

# The State Economy, the State Budget, and Pathways to Opportunity

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February 15, 2018



# Today's Road Map

## The State Economy

Long-Term Trends

Disparate Impact

Future Implications



## The State Budget

Slowing  
Revenue

Increasing  
Liabilities

**Shifting  
Priorities**

Austerity  
Mindset

Federal  
Challenges



## The New Fiscal Restrictions

Spending Cap

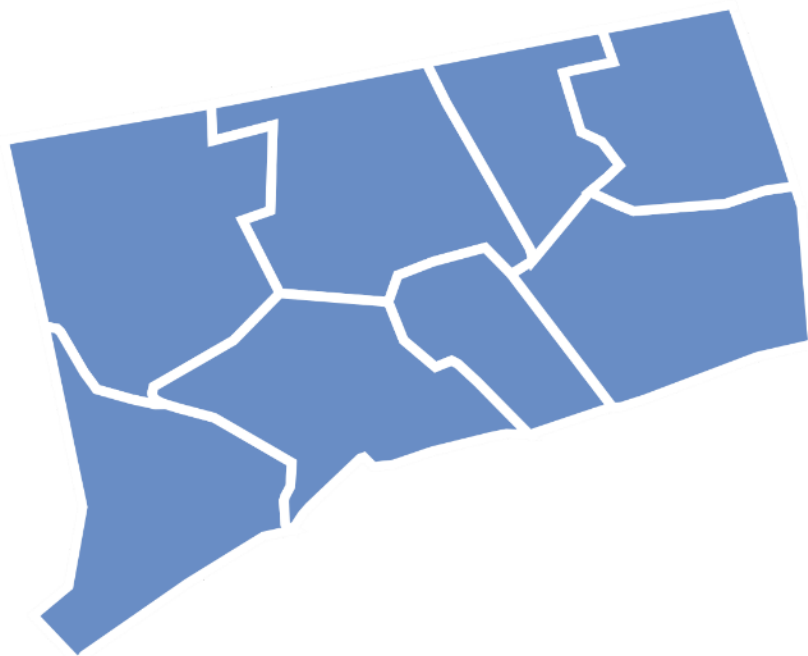
Volatility Cap

Bond Cap

Bond Lock



## Toward Solutions

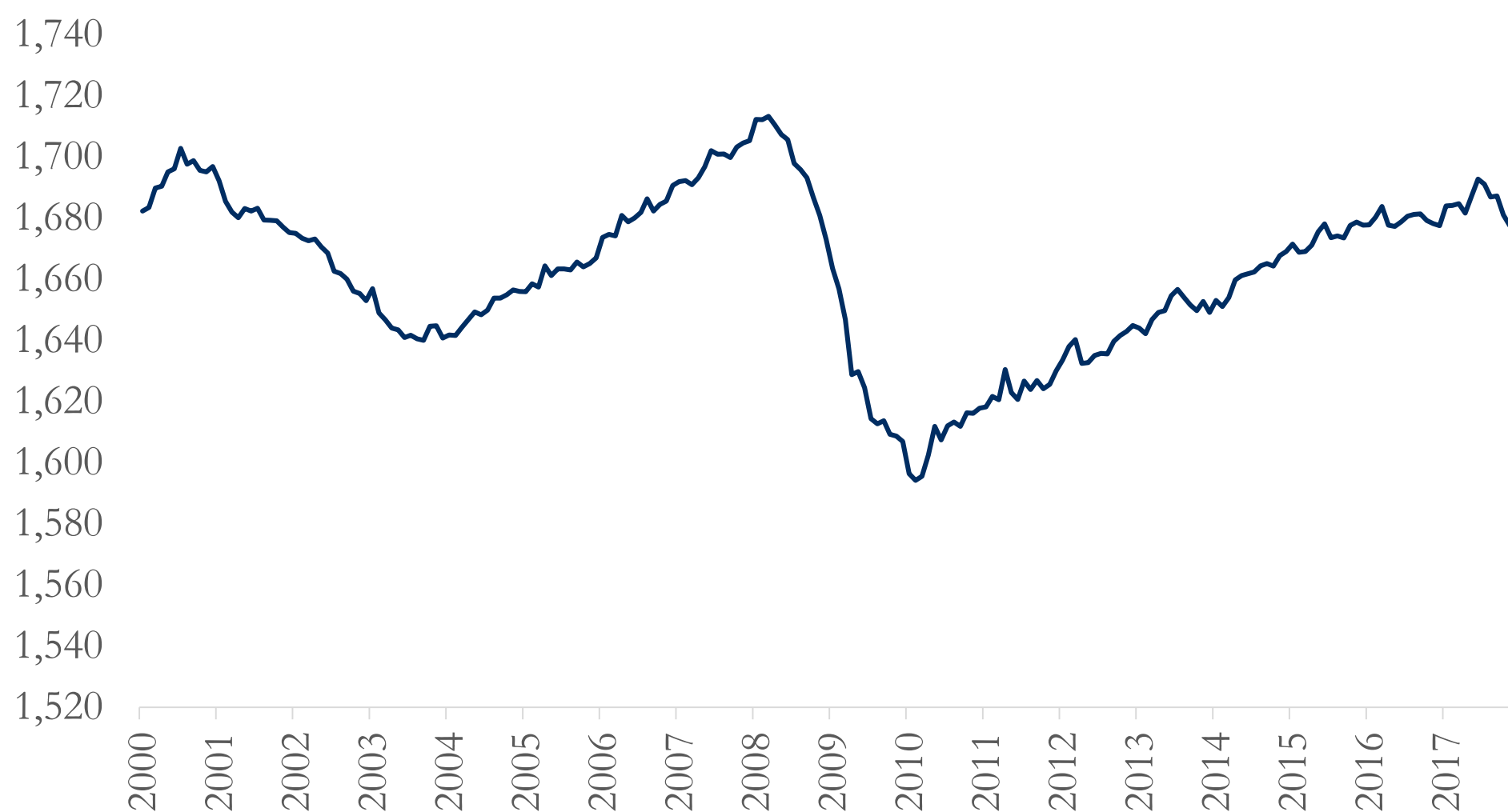


# State of Our Economy

Long-Term Trends

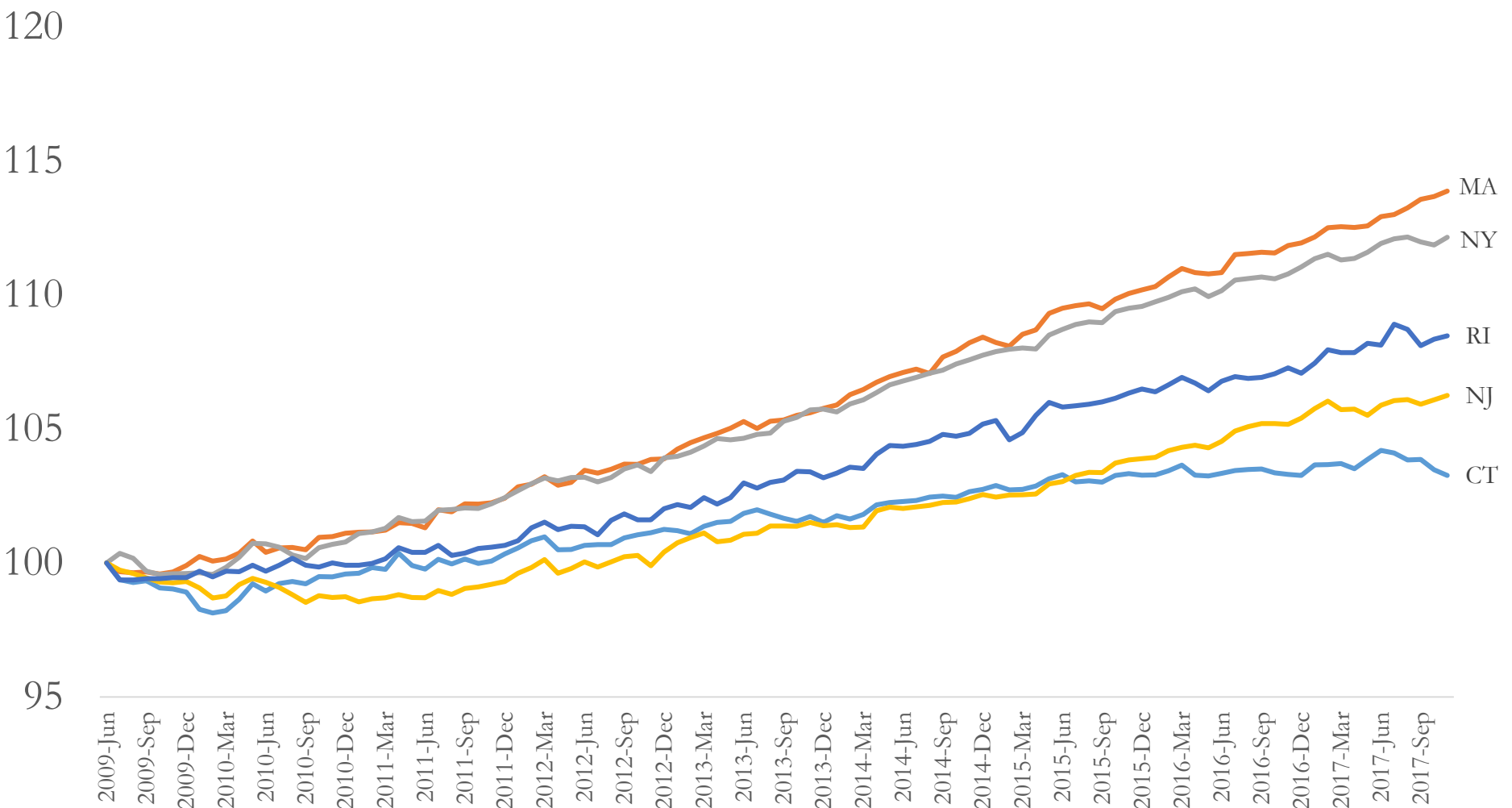
Disparate Impact

Future Implications



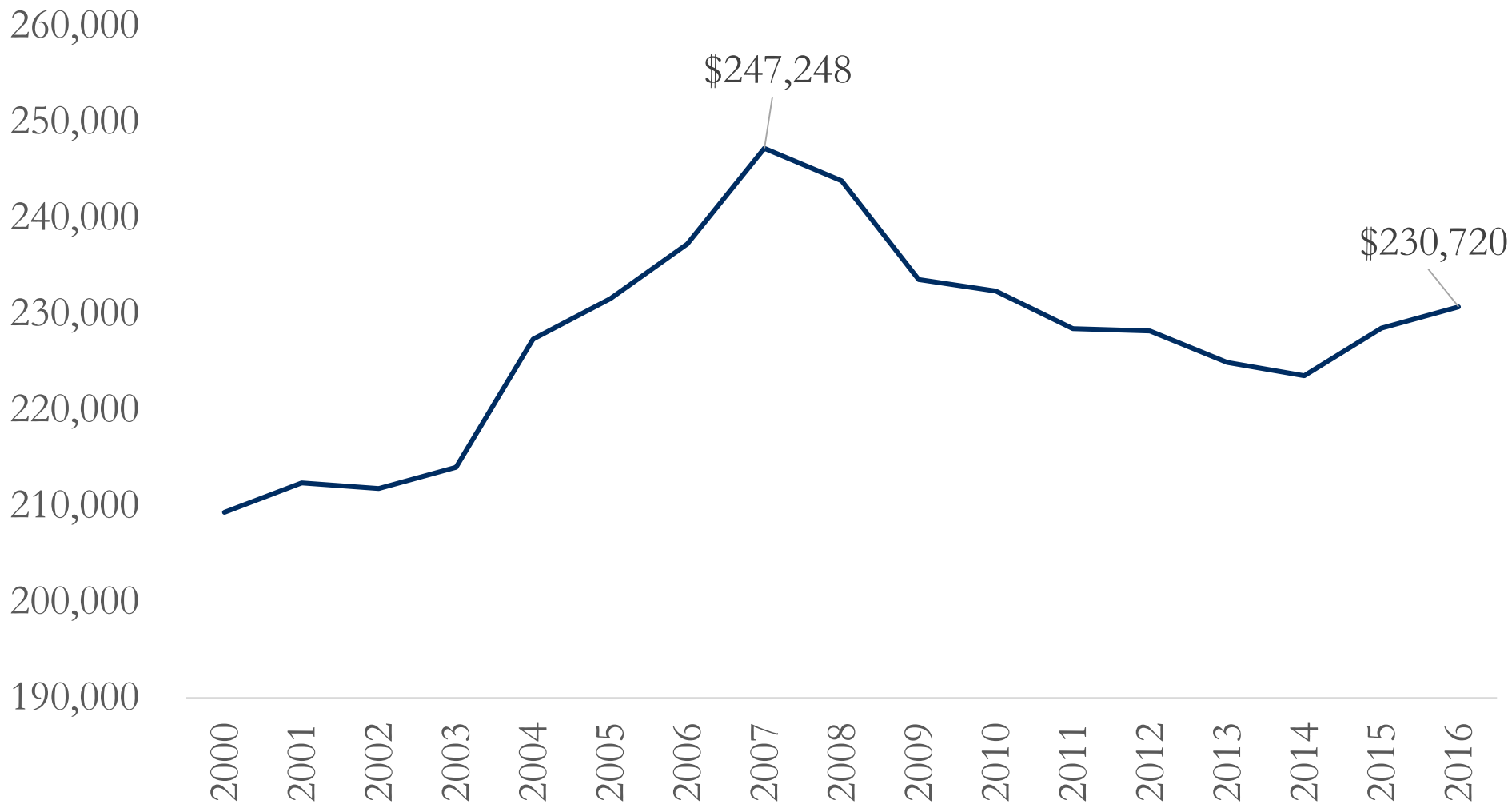
# Job Growth is Slow

All Employees: Total Nonfarm in Connecticut. Thousands of Persons, Seasonally Adjusted.  
Federal Reserve Economic Data: <https://fred.stlouisfed.org/series/CTNA#0>



