

Impact of Connecticut's Constitutional Spending Cap on Connecticut's Future

Connecticut Voices for Children
Budget Forum

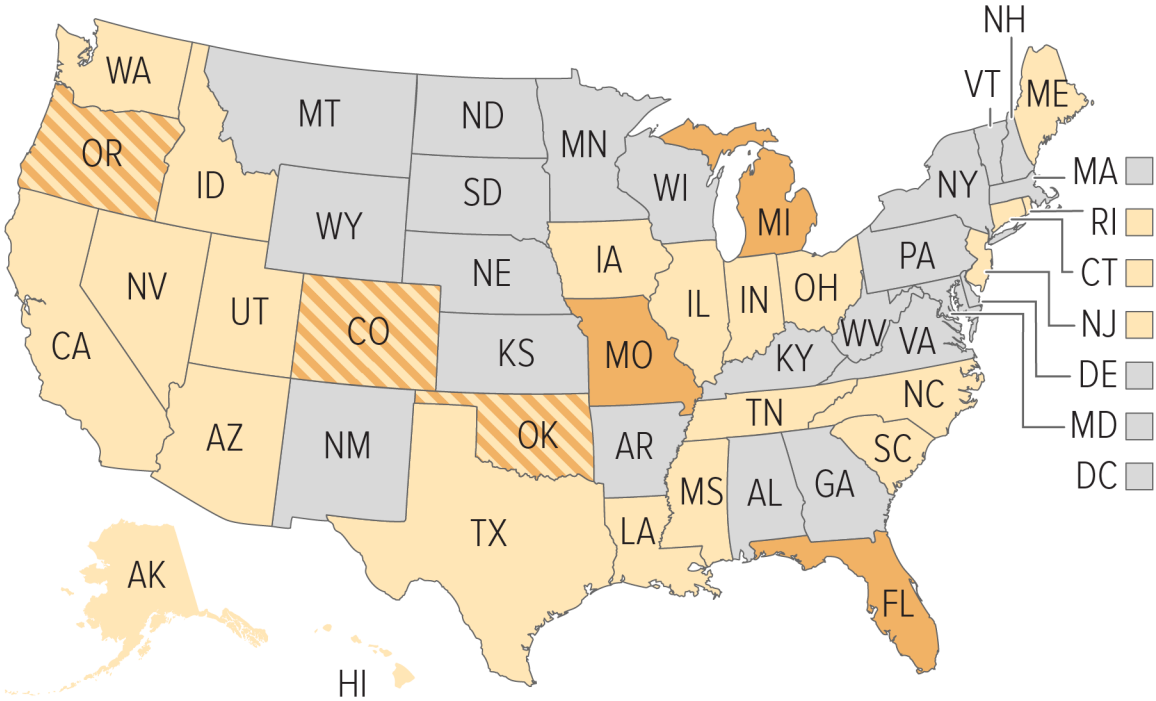
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More Than Half of States Have Tax or Spending Limits

- States with tax limits
- States with spending limits
- States with tax and spending limits
- States without tax or spending limits



Source: National Association of State Budget Officers, "Budget Processes in the States," 2015.

Public capital and economic growth: a critical survey

1. Introduction

Public

Journal of Monetary Economics 23 (1989) 177–200. North-Holland

IS PUBLIC EXPENDITURE PRODUCTIVE?*

David Alan ASCHAUER

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This paper considers the relationship between aggregate productivity and stock and flow government-spending variables. The empirical results indicate that (i) the nonmilitary public capital stock is dramatically more important in determining productivity than is either the flow of military spending, (ii) military capital bears little relation to productivity, and (iii) the flow of streets, highways, airports, mass transit, sewers, water systems, etc. has a significant positive effect on productivity. The paper also suggests an important role for the net productivity slowdown of the last fifteen years.

productivity in the private movements can be by the flow of traditional

What Have We Learned From Three Decades of Research on the Productivity of Public Capital?*

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October 8, 2009

Abstract

There has been a great deal of research effort devoted to measuring public capital, but no consensus has emerged yet. This paper surveys the literature by quantitatively analyzing a sample of 67 studies that have derived an average output elasticity of 0.146 and reported estimates. The short-run output elasticity is 0.146. In the long run, and after accounting for the depreciation of public capital to output increases by 0.146. The short-run output elasticities found in the early literature (estimating) estimates found more recently are significantly inflated by bidirectional

