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Impact of the Governor's FY 2019 Budget Adjustments on Children and Families

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February 2018

Introduction

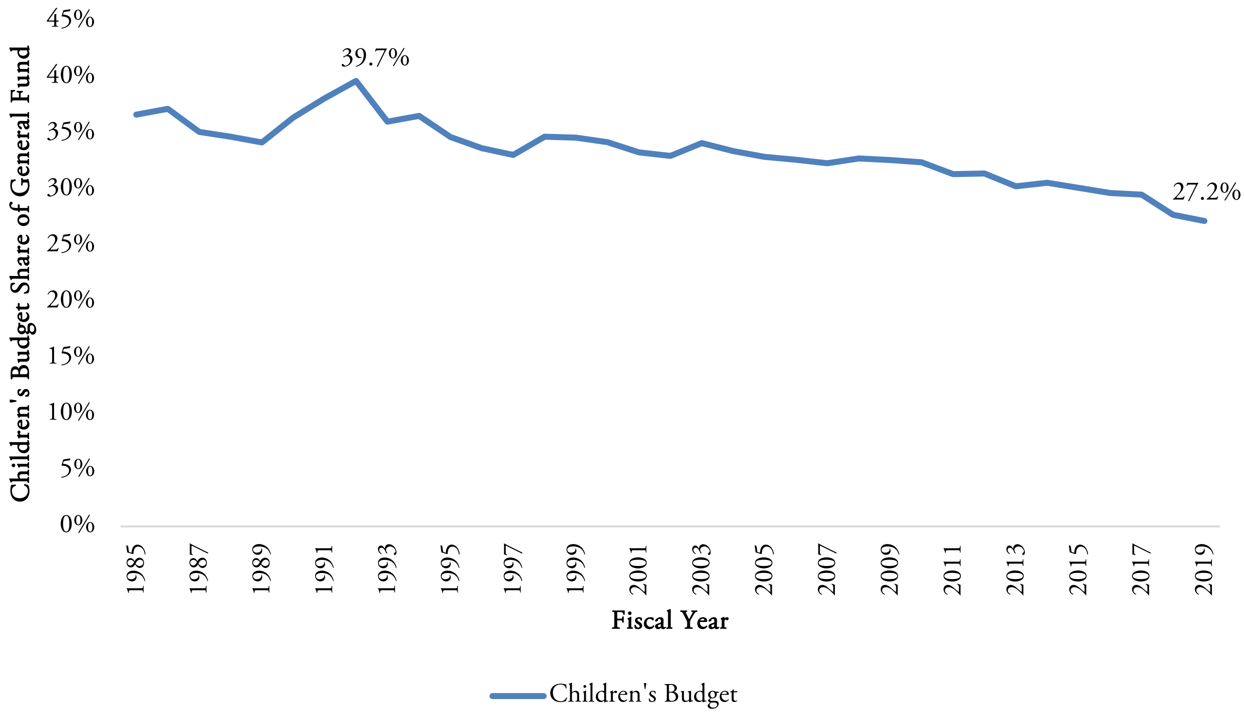
Connecticut's long-term fiscal health depends on economic growth that benefits families, businesses, and communities. We analyze Governor Malloy's Fiscal Year (FY) 2019 budget adjustments through this lens, evaluating the extent to which proposed adjustments support opportunity for all children and families, economic growth across the state, and a fiscally sound state government. We find that Governor Malloy's budget includes some welcome steps to narrow our long-term deficit, stabilize the state's fiscal situation, and tackle some of our pressing infrastructure needs. However, the proposal underfunds critical needs in areas such as early childhood development and community-based services. It also fails to address a number of structural changes essential to economic growth and shared prosperity.

Moving forward, we urge policymakers to ground their work in an understanding of the economic, demographic, and political changes that have contributed to today's ever-growing challenge. Connecticut's budget priorities should respond to our structural challenges with solutions that improve equity, advance inclusive economic growth, and ensure support for our most vulnerable residents.

The Children's Budget

To track trends in public spending, Connecticut Voices for Children created the Children's Budget, a compilation of all major state investments in children and families, including K-12 education, child welfare, early care and education, and family health. Analyzing changes in the Children's Budget allows us to assess appropriations over time to determine the state's relative priorities. Following last year's austerity approach to the biennial budget deficit, the Children's Budget fell to a record-low 27.7 percent of General Fund spending. **The Governor's FY 2019 adjustments would further reduce the Children's Budget to 27.2% of General Fund spending—an all-time low.**

Figure 1. Governor Would Bring Children's Budget to All-Time Low.



Source: Connecticut Voices for Children analysis.

The Governor's proposal would lower the Children's Budget by $216 million (3.4 percent) compared to original FY 2019 appropriations, primarily due to cuts to K-12 education ($99.1 million, or 3.3 percent) and health and human services ($99.9 million, or 3.9 percent).

Table 1. Cuts to Children's Budget by Component.

Children's Budget Component	FY 2019 Appropriated	Governor's Proposed Revised FY 2019 Amount	Change
K-12 Education	$2,968,933,107	$2,869.828,463	-$99,104,644 (-3.3%)
Early Care and Education	$314,106,136	$306,034,934	-$8,071,202 (-2.6%)
Higher Education	$531,206,103	$522,059,134	-$9,146,969 (-1.7%)
Health and Human Services	$2,554,889,463	$2,454,948,117	-$99,941,346 (-3.9%)
Total	$6,369,134,809	$6,152,870,648	-$216,264,161 (-3.4%)

Source: Connecticut Voices for Children analysis.

