Fifteen Years of Folly

The Failures of Connecticut's Income Tax

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About the Yankee Institute for Public Policy

The Yankee Institute for Public Policy, Inc. is a nonpartisan educational and research organization founded more than two decades ago. Today, the Yankee Institute's mission is to "promote economic opportunity through lower taxes and new ideas for better government in Connecticut."

About the Author

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In March 2005, the Institute published Dowd's study "The Value Gap," which examined the inefficiencies of the state's government-school districts. In January 2006, he authored "The Two Connecticuts: Public vs. Private Employment in the Nutmeg State," a groundbreaking study that exposed the disparities in pay, benefits, and working conditions between workers in Connecticut's government and private sectors.

He is the editor of *Connecticut Freedom Ryder*, a daily online publication that links to articles, announcements, and resources of interest to the Nutmeg State's pro-freedom community.

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Executive Summary

In August 1991, Connecticut legislators and Governor Lowell P. Weicker responded to a short-term budget crisis by enacting the state's first broad-based income tax.

Supporters hailed the income tax as a powerful mechanism to fix the state's fiscal condition and -- because it allowed minor cuts in other taxes -- jumpstart the Connecticut economy. But a decade and a half after its passage, it is now clear that the income tax has failed.

<u>The income tax has not been an effective fiscal tool</u>:

** when the state entered another recession at the turn of the century, **budget deficits returned**, as did tax hikes, heavy borrowing, and the complete withdrawal of Connecticut's "rainy day fund"*

** Connecticut's state tax burden continued to rise significantly after 1991, and **tax hikes as well as entirely new levies were adopted***

** **revenue from the income tax did not lead to property-tax relief** -- between 1991 and 2003, Connecticut property-tax collections rose 19.8 percent*

** the "spending cap" enacted to control state expenditures was **riddled with loopholes, and has been violated again and again** by governors and lawmakers*

** contrary to the claims of many income-tax supporters, **not one of the nation's non-income tax states followed Connecticut's lead***

<u>Neither has the income tax spurred economic growth</u>:

** **Connecticut job growth has been nonexistent since 1991** -- the Federal Deposit Insurance Corporation reports that since the early 1990s, "no other state … has had such stagnation in employment"*

** **personal-income growth slowed significantly** in the Nutmeg State in the post-1991 era*

** **median household income in Connecticut has fallen**, in inflation-adjusted terms, since 1991 -- nationally, median household income has grown*

** **Connecticut lost over 240,000 native-born citizens between 1990 and 2002**, and in the 1990s, **no state lost a greater percentage of its 18-to-34-year-olds***

It's time to admit that Connecticut's income tax was a major policy blunder. The state should consider shifting to a sales tax on all retail transactions (with a generous rebate program for low-income households). Doing so would likely produce a more reliable revenue stream, as well as eliminate the income tax's strong disincentives to work and invest.

Perhaps Connecticut's political leaders thought that the boom years of the 1980's would last indefinitely. Certainly they based their budgets on that hope.

- *New York Times*, December 1990[1]

An income tax is what makes possible all of the reductions in taxes which provide for economic development.

- Bill Cibes, Office of Policy and Management, March 1991[2]

They're foolish and stupid.

- State Rep. Richard Foley, Jr. on the Big Business-funded lobbying groups that supported a Connecticut income tax, March 1991[3]

Introduction

Between 1980 and 1989, only one state -- rapidly-growing Arizona -- increased its expenditures at a faster pace than Connecticut. The decade saw the Nutmeg State's spending soar by 173 percent, far outstripping the combined rates of inflation and population growth.[4]

By the end of the '80s, the state's economy began to chill, and then turn downright icy. A severe recession set in, one that began earlier and lasted far longer than the nation's economic downturn. The profits of Connecticut corporations tanked. Hundreds of thousands of jobs vanished. Consumer spending fell.

As a result, state tax collections began to dip. In what would have been an unthinkable development just a few years earlier, enormous budget deficits appeared on Connecticut's horizon.

In 1991, lawmakers and Governor Lowell P. Weicker responded by enacting several modifications to the state's revenue-raising system, the most prominent being Connecticut's first broad-based income tax.