Research on Effectiveness of Tax and Spending Limits Provides Lessons

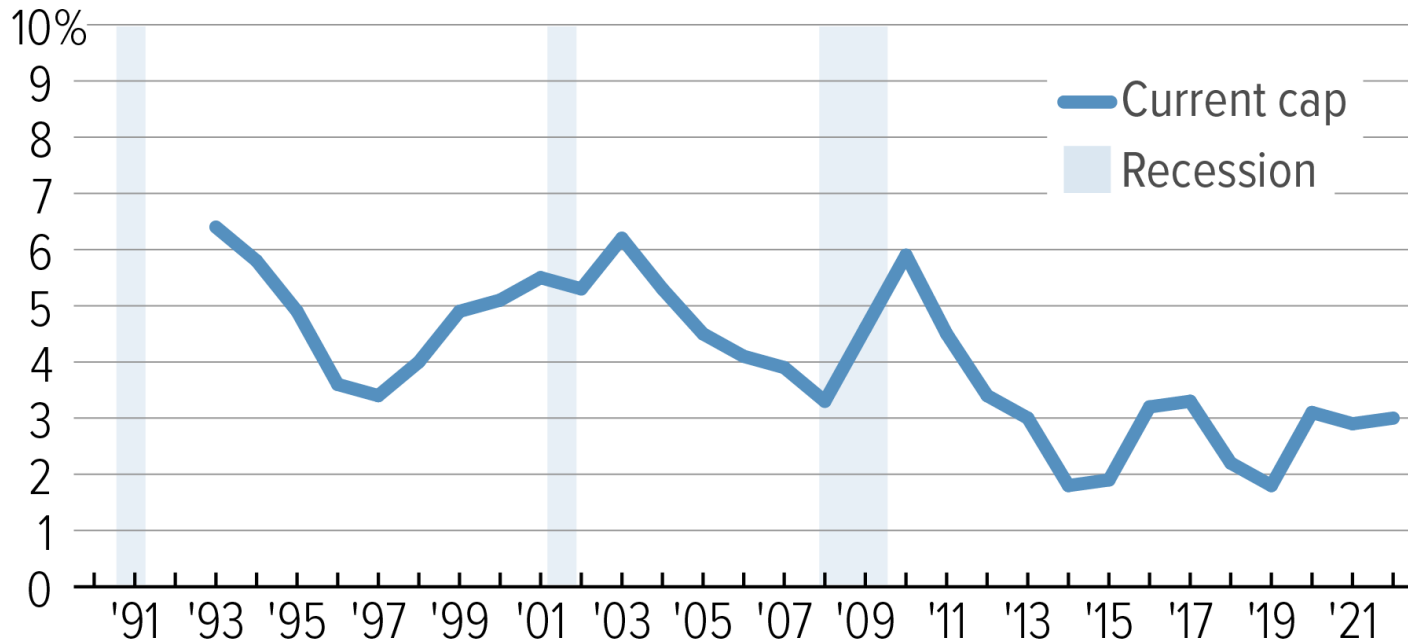
- Little evidence that limits improve state economies, especially in high-income states
- Results on whether limits reduce size of government are mixed and inconclusive
 - Underlying preference for smaller government can be attributed to limits
 - When needs exceed limits, there are ways to evade or relax limits

But Research and Experience Reveals Serious Side-Effects. Limits Can

- Squeeze budget when investment is needed most
- Make government less accountable by reducing transparency
- Reduce efficiency
- Undermine democracy

Spending Cap Growth Rate is Lowest During Economic Recoveries

Allowable percent growth current cap, 1993 - 2017



Sources: Cain, OFA, OPM, May, 2016 presentation. OPM Fiscal Accountability Report, Nov 2018.

Complex Rules Can Result in Less Public Oversight



Many Decisions are Made Without Public Oversight

- Non-appropriated funds do not receive as much scrutiny
- Tax expenditures are not reviewed every year
- Budgeting by emergency declaration is less open

States With Limits Look for Alternative Ways to Meet Needs

- New non-appropriated accounts funded directly
- Borrowing for programs previously supported by general fund spending
- Costs and responsibilities shift to local governments



The Volatility Cap – What is it?

- All revenues from Estimates and Finals portion of income tax above a **threshold** are deposited in Budget Reserve Fund before budget deliberation starts
- **Threshold** is determined by adjusting FY2017 Estimates and Finals collections (\$3.15M) annually for personal income