Below, we describe proposed changes to different areas affected by the Children's Budget—child welfare, juvenile justice, early care and education, K-12 and higher education, and health and human services—in detail.

Child Welfare and Juvenile Justice

The Governor's proposed adjustments to the budget for FY 2019 include a $4.3 million increase (0.6 percent) from what the Connecticut General Assembly appropriated to the Department of Children and Families (DCF) in FY 2019 to serve children and families receiving child welfare and behavioral health services. This increased budget stands in stark contrast to the Governor's proposed adjustments to the Judicial Department, which, starting in July

2018, will serve children and families involved in the juvenile justice system. The Governor proposed reducing the Judicial Department budget by $26.5 million (5.2 percent) and cutting juvenile justice services provided by the Court Supported Services Division (CSSD) of the Judicial Department amount by over $11.5 million, or 21.4 percent.

Although the Governor's cuts fall primarily on the Judicial Department, all too often, the child welfare system and the juvenile justice system serve the same children and families.[1] These are children who often come from impoverished homes, have a history of multiple traumas, and overwhelmingly experience educational and behavioral health challenges.[2] Aspects of the child welfare system, such as experiencing frequent placement changes, increase the risk that children will also become involved in the juvenile justice system.

These changes to the FY 2019 budgets for the Department of Children and Families (DCF) and the Judicial Department are best understood in the context of four major policies: budgetary lapses, a revised Juan F. exit plan, the closing of the Connecticut Juvenile Training School (CJTS), and the transfer of all juvenile justice services from DCF to the Court Supported Services Division (CSSD) of the Judicial Department.

The Governor's proposed adjustments to DCF's FY 2019 budget include annualizing $8.9 million in lapsed funds, most of which are taken from the personal services line item. These lapses are balanced by increasing DCF's budget for services by almost $11.4 million in FY 2019 and providing $4.99 million to add an additional 132 social workers in FY 2018. Both of these adjustments serve to implement the 2017 Juan F. Consent Decree Revised Exit Plan.[3] The consent decree called for a large number of reforms to the child welfare system to better protect abused and neglected children, mandating state funding and other resources necessary to achieve certain goals.[4] In the most recently negotiated exit plan, the court ordered Connecticut to increase social worker staffing so as to decrease the average number of children and families served by each social worker. Without further appropriations, DCF would have needed to decrease services or otherwise reallocate resources to be able to implement this order.[5] Indeed, DCF spent an estimated $12.4 million over appropriated funds in 2018 so that they could comply with Juan F. Consent Decree requirements.[6]

Additionally, the Governor's proposed adjustments to DCF's FY 2019 budget include appropriating $6.7 million after holdbacks to the Juvenile Justice Outreach Services line item. In the Legislature's FY 2018-2019 budget, the entirety of this line item ($11.1 million) was transferred to CSSD beginning in FY 2019. The Governor proposed moving a portion of these funds back to DCF to account for the fact that many of the behavioral health services included in this line item primarily serve non-adjudicated youth. These are services such as Functional Family Therapy that teaches families how to manage behavioral health crises and Work Learn programs that help youth learn vocational and life skills to transition into adulthood.

As part of the Connecticut General Assembly's bipartisan FY 2018-2019 budget, the Legislature included a policy change that requires closing CJTS and transferring responsibility for all juvenile justice services from DCF to CSSD in July of 2018. The Legislature appropriated $17.7 million to the Judicial Department in FY 2019 so that CSSD could create community-based secure housing facilities for high-risk youth, like those incarcerated at CJTS, and establish a continuum of services to serve youth more effectively in the least restrictive setting appropriate.[7]

The Governor's proposed adjustments for the FY 2019 reduces this appropriation by $7.6 million and transfers much of the money to DCF, leaving the Judicial Department with just $6.3 million to establish and fund residential settings and $3.9 million to fund services for high-risk youth. The $3.9 million left in CSSD's Juvenile Justice Services line item just covers the cost of services DCF provided to high-risk youth, such as the Fostering

Responsibility, Education, and Employment (F.R.E.E.) re-entry program and Multisystemic Therapy, a cognitive-behavioral intervention shown to reduce recidivism. This amount will not allow CSSD to create a robust and individually responsive continuum of care.

Additionally, the Governor's proposed budget adjustments combine the Judicial Department's Juvenile Alternative Incarceration line item and Youthful Offender Services line item, both of which provide an array of services to adolescent and young adult offenders within their communities. As part of this change, the Governor proposes extending the age of jurisdiction in delinquency to include young adults under the age of 21 by July, 2021.[8] Between combining these lines and shaving off a portion to balance the $19 million annualized lapse, the budget revisions cut $1.6 million from these services (5.0 percent) compared to their FY 2018 appropriations.

The Governor's proposed budget adjustments also make large cuts to services that prevent youth from becoming involved in the juvenile justice system. The Governor proposes cutting $1.7 million (53 percent) from the Youth Services Prevention line item, which funds community programs that help children at risk of becoming justice-involved develop their potential, build positive relationships with role models and prosocial peers, and improve their academic performance. Governor Malloy's budget adjustments also include a $100,000 decrease (10 percent) to the School-Based Diversion Initiative (SBDI), which reduces school-based arrests among youth with mental health needs, and $129,848 (4.0 percent) from Youth Service Bureaus, which connect youth and families with supportive services in their communities. Effective prevention and diversion programs, such as SBDI, can save states over $13 for every dollar spent.[9] These savings are achieved through reducing court costs, decreasing the instances of incarceration, and decreasing need for probation and parole services.