While the state had taxed capital gains, interest, and dividend income since the early 1970s, a levy had never before been placed on wages and salaries. (In the interest of simplicity, this paper will use the term "income tax" to refer to the tax passed in 1991, not the preexisting tax on "unearned" income.)

An earlier attempt to impose such a tax failed in 1971 -- the victim of a grassroots revolt of the Connecticut citizenry. Two decades later, a majority of the Nutmeg State's citizens remained opposed. A July 1990 poll revealed that

only about 26 percent of the state's residents favored an income tax, down from a record high of 41 percent recorded in early 1989. Seventy percent thought taxes were too high, compared to an average of about 60 percent through most of the 1980's. "Resistance to tax increases is the strongest I've seen in 20 years of polling," said … the [polling] center's director.[5]

The passage of the income tax was a triumph for the politicians, unions, and left-wing activists who had never given up their desire to tax the wages and salaries of Connecticut's workers. Overcoming both fiscal tradition and strong public opposition, their once-unimaginable victory would have profound impacts on the state's economic and fiscal health.

A decade and a half after it passed the legislature by the narrowest of margins -- and was quickly signed into law by a governor who refused to consider any alternatives -- it's time for an examination of the consequences of Connecticut's income tax.

What Was -- And Wasn't -- Done

In the summer of 1991, at the height of the budget crisis, a poll found:

Eighty percent of Connecticut residents consider state spending "too high," the highest percentage for such a response since … 1979. Forty-nine percent of Connecticut residents regard state government as "especially wasteful" compared with that of other states, also the highest percentage … for such a response since 1979. That figure was 21 percent higher than the figure … recorded in February.[6]

Nutmeggers who remember the lengthy budget standoff of 1991 are sure to recall talk of program "cuts," employee "layoffs," and government-union "concessions," but in the fullness of time it is now clear that actual reductions in state spending did *not* take place. As Table 1 indicates, Connecticut's budget continued to grow, in both current and inflation-adjusted amounts, through the period of "crisis." Between the 1988 and 1993 fiscal years, the time of maximum fiscal strife, the budget rose by an astonishing 25.7 percent in real dollars.

Table 1
Connecticut General Budget Expenditures, 1988-93 (in billions)

Fiscal Year	Current Expenditures	Real Expenditures
1988	5.66	9.69
1989	6.43	10.50
1990	7.07	10.95
1991	7.71	11.46
1992	7.96	11.49
1993	8.69	12.18

source: Connecticut Office of Fiscal Analysis publications; inflation adjustments based on Federal Reserve Bank of Minneapolis online calculator

Since legislators and Weicker (as well as his predecessor, William A. O'Neill) were unwilling to cut -- or even freeze -- spending, they needed to augment declining collections from sales and corporation taxes with a new source of revenue. They found that source in Connecticut workers' paychecks.

Several income-tax plans, some with flat and some with escalating rates, were proposed throughout 1991. The tax that finally won approval was a hybrid. On the surface, the plan had a flat rate of 4.5 percent. But a complex system of exemptions and credits -- one that remains largely in place today -- played havoc with the rate, causing it to be anything but flat. As *The New York Times* noted:

[T]he way exemptions and credits decline as income rises leads to "bubbles" in the tax rate at some levels. A couple earning $50,000, for example, will owe $1,071, according to state tax charts. If they earn $60,000, they will owe $1,944, or $873 more. The additional $10,000 in income will be taxed not at 4.5 percent, but at 8.73 percent.[7]

The levies placed on capital gains (7 percent) as well as interest and dividends (from 1 to 14 percent) were folded into the tax on wages and salaries.

The plan included a cut in the state sales tax, from 8 to 6 percent. But this relief was mitigated by an expansion of the sales-tax base to include over 150 additional transactions, including such things as miniature golf, livestock purchases, labor on home improvements, television and radio equipment, warranties, and ironically, tax-preparation services.[8]

A "spending cap" statute was also passed, and put before voters in the form of a referendum to put the measure in the Connecticut Constitution. (See appendix.)

Aside from the income tax, the reform that received the most attention was a "pro-business" cut in the state's highest-in-the-nation corporation tax.

Supporters of the state's new income tax -- *The New York Times* called it "a striking advance"[9] -- believed it was more than a solution to Connecticut's short-term budget imbalance.

