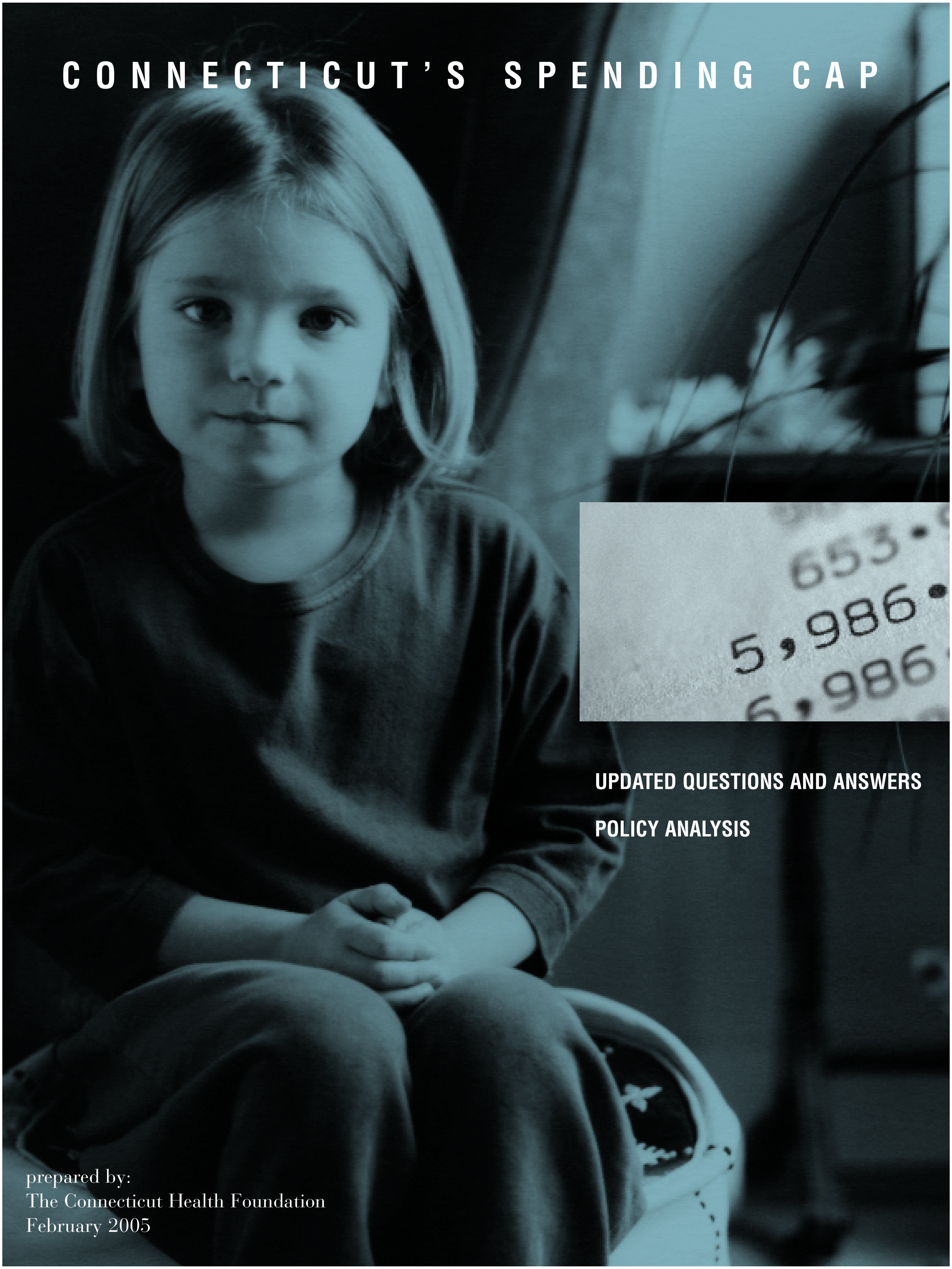
CONNECTICUT'S SPENDING CAP



UPDATED QUESTIONS AND ANSWERS

POLICY ANALYSIS

prepared by:
The Connecticut Health Foundation
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EXECUTIVE SUMMARY

Instituted in 1991 as part of an agreement to create a state income tax, Connecticut's limit on state expenditures is intended to ensure that the state budget does not grow beyond the taxpayers' ability to pay for programs and services.

The cap limits the increase in general budget expenditures each year to the average growth in personal income over the past five years or the rate of inflation over the last 12 months, whichever is greater. It applies to all state spending except payments on state debt, state grants to distressed municipalities, and first-year expenditures on federal mandates or court orders. The cap can be exceeded if the Governor declares an emergency or the existence of extraordinary circumstances and at least three-fifths of the General Assembly agree.

The Connecticut Health Foundation (CHF), in collaboration with the Washington, D.C.-based Center on Budget and Policy Priorities (CBPP), has updated its 2001 report to see if the cap is serving its intended purpose and if it has created any unintended consequences for the state's $15 billion dollar budget.

Has the Cap Been Working as Intended?

The cap has helped reduce the overall rate of spending growth, from an average of 11.7 percent a year during Fiscal Years (FY) 1987-1991 to an average of 4.8 percent per year during FY 1995-2001. During FY 2002-2004, spending growth was even slower, averaging 2.1 percent per year, but that was the result of reduced revenues (due to the economic downturn) rather than the spending cap.

Now, however, the state is at a crossroads. While revenues have begun to rebound from the economic downturn, the cap may prevent the state from restoring cuts made during the downturn. Each year's cap is calculated based on the state's actual expenditures in the prior year, as opposed to the total amount allowed by law. Since actual expenditures in recent years have been below the allowable amounts, the base from which future caps are calculated has been lowered, or "ratcheted down."

The ratchet effect is compounded by other elements of the cap, such as the use of a lagged five-year average in calculating personal income growth and the omission of capital gains income — a significant source of wealth in the state — from the measurement of personal income. The cap limit is further depressed by the exclusion of some state spending from the base (such as portions of previous surpluses that were used for recurring expenditures). Based on current economic projections, the cap will restrict the budget to 3 percent growth in FY 2008 — some $1.1 billion less than the amount needed to maintain current service levels.

SINCE ACTUAL EXPENDITURES IN RECENT YEARS HAVE BEEN BELOW THE ALLOWABLE AMOUNTS, THE BASE FROM WHICH FUTURE CAPS ARE CALCULATED HAS BEEN LOWERED, OR "RATCHETED DOWN."

The cap has created several unintended consequences for state budgeting practices. Since debt service payments do not count under the cap, state borrowing to finance ongoing expenditures has increased; Connecticut now has the third-highest rate of state tax-supported debt in the nation. Also, the cap has given the state an incentive to use the tax code rather than spending programs to deliver benefits, since tax expenditures do not count under the cap. In addition, the cap has limited spending growth below the state's economic capacity and created a disincentive for Connecticut to obtain new federal funds (since such funds count against the cap).

The budget submitted by the Governor for FY 2006-2007 illustrates the constraints of the spending cap. The Governor proposed an initiative designed to address concerns with inadequate funding of long term care in the state. Additional funds totaling $244 million would be directed to nursing homes and other long term care providers. The costs would be paid through a provider tax which would be matched by new federal funds. In order to accommodate this new initiative without reducing spending in other parts of the budget, the Governor has proposed exempting it from the cap.

Overall Findings

Connecticut's spending cap is one of the most restrictive in the country. As we found in 2001, the cap will cause spending to decline relative to the economy in future years. This will put significant pressure on state expenditures in all areas, including those affecting vulnerable populations.