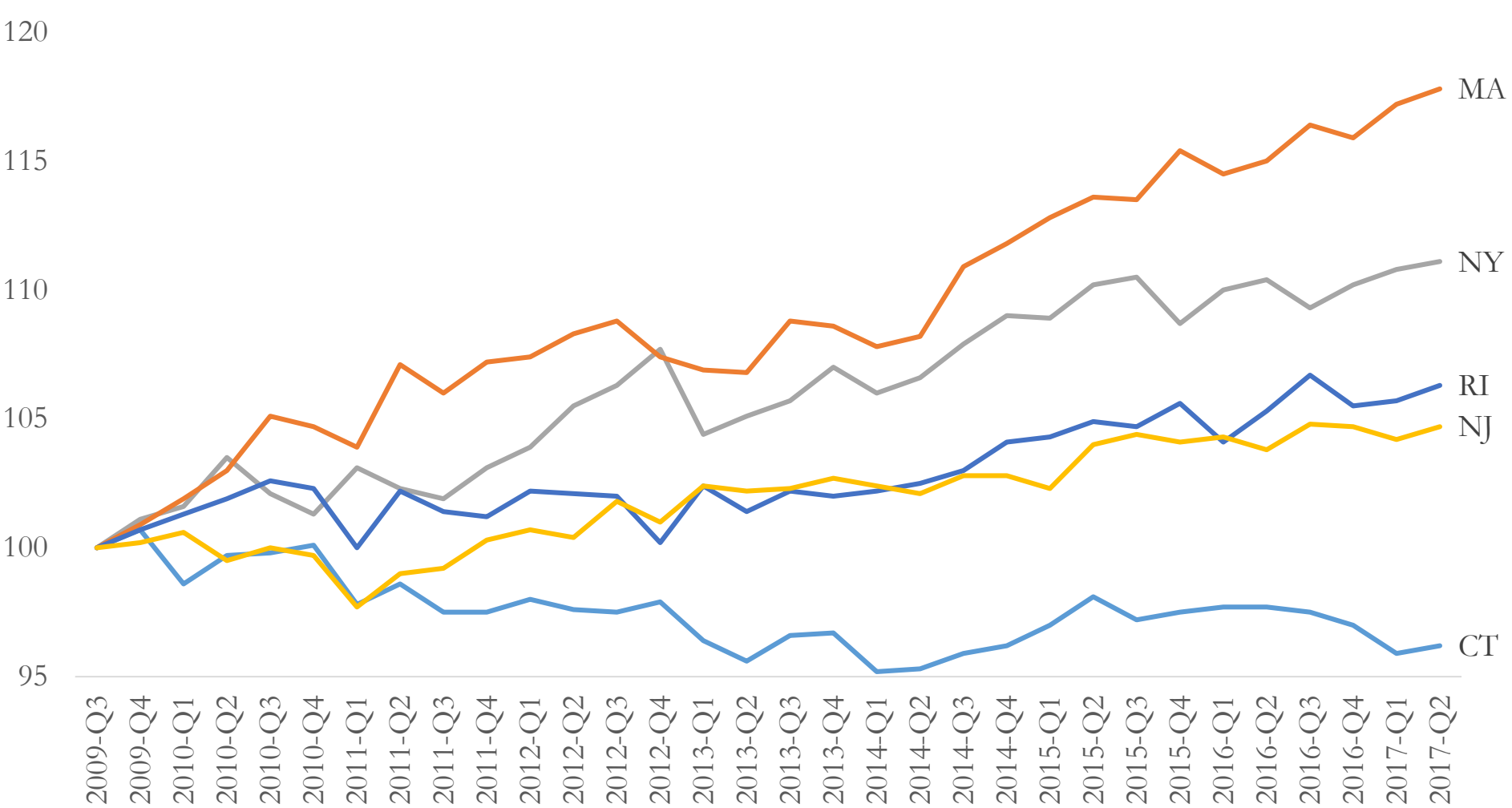
# Job Growth is Slow

All Employees: Total Nonfarm. Thousands of Persons, Seasonally Adjusted. June 2009 = 100. Federal Reserve Economic Data: <https://fred.stlouisfed.org/series/CTNA#0>



# State GDP Has Not Recovered

Real Total Gross Domestic Product for Connecticut, Millions of Chained 2009 Dollars, Annual, Not Seasonally Adjusted. Federal Reserve Economic Data: <https://fred.stlouisfed.org/series/CTRGSP>



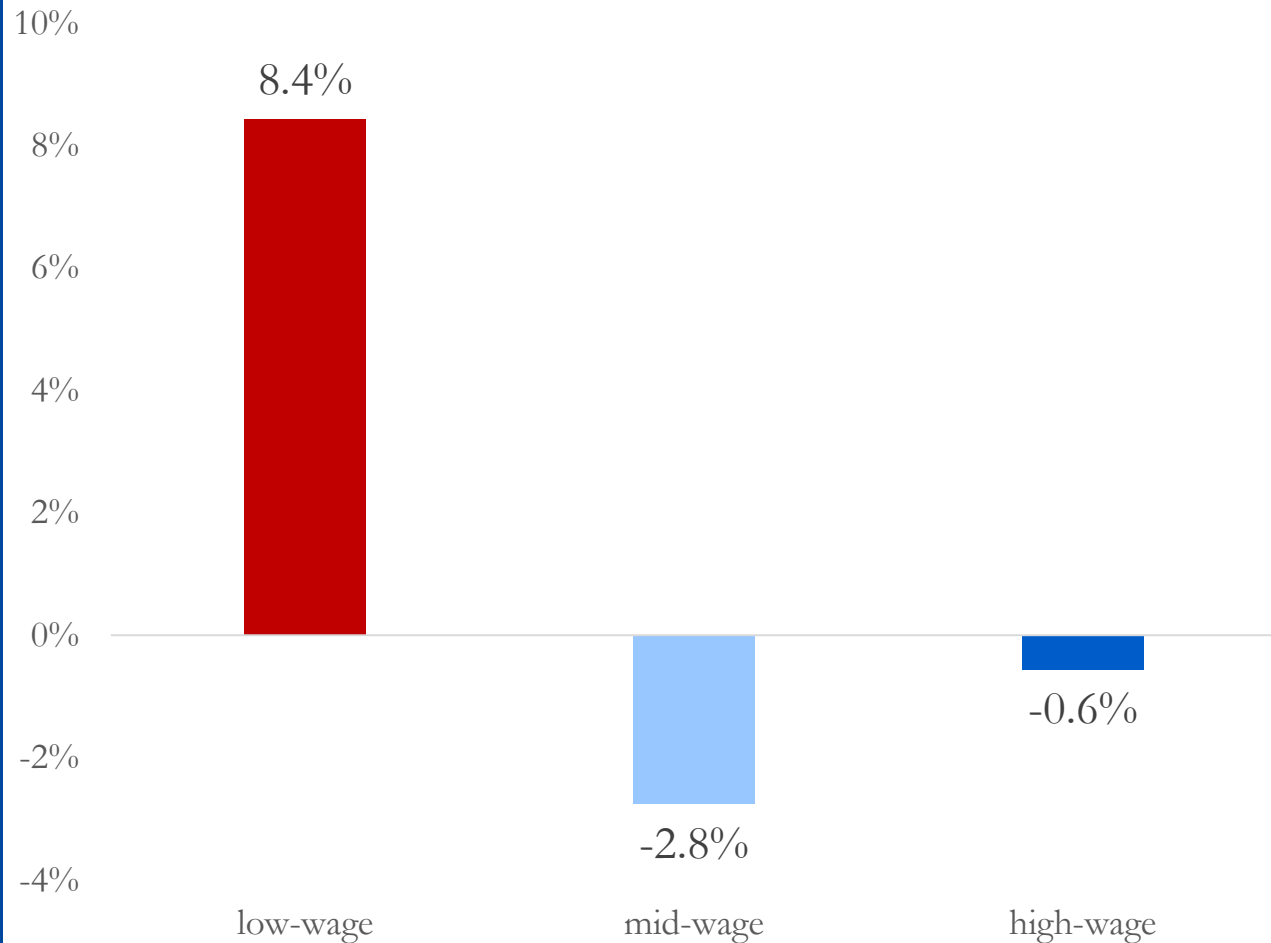
# State GDP Has Not Recovered

Real Total Gross Domestic Product for Connecticut, All Industries. Millions of Chained 2009 Dollars, Quarterly, Seasonally Adjusted. 2009 Q3 = 100. Federal Reserve Economic Data: <https://fred.stlouisfed.org/series/CTRQGSP>

# Shift in Our Economy

The Recovery Has Left Too Many Families Behind

Connecticut, % Change in Number of Jobs, 2011-2016



Source: Economic Policy Institute and CT Voices analysis of Current Population Survey

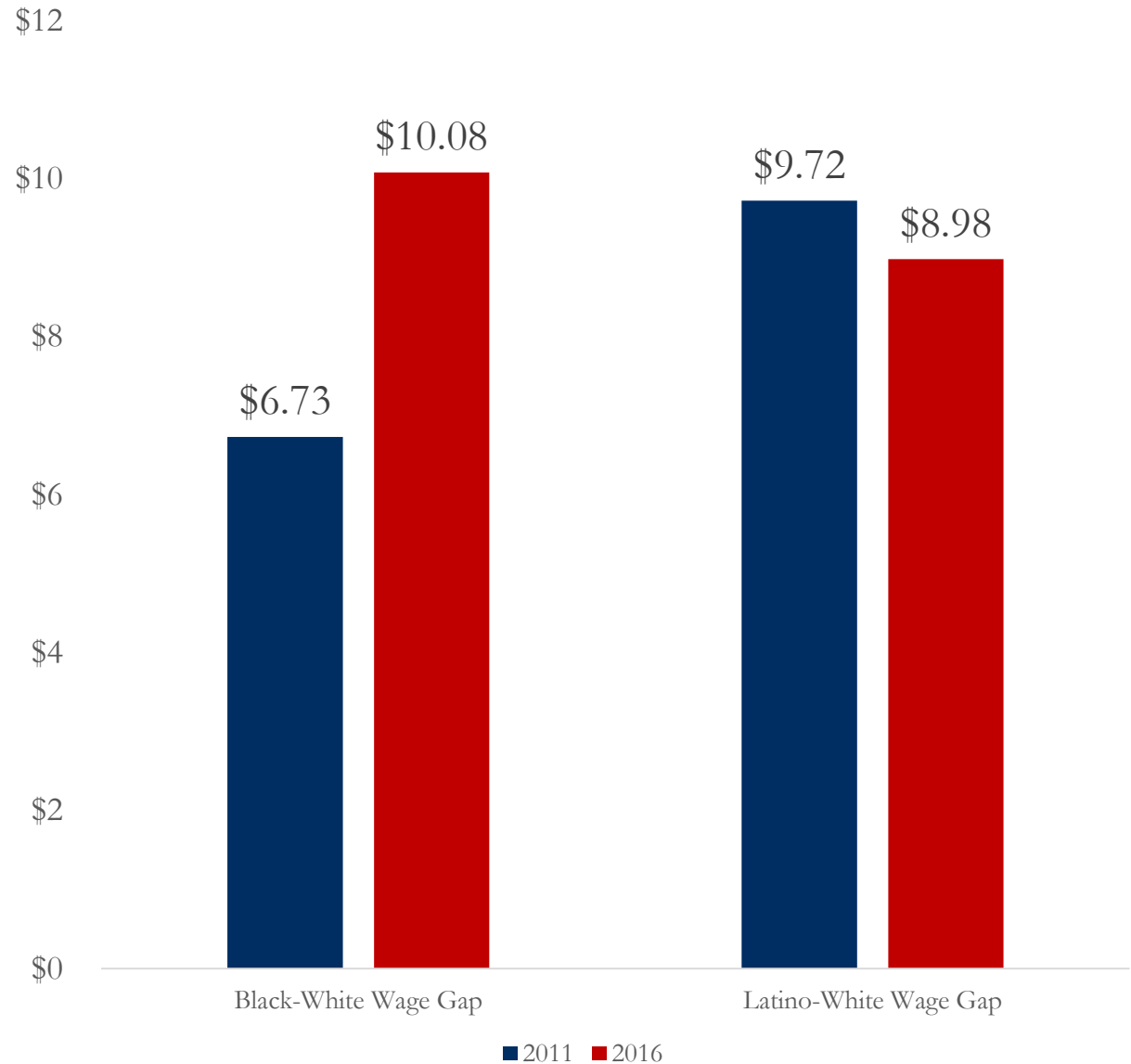
- 9.2% increase in share of low-wage work



# Disparate Impact of Recovery

Wages: Gaps between black and white wages have **increased** since the Great Recession.

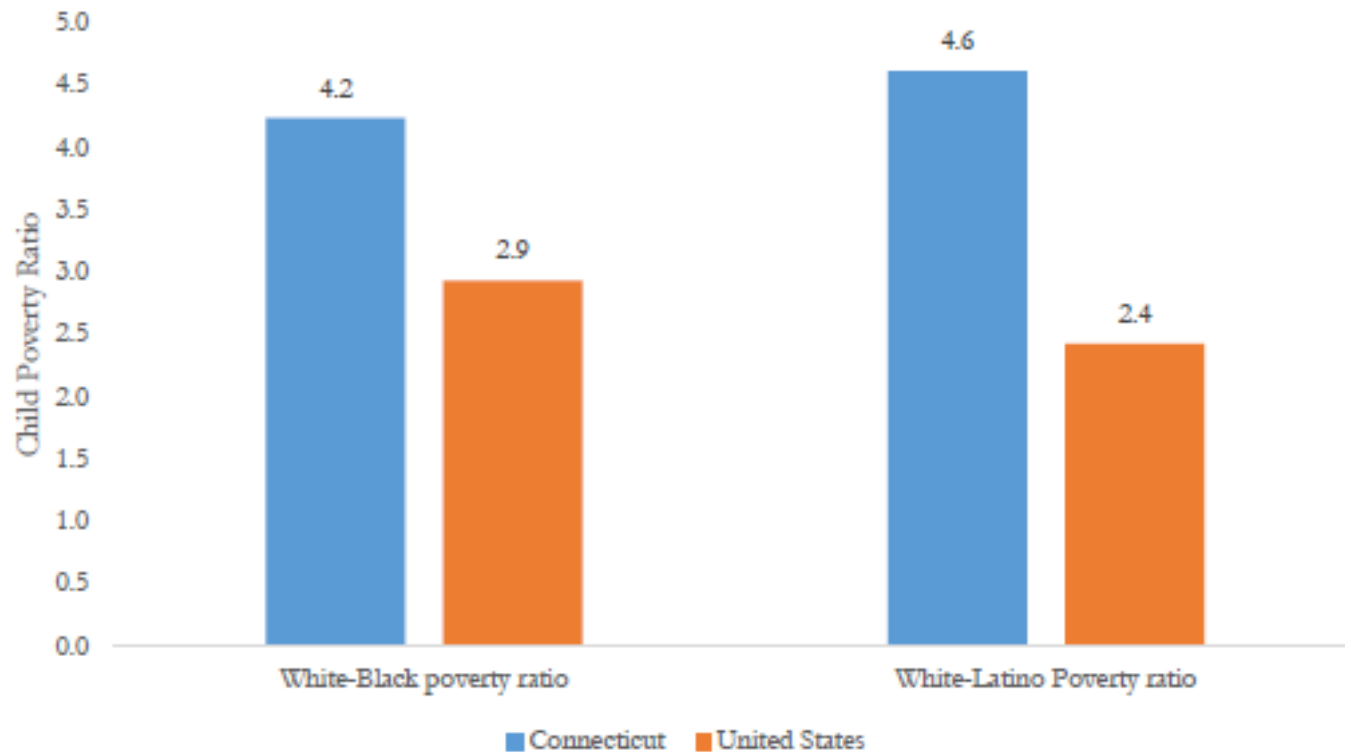
Black-White Disparities in Median Wages Have Increased Since 2011



Source: Economic Policy Institute analysis of Current Population Survey data. 2016 dollars.

## Connecticut's Racial Disparities in Child Poverty Greater than National Average

### Disparities in Child Poverty Rates by Race and Geography, 2016



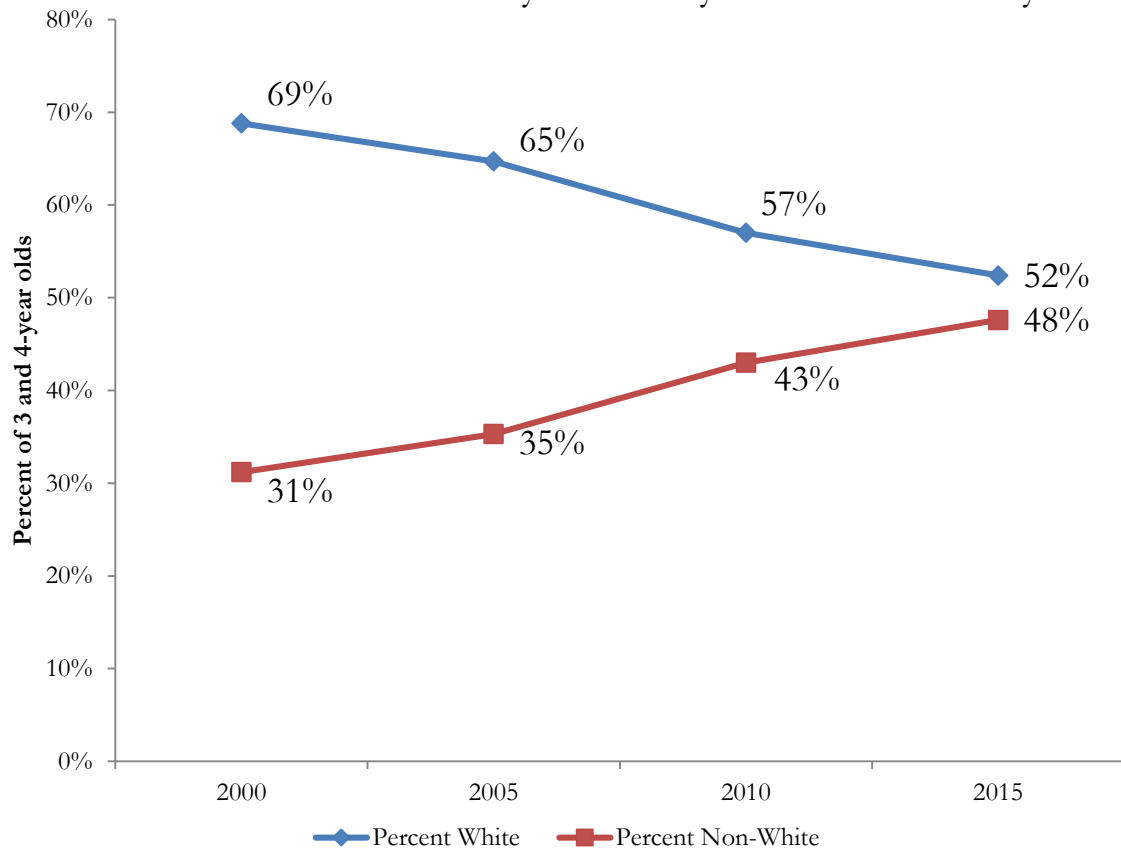
Source: CT Voices analysis of American Community Survey. Ratio of Black/Latino child poverty rate to white child poverty rate.

