroller.

² S. Geballe, *Getting Connecticut's Fiscal Ship in Order* (Connecticut Voices for Children, 2006), available at www.ctkidslink.org/publications/bud06fiscalship02.pdf.

II. Proposed FY 07 Spending Adjustments

A. In Brief

The Governor's proposed midterm adjustments to the FY 07 budget amount would result in a *net* change of \$113.5 million for all appropriated funds: a net increase of \$79.1 million through policy revisions and \$40.1 million in cross-agency revisions, offset by a net reduction of \$5.7 million through technical budget adjustments.³ The Governor's proposed FY 07 budget is a modest 0.7% greater than the FY 07 budget as enacted last year. Her proposed adjustments include \$78.9 million in new and expanded programs (of which \$21.0 million are new and \$57.9 million are expanded).

1. Growth in Spending. The Governor proposes a \$113.7 million increase in the current \$15.94 billion FY 07 budget, for a FY 07 all funds appropriation of \$16.05 billion. The Governor's proposed FY 07 budget is 0.7% more than the FY 07 budget approved last year, and 4.1% over FY 06 estimated spending levels.⁴ The Office of Fiscal Analysis (OFA), however, states that the proposed growth for all appropriated funds in FY 07 is 5.0% (not 4.1%); OFA counts the use of surplus in the year in which the funds are anticipated to be spent, rather than the year in which they are appropriated.

By comparison, growth in spending from FY 05 to FY 06 in all appropriated funds was 8.8%,⁵ and just 3.2% from FY 04 to FY 05. In the two years before this (FY 02 to FY 03 and FY 03 to FY 04), nominal state spending grew about 2% per year, which was well below historical averages in state spending, less than the rate of inflation, and below growth allowed by the spending cap. Indeed, adjusting for inflation, state spending *per person* declined by nearly 1% from FY 02 to FY 03 and by half that amount from FY 03 to FY 04.

³ OFA defines "policy revisions" to include increases due to new or expanded programs and decreases due to programmatic reductions or elimination; transfers also are treated as policy revisions. The Governor proposes a net increase of \$79.1 million through policy revisions (\$271.1 million in funding for new or expanded programs, offset by \$192.0 million for program cuts). "Technical revisions" include increases or reductions resulting from caseload changes or uncontrollable cost changes, as well as changes required as a result of existing mandates. The Governor proposes a net reduction of \$5.7 million through technical revisions (\$87.2 million in increases offset by \$92.9 million in reductions). Finally, "cross-agency revisions" are often technical in nature and sometimes are distributed among agencies in an across-the-board manner (such as centralization of certain business operations within the Department of Administrative Services). The Governor proposes a \$40.1 million net increase in cross-agency revisions (\$104.8 million in increases offset by \$64.7 million in reductions). Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), p. 15. Appendix C of OFA's summary (on pp. 53-74) provides an itemized listing of key changes.

⁴ PA 05-251 appropriated \$15.28 billion in funds for FY 06 and \$15.94 billion for FY 07 (net of projected savings). It assumed that \$116.4 million of the FY 06 budget and \$125.7 million of the FY 07 budget would not be spent, either through normal spending patterns or through "mandated" savings. In FY 06, for example, \$77.2 million of the projected savings were expected to lapse through normal spending patterns. It also appropriated a total of \$88.1 million to address FY 05 deficiencies in agency budgets. The \$88.1 million was to be used, in large part, for deficiencies in the budgets of the Department of Correction (\$28.5 million), the Department of Children and Families (\$11.8 million), OPM (\$10 million), Department of Transportation (\$8.8 million), Department of Mental Retardation (\$7.6 million), Department of Public Safety (\$6.5 million), Department of Mental Health and Addiction Services (\$5.8 million), and the Department of Public Works (\$2.5 million).

⁵ The nearly 9% growth in the FY 06 budget resulted primarily from two factors. First, OFA's spending growth calculations counted FY 05 surplus funds in the budget year in which they were to be expended (FY 06 or FY 07), rather than the year in which they were appropriated (FY 05). Second, the FY 06 budget included the new nursing home provider tax program that was devised to increase federal Medicaid reimbursements that could then fund provider rate increases.

An even longer-term perspective is also instructive: over the period FY 95 to FY 05, nominal growth in state spending averaged 4.4%/year, between FY 91-FY 95, it averaged 6.4%/year, and between FY 87-FY 91 it averaged 10.8%/year.⁶ In short, average annual growth in state spending in the last decade has been just slightly more than inflation, although the state's population has increased (including its student and elderly populations, who rely more heavily on state-funded services) and growth in certain areas of the state budget – such as health care – has greatly exceeded overall inflation rates.

2. Spending Cap. The Governor's proposed all funds appropriation for FY 07 of \$16.05 billion is \$12.2 million under the state spending cap. This assumes that the Governor's proposal to establish a new Casino Revenue Assistance Fund, amounting to \$496.8 million through a revenue intercept beginning in FY 07, would not be subject to the spending cap. As originally adopted, the FY 06 budget was \$24.3 million under the cap and the FY 07 budget \$10.3 million under the cap.⁷

The reasons that the Governor's proposed FY 07 budget can be under the cap by more than the original FY 07 budget was (\$12.2 million as compared to \$10.3 million) include: a) faster personal income growth (the originally-adopted budget for FY 07 assumed a five-year average in personal income growth of 3.54%, but actual growth is 3.88%, resulting in about \$40 million in additional room under the cap); b) about \$47 million of proposed spending increases result from federal mandates and court orders that are not counted against the cap this year; c) FY 06 spending under the Governor's mid-term adjustments is at the cap maximum, increasing the FY 06 budget base and thereby resulting in \$30 million in additional room under the cap.⁸

As discussed more fully in CT Voices' recent report, *Getting Connecticut's Fiscal Ship in Order*, the state spending cap as currently defined results in a ratcheting down of state spending with each recession, in part because a benchmark for allowable growth under the cap is a *lagged five-year average* of personal income growth (that does not include capital gains income in the measure of personal income) and allowable growth is based on what was actually spent in a prior year, rather than what the spending cap allowed for spending. As a result, though Connecticut's economy has been improving, the rate of allowable budget growth has been declining, and is applied to a budget base that was markedly reduced during the last recession. For example, although personal income is growing in FY 06 by about 9.9%, the FY 06 five-year average of personal income growth (which includes recession years) is 4.06%. In FY 07, the five-year average is 3.88%, while the Governor is conservatively projecting 5.7% growth in personal income.

To avoid spending cap constraints, there appears to be an increasing use of non-lapsing funds funded through revenue intercepts, with specified expenditures appearing not to count against

⁶ OPM, *Ability to Pay* (PowerPoint presentation, August 25, 2005), p.25.

⁷ Last year, the Budget Act's appropriation of \$635 million of additional spending in FY 05, coupled with authorization in earlier legislation to spend \$7.5 million to continue HUSKY A coverage for certain adults until June 30, 2005, and the independent \$20 million appropriation for stem cell research, resulted in the FY 05 budget exceeding the spending cap by \$370.8 million. In her emergency declaration of June 6 (necessary to exceed the spending cap), the Governor specified that any general budget expenditures in excess of the \$14.6 billion allowed under the cap in FY 05 would *not* be considered general budget expenditures for the purposes of cap calculations in future years, i.e., these additional expenditures would *not* be added to the budget base. An exception was made, however, for the nursing home provider tax program. The \$244 million in appropriations for this program were treated as a "non-capped" general budget expenditure for purposes of calculating the FY 06 cap, but *would* be included as part of the "capped" budget base for FY 07. After these adjustments, the FY 06 budget was \$24.5 million under the spending cap. OPM, *Report to the Appropriations, and the Finance, Revenue, and Bonding Committees* (November 15, 2005), p. 1.

⁸ *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006), p. 6.

spending cap limits. The Governor's proposed Casino Assistance Revenue Fund joins two similarly-constructed funds that were approved last year. PA 05-228, An Act Concerning Farm Land Preservation, Land Protection, Affordable Housing, and Historic Preservation, created a separate, non-lapsing account known as "The Land Protection, Affordable Housing and Historic Preservation Account" within the General Fund. It is funded by the diversion of fees collected when documents are recorded in the land records of all towns. Funds are expended from this account based on a statutory formula that gives equal amounts to tourism, housing, open space and farmland preservation. It is estimated that this account will contain \$30 million in FY 07. Similarly, PA 05-5 (October Special Session), An Act Concerning Comprehensive Campaign Finance Reform for State-Wide Constitutional and General Assembly Offices," created a Citizen's Election Fund as a non-lapsing account in the General Fund. This Fund is to receive \$17 million in escheats (unclaimed property) that would otherwise have been credited to the General Fund. The legislation specifies a mechanism to fund candidates based on certain eligibility criteria.

According to OFA, because spending done from these two accounts – as well as the Governor's proposed Casino Assistance Revenue Fund – is "not specifically appropriated" and "fall outside the customary purview of the legislature's appropriations review process," this spending is *not* to be counted against the spending cap. OFA rests this interpretation on the language of the spending cap itself. Specifically, Conn. Gen. Stat. §2-32a defines general budget expenditures as "...expenditures from appropriated funds authorized by public or special act of the general assembly."

Although the creation of new funds and revenue intercepts is a creative mechanism to avoid spending cap constraints, it is not a sound budget practice. As OFA notes, "[I]t is uncertain as to whether these off-budget funding mechanisms will be subject to the same level of examination afforded to items for which appropriations are distinctly made."⁹ These off-budget funding mechanisms are like tax expenditures, which also avoid the scrutiny that is necessary and appropriate in the annual budget process to ensure that they continue to serve an important state purpose.

3. *FY 06 Deficiency Appropriations.* In mid-November, 2005, OPM was projecting FY 06 agency deficiencies of about \$30.6 million in the General Fund and \$3.7 million in the Special Transportation Fund. It also speculated that the state may have to spend up to \$26 million to pay for the changes in the Low Income Energy Assistance program¹⁰ if no additional federal funds were forthcoming. Higher than projected energy costs have been a factor contributing to projected deficiencies.¹¹ OFA's estimate of FY 06 agency deficiencies were a bit lower, about \$28.5 million.¹²

The *FY 2006-07 Governor's Midterm Budget Adjustments* now show necessary FY 06 deficiency appropriations to be \$19.8 million in the General Fund and \$7.2 million in the Special Transportation Fund, for a total of \$27.0 million.¹³ HB 5009, *An Act Making Deficiency Appropriations*

⁹ Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), p. 20.

¹⁰ PA 05-2 (October 25, 2005 Special Session), AAC Heating Assistance, increases benefits under the CT Energy Assistance Program (CEAP) by \$200/month for about 70,400 households, provides benefits for moderate income households under the Contingency Heating Assistance Program (CHAP) of CEAP, increases the number of households provided with weatherization services, establishes a new program to provide furnace tune-ups and other energy efficiency services (available to all income groups), exempts from the sales tax between November 25, 2005 and April 1, 2006 sales of energy efficiency products and energy efficient heating equipment, and adopts various consumer protections to prevent price gouging.

¹¹ Testimony of Robert Genuario, OPM Secretary, to the Appropriations Committee (November 15, 2005).

¹² OFA, *FY 06 Projected General Fund and Transportation Fund Deficiency Information* (November 15, 2005).

¹³ *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006), p. A-3.

for the Fiscal Year Ending June 30, 2006, seeks the following deficiency appropriations: \$12 million for OPM's Energy Contingency account; \$7.2 million for the Department of Transportation (for other expenses and workers' compensation claims); \$3.78 million for the Department of Public Safety (for personal services, other expenses, and workers' compensation claims); \$1.3 million for the Public Defender Services Commission (for special public defenders and expert witnesses); \$1.1 million for the Department of Mental Health and Addiction Services (for behavioral health medications); \$0.5 million for the Department of Public Health (for a variety of services); \$0.4 million for the Department of Correction (for personal services); and the balance of \$0.1 million for the Office of the Chief Medical Examiner (for other expenses).

4. FY 06 Surplus Disposition.¹⁴ The Governor's would earmark \$511.8 million of her estimated FY 06 surplus as follows: a) \$335.3 million to the Budget Reserve Fund; b) \$85.5 million to pre-fund the FY 08 and FY 09 Economic Recovery Note Payments; and c) \$91.0 million to carry-forward to pay for FY 07 expenses (i.e., on-going purposes).¹⁵ The FY 06 surplus, however, may well exceed the Governor's estimate. On February 1, 2006, OFA projected that the FY 06 surplus would be \$661.5 million, or \$149.7 million more than the Governor's estimate of \$511.8 million.¹⁶

Of the Governor's proposed carry-forward of \$91 million in FY 06 surplus funds, \$50 million is to be used in FY 07 for Medicaid, \$35 million for state employee health service costs, and the balance for such FY 07 expenses as the Payment in Lieu of Taxes program for new manufacturing machinery and equipment (\$1.5 million), personal services at the Department of Emergency Management and Homeland Security (DEMHS), the Department of Mental Retardation (DMR), and the State Department of Education (SDE) (total of \$2.2 million), and unemployment and workers' compensation payments (\$1.7 million).¹⁷ By comparison, the budget approved last year authorized the carry-forward of about \$722.4 million of unspent and surplus funds from FY 05 into FY 06 and, in limited circumstances, into FY 07. That is, amount of FY 06 surplus carried forward

¹⁴ NOTE: FY 07 budget relies *also* on a total of \$232.3 million in FY 05 surplus, including for the teachers' retirement fund (\$50 million), ECS grants to towns (\$32.2 million), SDE grants to priority schools (\$7.83 million), Medicaid (\$4.2 million), stem cell research (\$10 million), payment on Economic Recovery Notes (\$67.6 million), PILOT for manufacturing equipment (\$5.66 million) PILOT for state property (\$5.3 million), PILOT for college and hospital property (\$5.3 million), PILOT for housing by DECD (\$2.22 million), OPM's contingency needs/private provider COLA (\$8 million), accrued leave (total of \$28.7 million), tax abatement by DECD (\$1.7 million), and matching grants for the Department of Higher Education (\$2 million). Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), pp. 10-11.

¹⁵ The use of surplus and carry-forward funds for on-going expenses is hardly new. For example, OFA determined last year that \$105.3 million of the FY 05 surplus funds also were to be used for on-going purposes in the FY 06 and FY 07 budgets, including for state employee costs (about \$50 million for personal expenses, other expenses, workers compensation claims, health service costs); Charter Schools (\$1.9 million); Priority School Districts (\$1 million); the State Department of Education's Open Choice program (\$1 million); and the Department of Correction's Community Support Services program (\$1.5 million); Medicaid costs (\$4.2 million); nursing home rates (\$2 million); cost of living increases on Department of Mental Health and Addiction Services' federal contracts (\$1.7 million); two Department of Economic and Community Development programs (Tax Abatement, \$3.4 million; Housing PILOT, \$4.4 million); and private provider rate increases beginning in FY 06 (\$15.9 million). Notably, 39% of these FY 05 surplus funds were earmarked for on-going purposes in FY 07, creating a budget "hole" in the FY 08 budget.

