

**Testimony of Connecticut Voices for Children
Regarding Connecticut's Economic Strategic Plan**

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To: DECD Commissioner Joan McDonald

Connecticut Voices for Children is a statewide, research-based public policy organization with a focus on improving the well-being of the state's children and families and the communities in which they live. We thank you for the opportunity to share our comments on your effort to create a "comprehensive strategy that will expand economic prosperity for our state."

The focus of our remarks will *not* be on specific ideas about housing, reducing the cost of doing business, labor force quality, and the like, but rather on the *process* by which Connecticut assures that its economic development resources are deployed in the most productive and cost-efficient manner. Our comments are guided, in part, by the following two comments – one by Connecticut Business and Industry Association (CBIA) and the other by the Connecticut Auditors of Public Accounts:

If Connecticut's economy is to remain competitive or expand, its economic development activities must:

- 1. Increase the overall productivity and incomes of its workers and residents.*
- 2. Maintain a high level of employment and job quality for all citizens.*
- 3. Create middle-class job opportunities for the jobless and the working poor.*
- 4. Generate revenues needed to make further investments in education, government, services, amenities, infrastructure and an enhanced quality of life.*

CBIA, *Connecticut's Economic Development Incentives: Separating Fact and Fiction* (April 2001), p. 12.

There should be objectives and standards or criteria relating to improving the State's economy, as well as a method of measuring achievement of these objectives, for all State funding that has been set aside to improve the economic climate in the State....Criteria, objectives, goals and procedures need to be established and available; the success or failure of each financial assistance project should be measured, as well as the total success or failure of the program, in compliance with Connecticut General Statutes, Section 32-1i.

CT Auditors of Public Accounts, *Performance Audit, State Financial Assistance Monitoring, Department of Economic and Community Development* (July 3, 2001), p. 25.

DECD should produce a biennial *Integrated Economic Development Budget* that reports on all public investment in economic development regardless of form (e.g., through grants, loans, tax expenditures and major tax code changes) by all public agencies and quasi-public agencies (not only DECD).

The *Budget* should outline - by category of the type of benefit provided, the purpose of the benefit, and the beneficiary (by type or name) – all state spending on economic development (as defined in DECD's *Economic Strategic Plan*).

Connecticut's economic development spending is spread across multiple state agencies and quasi-public entities, with no centralized oversight and – historically -- with sometimes weak oversight even over projects funded through DECD.¹ In addition, much state “spending” to foster economic development is through Connecticut's tax code – through preferential tax exemptions, exclusions, deductions, credits and rate reductions. This spending receives *no* regular oversight whatsoever. Consequently, Connecticut cannot measure the success of its economic development investments. Particularly in times of fiscal constraint – as appears Connecticut is again re-entering -- it is essential that the state be able to assess which economic development investments are bringing the state a good return (so they can be continued) and which are not (so economic development resources can be invested in some other activity with greater benefit to the state).

An important first step in assessing the effectiveness of Connecticut's economic development efforts is to know the *total* of our state's investments, the recipients of these investments and the returns on those investments. An *Integrated Economic Development Budget* can provide this information.² It is a report that details how much Connecticut is investing through grants or other appropriated spending, loans and loan guarantees, tax expenditures and any other form of financial support, and then further reports for each investment: 1) the type of investment; 2) its purpose(s); 3) which entities/industries are receiving the benefit; and 4) what is known about their current success in meeting the economic development outcomes that were proposed when the economic assistance was first provided and in meeting the state's current economic development needs. Summary tables can help legislators understand the relative proportions of Connecticut's investments across entity/industry and across type of the investment. Both direct subsidies and subsidies through the tax code must be included since --from an economic standpoint -- there is no difference between tax code provisions that provide special tax treatment for a specific industry or activity, and a grant or other traditional spending program that provides an equivalent amount of financial support for the same industry or activity.

Several states have embraced this approach. North Carolina, last year, passed legislation that requires publication of a report that lists and quantifies all economic development incentives offered by the state, including tax expenditures, grant and loan programs, and state appropriations that directly or indirectly support economic development. [North Carolina Session Law 2007-552, Extra Session, section 4]. Illinois began in 1993 to require the publishing of a

¹ See Auditors of Public Accounts, *Performance Audit: State Financial Assistance Monitoring Department of Economic and Community Development* (July 3, 2001).

