Arbitrary Austerity Harms Future Prosperity:

Framing Connecticut's Long-Term Challenges and Opportunities

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Executive Summary

With a $900 million deficit projected for the fiscal year beginning July 1, 2016[1] and widening to well over $2 billion by 2020,[2] Connecticut faces a looming, but not unmanageable, fiscal crisis. In response, the legislature has debated significant cuts to health and human services and to education.[3] While such cuts may offer a short-term solution to the budget gap, they do so at a significant cost to the long-term economic and social structure of the state. A myriad of factors have contributed to the current budget crisis, including disappointing tax revenues, slow growth in jobs and wages, rising long-term liabilities, a flawed tax structure and related social and economic inequalities.[4] Short-term fixes, particularly arbitrary austerity, will exacerbate these challenges and hurt Connecticut in the long-term. Connecticut needs a budget that starts to address these underlying issues and puts the state on a path to strong, sustainable, and equitable economic growth.

Fortunately, Connecticut can harness its remarkable economic strengths as it invests in a brighter future. Connecticut's residents remain on average some of the most prosperous in the country, the state is an attractive place to do business, and low interest rates and strong borrower ratings mean that Connecticut has some breathing room as it seeks structural solutions, while at the same time making targeted infrastructure investments to fuel growth.

This brief outlines some of the key structural challenges facing Connecticut, highlights the strengths the state can leverage in addressing those challenges, and offers some guiding principles for navigating the challenging road ahead. Designed as a comprehensive policy primer, it contains several links to more detailed issue briefs and analyses. Our goal is to shift the debate away from short-sighted cost-cutting towards solutions that are grounded in sound economics and focused on Connecticut's long-term prosperity.

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[1] Phaneuf, Keith and Becker, Arielle, CT Mirror. *Malloy Orders More Cuts as Lawmakers Vow to Close Deficit by April 1*. March 2016. Retrieved from: http://ctmirror.org/2016/03/16/malloy-orders-more-cuts-as-lawmakers-vow-to-close-deficit-by-april-1/

[2] Office of Fiscal Analysis. *Fiscal Accountability Report*. November 2015. Retrieved from: https://www.cga.ct.gov/ofa/Documents/year/FF/2016FF-20151113_Fiscal%20Accountability%20Report%20FY%2016%20-%20FY%2020.pdf (p. 2)

[3] *Governor's Proposed Appropriation Revisions for FY 2017*. Retrieved from: http://www.ct.gov/opm/lib/opm/budget/2017midterm/budget/51_section_c.pdf; For a summary, see: http://ctmirror.org/2016/02/03/malloy-would-cut-most-agency-budgets-municipal-aid/; see also, the Governor's March 16, 2016 recessions, retrieved from: https://assets.documentcloud.org/documents/2765252/Rescission-Transmittal-Letter-and-List-3-16-16.pdf

[4] For a clear statement of the connection between the state's "dysfunctional property tax structure," local land-use decisions, public education, and the long-term economic interests of the state, see Lemar, Anika Singh. Hartford Courant. *CT Blowing Chance to Fix Property Tax Problem*. April 2016. Retrieved from: http://www.courant.com/opinion/op-ed/hc-op-lemar-reform-ct-property-tax-0403-20160401-story.html

SECTION 1: Connecticut's Fiscal Challenges are Structural – and They Will Require Solutions Measured in Years, not Months

Connecticut's fiscal challenges trace back decades and will only grow worse if not addressed systematically. Among the largest challenges state lawmakers face: disappointing government revenues; rising long-term liabilities; persistent social, racial, geographic, and economic inequalities; and under-investment in areas critical to long-term prosperity.

1) Disappointing government revenues

Over the past several decades, Connecticut has developed an unbalanced fiscal system, distinct in its reliance on municipality-level taxation and service delivery, its emphasis on raising revenue through an outdated sales tax, and its heavy use of tax expenditures as tools for economic policy. Although the strong economic growth of the late 1990s and mid 2000s papered over some of these vulnerabilities, the Great Recession and subsequent slow growth have harmed Connecticut's ability to pay for critical government services, harm that has in turn been multiplied by systemic weaknesses, including stagnant economic growth, a shift toward low-wage jobs and a dramatic growth in tax expenditures.