¹⁶ Note also that when PA 05-251 (the 2005 Budget Act) was adopted, the FY 05 surplus was \$700.2 million. However, by November 2005, the surplus had increased to \$943.2 million (even after spending \$78.6 million for General Fund FY 05 deficiencies, providing \$7.5 million to extend HUSKY A benefits to certain parents and relative caregivers through June 30, 2005, and covering \$27.6 million in other expenditure requirements, although also recognizing \$76.4 million in additional lapses). As a result of this increase in FY 05 surplus, the amount able to be deposited in the Budget Reserve Fund this year increased from \$160.2 million to \$303.4 million, bringing the Fund total to \$605.6 million.

¹⁷ See OFA, *Synopsis of the Governor's FY 07 Midterm Budget Adjustments* (February 10, 2006), p. 15.

for use in subsequent fiscal years was nearly eight times greater than the carry-forward the Governor now proposes for use in FY 07.

5. Budget Reserve (“Rainy Day”) Fund. Just prior to our most recent recession, Connecticut’s Budget Reserve Fund was fully funded at the then-statutory level of 5% of General Fund appropriations – or \$594.7 million. When state revenues plummeted in FY 02, the Budget Reserve Fund was drained to address the FY 02 deficit. However, the Fund proved inadequate. Even after making deep spending cuts, Connecticut had to borrow to bring the budget into balance in both FY 02 (\$222 million) and FY 03 (\$97 million). The cost of such borrowing has been steep: \$319 million in principal and \$26 million in debt service, or a total of \$345 million.¹⁸ To avoid this in the future and to better assure that the Budget Reserve Fund has sufficient funds to carry Connecticut through a recession, over the past several years the statutory level for the Fund has been raised -- first to 7.5%, and then to 10%, of net General Fund appropriations.

Currently, the Budget Reserve Fund is about \$605.6 million (\$302.2 million from FY 04 surplus and \$303.4 million from FY 05 surplus). The proposed addition of \$335.3 million in FY 06 surplus would bring the total to \$940.9 million. While this is, in nominal dollars, about 50% *more* than the Fund has ever been, it would still be about 63% of the statutory level. That is, even with this \$335.3 million addition, the Fund would fall short of being fully funded at the 10% level by \$550.2 million.¹⁹

Importantly, however, both OPM and OFA project *deficits* in the state budget by FY 08. Thus, the last possible surplus, and therefore last possible *addition* to the Fund, may well be the FY 07 surplus, leaving the Fund well below the 10% statutory level.²⁰ Also to address the structural deficits projected beginning in FY 08, revenues from the Fund may be needed simply to balance the budget, and even without *any* downturn in the economy.

6. Grants to Towns. The 2005-2007 biennial budget increased formula grants to towns after several years of *predominantly flat* funding. These increases relied in part on the use of FY 05 *surplus funds*. Formula grants to towns in FY 06 were about \$139.9 million greater than in FY 05 (\$2,406.9 million in estimated FY 06 expenditures compared to FY 05 expenditures of \$2,267.0 million). Notwithstanding these increases, however, funding for these formula grants remained \$61 million less in FY 06 than was necessary to meet statutory requirements and fully fund the programs. In the FY 07 budget as currently adopted, the increase in funding for grants to towns is far more modest - just \$27 million more than in FY 06.

¹⁸ Payments on the \$222 million borrowed in FY 02 and the \$97 million borrowed in FY 03 began in FY 04 and were to extend through FY 09 as follows: \$49.8 million in FY 04, \$72.5 million in FY 05, \$70.1 million in FY 06, \$67.6 million in FY 07, \$65.3 million in FY 08, and \$20.1 million in FY 09. Last year, FY 05 surplus funds were set aside to pay the sums due in FY 06 and FY 07. The Governor has now proposed to set aside \$85.5 million of FY 06 surplus to pre-fund the remaining payments in FY 08 and FY 09.

¹⁹ Based on the Governor’s FY 07 net General Fund appropriations of \$14.91 billion, the maximum that could be deposited in the Budget Reserve Fund (i.e., 10% of net General Fund appropriations) would be \$1.491 billion. With the \$335.3 million deposit of FY 06 surplus funds, the Fund would remain \$550.2 million below this level.

²⁰ OPM projected that budget surpluses in FY 06 and FY 07 would permit additional deposits of \$306.0 million and \$224.9 million in each year, respectively, bringing the Fund total to \$1,133 million by the end of FY 07 (or about \$455 million short of the 10% FY 07 level). By FY 10, assuming no change in Fund balance, the Fund would be \$635.6 million short of the 10% FY 10 level. Note, however, that these projections have been somewhat inaccurate in the past. In 2005, it was projected that only \$76.3 million would be transferred to the Fund in FY 05. *In fact*, however, \$306.0 million was transferred.

The Governor’s proposed midterm adjustments would increase grants to towns by \$34.1 million over the FY 06 budget, and \$9.9 million over the amount originally appropriated for FY 07. This proposed increase for FY 07 is about 1% over FY 06, if one does not include the new Casino Assistance Revenue (CAR) grant discussed below (as it is not a source of *new* revenue to towns but a substitution of state funds for local property tax revenues). Under the Governor’s mid-term adjustments, education aid in FY 07 would increase by just 1.3% and non-education aid by just 0.5% as compared to FY 06. The FY 07 Education Cost-Sharing (ECS) grant would increase by only 0.4% over FY 06, the lowest rate of increase in 10 years.²¹

Changes in the formula grants between FY 05, FY 06, and the Governor’s proposed FY 07 adjustments are shown in the table below. As is evident from the table, the more significant growth in education and general government grants (excepting the CAR grant) occurs from FY 05 to FY 06; proposed growth between FY 06 and FY 07 is far less:²²

Summary of Changes in Formula Grants to Municipalities (in millions)			
Grant	FY 05	FY 06 (est.)²³	Gov’s Proposed FY 07
Education Grants			
Education Cost Sharing (ECS)	1,563.0	1,619.5	1,626.5
Public School Transportation	43.1	48.0	48.0
Non-Public School Transportation	3.3	4.0	4.0
Magnet Schools	67.9	85.5	95.4
Special Education –Student-Based Excess Cost	67.1	88.8	90.6
Special Education – Equity	0.0	3.0	0.0
Misc. Education Grants (priority school districts, adult education, other education grants)	122.5	133.0	142.5
Subtotal Education Grants	1,883.8	2,001.4	2,026.6
General Government Grants (except CAR)			
PILOT – Private, tax-exempt property (hospital, college)	105.9	111.2	111.2
PILOT –State property	72.5	77.9	78.1
Pequot Grants to Towns/Supplemental Municipal Aid	85.0	86.3	91.1
Town Aid Road Grants	20.0	28.0	28.0
LoCIP	30.0	30.0	30.0
PILOT- New manufacturing machinery & equipment	50.7	52.8	53.9
Miscellaneous General	19.1	19.3	20.8
Subtotal General Government Grants (except CAR)	383.2	405.5	413.1
TOTAL FORMULA GRANT (except CAR)	2,267.0	2,406.9	2,437.7

²¹ CT Conference of Municipalities, *CCM’s Initial Response to the Governor’s Proposed Budget*, available at www.ccm-ct.org.

²² As the Governor’s budget notes, “after years of capped and limited growth” the state’s education grants are projected to grow by 7.6% between FY 05 and FY 07. *FY 2006-07 Governor’s Midterm Budget Adjustments* (February 8, 2006), p. 41. Note that this growth rate is *not* adjusted for inflation or increase in student population

²³ These figures include all appropriations of the FY 05 surplus for use in FY 06 and FY 07, as well as the funds appropriated in the FY 06 and 07 budgets.

Casino Assistance Revenue (CAR) grant	0.0	0.0	496.8
TOTAL FORMULA GRANTS (including CAR)	2,266.8	2,409.4	2,936.5
Source: <i>FY 2006-07 Governor's Midterm Budget Adjustments</i> (February 8, 2006), p. 41.			

The Governor's proposed FY 07 mid-term adjustments would increase spending on education-related grants *over the current* FY 07 budget²⁴ as follows:

- Add \$3.5 million to the Priority School District Grants to fund 500 new pre-school "slots" for Education Reference Group "I" towns (increasing the number of "slots" from 7,000 to 7,500);
- Add \$0.51 million for the Early Childhood Competitive Grant Program account to fund five new districts with grants of \$107,000 each.

The Governor's proposed FY 07 mid-term adjustments also would eliminate funding for the Special Education Excess Cost-Equity grant that provides funding to towns that have extraordinarily high special education costs, transferring the \$4 million in education aid for this purpose to the Special Education Excess Cost-Student Based grant. In addition, the Governor's proposed FY 07 budget would:

- Add \$3.18 million for energy and marketing costs for the Capital City Economic Development Authority.
- Add \$4.25 million in funding for new Urban Violence grants.

Finally, the Governor proposed to transfer funding for the Mashantucket Pequot and Mohegan Grant to the General Fund where it will be re-named Supplemental Municipal Grant; \$86.25 million would then be appropriated from the General Fund and distributed to the towns under the pre-existing formula. In addition, she proposes to create a new Casino Assistance Revenue Grant that would be funded with revenues from the casinos (and in the first years, also a transfer of funds from the General Fund). This grant would offset the property tax revenues that would be lost by towns by the Governor's proposed repeal of the personal property tax on Connecticut-registered passenger vehicles or motorcycles not used in whole or part for commercial purposes. (Her proposed exemption appears to exclude certain pick-up trucks and motorcycles owned by individuals, while including vehicles not owned by individuals (e.g., by leasing companies)). A more detailed description of this proposal can be found in Section III of this report.

It should be noted that the Office of Fiscal Analysis' summary of the Governor's proposed FY 07 budget reports a different estimate for total FY 06 spending on major town grants from what is reported in the Governor's budget. OFA reports a total of \$2.363 billion in estimated FY 06 state funding to towns for major state grants, compared to the Governor's estimated \$2.407 billion.²⁵ Appendix A (Statutory Formula Grants) and Appendix B (Casino Assistance Revenue Grant) of OFA's February 27, 2006 report provides town-by-town analysis of state aid under the various grant programs.²⁶

²⁴ The Governor would continue the increases (over funding in FY 06) in education grants already adopted as part of the FY 07 budget, including increased funding for magnet schools and for priority school districts to increase the school readiness slot subsidy from \$7,750 to \$8,025.

²⁵ Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), pp.13-14.

²⁶ Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), pp. 32-52.

7. Impact of Federal Budget Changes. As CT Voices' recent report *Getting Connecticut's Fiscal Ship in Order* warns,²⁷ recent cuts enacted by the President and Congress in federal entitlement and discretionary spending are increasingly likely to impact Connecticut's budget. In fact, the Governor's proposed mid-term adjustments to the FY 07 budget include at least \$7.7 million in new state appropriations to cover programs and services previously funded with federal funds, including in the budgets of OPM (\$0.1 million), Department of Public Safety (\$0.6 million), Department of Mental Health and Addiction Services (\$0.4 million), Department of Transportation (\$3.0 million), Department of Social Services (\$0.5 million), Department of Correction (\$1.1 million), Judicial Department (\$1.9 million), and the Public Defender Services Commission (\$0.1 million).

8. Impact of Governor's Proposed Changes on the Out-Years. Notwithstanding that OFA's revenue estimates are higher than the Governor's, OFA finds that the Governor's proposed FY 07 budget would *increase* projected budget shortfalls beginning in FY 08. Specifically, OFA finds that the Governor's proposed FY 07 revisions (and primarily her proposed revenue changes, discussed below) would result in an *increase* to previously-projected deficits of \$267.8 million in FY 08, \$304.3 million in FY 09, and \$303.7 million in FY 10. Based on the Governor's proposed FY 07 revenue and spending revisions, OFA *now* estimates current services surpluses of \$140.5 million in FY 06 and \$70.8 million in FY 07, switching to current services *deficits* of \$492.2 million in FY 08, \$612 million in FY 09, and \$716.2 million in FY 10.²⁸

B. Proposed FY 07 Spending Adjustments, In a Bit More Detail

1. Overview of Proposed FY 07 Adjustments, in Context. The following table shows General Fund appropriation totals for the budgets of various state agencies of particular importance to children, youth, and families. Comparisons are made among actual spending in FY 02, estimated spending in FY 06, the FY 07 budget as currently enacted, and the Governor's proposed FY 07 midterm adjustments.

Note that in the following table:

- For the following agencies, the Governor's proposed FY 07 Midterm Adjustment budget is *less than* actual spending in FY 02, *not adjusted for inflation*: Department of Higher Education, State Library, Department of Public Health, Office of Policy and Management, Department of Labor, Office of Workforce Competitiveness, Department of Economic and Community Development, and Department of Environmental Protection.
- For the following other agencies, the Governor's proposed FY 07 Midterm Adjustment budget is *less than* FY 02 spending, *partially adjusted for inflation (to 2005 dollars only)*: University of Connecticut Health Center, Connecticut State University, Regional-Community Technical Colleges, and the Office of Protection and Advocacy:
- Agency budgets in which the Governor's proposed FY 07 Midterm Adjustment would *increase* funding over the FY 07 budget as currently approved are bolded and highlighted in blue in the column for the FY 07 Governor's Midyear Adjustment;

²⁷ S. Geballe, *Getting Connecticut's Fiscal Ship in Order* (Connecticut Voices for Children, 2006), available at www.ctkidslink.org/publications/bud06fiscalship02.pdf.

²⁸ Office of Legislative Research, *Supplemental Analysis of the Governor's 2005-2007 Midterm Budget Adjustments* (February 27, 2006), pp. 3, 22. OFA had predicted current services shortfalls of \$224.4 million in FY 08, \$307.7 million in FY 09, and \$412.5 million in FY 10 on February 1, 2006.

- Agency budgets in which the Governor’s proposed FY 07 Midterm Adjustment would *cut* funding from the FY 07 budget as currently approved are underlined and highlighted in red in the column for the FY 07 Governor’s Midyear Adjustment.