These proposed cuts to juvenile justice services could create destructive ramifications for years to come. With the closing of CJTS and the Governor's proposal to extend the age of juvenile jurisdiction, CSSD needs adequate funding to create, implement, and evaluate a service delivery system that will benefit youth and young adults with complex and high needs. While developmentally-responsive policies can lead to reduced crime and large cost savings, it is imperative for public safety that Connecticut invest necessary resources to provide adjudicated youth and young adults with the structure and supports they need to learn from their mistakes and grow into productive members of society.

Furthermore, transferring youth from DCF to CSSD and then cutting juvenile justice funds from CSSD could undermine Connecticut's efforts to exit from under Juan F. federal court monitoring, as some of these youth are dually committed to DCF and CSSD and others cycle between the child welfare system and the juvenile justice system. The consent decree mandates that the state must "provide funding and other resources necessary to fully implement and achieve sustained compliance with the 2017 Revised Exit Plan" (p. 3)[10] without specifying a single responsible department. Therefore, Connecticut must provide for the needs of vulnerable children involved in or at-risk of becoming involved in the child welfare system, regardless of which department is serving these children.

It is crucial not to undermine Connecticut's long, gradual progress to reduce the number of children involved in the child welfare system and the number of incarcerated children by cutting the programs and services that have made these efforts so successful.

Early Care and Education

Early care, preschool, and wrap-around programs that support young children and families are critical drivers of child well-being, kindergarten readiness, and family economic security. Although many of the benefits of early childhood are long-term, including increased earning potentials and decreased need for social services, early childhood investments have immediate pay-off in the form of increased workforce participation and support for local business.[11]

The Governor's budget calls for "invest[ment] in our people through education and health care" (p.4) and notes that "Connecticut has made meaningful and substantial progress improving public education from early education to higher education" (p. 7).[12] This budget avoids the devastating cuts discussed in various budget proposals last year, including eliminating the Office of Early Childhood entirely or closing the Care 4 Kids child care subsidy program again as part of a deficit mitigation strategy. (The line item that at first appears to be the largest funding change is actually a realignment of federal funds that will not result in any reduction of services.) However, the budget calls for no new investment in early childhood as a key driver of child well-being and economic opportunity for families.

The federal budget deal signed on February 9th pledged to double funding for the Child Care Development Block Grant (CCDBG), which provides the federal portion of Care 4 Kids funding. In an analysis of a previous iteration of this proposal, the Center for Law and Social Policy estimated that such a funding increase would bring $18.40 M in new federal funds for Care 4 Kids in Connecticut.[13] By law, CCDBG funds should be used to supplement - not supplant - state funding.[14]

Ensuring that new federal funds bolster the Care 4 Kids program is critical after last year's underfunding destabilized our early care and education system. During the year-long closure of Care 4 Kids, enrollment in the subsidy program plummeted, leaving seats in child care centers and homes empty while thousands of families in need could not afford care. Child care in many communities is already a low-margin business. With Care 4 Kids closed to new enrollments, providers reported having to close classrooms; the number of center-based programs that closed each year tripled between FY 2015 and FY 2017.[15] While the Governor does not directly call for further cuts to Care 4 Kids, he includes re-closing the program as an alternative option through which to achieve cost savings. The child care subsidy must remain open to ensure that families can obtain the care that they need when they need it. These new federal funds can be used to meet federal requirements pertaining to reimbursement rates and graduated phase-out for families experiencing moderate increases in income. (Currently, Connecticut has a waiver for these requirements.)

The Governor's budget proposes some annualizing small but meaningful cuts. The governor's proposed budget annualizes lapses from FY 2018, including $0.14 M (32 percent of appropriated funding) from Even Start, $0.34 M (45 percent) from the 2Gen-TANF program, and $0.10 M (2.0 percent) from Head Start. Although these programs are small, Even Start and the 2Gen-TANF programs provide critical wrap-around supports for the whole family. The gradual erosion of these programs year after year hurts our early childhood system as a whole, as wrap-around supports help families support child well-being and learning both at home and at school.[16]

K-12 and Higher Education

Connecticut can thrive only if all of its students receive access to a high-quality education that prepares them for college and careers. This budget proposal continues the trend of chipping away slowly at the programs that ensure that access. The Governor's latest budget proposal maintains many of the harmful cuts to education programming and grants set out in last fall's final FY 18-19 budget. The budget also consolidates the Office of Higher Education (OHE) into the State Department of Education (SDE).

Overall, the budget proposes a 2 percent ($62 million) cut to the SDE budget in the coming fiscal year. The largest cut by far is to the Education Cost Sharing grants, explained below in the section on municipal aid. Although we commend the choice of the executive branch to make sure that education funding is directed at towns that have the highest need, the budget also eliminates funding from two programs, Connecticut Writing Project and Bridges to Success. While both cuts were small in terms of the budget ($30,000 and $40,000 respectively) they reflect a concerning trend of cutting programs directed at supporting the education of students in those same high-need districts. For example, Bridge to Success provides programming that supports the social and emotional learning skill development, early literacy and college and career readiness of students in the Waterbury area.[17]

Also of concern, the budget further maintains the FY 2018-2019 budget's 86 percent cut to SDE's Talent Development Office. The Talent Development Office is responsible for many of the minority teacher recruitment efforts. This cut will impede Connecticut's ability to hire a diverse workforce. Minority teachers in K-12 have been linked to the academic success of minority students,[18] but in the 2016-17 school year, students of color made up 45 percent of students but only 8 percent of teachers identified as a minority.[19]

The fiscal impact of the annualized lapses and cuts to K-12 funding in the SDE budget are masked by the consolidation of the Office of Higher Education into the State Department of Education. The Governor transfers $36 million from the Office of Higher Education to the State Department of Education, moving both the Governor's Scholarship (also known as the Roberta B. Willis Scholarship) and the programming of the OHE into a new "Division of Post-Secondary Education." The services formerly within the Office of Higher Education would experience a $1.2 million cut to their budgets.

