

E X E C U T I V E S U M M A R Y

The mission of the Connecticut Health Foundation is to improve the health status of the people in Connecticut. The Foundation strives to serve the unmet needs of the state and its communities and to be responsive to unserved and underserved populations.

As the Foundation began identifying program priorities to be addressed in the fall of 2000, it became evident that Connecticut's spending cap limits the state's ability to respond to the issues facing residents across the state. The Foundation is especially concerned about severe crises in the areas of children's mental health and oral health.¹ At the same time, dramatic racial and ethnic disparities in health outcomes are preventing individuals, families and communities from enjoying the high quality of life many have come to expect in Connecticut.²

The state's ability to respond to these problems has been hampered by a number of factors, including the structure of the spending cap. As a result, the Foundation, in collaboration with Washington DC's Center on Budget and Policy Priorities, researched the spending cap and its effects. Our findings begin with a review of the structure of the cap:

CONNECTICUT'S SPENDING CAP CURRENTLY:

- Limits the increase in general budget expenditures to the 5 year average in personal income growth, or the 12 month rate of inflation, whichever is greater.
- Defines "General budget expenditures" as all state spending, except:
 - payments on the principal or interest of bonds, notes and other forms of debt
 - state grants to distressed municipalities (for grants in effect on July 1, 1991)
 - first year expenditures on federal mandates or court orders.
- Can be exceeded if the Governor declares an emergency or the existence of extraordinary circumstances, and at least 3/5ths of the General Assembly agrees.
- Is one of the most restrictive expenditure limits in the nation.

How has the cap been working so far?

- The cap has been among the factors bringing down the overall rates of spending growth from an average rate of 10.8% a year from Fiscal Year 1987-1991 to 4.5% during FY 1995-2000. However, these figures do not take into account that appropriations have exceeded the spending cap in each of the last three years, allowing a total of more than \$1.5 billion in state surplus dollars to be spent. A portion of those dollars were for recurring expenditures, but these dollars were never added to the base.
- Even in previous years where appropriated budget expenditures have not exceeded the cap, actual budget expenditures have. This has been done through the use of budget techniques such as lapses, carry forwards and the use of the surplus.
- The cap has had at least three potentially unintended consequences on state budgeting practices which could impact state policies and programs: increased state bonding, creation of a strong incentive to use tax expenditures, and an inability to capture new federal funds.

A. Increased Bonding: Bonded debt per capita has more than doubled over the past decade, leaving Connecticut with the second highest rate of state tax supported debt in the nation. Total General Fund indebtedness has increased from \$3.673 billion in FY 1992 to \$11.12 billion in FY 2001.

B. Incentive to use tax expenditures: Tax expenditures are a form of state “spending” implemented through the tax code and are rarely revisited by the legislature. (Examples include tax deductions, exemptions, and credits.) Since they do not appear as a line item in the state budget and are not subject to the spending cap, there is a powerful incentive to increase this form of “back door spending”.

C. Inability to capture new federal funds: Because most federal matching dollars fall underneath the spending cap, capturing new federal dollars brings the budget ever closer to the allowable limit. This is true even though the federal portion of matching programs are not “state spending” in the conventional sense. In FY 2001, the state is now so close to the spending cap limit that bringing in even \$10 million in new federal funds would be difficult to achieve.

What are the limitations imposed by the spending cap?

- The FY 2001 budget is now right at the limits of the cap. According to December 2000 projections from the Office of Fiscal Analysis, spending on current services alone will put the state \$220 million over the cap in FY 2002.³ Our research shows that unless adjustments are made, the state will continue to be over the cap by a minimum of \$127 million, and sometimes much more, for at least the next five years.

What actions could be taken to adjust the spending cap?

- Our research shows that the following options would create additional room under the cap:
 - Exempting Medicaid
 - Exempting tobacco settlement funds, *but only if this is calculated as starting in FY 1999*
 - Changing the income factor used to calculate the spending cap from personal income to adjusted gross income (to include capital gains income)
 - Re-basing by using some of this year’s surplus in the calculation for the cap next year.

*These adjustments would be effective because:
If fast growing programs are removed from the base, additional room under the cap will be created. If slow growing programs are removed, the spending cap will be tightened. When programs that are in the base grow quickly - at a rate faster than the increase in the spending cap growth limit - they consume a greater proportion of available growth and crowd out other programs.*

- Because the following programs grow slowly, our research shows that these possible exemptions would further restrict available room under the cap:
 - Exempting all federal funds
 - Exempting Education Equalization (ECS) funds
 - Exempting Special Education funds
 - Treating unfunded state employee pension funds as exempt debt payments.

Will the public support changes to create additional room under the cap?

- The answer is a qualified yes. In a poll conducted for the Foundation by the University of Connecticut's Center for Survey Research and Analysis, 57% of respondents strongly or somewhat favored the spending cap. At the same time, 55% of respondents said that in general, they would favor making changes to the spending cap to allow spending in certain areas.
- The percent of respondents showing support for changing the cap to allow increased spending was even higher when they were asked to make decisions regarding the specific programs involved. Of those who had opinions, 80% said they would strongly or somewhat support changing the cap to allow increased spending on children's mental health programs or on programs that help people gain access to health care. Similar levels of support were shown for prescription drug programs for those without insurance. (A full report on attitudes toward the spending cap in Connecticut is included in the Appendix.)

Conclusion

The spending cap as presently constituted is creating significant pressure on state expenditures in areas which affect vulnerable populations, from mental health programs to prescription drugs subsidies. If adjustments to the cap are not made, this pressure will increase dramatically over the next few years, requiring major programmatic cutbacks in areas that the public cares about. Connecticut faces a stark choice: either cut essential programs or change the parameters of the spending cap.

In the *short term*, action could be taken to re-base the spending cap to address pressing issues such as the mental health crisis. Re-basing would also recognize the presence of certain ongoing expenditures which have been made from the surplus in previous years.

Several *long term* statutory adjustments could also be made to ensure that the cap does not prevent the state from meeting the vital needs of all of its residents. These include exempting Medicaid, exempting tobacco settlement funds from the time they were first received by the state, and changing the income factor used to calculate the spending cap from personal income to adjusted gross income so that capital gains income is included.

The tables on the following page give an indication of how much room would be created by each of these adjustments.