# Disparities in Child Poverty

Higher than national average

# Racial Disparities Matter: We Are Truly *In It Together*

Connecticut's 3 and 4-year olds by Race and Ethnicity



American Community Survey one-year estimates

## The Devastating Effects of Poverty

**Living in or near poverty increases the chance a child suffers toxic stress.** Studies have shown toxic stress in children can lead to lifelong problems in learning, behavior, and both physical and mental health.

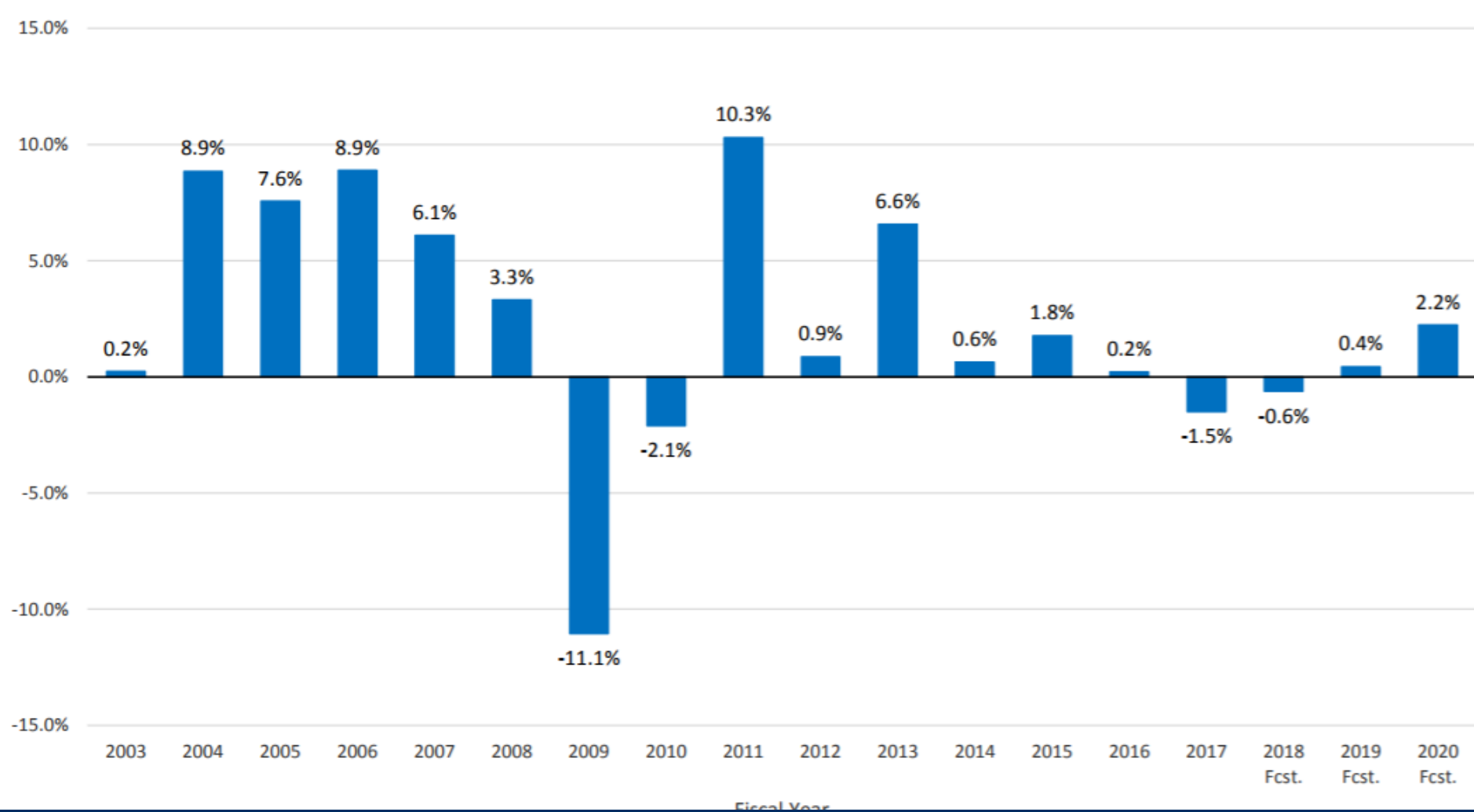
**What's more, toxic stress has a direct effect on the workforce of tomorrow.** Researchers found a \$3,000/year lower family income in childhood was associated with **17% lower productivity in adulthood.**

Duncan et al (2010), Harvard Center on Developing Child

# State Budget Drivers

Revenue

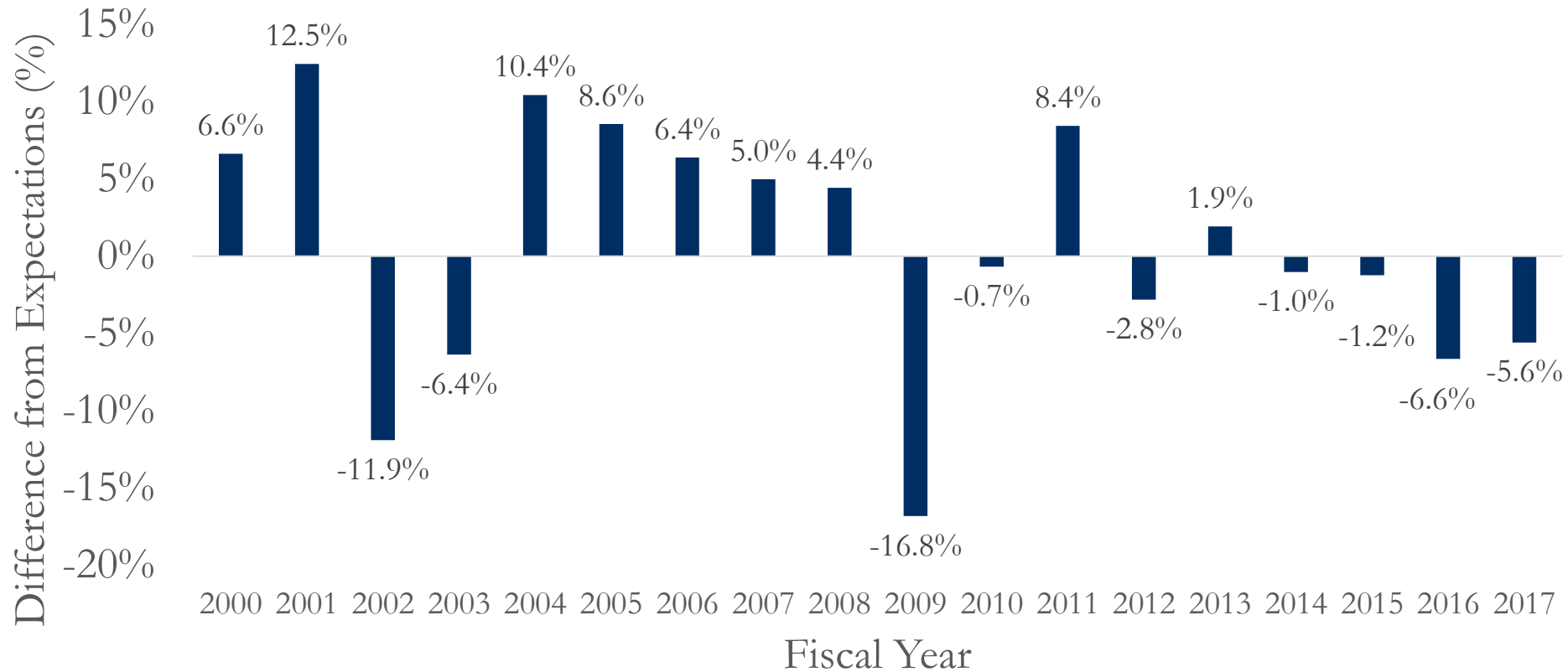




# Revenue Growth is Slowing

General Fund Revenue, Annual Rate of Growth, 2003-2019.  
Source: Office of Policy and Management