Since FY 2002, the economic downturn and lowered state revenues have limited state spending, not the cap. Although state spending each year has been below the level allowed by the cap, that situation is changing. Current projections indicate that the amount of spending needed to maintain current services will exceed the cap level in FY 2006. While the amount of revenue available still may restrict the state's ability to fully fund services, if revenue growth improves more rapidly than expected — as is very possible — or new state or federal revenues are identified, the cap will be a limiting factor in FY 2006 and beyond.

According to projections from the General Assembly's Office of Fiscal Analysis (OFA), simply continuing current services would put the state $650 million over the cap in FY 2006. Our research shows that the cost of maintaining state programs will continue to exceed the cap for at least the next several years unless adjustments are made.

Thus, the state faces a stark choice: either cut essential programs or change the parameters of the cap. In the short term, action could be taken to change the spending cap methodology to address the gradual "ratcheting down" of the base that occurs as a result of periodic economic downturns.

Several long-term adjustments, listed below, could be made to ensure that the cap fulfills its intent without preventing the state from meeting the vital needs of all of its residents. The cap also could be eliminated altogether through the constitutional amendment process.

The following adjustments would create additional room under the cap:

- exempting Medicaid from the cap, assuming the program is not changed significantly;
- exempting all new federal funds (not just those that result from mandates) from the cap;
- increasing the factor used to calculate each year's cap by:
    - using a more current measure of personal income growth,
    - including capital gains in the measure of personal income,
    - adjusting the growth factor to account for growth in specific populations; and
- using the previous year's allowable spending instead of actual spending to calculate the following year's spending cap base.

The following adjustments, in contrast, would make the cap even more restrictive:

- exempting all federal funds from the cap (not just all new federal funds); and
- exempting Education Equalization (ECS) funds.

These two funding streams grow more slowly than the cap allows, which creates room for other programs under the cap to grow somewhat more quickly than the cap allows. Removing these slow-growing programs from the base, therefore, would tighten the spending cap. On the other hand, removing fast-growing programs from the cap, in contrast, creates additional room under the cap.

Table 1

How Selected Changes Would Affect the Spending Cap (in millions)

Adjustments That Create Room Under the Cap	FY 2006	FY 2007	FY 2008
Exclude Medicaid	$111	$157	$279
Exclude Medicaid (including reduced cost due to federal Medicare changes)	$81	$62	$178
Increase allowable growth factor by 0.5 percent	$57	$120	$186
Use current personal income growth	$38	$149	$349
Use allowable spending as base	$127	$151	$201
Exclude Medicaid and use current personal income growth	$139	$268	$539
Adjustments That Reduce Room Under the Cap			
Exclude all federal grants	$-242	$-293	$-270
Exclude ECS	$5	$-48	$-94

CONNECTICUT'S SPENDING CAP

As CHF works to address pressing public health needs, it is clear that Connecticut's spending cap limits the state's ability to respond to these and other issues facing residents across the state. The Foundation is especially concerned about 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 many individuals, families, and communities from enjoying the high quality of life they 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 CBPP, took another look at the effects of the spending cap first examined in the Spring of 2001. Our research findings begin with a review of the structure of the cap.

Connecticut's spending cap was instituted in 1991 at the time the state adopted an income tax. The cap limits the increase in general budget expenditures each year to the average growth in personal income over the past five years or the rate of inflation over the last 12 months, whichever is greater. It applies to all state spending except payments on state debt, state grants to distressed municipalities, and first-year expenditures on federal mandates or court orders. The cap can be exceeded if the Governor declares an emergency or the existence of extraordinary circumstances and at least three-fifths of the General Assembly agree. *(See page 27 for the full text of the statutory and constitutional versions of the cap.)*

How is the cap calculated?

The previous year's appropriated funds, minus any dollars spent on the three exempt areas constitutes the base. The base is then multiplied by the allowable growth rate to produce the cap for the coming year. At its core, the calculation looks like this:

LAST YEAR'S APPROPRIATED FUNDS MINUS EXEMPTIONS = BASE

BASE MULTIPLIED BY ALLOWABLE GROWTH RATE (ABOUT 4.46 PERCENT FOR FY 2005) = ALLOWABLE SPENDING LEVEL INCREASE

Table 2

Current Spending Cap (in millions)

	Current Spending Cap from FY 2004 to FY 2008	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Take the amount of funds appropriated the year before	Base Appropriated Funds	$13,217.8	$13,755.3	$14,617.0	$15,071.3	$15,719.2
Subtract spending that doesn't count under the cap	Less Non-Capped Expenditures					
	Debt Service	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
	Grants to Distressed Municipalities	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
	Total Non-Capped Expenditures-Prior Year	$2,741.9	$2,834.2	$3,181.8	$3,055.7	$3,181.6
Result: The base amount the cap is calculated on	Net Base Capped Expenditures	$10,475.9	$10,921.1	$11,435.2	$12,015.6	$12,537.4
Multiply by the allowable growth rate	Times 5-year Avg. Growth in Personal Income	5.27%	4.46%	4.06%	3.54%	2.96%
Result: The dollar amount that the budget can grow	Allowable Capped Appropriation Growth	$552.1	$487.1	$464.3	$425.4	$371.1
Add growth + base = total amount allowed for programs under cap	Net Capped Appropriation = Growth + Base	$11,028.0	$11,408.2	$11,899.5	$12,440.9	$12,908.5
Add back in what's not covered by the cap	Plus Non-Capped Expenditures: Current Year					
	Debt Service	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
	Federal Mandates and Court Orders	$1.8	$42.5	$116.1	$96.5	$0.0
	Grants to Distressed Municipalities	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
	Total Non-Capped Expenditures	$2,850.3	$3,208.8	$3,171.8	$3,278.3	$3,412.0
Result: Total amount allowed to be spent on all programs	Gross Spending Cap - Appropriation	$13,878.3	$14,617.0	$15,071.3	$15,719.2	$16,320.5
For past years – what was actually spent. For future years – what it costs to maintain current programs	Actual Gross Appropriation/Current Services	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Difference between what the cap allows & current programs. State is over cap if positive, under cap if negative	Over/(Under) the Spending Cap	-$122.9	$0.0	$822.7	$949.4	$1,098.2

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*

Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*

WHERE DOES CONNECTICUT'S CAP STAND NATIONALLY?

According to a recent survey by the National Conference of State Legislatures, 27 states have constitutional or statutory limits on overall taxation, expenditures, or both.[3] Many of these limitations, however, are guidelines rather than hard-and-fast limits; in other words, it is relatively easy for states to adjust to changing fiscal conditions despite the limit. For example, limits that are in statute, rather than the constitution, can be amended by the legislature to address a particular policy change or change of circumstance.

Connecticut's spending cap is one of the most restrictive in the nation:

- **It applies to a base that includes 80 percent of all state expenditures, including most federal dollars received by the state.** The spending limitations imposed by most other states cover only about 50 percent of state spending and usually exclude federal funds. Some other states allow exemptions that Connecticut does not, such as for capital expenditures, aid to municipalities (Connecticut exempts only aid to distressed municipalities), Medicaid, and high-growth areas such as corrections.

- **Connecticut is only one of two states to use a growth formula based on a five-year average in personal income growth.** Most states use a shorter time period, from one to three years. Connecticut's approach, while not as restrictive as a formula based on population growth plus inflation, mixes in slow-growth years with high-growth years, thus limiting the growth in allowable spending in good economic times.

- **Of the 19 states that allow a legislative override of their cap, Connecticut is one of only five to require the Governor to declare an emergency first.**

- **Each year's cap is based on the previous year's actual expenditures, rather than allowable expenditures.** In an economic downturn, when declining revenues cause a decrease in spending, the spending base is ratcheted down and becomes permanently lower. Some other states use allowable spending as the base for calculating the cap, which allows the state to restore spending cuts once revenue growth resumes.

Connecticut's spending cap is one of the **most restrictive** in the nation.