Advocates claimed (and continue to claim) that Connecticut's primary reliance on an "inelastic" sales tax and a "very volatile" corporation tax[10] needed to be replaced with a central reliance on an income tax that offered "a sounder revenue base to enable the legislature to meet the state's needs."[11] The previous system was a "fiscal throwback" that made it "it impossible to predict or plan long term."[12]

But the benefits didn't end there, supporters averred. A lower sales-tax rate would reduce costs for businesses, which paid a substantial portion of the state's sales-tax revenue. And since a sky-high corporation tax hindered Connecticut's economic competitiveness, some relief from it would "create economic activities in the state of Connecticut which will provide a standard of living which our people deserve through the 1990s."[13]

A reduced sales tax rate, the conventional wisdom held, would also make the state's tax burden less "regressive," thus boosting the economic prospects of lower-income families.

Fiscally Incorrect

Fifteen years later, it is clear that the rosy predictions of income-tax supporters were wildly off the mark.

We have already seen how despite the promises of Weicker and legislators, actual, lasting budget cuts played no role in restoring Connecticut's fiscal balance -- the largest tax increase in state history and heavy borrowing were used to close the gap.

Today, even after adjusting for both inflation and population, Connecticut spends more tax revenue and has more employees on its payroll than it did in 1991. It is now clear that legislators such as State Rep. Robert Farr, who was "willing to accept an income tax in exchange for the downsizing of state government,"[14] were duped.

But close scrutiny of the revenue side of the state budgeting process also exposes the failures of 1991's tax shift.

Collections from the income tax proved to be more prone to economic downturns than the levy's supporters implied. In the recession that began at the start of the new century -- which just as the previous downturn, was more severe in Connecticut than in the nation as a whole -- budget deficits returned. Revenue collections from the income tax fell in both the 2002 and 2003 fiscal years. (In contrast, revenue from the sales tax fell in only 2002.)

A return to budget deficits also brought the kind of fiscal friction and trickery cited by income-tax supporters as a key reason to adopt the levy in the first place. In 2002 the state's budget reserve, commonly known as the "rainy day fund," was exhausted with a single withdrawal of almost $600 million. In addition, one-time revenue infusions, the floating of "economic recovery notes," starting a new fiscal year without an approved budget, and numerous hikes in non-income tax rates all reappeared, in a veritable rerun of the events of the late 1980s and early 1990s.

The most recent budget imbalance exposed an ugly truth: Connecticut's new, income-tax reliant fiscal structure simply couldn't keep up with state politicians' appetite for revenue. As Table 2 shows, in both the period immediately after adoption, and again during the last few years, the income tax was repeatedly augmented with hikes to existing taxes -- as well as entirely new levies.

Table 2
Notable New Taxes/Tax Hikes Enacted In Connecticut Since 1991

Year	Tax Change
1992	corporation tax extended to nonprofits' business income
	hotel and lodging tax extended to campgrounds
	sales tax expanded (transportation services, raw materials bought out of state, golfing services)
1993	cigarette tax increased 2¢
	AMT for income tax imposed
	sales tax expanded (hospital patient-care services, shipping charges, consulting services, prefab homes)
1994	cigarette tax increased 3¢
	insurance-premium tax extended to HMOs

	1 percent surcharge on dry cleaning
2001	cigarette tax increased 61¢
2002	$250 annual tax imposed on limited liability companies, S corporations and partnerships
	corporations required to pay $250 minimum tax regardless of credits
	per-gallon diesel tax increased 8¢
	sales tax expanded (self-storage rentals)
	3 percent rental-car surcharge expanded to rental trucks
2003	**income-tax rate raised from 4.5 to 5 percent**
	20 percent surcharge on corporation/business tax
	sales tax expanded (health clubs, newspapers and magazines)
	temporary death tax on estates over $1 million
	5 percent gross earnings tax imposed on satellite television providers
	cigarette tax increased 40¢
	local real-estate conveyance tax increased to 0.25 percent (0.50 percent for 18 municipalities)
2004	25 percent surcharge on corporation tax
2005	state death/gift tax imposed
	petroleum-products gross earnings tax increased 40 percent by 2014
	6 percent tax on nursing homes imposed

While a few tax changes in the post-1991 era did aid some taxpayers (e.g., a property-tax credit applied to homeowners' income-tax obligations, a separate 3 percent rate applied to initial taxable income, additional cuts to the corporation-tax rate), the benefits of these reductions proved illusory. Between 1992 and 2004 inflation-adjusted, per capita state tax collections rose from $3,459 to $4,072 -- an increase of over 17 percent.[15]

The story is the same for municipal taxation, which deserves inclusion in any analysis of state finances. Connecticut's local and state expenditures are not separate, but significantly interconnected. The state mandates programs that municipalities must provide, and aggressive lobbying by local officials drives up the amount of state revenue distributed to cities and towns.