Agency (General Fund Budget)	FY 02 (Actual Spending) [\$M]	FY 02 (adjusted for inflation, to 2005\$)	FY 06 Est. [\$M]	FY 07 As Enacted [\$M]	FY 07 Gov’s Proposed Adjustments (\$M)
Legislative Management	\$48.621	\$52.997	\$56.831	\$59.889	\$59.889
Perm. Comm. On Status of Women	\$0.549	\$0.598	\$0.691	\$0.705	\$0.705
Commission on Children	\$0.572	\$0.623	\$0.772	\$0.818	\$0.818
Latino & Puerto Rican Affairs Commission	\$0.366	\$0.399	\$0.460	\$0.486	\$0.486
African-American Affairs Commission	\$0.279	\$0.304	\$0.354	\$0.373	\$0.373
DCF	\$539.882	\$588.471	\$726.170	\$758.984	<u>\$787.981</u>
Children’s Trust Fund	\$5.318	\$5.797	\$10.259	\$11.101	<u>\$11.265</u>
Office of the Child Advocate	\$0.548	\$0.597	\$0.924	\$0.985	<u>\$0.988</u>
State Dept. of Education	\$1,995.545	\$2,175.144	\$2,181.124	\$2,218.540	<u>\$2,228.583</u>
Dept. of Higher Education	\$62.696	\$68.339	\$45.443	\$45.959	<u>\$48.775</u>
University of Connecticut	\$190.560	\$207.710	\$205.226	\$212.977	<u>\$212.999</u>
UConn Health Center	\$74.293	\$80.979	\$75.956	\$76.501	<u>\$76.597</u>
CT State University	\$139.276	\$151.811	\$143.847	\$148.226	<u>\$148.597</u>
Regional Community- Technical Colleges	\$129.262	\$140.896	\$134.085	\$136.108	<u>\$136.764</u>
Teachers’ Retirement Board	\$217.762	\$237.361	\$249.345	\$262.513	<u>\$262.164</u>
State Library	\$17.439	\$19.009	\$10.999	\$11.107	<u>\$11.540</u>
Department of Social Services	\$3,589.653	\$3,912.722	\$4,245.855	\$4,343.975	<u>\$4,278.301</u>
Department of Public Health	\$77.752	\$84.750	\$73.564	\$73.411	<u>\$76.462</u>
Department of Mental Retardation	\$701.326	\$764.445	\$816.917	\$845.753	<u>\$863.407</u>
Department of Mental Health & Addiction Services	\$411.486	\$448.510	\$482.215	\$487.325	<u>\$498.740</u>
Office of Protection & Advocacy	\$2.579	\$2.811	\$2.470	\$2.706	<u>\$2.510</u>

Agency (General Fund Budget)	FY 02 (Actual Spending) [\$M]	FY 02 (adjusted for inflation, to 2005\$)	FY 06 Est. [\$M]	FY 07 As Enacted [\$M]	FY 07 Gov's Proposed Adjustments (\$M)
Office of Policy & Management	\$226.079	\$246.426	\$150.444	\$127.025	\$140.837
Dept. of Public Safety	\$129.566	\$141.227	\$147.946	\$138.918	\$165.721
Judicial Department	\$343.767	\$374.706	\$393.601	\$404.844	\$404.028
Public Defenders Services ²⁹	\$32.838	\$35.793	\$39.084	\$37.944	\$50.930
Dept. of Correction	\$513.374	\$559.578	\$583.322	\$600.500	\$614.833
Dept. of Labor	\$59.421	\$64.769	\$52.465	\$52.927	\$54.816
Office of Workforce Competitiveness	\$6.772	\$7.381	\$5.905	\$5.662	\$5.692
Dept. of Economic & Community Development/Dept. of Business & Employment	\$23.631	\$25.758	\$16.991	\$18.672	\$21.013
Dept. of Environmental Protection	\$42.585	\$46.418	\$33.118	\$34.037	\$34.824
Elections Enforcement Commission	\$0.789	\$0.860	\$1.134	\$1.126	\$1.404
Ethics Commission/Office of State Ethics	\$0.995	\$1.085	\$0.779	\$1.445	\$1.787
Freedom of Information Commission	\$1.262	\$1.376	\$1.804	\$1.608	\$1.911
Debt Service –State Treasurer	\$992.071	\$1,081.357	\$1,273.379	\$1,388.328	\$1,380.842
TOTAL GENERAL FUND (if all agencies are included, but excluding projected savings)	\$11,662.265	\$12,711.869	\$14,290.153	\$14,859.669	\$15,024.184

2. Proposed FY 07 Adjustments, By Key Agency³⁰

a. Department of Children and Families. The Governor's Midterm Budget Adjustments would increase DCF's FY 07 General Fund budget by close to \$29 million, to \$787.98 million. This is a 19.5% (\$128.4 million) increase in just two years (since FY 05) and a 76% (\$340.5 million) increase since FY 00. Coupled with this very significant increase in funding has been some

²⁹ Funding related to the payment for the appointment of counsel in child protective service and related cases is transferred in FY 07 from the Judicial Department to a new Commission on Child Protection which is in the Public Defender Services Commission for administrative purposes only. The large increase in the Public Defender budget and decline in the Judicial Department budget (offset by some funding increases) results from this change.

³⁰ This summary is based on the Office of Fiscal Analysis report, *Synopsis of the Governor's FY 07 Midterm Budget Adjustments* (February 10, 2006) and also the *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006).

measurable progress in practice.³¹ For example, the number of children in residential care has declined by nearly 25% over the last 22 months; more than 200 children and youth are now receiving care in a more appropriate, community-like setting. The number of children in *out-of-state* residential programs also has declined, by 40% (197 children) since September 2004. Among children whose permanency plan is adoption, the likelihood of a “timely” adoption (i.e., within 24 months or less) is almost three times greater than in the first quarter of 2004. Also, as a direct result of increased financial support for more foster care clinics, the percentage of children and youth who receive a timely multi-disciplinary examination upon entering foster care has increased from 19% in early 2004 to 72% now.

The Governor’s proposed changes to DCF’s FY 07 budget for juvenile justice include:

- *Community Diversion Boards.* Combating urban violence by fully funding the one existing Community Diversion Board in Hartford, and establishing two new Boards in Bridgeport and New Haven. These Boards hold youth responsible for their actions by requiring restitution to victims, while concurrently addressing the mental health, substance abuse, and other needs of the youth. Funding of \$0.55 million is proposed.
- *In-home services.* Expanding intensive in-home services by purchasing 100 additional Family Functional Therapy (FFT) slots to serve about 250-300 additional juvenile justice clients annually and “to expand evidence-based and intensive home-based services to address problems with program access, capacity, and adequacy of post-treatment follow-up,”³² at a cost of \$1 million.
- *Emily J.* Adding \$3.51 million for a statewide expansion of services as agreed to under the Emily J. Settlement Agreement.
- *Gender-specific services.* Expanding programs for girls involved in the juvenile justice system, by:
 - Opening a new 4-bed self-contained secure state-operated facility for girls, at a half-year cost of \$0.464 million for fifteen positions and associated other expenses (and with a proposed bonding authorization of \$1 million recommended for capital costs associated with this facility)
 - Opening 3 additional group homes to serve 4-6 girls each, at a three-quarter year cost of \$2 million (\$3 million in FY 08)
 - Funding 3 additional Multi-Dimensional Treatment Foster Care programs, at a half-year cost of \$0.375 million (\$0.75 million in FY 08)
- *Residential treatment.* Achieving savings of \$4.61 million from downsizing residential treatment programs for girls that have had difficulty starting and/or have not been fully utilized.
- *Community supports.* Establishing juvenile justice community supports by:
 - Developing two Educational Re-entry and Support Programs to provide comprehensive transition, reintegration, and support services in two cities through a partnership with local schools and community-based organizations, at a cost of \$1.028 million
 - Funding a School-Based Balanced and Restorative Justice (BARJ) Program for delinquent youth that encompasses community safety, accountability and skill development, at a cost of \$0.225 million.
- *Alternatives to CJTS.* Authorizing \$5 million in bonding to support the planning and development of new, smaller Treatment, Reintegration and Education Centers that will replace the

³¹ Greater detail about these proposed budget changes and about changes in practice was provided in the testimony of DCF Commissioner Darlene Dunbar to the Appropriations Committee on February 17, 2006, and is incorporated in this summary.

³² Testimony of DCF Commissioner Darlene Dunbar to the Appropriations Committee (February 17, 2006).

Connecticut Juvenile Training School and provide more appropriate care to the boys now housed at CJTS.

The Governor's proposed changes to DCF's FY 07 budget for Behavioral Health/Child Protective Services include:

- *Home-based services.* Expanding Intensive Home-Based Services by purchasing additional Family Functional Therapy (FFT) slots to allow for the diversion of children and youth from out-of-home care and/or to bring them back to their homes and communities, at a cost of \$0.5 million.
- *Family reunification services.* Creating a new Intensive Reunification Program for families experiencing the initial removal of a child for protective services reasons that immediately puts in place in-home services following the removal of the child (but before a contested hearing on an Order of Temporary Custody). The program would be “designed to reduce those risk factors that lead to the removal of a child during the period of time prior to the contested custody hearing” with the goal of avoiding the permanent removal of the child if the risk can be sufficiently reduced, thereby avoiding “the psychological damage that such removals can entail.”³³ Cost is stated by OFA to be \$1.125 million (but stated in the Governor's budget to be a net increase of \$0.625 million).
- *Therapeutic group homes.* Based on DCF's spring 2005 review of children in residential facilities that identified over 250 children and youth who would be more appropriately placed in small group homes (rather than residential facilities), the Governor's budget would further expand existing group home capacity by:
 - Annualizing the cost of the 24 private Therapeutic Group Homes that are to be opened by June 30, 2006 and that were developed in response to an agreement of the Juan F. Transition Task Force, at a cost of \$12.28 million
 - Continuing the development of group home capacity to meet the needs of the approximately 85 children who remain on the list of identified children needing group home services by providing \$4.75 million to continue capacity development
 - Providing \$0.25 million to support an evaluation of the effectiveness of group homes.
- *Youth shelters/emergency care.* Replacing the current DCF-funded Emergency Shelter System for adolescents needing emergency care (which was “not intended to serve children with the range of behavioral health issues and needs that they are currently serving”) with fourteen smaller programs with about six beds each. These new Short Term Assessment Centers will be “capable of providing for the stabilization of the children they serve, while assessing, and transitioning the child to an appropriate longer-term placement or reunifying him or her with their family.” The cost of this transition, and of providing an array of on-site clinical supports to this population of children and youth who are presenting with clinical issues of increasing intensity and complexity, is estimated at \$1.55 million.
- *Savings.* Achieving other savings by:
 - Delaying implementation of a new Medication Management System until October 2006, for a savings of \$0.419 million
 - Delaying a budgeted enhancement of services provided by Traditional Group Homes until October 2006, for a savings of \$0.302 million
 - Updating cost estimates associated with development of Treatment Foster Care Homes due to slower-than-expected recruitment of homes, for a savings of \$3.05 million.

³³ Testimony of DCF Commissioner Darlene Dunbar to the Appropriations Committee (February 17, 2006).

Other changes proposed by the Governor for the FY 07 budget include:

- Reducing what have been shown to be excessive budget reductions associated with limiting the administrative and general costs of private provider contracts, for a cost of \$3.6 million.
- Providing additional funding of \$1.374 million to meet DCF's anticipated needs for office space, and associated moving costs.
- Providing \$2.61 million in funds for salary adjustments for staff in settled bargaining units.
- Providing \$1.83 million in funds for increased energy costs.

Finally, the Governor recommends a 2% Cost of Living Adjustment (COLA) for private providers effective October 1, 2006. She recommends adding \$2.46 million to DCF's budget for these COLA increases, to be supplemented by \$2.28 million that will be transferred to DCF from OPM's Contingency Needs account in FY 07 (representing FY 05 surplus funds carried forward, but not used by OPM, in FY 06 and now carried forward to FY 07 for this purpose).

b. Council to Administer the Children's Trust Fund

The Governor proposes \$0.225 million in new FY 07 funding (and \$0.3 million in FY 08) to replace funds currently being used as match for a federal leverage grant that has been used to fund Nurturing Families Network (NFN) services. The NFN program currently operates in twenty-five of the twenty-nine birthing hospitals in Connecticut, providing early identification and intervention services for at-risk mothers and newborns to prevent child abuse and neglect. Four additional programs are to become operational in FY 07. The replacement of the federal dollars with state funds will enable Connecticut to claim Medicaid reimbursement for these services, resulting in a projected General Fund revenue *gain* of about \$2.6 million in FY 07 (and \$3.5 million in FY 08).

c. State Department of Education (SDE)

The FY 07 SDE General Fund budget proposed by the Governor (\$2,228.6 million) is \$10.04 million more than the FY 07 budget as originally adopted. It is also \$47.5 million more than estimated spending by SDE in the FY 06 budget, i.e., just a 2% increase *not adjusted for inflation or an increase in the number of students being educated*.

An even longer-range look at SDE's budget is crucial. In FY 01, SDE spent \$2,170 million. Thus, the Governor's proposed FY 07 budget is just \$58.6 million more than the amount SDE actually spent in FY 01. That is, since FY 01, SDE's budget has increased a *total* of 2.7%, or less than 0.5%/year, well below the rate of inflation. To merely keep pace with inflation, SDE's FY 07 budget would need to be more than \$2,400 million (based on its FY 01 budget).

In short, although education is key not only to individual and family economic security but also to Connecticut's economic competitiveness, *state* investment in public education has markedly declined since FY 01, taking inflation into account.

The Governor's proposed changes to SDE's FY 07 budget include:

- *School readiness.* Providing \$3.484 million in additional funds to the Priority School District account to increase from 7,000 to 7,500 the number of pre-school "slots" for children in schools in Education Reference Group I (the state's poorest school districts).

- *Early childhood programs.* Providing \$0.535 million in additional funds to the Early Childhood Program so that five additional communities can receive funds through the Early Childhood Competitive Grant program at \$107,000 each.
- *Connecticut Mastery Tests.* Adding \$1.5 million to develop separate Connecticut Mastery Tests for students with disabilities (to address the requirement of the federal No Child Left Behind law that almost all children take the CMT).³⁴
- *Charter schools.* Providing \$1.72 million in new funds to support the “natural growth” in enrollment in the state’s charter schools that have more than six grades. If a school has more than six grades, the enrollment ceiling of 300 students will be allowed to increase to 400 students (a change that will allow charter schools collectively to educate about 215 more students).
- *NCLB litigation.* Adding \$0.25 million to pay for legal and education experts to defend against the December 2005 lawsuit brought by the CT Coalition for Justice in Education (joined by public schools students and their guardians) to challenge the adequacy of Connecticut’s state funding for education.
- *Amer-I-Can.* Providing \$0.25 million in funds for a pilot “Amer-I-Can” program that “empowers students to take charge of their own lives so they can achieve their full potential.”
- *Other.* Adding \$2.01 million for increased energy costs, \$0.75 million for salary adjustments, and \$45,000 for a new internal audit position.

In addition, the Governor proposes to re-allocate \$569,000 of funds from the Inter-District Cooperation grant account to the Magnet School grant (\$420,000) and the Open Choice grant (\$149,000) for enhanced summer school programs. The Governor also proposes to re-allocate \$4 million in funds from the Special Education Excess Cost-Equity grant to the Excess Cost-Student Based grant.

4. Department of Higher Education

The Governor’s proposed \$2.82 million (7.3%) increase in funding for the Department of Higher Education would bring DHE’s proposed FY 07 budget to \$48.8 million. This amount, however, remains far *less than* the amount actually spent by DHE in FY 02 (\$69.1 million), not even adjusting for inflation. Adjusted for inflation,³⁵ DHE’s FY 07 budget, as proposed by the Governor, would be almost 30% *less than* its FY 02 budget (\$19.6 million less).