HOW HAS THE CAP BEEN WORKING SINCE 1991?

While spending growth has fluctuated from year to year since the cap was instituted in 1991, expenditure growth rates overall have been on a downward trend, as illustrated in the figure below.

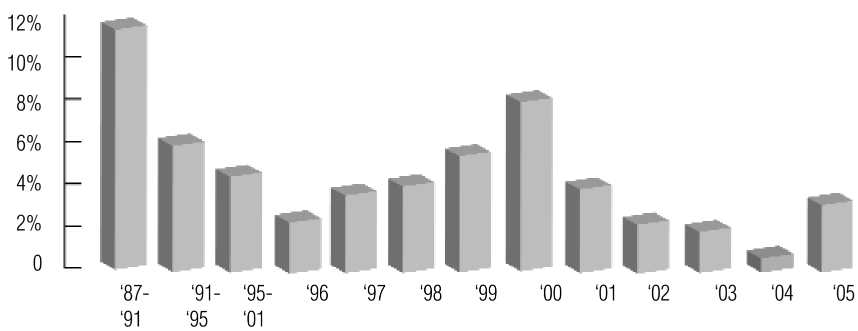


Figure 1

Budgeted Expenditure Growth Rates By Fiscal Year

Source: OFA (adjusted for comparability, includes spending from surplus)

The spending cap has been "re-based"at least twice.[4] (In other words, the base used to calculate the subsequent year's cap was adjusted upward to include funds not previously counted in the base.) Yet some spending has never been reflected in the base. When recurring expenditures are not added to the base, that pushes the state closer and closer each year to the allowed limit.

For example, when the state ran a surplus from FY 1998 to FY 2001, appropriations exceeded the spending cap every year, which allowed the state to spend $1.79 billion in state surplus dollars. Yet these funds were not added to the base for subsequent years, even though the Governor could have declared that part or all of a budget surplus would be counted in the base and OFA determined that some of the surplus funds from FY 1998-2001 were used for ongoing expenses. Adding all surplus spending to the base (minus debt reduction and transfers to the budget reserve) would have raised the spending limit by almost $1.6 billion over the FY 1998-2001 period.

Other sources of spending that have not been added to the base involve technical budgeting practices such as unachieved lapses and carry forwards.[5]

Table 3

Surplus Spending Minus Debt Reduction and Transfers to Budget Reserve

FY 1998	$249 million
FY 1999	$591 million
FY 2000	$462 million
FY 2001	$292 million
Total:	**$1.594 billion**

Source: CBPP calculations of OFA data

The combination of using actual rather than allowable expenditures to calculate the cap and failing to count some sources of spending in the base has the effect of "ratcheting down" the base over time. The fact that Connecticut uses a lagged five-year average in calculating the growth in personal income, rather than the more common one- to three-year average, compounds the ratcheting problem.

Due to the effects of the recession and the downturn in personal income growth, the allowable growth rate in state spending under the cap will decline to as low as 3 percent in FY 2008. It has been in the 5 percent to 6 percent range for the last few years. The cap would restrict spending to some $1.1 billion below the amount needed to maintain current services in FY 2008.

The state will likely face significant spending limits for some time, which could begin as early as FY 2006.

Unintended consequences

In addition to the ratchet effect, the cap has resulted in at least three potentially unintended consequences on state budgeting practices, which could have an adverse impact on state policies and programs:

- **Increased state borrowing.** Because debt service payments are explicitly excluded from the cap, the state has turned to bonding to fund ongoing operating expenses as well as capital expenses.

  As a result, Connecticut now spends 12 cents of every dollar on interest payments, reducing the funds available for other purposes. Total debt service has grown from $802 million in FY 1994 to $1.7 billion in FY 2005 — more than the state spends on the departments of Mental Health and Addiction Services, Mental Retardation, Public Health, and the Office of Health Care Access combined. According to the U.S. Census Bureau, in FY 2002 Connecticut's debt was the third highest in the nation at $6,008 per capita, compared with a national average of $2,234.[6]

- **Incentive to use tax expenditures.** A tax expenditure is a form of targeted tax treatment (such as an exemption, credit, deduction, exclusion, or reduced tax rate) that is intended to accomplish a public policy purpose. Tax expenditures reduce state revenue, so their budgetary economic effect is equivalent to that of spending programs.

The combination of using **actual** rather than **allowable expenditures** to calculate the cap and **failing to count** some sources of spending in the base has the effect of **"ratcheting down"** the base over time.

Unlike spending programs, however, tax expenditures are not subject to the spending cap. Therefore, the practice of spending via the tax code is likely to increase rapidly. For FY 2005, OFA estimates the state will spend $425.9 million in exemptions, deductions, and credits against the corporate income tax and $178.3 million in business and agricultural exemptions against the sales tax. One example is a $20 million tax exemption for advertising agency services, including direct mail advertising. Another example is a narrowly defined sales-tax exemption enacted in 2002 retroactively benefiting a charter aircraft company. In the first year of the aircraft company exemption, the state lost $800,000 in revenue, with a subsequent loss of $200,000 in revenue each year since then.

In addition, because tax expenditures tend to operate automatically once enacted and are not subject to annual review, the state has created built-in losses to Connecticut's revenue stream.

- **Disincentive to obtain new federal funds.** The structure of Connecticut's spending cap has created a disincentive for the state to obtain new federal funds. Connecticut typically receives a 50 percent match for every state dollar spent on certain federal programs, and sometimes receives a match rate as high as 90 percent. But because both state appropriations and federal matching dollars count toward the cap, capturing new federal dollars brings the budget even closer to the allowable limit.

An example: despite the severe needs in its adult mental health system, Connecticut has declined to pursue the Medicaid Adult Rehabilitation Option, forgoing an opportunity to bring in new federal funds. In addition, the Child Rehabilitation Option is used only to maximize revenue for clinical services in residential treatment, with no community services covered. The recent report from the Lieutenant Governor's Mental Health Cabinet estimates that the Medicaid Rehabilitation Option could bring in $10.5 million a year in revenue in FY 2007-2009, and the Medicaid Supervised and Supported Housing Option could bring in $9.6 million in FY 2007, increasing to $11.2 million in FY 2008. However, the cap has created a disincentive to capture these funds.

Connecticut has **declined** to pursue the Medicaid Adult Rehabilitation Option, forgoing an opportunity to bring in new federal funds…**$10.5 million a year in revenue** in FY 2007-2009.

WHAT LIMITATIONS ARE IMPOSED BY THE SPENDING CAP?

The experience of the 1990s shows that when the state's economy is growing, the state approaches and then exceeds the cap limit. Now that economic growth has resumed after the recession, Connecticut is expected to exceed the cap once again.[7] The historical pattern is illustrated in Table 4 below:

Table 4

Amount that Actual Appropriations Were Below the Spending Cap (excluding surplus spending)

FY 1993	$120.0 million
FY 1994	$39.1 million
FY 1995	$53.4 million
FY 1996	$20.1 million
FY 1997	$3.6 million
FY 1998	$0.4 million
FY 1999	$2.3 million
FY 2000	$0.4 million
FY 2001	$0 million
FY 2002	$78.2 million
FY 2003	$333 million
FY 2004	$122.9 million

Source: OFA

Under current projections, the cost of simply maintaining existing programs — apart from any additional spending on unanticipated needs or new programs — will exceed the cap by significant amounts during the next three years.

For example, in FY 2006 the cost of continuing existing programs is estimated to equal $15.9 billion — an increase of $1.3 billion compared to FY 2005. The spending cap would allow growth of just $450 million — more than $800 million less than the amount needed to maintain current services. Each year the gap between the cost of maintaining services and the cap will widen. By FY 2008, it will exceed $1 billion.