The revenue generated by the state's post-1991 fiscal infrastructure generated no lasting relief for Connecticut's property owners, who now bear the second highest per capita tax burden among the 50 states.[16] As Table 3 indicates, collections from the property tax continued to rise, climbing by 19.8 percent (far higher than population growth) in real terms between 1991 and 2003, the most recent fiscal year for which the state has provided data.

Table 3
Total Connecticut Property-Tax Revenue Collections (in billions)

Fiscal Year	Revenue (inflation adjusted)
1991	5.76
1992	5.97
1993	6.06
1994	6.07
1995	6.06
1996	6.02
1997	6.07
1998	6.10
1999	6.17
2000	6.18
2001	6.30
2002	6.61
2003	6.90

source: "Municipal Fiscal Indicators," Office of Policy and Management; inflation adjustments based on Federal Reserve Bank of Minneapolis online calculator

As the data in Table 4 indicate, between the late 1980s and 2006, the portion of total personal income earned in Connecticut that was claimed by state and local government climbed from 9.3 to 11.3 percent.

Table 4
Percentage of Connecticut Personal Income Devoted to State/Local Taxes

1988	9.3
1989	9.4
1990	9.7
1991	10.5
1992	11.0
1993	10.9
1994	11.2
1995	11.4
1996	11.4
1997	11.5
1998	11.7
1999	11.5
2000	11.2
2001	10.8

2002	10.7
2003	10.8
2004	10.8
2005	11.3
2006	11.3

Source: The Tax Foundation

It's also worth noting that during this period, the amount of state personal income that was sent to the federal treasury rose from 22.5 to 24.6 percent.[17] When the federal and state-local tax burdens are combined, Connecticut's citizens bear the highest tax burden in the nation.

Liberal public-finance analysts were downright gleeful when Connecticut's income tax became law. Federation of Tax Administrators Executive Director Harley T. Duncan believed that the Nutmeg State's farsighted politicians were blazing a trail for others: "I would not be surprised to see three or four other states adopt a personal income tax, not this year but certainly over the next several years. The most likely prospects are Texas, Tennessee and New Hampshire, and possibly also South Dakota."[18]

The Nutmeg State was "finally … facing up to the inevitable," agreed Steven D. Gold, director of the Center for the Study of the States at the State University of New York. Others were sure to follow: "I think Connecticut is the first of numerous states that will have to pass an income tax in the 1990s."[19]

Fifteen years later, no state that did not have an income tax in 1991 has adopted one.

Welcome to Harder Times

"A good rule of thumb," observed N. Gregory Mankiw, former chairman of the White House's Council of Economic Advisers, "is that when you tax an activity, you get less of it."[20]

Skeptics of Mankiw's aphorism need look no further than Connecticut to gauge its accuracy. Since Connecticut began to tax working, net job creation has ground to a halt.

Economists, politicians, and reporters frequently cite the fact that Connecticut has yet to regain the number of jobs it had at its period of peak employment in the summer of 2000. But a recent Federal Deposit Insurance Corporation report revealed that the problem goes back even further -- since the early 1990s, "no other state in the country has had such stagnation in employment."[21]

As Table 5 indicates, employment growth since adoption of the income tax has been almost nonexistent.

Table 5
Connecticut Nonfarm Employment

Year	Employment	Growth
1976	1.32 million	
1991	1.71 million	29.5 percent
2006	1.72 million	0.6 percent

source: Connecticut Department of Labor (average of monthly nonfarm employment; seasonally adjusted; 2006 average is for January-June)

In contrast, U.S. employment has risen by over 20 percent since 1991.[22]

Unlike employment, Connecticut's total personal income did grow in the post-1991 era. But according to federal earnings data, the rate of growth slowed significantly.