As part of her Jobs Initiative, the Governor recommends establishing a loan forgiveness program (at a cost of \$3.0 million) for students who agree to work in a Connecticut high-needs field for up to five years after graduation. Half of the funding is specifically designated for students who become math or science teachers. However, the Governor’s FY 07 budget adjustments would also *cut* the Connecticut Independent College Student Grant funds by \$0.27 million, while providing about \$87,000 to fund the federal maintenance of effort requirement for the Capitol Scholarship Program.

That the Governor’s proposed increases in FY 07 are so modest, and do not even bring state funding for DHE up to FY 02 spending levels, poses significant risk to Connecticut’s economic

³⁴ Note that Connecticut filed litigation against the federal government to challenge the No Child Left Behind Act’s unfunded mandates that are estimated to impose some \$50 million in costs on Connecticut, without federal compensation.

³⁵ Throughout this report, the rate of inflation is based on the Consumer Price Index rather than more specific indices, such as the consistently-higher Higher Education Price Index (HEPI)(2.2% compared to 4.7% respectively in 2005). Board of Governors for Higher Education, *Connecticut Public Higher Education: 2005 System Trends*, p. 45. Thus, this report’s measure of erosion of public investment in higher education is a conservative one.

competitiveness. As noted in the Governor's proposed budget, nearly 78% of Connecticut's 34,570 public high school graduates in 2004 entered 2- or 4-year higher education institutions. Of these students, slightly more than 40% *left* Connecticut to attend college. To encourage more of Connecticut's youth to remain within the state for college – and thereby help stem the out-migration of so many of our youth – Connecticut must not only restore the funds that were cut from the CT Independent College Student Grant and the CT Aid for Public College Student Grant when deficits began, but then must also *increase* funding for these grants and loan forgiveness programs.

5. *Department of Social Services*

The FY 07 DSS General Fund budget proposed by the Governor (\$4,278.3 million) is \$85.7 million *less than* the FY 07 budget as originally adopted (\$4,364.0 million). It is just \$32.5 million more than estimated spending in FY 06 budget (\$4,245.9 million), a very modest 0.8% increase, that is less than inflation.

The *increases* in funding proposed by the Governor for FY 07 would make the following changes:

- *Fund a 2% rate increase* for nursing homes, residential care homes, and Intermediate Care Facilities for the Mentally Retarded (ICF/MRs) at a total cost of \$31.6 million, of which \$19.1 million is included as proposed new funding in the DSS FY 07 budget (with the balance being FY 05 surplus funds in OPM's budget that are being carried-forward for this purpose);
- *Enhance dental services for HUSKY children* at a cost of \$2.95 million in new funds in FY 07. These funds will implement the "Access for Baby Care"(ABC) Program on a pilot basis. Under this program, the child's current pediatrician would examine an infant at regular intervals before the child reached age 3 and would apply topical fluoride to prevent tooth decay, as well as teach infant oral hygiene practices. In addition, DSS would expand its dental program to cover sealant coverage for children's eight premolars, based on evidence that such sealants prevent tooth decay that can lead to more extensive dental disease (and the higher dental costs to treat it). According to DSS, national data show that the decay rate in a sealed tooth is about 10% that of an unsealed tooth.³⁶
- *Provide start-up funds for a premium assistance program* for clients in HUSKY A. Under this proposal, DSS would seek a federal waiver that would allow it to require HUSKY A clients³⁷ to enroll in health plans offered by their employers when the plans were available and affordable. Start-up funds of \$0.5 million are proposed in FY 07 for "administrative efforts" needed to implement the program. Under the initiative, DSS would develop a "wrap-around" program that will "coordinate coverage between the Medicaid program and private insurance plans, assuring no loss of benefits and no change in coverage."³⁸ DSS would help cover any additional costs to the families (such as premiums, deductibles, and co-pays). It is estimated that savings of \$5 million in Medicaid will be achieved in FY 08 because employers of HUSKY A recipients would now be contributing to their health care coverage.

³⁶ CT Department of Social Services, *Midterm Adjustments to the FY 2007 Budget –Reduction Adjustment: Sealant Coverage for Pre-Molars* (November 8, 2005).

³⁷ DSS testified that, according to a survey by the Office of Health Care Access, almost 13,000 HUSKY families are eligible for employer coverage but have not enrolled due to cost, and 23,000 HUSKY adults are enrolled in employer-based coverage but have other family members enrolled in HUSKY. *Testimony of Patricia Wilson-Coker to the Appropriations Committee* (February 17, 2006), p. 3.

³⁸ *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006), p. 33.

- *Transportation for Employment Independence Program.* Due to the depletion of federal TANF High Performance Funds (which are no longer available to DSS), \$0.5 million in state funds is proposed to restore “some of the transit routes that provide transportation to employment sites of TFA clients” that had previously been funded with these federal funds.
- *Elderly nutrition program.* Due to reductions in federal funding and increasing costs, \$0.5 million in new state funds are proposed to allow this program to continue to provide meals and nutrition education to seniors age 60 and older (and concurrently help keep older adults in their homes and avoid costly hospitalizations and nursing home costs). In 2004, this program served 24,700 seniors, with each participant receiving about 100 meals. In FFY 2004, federal funding was \$1.99 million, but has been cut by \$0.47 million. Without state funding to address rising costs and caseloads and this reduction in federal funding, the number of meals served would need to be reduced by 120,000 in the upcoming year.
- *Nursing Facility Transition Project.* \$0.1 million is proposed to ensure continued operation of this project that helps state residents with disabilities who choose to leave nursing home placements transition to the community.

In addition, the Governor proposes to extend Acquired Brain Injury (ABI) and Personal Care Assistance (PCA) waiver services to clients after they reach the age of 65. While the Governor states that “no additional funds are expected to be needed in FY 2007,” she also notes that “allowing clients to continue on the waiver may result in the need to increase the number of slots under these waivers in subsequent fiscal years.”³⁹

The Governor also proposes a number of changes that would result in *reductions* in DSS’ FY 07 funding. These changes include:

- *Change Medicaid’s medical necessity definition.* The proposed new definition, like the definition adopted as part of the recent restructuring of the State Administered General Assistance Program, would “combine the concepts of medical necessity and appropriateness under a single definition as is done in Medicare and under most public sector and commercial health insurance programs,” and would update DSS’ definition to “allow for evidence based medical necessity decisions.”⁴⁰ The estimated “savings” from this change, resulting from DSS avoiding “unnecessary medical expenses,” are \$3.1 million in FY 07.
- *Revise funding to reflect current expenditure and caseload trends.* An estimated \$48.95 million would be saved based on current caseload trends, without a reduction in services.
- *Require certification for medication administration in residential care and boarding homes.* Current law allows unlicensed personnel to obtain certification for the administration of medication. The Governor proposes to require residential care homes and boarding homes to have staff certified to provide medication to residents, rather than relying on nurses employed by home health agencies to provide such medication. Currently, these nurses receive \$58.76 for a medication administration visit (and half the amount for each subsequent client at the same location). That is, according to DSS, a nurse administering medications to six clients in the same boarding home might receive \$205 although the total visit may last only 30 minutes. This change is estimated to save \$1.29 million.
- *Modified prior authorization requirements for home health aides.* Current DSS policy allows home health aides to provide 20 hours per week per client of home health services without

³⁹ FY 2006-07 Governor’s Midterm Budget Adjustments (February 8, 2006), p. B-103.

⁴⁰ CT Department of Social Services, *Midterm Adjustments to the FY 2007 Budget –Reduction Adjustment: Sealant Coverage for Pre-Molars* (November 8, 2005).

requiring prior authorization. The Governor proposes to reduce this number to 14 hours per week per client (DSS' estimate of the time required to provide "medically necessary hands-on-care to persons who need assistance with the Activities of Daily Living (ADLs). DSS estimates a savings of \$0.88 million as a result, since "most payments for services between 14 and 20 hours would be eliminated."

- *Recycle customized wheelchairs.* DSS' expenditures for durable medical equipment have increased from \$19.2 million in FY 02 to \$30 million in FY 05. A significant portion of this cost is for customized wheelchairs; custom power wheelchairs, for example, range in cost from \$6,000 to \$28,000 each, while customized wheelchairs cost between \$4,000 and \$5,000 each. Current law requires nursing homes to either discard customized wheelchairs or donate them to a decedent's family when the wheelchair can no longer be used. The Governor proposes to allow nursing homes to recycle customized wheelchairs; the increased use of refurbished wheelchairs is projected to save \$0.84 million, since refurbished chairs can sell for 75% of the cost of a new chair.
- *Carry-forward FY 2006 funds.* The Governor proposes to carry-forward \$50 million in FY 06 funds for use in DSS' budget in FY 07.

KidCare. The Governor re-allocates funding to support the KidCare behavioral health partnership between the DSS and DCF. The primary goal of this partnership has been to provide access to a more comprehensive and coordinated system of community-based behavioral health services and supports for the approximately 310,000 individuals enrolled in managed care through HUSKY, as well as children and youth in DCF's Voluntary Services program. Beginning in January 2006, behavioral health services are being carved out of Medicaid managed care. An Administrative Services Organization, under contract to DSS and DCF, now authorizes and manages behavioral health services, but without bearing financial risk. To fund this transition, the FY 07 budget assumes a shift in funding of \$103.7 million *from* the managed care organizations (which will no longer manage or pay claims for this care) to KidCare. Funds also have been budgeted to accommodate a projected increase in service utilization, as well as the cost of the contract with the ASO. DSS estimates that the KidCare initiative will result in a *net increase* in costs of \$8.3 million in FY 06 and \$12.8 million in FY 07.⁴¹

A Bit of Context. Although one in ten Connecticut children lives below the federal poverty level (\$20,000/year for a family of four) and about one in four children lives below Connecticut's self-sufficiency standard, Connecticut has been *cutting* funding for programs that are essential to families seeking to achieve economic self-sufficiency.

In fact, DSS' total spending for non-health related income support programs for families raising children (e.g., cash assistance, child care, transportation assistance, energy assistance, housing assistance, job training, safety net services) has been *cut by more than 50%* since 1995, *not even adjusting*

⁴¹ The Governor's budget also assumes Medicare Part D savings of \$41.3 million in FY 07 for ConnPACE (since, with the implementation of Part D, about 50,000 ConnPACE enrollees will have at least a portion of their pharmacy needs paid for by the federal program). It also projects an annual cost of \$5.4 million from Part D for Medicaid coverage of co-payments for dual eligibles enrolled in Part D, based on legislative action in the November Special Session. CT Department of Social Services, *Midterm Adjustments to the FY 2007 Budget –Reduction Adjustment: Sealant Coverage for Pre-Molars* (November 8, 2005). NOTE: federal law requires as a condition of Part D that states pay a "clawback" to the federal government to help defray a portion of the Medicare drug expense for full-benefit dual eligibles whose Medicaid drug coverage (previously paid for in part by the state) is now assumed by the federal government through Part D. In FY 06, Connecticut must pay the federal government \$51.5 million, and \$138.6 million in FY 07. *FY 2006-07 Governor's Midterm Budget Adjustments* (February 8, 2006), p. 34.

for inflation (\$513.9 million in FY 95, compared to \$254.6 million in FY 06). If one adds in funding for job training in the Department of Labor budget, total funding declined by 43% over this period (\$523.8 million in FY 95 compared to \$298.0 million in FY 06). Adjusted for inflation, the total decline in funding was 67%..

About 23,000 families raising children still receive Temporary Family Assistance. The average TFA grant - \$445/month – provides an income that leaves a family raising children in *deep* poverty (defined as less than 50% of the federal poverty level). Yet deep, and persistent, poverty has been shown in repeated research to be strongly associated with multiple adverse developmental outcomes for children, in health and educational attainment specifically. Despite the pressing need to address child poverty, about 40% of federal welfare funds (TANF) are now being used to cover various DCF expenses, just as state funding has been diverted to other uses.

The Governor’s proposed budget continues this trend of dismantling “ladders” to economic opportunity, and creating new “chutes” to lives of persistent poverty. For example, her FY 07 budget would:

- Reduce funding for cash assistance by \$11.4 million “based on current expenditures and caseload trends.” These funds could be used, instead, to increase the basic cash assistance grant, which has not been adjusted upward for more than a decade.
- Cut Medicaid by \$61.2 million, although more than 10,000 HUSKY recipients have lost coverage due to new barriers to eligibility (e.g., elimination of self-declaration of income) and elimination of eligibility enablers (e.g., continuous eligibility) and actual access to health care for those enrolled in Medicaid – particularly for specialty care – is impeded by reimbursement rates that are well below market rates (and often below the actual cost to provide the care).
- Increase funding for Care 4 Kids (the child care subsidy program that in FY 05 provided child care assistance to about 23,000 children each month) by a meager 1.6% over FY 06 funding (to \$69.7 million). Adjusting for inflation, this represents a *cut* in funding compared to FY 06 and maintains funding at just 57% of funding in FY 02 (\$121.6 million), leaving many families who are in need of child care unable to afford it.

6. Department of Public Health

The FY 07 DPH General Fund budget proposed by the Governor is \$3.05 million *more than* the FY 07 budget as originally adopted. It is just \$2.9 million more than estimated spending in FY 06 budget, a 3.9% increase (\$76.463 million in the Governor’s proposed FY 07 adjustments, compared to \$73.564 million in FY 06).

Broader context is important. DPH’s proposed FY 07 budget remains *less than* DPH’s actual spending in FY 02 – five years earlier – not even adjusted for inflation (\$76.463 million in FY 07 as compared to \$77.752 million in FY 02). Adjusted for inflation, the FY 07 proposed budget is less than 90% of DPH’s actual spending in FY 02, a troubling decline given increasing threats of epidemic disease and bioterrorism.

The Governor proposes two modest increases in DPH’s budget over the FY 07 budget as adopted last year:

- *Newborn Screening.* Two changes are proposed to the Connecticut Statewide Newborn Screening Program which has experienced a significant growth in caseload since January 2005 in response to an expansion of the genetic and metabolic disorders for which the State Laboratory tests. First, the Governor proposes to intercept an additional \$0.16 million in newborn screening fees to support DPH's increased costs for newborn screening. Currently, \$0.35 million of the \$1.2 million in Newborn Screening Testing fees that are collected each year are intercepted and provided to DPH to pay for the costs of conducting this testing; the balance is counted as General Fund revenues. This proposal to intercept a total of \$0.5 million in fees would result in no additional expense to the state, but would reduce General Fund revenues by \$0.155 million. Second, the Governor recommends \$0.124 million in new state funding to support the cost of increased referrals to the state's two regional genetic treatment centers and of follow-up care for infants identified by the testing to be at risk for metabolic and genetic diseases.

- *Vaccinations.* The Governor recommends a total of \$1.945 million in new funding for DPH's immunization program: a) \$0.35 million to support the costs of expanding Connecticut's childhood immunization program to provide a new, more effective pertussis (whooping cough) vaccine to youth aged 11-18 years (an estimated 27,000 doses will be provided to youth who are ineligible for Medicaid); and b) \$1.6 million to provide routine immunization against Meningococcus for children aged 11 years and older while continuing vaccination of all college entrants living in dormitories (currently paid for with expiring private funds).