# Difference Between Expected and Actual Collections, Personal Income Tax

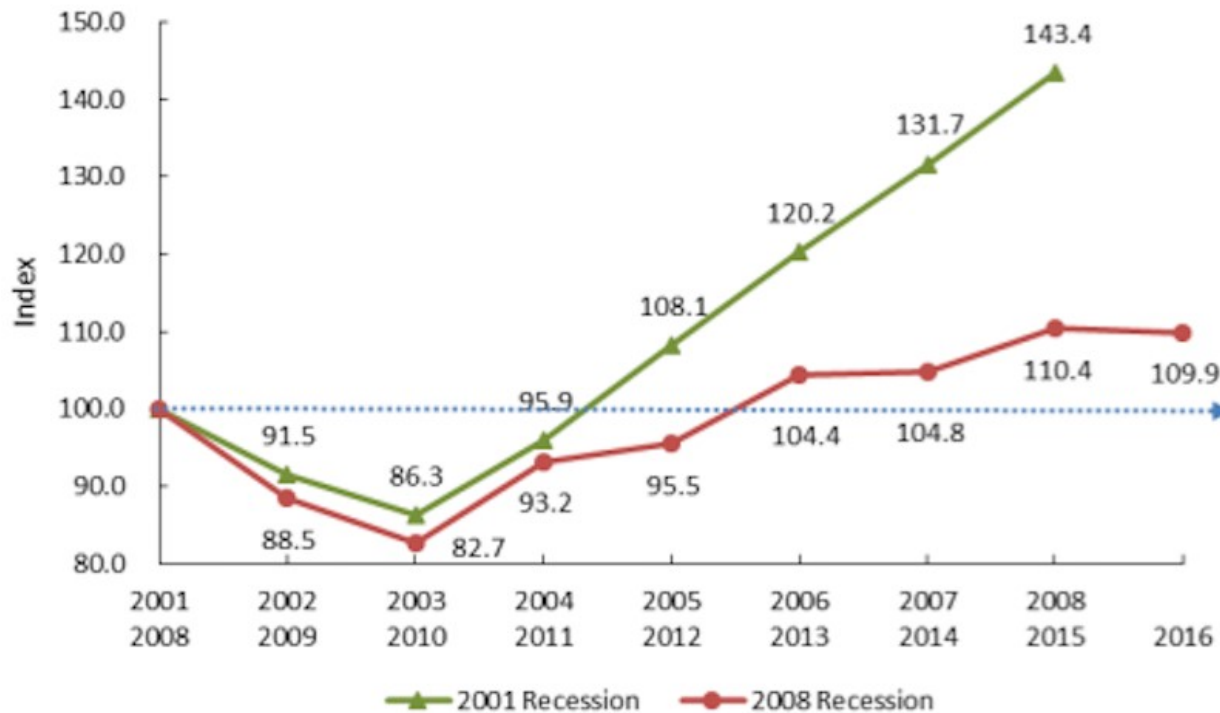


## Income Tax Collections Have Deviated

Office of State Comptroller and Connecticut State Finance Project

# Behind the Anemic Revenue Growth

Personal Income Tax  
Impact of Recessions on Baseline Revenue



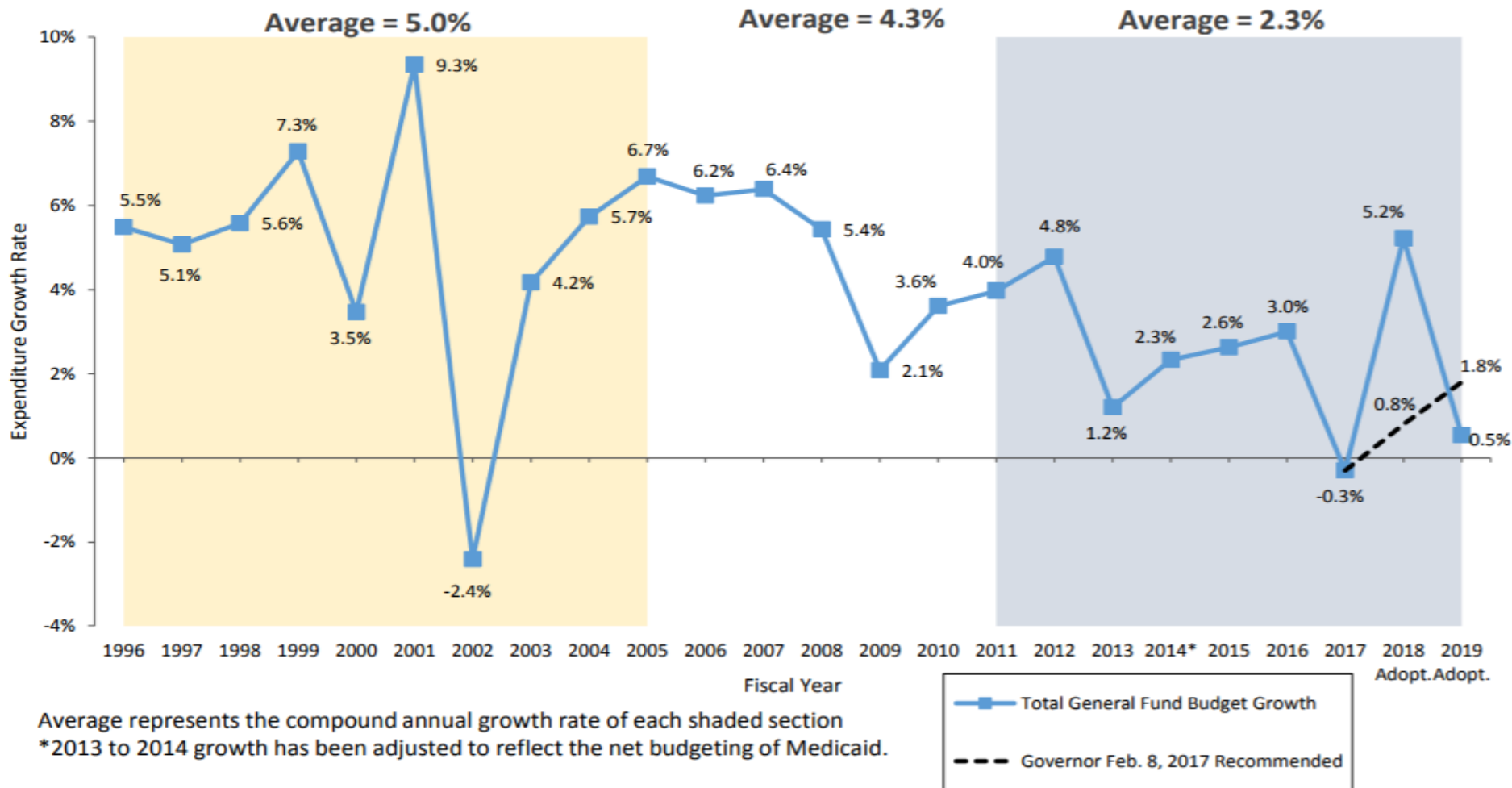


# State Budget Drivers

Liabilities



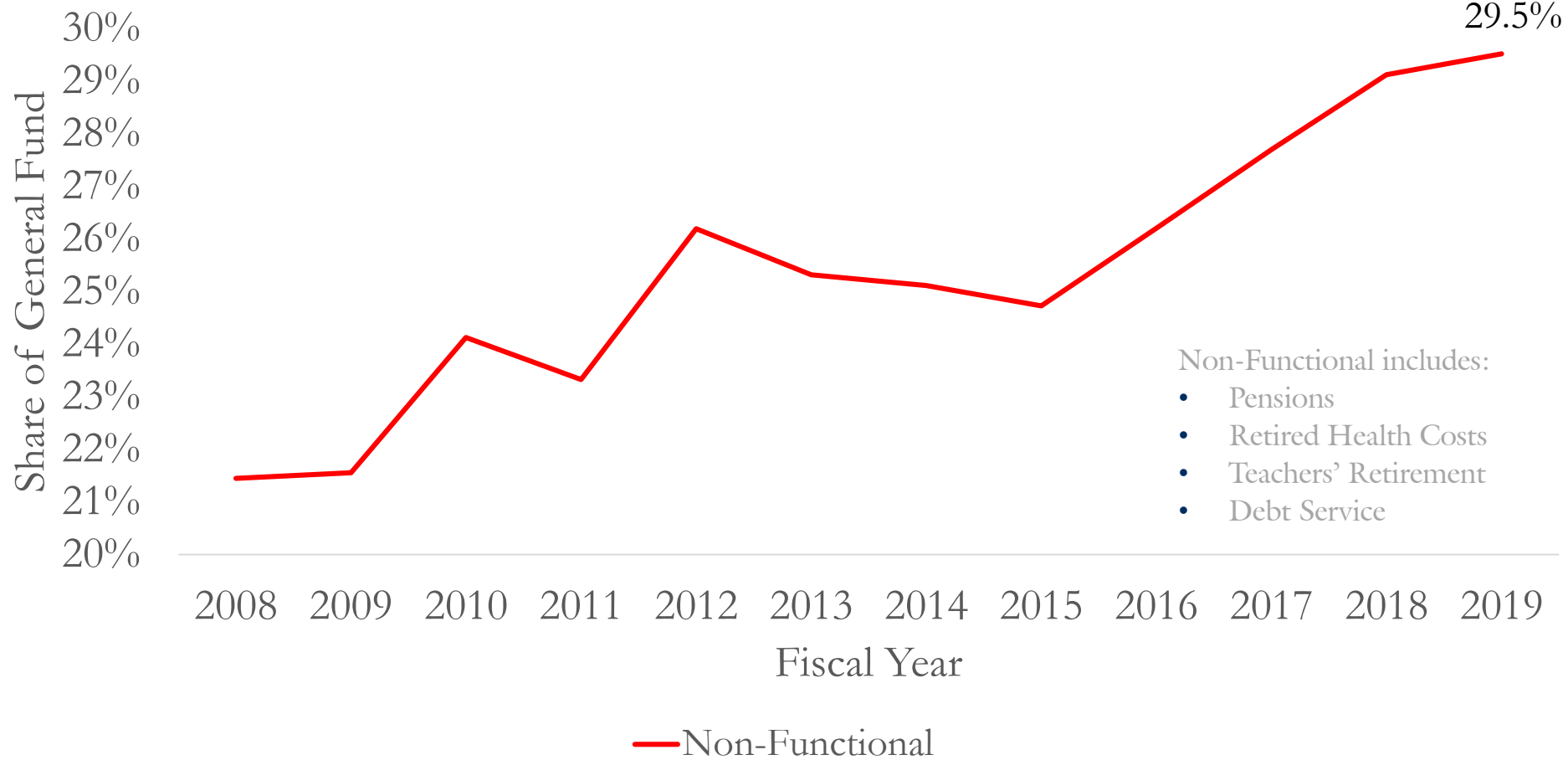




# OPM: “It is not a spending problem.”

Expenditure growth, General Fund, 1996-2019, Office Of Policy And Management

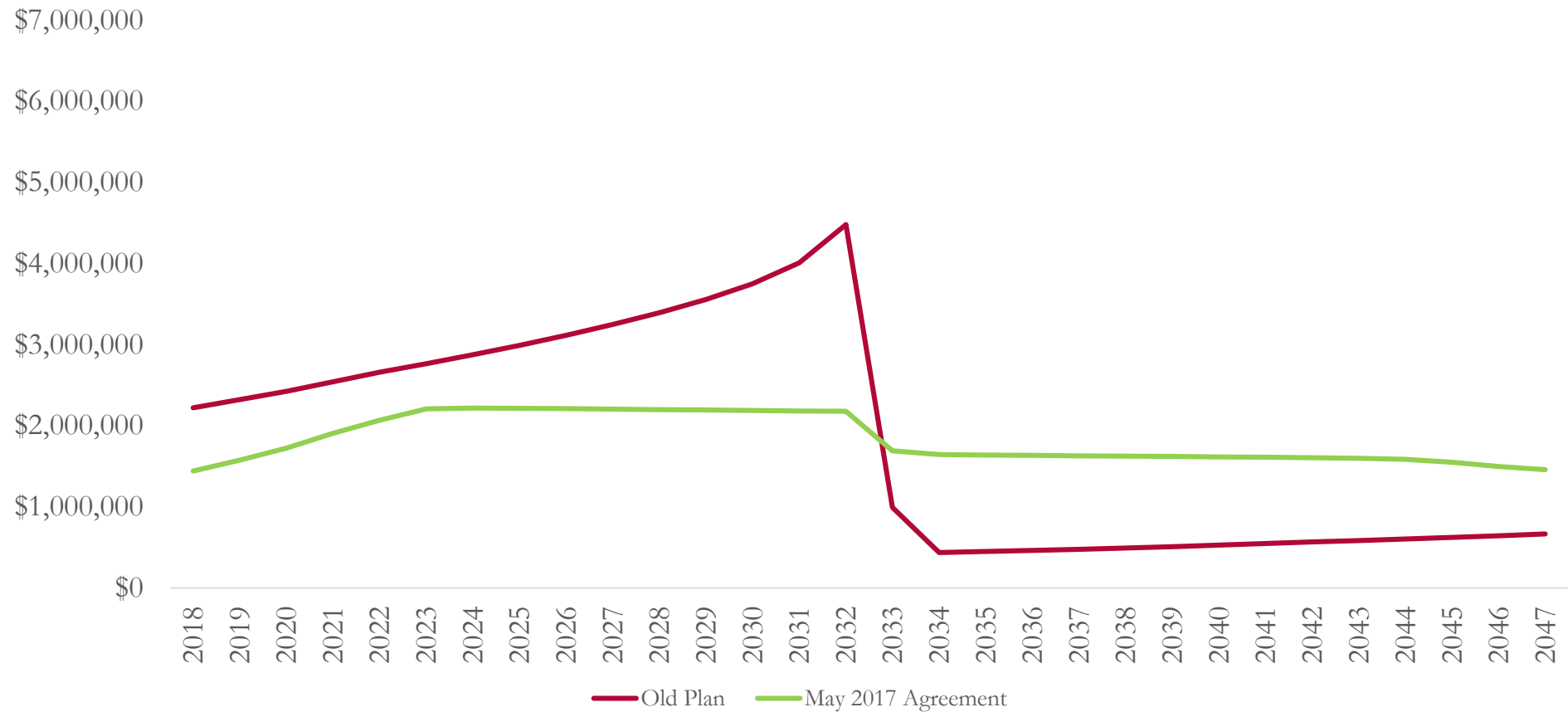
## Non-Functional



# Rising Nonfunctional Costs

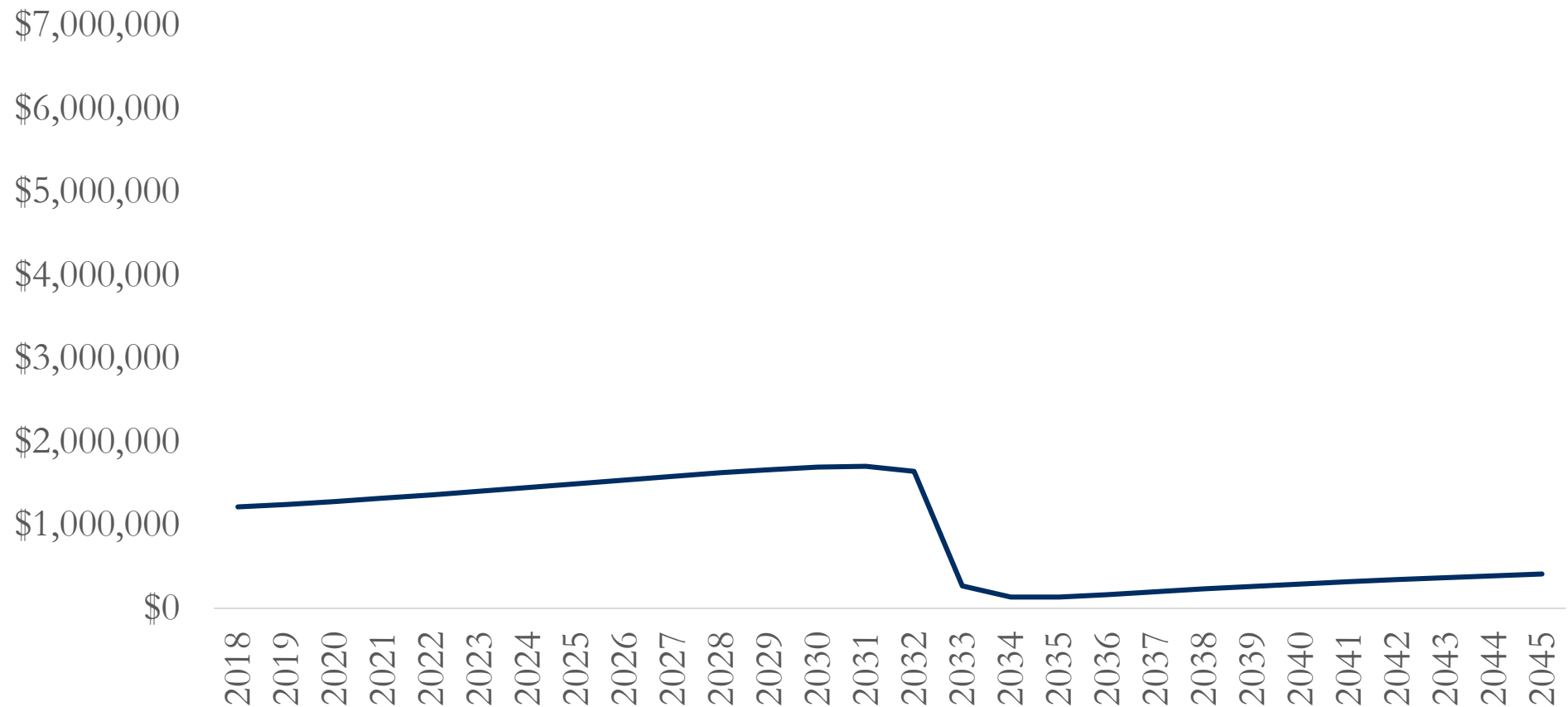
Source: Connecticut Voices for Children analysis

## Projected State Employee Retirement System Contributions (in Thousands)



# Looming Liabilities- SERS

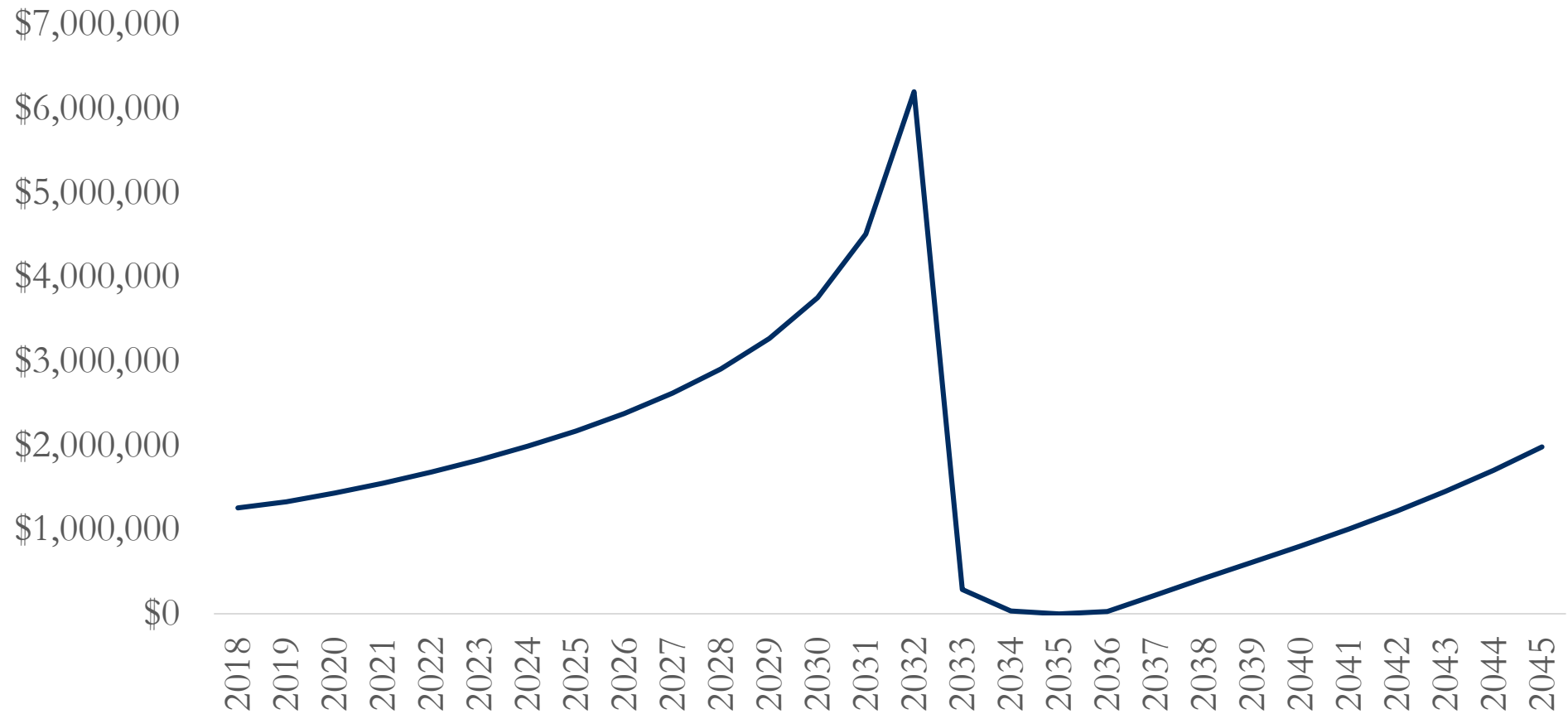
## Projected TRS Contributions (in Thousands)



# Looming Liabilities- TRS

Boston College Center for Retirement Research (8.5% rate of return)

