CONNECTICUT VOICES FOR CHILDREN

Taking Stock: Four Decades of State Revenues, Expenditures, and Deficits

January 2012

This report puts Connecticut's budget in perspective. It compares our response to the current downturn with our reaction to the previous two, it assesses the impact of recent changes on the progressivity of our tax code, and it places our current expenditures and taxes in historical context. Taking this broad view yields a set of conclusions that have received little attention and in some cases, run contrary to conventional wisdom.

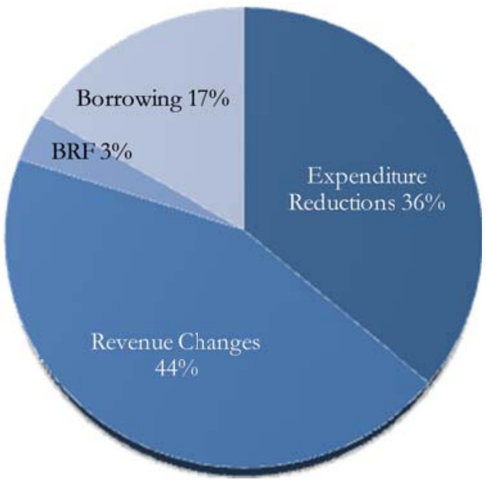
- In response to this recession, as compared to the previous two, Connecticut raised revenues proportionately less and cut expenditures proportionately as much or more.
- Although the state and local tax code remains regressive, it is more progressive now than before the recent recession, thanks largely to the passage of a refundable state earned income tax credit (EITC) and adoption of more progressive income tax rates.
- State expenditures have stayed quite constant as a proportion of personal income over the last two decades, after an increase in the late 1980s and early 1990s.
- Spending on human services, debt service, and corrections largely drove the increase of the late 1980s and early 1990s, and they have accounted for 89% of the rise in expenditures per $1,000 of personal income since 1986.
- Like state expenditures, General and Transportation Fund tax revenues (i.e., nearly all tax revenues) have plateaued as a proportion of personal income over the last 20 years, after an increase in the early 1990s.
- Over the last 20 years, revenues from the income tax have risen as a proportion of personal income, while revenues from general sales and corporation business taxes (CBT) have fallen markedly.

In reaching these conclusions, we relied on the most authoritative figures available, drawing budget data from the State Comptroller, Office of Fiscal Analysis, Finance, Revenue, and Bonding Committee, and Office of Policy and Management. Where appropriate, we accounted for inflation or personal income growth. The full details of our methodology are contained in the Appendix at the end of this report.

New Haven Office: 33 Whitney Ave. • New Haven CT 06510 • Phone: 203.498.4240 • Fax: 203.498.4242
Hartford Office: 53 Oak St. Suite 15 • Hartford CT 06106 • Phone: 860.548.1661 • Fax: 860.548.1783
Web Site: www.ctkidslink.org
E-mail: voices@ctkidslink.org

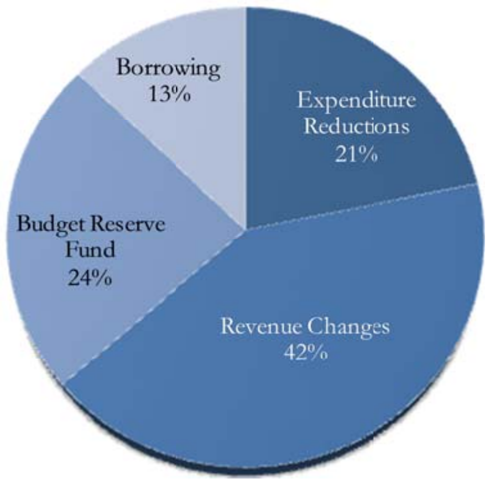
A. Actions Taken to Eliminate State Deficits
Figures adjusted to current dollars