7. Department of Mental Health and Addiction Services

The Governor proposes a FY 07 DMHAS General Fund budget of \$196.85 million. This is \$1.63 million *more than* FY 07 budget as originally adopted (\$195.22 million), and is \$7.74 million more than estimated spending in the FY 06 budget (\$189.11 million), a 4.1% increase.

The *increases* in funding proposed by the Governor for FY 07 would result from the following changes:

- *Fund a 2% COLA for private grant-funded providers.* \$1.55 million is recommended (in addition to \$1.34 million of FY 05 surplus funds that will be transferred from OPM) to provide a 2% cost of living adjustment effective October 1, 2006 for grant-funded private providers.
- *Energy.* \$2 million of new funds are proposed for increased energy costs
- *Technical adjustments.* \$7.23 million of new funds are proposed for salary adjustments for settled bargaining units, \$1.6 million to annualize the cost of FY 06 deficiencies in DMHAS' "other expense" and "professional services" accounts, and \$90,000 to support social work services at Common Ground in Willimantic (services which had previously been funded with carry-forwards).
- *Forensic Transitional Case Management Program.* \$0.4 million in new state funds are proposed to continue this program that had been funded through a federal Justice Assistance Grant. The program provides case management services for offenders with substance abuse problems who are transitioning from correctional facilities to the Hartford and Waterbury areas.
- *Client information system.* \$0.2 million in new funding is proposed for two positions that will support the development and implementation of a new client information system that is to be funded with a new \$4.7 billion bond authorization. The system is designed to reduce the possibility of medical and medication errors, and thereby enhance the quality of care and assure continued compliance with JCAHO (which accredits DMHAS facilities).

- *Career-based mentoring.* The Governor proposes \$0.2 million as part of her “urban violence” initiative to support career-based mentoring for high risk inner city youth, and the implementation of a model youth violence prevention initiative “designed to break the cycles of violence, crime and substance abuse among middle/high school youth.”

The *reductions* proposed in the DMHAS budget would result from the following changes proposed by the Governor:

- *Partial hospital programs.* Save \$0.51 million by eliminating funding for partial hospital programs under the General Assistance Behavioral Health Program, and rely instead on intensive out-patient programs “where clinically appropriate.”
- *General Assistance Enhanced Care Clinics.* Save \$0.6 million by eliminating funding for this new service “due to problems with current statutory language.”
- *Detox services.* Remove from DMHAS’ budget the \$0.75 million saved through the FY 06 closure and subsequent restructuring of detox services in Norwalk.

The Governor proposes to maintain funding for all 500 units of housing in the supportive housing “Next Steps” initiative adopted last year. The initiative was funded at \$1.6 million in FY 06 and \$6 million in FY 07, with annualized costs estimated at \$12 million.

8. Department of Mental Retardation

The FY 07 DMR General Fund budget proposed by the Governor is \$17.65 million *more than* the FY 07 budget as originally adopted. It is \$46.49 million more than estimated spending in FY 06 budget, a 5.7% increase (\$863.4 million in FY 07 as revised, compared to \$816.9 billion in FY 06).

The Governor’s proposed *increases* in the FY 07 budget would:

- *Fund a 2% rate increase for grant-funded private providers* effective October 1, 2006. \$4.21 million in new funds are proposed for DMR’s budget in FY 07 and an additional \$3.66 million is to be transferred from OPM’s Contingency Needs account (from FY 05 surplus funds)
- *Fund services for additional youth ageing out from current placements.* \$1.93 million of new funds are proposed for FY 07 to provide residential program placements for 24 additional youth who are expected to age-out of their current placements and require residential program placements in FY 07. In addition, \$0.17 million in new funds are proposed to provide day program placements for 11 individuals expected to age-out of their current placements and who require day program placements.⁴²
- *Provide funds* for increased energy costs (\$1.77 million), for salary adjustments (\$6.94 million), and for increased charges for fleet vehicles (\$0.54 million).

In addition, the Governor proposes to transfer \$3.6 million from DCF to DMR to continue the initiative started in FY 06 that transfers individuals with mental retardation and a behavioral health

⁴² Children and youth with mental retardation who are living at home and who require special day and/or residential programs are placed in such settings, with funding provided by the local education authority and DCF. These placements not only contribute to their educational development, but also allow their parent/caretaker to maintain employment to support the family. When these youth reach a certain age, generally 21, they “age-out” of these particular systems. Funding for continued placement must be provided by DMR. *FY 2006-07 Governor’s Midterm Budget Adjustments* (February 8, 2006), p. 30.

diagnosis who are currently being served in DCF's Voluntary Services Program to DMR, with the expectation that their needs will be better served by DMR's service delivery system. The Governor also *retains* the \$12.7 million in funds already approved for the FY 07 budget that would allow 150 new individuals to be removed from the DMR wait-list and placed into appropriate settings as required by the settlement agreement in ARC CT v. Connecticut.

9. Governor's Office

The FY 07 General Fund budget proposed by the Governor for her own office is \$0.54 million more than the FY 07 budget as originally adopted. It is \$0.6 million more than estimated spending in FY 06 budget, just a 17.7% increase (\$3.995 million in FY 07 as revised, compared to \$3.394 million in FY 06).

The \$535,000 in new funds proposed for the Governor's FY 07 budget is for three positions, equipment and other expenses to establish the Office of Economic Development Policy within the Governor's Office. Included in this sum is \$250,000 for an economic development study to determine what structural and programmatic changes are needed to ensure that economic development policy retains and creates jobs in the state, to improve program coordination, and provide more comprehensive services in an effort to attract businesses to Connecticut.

10. Office of Policy and Management

The FY 07 OPM General Fund budget proposed by the Governor is \$13.8 million *more than* the FY 07 budget as originally adopted. It is \$9.61 million *less than* estimated spending in FY 06 budget, a 6.4% *cut* (\$140.84 million in the Governor's proposed FY 07 budget, compared to \$150.44 million in FY 06).

Taking a slightly longer perspective, the reduction in OPM's budget in the last five years has been sharp. The proposed FY 07 OPM budget is \$86 million *less than* OPM's actual spending in FY 02 – five years earlier – not even adjusted for inflation (\$140.837 million in FY 07 as compared to \$227.079 million FY 02). Adjusted for inflation, the FY 07 proposed budget is *just 57%* of the amount that OPM spent in FY 02.

The Governor recommends new funding in FY 07 for the following purposes:

- *Urban violence.* \$4.25 million to establish a new grant program for municipalities focused on preventing urban violent crime involving young people.
- *CCEDA.* \$3.2 million in additional funding to the Capital City Economic Development Authority for operations (energy) and marketing costs for the Connecticut Convention Center and the Greater Hartford Convention and Visitors Bureau.
- *Energy.* \$10 million for increased energy costs,⁴³ as well as \$0.1 million to compensate for expiring federal funds resulting from reductions by the federal Department of Energy. The \$0.1 million would be transferred to the proposed new Department of Energy, along with

⁴³ In total, the Governor's proposed FY 07 budget provides an additional \$40 million statewide (\$34 million in the General Fund and \$6 million in the Transportation Fund) for increasing energy costs in agencies.

five energy policy staff from OPM (and the associated \$0.24 million in personal service funds).⁴⁴

- *Staff.* \$0.34 million to increase OPM staffing levels (by 5 positions) to address legislative mandates involving justice planning and conservation and development planning and \$0.2 million (as a technical adjustment) to modify the FY 07 appropriation made as a result of PA 05-3 (June Special Session) that transferred funds and positions to OPM for a Criminal Justice and Planning Division.
- *Criminal Justice Information System.* \$0.45 million to provide on-going application support and system maintenance for the Offender Based Tracking System (OBTS), which is designed to track an individual's progress through the criminal justice system to facilitate the apprehension of offenders and the disposition of their cases. More than \$25 million in bond funds have been spent since 1993 to develop the OBTS.
- *Census Data Center.* A meager \$75,000 is proposed to reimburse the University of Connecticut's Center for Economic Analysis and Population Research for census-related activity. NOTE: Connecticut is one of a very few states that does not have a well-developed state Census Data Center that provides current information to state and local government, policy makers, businesses, and residents of the state.

The Governor's proposed *reductions* to the FY 07 OPM budget include:

- *LEAP.* Eliminate funding of \$0.85 million for the Leadership, Education, Athletics in Partnership Program (LEAP), an award-winning after-school and summer program targeted at urban at-risk youth.
- *PILOT.* Because FY 06 expenditures for Payments in Lieu of Taxes for new manufacturing machinery and equipment were significantly below the sum appropriated, \$2.5 million is reduced from the FY 07 budget.

Finally, the Governor proposes to transfer \$8 million of FY 05 surplus funds that had been appropriated and carried-forward for OPM's Contingency Needs account to various agencies to help pay for a 2% cost of living adjustment for certain private providers, effective October 1, 2006.

11. Department of Business and Employment

The Governor proposes to re-name the Department of Economic and Community Development the Department of Business and Employment. The FY 07 General Fund budget proposed by the Governor for this newly-named Department is \$2.34 million more than DECD's FY 07 budget as originally adopted. The proposed FY 07 budget is about \$4 million more than estimated spending in the FY 06 budget, a 24% increase (\$21.01 million in FY 07 as revised, compared to \$16.99 million in FY 06). The proposed FY 07 budget, however, is *less than* the amount DECD actually spent in FY 02 (\$21.8 million), *not* adjusting for inflation. In fact, adjusted for inflation, the proposed FY 07 budget is about 10% less than the amount DECD spent in FY 02.

As part of her *Jobs Initiative*, the Governor proposes new funding in FY 07 to:

- *Create a Planning and Community Development Planning Office* that would incorporate housing planning into state economic development strategy (\$0.125 million).

⁴⁴ The Governor proposes to establish a new Department of Energy with 8 staff and a FY 07 appropriation of \$0.85 million. Three of these positions and \$235,000 would be transferred from OPM's Energy Management Division.

- *Establish a Connecticut Research Institute* to collect statewide data and develop economic development policy initiatives (\$0.5 million).
- *Create an Office of National and International Commerce* to market Connecticut as business friendly (\$0.125 million).
- *CONNSTEP*. Fund CONNSTEP, the state’s manufacturing resource center that offers technical assistance to help state manufacturers, through the General Fund instead of bond funds (\$1 million).
- *Other*. Adjust funding for congregate facilities’ operational costs (to offset residents’ increasing medical costs which are consuming larger parts of their fixed incomes)(\$0.14 million), provide funding to fulfill PA 05-239 which requires the agency to develop and maintain a comprehensive inventory of all assisted housing in the state (\$77,250), and provide funding for salary adjustments (\$0.37 million).

13. *Department of Labor*

The FY 07 DOL General Fund budget proposed by the Governor is \$1.89 million *more than* the FY 07 budget as originally adopted. It is \$2.35 million more than estimated spending in the FY 06 budget, a 4.4% increase (\$55.49 million in FY 07 as revised, compared to \$53.14 million in FY 06).

A longer-term perspective is important. In FY 02, DOL’s budget was \$59.42 million (\$64.77 million in 2005 dollars). Thus, the proposed FY 07 budget is \$3.9 million (7%) *less* than DOL spent in FY 02. Adjusted for inflation, the proposed FY 07 budget is \$9.28 million (14%) less.

As part of her *Jobs Initiative*, the Governor proposes new funding in FY 07 to:

- *Create the 21st Century Jobs Program*. This program would provide financial incentives and technical assistance to small businesses that cannot afford the full cost of employee training programs for incumbent workers. Employers would be required to pay for 50% of the cost of the training (\$1.5 million).
- *Expand Apprenticeship Opportunities*. The Governor proposes to create new and additional apprenticeships (in occupations such as childcare development specialists and youth development practitioners, and in the fields of healthcare, information technology, and advanced manufacturing) as well as provide direct services to apprenticeship sponsors (employers, labor-management organizations) and apprentices. (\$250,000).
- *Connecticut Career Resource Network*. The Governor recommends picking up with \$150,000 in state funds the cost of the federally-funded Connecticut Career Resource Network (CCRN). Federal support for CCRN has declined for the last several years, and was eliminated in the federal FY 07 budget. CCRN is a primary source of Connecticut-specific career information used by the education community (teachers, guidance counselors, students and their parents), as well as by the workforce investment system to make informed decisions about career choices and preparation. It provides this information through publications, workshops and conferences, Internet-based information systems, training, and the marketing of career-related materials.

The Governor also proposes a \$0.1 million reduction in the FY 07 budget for the Jobs First Employment Services Program (stating that the funding was “duplicative”), proposes to transfer \$0.3 million in funds in the DOL budget for the Spanish American Merchant Association to the OWC budget, and adds \$0.33 million for salary adjustments for DOL staff.

14. Office of Workforce Competitiveness

The FY 07 OWC General Fund budget proposed by the Governor is \$30,087 *more than* the FY 07 budget as originally adopted. It is \$0.23 million *less than* estimated spending in FY 06 budget, a 3.6% *reduction* (\$5.69 million in FY 07 as revised, compared to \$5.91 million in FY 06).

A longer-term perspective is important. In FY 02, OWC's budget was \$6.77 million (\$7.38 million in 2005 dollars). Thus, the proposed FY 07 budget is \$1.1 million (16%) *less* than OWC spent in FY 02. Adjusted for inflation, the proposed FY 07 budget is \$1.69 million (23%) *less*.

As noted above, the Governor proposes to transfer \$0.3 million for the Spanish American Merchant Association from the DOL budget to the OWC budget. In addition, she proposes a reduction of \$83,098 to the CETC Workforce account and \$0.2 million to "other expenses" to "reflect historical spending patterns.'

15. Department of Public Safety

The FY 07 DPS General Fund budget proposed by the Governor is \$20.8 million *more than* the FY 07 budget as originally adopted. It is \$17.78 million *more than* estimated spending in FY 06 budget, a 12% *increase* (\$165.72 million in FY 07 as revised, compared to \$147.95 million in FY 06). This represents a pattern of continued growth in the DPS budget. In FY 02, spending was \$129.57 million (i.e., \$36.16 million less than the proposed FY 07 budget).

The Governor recommends additional FY 07 funding for the following purposes:

- *Combat urban crime.* \$0.52 million to pay over-time stipends to municipal police officers to establish a taskforce to combat urban violent crime. The task force would consist of both municipal police and state troopers, and would target "hotspots" of crime in urban areas.
- *DNA databank.* \$0.32 million to pickup four expiring federal positions and add one new position to help mitigate the current backlog of samples for the DNA databank. This includes funds (\$62,250) to purchase additional DNA kits.
- *Municipal stipends.* \$0.24 million to continue providing municipalities with \$1,200 monthly stipends to police departments who work with the State Narcotics Taskforce and federal law enforcement agencies.
- *Fingerprint cards.* \$0.15 million for a vendor to scan the existing backlog of 142,500 fingerprints cards.
- *Additional staff.* \$85,000 for two additional staff to conduct criminal history records checks for current or prospective employees of homemaker companion agencies, \$65,645 to add a Quality Control Manager to the Toxicology Lab, \$60,926 for an Information Technology position to aid in the maintenance, application support, and system administration of the Connecticut Online Law Enforcement Communications Teleprocessing (COLLECT), system and \$45,305 for a Fire and Life Safety Specialist position to review plans and do code inspections for compliance with the State Fire Safety Code and to assist in the implementation of the provisions of PA 05-3, § 110 (which requires inspections of residential buildings of more than 25 occupancies).

