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Testimony before the General Assembly Spending Cap Commission

Roger Senserrich- Policy Director, Connecticut Association for Human Services – 4/18/2016

Good afternoon Chairman Cibes, Chairwoman Widlitz and members of the Spending Cap Commission. My name is Roger Senserrich, and I am the Policy Director for the Connecticut Association for Human Services (CAHS). CAHS is a statewide nonprofit agency that works to reduce poverty and promote economic success for children and families through both policy and program work.

I am here to discuss the implementation of the constitutional spending cap in statute. I want to stress the fact that although that fiscal prudence is often a good idea, a badly designed set of fiscal rules could be counterproductive to our state, and lead our economy and services to decline.

Tax and expenditure limits are common in state governments. According to the National Conference of State Legislatures¹, as of 2012, 30 states had either constitutional or statutory fiscal limits. These legal limits to tax and spending policy are based on the implicit idea that legislators cannot be trusted completely in regards to budgeting. Barring a concrete, defined rule, elected officials will overspend with wasteful programs or favor special interests, instead of focusing state government's efforts and resources on a set of specific priorities. Not only that, but voters will not penalize legislators who spend too much and raise taxes, so a legal limit to spending becomes an acceptable compromise.

These arguments have some merit: legislators are sometimes prone to overpromise, and politicians, especially in times of unexpectedly strong revenues, can spend more than what a state can really afford. Connecticut's experience a decade ago, when the financial bubble that preceded the great recession led to inflated tax receipts, makes the need to be cautious clear.

This does not mean, however, that any implementation of a spending cap makes sense. Any cap the General Assembly puts in place needs to take into account both the need for fiscal restraint in times of exuberance and the long-term imperatives that Connecticut's government will face in the coming decades.

On a comparative analysis of state fiscal crises following the great recession, Roderick Kiewiet and Matthew McCubbins² point out that state governments' difficult fiscal recovery derives both from the sluggish economic growth that follows financial crisis and nationwide long-term budget trends. The combination of an aging population and increased need for social services for the elderly, especially Medicaid, makes increased spending almost inevitable. This, paired with pension and health care obligations for public workers approved by this General Assembly, translates into a long-term budget outlook that inevitably requires either additional spending or unacceptable choices.

What a poorly designed or overly restrictive spending cap would do is to force Connecticut to allow increased health care costs, services for the elderly and past pension and health obligations to slowly crowd out everything else from

¹ National Conference of State Legislatures (2012) State Tax and Expenditure Limits Report.

² Kiewit, R. and McCubbins, M. (2014) "State and Local Government Finance: The New Fiscal Ice Age". Annual Review of Political Science, 17:105-122.

the state budget. Faced with increasing need, the General Assembly would have to decide if it wants to reduce spending on seniors, break long-standing contracts, or cut the rest of the budget--meaning children and the poor.

This, in fact, is already happening. Connecticut Voices for Children, in a recent analysis, breaks down the state budget into four major components³: services for children (education, child care, child protection services, etc.), debt service and fringe benefits (essentially, past obligations), adult health and human services, and everything else. In 1990, 36% of state spending flowed to children's services, 27% to adult human services, and 18% to fringe and debt. Last year, the children's budget only covered 31% of the state budget, adult human services 28%, and fringe and debt 26%. Medicaid spending has almost doubled during this period. The spending cap, poorly implemented as it is now, has already forced the state to make these choices. And it has done so in a way that hurts the most vulnerable: children and the poor.

In addition, the spending cap has produced a slew of questionable budget practices that the General Assembly has used to circumvent the limit. The staggering increase of tax expenditures (70% growth since 2000, according to CT Voices⁴), business tax credits, and bonding (up 39% from 2008 to 2015⁵), all "outside" the cap, are the main examples.

Our recommendations for the panel regarding the spending cap are the following:

- a. The spending cap needs to take into account future fiscal needs of the state derived both from demographics and past obligations. This can be achieved by either excluding spending due to demographic changes in the state, as well as debt and fringe costs from the general budget expenditure baseline, or by including an automatic adjustment mechanism that accounts for this increased spending.
- b. The definition of general budget expenditures should include a mechanism to correct for reduced spending during recessions. This is necessary to avoid making the spending cap self-reinforcing, turning bad budget years into persistent drags on the increase of the spending limit.
- c. The definition of personal income should be corrected to include capital gains. The current calculation excludes them as source of income, greatly underestimating the state's fiscal capacity.
- d. The calculation of personal income gains should abandon the current 5-year average. Using this average limits cap growth long past recessions, and has little relation with the state fiscal health for the budget year. We suggest using projected personal income growth during the current budget year.

In addition, any spending cap should be paired with a well-defined, flexible and reliable emergency fund. The General Assembly incorporated a strong reform of the rainy day fund last year in the budget. We believe that the spending cap legislation should be linked to the fund, ensuring that reserves are built so the state is able to face fiscal shocks without having to cut essential services.

Above all, the state must look beyond how much we tax and spend, and focus more on how well we do it. Measured both in terms of state and local taxes as percentage of personal income and as size of state and local government as percentage of the state economy, Connecticut ranks in the bottom half among states in terms of how much we tax and spend⁶. Our recent report on the state's fiscal crisis⁷ stresses the fact that the recurrent deficits are not just a matter of insufficient revenue or excessive spending, but also of an outdated, inefficient tax system and often inefficient service delivery and institutions. The spending cap, albeit necessary, is an incomplete, clumsy way to deal with Connecticut's fiscal programs. Any permanent solution to our fiscal woes will require looking beyond budgeting rules and tackling real reforms.

Thank you for your time today.

³ <http://www.ctvoices.org/issue-areas/budget-and-tax-fiscal-policy-center/tracking-childrens-budget>

⁴ <http://www.ctvoices.org/sites/default/files/bud16offbooksspending.pdf>

⁵ <http://www.osc.ct.gov/2008cafr/cafr2008.pdf>

⁶ <http://cahs.org/wp-content/uploads/2014/04/CT-comparative-taxes.pdf>

⁷ <http://cahs.org/wp-content/uploads/2016/04/Budget-crisis.pdf>