The Governor's proposed budget also annualized the 2018 lapses in the budget for UConn. This represents a 2 percent cut from the final FY 18-19 budget appropriations. The vast majority of this money is taken out of the "Operating Expenses" line item, with a small share taken from Next Generation Connecticut—an initiative created to expand the potential educational opportunities offered at UConn.

Health and Human Services

Access to quality and affordable health care for both children and their parents is vitally important for children's growth and development. Connecticut's Medicaid and CHIP programs (HUSKY Healthcare) are a key part of providing healthcare to children and families. The Center for Medicare and Medicaid Services reports that over 835,000 individuals were covered by Medicaid and CHIP in Connecticut in November 2017. Of these, about 335,500 were children.

Since 2015, income eligibility levels for parents/caretaker relatives in HUSKY A have been reduced from 201 percent of the Federal Poverty Level (FPL) to 138 percent FPL. This resulted in at least 18,000 adults losing HUSKY coverage to date. It is anticipated that another 13,000 will lose HUSKY coverage beginning in January, 2019.

In addition to reductions in income eligibility in the Medicaid program, support for health care providers has been reduced in past budgets and through holdbacks in funding this fiscal year. The Governor proposes continuing to erode support for the health care infrastructure in several areas.

By annualizing last year's lapses, state funding for School Based Health Centers (SBHCs) would be reduced by 5 percent and funding for a new center would be eliminated, for a total reduction of $645,000. These cuts follow a series of reductions since funding peaked in FY 2015. Some services provided by SBHCs are reimbursed by HUSKY or private insurance but barriers such as high deductibles and lack of or limited coverage for some services prevent Centers from receiving third-party reimbursements for some needed services. SBHCs provide primary care, including mental and oral health services, to tens of thousands of school-age children. The proposed cuts leave children at risk for untreated health issues that impact their ability to succeed in school and in life.

Reimbursements for primary care providers in the Medicaid program are reduced by 10 percent. Under the Affordable Care Act, primary care provider rates were increased by about 50 percent for two years. After federal funding for this increase ended, Connecticut continued to fund the higher rates using state funds. The adopted budget cut these rates by 5 percent. The Governor proposes to cut them by 10 percent. Estimated savings of state funds are $3.5 million. Total Medicaid expenditures, including the federal share, would be reduced by $8.5 million in FY 2019 and $9.3 million when the change is annualized. These changes may reduce available services by reducing the number of doctors willing to accept patients with Medicaid.

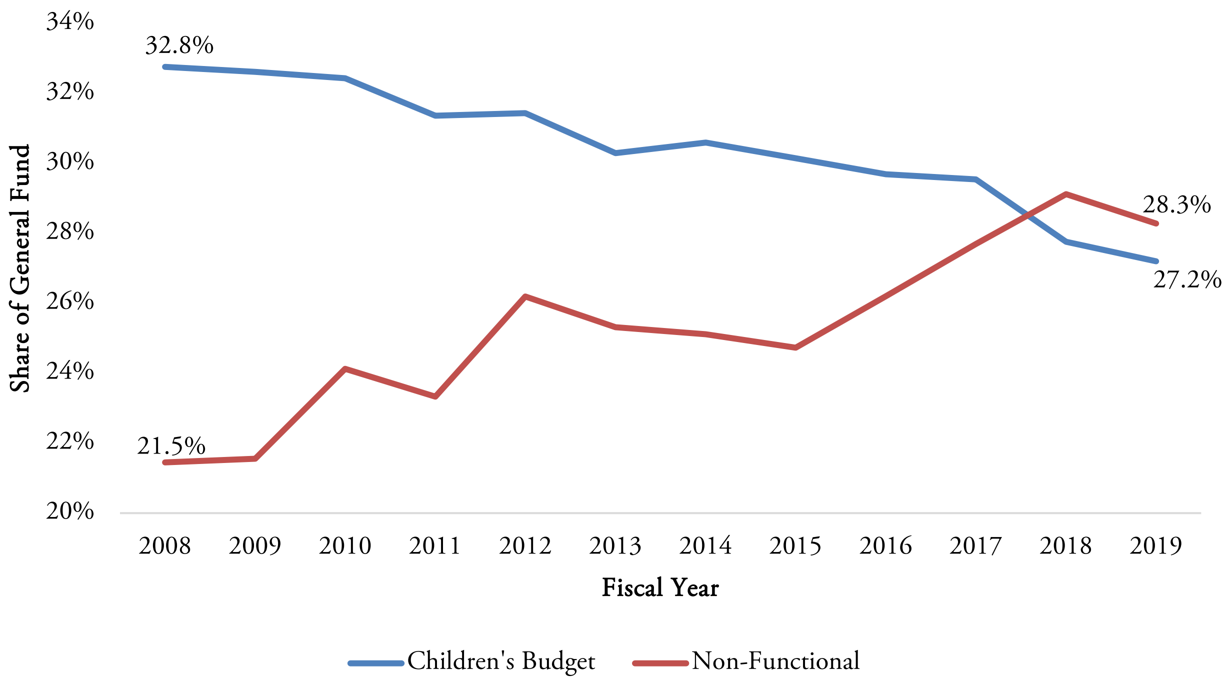
Grants to support mental health and substance abuse services, provided by DMHAS, are once again reduced. These grants help offset costs of local programs that serve uninsured and underinsured individuals. The Governor proposes a reduction of about $3 million.