Stagnant economic growth

The 2008 financial crisis appears to have hurt Connecticut's economy more than most states, and Connecticut has recovered more slowly as well. From 2002 to 2007, Connecticut's real wage expansion was roughly on pace with the rest of the nation.[5] After the recession, however, Connecticut's recovery has lagged all but eight states.

At least some of this difference may be attributed to the outsized role of the financial sector in the Connecticut economy and that sector's slow recovery from the 2008 financial crisis. According to data from the Bureau of Economic Analysis (BEA), real wages and salaries in the financial sector expanded by 5.6 percent per year from 2002 to 2007, accounting for nearly half of total wage and salaries growth during the period. Wages in this sector then plummeted by 12 percent during 2008 to 2009 before recovering some of those losses in 2009 to 2010, growing by 7.2 percent. More recently, however, the industry has again declined by an average of 0.6 per year from 2010 to 2014.[6] Decelerations in the government and health care sectors have further depressed Connecticut's wage growth.[7,8]

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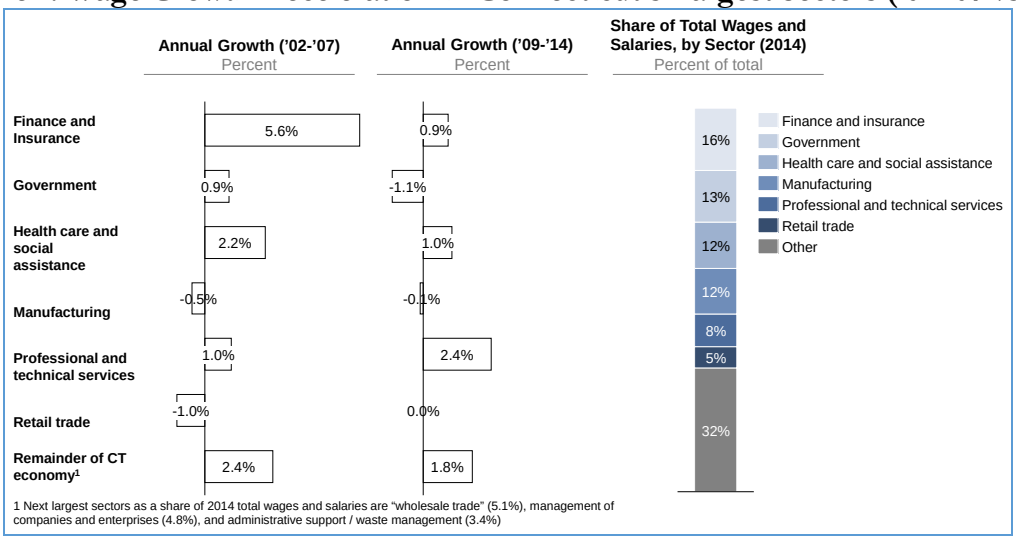
[5] Bureau of Economic Analysis regional personal income data ("Wages and Salaries by Industry" dataset). Retrieved from online tool at: http://www.bea.gov/itable/iTable.cfm?ReqID=70&step=1#reqid=70&step=1&isuri=1; adjusted for inflation using BEA's Implicit Price Deflator (GDP) estimates: http://bea.gov/iTable/iTable.cfm?reqid=9&step=3&isuri=1&903=13#reqid=9&step=3&isuri=1&903=13

[6] This decline has occurred despite the state's aggressive spending to retain finance jobs through tax breaks and other incentives. That spending has included hundreds of millions of dollars in tax expenditures (http://trendct.org/2016/02/17/tracking-government-subsidies-to-businesses-in-connecticut/), forgivable loans (http://www.courant.com/business/hc-ubs-to-stay-in-stamford-connecticut-20141031-story.html), and other incentives, including state and local tax credits.