Between 1977 and 1991, total personal income in the Nutmeg State expanded by an inflation-adjusted 45.3 percent. During the same period, the nation's total personal income grew by only 37.2 percent.

Between 1991 and 2005, however, the roles reversed. Connecticut now lagged the national income-growth figure. From 1991 to 2005, personal-income growth was 42.0 percent for the nation, but only 33.2 percent for Connecticut.[23]

A different economic measurement provides even more disturbing findings. Unlike total personal income, which can be skewed by a relatively small amount of extremely affluent individuals, median household income offers a depiction of the conditions of a "typical" household -- half earn more than the median figure, half earn less.

Between 1991 and 2004, the most recent figure available from the U.S. Census Bureau, median household income in the Nutmeg State fell by almost $3,300. In contrast, the national figure rose by almost $2,800.[24]

Many continue to insist that Connecticut is "the wealthiest state in the union," based on the state's unquestionably high per capita income. But when one accounts for the high cost of living, this claim starts to crumble. For example, the price of electricity in Connecticut is now 66.8 percent higher than the national average.[25] Housing, groceries, transportation and healthcare are all significantly more expensive in Connecticut. So while incomes may be lower in other states and regions, a lower cost of living -- which usually includes a substantially lower tax burden -- has made them more attractive to residents of the Nutmeg State who are willing to accept lower pay (on paper) if it means a better quality of life and greater purchasing power.

In the last decade and a half, a high number of Nutmeggers have done just that. In the 1990s, Connecticut was one of only two states to lose population.

That should not have come as a surprise. Research shows that high-tax states such as Connecticut have been losing population to low-tax states for decades. In 1991, the *Wall Street Journal* warned states that were considering the imposition of income taxes that

during the 1980s, the 10 states with little or no income tax saw population growth that on average was 9 percentage points above the national average. Nevada, the state with the lowest taxes on the wealthy, grew by 41%. The so-called "tax fairness" states grew 2.4 percentage points below the national average, with sunny California the lone boom state.[26]

Migration patterns remained consistent in the 1990s. A 2003 report by The Taxpayers Network documented that from 1990 to 1999, over 2.6 million native-born Americans moved from high-tax states to low-tax states -- "a migration of about one thousand persons per day for each business day during this period."[27]

Between 1990 and 2002, over 240,00 native-born Americans fled Connecticut.[28] (Immigration -- legal and illegal -- helped lessen the state's overall population loss.) This exodus is likely to have serious repercussions, warns research fellow Matt Ladner: "States with flat and declining populations face relative economic stagnation as people move to more dynamic parts of the country."[29]

Young adults have demonstrated a particular eagerness to leave Connecticut. A 2005 Connecticut Economic Resource Center report revealed that in the 1990s, "Connecticut had the greatest relative loss [in the 18-to-34-year-old age group] of any state, with a 23 percent decline, or more than 200,000 fewer people in this age bracket at the end of the decade."[30]

Finally, the "progressive" consequences promised by so many income-tax supporters have, in many ways, failed to materialize. It is curious that the same politicians and activists who lobbied so strenuously against the state's allegedly "regressive" tax structure in 1991 now bemoan the widening gap between rich and poor in Connecticut.

According to Connecticut Voices for Children, a leftist lobbying group: "The state's lowest-income families experienced the steepest drop in real (inflation-adjusted) income in the nation in the 1990s. In real dollars, Connecticut's lowest-wage workers earned less in 2004 than they did in 1990."[31]

The current state-local tax burden also falls disproportionately on lower-income families. Connecticut liberals frequently cite an Institute on Taxation and Economic Policy report that found the 80 percent of Nutmeg State families that earn less than $97,000 pay 9.75 percent of their incomes to state and local taxes, while the 1 percent of families that earn over $471,000 pay only 4.4 percent.[32]

Fool Me Once...