In a few areas, the Governor expands health care resources. Five million dollars are added to the DDS budget to provide funds for emergency placement needs, including youth in hospital emergency departments. Furthermore, the newly created Office of Health Strategy (OHS) is included in the proposed budget with funding of $5.8 million, about $2 million of which is from the General Fund. (The remainder is from the Insurance Fund.) The purpose of OHS is to develop and implement a comprehensive health care vision for the state, including a cost containment strategy and to coordinate health care technology initiatives, planning, regulation, and reform strategies.

Increasing Nonfunctional Costs

A key factor contributing to the decreasing share of the state budget devoted to children and families has been the sharp increase in current nonfunctional obligations, which include contributions to Connecticut's state employee and teacher pension systems, as well as debt service and costs related to retiree health care. This increase, largely due to policymakers' failure to contribute to these programs for decades, resulted in last fall's budget increasing nonfunctional costs by $540.2 million (8.7 percent) from FY 2018 to 2019. Governor Malloy seeks to slow this growth to $170.6 million (2.7 percent), largely by implementing last year's agreement with the State Employee Bargaining Agent Coalition, the state employee union.

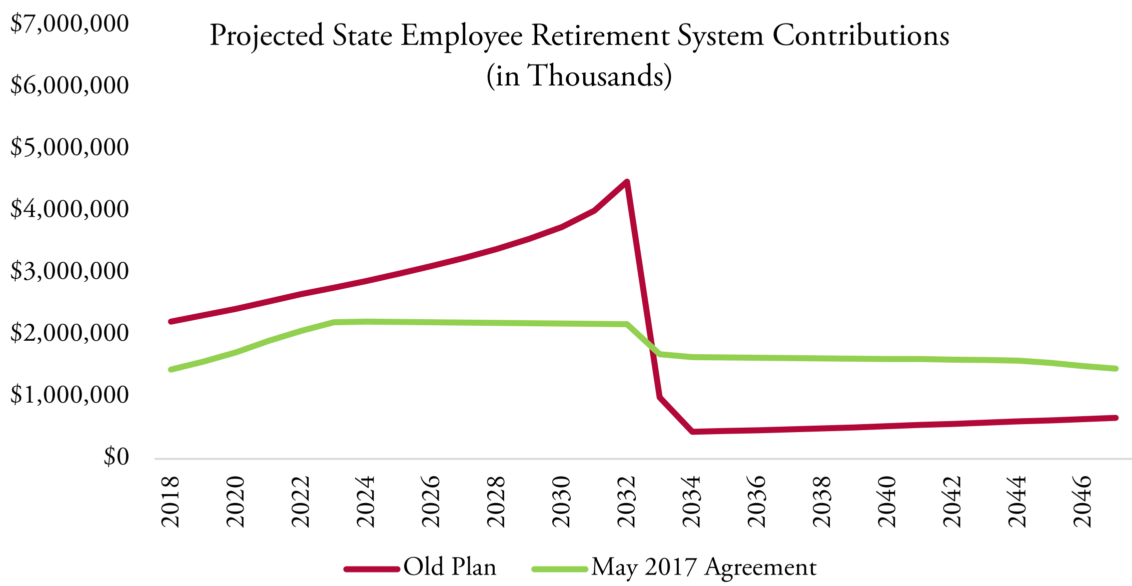
Figure 2. Nonfunctional Costs Now Exceed Children's Budget.



Source: Connecticut Voices for Children analysis.

Governor Malloy proposes to achieve additional short-term savings by recommending reforms to the Teachers Retirement System similar to those made to the State Employees Retirement System (SERS) last session. Like TRS, SERS faced a rapidly increasing spike in costs by 2032, shown in the red line below. The Governor, the General Assembly, and SEBAC agreed to extend these costs over a longer period of time (shown in the green line below), reducing the maximum required contribution but increasing overall costs.

Figure 3. Latest State Employee Union Deal Flattened Oncoming Increase.



Source: Actuarial analysis of SEBAC agreement.

However, similarly reforming TRS is more complicated: in 2008, then-Governor Rell issued a $2 billion bond to fund TRS, promising as part of the bond covenant that the state would pay its required contribution until 2032 or until the debt was paid off.[20] Because covenants are contracts, there seem to be legal obstacles to modifying the terms of the current TRS payment schedule.[21] Governor Malloy has not yet introduced statutory language this session to reform TRS, so it remains to be seen whether his proposal would stand constitutional muster.

Municipal Aid

Children and families thrive when they live in vibrant communities. Because the 169 towns and cities across Connecticut rely on property tax revenue to fund essential services, the relative wellbeing of communities depends on the relative wealth of its residents. As a result, access to resources and opportunities is not equitable across the state, creating a multi-generational cycle of wealth or poverty depending upon the zip code into which one was born.

The Governor seeks to rebalance the equation by directing municipal aid to communities with the least property wealth. Nonetheless, proposed cuts might potential force some municipalities to reduce spending for key priorities, such as education.