² See, e.g., D. Lavine, *An Integrated Economic Development Budget: Putting Apples and Oranges in the Same Basket*, *Texas Business Review* (Bureau of Business Research, University of Texas at Austin, February 2001).

Unified Economic Development Budget that includes tax expenditures, requires detailed and standardized information about companies receiving economic development support in any form, requires annual evaluations of this support and provides for recapture of support if projects are terminated prematurely. [Illinois PA 93-0552]

To assure that the *Unified Development Budget* presents adequate information, Connecticut also should establish annual reporting requirements for each economic development investment. Each business or other entity receiving any form of financial assistance related to state economic development would be responsible for filing an annual report with the agency responsible for the assistance (including the Department of Revenue Services for tax expenditures). These reports could be used by DECD in creating the *Unified Development Budget*. In addition, reporting to the General Assembly by the state agencies and quasi-public entities responsible for economic development assistance (including DRS) should be enhanced.

Useful templates for subsidy-specific reporting is Minnesota's Business Assistance Form (used to report each business subsidy and financial assistance agreement signed by any local government/agency and all state government agencies authorized to provide business subsidies), and the Maine Economic Development Incentive Report.

a. **DECD's Economic Strategic Plan Should Encompass the Role and Impact of Tax Expenditures, Requiring Periodic Assessment of Their Economic Return and Consistency with the State's Overall Strategic Plan for Economic Development**

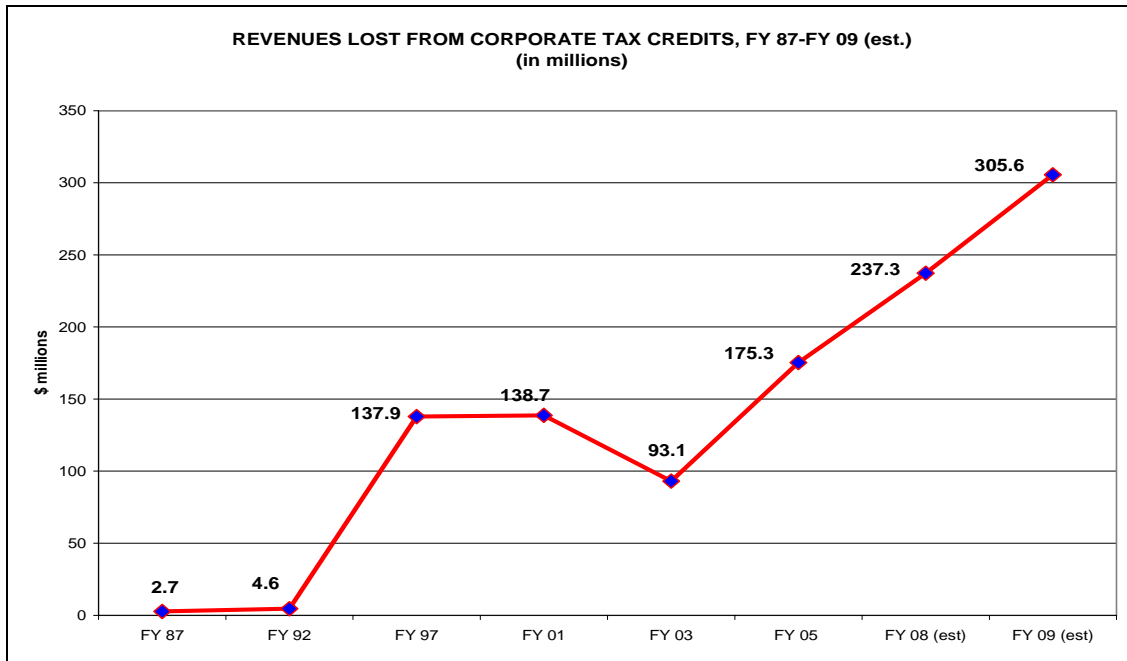
Tax expenditures (tax exemptions, deductions, credits, rate reductions and other preferential tax treatment) represent a significant form of government spending for economic development. The Office of Fiscal Analysis's recently-released *Connecticut Tax Expenditure Report* (January 2008) identifies a total of **\$4.99 billion** in projected revenue losses in FY 09 through "major identifiable tax expenditures." Of this total, **about \$2.07 billion** is expressly for the benefit of Connecticut businesses. That is, the economic benefit provided to Connecticut businesses through the state tax code is **more than a tenth of the entire** state budget, and far in excess of the funds appropriated to DECD.