[7] Wages and salaries growth from "government and government enterprises" is down from 0.9% per year from 2002-2007 to -0.6% in 2010-2014; "health care and social assistance" growth down from 2.2% to 1.0% per year.

[8] Connecticut's public sector employment has declined by roughly ten thousand jobs since 2010 after holding relatively flat in the preceding decade. Although a small drop in percentage terms (~1% of public sector employment), the impact of this decline is particularly heavily felt during lean economic times, when governments often spend more in efforts to boost their economies. For jobs data, see: http://www1.ctdol.state.ct.us/lmi/sectors/Government.asp. For more on the role government spending can play in stimulating economies (and the negative implications of cutting government spending during periods of economic weakness), see, e.g., Bivens, Josh. Economic Policy Institute. *Another Reminder About the Stupidity of Austerity*. November 2014. Retrieved from: http://www.epi.org/blog/reminder-stupidity-austerity/

Figure 1: Wage Growth Deceleration in Connecticut's Largest Sectors ('02-'07 vs '09-'14)



Source: Department of Commerce, Bureau of Economic Analysis

Because income tax revenues make up 53 percent of the general fund,[9] Connecticut has been hurt particularly hard by the post-Recession slow growth in wages. It is unclear whether this disappointing growth represents a "new economic reality," as Governor Malloy suggested in this year's State of the State address, or merely the lingering aftershocks of a major financial crisis.

Rise of low-wage jobs

Despite a declining unemployment rate, down to 5.5% from a high of 10% during the Great Recession,[10] residents have struggled to find jobs with salaries comparable to those they lost. Much of the country has suffered from this trend, but Connecticut has fared particularly poorly. Of Connecticut's nine largest employment sectors, employment in five have not recovered to pre-2008 levels, with job growth highest from 2008 to 2015 in the low-paying f leisure and hospitality sector.[11]

Figure 2: Connecticut Industry Growth – January 2008 - June 2015, and Average Annual Pay

Industry	Jan 2008 - June 2015 Change	2014 Average Annual Pay
Manufacturing	-15%	$81,393
Information	-14%	$93,027
Financial activities	-9%	$146,597
Construction	-3%	$61,052
Trade, transportation, and utilities	-3%	$47,564
Service providing	5%	$62,929
Professional and business services	8%	$84,715
Education and health services	13%	$51,947
Leisure and hospitality	26%	$20,847

Source: Bureau of Labor Statistics, Quarterly Census of Employment and Wages

[9] Office of Fiscal Analysis. *State Budget Projections*. March 28, 2016. Retrieved from: https://www.cga.ct.gov/ofa/Documents/year/proj/2016PROJ-20160328z_March%2028,%202016%20General%20Fund%20Projections.pdf

[10] As of February, the last month for which data is available. From Connecticut Department of Labor data. Retrieved from: http://www1.ctdol.state.ct.us/lmi/unempratectus.asp

[11] More than half of the state job growth from 2010 to 2014 came in the form of jobs paying in the bottom quintile of wages. See Kennedy et. al. Connecticut Association of Human Services. *The Economic and Fiscal Impact of Low-Wage Work in Connecticut*. April 2015. Retrieved from: http://cahs.org/wp-content/uploads/2015/04/issueBriefCT6.pdf