The Governor's proposal reduces statutory formula aid to municipalities by $96.8 million (3.9 percent) compared to FY 2019 levels.[22] More than two-thirds of this reduction is to the Education Cost Sharing (ECS) formula, the state's program to reduce disparities in education funding between towns. The Governor would continue his 7.95% cuts to the ECS grant into FY 2019 and eliminate funding for 33 of the most property-wealthy towns. While we appreciate the Governor's effort to better target aid to municipalities in need, Connecticut must ensure that its overall funding for education is equitable and adequate to prepare a 21st-century workforce.

The Governor's next largest municipal aid reductions are to Connecticut's Payment in Lieu of Taxes (PILOT) program, which compensates municipalities for state laws that forbid them from taxing certain kinds of property, including state buildings, private universities, and hospitals. The program receives a $20.2 million (12.5 percent) cut, largely because the Governor would cap PILOT grants at FY 2018 levels. He also would eliminate PILOT funding for the same 33 property-wealthy towns that would lose their ECS funding. Given that policymakers have underfunded PILOT for years, further reducing the program's support will exacerbate the structural challenges of Connecticut's cities.

Once again, we recognize the equitable intent behind the Governor's effort to better target aid to communities in need. However, we are concerned that reductions in PILOT funding perpetuate the upside-down nature of the property tax, especially considering that the Governor also eliminates the property tax credit for middle-income families. We are also concerned that cutting PILOT funding will further tilt Connecticut's economic infrastructure away from its core cities, which are vital to the state's economic growth.

Revenue and Tax Policy

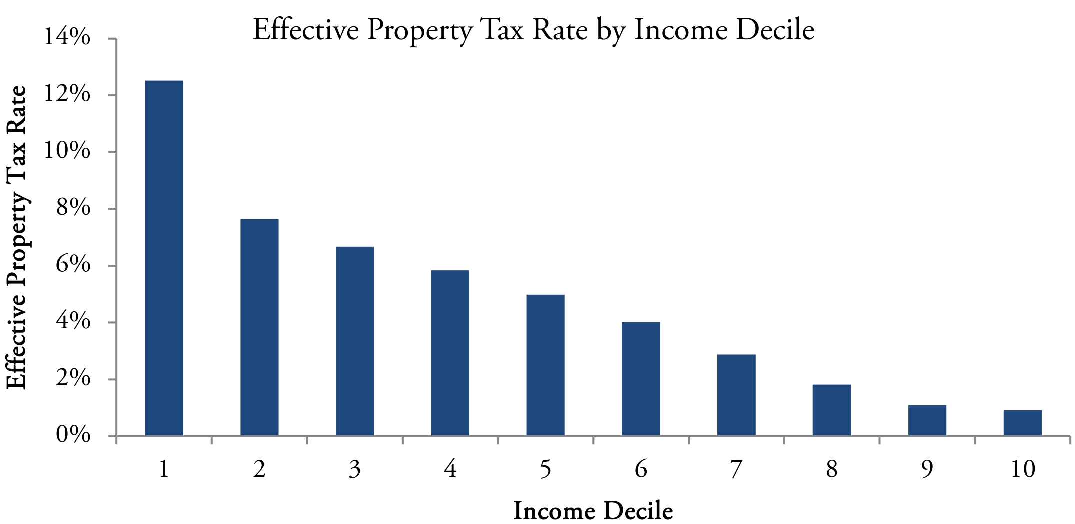
An effective revenue system should advance inclusive economic prosperity, equitable opportunity, and support for our most vulnerable residents. Doing so requires adhering to core taxation principles of equity, adequacy, and transparency.

Although the Governor's budget reflects an effort to provide adequate revenue for state government, it includes changes that make the system less equitable. Furthermore, it fails to correct existing structural flaws that will over time limit revenue growth and forestall our state's ability to fund key priorities such as early childhood, transportation, and workforce development.

To balance a projected $165.2 million deficit for FY 2019, the Governor proposes to raise $234.6 million in new General Fund revenue.[23] His revenue proposals include:

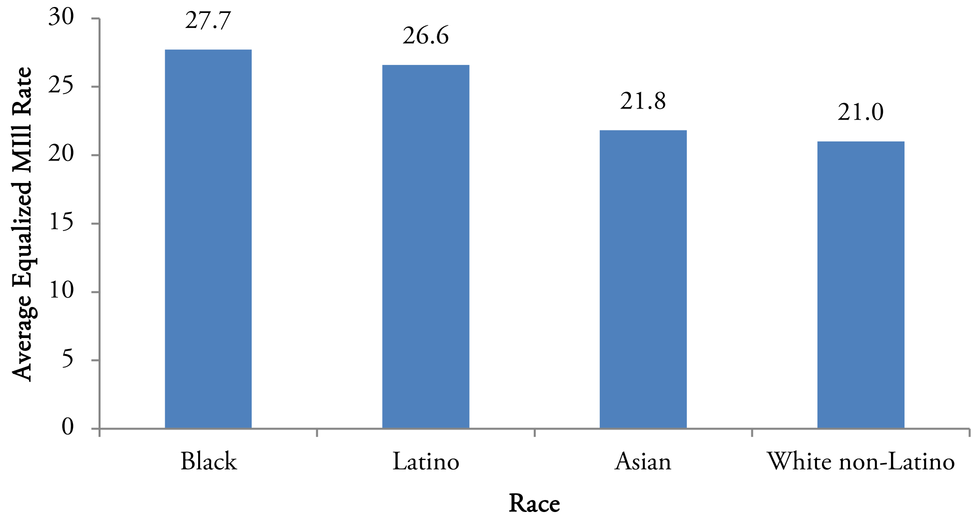
- Eliminating the $200 property tax credit for the elderly and households with dependents (raising $50 million): Currently, the state offers a maximum of $200 to residents to credit against their state income tax for property taxes paid. The Governor would eliminate this program, raising taxes for middle-income families and building upon prior reductions.[24] This policy would exacerbate the flaws of Connecticut's upside-down property tax system and make life harder for working families—the very families harmed by years of austerity.
- Changing our corporate tax code (raising $47 million): The Governor extends a surcharge on corporate income, eliminates a cap on taxes related to multistate corporations, and repeals a law intended to encourage brownfield redevelopment.[25] These changes capture some of the savings that the federal tax law gave corporations by reducing the U.S. corporate tax rate from 35 to 21 percent.
- Increasing cigarette taxes (raising $34.2 million): The Governor proposes to increase cigarette taxes by $0.25 per pack in addition to increased taxes on cigars and e-cigarettes. Research has found that cigarette taxes reduce smoking rates and thus decrease health costs.[26]