Even at the time, the assumption that enactment a broad personal-income tax was wise for both fiscal and economic reasons flew in the face of years of reputable research. Starting in the 1970s and continuing through the following decade, economists and public-policy researchers had documented the undesirable outcomes of high tax burdens. A study by Harris Bank

pioneered the research in the area of state and local taxes and economic growth. Robert Genetski and Young Chin calculated relative total tax burdens and relative personal income gains for all 50 state in their groundbreaking 1978 study "The Impact of State and Local Taxes on Economic Growth." They demonstrated that states that increased their tax burdens experienced lower rates of personal growth.[33]

Analysis throughout the 1980s mirrored these results. One study by the congressional Joint Economic Committee concluded:

The evidence is strong that tax and expenditure policies of state and local government are important in explaining variations in economic growth between the states -- far more important than other factors frequently cited such as climate, energy costs, the impact of federal fiscal policies, etc. It is clear that high rates of taxation lower the rate of economic growth, and that states that lower their tax burdens are rewarded with an enhancement in their economic growth.[34]

In the post-1991 period, this assessment continued to be confirmed by researchers. The Joint Economic Committee replicated its earlier findings in 1995, and a 1996 analysis by the Federal Reserve Bank of Atlanta found that "tax rates are negatively related to growth and are sufficiently variable over time to reasonably explain variations in growth rates."[35]

Research in the new century brought more corroboration for the theory that large state tax burdens stifle economic growth, drive workers and investment away, and fail to generate revenue that matches politicians' expenditure habits. For example, a 2001 U.S. Census Bureau report documented that three states with no income taxes generated the *largest* revenue gains between 1990 and 2000. Energy-related revenue growth played a role with two of the states -- Alaska and Wyoming -- but that wasn't the case for New Hampshire, which ranked at the very top.[36]

In 2002 an American Legislative Exchange Council (ALEC) report compared the economic performance of states since the recession of the early 1990s. Economist Stephen Moore discovered that the states which had relied the most on tax hikes to close fiscal imbalances "had among the worst subsequent rates of economic growth." In addition, "their budget problems persisted longer than states that did not raise taxes."

The ALEC report ranked the economic performance of the 50 states between 1990 and 2000. Connecticut placed 47th in population growth, 41st in real personal-income growth, and dead last in job creation.

"Governors attempted to enact 'soak the rich' tax hikes in the early 1990s," Moore concluded, "only to see their state plunge into even deeper pools of red ink and endure further economic downturn."[37]

In 2003, budget analyst Steven Slivinski observed that "forty years of evidence shows that comparative tax burdens matter. If a state has a higher tax burden than its competitor and neighboring states, it will be at an economic disadvantage by handicapping its potential for economic growth."[38]

Back, to the Future?

A discussion of alternatives to Connecticut's failed income-tax experiment lies beyond the scope of this analysis. But a few points bear attention, because some of the most compelling current research on efficient, pro-growth reforms of state taxation relates directly to Connecticut's fiscal history.

In addition to documenting the detrimental effects of high state tax burdens, researchers have begun to discover that not all taxes have an equal effect -- i.e., some taxes are more harmful than others.

Economist Richard Vedder, a leading authority on state and local taxation, believes "the income tax is the champion of bad taxes, in terms of its destructive effect on people, prosperity, and their economic well-being."[39]

Debra Roubik, chief economist of VisionEcon, agrees:

All of the virtues that are typically honored by financial rewards -- virtues such as thrift, enterprise, hard work and innovation -- are the same virtues discouraged by the income tax. While some may believe that such an income redistribution only works to level the playing field, in reality, tax policies that attempt to redistribute have been proven to demolish the playing field instead.[40]

Florida State University Professor Thomas R. Dye is one of many analysts who believes that graduated income-tax rates add an extra element of destructiveness:

It is not only the total tax burden that creates disincentives to economic growth, but also the types of taxes governments choose. Consumption-based taxes, notably state sales taxes, may not have the same negative effect on productivity as corporate or individual taxes. It is true that sales taxes are paid out of personal income, but it is consumption that is being taxed directly, not work, savings, or investment. Income taxation with graduated rates has a more harmful effect because it substantially lowers the rate of return on the work and savings of the most productive citizens. Even relatively modest overall tax burdens can have a very adverse effect on economic growth if these burdens are carries disproportionately by the most productive individuals and firms. These individuals and firms are usually the most mobile, and a state income tax with a high top rate creates a strong incentive to relocate.[41]

Throughout the conflict of 1991 and continuing to the present day, Connecticut income-tax proponents have had no adequate answer to this simple question: In what way was a tax structure that permitted inflation-adjusted spending growth of 64.3 percent during the '80s somehow "inadequate"?