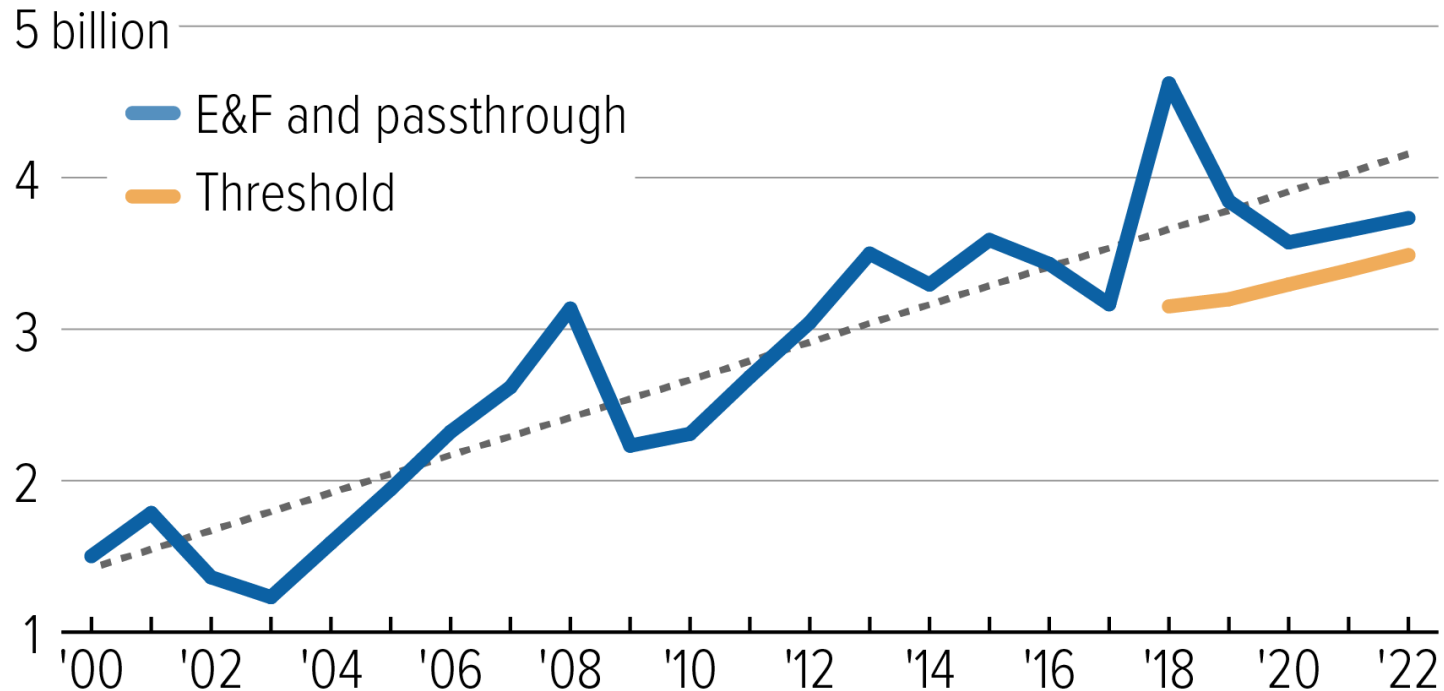
The Advantages of a Volatility Cap in Principle

- Prospective deposits build the reserve fund
- Has potential to smooth out ups and downs of business cycle
- Does not affect spending priorities the way spending limits do

Problems With the Volatility Cap As Designed

- Stifles growth in income tax not just one-time spikes (see graph)
- Can require deposits in years when deficits are projected
- Creates preference for taxes on wages and non-income taxes?

Current formula captures more than surplus above trend growth



Source: OPM Fiscal Accountability Report, Consensus Review Report

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Does Connecticut need all these caps and limits?



Connecticut Revenues are not high compared to other states

- Connecticut ranks 14th in state/local taxes as share of state income
- BUT ranks **SECOND-LOWEST** in state/local own-source revenue as share of state income because of low use of user fees
- Tax Foundation ranking showing 2nd highest tax levels misleading;
 - Doesn't include fees and charges
 - Includes taxes paid to other states such as income taxes to New York, property taxes on second homes, sales and fees paid while traveling, severance taxes included in energy bills

Connecticut's spending is not high compared to other states

- Connecticut ranks 2th from bottom in state/local expenditures as share of state income
- Ranks low compared to other states on state and local spending as share of state income in important areas:
 - 40th on state and local education spending
 - 41st on higher education spending
 - 41st on public welfare spending
 - 47th on spending on highways

Source: US Census State and Local Government Finances 2016

Tax and Spending Limits are Not The Way to Build Economic Prosperity

- Public in other states have recognized shortcomings of tax and spending limits
- Colorado suspended TABOR for five years; 29 other states considered TABORs and did not adopt them

Fiscal Policy Blueprint for Economic Prosperity

- Invest in Education and Health
- Launch Public Infrastructure Projects
- Boost Household Incomes
- Improve Budget Planning and Modernize Tax Code

Conclusion

- Changing Connecticut's caps to more accurately reflect reality of state's economy and spending needs would
 - result in greater ability to meet those needs and a more transparent and accountable budget process
 - without tying the hands of future legislators before the state's economic and fiscal circumstances are known.
- Other more effective ways to improve budget process include the budget stabilization fund with revised deposit rules that fix the volatility cap, improved tax expenditure oversight, and consistent current services budgeting

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