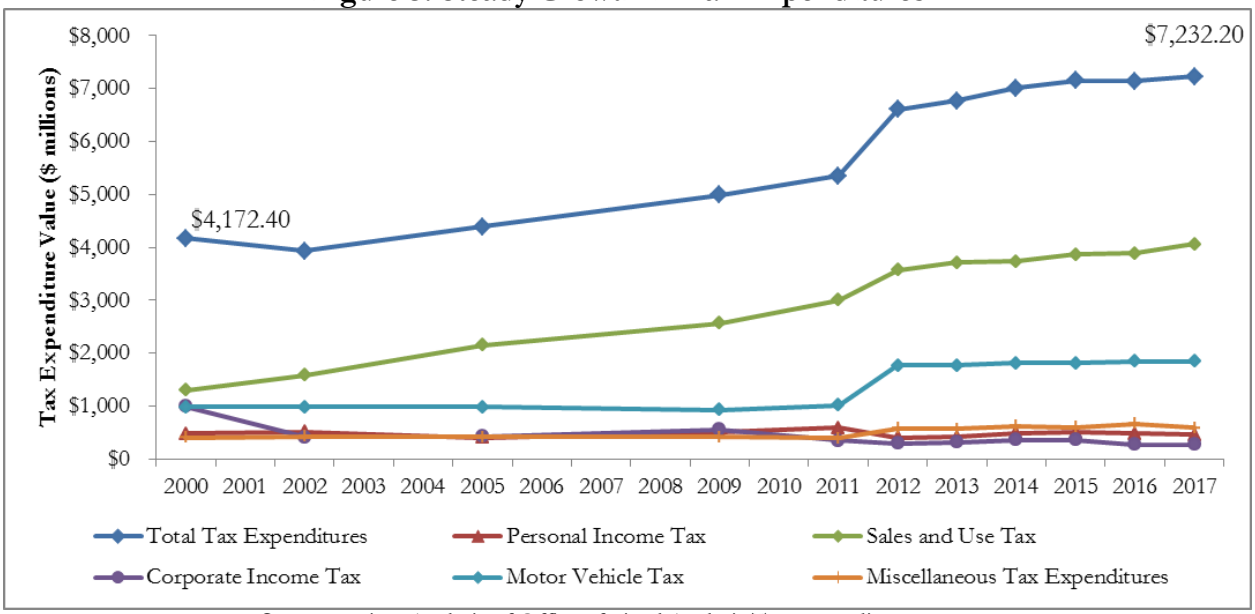
Although this economic shift has been felt most acutely by those forced into lower-paying jobs, the entire state is impacted by the low-wage job swap. First, as low-wage jobs have grown more quickly than high-paying ones, state revenue streams have been hurt by decreasing income tax revenues. Second, some of the largest and most profitable employers in industries that have seen the strongest growth during the recovery are relying on public assistance programs to supplement the low wages they pay their employees. Increased reliance by low-wage employers on work-support programs shifts costs to the state, contributing to budget shortfalls and threatening those very programs that provide working families a ladder into the middle class.[12]

Growth of tax expenditures

Unlike spending on schools, hospitals, and transportation, there will be little public debate during this year's budget negotiations on the $7.2 billion of revenue lost to tax expenditures. Tax expenditures reduce the amount of taxes that individuals and businesses owe in order to advance certain public policy goals, including making our tax code fairer and incentivizing the behavior of individuals and businesses. Once tax expenditures are enacted, however, they are rarely reviewed and typically become a permanent cost to the state – even when changing economic conditions or policy priorities would suggest that they should be modified or repealed. Connecticut' failure to review tax expenditures on a regular basis and to repeal those that are no longer serving their desired purposes has deepened the state's fiscal hole.

Tax expenditures have gradually increased from $4.2 billion in 2000 to nearly $7.2 billion in 2017, driven primarily by growing expenditures tied to the sales and use tax.

Figure 3: Steady Growth in Tax Expenditures[13]



Source: Voices Analysis of Office of Fiscal Analysis Tax Expenditure Reports.