In light of the manifest failures of Connecticut's income tax to produce the fiscal and economic benefits its advocates predicted, it may be time to examine whether the state would be better served by a shift away from taxing income and toward -- once again -- taxing retail sales.

Vedder argues that

empirical evidence generally suggests that consumption taxes have far fewer adverse economic effects than income and property levies. The reason for this is simple. Income taxes and property taxes penalize productive activity. They tax enterprise and creativity (unless you are a tax lawyer) and in so doing, they discourage such activity. Consumption taxes, on the other hand, while they do discourage some consumption, through the absence of production taxes may encourage individuals to just work harder to overcome the consumption tax burden.[42]

Economist Byron Schlomach of the Texas Public Policy Foundation lists the virtues of his state's consumption tax:

* Simplicity -- generally low compliance costs

* Does not favor big business over small business by putting a premium on the skill of CPAs and tax attorneys

* Transparency -- people know the true cost of government

* Horizontal equity -- those similarly situated pay the same (partly due to simplicity)

* Does not directly discourage work effort, job creation, or investment

* Is less likely to "pyramid" (build on itself and distort economic decisions)

* Does not depend on the structure of the economy or major industries to fund government[43]

Skeptics of the benefits of consumption taxes are confronted with the fiscal reality -- not the theory -- of states such as Florida, Texas, and Nevada, which have impressively grown their economies and populations despite their heavy reliance on sales taxation.

Increasingly, a comprehensive retail-sales tax on all goods and services is being explored by tax researchers and reformers at the state and federal level. Their belief, backed by compelling evidence, is that eliminating income taxes not only reduces the inefficiencies brought on by compliance costs, but removes disincentives to work, save and invest. (Most sales-tax-oriented reform proposals feature a rebate program that would compensate low-income households for their payment of sales taxes on basic necessities.)

Connecticut's decisionmakers would be wise to follow this discussion closely, and consider whether such a shift might correct the obvious inadequacies of the Nutmeg State's present tax structure.

Conclusion

In a 1993 postmortem on the income-tax battle, former legislator Miles Rapoport foresaw a bright future for the Nutmeg State:

We are hopeful that we have constructed a platform of fiscal stability that will allow us to move on to these other critical areas of state responsibility -- health care reform, education, poverty, and so on. If we can do that, it will only be because of the victory, long in coming and tremendously hard won, of fiscal *sanity and of a public sector with the capacity to deal with the very serious issues we continue to face. Of that victory, and of the years of organizing that made it possible, people in Connecticut can be justly proud.*[44]

Fifteen years of actual experience have exposed Rapoport's vision as profoundly (almost laughingly) naïve. Connecticut's government-school system has become *less* efficient in the last decade and a half. Poverty and urban violence remain intractable problems that no amount of public expenditures seems able to halt. "Fiscal stability" failed to materialize after 1991, and the budget struggle of 2002 and 2003 closely resembled what occurred a decade earlier. The state and local tax burdens continued to rise in the 1990s and well into the new century. And in many ways, economic conditions in Connecticut, despite a brief period of vibrancy in the late '90s, continued to worsen. Even by some of the metrics so often cited by left-wing activists -- e.g., "income inequality" -- the Connecticut political establishment's decision to tax all personal income in the state has been a disappointment.

To be sure, factors beyond politicians' control have contributed to Connecticut's fiscal and economic woes. Greater international competition, the steady decline of manufacturing employment, and ever-rising healthcare costs have all played a role. But other states in the Northeast and throughout the nation face these challenges as well (and some additional obstacles of their own, such as workforces that are far less educated than Connecticut's) while still managing to boost their economies, grow their populations, and preserve low tax burdens.

Proponents of Connecticut's income tax have much to answer for. Their proposal both failed to achieve lasting fiscal benefits and was unable to turn around a sagging economy.

With a decade and half of hindsight, it is now clear that passage of Connecticut's income tax was an act of fiscal irresponsibility justified by a "crisis" generated by a decade of fiscal irresponsibility. Failure to address the fundamental problem -- i.e., runaway state spending -- combined with a massive tax hike and tedious (and ultimately, pointless) bickering over what minor tax cuts to pass left the vast majority of Nutmeg State's workers, taxpayers, families, and businesses worse off.