<u>FY 1989-1992</u>



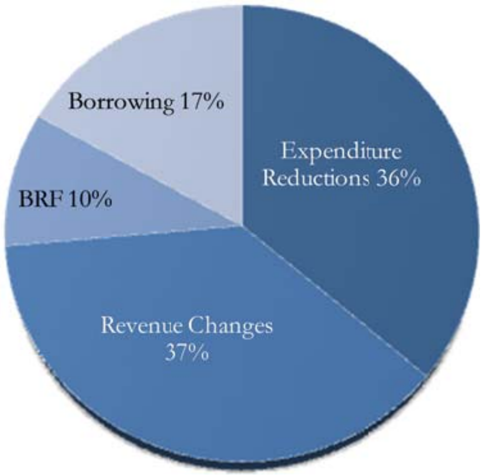
Deficit Mitigation:
$10.72B

<u>FY 2002-2003</u>



Deficit Mitigation:
$3.32B

<u>FY 2009-2013</u>



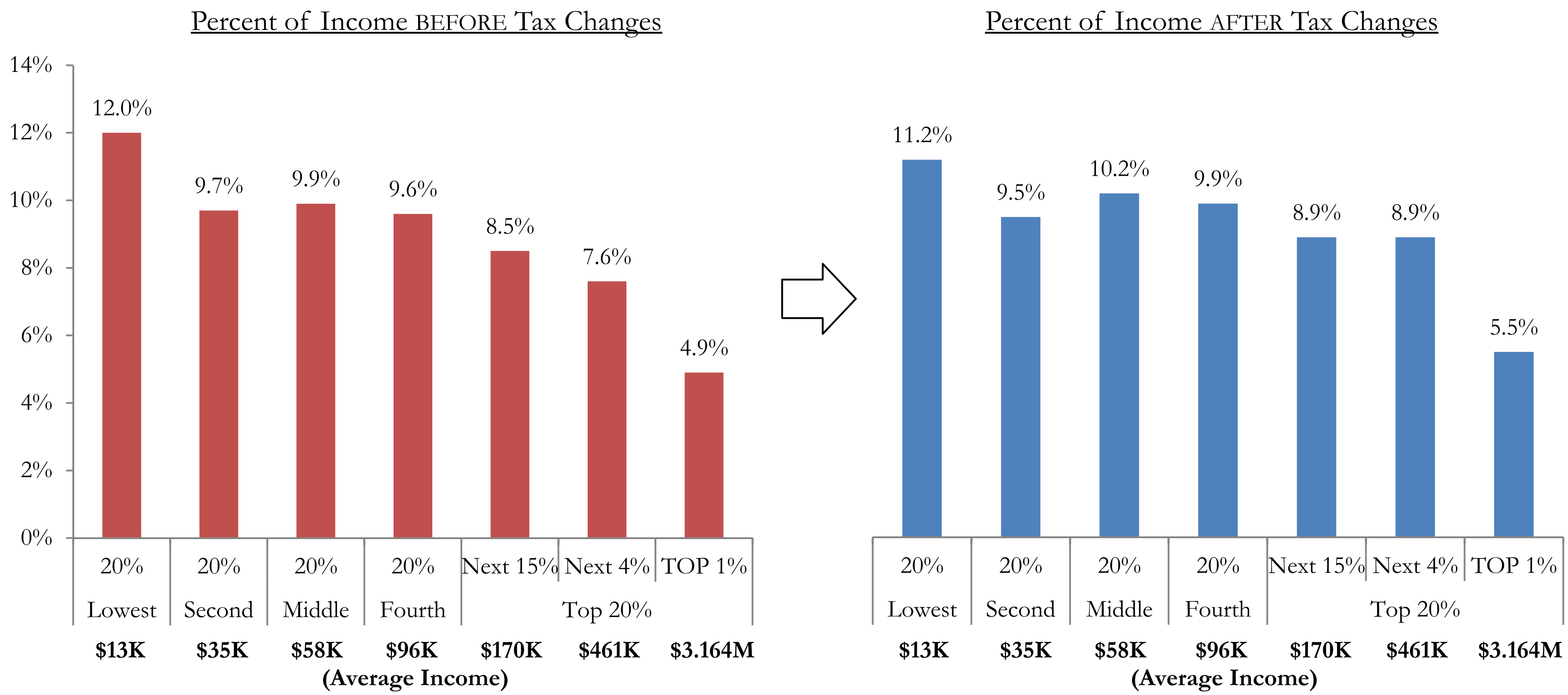
Deficit Mitigation:
$14.54B

Sources: Finance, Revenue, and Bonding Committee for FY89-92 and FY02-03; Office of Fiscal Analysis for FY09-13

- **In response to this recession, as compared to the previous two, Connecticut raised revenues proportionately less and cut expenditures proportionately as much or more.**

To gauge the state's response to each recession, we must consider all the years in which the recession created deficits that required mitigation. Comparing the O'Neill-Weicker, Rowland, and Rell-Malloy reactions to the previous three recessions, we find a good deal of consistency. However, the most recent response raised revenues proportionately less than the preceding two.

