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Testimony in Support of S.B. 1135
AN ACT ESTABLISHING A SUSTAINABLE PATH FOR MAINTAINING THE BUDGET RESERVE FUND AND REDUCING THE EFFECT OF REVENUE VOLATILITY ON THE STATE BUDGET.
4/23/15 – Testimony by Roger Senserrich

Good morning Senator Fonfara, Representative Berger and members of the Finance, Revenue and Bonding Committee. My name is Roger Senserrich, and I am the Policy Director at the Connecticut Association for Human Services (CAHS). CAHS is a statewide non profit agency that works to reduce poverty and promote economic success through both policy and program work.

Thanks for the opportunity to testify today on behalf of CAHS about S.B. 1135, a bill addressing the Budget Reserve Fund. This proposed legislation introduces several welcome changes to the current funding rules for the rainy day fund, strengthening it and providing some welcome stability.

The changes introduced in this bill would help reduce the effects that revenue volatility has on the state budget. In addition, new provisions would provide automatic funding to the state's underfunded pension system, helping close the current gap in the long term. Finally, the legislation would place restrictions on the General Assembly on how the Reserve Fund can be used. Any changes in the rules or the amount of money that the General Assembly has to correct deficits would require a three fifth majority to be enacted, ensuring a sound long term fiscal management. CAHS fully supports S.B.1135, and encourages the committee to approve these sound fiscal practices.

Long term fiscal rules are important, but we have to acknowledge that the state currently has more pressing, immediate fiscal needs. Besides supporting S.B. 1135, CAHS also wants to testify in favor of higher revenue in the upcoming fiscal year to avoid harmful cuts to public services.

The Governor's budget proposal includes nearly $600 million in cuts. Most of these cuts affect programs and services that are vital to Connecticut families, and can hamper family economic success, social mobility and state's long term economic growth. The cuts include:

- **$158 million from the State Department of Education**. These cuts come mostly from capping funding to municipalities, reducing their grant funding for services like transportation or special education.
- **$49.5 million from the HUSKY health insurance program**. The changes will eliminate coverage for parents in families with incomes between 138% and 200% of the federal poverty level, forcing them to apply for coverage on Access Health CT and pay premiums. In addition, coverage for pregnant women

would be greatly reduced to the point of making Connecticut one of the states with the most restrictive requirements – only Idaho, South Dakota and Oklahoma currently have comparable eligibility limits.

- **$65.9 million from higher education**. The cuts include a severe reduction on grant funding for remedial education programs aimed at ensuring access to college to many low income students.
- **$11.3 million from the Office of Early Childhood**. Cuts include performance evaluation programs, as well as cuts to Smart Start.
- The budget also eliminates several very successful workforce development programs, like Strive and Youth Employment, as well as several community education programs, including grants for community early care planning groups.

These budget cuts are unfair, and have a disproportionate impact on low income families and children. Although spending in children and families makes up only a third of the budget, more than half of the cuts are falling directly on them.

In the long term, these cuts are investments we are not making on these children and families. Lower education spending can and will reduce school achievement in the future, leaving the state with a less productive workforce. Lower healthcare spending will reduce access to prenatal care for thousands of mothers, bringing worse health outcomes down the road. Underinvestment in higher education will widen the gap between employers' needs and the state workforce in the coming years.

In addition, some of the news sources of revenue included in the Governor's proposal fall the hardest in low-income families. The budget delays a scheduled increase in Connecticut's Earned Income Tax Credit[i]. A large portion of included new revenue comes from not restoring the clothing sales tax exemption. A recent study by the state Department of Revenue Services[ii] indicates that Connecticut tax system as a whole is very regressive. Households in the lower 10% of the income distribution paying close to 24% of their income in state and local taxes, compared to the 6.4% effective tax rate faced by the top 20%. These changes would make this imbalance worse.

To avoid damaging cuts and restore the progressivity of our tax system we believe we need to look at other sources of revenue. Connecticut Voices for Children, in a recent report[iii], has shared several new revenue options, including:

- **Raising the top marginal income tax rates for households making more than $500,000 a year:** the income tax is the most progressive form of taxation in the state's tax code. Currently Connecticut's top marginal rates are well below the states in our region; a modest increase (to 7% for incomes $500,000-1,000,000 and 7.5% for incomes above $1,000,000) would only affect 2% of Connecticut households and potentially raise $300 million in new revenue. This increase will not lead to wealthy residents leaving the state; studies have repeatedly showed that tax rates are not a factor in this regard[iv].
- **Eliminating outdated tax expenditures:** the Office of Fiscal Analysis produces an annual report on Connecticut tax expenditures[v]. These are tax breaks and incentives included in

the tax code to support nascent industries or promote economic activity. Many of the exemptions and deductions, however, are outdated, and have a strong financial impact on the budget. We support eliminating many of these expenditures, as well as adding an automatic sunset clause to all provisions.
A 1997 break for internet services,, for instance, costs the state more than $62 million a year. Eliminating it would generate enough revenue to reverse all the HUSKY cuts. The health and athletic club services exemption would raise close to $11 million, enough to fully offset the restoration of the EITC.

- **Broaden the base on the sales tax:** services are currently not taxed in Connecticut unless done so through legislative action. Broadening the base to cover currently exempt services could potentially raise enough revenue to lower the overall rate while preserving exemptions for low-income families.
- **Enact combined reporting:** corporations that operate in more than one state currently can use creative accounting practices when reporting income to avoid paying Connecticut taxes. Combined reporting closes that loophole by making companies report income and expenses together. This minor change will eliminate an unfair advantage that larger corporations have over small business that only operate within the state, and raise $20 million.
- **Other options:** introducing a sugar sweetened beverage and candies could raise up to $179 million, while providing benefits to public health.

CAHS believes that Connecticut needs to have a fiscally responsible state government. S.B. 1135 is a good step in this direction, creating a strong Budget Reserve Fund that would ease year to year revenue fluctuations.

In order to accomplish a healthy budget, however, building a solid reserve is not enough: we need a state government that is able to invest in infrastructure, in education, in giving a second chance to those that fall on hard times. It is for this reason that we encourage this committee to seek new revenue streams to make these investments possible. Thanks for your time today.

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[i] It was scheduled to be restored to 30% of the Federal tax credit; it this budget it would remain at 27.5%.
[ii] http://www.ct.gov/drs/lib/drs/research/drstaxincidencereport2014.pdf
[iii] Defiesta, N. and Shemitz, E. (2015) "Funding Our Future: Child and Family Friendly Revenue Options" CT Voices for Children. Available here: http://www.ctvoices.org/publications/funding-our-future-child-and-family-friendly-revenue-options
[iv] See http://www.cbpp.org/cms/?fa=view&id=3556 for a literature review. The main driver for migration outflows in Connecticut and the Northeast, incidentally, is housing prices – and middle class families are more likely to leave than the wealthy.
[v] See http://www.cga.ct.gov/ofa/Documents/year/TER/2014TER-20140102_Tax%20Expenditure%20Report%20FY%2014.pdf for 2014's version.