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

State GDP Has Not Recovered

Shift in Our Economy

The Recovery Has Left Too Many Families Behind

- 9.2% increase in share of low-wage work

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

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

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

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

Disparities in Child Poverty Rates by Race and Geography, 2016

![Bar chart showing child poverty ratio by race in Connecticut compared to the United States.](chart.png)

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

- **Percent White**
  - 69% in 2000
  - 65% in 2005
  - 57% in 2010
  - 52% in 2015

- **Percent Non-White**
  - 31% in 2000
  - 35% in 2005
  - 43% in 2010
  - 48% in 2015

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
Source: Office of Policy and Management
Income Tax Collections Have Deviated
Office of State Comptroller and Connecticut State Finance Project
Behind the Anemic Revenue Growth
State
Budget
Drivers
Liabilities
OPM: “It is not a spending problem.”

Rising Nonfunctional Costs
Source: Connecticut Voices for Children analysis

Non-Functional includes:
- Pensions
- Retired Health Costs
- Teachers’ Retirement
- Debt Service

Non-Functional

Share of General Fund

Fiscal Year

Non-Functional

29.5%
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

Fear of Millionaire Migration

Estate tax cuts of $15.6 in FY 2019

Tax Increase on Low to Middle Income

Reduce EITC: $35M/year

Restrict property tax credit: $55.3M/year

More Spending Cuts on the Way

Budget directed cuts of $881.6 million

Additional cuts possible if revenue projections not met

CT Voices analysis of budget proposals
12 States, DC, & NYC Have Higher Income Tax Rates Than Connecticut
Top personal income tax rate, tax year 2017

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

9 States, DC, & NYC Have Top Corporate Income Tax Rates Higher Than Connecticut’s
Top corporate income tax rate, tax year 2018

The Number of High-Income Taxpayers in Connecticut is Growing
Number of Federal tax returns filed by Connecticut residents


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

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

Source: Yale Law School Legislative Clinic, Jesse Marks
State Budget Drivers: The Federal Threat
### FY 2016 Federal Funding to CT (in millions)

<table>
<thead>
<tr>
<th>Program</th>
<th>Amount (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid</td>
<td>4,582</td>
</tr>
<tr>
<td>Supplemental Nutrition Assistance Program (SNAP)</td>
<td>788</td>
</tr>
<tr>
<td>Children’s Health Insurance Program (CHIP)</td>
<td>62</td>
</tr>
<tr>
<td>Temporary Assistance to Needy Families (TANF)</td>
<td>267</td>
</tr>
<tr>
<td>Child Care and Development Block Grant</td>
<td>53</td>
</tr>
<tr>
<td>Social Services Block Grant</td>
<td>18</td>
</tr>
<tr>
<td>21st Century Community Center Learning Centers</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: Federal Funds Information for States
Downward Pressure on State Revenue

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

- Poorest 20%
- Second 20%
- Middle 20%
- Fourth 20%
- Next 15%
- Next 4%
- Richest 1%

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The New Fiscal Restrictions
What is the spending cap?

- 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

- 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)

<table>
<thead>
<tr>
<th>Scenario</th>
<th>2026</th>
<th>2028</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assuming amortization under current agreement, 8% return</td>
<td>$0.0 B</td>
<td>$0.0 B</td>
</tr>
<tr>
<td>Assuming amortization under current agreement, 6.5% return</td>
<td>$-0.8 B</td>
<td>$-0.8 B</td>
</tr>
<tr>
<td>Assuming amortization under current agreement, 5.5% return</td>
<td>$-1.1 B</td>
<td>$-1.1 B</td>
</tr>
</tbody>
</table>

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.

Source: Payment schedule based on BC Center for Retirement Research Estimates; Crowdout Estimates based on CT Voices – Yale analysis
What is the volatility cap?

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

- PIT - Estimates & Finals: $3,116,529,165 (19%)
- PIT - Withholdings: $5,300,630,655 (32%)
- Everything else: $7,959,241,902 (49%)
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.

- New bonding restrictions may jeopardize critical investments essential to Connecticut’s ability to attract business.
Bond Lock

We need to fix this NOW.
Toward Solutions
Equity Opportunity
• 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
An Opportunity Agenda

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
Modernize Upside-Down Tax Code
Support Investments in Economic Growth, Equity and Opportunity
Our Property Tax System is Upside-Down

Our Property Tax System Furthers Racial Disparities

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

<table>
<thead>
<tr>
<th>Rate</th>
<th>Additional Annual Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.35%</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>6.00%</td>
<td>$1.18 billion</td>
</tr>
<tr>
<td>5.50%</td>
<td>$730 million</td>
</tr>
</tbody>
</table>

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

Institute for Taxation and Economic Policy. Analysis does not include business to business transactions and exemptions education, health, and shelter.
An Opportunity Agenda

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Average Cost of Center-Based Care</th>
<th>Households with children under 5 for whom cost of care met affordability threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>One Infant</td>
<td>$14,079</td>
<td>25.8%</td>
</tr>
<tr>
<td>One Preschooler</td>
<td>$11,669</td>
<td>35.3%</td>
</tr>
<tr>
<td>One Infant &amp; One Preschooler</td>
<td>$25,748</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

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.

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**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
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.

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
Equity and Excellence in Education
Funding equity in resources to support equity in opportunity