A major cause of this problem is the fact that the state uses a lagged five-year average in personal income growth to calculate the allowable growth in state spending from year to year. Two of the rationales for using changes in personal income to help calculate a state spending limit are to ensure that the size of state government:

- does not consume a larger share of the economy over time, and does not exceed the state's ability to pay for services; and
- is able to grow when the state's economy grows, so that the state can respond to the additional needs and desires for government services that a growing economy creates.

However, the Connecticut spending cap goes far beyond these goals. In Connecticut, the years used to determine the allowable growth have very little to do with the actual growth in the state's economy during the budget year under consideration.

For example, during the latter half of the 1990s, when the state's economy was prospering, personal income grew about 6 percent per year. Yet the annual growth allowed by the cap averaged only 4.3 percent during this period because it was based in part on personal income growth from several years earlier, when the economy was less prosperous. In the recession years of FY 2001-2004, the situation was reversed: the state's personal income grew about 2 percent per year, but the spending cap — which was based in part on the faster personal income growth of the later 1990s — would have allowed 6 percent annual spending growth.

Now that the state's economy is recovering, the cap will serve to reduce spending relative to the size of the state's economy. Connecticut's economy — as measured by personal income — is projected to expand 4.5 percent to 5 percent in FY 2007-2008, but the cap is estimated to allow growth of only 3.5 percent and 3 percent, respectively, in these two years. As a result, state government will shrink relative to the economy despite an increasing demand for services and the state's renewed ability to fund them.

STATE GOVERNMENT WILL SHRINK RELATIVE TO THE ECONOMY DESPITE AN INCREASING DEMAND FOR SERVICES AND THE STATE'S RENEWED ABILITY TO FUND THEM.

The budget submitted by the Governor for FY 2006-2007 illustrates the constraints of the spending cap. The Governor proposed an initiative designed to address concerns with inadequate funding of long term care in the state. Additional funds totaling $244 million would be directed to nursing homes and other long term care providers. The costs would be paid through a provider tax that would be matched by new federal funds. In order to accommodate this new initiative without reducing spending in other parts of the budget, the Governor has proposed exempting it from the cap.

In Connecticut, the years used to determine the **allowable growth** have very little to do with the **actual growth** in the state's economy during the budget year under consideration.

WHAT ACTIONS COULD BE TAKEN TO ADJUST THE CAP?

The Foundation examined three possible types of actions to adjust the cap — adding new exemptions to the cap, making technical adjustments in the cap calculation, and eliminating the cap altogether through the constitutional amendment process — and the specific methods by which these could be accomplished. *The following sections summarize the results of our analysis. The tables in the Appendices show the detailed calculations.*

1. We examined four potential new exemptions to the cap:

a. Medicaid funds;
b. new federal dollars;
c. all federal funds; and
d. Education Equalization (ECS) funds.

Each of these options would require a statutory change, although they also could be implemented by amending the constitutional cap.

2. We examined four options for changing the factors used to calculate the spending cap:

a. increasing the allowable growth factor to account for growth in special subpopulations;
b. using a more current estimate of personal income growth or a three-year average instead of a five-year average;
c. including capital gains income in the calculation of personal income growth; and
d. using the previous year's allowable spending instead of actual spending to calculate the following year's spending cap base.

Changes to the growth factor would require a statutory change, although they also could be implemented by amending the constitutional cap.

It would be possible to implement more than one of these changes at once. As an example, we looked at removing Medicaid funds from the cap together with changing the growth factor.

3. We examined eliminating the cap altogether, which would require a constitutional change.

Adjustments That Would Create Room Under the Cap

Exempt Medicaid (option 1a).
For a variety of reasons, including increasing health care costs, Medicaid spending is projected to rise faster than both general inflation and spending on state discretionary programs. Given this rate of growth — major portions of which are not under the state's control — and the critical importance of health care, the state could exempt Medicaid from the spending cap.

Exempting Medicaid would create approximately $111 million in additional room under the cap in FY 2006, growing to $279 million in FY 2008.

This estimate of projected Medicaid spending is based on the current service projections included in the Governor's FY 2006-2007 budget. Those projections include the effect of the new federal Medicare prescription drug benefits. Under the Medicare drug law, the responsibility for covering the cost of prescription drugs for many people who qualify for both Medicare and Medicaid will shift from Medicaid to Medicare. This should reduce combined federal and state spending on Connecticut's Medicaid program.[8]

For the first estimate we have adjusted the current service projections to remove the effect of the Medicare drug law in order to see the ongoing effect of removing Medicaid from the spending cap.

Changes, like the prescription drug change resulting from federal or state actions, would alter these results. Taking the estimated impact of the prescription drug changes on Medicaid into account, we estimate that exempting Medicaid from the spending cap would create approximately $81 million in additional room under the cap in FY 2006 and $178 million in FY 2008.

Exempt new federal programs (option 1b).
The intent of the spending cap is to ensure that the state spends within its means, not restrict additional revenue coming in from the federal government. Yet when the state is close to the spending cap limit, the cap discourages the state from accepting new federal revenue.

Exempting new federal programs or funds from the cap for one year, as the state currently does with federal mandates and court orders, would enable the state to capture new federal revenues and thereby reduce the amount of state revenue it needs. To get the most benefit from this change, the state would need to include expansions of existing programs in its definition of "new" federal funds.[9]

Medicaid spending is projected to rise faster than both general inflation and spending on state discretionary programs.

THE DEFINITION OF "PERSONAL INCOME" CONNECTICUT USES TO DETERMINE THE ALLOWABLE GROWTH RATE...DOES NOT INCLUDE CAPITAL GAINS INCOME.

The next three options are ways to modify the spending cap calculation by changing the growth factor.

Account for growth in specific subpopulations (option 2a).
The first of these is to adjust for changes in populations that may grow faster than the overall rate of population growth and require higher levels of state services. One example is elderly people, who tend to have higher health care costs. The growth factor in Connecticut's cap is based on growth in personal income. Personal income increases as a result of additional population, rising prices (inflation) and expanded economic activity.

When one of the subpopulations that receive public services — such as the elderly or school-aged children — grows faster than the general population, personal income growth may understate the need for state investments. Adding an adjustment based on growth in a specific subpopulation could correct this. The amount of the adjustment would depend on the specific population chosen.

For example, the effect of increasing the growth factor by 0.5 percent would be to increase room under the cap by an estimated $57 million in FY 2006 and $186 million in FY 2008.

Use a more current measure of personal income growth (option 2b).
Some states, such as Arizona, Idaho, North Carolina, and Oregon, base their spending limit on the estimate of personal income developed as part of the official economic forecast included in their budget deliberations, as opposed to using a historical average as Connecticut does. This option would restrict spending growth to the rate of growth in the state's economy, unless an economic downturn occurred during the fiscal year after the budget was adopted. In that case, however, state revenues would likely be affected if the decline was significant and the state would generally reopen budget deliberations. Based on current projections of personal income growth, this change would increase room under the cap by an estimated $38 million in FY 2006 and $349 million in FY 2008.

Include capital gains in the calculation of income growth (option 2c).
The definition of "personal income" Connecticut uses to determine the allowable growth rate comes from the U.S. Bureau of Economic Analysis; it does not include capital gains income. The definition Connecticut uses in calculating its income tax, in contrast, is federal Adjusted Gross Income (AGI), which does reflect this measure of wealth.