The Governor also proposes \$14.49 million in new funds for salary adjustments, \$2.7 million to adjust the overtime base, \$2.55 million to annualize the FY 06 "other expenses" deficiency, \$2.23 million for increased energy costs, \$1.1 million for fleet purchases, \$1.1 million for the COLLECT

system, and \$0.15 million in operating funds for mobile data terminals, among other proposed FY 07 increases.

16. *Division of Criminal Justice*

The FY 07 Division of Criminal Justice budget proposed by the Governor is \$4.29 million *more than* the FY 07 budget as originally adopted. It is \$3.98 million more than estimated spending in FY 06 budget, a 9.4% increase (\$46.27 million in FY 07 as revised, compared to \$42.29 million in FY 06).

Urban crime initiative. The Governor recommends \$0.4 million in additional funding in FY 07 for six new positions (three prosecutors and three inspectors) to staff the Racketeering and Continuing Criminal Activities Unit, which is to “employ a vertical prosecution approach” to “maximize effectiveness” in combating of urban violent crime. The budget also would add an additional prosecutor position to prevent a backlog of federal habeas corpus petitions and improve response time, and also increase the pay of 13 State’s Attorneys by \$3,000 effective October 1, 2006. The proposed FY 07 budget also adds \$3.1 million for salary adjustments and \$0.56 million to annualize the deficiency in the forensic sex evidence exams account.

17. *Public Defender Services Commission*

The FY 07 Public Defender budget proposed by the Governor is \$12.99 million *more than* the FY 07 budget as originally adopted. It is \$11.85 million more than estimated spending in FY 06 budget, a 30% increase (\$50.93 million in FY 07 as revised, compared to \$39.08 million in FY 06).

Nearly all of this increase, however, is attributed to the transfer of funding for court-appointed counsel in child abuse and neglect cases from the Judicial Department to a new Commission on Children Protection, which is now in the Public Defender Services Commission for administrative purposes only. The new Commission on Child Protection is to assume responsibility for appointment, training, supervision and payment of counsel on July 1, 2006. A total of \$9.512 million is transferred into the Public Defender’s budget in FY 07: \$9.2 million for the Commission on Child Protection account to pay counsel, and the rest to fund five positions for the Commission, one of whom is the Chief Child Protection Attorney.

The increases proposed by the Governor for FY 07 include \$2.68 million for salary adjustments, \$0.68 million to annualize the deficiency in the special public defender non-contractual and expert witness accounts, \$63,550 to pick-up with state funds one social worker position previously funded with federal funds (so that all Geographical Area offices have at least one social worker assigned), and \$37,642 to increase the salaries of 17 Public Defenders by \$3,000 effective October 1, 2006 (to keep consistency with the salary provisions for the State’s Attorneys).

18. *Judicial Department*

The FY 07 Judicial Department budget proposed by the Governor is \$0.82 million *less than* the FY 07 budget as originally adopted. It is \$10.4 million more than estimated spending in FY 06 budget, a 2.6% increase (\$406.1 million in FY 07 as revised, compared to \$393.6 million in FY 06).

The Governor recommends, for FY 07:

- *Juvenile justice.* A funding increase of about \$3.78 million for various juvenile justice programs administered by the Judicial Department's Court Support Services Division (CSSD). Roughly one-half (\$1.94 million) would be used to pick up expiring federal grants. These funds currently support: a) programs of court diversion for girls (i.e., two six-bed programs, one in Waterbury and one in New Haven)(\$1.25 million); b) 225 slots of Multi-Systemic Therapy for Juvenile Offenders (\$0.187 million); and c) 224 slots at Juvenile Risk Reduction Centers serving New Haven, New London, Hartford and Bridgeport for medium risk youth at risk of continued court involvement or recidivism (\$0.5 million). The rest of the increase (\$1.87 million) would be used to improve medical, mental health and nursing services for juveniles in state-run detention facilities and community-based alternatives to detention to comply with the Emily J settlement agreement.
- *GPS monitoring of sex offenders.* The Governor recommends expanding the Geographic Positioning System (GPS) pilot program of supervision that CSSD administers from 8 to 250 sexual offenders and includes \$1.29 million in funding for fifteen more adult probation officers, contractual and other expenses.
- *COLA.* \$0.58 million for a 2% Cost of Living Adjustment for private providers effective October 1, 2006, with \$0.5 million more to be transferred from OPM Contingency Needs account from FY 05 surplus.
- *Other.* The Governor proposes \$2.44 million for increased energy costs and \$0.8 million for "objective job evaluation."

The Governor recommends eliminating funding for the Justice Education Center (for a savings of \$0.22 million); the Justice Education Center performs various services for the Judicial Department, such as grant writing and program evaluation. The Governor also proposes to transfer \$9.512 million in funds from the Judicial Department budget to the Public Defender budget for the use of the new Commission on Child Protection. This Commission, established last year, will assume responsibility for the appointment, training, supervision and payment of attorneys for children and parents in child abuse and neglect cases effective July 1, 2006 (see above).

19. Department of Correction

The FY 07 DOC General Fund budget proposed by the Governor is \$14.33 million *more than* the FY 07 budget as originally adopted. It is \$31.5 million more than estimated spending in FY 06 budget, a 5.4% increase (\$614.833 million in FY 07 as revised, compared to \$583.322 million in FY 06). This continues a trend of steady increase in the DOC budget. In FY 02, DOC spent \$513.374 million; the proposed FY 07 budget is \$101.5 million (or nearly 20%) greater than the FY 02 budget, not adjusting for inflation.

The Governor recommends additional FY 07 funding for the following purposes:

- *Collaborative Mental Health Alternative Incarceration Project.* \$0.5 million to pickup expiring federal funds that were the Department of Correction's contribution to this project.
- *Substance abuse programming.* \$0.56 million to pickup other expiring federal funds for four positions and residential beds for substance abuse programming.
- *Inmate health services.* \$0.22 million for three positions to audit and monitor the UCONN health center's contract to provide health services to inmates, as well as to ensure compliance with consent decrees and settlement agreements, such as the recent settlement with the Office of Protection and Advocacy regarding mentally ill inmates.

- *GPS monitoring of sex offenders.* \$0.2 million for two additional parole officers and 30 passive global positional system (GPS) devices to monitor sex offenders.
- *COLA.* \$0.27 million for a 2% Cost of Living Adjustment for private providers effective October 1, 2006, with \$0.2 million more to be transferred from OPM Contingency Needs account from FY 05 surplus.

In addition, the Governor proposes \$4 million to annualize the FY 06 deficiency, \$2.72 million for salary adjustments, and \$6.1 million for increased energy costs. She also proposes to cut funding for workers' compensation claims based on re-estimates of requirements.

20. Department of Environmental Protection.

The FY 07 DEP budget proposed by the Governor is \$0.79 million *more than* the FY 07 budget as originally adopted. It is \$1.7 million more than estimated spending in FY 06 budget, a 5.1% increase (\$34.823 million in FY 07 as revised, compared to \$33.118 million in FY 06).

A longer-term perspective is important. In FY 02, DEP's budget was \$42.59 million (\$46.42 million in 2005 dollars). Thus, the proposed FY 07 budget is actually \$7.76 million (18%) *less* than DEP spent in FY 02. Adjusted for inflation, the proposed FY 07 budget is \$11.6 million (25%) less.

The sole changes proposed by the Governor for FY 07 are a \$0.3 million increase for salary adjustments and a \$0.48 million increase for increased energy costs.

21. Transportation

a. Department of Transportation. The Governor proposes to increase the subsidy for bus operations by \$6.5 million (\$3.5 million for higher fuel costs and \$3.0 million to offset loss of federal funds) and provide an additional \$4.0 million for Highway and Bridge Renewal Equipment

b. Department of Motor Vehicles. The Governor proposes an additional \$17 million in bond funds for DMV's computer software and hardware upgrades (in addition to the \$10 million previously authorized), as well as \$0.4 million for nine additional Commercial Vehicle Safety Inspectors, \$0.6 million to upgrade and adding security measures to prevent fraud in the issuance of drivers' licenses, and \$0.73 million in additional funding to staff branch offices and open additional days.

c. Bonding. The Governor recommends a total of \$344 million in new bond funds that will be used to leverage over \$300 million in federal funds for transportation-related purposes. These funds would be used for:

- *New Britain Bus Way* (between New Britain and Hartford). State bond funds of \$50 million (in addition to the \$33 million previously provided) and \$253 million of federal funds for capital expenses. \$6 million annual operating subsidy starting in FY 10.
- *Service and Maintenance Building Improvements on the New Haven Lines at Danbury, New Canaan and Waterbury.* \$45 million in state bond funds to improve facilities (of which \$7 million is earmarked for train controls and signals). \$1 million annual operating subsidy beginning FY 10.
- *Commuter Train Service between New Haven-Hartford-Springfield, MA.* Initial capital investment of \$146 million in state funds (and \$16 million in federal funds). \$8.5 million annual operating subsidy beginning in FY 11. This would provide for eight trains a day in each direction, use

eight existing stations and three new stations (North Haven, Newington & Enfield) and provide Shuttle Bus Service to Bradley Airport from 11 train stations.

- *Rail Station and Parking Lot Improvements for New Haven and Shore Line East.* \$40 million in capital investment for improvements.
- *Rehabilitation of rail cars.* \$25 million in capital investment for the rehabilitation of up to 40 rail cars for use in commuter lines.
- *Connections.* Improve transit connections between rail stations and select employment centers by providing operating funds of \$1 million in FY 08 and \$2 million/year beginning FY 11.
- *West Haven Rail Station and Parking Facilities.* \$11 million in capital investments and anticipated \$44 million in federal funds (requires Congressional action to secure the \$44 million).
- *Greater Hartford area infrastructure improvements.* \$25 million in capital investment to support economic development projects (such as Rentschler Field development in East Hartford).

d. *Revenue sources.* The Governor proposes to increase – by \$40 million/year beginning FY 07 through FY 10 - the transfer of revenues received from the Oil Companies Tax from the General Fund to the Special Transportation Fund, and then to increase the transfer again – to \$60 million/year -- beginning in FY 11.

22. Other

Expand the Office of State Ethics. The new office has expanded by three positions to include a total of 19 positions. To assist in the agency's expanded responsibilities of public education and ethical enforcement, new Other Current Expense accounts are established: Judge Trial Referee Fees, Reserve for Attorney Fees, and Information Technology Initiatives. The Governor recommends an increase of \$0.34 million in FY 07 to accommodate the additional staff and its responsibilities.

State Elections Enforcement Commission. P.A. 05-5, An Act Concerning Comprehensive Campaign Finance Reform for State-Wide Constitutional and General Assembly Offices, imposed a number of significant mandates on the agency, such as the redesign and implementation of the electronic filing system for campaign reporting, and the creation of a large database and infrastructure to identify all the principals of state contractors subject to the ban on contributions to campaigns. The legislation provided funding to hire 15 staff positions and computer equipment required to satisfy the Act's many mandates, and such funding is derived from the Citizen Election Fund account (CEF) within the General Fund. However, there are day-to-day recurring operational costs (such as postage, supplies, printing, mileage reimbursements) necessary to support the increase in staff and areas of responsibility, which were not included in the CEF. The Governor's budget therefore recommends an increase of \$0.14 million in FY 07 to ensure that the provisions of P.A. 05-5 can be satisfied.

Reserve for Salary Adjustments. The Governor proposes to transfer \$61.5 million in the Reserve for Salary Adjustments account to agency budgets for settled collective bargaining contract costs and add about \$57.1 million in funding to the original FY 07 budget to provide for unsettled collective bargaining contracts and other related costs.

Department of Consumer Protection. The Governor proposes to provide \$0.19 million in new funding for four positions to establish a Homemaker-Companion Registration Program. Currently there is no oversight of those providing homemaker services on a non-medical, in-home basis. This initiative would require the registration of homemaker-companion agencies, establish a \$300 licensing and annual renewal fee, and require a criminal history records check for current or prospective

employees. The Governor also proposes \$0.1 million to establish a Child Protection Registry. Specifically, parents and schools would be able to register electronic contact points for minor children (contact points would include e-mail addresses, instant message identities, wireless phones, pagers, and fax numbers). Persons would then be prohibited from sending any message to these contact points that advertises any product or service or links to advertising for any service that a minor is prohibited by law from purchasing, viewing, possessing, participating in, or receiving. The program would provide for fines and penalties, as well as civil damages for violations.

Department of Energy. The Governor proposes to establish a new Department of Energy. She would provide \$0.62 million in new funding in FY 07 for five new planning and energy specialist positions and also transfer \$0.24 million and three General Fund positions from the Office of Policy and Management's Energy Division to the new Department of Energy.

Office of Consumer Counsel. The Governor proposes to provide funding for four new positions to handle the increase in workload created by PA 05-12 (June Special Session) for the Energy Independence Act.

Private Provider Cost of Living Adjustment. As mentioned in earlier agency descriptions, the Governor recommends that \$17.1 million be used in FY 07 to provide a 2% cost of living adjustment (COLA) for certain private providers under contract with the Departments of Mental Retardation, Mental Health and Addiction Services, Children and Families and Correction; the Judicial Department; and the Council to Administer the Children's Trust Fund, effective October 1, 2006. The \$17.1 million includes \$9.1 million in new appropriations and \$8 million in contingency needs funding that had been appropriated from the FY 05 surplus and is currently in the OPM budget.

III. Revenues

A. In Brief

The choices that need to be made about the FY 07 budget benefit from a marked increase in projected revenues in FY 07. *Current* General Fund revenue projections are about \$410 million *more than* the revenues projected when the FY 07 budget was adopted last year. The Governor states that these FY 07 revenue estimates "remain conservative" in that "the personal income tax is expected to register growth of 5.7%, down from this year's projected growth of 9.9% and the sales tax is projected to grow by a modest 4.2%."⁴⁵

Based on these projections of increased revenues, and "the State's willingness to control its expenditures," the Governor proposes "significant tax relief" that will total a net "\$294.5 million in FY 2006-07 alone." She also proposes other revenue changes (including fund transfers) that have an impact on General Fund revenues in FY 07 and thereafter.

Key components of the Governor's proposed *tax* changes are highlighted in the following table (taken from p. 3 of the Governor's Mid-Term Budget Adjustments for FY 07):

⁴⁵ FY 2006-07 Governor's Midterm Budget Adjustments (February 8, 2006), p. 3.