B. Impact of the FY 2009-2013 State Deficit Mitigation by Income Group: State and Local Taxes as Percent of Income



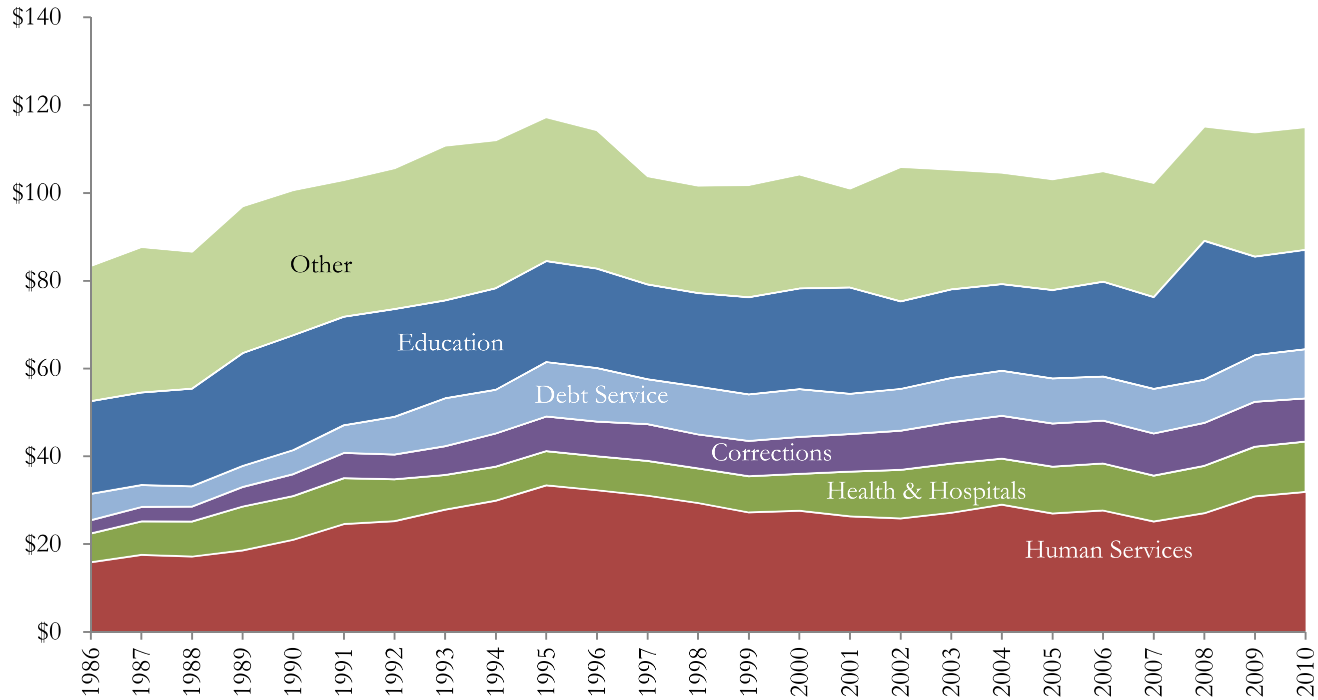
Source: Institute on Taxation and Economic Policy

- **Although the state and local tax code remains regressive, it is more progressive now than before the recent recession, thanks largely to the passage of a refundable state EITC and adoption of more progressive income tax rates.**

Over the last several years of deficit mitigation, taxpayers in the lowest 20% of the income scale saw the share of income they pay in taxes fall, from 12% to 11.2%, because of a new state earned income tax credit (EITC). Those in the middle three quintiles experienced only small changes, while those in the top 20% saw moderate increases due largely to the implementation of more progressive personal income tax rates. However, taxes on the top 20%, and the top 1% in particular, remain substantially lower than those on the large majority of Connecticut taxpayers. The wealthiest 1% pay less than half the proportion of their income as do the poorest 20%.

C. State Expenditures, FY 1986-2010

State Expenditures per $1,000 of Personal Income



Source: Comptroller's Comprehensive Annual Reports

- **State expenditures have stayed quite constant as a proportion of personal income over the last two decades, after an increase in the late 1980s and early 1990s.**

  Compared with per capita spending, expenditures per $1,000 of personal income is a superior measure of government's size and affordability since it takes into account growth in the state's economy. According to U.S. Census Bureau data, Connecticut state spending as a proportion of personal income ranked 14th lowest in the country in 2010, this in a state without county government where more services must be provided at the state level.[1]