Unlike funds appropriated to DECD and other state agencies with responsibility for economic development, tax expenditures are *not* reviewed annually. Rather, once a tax expenditure is enacted, it is rarely revisited, it need not be reenacted and, absent legislative action, it *continues to exist* in perpetuity. By contrast, direct expenditures must be reenacted (appropriated) at least biennially and, absent legislative action approving them anew, they *cease to exist*.

For this reason, public investment in economic development that is made through our tax code *must be* a part of any comprehensive strategic economic plan and reviewed periodically not only by DECD but also by the General Assembly, in light of changing fiscal and public policy realities, to determine whether or not specific tax expenditures should be continued.

The need for *some* state agency to focus attention on the economic impacts of tax expenditures, and how well they are integrated into an overall economic development strategy for the state, is well illustrated by the recent growth in tax credits.

Connecticut's revenue loss from corporation business tax credits has increased 113-fold since 1987. In 1987, Connecticut had a total of nine credits against the corporation business tax. In that year, 289 corporate tax returns claimed a total of \$2.7 million in tax credits. By 2003, the number of credits had increased to twenty-three, and 7,266 returns claimed a total of \$93.1 million.³ OFA now projects a \$305.6 million revenue loss in FY 09 from corporate business tax credits.⁴ This is 113 times greater than the revenue loss from corporate business tax credits 20 years ago, and **nearly 6 times greater than DECD's total FY 08 budget (including bond and carry-forward funds).**



Credits against other business taxes also have increased. In FY 95, there were two tax credits against the public service companies tax, with an estimated revenue loss of less than \$0.2 million and one tax credit against the insurance premiums tax with an estimated revenue loss of \$0.2 million.⁵ OFA now projects a \$5.5 million revenue loss in FY 09 from the six credits against the public service companies tax, and an additional \$27.2 million revenue loss in FY 09 from the thirteen credits against the insurance premiums tax.⁶

There appears to be no comprehensive economic development strategy guiding the adoption of new tax credits. The Office of Policy and Management reports that Connecticut is projected to lose close to \$288 million in tax revenues in the upcoming fiscal year (FY 09) on account of its 31 tax credits against the corporation business tax. OFA estimates a \$338.3 million revenue loss in FY 09 on account of 37 different credits against the corporate, public service company and insurance premiums taxes together. Yet, as seems clear from the following table, no comprehensive economic development plan has guided the choice of activities that these \$338.3

³ OFA, *Connecticut Revenue and Budget Data* (February 27, 2006)

⁴ OFA, *FY 08-FY 12 General Fund and Transportation Fund Budget Projections and Fiscal Information* (November 15, 2007), p. 27.

⁵ OFA, *Tax Expenditure Report 1993-1995 Biennium*

⁶ OFA, *FY 08-FY 12 General Fund and Transportation Fund Budget Projections and Fiscal Information* (November 15, 2007), pp. 28-29. NOTE: OFA's total for credits against the insurance premiums tax (\$26.2 million) is in error. The total of the credits listed is \$27.2 million.

million in tax credits seek to encourage, much less the proportion of investment allocated to each type of activity:

Tax Credits To Be Claimed In FY 09 (for Projected Revenue Loss Of \$338.3 Million)	Projected % of total value of credits to be claimed
Film (Industry, Infrastructure, Digital Animation)	34.4%
Fixed capital	17.7%
Historic rehabilitation (homes, mixed use)	15.2%
Electronic data processing	11.8%
Job creation	3.5%
Research and experimentation	3.0%
Sale of tax credits (R&D, R&E)	2.2%
Housing program contribution	1.9%
Displaced worker	1.8%
Insurance reinvestment	1.6%
Research and development	1.5%
Machinery and equipment	0.7%
Human capital	0.7%
Neighborhood assistance	0.7%
Remaining 20 credits (total)	3.3%
Source: Office of Fiscal Analysis, <i>FY 08-FY 12 General Fund and Transportation Fund Budget Projections and Fiscal Information</i> (November 15, 2007), pp. 27-29.	