Potential Adjustments to the Spending Cap

Table 5

Estimated Effect of Changes that Would Create Room Under the Spending Cap (in millions)

	Gross Spending Cap - Appropriation				
Alternatives	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Current Cap	$13,878	$14,617	$15,071	$15,719	$16,321
Option 1a. Exclude Medicaid	$13,878	$14,643	$15,182	$15,875	$16,599
Option 1a. modified Exclude Medicaid (including reduced cost due to federal Medicare changes)	$13,878	$14,643	$15,152	$15,781	$16,499
Option 2a. Increase Allowable Growth Factor by 0.5 Percent	$13,878	$14,672	$15,128	$15,839	$16,507
Option 2b.Use Current Personal Income Growth	$13,878	$14,617	$15,109	$15,868	$16,669
Option 2d. Use Allowable Spending as Base	$13,878	$14,745	$15,198	$15,870	$16,521
Option 1a and 2b. Exclude Medicaid and Use Current Personal Income Growth	$13,878	$14,643	$15,210	$15,987	$16,860
Difference Between Revised Cap and Current Cap					
Option 1a. Exclude Medicaid	$0	$ 26	$111	$157	$279
Option 1a. modified Exclude Medicaid (assuming reduced cost due to federal Medicare changes)	$0	$ 26	$ 81	$ 62	$178
Option 2a. Increase Allowable Growth Factor to 0.5 Percent	$0	$ 55	$ 57	$120	$186
Option 2b. Use Current Personal Income Growth	$0	$ 0	$ 38	$149	$349
Option 2d. Use Allowable Spending as Base	$0	$128	$127	$151	$201
Option 1a and 2b. Exclude Medicaid and Use Current Personal Income Growth	$0	$ 26	$139	$267	$539

During the last half of the 1990s, Connecticut's total AGI grew one to two percentage points faster per year than personal income. However, during economic downturns, when capital gains income is reduced, the two growth factors currently being used — personal income or inflation — would most likely be higher than federal AGI.

In order to ensure stability, the spending cap calculation could use the growth in personal income as currently measured, or federal AGI, or the rate of inflation, whichever is greatest. With this change, the cap would more accurately reflect the state's ability to pay for its spending. However, if these measures were all based on historical averages, the change would not address the problem of using lagged measures previously described.

Change the cap base calculation from actual to allowable expenditures (option 2d). Historically, the cap limit has been calculated based on the state's actual expenditures, not the expenditures that are allowed by law. This has lowered the spending base for future cap calculations. If the calculation was based on what the state could have legally spent under the cap, $127 million more room would be created in FY 2006, and $201 million more in FY 2008. This option is effectively a form of re-basing.

The state could implement more than one of these changes simultaneously. As an example, we looked at removing Medicaid funds from the cap together with changing to a more current estimate of personal income growth. Taken together, these changes would increase room under the cap by an estimated $139 million in FY 2006 and $539 million in FY 2008.

Eliminating the Spending Cap (option 3)

If the majority of voters of the state agreed, the cap could be eliminated through the constitutional amendment process. The General Assembly would have to approve sending this question to the voters by a three-quarters margin.[10] If voters approved, the restrictions imposed by the cap would be lifted and the budget could grow at a rate beyond the current growth factor.

Removing the spending cap would eliminate incentives to increase borrowing and use tax expenditures, and remove the disincentive to capture federal funds. While the absence of a spending cap could tempt the state to spend beyond its means, many checks and balances would remain to prevent such an outcome. Removing the cap would increase policymakers' ability to respond to changing fiscal and economic conditions and create an opportunity to match budget growth more closely with the state's overall economic condition.

If the **majority of voters** of the state agreed, the cap could be eliminated through the **constitutional amendment process.**

Adjustments That Would Further Restrict Spending Under the Cap

Our research shows that the following two adjustments would further restrict available room under the cap:

- exempting all federal funds (option 1c); and
- exempting Education Equalization (ECS) funds (option 1d).

These options would restrict room under the cap because neither of these funding streams are expected to grow at a consistently high rate in coming years. (Federal funds may actually decline in certain years.) As long as these funding streams are part of the spending cap base, their relatively slow growth rate creates room for other programs in the base to grow somewhat more quickly than the cap would otherwise allow. Removing these slow-growing funding streams from the base, therefore, would tighten the spending cap.

For example, if Connecticut were to remove all federal grants from the cap, the cap would decline by about $242 million in FY 2006 and by $270 million in FY 2008. Similarly, if Educational Equalization funds were removed from the cap, the cap would be basically unchanged in FY 2006 and decline by about $94 million in FY 2008.

For example, if Connecticut were to **remove** all **federal funds** from the cap, the cap would **decline** by about $242 million in FY 2006 and by $270 million in FY 2008.

Table 6

Estimated Effect of Changes that Would Reduce Room Under the Spending Cap (in millions)

	Gross Spending Cap - Appropriation				
Alternatives	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Current Cap	$13,878	$14,617	$15,071	$15,719	$16,321
Exclude All Federal Funds	$13,878	$14,436	$14,830	$15,426	$16,051
Exclude ECS	$13,878	$14,589	$15,076	$15,671	$16,227
Difference Between Revised Cap and Current Cap					
Option 1c. Exclude All Federal Funds	$0	-$181	-$242	-$293	-$270
Option 1d. Exclude ECS	$0	-$28	$5	-$48	-$94

CONCLUSION

ANALYSIS

Our analysis confirms what we found in 2001: Connecticut's spending cap is one of the most restrictive in the country, and its current structure will cause state spending to lag well behind economic growth in future years. This will place significant pressure on state programs that serve vulnerable populations, from mental health programs to prescription drug subsidies. The cap has produced other negative effects as well, including discouraging the state from seeking new sources of federal revenue.

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 change the way the cap is calculated in order to address the gradual "ratcheting down" of the base caused by economic downturns.

Over the long term, several statutory or constitutional adjustments also could be made to ensure that the cap does not prevent Connecticut from meeting the vital needs of all of its residents. These include exempting Medicaid and changing the income factor used to calculate the spending cap to better reflect economic growth. Removing the cap also could be proposed to voters as one choice to address the limitations it imposes on their state government.

NOTES

1. For more information on the children's mental health crisis, see the report commissioned by the Connecticut Health Foundation: Connecticut Voices For Children. The State of Children's Mental Health In Connecticut: A Brief Overview. June 2000. www.cthealth.org

   See also this joint investigation by the State of Connecticut, Office of the Child Advocate and the Attorney General. The Cost of Failure. March 2003. www.ct.gov/oca/cwp/view.asp?a=1301&q=270364

   For more information on the oral health crisis, see Edelstein, Burton L. DDS, MPH. From the Mouths of Babes: Revelations from the Oral Health of Connecticut's Urban Poor Preschoolers. www.ctoralhealth.org/ COHI1204.pdf

2. For more information on racial and ethnic disparities in health care in Connecticut, see Wilson, Ardell A. DDS, MPH. Chief, Bureau of Community Health, Connecticut Department of Public Health. October 27, 2004. www.dph.state.ct.us/ Publications/BCH/roadmap_2004.pdf

3. Of the 27 limits, 17 (including Connecticut's) are in the state's constitution.

4. Significant adjustments have been made to the base calculation at least twice: The first time the cap was "re-based" was in 1994, when $289.8 million was added to the previous year's base. This adjustment was made to reflect the change from the Uncompensated Care Pool (which had been off budget) to funds provided for Medical Assistance Disproportionate Share – Emergency Assistance in the Department of Social Services.

   The cap was re-based a second time in 2000, when the $27.1 million appropriation of Workforce Investment Act (WIA) federal grants was treated as a "federal mandate." This had the effect of exempting these funds from the cap in FY 2001 and placing them in the FY 2001 base for spending cap calculations going forward. The WIA funds had replaced federal Job Training Partnership Act (JTPA) funds that were not subject to appropriation.

5. Lapses are a budgeted estimate of expected savings in a budget year that will come from unanticipated sources within state agencies. (For example, if positions go unfilled or a new program is established later than anticipated.) In recent years the legislature has also given the Governor authority to institute additional lapses in the form of rescissions. These savings can be applied to cover shortfalls in other areas (known as "deficiencies").