## Projected TRS Contributions (in Thousands)



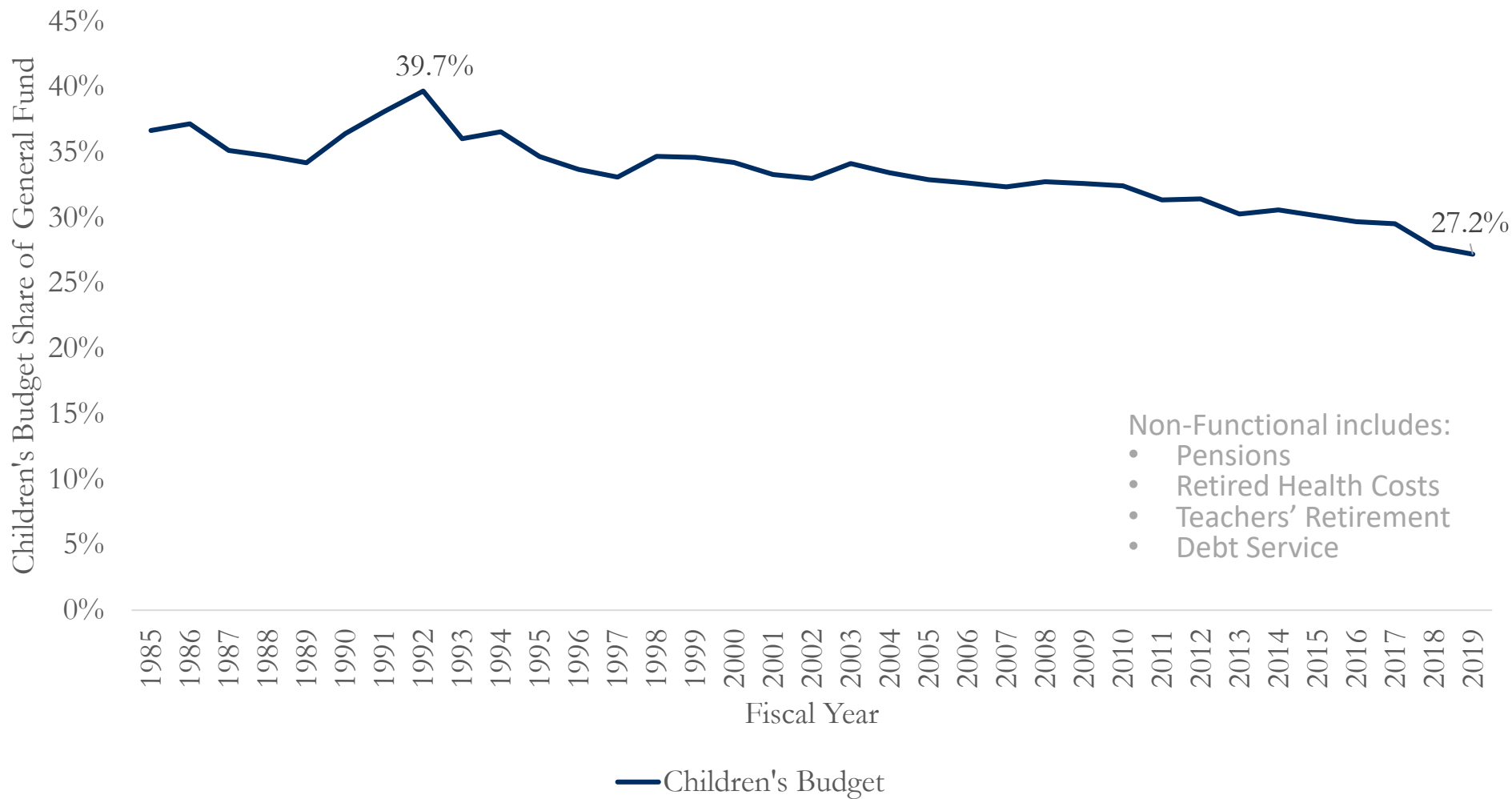
# Our Looming Problem

Boston College Center for Retirement Research (5.5% rate of return)

# State Budget Drivers

Shifting Priorities

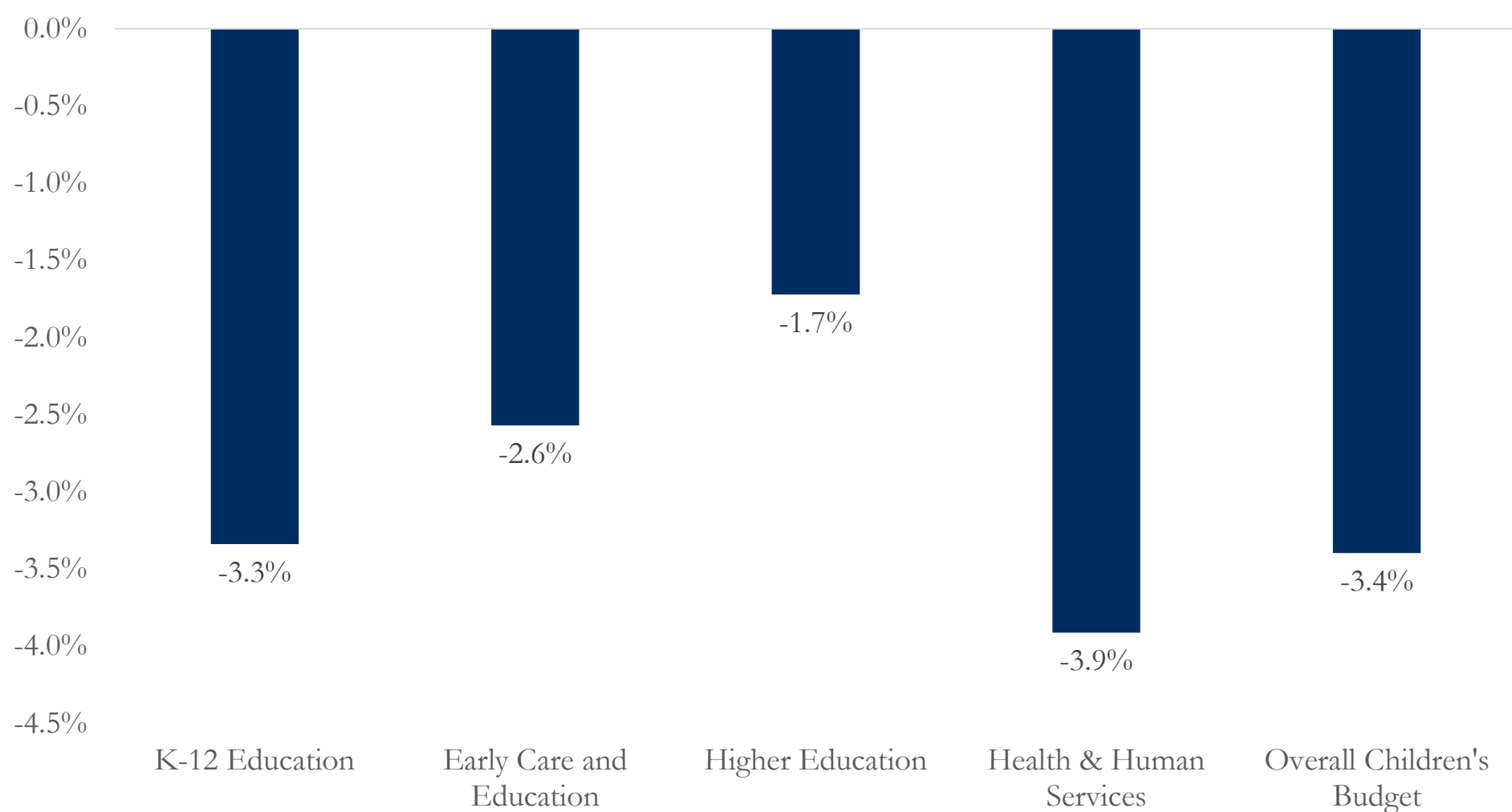




# Connecticut Prioritizes Children Less

Governor's Proposed FY 2019 Budget Adjustments.

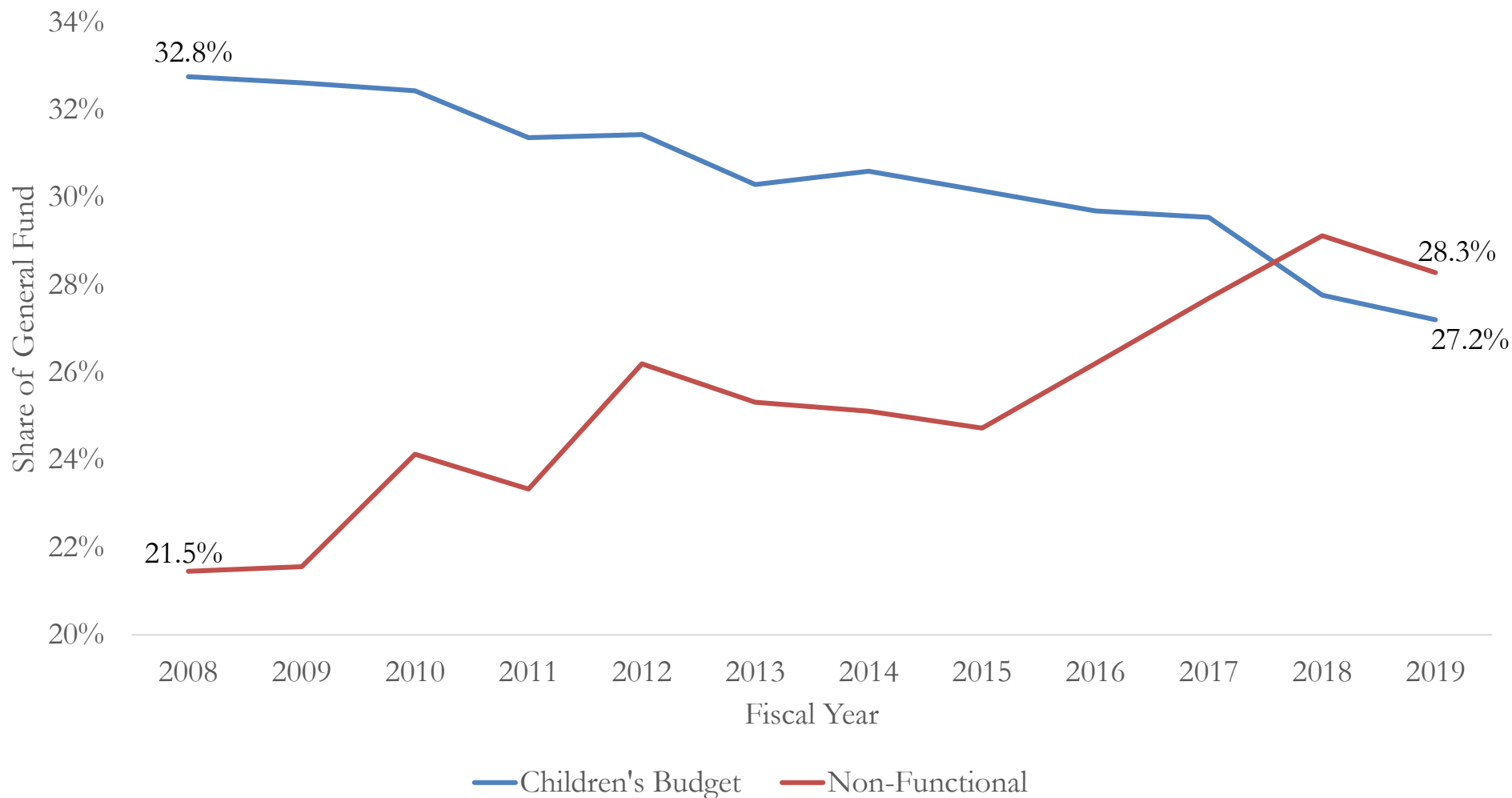
Source: Connecticut Voices for Children analysis



# Governor Would Reduce Funding for Children

Source: Governor's Proposed FY 2019 Budget Adjustments. Connecticut Voices for Children analysis





**Shifting Priorities:**  
**We Spend More on Non-Functional Costs Than on Children**

Source: Connecticut Voices for Children analysis

# State Budget Drivers

Austerity Mindset  
(no structural change)



# Austerity Mindset

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Fear of  
Millionaire  
Migration

Tax Increase on Low to  
Middle Income

More Spending Cuts on  
the Way

Estate tax cuts  
of \$15.6 in FY  
2019

Reduce  
EITC:  
\$35M/year

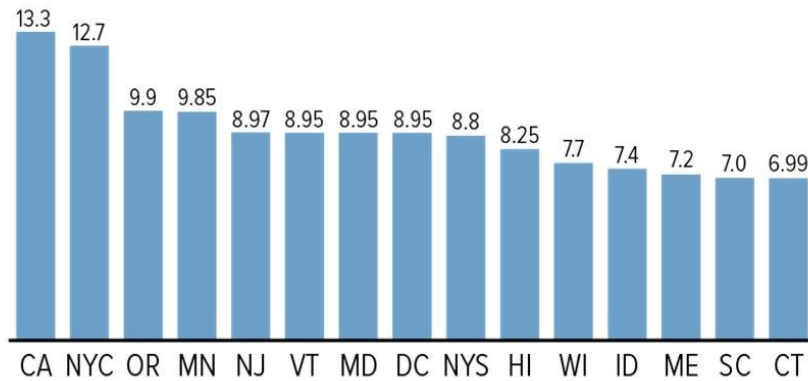
Restrict  
property tax  
credit:  
\$55.3M/year

Budget  
directed cuts  
of \$881.6  
million

Additional  
cuts possible  
if revenue  
projections  
not met

## 12 States, DC, & NYC Have Higher Income Tax Rates Than Connecticut

Top personal income tax rate, tax year 2017

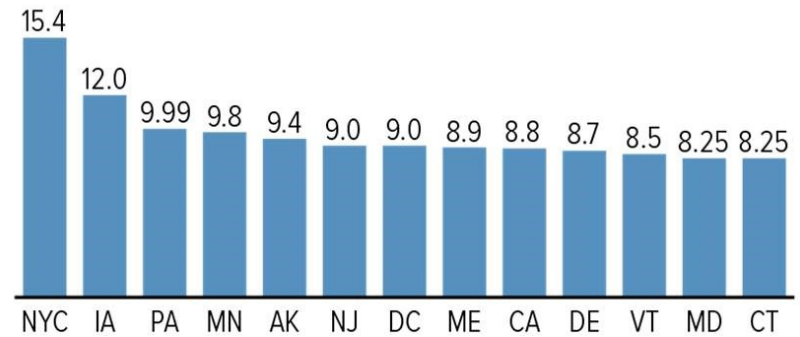


Source: Federation of Tax Administrators.

2

## 9 States, DC, & NYC Have Top Corporate Income Tax Rates Higher Than Connecticut's

Top corporate income tax rate, tax year 2018

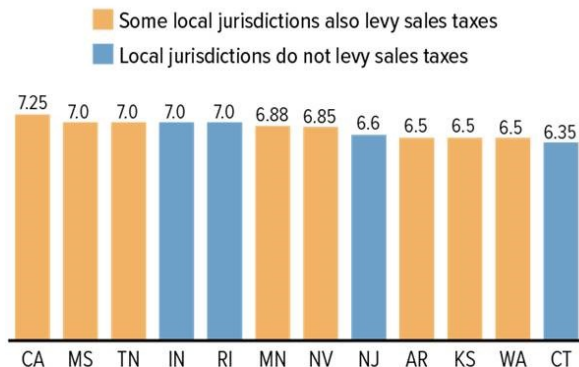


Source: Federation of Tax Administrators, tax year 2018. Connecticut includes 10% surcharge.

3

## 11 States Have Higher Sales Tax Rates Than Connecticut – and 8 of the 11 Have Additional Local Sales Tax Rates

General sales tax rate, tax year 2018

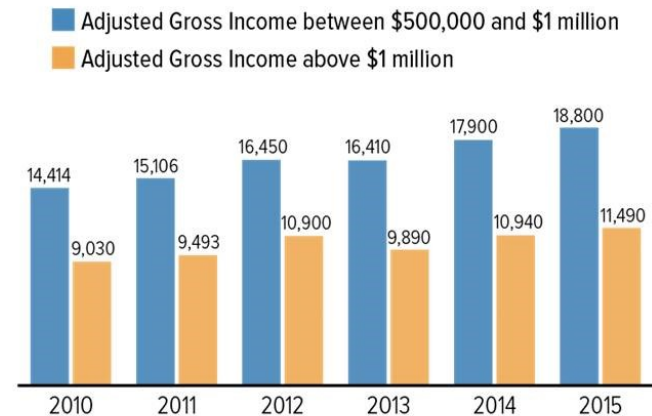


Source: Federation of Tax Administrators, tax year 2018. California includes uniform statewide local sales tax rate.