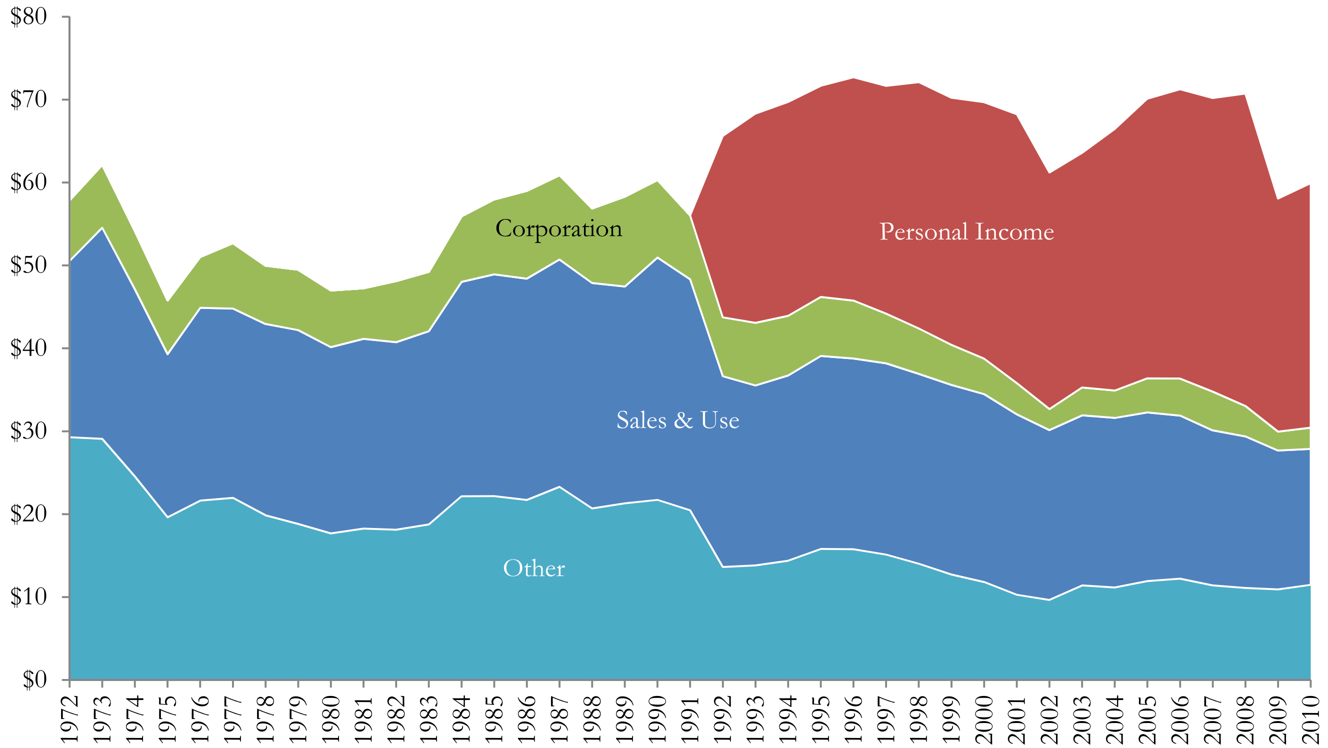
The two upticks in expenditures per $1,000 of personal income, in the early 1990s and late 2000s, reflect two recessions: during such downturns, personal income falls, increasing the expenditures/income measure even if the numerator, expenditures, remains constant. Moreover, during recessions, there is upward pressure on state spending as more residents lose jobs and become eligible for publicly funded health and other benefit programs.

- **Spending on human services, debt service, and corrections largely drove the increase of the late 1980s and early 1990s, and they have accounted for 89% of the rise in expenditures per $1,000 of personal income since 1986.**

Over the last generation, the main drivers of cost growth have been human services, corrections, and debt service, consistent with experience across the country. From 1991-2009, the rate of inflation for health care, the vast majority of "human services," averaged about 6% nationwide and in Connecticut, considerably above overall inflation.[2] Meanwhile, changes in criminal justice policy helped lead to a nearly 400% increase in prison populations nationwide from 1980-2009,[3] with Connecticut's growing by more than 350%.[4] Also, during this time courts mandated the Department of Children and Families, included under "corrections" in the state's classification system, to increase funding and staffing in order to address systemic problems in caring for abused and neglected children. The state's debt payments, too, are not unusual, as only a cursory look at the national news can demonstrate.