[12] Such programs include the earned income tax credit, childcare, and health coverage. See our *Testimony Supporting S.B. 391: An Act Concerning The Recoupment Of State Costs Attributable To Low-Wage Employers:* http://www.ctvoices.org/sites/default/files/030816_humansvc_sb391_lowwages.pdf

[13] See our brief, *Reviewing Tax Expenditures: Improving Transparency and Accountability in Over $7 Billion of Off-the-Books Public Spending:* *http://www.ctvoices.org/publications/reviewing-tax-expenditures-improving-transparency-and-accountability-over-7-billion-boo*

Use of corporate credits has also grown significantly over the past few decades, as lawmakers seek to attract and retain businesses. In 2003, corporate taxpayers claimed $93.1 million in tax credits, but by 2012 that number had increased to $151.4 million.[14] In 2013, the value of those tax credits carried forward totaled $2.5 billion. Such credits have been concentrated in some of Connecticut's worst-performing sectors, including manufacturing and finance, raising questions about the credits' efficacy.[15]

Many other Connecticut companies barely pay any taxes at all.[16] For instance, more than 160,000 Connecticut companies operating as LLCs, LLPs, S corporations, and other pass-throughs pay just a nominal business entity tax of $250 every two years.[17,18]

Before the personal income tax system was adopted during the 1992 fiscal year, Connecticut collected a large share of its general fund revenues from corporate taxes (13.2 percent in 1991).[19] However, an expanding number of tax expenditures, combined with already-low tax rates, have led to corporate income tax collections totaling less than 4 percent of overall tax collections, significantly less than New York (6 percent) and Massachusetts (9 percent).[20, 21]

2) Rising long-term liabilities

Connecticut is struggling under the burden of long-term financial obligations that were in some cases made decades ago – and will take additional decades to address. For instance, many of Connecticut's pension promises were made more than 30 years ago and have been consistently under-funded in the years since. Unfunded state employee pension liabilities have grown rapidly from $3.2 billion in 1992 to $14.9 billion in 2014, while unfunded teachers' pension liabilities grew from $2.6 billion to $10.8 billion during the same period.[22] More than half of state employee pension liabilities are for "tier 1" employees, or those hired before July 1, 1984, while nearly all of the unfunded teachers' pension liabilities are for teachers hired before 1979.[23] The state has failed to fund those programs in the decades since, increasing the burden placed on this and future generations to pay for workers who, in many cases, retired years ago.[24]

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[14] Luna, LeAnn and Murray, Matthew. Presentation to CT Tax Panel. *An Evaluation of Connecticut's Corporate Income Tax*. October 2015. Retrieved from: https://www.cga.ct.gov/ofa/Documents/year/proj/2016PROJ-20160328z_March%2028,%202016%20General%20Fund%20Projections.pdf (p. 32)

[15] According to Good Jobs First, tax credits also typically find their way to large corporations rather than the small businesses they are often designed to support LeRoy et. al. Good Jobs First. *Shortchanging Small Business*. October 2015. Retrieved from: http://www.goodjobsfirst.org/sites/default/files/docs/pdf/shortchanging.pdf

[16] For example, Purdue Pharma, the maker of the pain medication, OxyContin.

[17] CT Department of Revenue Services. *Fiscal Year 2014-2015 Annual Report.* Retrieved from: www.ct.gov/drs/lib/drs/research/annualreport/drs_fy15_annual_report.pdf (p. 15)

[18] The dramatic transformation in the structure of business activity (54.2% of U.S. business income in 2011 was earned in the pass-through sectors, compared to only 20.7% in 1980) "accounts for much of the rise in inequality." Wessel, David. Wall St. Journal. *Surprising Data on Who Owns U.S. Firms & How Much They Pay in Taxes*. September 2015. Retrieved from: http://blogs.wsj.com/washwire/2015/09/24/surprising-data-on-who-owns-u-s-firms-and-how-much-they-pay-in-taxes/

[19] Corporation business taxes were calculated in FY 1991 as the greater (1) of 11.5% of net income proportioned to CT or (2) 0.31% of the average value of capital stock and surplus reserves, plus a 20% surtax. The State Budget for the 1990-1991 Fiscal Year. Retrieved from: https://www.cga.ct.gov/ofa/Documents/year/BB/1991BB-19900701_FY%2091%20Connecticut%20State%20Budget.pdf. (p. 19-20)