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## The Number of High-Income Taxpayers in Connecticut is Growing

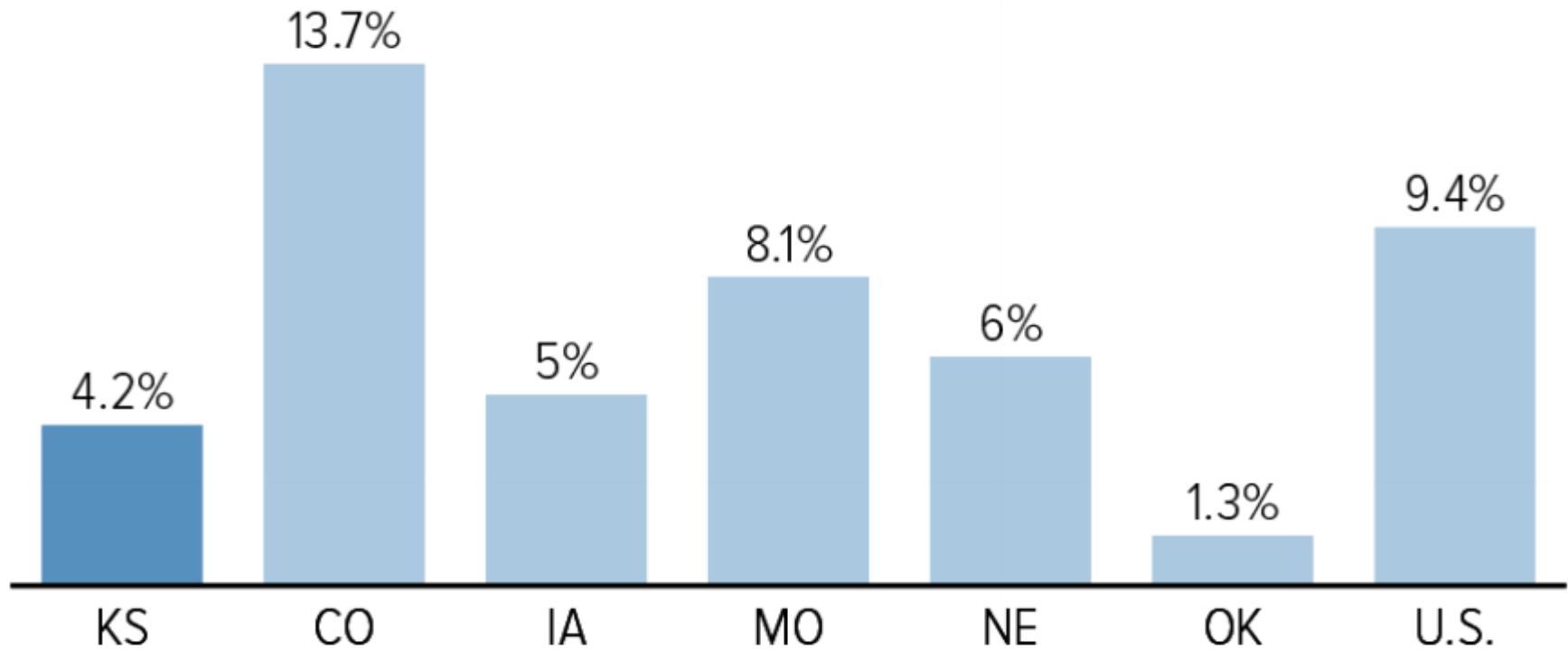
Number of Federal tax returns filed by Connecticut residents



Source: IRS statistics of income database. All years for which data are available are shown.

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# Private-Sector Job Growth: Kansas Lagged Most Neighbors and U.S. After Cutting Taxes



## Austerity Hasn't Worked Elsewhere

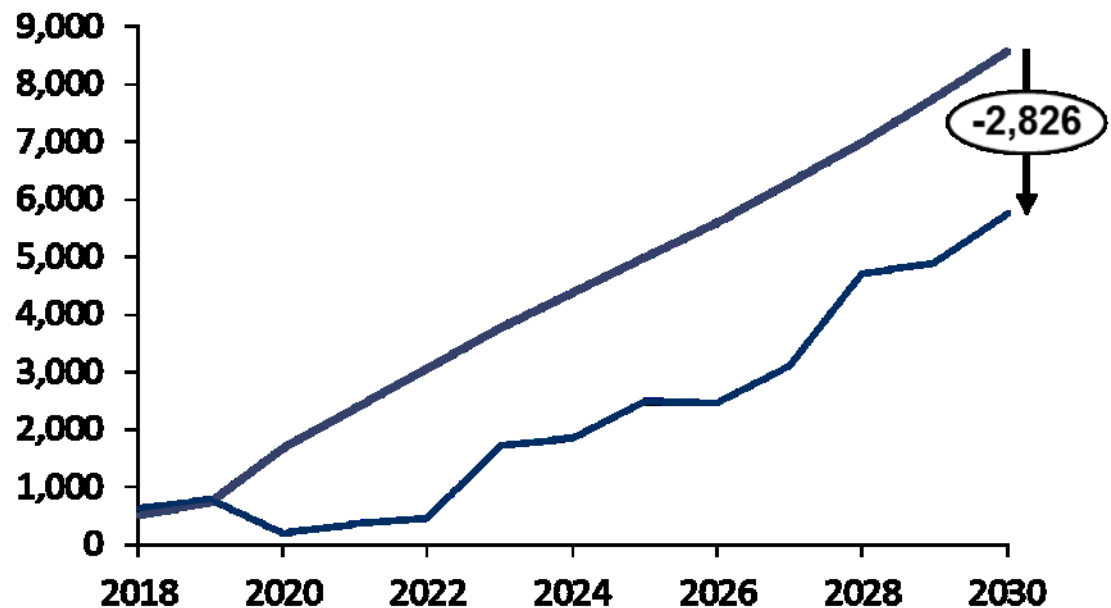
Source: Center on Budget and Policy Priorities. Data cover December 2012 (month before tax cuts took effect) to May 2017 (month before they were scaled back).

# Projected Fiscal Imbalance

Absent changes to current taxes and tax rates, the rapid growth of non-functional costs will result in a \$2.8 billion annual fiscal imbalance by 2030 resulting in heavy cuts to current services

## Comparison of Fixed Cost vs. Revenue Growth Projections (2018-2030)

\$ Millions







# State Budget Drivers: The Federal Threat

# Federal Funds at Risk

Federal Grants Make Up 1/5<sup>th</sup> of Connecticut's Budget

FY 2016 Federal Funding to CT (in millions)	
Medicaid	4,582
Supplemental Nutrition Assistance Program (SNAP)	788
Children's Health Insurance Program (CHIP)	62
Temporary Assistance to Needy Families (TANF)	267
Child Care and Development Block Grant	53
Social Services Block Grant	18
21 <sup>st</sup> Century Community Center Learning Centers	7

Source: Federal Funds Information for States



# Downward Pressure on State Revenue

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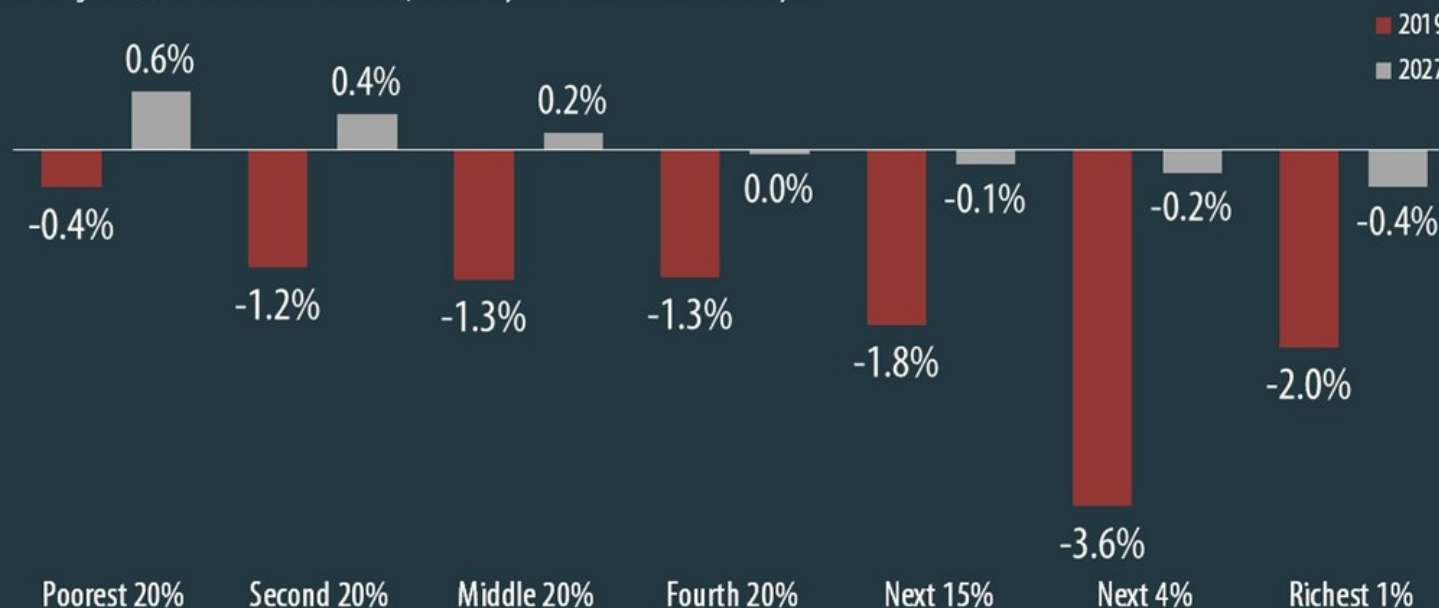
Eliminating State and Local Tax (SALT) Deduction:  
could create downward pressure on state taxes

Estate tax cuts: could jeopardize Connecticut's  
\$150 million-per-year revenue source

# Exacerbates Upside-Down Tax Structure

## Final GOP-Trump Tax Bill Gives Larger Tax Cuts to Upper-Income Connecticut Residents in 2019, Raises Taxes on Low-and Middle-Income Residents in 2027

*Tax Change as a Share of Income in 2019 and 2027, Includes Impact of ACA Individual Mandate Repeal*





# The New Fiscal Restrictions

# What is the spending cap?

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- Part of 1991 income tax compromise
- 2017 budget included new definitions to further limit budget growth
- Limits support to distressed municipalities
- Brings pensions back under cap



# Impact of Spending Cap

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- For FY 2019 budget, we can only spend 1% (\$200 million) more than present appropriations
- This restriction comes on top of years of austerity budgeting.
- Consider a few of the FY 2016 budget cuts:
  - Reduced Medicaid eligibility, affecting 18,900 parents
  - Reduced property tax credit from \$300 to \$200
  - Cut more than \$130 million from K-12 education

**Returning to FY 2016 spending levels would  
take up almost all of the room under cap-**

Although designed to incentivize early payment of pension obligations, the spending cap poses a risk should unexpected costs escalate

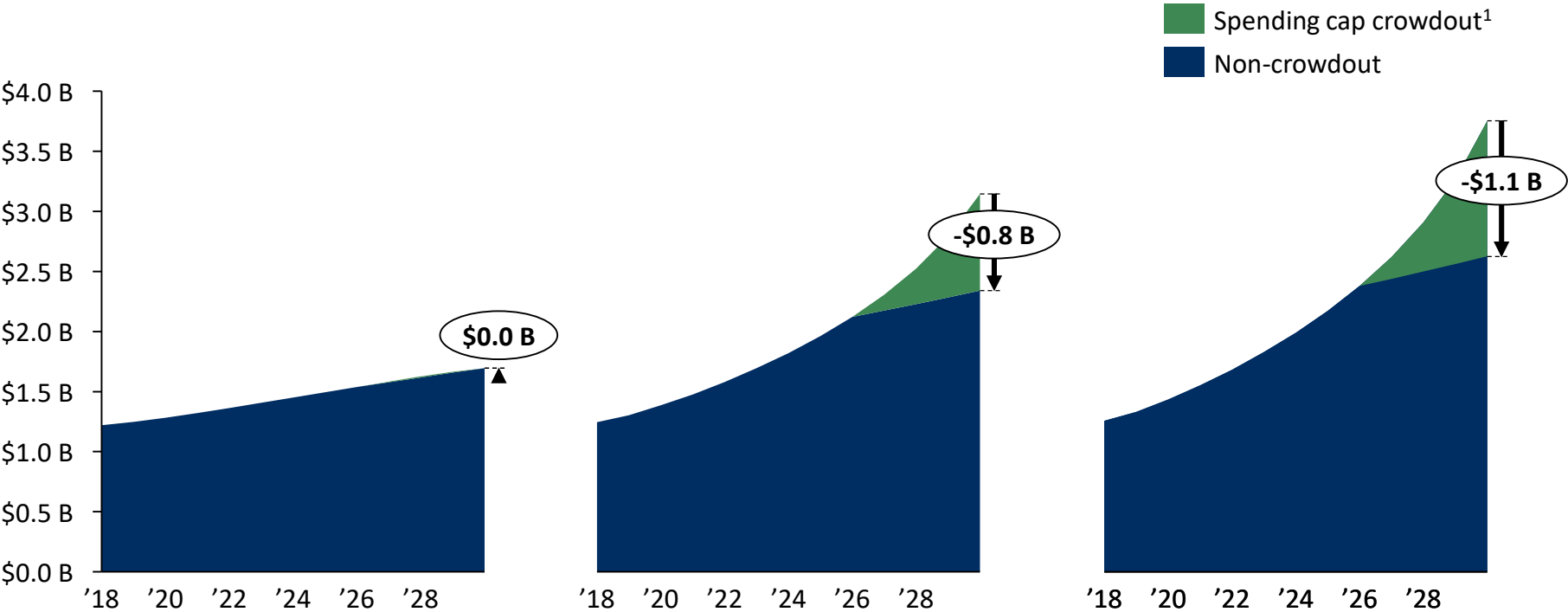


Spending Cap Impact of Teacher’s Retirement System Contributions (2018-2030)

Assuming amortization under current agreement, 8% return

Assuming amortization under current agreement, 6.5% return

Assuming amortization under current agreement, 5.5% return



TRS contribution increases post-2026 will fall under the spending cap, meaning that deviation from the current payment plan or the realization of risks which push up CT’s unfunded liability (e.g., market returns less than 8%) could effectively push the spending cap down)