It's time for a sober discussion of the consequences of Connecticut's income tax -- one that is driven by data, not emotions, class warfare, and wishful thinking. Only then will citizens and elected officials be able to fix the mistakes of 1991, and thus place the state's finances and economy on a firmer foundation.

Appendix: The 'Cap' That Never Quite Fit

The "spending cap" is probably the most misunderstood component of Connecticut's complicated fiscal infrastructure.

The measure was passed by the legislature -- very narrowly -- during the budget standoff of 1991. But it was also put to voters, as an addition to the state's constitution, in a statewide referendum. (In November 1992, voters approved the cap by a 4-to-1 margin.)

Both the cap's statutory and constitutional language state that Connecticut's "general budget expenditures" for any fiscal year cannot exceed spending in the previous fiscal year "by a percentage which exceeds the greater percentage increase in personal income or percentage increase in inflation."

But the constitutional amendment submitted to voters in 1992 left it up to *legislators* to define the cap's three key terms: "increase in personal income," "increase in inflation," and "general budget expenditures." And *three fifths* of legislators, not a simple majority, were needed to agree on the definitions.

Fourteen years later, the Connecticut General Assembly has not defined the terms by the required margin. Lawsuits to compel lawmakers to do so, filed in both federal and state courts, were dismissed. Furthermore, notes Robert Satter, a judge, former legislator, and expert on the Connecticut legislature,

although the spending cap exists in the statutes, it is not legally binding on the legislature. This conclusion is consistent with the established principle stated in Patterson v. Dempsey*, that one General Assembly cannot "effectively control the enactment of legislation by a subsequent General Assembly." When a legislature does pass a law inconsistent with a prior law, the court added, it impliedly repeals the prior law. Applying this ruling to the statute that created the spending cap, if the General Assembly passes and the governor signs legislation that appropriates funds in excess of the cap, the cap is impliedly repealed for the period of the excess appropriation.*[45]

Even if politicians in Hartford were bound to adhere to the cap, expenditures were (and remain) likely to grow faster than the rate of personal-income growth or inflation. This is because the cap allows for the declaration of "emergency" or "extraordinary" conditions that permit excess spending. Such declarations were made repeatedly in the late 1990s:

In the past three fiscal years, in order to spend budget surpluses, [Governor] Rowland has issued a declaration of "extraordinary circumstances," and he and the legislature have jointly agreed to overspend the caps in those years by a combined $953 million, the nonpartisan Office of Fiscal Analysis noted in a

January memo …. The amounts of overspending were $194.5 million in 1997-98; $525.7 million in 1998- 99; and $232.8 million in 1999-2000.[46]

More recently, Governor M. Jodi Rell declared an "emergency" in order to exceed the cap in an effort to secure more federal subsidies for Connecticut nursing homes.[47]

Even if the cap had not been subverted due to a series of dubious "emergencies," the measure would fail to measure up to the tough standards of other states' spending controls. A 2005 analysis by Americans for Prosperity gave Connecticut's cap a grade of C-.[48]

The major cause of the cap's inadequacy is the list of expenditures that are not subject to any limit, including:

* debt service

* transfers of surplus funds to the budget reserve fund

* statutory grants to "distressed" municipalities

* first-year costs of federal mandates and court-ordered expenditures[49]

Without question, the most egregious of these four exemptions involves state borrowing. As the (Waterbury) *Republican-American* observed in 2005:

Since 1990, the state debt has increased by $9 billion and the state has issued $15.4 billion in bonds. Because of the way lawmakers set up the cap, all this spending was exempt. That includes the $2 billion borrowed to pay the day-to-day expenses of state agencies in the last five years; that $2 billion should have been in the budget and subject to the cap. This year, the staggering state debt will cost taxpayers $1.73 billion; naturally, that's exempt from the cap, too.[50]

Unenforceable, and riddled with loopholes and opt-outs even if it weren't, Connecticut's spending cap is essentially a dead letter. Many politicians in Hartford pay lip service to the measure -- spending plans are often said to be a certain amount "under the cap" -- but in Satter's words:

The spending cap, as it stands now, clearly does not constitute a constitutional limitation on spending by the legislature nor is it binding as a statutory limitation, since any statute can be repealed or amended by a simply majority vote of the legislature and the governor's concurrence. The cap can be (and has been) superseded simply by an act of the legislature appropriating amounts in excess of the limit.[51]

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