Indeed, *more than one-third* of the projected FY 09 revenue loss (\$116 million, or 34.4% of the total) results from tax credits is attributed to the three very new *transferable* film industry credits: the film credit (\$90.5 million), the film industry infrastructure credit (\$10 million) and the film industry digital animation credit (\$15.5 million). Notably, only the digital animation credit is *capped*, the other two credits are *uncapped* meaning that the state's public investment will grow unchecked, without any independent assessment of the merit, and opportunity cost, of investment of this scale in one nascent and somewhat transient industry.

b. DECD's Economic Strategic Plan Should Consider If Tax Expenditures Should be Sunsetting, and Whether the Office of Fiscal Analysis' *Tax Expenditure Report* Should be Enhanced, to Increase Transparency and Accountability of Public Investment Through Connecticut's Tax Code for Economic Development Purposes

The merit of sunsetting tax expenditures. Currently, tax expenditures are reviewed and changed only through affirmative legislative action to repeal or amend the law creating them. However, review can be automatic if there is a sunset provision in the law that creates the tax expenditure itself. Tax expenditures with sunset provisions, like budget expenditures, come to an end at a date certain unless the legislature takes affirmative action to continue them.

Sunsetting tax expenditures would help assure parity in the review of spending on both "sides" of the budget and provide DECD the opportunity to weigh in on the appropriateness of particular tax expenditures in meeting current economic development needs.

The merit of expanding Connecticut's Tax Expenditure Report. This report, prepared every two years by OFA, is an extremely helpful tool for understanding the “spending” Connecticut does through its tax code for the benefit of certain taxpayers. It is essential in promoting fiscal transparency. Its value in promoting not only transparency, but also fiscal accountability and consistency with Connecticut's overall economic development plan, would be enhanced by:

- Organizing the report not only by tax type, as is currently done, but also by goal (education/job training, job growth, etc.) so that the reader can more easily understand the magnitude of different categories of investments supported financially through the tax code.
- Expanding current reporting regarding which taxpayers benefit from each tax expenditure by showing not only the approximate number of taxpayers who benefit from each tax expenditure (as is currently done), but also by providing more description of who these taxpayers are (approximate size/geographic location/nature of business or company, average income level of individuals/businesses, and other meaningful metric of analysis).
- For the major business tax credits/exemptions, identifying the names of the corporations that have claimed the benefit and the tax benefit derived by each (so there is some parity with regard to disclosure with DECD-awarded financial assistance).
- Expanding commentary in the report regarding trends in state tax expenditure growth, projected impact on state revenues in out-years (in real dollars), and impact on tax code equity.

The proposed expansions of the Report outlined above would enhance the valuable information now provided in the Report by helping readers (and DECD) understand better *which* taxpayers are benefiting and *which* types of activities Connecticut is subsidizing through tax expenditures.

c. DECD's Economic Strategic Plan Should *Not* be a Stand-Alone Document But Should be an Integral Part of a Long-Term, Strategic Plan for the State of Connecticut.

Unlike some other states, Connecticut has *no* comprehensive long-term, strategic planning process or plan. While individual state agencies may have some strategic plans (e.g., DECD's new economic development plan), there is *no* single plan that integrates planning across state agencies, from economic development to education and human services. For a \$18 billion/year enterprise – like Connecticut -- to have *no* comprehensive plan for where it wants to go and how it wants to get there is problematic and can lead to wasteful state spending. Contributing to Connecticut's lack of planning was the lay-off of virtually all planners in the Office of Policy and Management in FY 02-03 when the state budget was in deficit (as well as planners in many other state agencies). Recently, a Legislative Program Review and Investigations Committee study of this issue was released, recommending that Connecticut establish a long-term planning entity with ties to multiple branches of government that is empowered to develop an integrated, state strategic plan, as has been done (for example) in Virginia. Connecticut Voices for Children fully supports this concept

Conclusion

An Integrated Economic Development Budget would assure that state resources are used most efficiently to promote economic development by bringing together -- in a single document -- information on *all* economic development assistance provided by the state in *any form*, and by any public or quasi-public agency, so the totality of our investment can be assessed by type of investment, firms benefiting, and return to the State of Connecticut and its residents. Just as the Appropriations Committee increasingly incorporates Results-Based Accountability in its budgeting for health, education, and human service programs, so too should our investments in economic development be assessed so that they are directed into activities that provide greatest economic return to the state – in new, high quality jobs; a well-educated workforce; a modern and adequate infrastructure, and like investments that assure the continued prosperity of our state.