# What is the volatility cap?

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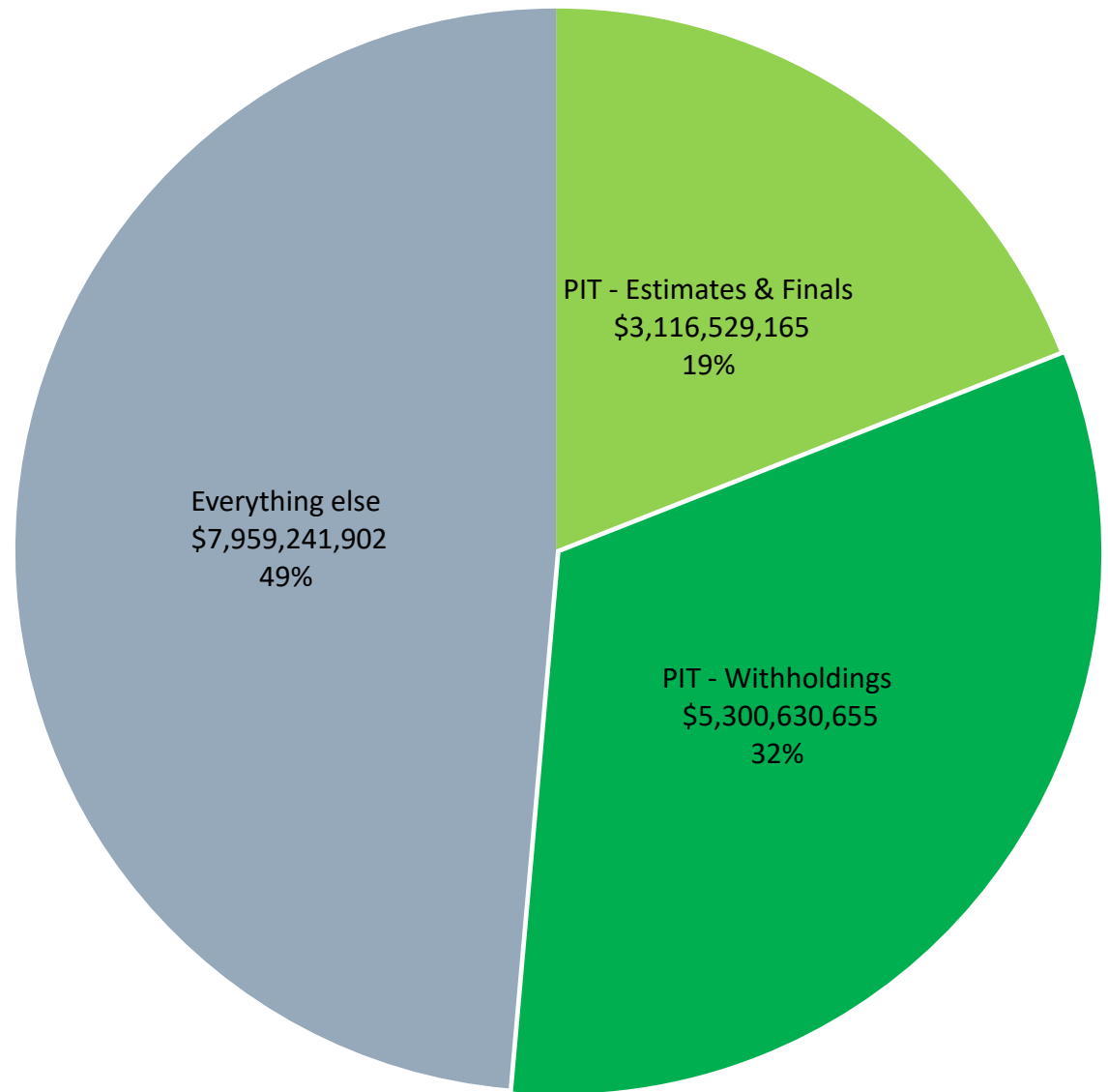
A portion of any additional income tax revenue will be locked in the Rainy Day Fund.

But not just *any* portion...

# Volatility Cap

Most Revenue is  
from Income Tax

1/3 of Personal  
Income Taxes are  
from Estimates &  
Finals







- New bonding restrictions may jeopardize critical investments essential to Connecticut's ability to attract business

Beginning in May 2018, Bond Lock requires the state to promise as part of its bonds not to change the spending cap or volatility cap for the next 10 years

Even a unanimous legislature could not repeal the bond or volatility caps or redefine the constitutional spending cap.

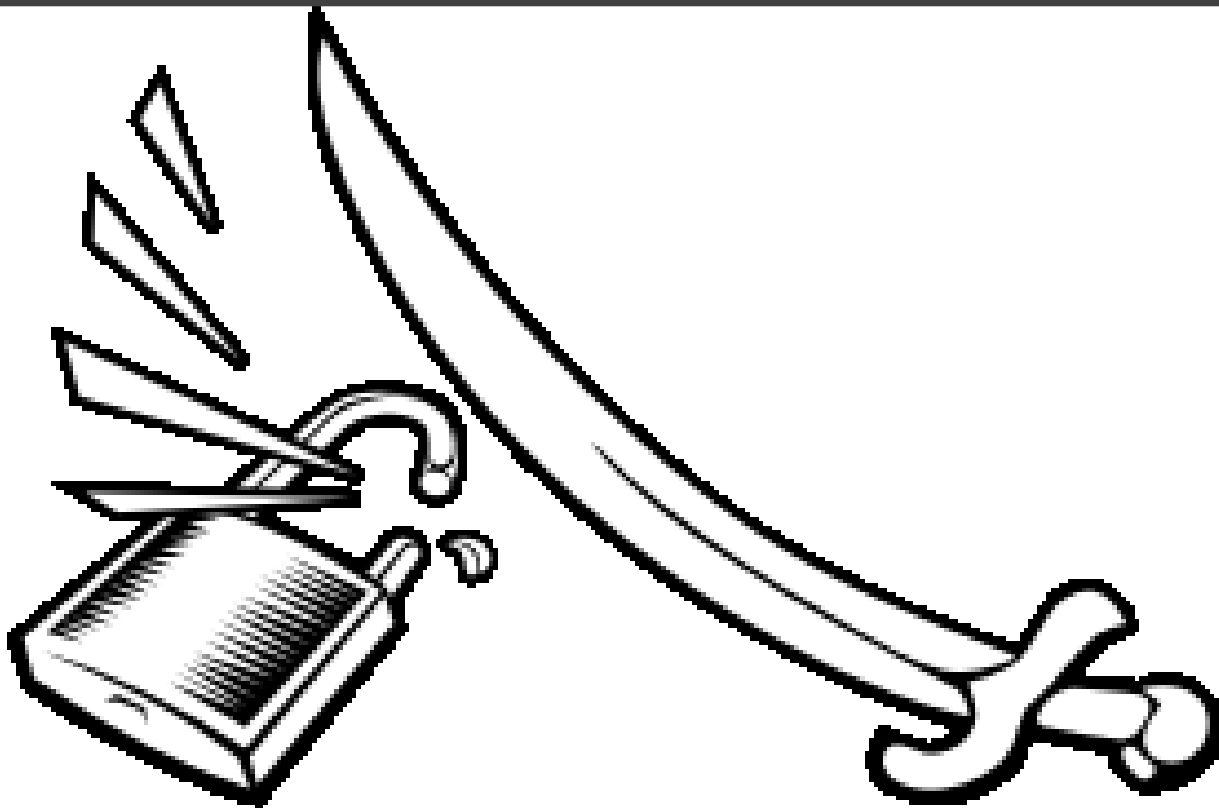
Would also tie hands of future legislators, preventing much-needed investment in infrastructure or economic development.

## Bond Cap & Bond Lock

# Bond Lock

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We need to fix this NOW.



# Toward Solutions

Equity Opportunity

~~PROBLEM~~  
SOLUTION

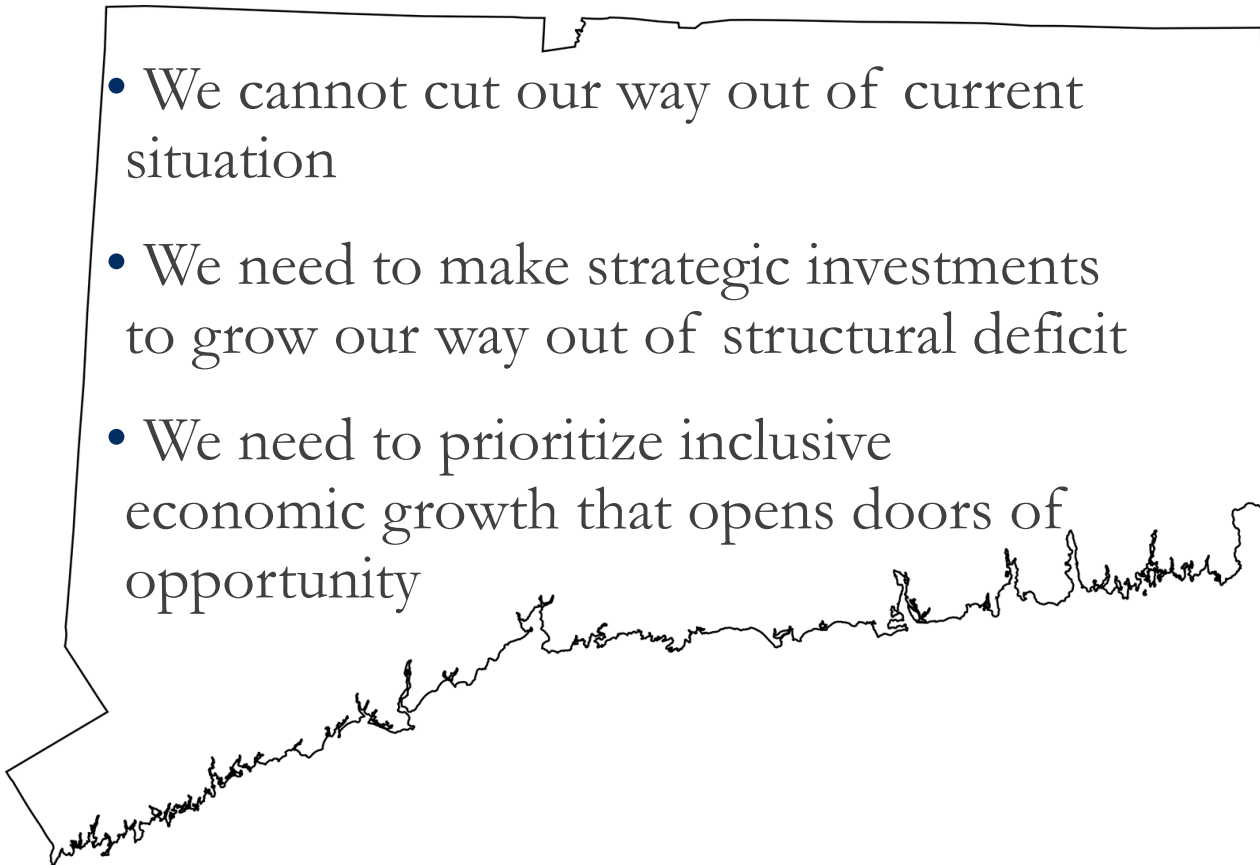


# Pathways to Opportunity

Inclusive  
Economic  
Growth

Thriving Children  
and Families

Equity and  
Excellence in  
Education

- 
- A black outline map of the state of Ohio, oriented horizontally. The map is positioned on the right side of the slide, with its top edge roughly aligned with the top of the text area. The map's outline is simple, showing the state's borders and major geographical features like the Lake Erie shoreline.
- We cannot cut our way out of current situation
  - We need to make strategic investments to grow our way out of structural deficit
  - We need to prioritize inclusive economic growth that opens doors of opportunity

**Inclusive Economic Growth**

**Fix fiscal restrictions** to preserve state's ability to invest in children and families

**Modernize our tax code** to adapt to service economy

**Examine and evaluate business tax breaks** just as we evaluate other spending

An equitable, adequate, transparent and sustainable revenue system

**Thriving Children & Families**

Focus on prevention rather than intervention

Protect the remarkable progress of our Medicaid and CHIP programs

Ensure children and youth in our child welfare system have the supports they need to succeed

Integrate diversion, behavioral health and community based services to reduce entry into the juvenile justice system

**Equity and Excellence in Education**

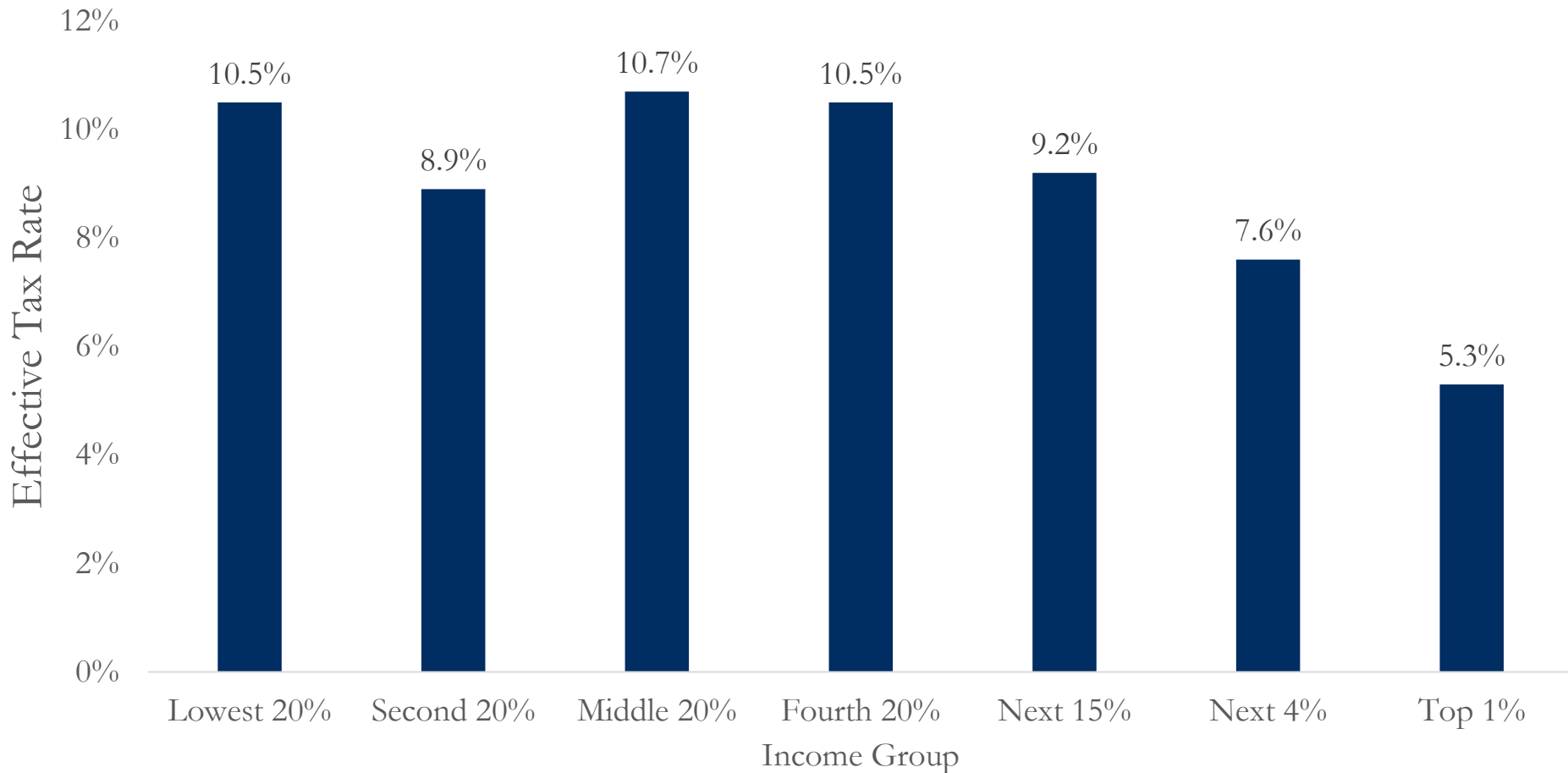
Provide every child with the foundation for a lifetime of growing, learning, and engaging with one's community

Ensure that educational environments are equitable and represent the needs of the communities they serve