Figure 4. Connecticut's Property Tax System is Upside-Down.



Source: Department of Revenue Services. Tax Incidence Report. 2011 tax year. 1 is least income, 10 is most income.

Figure 5. Our Property Tax System Furthers Racial Disparities.



Source: Connecticut Data Collaborative and OPM, Municipal Fiscal Indicators. Average equalized mill rate is the mean of all towns' equalized mill rates weighted by the population of each race in each town. Equalized mill rate is property tax levy expressed as percentage of market value.

Encouragingly, the Governor does propose structural reforms to Connecticut's transportation finance system. He has proposed statewide tolling after FY 2023 to raise between $600 million to $800 million per year.[27] In addition, he proposed to increase the gasoline tax by 2 cents in FY 2019, 1 cent in FY 2020, 2 cents in FY 2021, and 2 cents in FY 2022—an increase of 7 cents (28 percent) over four years. This would raise $30 million for transportation in FY 2019 alone. These are reforms that Connecticut desperately needs: a report last December by the Office of Policy and Management projected that Connecticut's Special Transportation Fund will be insolvent by 2020.[28] We applaud the Governor for proposing to develop the robust physical infrastructure it needs to compete in the 21st century. However, we are concerned that investing tolling dollars may run afoul of the spending cap, detailed below.

The Governor also proposes two policies to better position the state in light of the new federal tax law. Previously, taxpayers could deduct their state and local taxes (SALT) from their federal tax liability in full. The new federal tax law changed this, capping the deduction at $10,000 for individuals. This punishes states, such as Connecticut, that choose to invest in critical services for children and families.

The Governor's first policy would allow municipalities to set up local charitable funds and offer a property tax credit in return for contributions. Under the new federal law, deductions for state and local taxes are capped at $10,000, but deductions for charitable contributions are not, as long as those contributions do not surpass 60 percent of adjusted gross income.[29] This arrangement may allow Connecticut residents to effectively deduct more than $10,000 worth of state and local taxes from their federal tax liability.

For example, an individual owing $12,000 in local property taxes could contribute $12,000 to their town's charitable fund. In return, the town could give the individual $12,000 in property tax credits so that the individual still pays $12,000 to their town ($12,000 in a charitable contribution, rather than $12,000 as a charitable contribution and $12,000 in taxes). The individual could then fully deduct their $12,000 charitable contribution from their federal tax liability—$2,000 more than the $10,000 cap.

The Governor's second policy would shift taxes for owners of passthrough businesses from the individual level to the business entity level. Currently, owners of passthrough businesses report their state business income on their state personal income tax return, of which they can only deduct $10,000 from their federal return. However, businesses can fully deduct state taxes as a business expense. Thus, Governor Malloy proposes shifting a portion of the taxes for owners of passthrough businesses from the individual level—where the deduction at the federal level is capped—to the business entity level—where the deduction is not capped. The business will then be able to deduct this state tax fully as a business expense (whereas the business owners could deduct a maximum of $10,000 if it were a personal income tax). In effect, this will allow business owners to reclaim part of the SALT deduction that they lost with the federal tax bill.

For example, the single owner of a local successful locksmith company may earn $1,000,000 in a given year from his business as his sole source of income. Under current law, he would pay $69,850 in state personal income taxes but only be able to deduct $10,000 of that from his federal liability.[30] Under Governor Malloy's proposal, the state would first tax that $1,000,000 at the business level, before it gets "passed through" to the owner, at a rate of 6.99 percent; in this example, the business would pay $69,900 in taxes. However, the business could fully deduct its state business taxes from its federal return. The owner would receive a $69,900 credit on her income tax, and thus, the state would effectively preserve her ability to fully deduct state and local taxes.

The federal tax changes have pressured Connecticut to adjust its policies to remain competitive even though these changes mostly benefit the wealthy. If Connecticut adapts to the federal government's new tax policies in ways that prioritize the wealthy over the middle class, it should pair these policies with those that support working children and families, such as restoring the state Earned Income Tax Credit to 30 percent of the federal credit.

Fiscal Restrictions

Policymakers need the flexibility to meet rapidly-changing needs today and build thriving communities tomorrow. However, last fall's budget imposed four new restrictions—a bond lock, spending cap, volatility cap, and bonding cap—that diminish this flexibility, tying the state's hands and making it more difficult for Connecticut to make the strategic investments necessary to promote equitable opportunity and inclusive economic growth. The Governor's budget did not address these restrictions, neglecting an issue that, if not addressed before the state issues bonds after this May, will hamper Connecticut's core functioning for the next decade.