Governor's Proposed Tax Changes: FY 07 Impact (in millions)			
Revenue Changes	Consumers	Business	Total
Repeal local property tax on automobiles	(\$496.8)		(\$496.8)
Repeal property tax credit against income tax	\$325.0		\$325.0
Repeal 15% business tax surcharge		(\$32.2)	(\$32.2)
Enact new film industry tax credit		(\$5.0)	(\$5.0) ⁴⁶
Enact new jobs creation tax credit		(\$2.0)	(\$2.0) ⁴⁷
Enacted new displaced worker tax credit		(\$4.5)	(\$4.5)
Reduce public service companies tax rate on gas & electricity by 25%	(\$21.1)	(\$23.8)	(\$44.9)
Phase out estate tax by 2010	(\$34.1)		(\$34.1)
TOTAL	(\$227.0)	(\$67.5)	(\$294.5)

Source: FY 2006-07 Governor's Midterm Budget Adjustments (February 8, 2006), p. 3.

The Governor proposes other changes that will impact on General Fund revenues in FY 07 that were not included in this summary of tax changes. They include:

- ❖ *A reduction of \$435.6 million* by redirecting Indian Gaming Revenue from General Fund to a new Casino Assistance Revenue (CAR) Fund.
- ❖ *A reduction of \$61.2 million* by transferring funds from General Fund to CAR Fund.
- ❖ *An addition of \$86.3 million* by eliminating the Pequot and Mohegan Fund as a separate budget fund and, instead, establishing a "Supplemental Municipal Assistance Grant" that is a part of the General Fund and is to be funded at \$86.25 million annually.
- ❖ *A transfer of revenues from the Oil Companies Tax* from the General Fund to the Special Transportation Fund to finance various transportation initiatives (\$40 million/year beginning in FY 07 through FY 10, increasing to \$60 million/year beginning in FY 11).
- ❖ *A reduction of \$12.0 million* through elimination of the transfer from the Energy Conservation and Load Management Fund to the General Fund.
- ❖ *A loss of \$0.16 million* through the increase in the intercept of newborn screening fees to pay for DPH's newborn screening tests. Currently, \$345,000 of the \$1.2 million in newborn screening testing fees are intercepted each year to pay for DPH's testing program. The Governor would increase the intercept to \$500,000/year, resulting in a General Fund revenue loss of \$155,000.

In addition, the Governor's proposed three-month extension of the current, temporary sales tax exemption for residential weatherization and energy efficiency products and energy efficient heating equipment would result in a FY 06 revenue loss of about \$3 million.

In sum. The tax, fund transfer, and other revenue changes proposed by the Governor would result in a *net reduction* in FY 07 General Fund revenues of \$251.0 million (according to the Governor) and

⁴⁶ As discussed later, section 6 of SB 51, *An Act Concerning Tax Incentives for Individuals and Businesses*, which would create this credit specifies that the amount of the tax credit allowed under this section "shall not exceed five million dollars" in connection with "any one motion picture production." Thus, the revenue loss may well exceed the \$5 million stated in the Governor's Budget.

⁴⁷ As discussed later, section 3 of SB 51, *An Act Concerning Tax Incentives for Individuals and Businesses*, which would create this credit caps the total credits that can be claimed at \$10 million annually.

\$263.9 million (according to OFA), and a \$40.0 million increase in revenues for the Special Transportation Fund.⁴⁸

Importantly, this reduction is *particularly ill-advised* given OPM and OFA’s projections of a General Fund *structural deficit* starting in FY 08. OFA’s projections about growth in revenues and expenditures – made *prior to* the Governor’s proposed budget revisions -- reveals the gap between the two. This gap *was* projected to result in a \$158 million General Fund deficit beginning in FY 08, increasing to \$241.8 million in FY 09, and \$340.5 in FY 10.⁴⁹ OFA’s *updated* projections (as of the end of February 2006) -- based on adoption of all of the Governor’s proposals and reflecting revised funding requirements --- show that there would be current services surpluses of \$140.5 million in FY 06 and \$70.8 million in FY 07, and current services deficits of \$492.2 million in FY 08, \$612 million in FY 09, and \$716.2 million in FY 10.⁵⁰

General Fund Growth Rates			
	FY 08	FY 09	FY 10
General Fund Revenue Growth	3.7%	3.6%	3.2%
General Fund Expenditure Growth	5.6%	3.9%	4.1%
Source: OFA, <i>Fiscal Forecast Presentation to the Appropriations and Finance Committees</i> (November 29, 2005), p. 8.			

Although the Governor’s *Midterm Budget* quotes George Santayana in warning that “Those who cannot remember the past are condemned to repeat it,” the Governor’s proposed revenue changes put Connecticut on the same ill-advised course that it followed in the late 1990s when the state cut \$2 billion from its tax base, relying on temporarily-inflated revenues. Then, when the state recession began in FY 02, revenues fell by \$1 billion, and the budget reserve proved inadequate, deep and painful cuts in spending were necessary, from which the state still has not recovered.

B. Proposed Revenue Changes, A Bit More Detail

The Governor’s midterm FY 07 budget proposes \$294.5 million in net tax reductions for FY 07. Her proposed changes,⁵¹ with associated revenue gains or losses, are as follows:

1. *Personal Income Tax*

The Governor proposes to eliminate the tax credit for property taxes paid on a taxpayer’s primary residence or automobiles, beginning with the 2006 income year. This is anticipated to result in a

⁴⁸ OFA’s estimates of revenue losses and gains from these various proposals differ somewhat from the Governor’s projections. Specifically, OFA reports a \$35.4 million revenue loss from repeal of the corporate tax surcharge (compared to the Governor’s \$32.2 million loss), a \$47.8 million loss from the 25% rate reduction for gas and electric utility charges (compared to \$44.9 million), a \$33.9 million loss from the phase-out of the estate tax (compared to \$34.1 million), and a \$318 million loss from repeal of the property tax credit against the income tax (compared to \$325 million). In total, OFA estimates a FY 07 General Fund revenue loss of \$263.9 million resulting from the Governor’s tax and fund transfer proposals, compared to the Governor’s total loss of \$251.0 million. Office of Legislative Research, *Supplemental Analysis of the Governor’s 2005-2007 Midterm Budget Adjustments* (February 27, 2006), p. 9.

⁴⁹ OFA, *FY 06-FY 10 General Fund and Transportation Fund Budget Projections and Fiscal Information* (November 15, 2005), p. 3.

⁵⁰ Office of Legislative Research, *Supplemental Analysis of the Governor’s 2005-2007 Midterm Budget Adjustments* (February 27, 2006), p. 2.

⁵¹ More detail on the Governor’s proposals is in SB 50, *An Act Eliminating the Personal Property Tax on Certain Motor Vehicles*, and SB 51, *An Act Concerning Tax Incentives for Individuals and Businesses*.

General Fund revenue gain of \$325 million in FY 06, which will help offset the revenue losses that result from the Governor’s proposed Casino Assistance Revenue Fund and related repeal of the property tax on automobiles.

NOTE: The maximum credit for property taxes paid that is available to taxpayers under current law is \$350, and not all taxpayers benefit. The credit provides *no* benefit to taxpayers whose income is low, since they have no income tax liability to offset. It provides no benefit to taxpayers who rent (rather than own) their homes and do not have a car. The credit *also* provides no benefit to *higher* income taxpayers, because it totally phases out at higher income levels.

2. *Property Tax*

The Governor proposes to eliminate the personal property tax on passenger motor vehicles (but not on commercial or combination registered vehicles). To offset the revenue loss that cities and towns would experience through this repeal, the Governor plans to reimburse towns fully for lost property tax revenues. Her proposed mechanism to do so is as follows:

- Establish a new Casino Assistance Revenue (CAR) Fund, independent of the General Fund, that would provide payments to towns for lost property taxes with this repeal;
- Intercept 100% of the revenues the state now receives from payments made by the two Native American casinos before they are credited to the General Fund and credit them, instead, to this new CAR Fund (also diverting use of these funds from state spending cap constraints).
- Transfer additional funds from the General Fund to the CAR fund in FY 07 through FY 10, because the casino revenues will not be adequate to fully reimburse towns for lost property tax revenues. Then, as casino payments increase, reduce the transfer from the General Fund, as shown in the following table:

Governor’s Proposal to Compensate Towns for Property Tax Lost Through Repeal of Property Tax on Automobiles (in millions)		
Amount of CAR Fund Payments to Towns	Amount from Indian Gaming Revenues	Amount transferred to CAR Fund from General Fund
FY 07: \$496.8	\$435.6	\$61.2
FY 08: \$496.8	\$448.7	\$48.1
FY 09: \$496.8	\$472.1	\$24.7
FY 10: \$496.8	\$486.3	\$10.5
FY 11: \$500.9	\$500.9	\$0
Source: <i>FY 2006-07 Governor’s Midterm Budget Adjustments</i> (February 8, 2006), p.19.		

In addition, the Governor proposes to rename the Mashantucket Pequot and Mohegan grant the Supplemental Municipal Aid Grant and include it as part of the General Fund, rather than continue it as a separate fund.

Although there has been widespread support for reform of Connecticut’s property tax system and this proposal would help *some* lower-income families who do not benefit from the current property tax credit against the income tax (as discussed above), this particular proposal has a number of limitations. They include:

- a) Higher-income families with expensive and/or multiple cars will receive significant monetary benefit from this change, and without any offsetting cost (since many have incomes too high to qualify for the current property tax credit against the income tax);
- b) The CAR payments to towns would remain flat for five years, and not grow at a level that approximates the growth in revenues towns would receive if they were allowed to continue to collect this tax;
- c) Towns would lose the authority to levy this tax and thereby receive this rather stable source of revenues. Instead, towns would become reliant on a state revenue stream from casinos that may or may not continue its current pattern of growth. Towns also would be faced with the possibility, in tough fiscal times, of reductions in state payments as has occurred with other state property tax reimbursement programs (such as PILOT);
- d) The proposal reduces *net* General Fund revenues (revenues intercepted from the General Fund for the CAR Fund less the \$325 million revenue gain to the General Fund from the repeal of the property tax credit against the income tax), even though OPM and OFA both predict a structural deficit beginning in FY 08.

3. *Corporation Business Tax*

The Governor proposes a number of changes intended to improve Connecticut's "business climate." They include:

- *Corporate tax surcharge.* The current 15% surcharge for income year 2007 would be repealed (and the 20% surcharge for 2006 remain in effect). This would result in a revenue loss of \$32.2 million in FY 07 and a total revenue loss of \$47 million. The surcharge currently applies to all corporations except those that owe only the \$250 minimum tax. Importantly, while many assume that the minimum \$250 tax is paid by small, start-up businesses, in fact 18 of the top 100 corporations headquartered in Connecticut (based on total sales in 2003) paid the \$250 minimum tax. In addition, an additional 18 of these 100 largest businesses did not pay the corporate income tax at all. Organized as a LLC, LLP, or other like legal entity, these firms paid only a \$250 "business entity" tax.⁵²
- *Film industry tax credit.* A new tax credit would be created against the corporation income tax for in-state expenses related to pre-production, production, and post-production of a "motion picture." "Motion picture" is defined to include not only a feature-length film, videos (including music videos), and a television series of up to twenty-seven episodes in a season, but also a commercial. "Production expenses" is defined to include wages and salaries of all persons employed in production-related activities (but not the wages and salaries that exceed \$1 million paid to any one or more individuals involved in the production), set production expenses, editing and related services, film processing, special effects and other related expenses. "Production expenses" does not include costs in advertising the production. Eligible productions must be wholly or partly made in Connecticut and intended for a national audience or as television pilots. A firm would be eligible for this credit if the production expenses for an eligible project that are clearly and demonstrably incurred in Connecticut (Connecticut production expenses) exceed \$250,000; the credit would then be equal to 25% of its Connecticut production expenses.

⁵² Legislative Program Review and Investigations Committee, *Connecticut's Tax System* (January 19, 2006), p. 51.

Although the FY 07 cost of this credit was estimated by the Governor to be \$5 million, the bill proposing the credit (SB 51, §6(d)) specifies that the amount of the tax credit allowed under this section “*in connection with any one motion picture production*” shall not exceed \$5 million. There is no cap on the total amount of such credits that can be taken in a single year by a single firm, or by all firms claiming the credit, so the fiscal impact may well exceed the \$5 million projected by the Governor. Under this bill, unused credits cannot be carried forward; the credit is available only in one income year. Further, the amount of tax credit allowed in any income year cannot exceed the amount of tax due from the production company with respect to that income year. The Connecticut Commission on Culture and Tourism (CCCT) is authorized to determine eligibility and award credit certificates to production companies. The bill specifies the procedures for the CCCT to follow to approve costs and credits, but without the same detailed standards as are included for the job creation credit (described below). The bill also allows the Commissioner of Revenue Services to adopt regulations, in consultation with CCCT, to administer the credits.

The rather sudden appearance of this proposal for a new credit to subsidize production of movies, television pilot series, videos and music videos, and commercials is likely closely related to recent negotiations with the proposed developer of the Utopia project on the former grounds of the Norwich State Hospital, efforts by this industry more generally to get such credits from states in New England,⁵³ and also the presence of ESPN in the state.

- *Job creation tax credit.* This new tax credit, which can be taken against the corporation, insurance premium, and utility company taxes, would benefit firms that: a) relocate to Connecticut; b) create at least fifty new, full-time jobs in Connecticut; and c) hire new employees for these jobs and keep them employed for at least twelve months. A qualifying firm could claim a credit equal to 25% of the income tax deducted and withheld from the wages of each new employee, for five successive years. Unused credits would expire each year and could not be carried forward to future years. The total amount of credits granted to all firms cannot exceed \$10 million in any one fiscal year. Firms planning to re-locate to Connecticut and claim the credit would be required to apply to the Commissioner of Economic and Community Development for the credits. The Commissioner is authorized to approve full or partial credits only if the proposed company relocation: a) is not economically viable without the credits; and b) provides a net benefit to economic development and employment in the state. The proposed bill that would enact this new credit (SB 51, §3) also provides for recapture of some portion of the credit if the number of new jobs created and maintained falls below what had been initially stated. Specifically, if the number of new employees falls below that for which the firm claimed credits, and these employees are not replaced by other new employees (excluding employees transferred from another location or from a related party), the DECD Commission is required to recapture part of the credit according to the following schedule: a) 90% of the credits if the firm defaults after one year; b) 65% after two years; c) 50% after three years; and d) 30% after four years. The bill also specifies additional eligibility criteria for firms and jobs, and establishes procedures for applying for and approving both eligibility and for claiming credits. Enactment of credit is anticipated to result in a revenue loss of \$2 million in FY 07, and additional revenue losses in years thereafter.⁵⁴

⁵³ See, e.g., Massachusetts Budget and Policy Center, *Facts at a Glance: The \$60 Million Movie Industry Tax Cut*; Massachusetts Department of Revenue, *Revenue Impact Analysis: An Act Providing Incentives to the Motion Picture Industry* (July 15, 2005).