Prepare all of Connecticut's youth for success in college and career

# An Opportunity Agenda

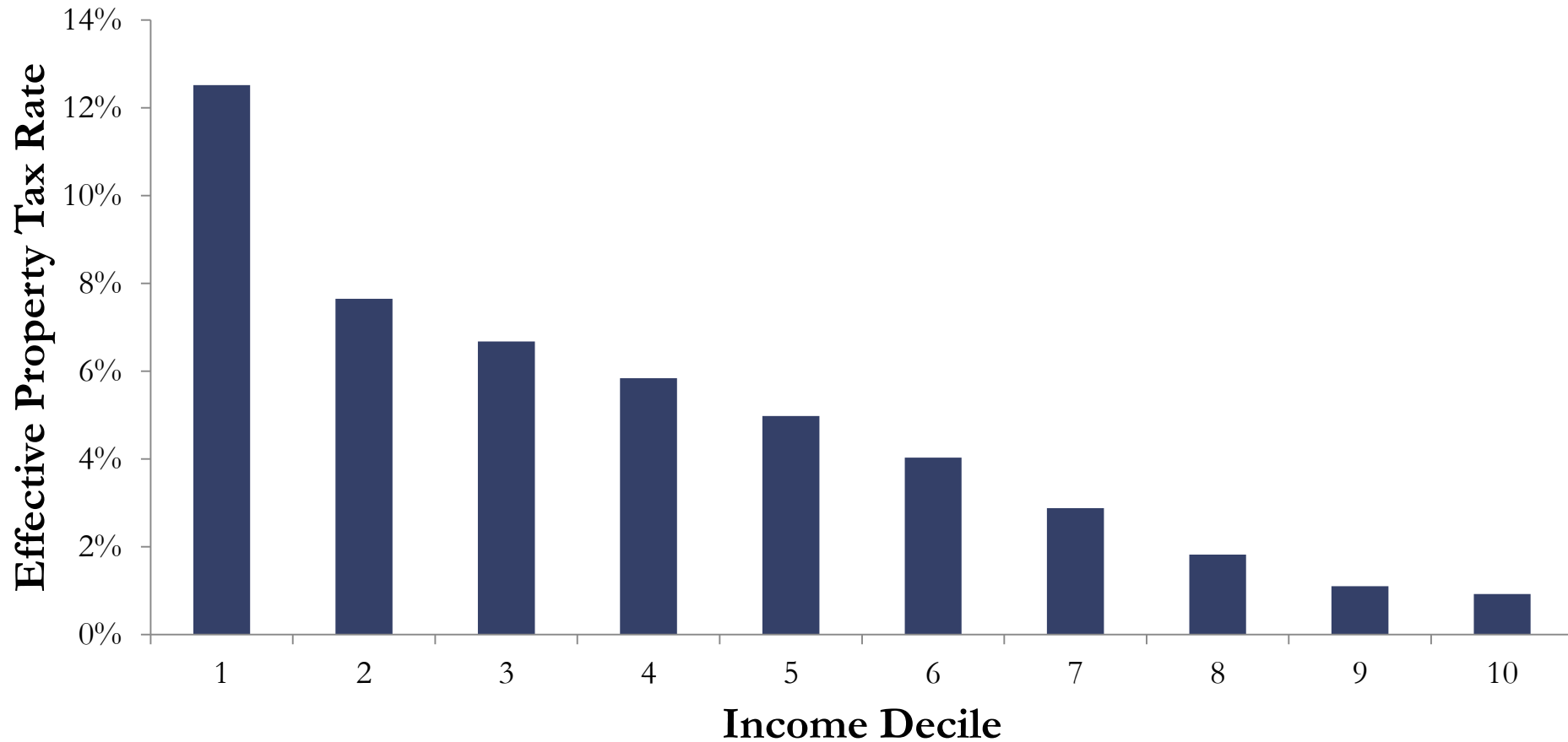
## State and Local Taxes as Share of Family Income



# Modernize Upside-Down Tax Code

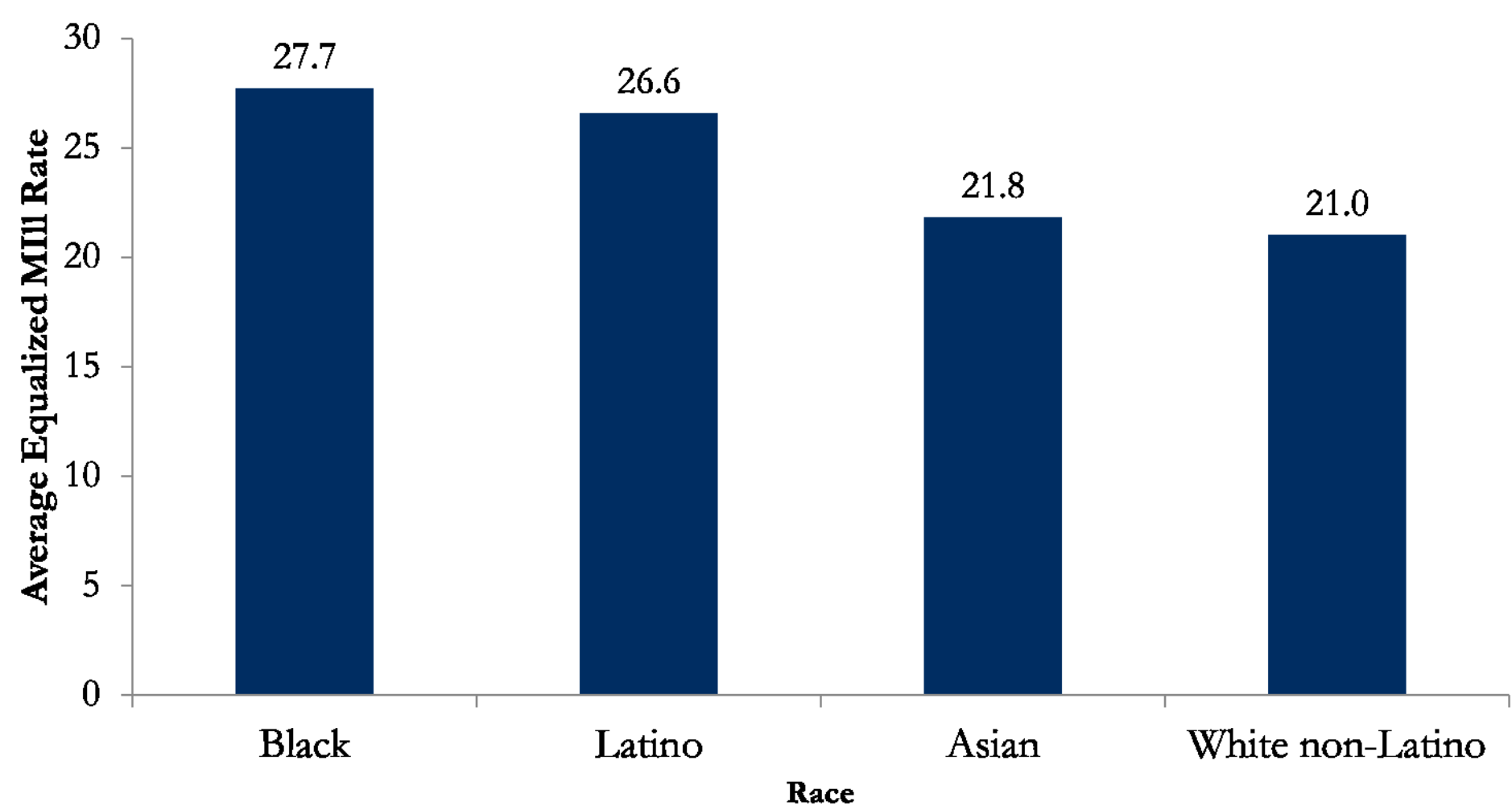
Support Investments in Economic Growth, Equity and Opportunity

# Effective Property Tax Rate by Income Decile



## Our Property Tax System is Upside-Down

Source: Department of Revenue Services. Tax Incidence Report. 2011 tax year.

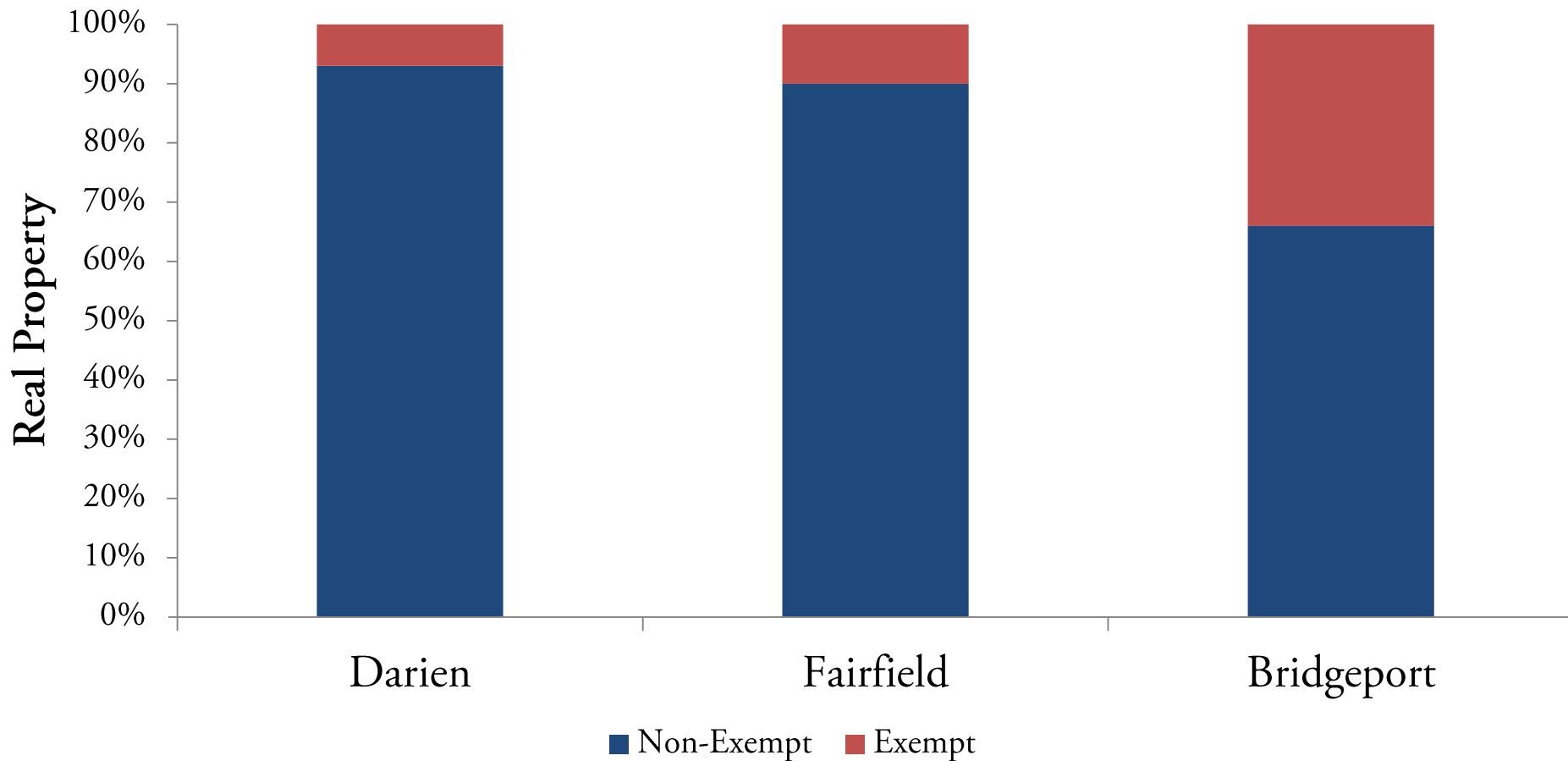


# Our Property Tax System Furthers Racial Disparities

Source: Connecticut Data Collaborative and OPM, Municipal Fiscal Indicators.



Share of Exempt Property by Town



# Our Property Tax System Stifles Economic Development

Source: Office of Fiscal Analysis FY 16-17 Budget Book. FY 16 values.

# Including Services in Sales Tax Would Generate up to \$1.5 billion

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Rate	Additional Annual Revenue
6.35%	\$1.5 billion
6.00%	\$1.18 billion
5.50%	\$730 million

Example services taxed: travel agent services, diaper service, bowling alleys

## Inclusive Economic Growth

Fix fiscal restrictions to preserve state's ability to invest in children and families

Modernize our tax code to adapt to service economy

Examine and evaluate business tax breaks just as we evaluate other spending

An equitable, adequate, transparent and sustainable revenue system

## Thriving Children & Families

Focus on prevention rather than intervention

Protect the remarkable progress of our Medicaid and CHIP programs

Ensure children and families have the community based supports they need to succeed-reducing entry into and improving outcomes for state involved children.

## Equitable Education

Ensure that educational environments are equitable and represent the needs of the communities they serve

Prepare all of Connecticut's youth for success in college and career

# An Opportunity Agenda

## Average Costs of Child Care and Households' Ability to Pay For 2016

	Average Cost of Center-Based Care	Households with children under 5 for whom cost of care met affordability threshold
One Infant	\$14,079	25.8%
One Preschooler	\$11,669	35.3%
One Infant & One Preschooler	\$25,748	6.9%

Source: CT Voices analysis of Child Care Aware reports of the average cost of center-based care per year and of Census micro-data. Affordability threshold based on DHHS and OEC definition, which states that to be affordable, child care must cost no more than 10% of household income.

## The Critical Role of Child Care

Invest in Care 4 Kids

Support Wrap Around Services

## Inclusive Economic Growth

Fix fiscal restrictions to preserve state's ability to invest in children and families

Modernize our tax code to adapt to service economy

Examine and evaluate business tax breaks just as we evaluate other spending

An equitable, adequate, transparent and sustainable revenue system

## Thriving Children & Families

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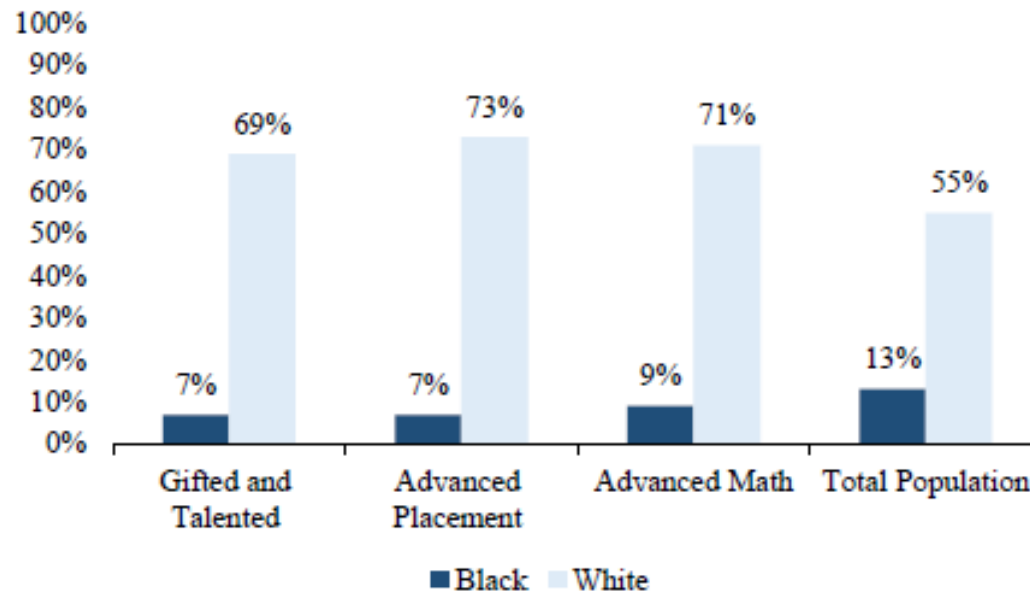
## Equity and Excellence in Education

Ensure that educational environments are equitable and represent the needs of the communities they serve

Prepare all of Connecticut's youth for success in college and career

# An Opportunity Agenda

Percentage of Students across all grades Enrolled in Gifted and Talented, Advanced Mathematics and at Least One Advanced Placement Course by Race



*Source: United States Department of Education – Civil Rights Data Reporting 2016*

# Equity and Excellence in Education

Funding equity in resources to support equity in opportunity

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Ellen Shemitz,  
Executive Director  
[eshemitz@ctvoices.org](mailto:eshemitz@ctvoices.org)

203.498.4240 (x108)

Ray Noonan,  
Assoc Fiscal Policy Fellow  
[rnoonan@ctvoices.org](mailto:rnoonan@ctvoices.org)

203.498.4240 (x113)

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