The most important and time-sensitive issue for this session is the bond lock. A section of the law implementing last fall's budget stipulates that whenever the state issues a bond for a two-year period beginning in May, it must vow not to change three new spending and revenue restrictions for the life of the bond (typically 10 years) except in extraordinary circumstances. Because bonds are considered contracts, Connecticut would be legally bound to maintain these spending and revenue restraints, despite what future Governors or legislatures might find to be in the best interests of the state. Any effort to break the covenant would invite litigation, cost the state scarce dollars in immediate payment of principal, interest, and penalties, and give investors power over fundamental matters of governance. Precisely how damaging the bond lock is depends upon the details of the three restraints it seals into contract: the spending cap, the volatility cap, and the bond cap.

Last year's budget greatly expanded the reach of the constitutional spending cap, restricting the state's ability to meet vital needs and build thriving communities. Originally passed in 1991 as part of the compromise enacting the personal income tax, the constitutional spending cap requires that "general budget expenditures" not grow at a rate greater than the "increase in personal income" or "increase in inflation," whichever is greater. It leaves the definitions of those three terms to the legislature, stipulating that defining or amending them requires a three-fifths vote of each house in the General Assembly.

It took more than twenty-five years for the General Assembly to define those terms, doing so only in last year's budget and without prior debate on the spending cap definitions. As a result of the final budget's near-unanimous enactment, Connecticut now has a spending cap which broadly applies to almost all general budget expenditures, including expenditures to redress the structural inequities faced by families in our distressed municipalities.

The Office of Policy and Management estimates that the spending cap prevents policymakers from investing more than an additional **$170.2 million** above Governor Malloy's proposed FY 2019 appropriations—not nearly enough to support system-level investments in Connecticut's future, much less undo recent budgets' austerity. For example, restoring the Children's Budget to FY 2016 levels—a budget that eliminated Medicaid for 20,000 parents, reduced the property tax credit from $300 to $200, and cut more than $130 million from K-12 education—would cost $237.6 million, more than the room available under the cap. Furthermore, because the spending cap applies to expenditures from *any* appropriated fund, it would also apply to the $600-$800 million in annual Special Transportation Fund dollars that Governor Malloy proposes to raise from tolling, potentially severely restricting the use of those dollars to revitalize our infrastructure. A future administration could potentially work around this restriction by electing to not appropriate transportation funding, but in doing so would create a less transparent budget.

In addition to expanding the constitutional spending cap, last fall's budget also provided for a statutory "Volatility Cap," essentially restricting the state's use of new funds from one of its most volatile but equitable sources. The state's personal income tax revenues are composed of two parts: "withholdings," from paychecks, and "estimates and finals," the typical means of paying for investment-related earnings. The Volatility Cap forces the state to deposit any estimates and finals revenue in excess of $3.15 billion into the Rainy Day Fund, which it can use only during emergencies.

In FY 2017, Connecticut collected $3.12 billion in estimates and finals revenue, almost passing that threshold. Because estimates and finals tend to be paid by wealthy individuals, the Volatility Cap would likely dampen the effects of any income tax increase on the wealthy: the state could use only the withholdings portion of any new revenue raised for general expenditures, while it would be compelled to lock the estimates and finals portion away for another day. Estimates and finals constituted more than one-third of income tax revenues in FY 2017. Connecticut's overall tax system is already upside-down, and the personal income tax is one of only two state taxes that help correct that imbalance. By limiting the ability to raise additional revenue through the personal income tax, Connecticut has made it more difficult to develop an equitable tax system.

Last fall's budget also imposed various restrictions on state bonding, often used to build schools and stimulate economic development. Additional work is necessary to map how these bonding caps will impact the state's ability to facilitate equitable economic growth. Any bond restrictions that limit Connecticut's ability to attract new business, such as investments in critical transportation or information technology infrastructure, would likely undermine the state's long-term prosperity.

Conclusion

The solution to Connecticut's budget woes lies not with tax hikes for working families or short-term revenue tweaks. Rather, we need a new approach, one grounded in a commitment to economic growth, shared prosperity, and equitable opportunity for every child. As the General Assembly considers the Governor's proposal, we urge it to prioritize the following:

1. **Restore the state's ability to build thriving communities.** The spending cap, volatility cap, and bond cap all potentially limit the state's ability to create a more prosperous tomorrow. Most troubling of all, the Bond Lock, if not fixed by May 2018, will cement existing language as the law of the land for a decade. Legislators must preserve their ability to adapt any budgetary policies to new economic conditions.
2. **Modernize Connecticut's revenue system.** Connecticut must adopt a balanced approach to structural budget reform, considering the whole range of policy options—including systemic overhauls to our revenue system. These overhauls could include eliminating special-interest exemptions in our tax code, collecting a larger share of taxes due on internet sales, broadening the base of sales and use taxes to capture the growing value of services in today's economy, and reforming our wealth, income, and corporate taxes.
3. **Invest in Connecticut's future.** Creating equitable pathways to opportunity will not only allow more of our children to reach their full potential; it will also grow the state's economy. Restoring the Earned Income Tax Credit, fully funding Care 4 Kids, and protecting HUSKY health coverage for working families, among other policies, helps ensure that every child in our state receives a meaningful opportunity to succeed.

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