D. General and Transportation Fund Tax Revenues, FY 1972-2010

Tax Revenues per $1,000 of Personal Income



Source: Office of Fiscal Analysis for 1972-2008; Office of Policy and Management for 2009-2010

- **Like state expenditures, General and Transportation Fund tax revenues (i.e., nearly all tax revenues) have plateaued as a proportion of personal income over the last 20 years, after an increase in the early 1990s.**

As with expenditures, taxes as a proportion of personal income is a better metric than per capita taxes since it takes into account growth in the state's economy over the last 40 years. This is especially true because taxes are usually percentages: if income increases, the same rate will generate more tax revenues. According to U.S. Commerce Department figures, Connecticut state taxes per $1,000 of personal income ranked 18th highest in the country in fiscal year 2009 at $66, versus the national average of $58.[5]

- **Over the last 20 years, revenues from the income tax have risen as a proportion of personal income, while revenues from general sales and corporation business taxes (CBT) have fallen markedly.**

  Revenues from the income tax have risen, while general sales and CBT receipts—formerly the bulk of tax revenues—have fallen. As a proportion of personal income, sales tax and CBT receipts dropped 44% and 73%, respectively, between 1990 and 2010. This change is likely due to the shift towards a service, rather than goods-based (and sales taxed) economy and a combination of CBT cuts, expanded tax loopholes, and tax avoidance by businesses.

  The cumulative effect of these changes has been to shift the mix of state tax revenues in favor of the personal income tax, which now represents about half of tax revenues. The personal income tax tends to be more volatile than other revenue sources, like the general sales tax, although it is also more progressive.

Appendix

A. Actions Taken to Eliminate State Deficits

The General Assembly's Finance, Revenue, and Bonding Committee provided Connecticut Voices with data for the earlier two charts, FY89-92 and FY02-03. For the most recent chart, data are from the Office of Fiscal Analysis's budget books, available at http://www.cga.ct.gov/OFA/.

Federal stimulus revenues were not included in the FY09-13 deficit mitigation chart in order to provide a direct comparison with the previous two deficit responses, where there was no such federal assistance.

B. Impact of the FY 2009-2013 State Deficit Mitigation by Income Group: State and Local Taxes as Percent of Income

This analysis was conducted by the Institute on Taxation and Economic Policy (ITEP), a non-profit, non-partisan research organization, founded in 1980, that works on local, state, and federal tax issues. Since 1996, ITEP has maintained a micro-simulation model of the tax systems of the federal government, the 50 states, and the District of Columbia. The ITEP model produces estimates of the actual tax burden on taxpayers in different income brackets. While similar to the models produced by the U.S. Treasury Department, Congressional Joint Committee on Taxation, and Congressional Budget Office, ITEP's model is unique in allowing state-level estimates. More details can be found at http://itepnet.org/.

C. State Expenditures, FY 1986-2010

Expenditure data were drawn from the State Comptroller's comprehensive annual reports, the same used by investors in evaluating Connecticut's fiscal health. All of these reports are available at http://www.osc.ct.gov/reports/.

To adjust for inflation, the U.S. Bureau of Economic Analysis's (BEA) state and local GDP deflator, which measures inflation for purchases made by state and local governments, was used; it is available at http://www.econstats.com/gdp/gdp__a4.htm. Personal income statistics were also drawn from the BEA, available at http://www.bea.gov/regional/index.htm.

D. General and Transportation Fund Tax Revenues, FY 1972-2010

Tax revenues for 1972-2008 were taken from the Office of Fiscal Analysis's most recent publication, *CT Revenue and Budget Data as of July 2009*, which is available at http://www.cga.ct.gov/ofa/Revenue.asp. Data for 2009-2010 were drawn from the Office of Policy and Management's *FY 2012 – FY 2013 Biennium Economic Report of the Governor*, which is available at http://www.governor.ct.gov/malloy/cwp/view.asp?a=11&Q=473940. Inflation and personal income statistics were drawn from the same sources as in Section C.

[1] U.S. Census Bureau, *2010 Annual Survey of State Government Finances*, http://www.census.gov/govs/state/.
[2] Kaiser Family Foundation, StateHealthFacts.org, *Health Costs & Budgets*, http://statehealthfacts.org/comparecat.jsp?cat=5&rgn=8&rgn=1.
[3] Bureau of Justice Statistics, U.S. Department of Justice, *Correctional Populations 1980-2009*, http://bjs.ojp.usdoj.gov/content/glance/tables/corr2tab.cfm.
[4] Connecticut Department of Correction, *Incarcerated Population and Authorized Positions 1968-2010,* http://www.ct.gov/doc/cwp/view.asp?a=1505&q=265602.
[5] Office of Policy and Management, *FY 2012 – FY 2013 Biennium Economic Report of the Governor,* February 2011, http://www.governor.ct.gov/malloy/cwp/view.asp?a=11&Q=473940.