   This technique of using lapses to cover deficiencies results in spending that does not have to be appropriated and therefore is not counted toward the spending cap. It also can mean that the base amount of appropriations that are used to determine the next year's cap can be understated, requiring additional spending reductions in the following year to keep the budget under the cap. From FY 2000 to FY 2003, lapses have been predicted to be between $103 million and $251 million, with actual savings ranging from $96 million to $161 million. If the predicted savings do not occur (which sometimes happens), the state is that much closer to the spending cap limit in a given year.

   Carry forwards are funds which were originally budgeted for one fiscal year, but are held over until the next budget year. If funds are carried over from one year to the next, they do not count against the spending cap limit in the year that they were originally budgeted.

   While the spending of surplus funds is provided for in the cap statute, there are no statutory or constitutional provisions which address the use of lapses and carry forwards with respect to the cap.

6. United States Census Bureau, 2002 State Government Finance Data www.census.gov/govs/www/state01.html

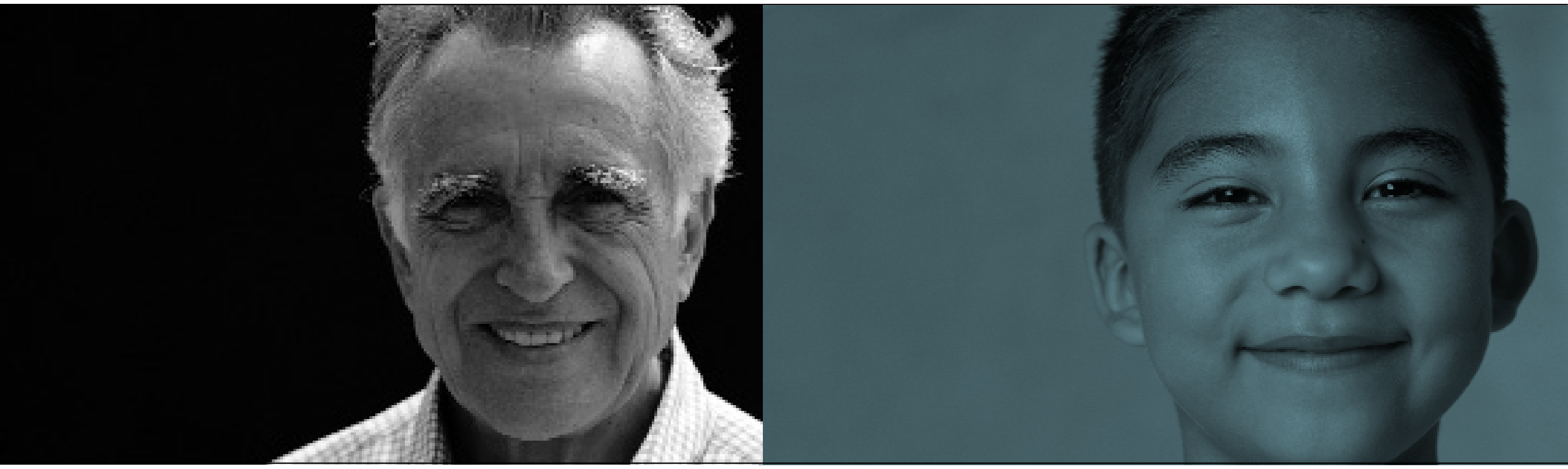
7. Estimates vary, but in January 2005 both OFA and the Governor's Office projected that current service spending would exceed the spending cap in FY 2006. OFA projected that current service spending would exceed the cap by $515.8 million to $650 million — depending on whether the state spent up to the cap in FY 2005 — and the Governor's Office projected an overage of about $800 million.

8. According to estimates in the Governor's proposed budget, the prescription drug changes in the Medicare Prescription Drug Improvement and Modernization Act (MMA) will reduce Connecticut's combined federal and state Medicaid spending by $29.9 million in FY 2006 and $94.6 million in FY 2007. Most of the reduction is in federal spending.

9. Exempting new spending financed with federal dollars from the cap for a year, and then adding the program to the base makes more room under the cap compared to the current procedure. Current practice requires that all of the increase in spending from a new program funded by federal dollars must come from the allowable growth for the year the program is instituted. This reduces funds available for other programs within the cap limit. If new federal programs were instead exempted from the cap for a year and then added to the base of the cap, the amount of additional room created under the cap after the first year will increase if the program's growth rate is slow and decrease if the program grows rapidly.

10. It takes a minimum of months and sometimes years to amend the state Constitution. Amendments to the Constitution must first be approved by a three-quarters vote in both chambers of the General Assembly and then by a simple majority of voters in a statewide election.

    The timetable for getting an amendment to the Constitution on the ballot is as follows: if the legislature passes an amendment by a three-fourths margin, the amendment question will appear on the ballot on Election Day of the next even-numbered year. However, if the legislature approves of an amendment by more than a simple majority but less than three quarters vote, the amendment will be held over in the General Assembly until the next legislature is elected in the next even-numbered year. The proposed amendment must then pass by the three-quarters margin to be sent to the voters for their approval or rejection, which would happen on Election Day of the next even-numbered year.



METHODOLOGY

The tables that model the effect of various changes to the spending cap were calculated by the CBPP in the following way:

The basis for each of these scenarios is the spending cap calculation included in the Governor's FY 2006-2007 budget proposal available at www.opm.state.ct.us/budget/2006-2007books/2006-2007gov budget.htm.

With these figures as a base (See Table 2), the Center modeled each change by adjusting the exclusions from the spending cap and then computing the impact of this adjustment on the base for future years. For FY 2006 and future years, each year's base is set to be the lower of the adjusted spending cap or the current services projection. This analysis assumes that FY 2008 current services will be 4.5 percent higher than in FY 2007.

Projected spending estimates for specific programs are based on the current service figures in the Governor's proposed budget. Other assumptions are noted at the bottom of the individual tables.

Table 7

Option 1a. Estimated Effect of Excluding Medicaid (in millions) – adjusted to remove effect of Medicare prescription drug plan

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,617.0	$15,182.1	$15,875.9
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Medicaid	**$0.0**	**$0.0**	**$2,785.1**	**$2,935.8**	**$3,165.8**	**$3,319.8**
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$5,619.3	$6,117.6	$6,221.5	$6,501.6
Net Base Capped Expenditures	$10,210.5	$10,475.9	$8,136.0	$8,499.4	$8,960.6	$9,374.3
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.46%	4.06%	3.54%	2.96%
Allowable Capped Appropriation Growth	$633.1	$552.1	$362.9	$345.1	$317.2	$277.5
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$8,498.9	$8,844.5	$9,277.8	$9,651.8
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Medicaid	**$0.0**		**$2,935.8**	**$3,165.8**	**$3,319.8**	**$3,535.6**
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$6,144.6	$6,337.6	$6,598.1	$6,947.6
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,643.5	$15,182.1	$15,875.9	$16,599.3
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	-$26.5	$711.9	$792.7	$819.3
Difference from current cap	**$0.0**	**$0.0**	**-$26.5**	**$110.8**	**$156.7**	**$278.8**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*
Medicaid spending is current services estimate from Governor's FY 2006-2007 budget adjusted to remove the effect of estimated savings due to federal changes in Medicare prescription drug coverage.
Spending is increased by $29.9 million in FY 2006 and $94.6 million in FY 2007.
Assumes that Medicaid retains its current structure.