⁵⁴ For a comparison of this job creation tax credit and the final version of the business employment incentive program considered by the General Assembly in the 2005 session (sSB 620, as amended by Senate A, LCO 6442), see Office of Legislative Research, *Governor's Business Tax Proposals (SB 51)* (February 14, 2006), pp. 3-5.

- *Displaced worker credit.* This new tax credit would be available against the insurance premiums tax, the corporation business tax, and the utility company tax. It would provide a \$1,500 per worker credit to firms that, on or after January 1, 2006, hired workers who: a) were employed in Connecticut; and b) were let go by a previous employer as a direct result of a business restructuring in which at least 10 Connecticut employees were terminated by the same employer. It would allow a firm that hires a displaced (laid-off) worker to claim a credit of \$1,500 per year for each displaced worker hired after January 1, 2006 provided the new employer: a) paid the workers at least 75% of their previous annual wages/salary for the twelve months of employment; b) was not a related party to the older employer at the time of termination; and c) did not claim for the same worker both this credit and the existing credit for hiring displaced electrical workers. The credit would be allowed for the income year during which the displaced worker first completes twelve full months of full-time employment with the firm. The credit is anticipated to result in a revenue loss of \$4.5 million in FY 07. (SB 51, §5)

Although the Governor bases these proposals on a perceived need to “improve the business climate,” the recent study by the Program Review and Investigations Committee of the General Assembly on Connecticut’s tax system notes that Connecticut’s business taxes have been “reduced substantially” and now are not “more burdensome than other states.” Further, *The Connecticut Economy*, after review of Connecticut’s various business taxes concluded, “There’s no disputing that job growth has been sluggish in the Nutmeg State. But the data just reviewed make it hard to argue that the main source of this ooze is an undue burden of business taxation.” Indeed, the author suggests that Connecticut should “trumpet to the world that Connecticut is a *low-tax* state to do business.”⁵⁵

The Committee’s study also questions the propriety of “using the tax system to influence economic decisions on spending or investments.” The study, in particular, casts doubt on the effectiveness of tax credits, stating “While corporations may be able to superficially demonstrate the use of a particular feature or credit (e.g., number and value of research and development credits taken) it is difficult to assess whether these policies are achieving the desired outcome.”⁵⁶ It concludes, “[L]egislative efforts at spurring economic development through tax credits and incentives appear to have little positive effect on job growth or in enhancing the state’s competitive position.”⁵⁷

4. *Unified Gift and Estate Tax*

The Governor proposes to phase out Connecticut’s unified gift and estate tax, which was enacted last Session to replace Connecticut’s existing gift and inheritance taxes, as well as to de-link Connecticut law from federal estate tax changes. This new unified gift and estate tax set a relatively high threshold for taxation – combined taxable gifts and estate proceeds over \$2 million – but was written so as to create a “cliff,” i.e., an estate of \$2 million would have no tax liability while an estate of \$2,000,001 would incur tax on the entire amount, or \$99,600.

⁵⁵ A. Wright, “Connecticut Business Taxes in Perspective,” *The Connecticut Economy* (Spring, 2006), pp. 4-7 (relying in large part on a comprehensive study of state business tax burden across all states commissioned by the Council on State Taxation, a trade association of nearly 600 corporations doing business in multiple states and nations, and completed by tax researchers affiliated with Ernst & Young.

⁵⁶ Legislative Program Review and Investigations Committee, *Connecticut’s Tax System: Findings and Recommendations* (January 19, 2006), p. 49.

⁵⁷ Legislative Program Review & Investigations Committee, *Connecticut’s Tax System, Findings and Recommendations*, Adopted 1/19/06 pp.1-2.

This is Connecticut’s most progressive tax. In 2003, for example, the number of taxable estates in Connecticut was only 2.2% of the total number of deaths. Taxes on the transfers of accumulated wealth also have been a part of Connecticut’s tax code since at least the early 1900s, and the tax is estimated to bring in \$108.2 million in FY 06, \$149.7 million in FY 07, and \$151.7 million in FY 08.⁵⁸

Rather than amend this new law to address the cliff issue, the Governor proposes instead to phase-out the tax altogether by increasing the exemption level as follows: \$2 million exemption in income year 2005, \$4.1 million in 2006, \$5.1 million in 2007, \$7.1 million in 2008, \$10.1 million in 2009, and no tax beginning in 2010. In addition, the Governor proposes to eliminate the current cliff effect by imposing the tax only on the “excess” over the exemption level (SB 49, An Act Phasing Out the Unified Gift and Estate Tax). The estimated revenue loss in FY 07 from the Governor’s proposed changes is \$34.1 million, but would increase in subsequent years through full repeal.

5. *Public Service Companies Tax*

The Governor proposes to make a 25% across-the-board cut in Connecticut’s public utility tax effective July 1, 2006. Specifically, the bill (SB 51, §§ 4, 7) would cut the tax rates on quarterly electric and gas company gross earnings from residential and nonresidential transmission and distribution services by 25%. The Governor estimates that more than 50% of these savings would benefit Connecticut businesses; the balance would benefit residential customers. The total expected revenue loss is \$44.9 million in FY 07 alone.

As shown in the table below, although the cut proposed is 25% “across-the-board,” businesses benefit to a greater extent from the cut than residential customers, and consumers who purchase electricity would benefit more than those who rely on gas. That either group would actually “benefit” from the rate reduction, however, *assumes* that the cost-savings from the reduction in tax would actually be passed on to the consumer.

Governor’s Proposed Public Utilities Tax Rate Reduction: A 25% “Across the Board” Rate Reduction			
	Current rate	Proposed	Rate reduction
Residential			
-Gas	4.000%	3.000%	1.000%
-Electric	6.800%	5.100%	1.700%
Commercial			
-Gas	5.000%	3.750%	1.250%
-Electric	8.500%	6.375%	2.125%
<i>Source: FY 2006-07 Governor’s Midterm Budget Adjustments (February 8, 2006), p.16.</i>			

For example, *assuming that the benefit of this rate reduction was passed on to consumers*, a consumer purchasing \$100 of gas would enjoy a \$1 reduction in tax if a residential customer, and a \$1.25 reduction in tax if a commercial customer – a difference of \$0.25 for every \$100 of gas purchased. The differential could be even greater for those who purchase electricity. The consumer purchasing \$100 of electricity would enjoy a \$1.70 reduction in tax if a residential customer and a \$2.125

⁵⁸ Office of Fiscal Analysis, *Connecticut State Budget 2005-2007*, p.34

reduction in tax if a commercial customer, a difference of \$0.425 for every \$100 of electricity purchased.

6. Sales Tax

The Governor proposes to continue the exemption from Connecticut's sales and use tax for sales of "residential weatherization products,"⁵⁹ a term defined to include a range of products from caulking and window and door weather strips to water heaters, natural gas furnaces, and windows that meet the federal Energy Star standard and furnaces that are "not less than eighty-five per cent efficient." The sales tax exemption would extend from November 25, 2005 to June 30, 2006, rather than end on April 1, 2006 (SB 51, §8). The projected "one time" revenue loss from the exemption as originally adopted – for four months -- was \$4.0 million. Assuming an average loss of \$1 million of sales tax revenues per month of exemption, the Governor's proposal to extend the exemption an additional three months may result in an additional revenue loss of \$3 million in FY 06.

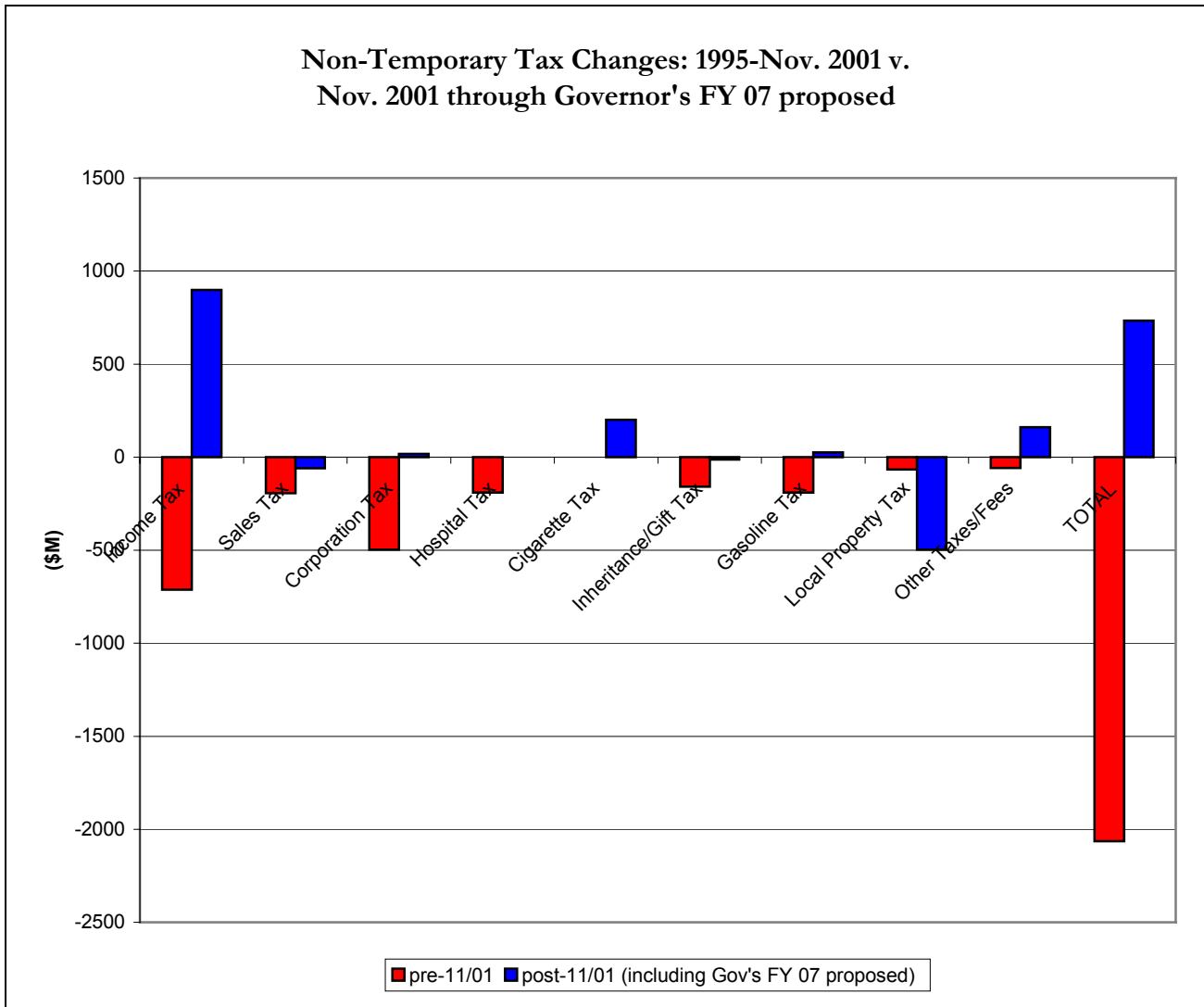
C. The Governor's Proposed FY 07 Tax Changes, in Historical Context

The following chart compares the changes in net *non-temporary* taxes, by type, enacted during two different periods: a) from 1995 (when Governor Rowland began to lead the state) to November, 2001 (when Connecticut's recession began to be felt in the state budget); and b) from November 2001 through, *and including*, the Governor Rell's proposed changes for FY 07.

As is evident from this chart, the net *increase* in non-temporary taxes since November 2001 (about \$734 million) is *less than half* the net *reduction* in taxes between 1995 and November 2001 (\$2.064 billion). In addition, *who* is paying tax has changed. Since 1995, there have been net *increases* in the personal income tax, the cigarette tax, and "other taxes and fees" – all of which are borne, disproportionately, by individuals rather than corporations. By contrast, net taxes on corporations have declined throughout the period, continuing a trend that began in the early 1990s after the passage of the broad-based personal income tax. While it was wholly appropriate, and necessary for Connecticut's economic competitiveness, to reduce the corporation business tax rate to what is now the national average, the continued erosion of the corporation business tax *base* through new tax credits, exemptions, deductions, and changes in apportionment formulas is of significant concern. These changes have increased the inequity of the tax across Connecticut businesses – favoring large, multi-state corporations over smaller, Connecticut-based businesses and allowing some of Connecticut's largest businesses (by sales) to avoid corporation income tax completely. As the Legislative Program Review and Investigations Committee recently reported, 18 of Connecticut's 100 largest corporations (by 2003 total sales) did not pay the corporate income tax at all. Organized as a LLC, LLP, or other like legal entity, these firms pay only a \$250 "business entity" tax.⁶⁰

⁵⁹ This exemption was adopted as part of PA 05-2 (October Special Session), An Act Concerning Home Heating Assistance. The estimated "one-time" cost of this sales tax exemption, for the period November 25, 2005 through April 1, 2006 was \$4.0 million. OFA's estimate of revenue loss was based on data related to a new federal personal income tax credit for energy efficiency improvements to existing homes, which allows taxpayers up to a \$500 (lifetime) tax credit for the purchase and installation of such items as upgraded thermostats, replacement windows, and high efficiency heating and cooling equipment (central air conditioning, heat pump, water heater, furnace, or boiler). The General Fund revenue loss was based on Connecticut's prorated share of the Joint Committee on Taxation's estimate of the federal revenue loss from its new credit, "plus a factor for new residential construction" during the period of the exemption.

⁶⁰ Legislative Program Review and Investigations Committee, *Connecticut's Tax System* (January 19, 2006), p. 51.



IV. Conclusion

As discussed fully in Connecticut Voices for Children's February 2006 report, *Getting Connecticut's Fiscal Ship in Order*, Connecticut's past budget choices have placed the state's long-term fiscal health – as well as its economic competitiveness and high quality of life – in jeopardy. The upcoming retirements of the baby boomer generation means that time is truly of the essence in getting the state's fiscal ship in order.

Bold action is essential.

Bold action to create a truly comprehensive plan for the State of Connecticut – that incorporates and *integrates* existing state plans on a variety of topics (e.g., transportation, community development), and also addresses areas discussed in no plan at all.

Bold action to build the internal capacity of state government to implement (and monitor implementation of) the plan, evaluate the cost-effectiveness of public investment, and measure the

state's progress against clear and accepted benchmarks of child, family, community, and economic well-being.

Bold action to increase taxes *now* to generate the revenues necessary to make public investment at the scale that the times and Connecticut's needs require, as well as to address our currently high state indebtedness and unfunded liabilities.

And bold action to amend the spending cap (or to agree to suspend it) to allow such a significant infusion of new public investment.

Unfortunately, the Governor's proposed FY 07 budget not only fails to take these bold actions, but actually would put Connecticut in *worse* fiscal shape. In particular, her proposal to cut revenues would *deepen* Connecticut's projected structural deficits beginning in FY 08.

The General Assembly has the opportunity to reverse course. As it makes its spending and revenue choices, it is imperative that it take a longer range view – looking not only at the impacts of past budget choices, but also the longer-term impacts of the choices to be made in 2006.

This is no time to be timid.