Table 8

Option 1a modified. Estimated Effect of Excluding Medicaid with Federal Changes to Medicare Prescription Coverage (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,617.0	$15,152.2	$15,781.3
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Medicaid	**$0.0**	**$0.0**	**$2,785.1**	**$2,935.8**	**$3,135.9**	**$3,225.2**
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$5,619.3	$6,117.6	$6,191.6	$6,407.0
Net Base Capped Expenditures	$10,210.5	$10,475.9	$8,136.0	$8,499.4	$8,960.6	$9,374.3
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.46%	4.06%	3.54%	2.96%
Allowable Capped Appropriation Growth	$633.1	$552.1	$362.9	$345.1	$317.2	$277.5
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$8,498.9	$8,844.5	$9,277.8	$9,651.8
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Medicaid	**$0.0**	**$0.0**	**$2,935.8**	**$3,135.9**	**$3,225.2**	**$3,434.8**
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$6,144.6	$6,307.7	$6,503.5	$6,846.8
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,643.5	$15,152.2	$15,781.3	$16,498.6
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	-$26.5	$741.8	$887.3	$920.1
Difference from current cap	**$0.0**	**$0.0**	**-$26.5**	**$80.9**	**$62.1**	**$178.1**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*
Assumes that Medicaid retains current structure.

Table 9

Option 2a. Estimated Effect of Increasing Growth Factor by 0.5 percent (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,617.0	$15,128.4	$15,838.8
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$2,834.2	$3,181.8	$3,055.7	$3,181.8
Net Base Capped Expenditures	$10,210.5	$10,475.9	$10,921.1	$11,435.2	$12,072.7	$12,657.0
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.96%	4.56%	4.04%	3.46%
Increase			**0.5%**	**0.5%**	**0.5%**	**0.5%**
Allowable Capped Appropriation Growth	$633.1	$552.1	$541.7	$521.4	$487.7	$437.9
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$11,462.8	$11,956.6	$12,560.5	$13,094.9
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$3,208.8	$3,171.8	$3,278.3	$3,412.0
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,671.6	$15,128.4	$15,838.8	$16,506.9
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	-$54.6	$765.6	$829.8	$911.8
Difference from current cap	**$0.0**	**$0.0**	**$54.6**	**$57.2**	**$119.6**	**$186.4**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*

Table 10

Option 2b. Estimated Effect of Using Current Personal Income Growth (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,617.0	$15,109.0	$15,868.0
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$2,834.2	$3,181.8	$3,055.7	$3,181.8
Net Base Capped Expenditures	$10,210.5	$10,475.9	$10,921.1	$11,435.2	$12,053.3	$12,686.2
Times 5-year Avg. Growth in Personal Income	**6.20%**	**5.27%**	**4.46%**	**4.39%**	**4.45%**	**4.50%**
Allowable Capped Appropriation Growth	$633.1	$552.1	$487.1	$502.0	$536.4	$570.9
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$11,408.2	$11,937.2	$12,589.7	$13,257.1
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$3,208.8	$3,171.8	$3,278.3	$3,412.0
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,617.0	$15,109.0	$15,868.0	$16,669.1
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	$0.0	$785.0	$800.6	$749.6
Difference from current cap	**$0.0**	**$0.0**	**$0.0**	**$37.7**	**$148.8**	**$348.5**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*

Table 11

Option 2d. Estimated Effect of Using Allowable Spending as Base in Place of Actual Spending (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,878.3	$14,745.5	$15,198.0	$15,869.9
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$2,834.2	$3,181.8	$3,055.7	$3,181.8
Net Base Capped Expenditures	$10,210.5	$10,475.9	$11,044.1	$11,563.7	$12,142.3	$12,688.1
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.46%	4.00%	3.70%	3.32%
Allowable Capped Appropriation Growth	**$633.1**	**$552.1**	**$492.6**	**$462.5**	**$449.3**	**$421.2**
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$11,536.7	$12,026.2	$12,591.6	$13,109.3
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$3,208.8	$3,171.8	$3,278.3	$3,412.0
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,745.5	$15,198.0	$15,869.9	$16,521.3
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	-$128.5	$696.0	$798.7	$897.4
Difference from current cap	**$0.0**	**$0.0**	**$128.5**	**$126.8**	**$150.7**	**$200.8**

Source: CBPP calculations using base figures from Governor's FY 2006-2007 budget.
Notes: FY 2008 current services spending estimated assuming 4.5 percent growth.

Table 12

Option 1c. Estimated Effect of Excluding All Federal Funds (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,436.2	$14,829.5	$15,425.8
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
All Federal Funds	**$0.0**	**$0.0**	**$2,563.7**	**$2,497.2**	**$2,545.0**	**$2,592.0**
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$5,379.9	$5,679.0	$5,600.7	$5,773.8
Net Base Capped Expenditures	$10,210.5	$10,475.9	$8,357.4	$8,757.2	$9,228.8	$9,652.0
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.46%	4.06%	3.54%	2.96%
Allowable Capped Appropriation Growth	$633.1	$552.1	$372.7	$355.5	$326.7	$285.7
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$8,730.2	$9,112.7	$9,555.5	$9,937.7
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
All Federal Funds	**$0.0**	**$0.0**	**$2,497.2**	**$2,545.0**	**$2,592.0**	**$2,701.0**
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$5,706.0	$5,716.8	$5,870.3	$6,113.0
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,436.2	$14,829.5	$15,425.8	$16,050.7
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	$180.8	$1,064.5	$1,242.8	$1,368.0
Difference from current cap	**$0.0**	**$0.0**	**-$180.8**	**-$241.8**	**-$293.4**	**-$269.8**

Source: CBPP calculations using base figures from Governor's FY 2006-2007 budget.
Notes: FY 2008 current services spending estimated assuming 4.5 percent growth.

Table 13

Option 1d. Estimated Effect of Excluding Education Equalization Funds (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,589.4	$15,076.1	$15,671.2
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Education Equalization Aid (ECS)	**$0.0**	**$0.0**	**$1,522.6**	**$1,562.9**	**$1,659.9**	**$1,665.6**
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$4,356.8	$4,744.7	$4,715.6	$4,847.4
Net Base Capped Expenditures	$10,210.5	$10,475.9	$9,398.5	$9,844.7	$10,360.5	$10,823.8
Times 5-year Avg. Growth in Personal Income	6.20%	5.27%	4.46%	4.06%	3.54%	2.96%
Allowable Capped Appropriation Growth	$633.1	$552.1	$419.2	$399.7	$366.8	$320.4
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$9,817.7	$10,244.4	$10,727.3	$11,144.1
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Education Equalization Aid (ECS)	**$0.0**	**$0.0**	**$1,562.9**	**$1,659.9**	**$1,665.6**	**$1,670.6**
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$4,771.7	$4,831.7	$4,943.9	$5,082.6
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,589.4	$15,076.1	$15,671.2	$16,226.7
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	$27.6	$817.9	$997.4	$1,191.9
Difference from current cap	**$0.0**	**$0.0**	**-$27.6**	**$4.8**	**-$48.1**	**-$93.8**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*

Table 14

Options 1a and 2b combined. Estimated Effect of Excluding Medicaid and Using Current Personal Income Growth (in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Base Appropriated Funds	$12,925.3	$13,217.8	$13,755.3	$14,617.0	$15,210.1	$15,986.7
Less Non-Capped Expenditures						
Debt Service	$1,426.2	$1,438.1	$1,584.8	$1,871.9	$1,713.4	$1,837.2
Grants to Distressed Municipalities	$1,279.6	$1,303.8	$1,249.3	$1,309.9	$1,342.3	$1,344.6
Medicaid	**$0.0**	**$0.0**	**$2,785.1**	**$2,935.8**	**$3,165.8**	**$3,319.8**
Total Non-Capped Expenditures-Prior Year	$2,714.8	$2,741.9	$5,619.3	$6,117.6	$6,221.5	$6,501.6
Net Base Capped Expenditures	$10,210.5	$10,475.9	$8,136.0	$8,499.4	$8,988.6	$9,485.1
Times Growth in Personal Income	**6.20%**	**5.27%**	**4.46%**	**4.39%**	**4.45%**	**4.50%**
Allowable Capped Appropriation Growth	$633.1	$552.1	$362.9	$373.1	$400.0	$426.8
Net Capped Appropriation = Growth + Base	$10,843.6	$11,028.0	$8,498.9	$8,872.5	$9,388.6	$9,911.9
Plus Non-Capped Expenditures: Current Year						
Debt Service	$1,438.1	$1,590.3	$1,871.9	$1,713.4	$1,837.2	$2,062.0
Federal Mandates and Court Orders	$5.1	$1.8	$42.6	$116.1	$96.5	$0.0
Grants to Distressed Municipalities	$1,264.0	$1,258.2	$1,294.3	$1,342.3	$1,344.6	$1,350.0
Medicaid	**$0.0**	**$0.0**	**$2,936.0**	**$3,166.0**	**$3,320.0**	**$3,536.0**
Total Non-Capped Expenditures	$2,707.2	$2,850.3	$6,144.6	$6,337.6	$6,598.1	$6,947.6
Gross Spending Cap - Appropriation	$13,550.8	$13,878.3	$14,643.5	$15,210.1	$15,986.7	$16,859.5
Actual Gross Appropriation/Current Services	$13,217.8	$13,755.4	$14,617.0	$15,894.0	$16,668.6	$17,418.7
Over/(Under) the Spending Cap	-$333.0	-$122.9	-$26.5	$683.9	$681.9	$559.2
Difference from current cap	**$0.0**	**$0.0**	**$26.5**	**$138.9**	**$267.5**	**$539.0**

Source: *CBPP calculations using base figures from Governor's FY 2006-2007 budget.*
Notes: *FY 2008 current services spending estimated assuming 4.5 percent growth.*
Medicaid spending is current services estimate from Governor's FY 2006-2007 budget adjusted to remove the effect of estimated savings due to federal changes in Medicare prescription drug coverage.
Spending is increased by $29.9 million in FY 2006 and $94.6 million in FY 2007.
Assumes that Medicaid retains its current structure.

Statutory Spending Cap

In August 1991, the General Assembly enacted a spending cap as part of negotiations over creating a state income tax. This “statutory” cap can be modified through legislative action.

Sec. 2-33a. Limitation on expenditures authorized by General Assembly

The general assembly shall not authorize an increase in general budget expenditures for any fiscal year above the amount of general budget expenditures authorized for the previous fiscal year by a percentage which exceeds the greater of the percentage increase in personal income or the percentage increase in inflation, unless the governor declares an emergency or the existence of extraordinary circumstances and at least three-fifths of the members of each house of the general assembly vote to exceed such limit for the purposes of such emergency or extraordinary circumstances. Any such declaration shall specify the nature of such emergency or circumstances and may provide that such proposed additional expenditures shall not be considered general budget expenditures for the current fiscal year for the purposes of determining general budget expenditures for the ensuing fiscal year and any act of the general assembly authorizing such expenditures may contain such provision. As used in this section, "increase in personal income" means the average of the annual increase in personal income in the state for each of the preceding five years, according to United States Bureau of Economic Analysis data; "increase in inflation" means the increase in the consumer price index for urban consumers during the preceding twelve-month period, according to United States Bureau of Labor Statistics data; and "general budget expenditures" means expenditures from appropriated funds authorized by public or special act of the general assembly, provided (1) general budget expenditures shall not include expenditures for payment of the principal of and interest on bonds, notes or other evidences of indebtedness, expenditures pursuant to section 4-30a of the general statutes, or current or increased expenditures for statutory grants to distressed municipalities, provided such grants are in effect on July 1, 1991, and (2) expenditures for the implementation of federal mandates or court orders shall not be considered general budget expenditures for the first fiscal year in which such expenditures are authorized, but shall be considered general budget expenditures for such year for the purposes of determining general budget expenditures for the ensuing fiscal year. As used in this section, "federal mandates" means those programs or services in which the state must participate, or in which the state participated on July 1, 1991, and in which the state must meet federal entitlement and eligibility criteria in order to receive federal reimbursement, provided expenditures for program or service components which are optional under federal law or regulation shall be considered general budget expenditures.

1991, June Special Session, P.A. 91-3, Section 30, effective August 22, 1991.

Constitutional Spending Cap

In August 1991, the General Assembly also proposed to add a balanced budget provision and the spending cap to the state’s constitution. In November 1992, this “constitutional” cap was approved by Connecticut voters by a 4 to 1 margin. The constitutional cap requires the General Assembly to enact statutory language to implement it, which has not yet occurred.

A 1993 opinion from the Attorney General clarified that the statutory cap will remain in place until the General Assembly approves, by a three-fifths majority, legislation to implement the constitutional cap.

ARTICLE XXVIII.

Limit on state expenditures. Maximum authorized increase; “emergency or extraordinary circumstances”; definitions to be defined by general assembly.

Sec. 18 a. The amount of general budget expenditures authorized for any fiscal year shall not exceed the estimated amount of revenue for such fiscal year.

b. The general assembly shall not authorize an increase in general budget expenditures for any fiscal year above the amount of general budget expenditures authorized for the previous fiscal year by a percentage which exceeds the greater of the percentage increase in personal income or the percentage increase in inflation, unless the governor declares an emergency or the existence of extraordinary circumstances and at least three-fifths of the members of each house of the general assembly vote to exceed such limit for the purposes of such emergency or extraordinary circumstances. The general assembly shall by law define "increase in personal income", "increase in inflation" and "general budget expenditures" for the purposes of this section and may amend such definitions, from time to time, provided general budget expenditures shall not include expenditures for the payment of bonds, notes or other evidences of indebtedness. The enactment or amendment of such definitions shall require the vote of three-fifths of the members of each house of the general assembly.

c. Any unappropriated surplus shall be used to fund a budget reserve fund or for the reduction of bonded indebtedness; or for any other purpose authorized by at least three-fifths of the members of each house of the general assembly.

Adopted November 25, 1992.

About the Authors

Alison Johnson is a nonprofit consultant with expertise in public policy, the Connecticut state budget, and the development of coalitions in the health and human services fields. Prior to starting her consulting firm, Johnson served as the Director of the Nonprofit Human Services Cabinet; Director of Advocacy and Government Relations at the Connecticut Association for Human Services; and as Legislative Coordinator and Program Associate at the American Lung Association of Connecticut. The Wesleyan University graduate currently serves on the Advisory Board of the Aetna Foundation Children's Center at St. Francis Hospital; ConnectiCare's Member Advisory Board; and the City of Middletown's Resource Recycling Council.

Elizabeth McNichol is a Senior Fellow at the Center on Budget and Policy Priorities specializing in state fiscal issues including methods of opening up state budget processes and long-term structural reform of state budget and tax systems. She has served as Director of the Center' State fiscal Project. Prior to joining the Center, the University of Chicago graduate served as Assistant Research Director of the Service Employees International Union in Washington, D.C., and as a Joint Finance Committee staff member for the State of Wisconsin Legislature specializing in property taxes and state aid to local governments. For more information about the Center, please visit www.cbpp.org.

The Connecticut Health Foundation (CHF) is the state's largest independent, non-profit grantmaking foundation dedicated to improving the health of the people of Connecticut through systemic change, program innovation, and public health policy analysis. Since it was established in July of 1999, CHF has funded more than $17.8 million of grants in three priority areas — children's mental health, reducing racial and ethnic health disparities, and oral health.

For additional information, please contact Monette Goodrich, Vice President of Communications & Public Affairs, at 860.224.2200 or monette@cthealth.org.

The full report and a one-page executive summary are available at www.cthealth.org.

Connecticut Health Foundation

74B Vine Street • New Britain, CT 06052

www.cthealth.org