[20] Luna, LeAnn and Murray, Matthew. Presentation to CT Tax Panel. *An Evaluation of Connecticut's Corporate Income Tax*. October 2015: https://www.cga.ct.gov/fin/tfs%5C20140929_State%20Tax%20Panel%5C20151013/Connecticut%20business%20taxes.pdf (p.30)

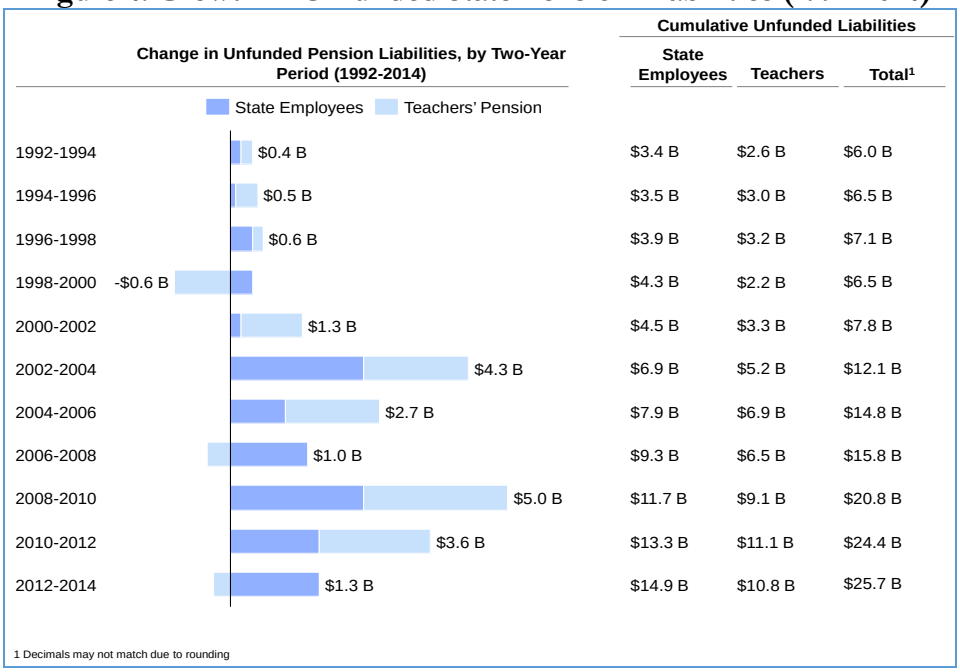
[21] Recognizing the problem, Connecticut lawmakers have started to act. In the summer of last year, lawmakers passed a bill limiting tax credits for future years to 50.01% of pre-credit tax liability (down from 70% prior to the bill's passage). Luna (p. 32)

[22] Office of Policy & Management. *Fiscal Accountability Report: Fiscal Years 2016-2020.* November, 2015. Retrieved from: http://www.ct.gov/opm/lib/opm/budget/fiscalaccountability/fiscal_accountability_november2015.pdf. (p. 34-35)

[23] Aubry, Jean-Pierre and Munnell, Alicia. *Final Report on State Employees Retirement System and Teachers' Retirement System*. November, 2015. Retrieved from: https://assets.documentcloud.org/documents/2511156/final-report-on-ct-sers-and-trrs-11-6-2015-boston.pdf.

[24] According to a recent report from the Center for Retirement Research at Boston College that was commissioned by OPM, this funding gap is driven by a few factors: (1) legacy costs from benefits promised before the systems were pre-funded in the 1970s and

Figure 4: Growth in Unfunded State Pension Liabilities (1992-2014)



Source: Office of Policy & Management. Fiscal Accountability Report: Fiscal Years 2016-2020.

Governor Malloy,[25] Treasurer Denise Nappier,[26] and Comptroller Kevin Lembo[27] have all put forward proposals for paying down these obligations. The question at the core of the debate is how best to spread this burden over time. Regardless of the ultimate decision, all plans will require the state's contribution to increase significantly from the $1.5 billion paid last fiscal year and continuing for at least the next few decades.[28] In addition to these pension difficulties, the state's bonded indebtedness is in excess of $22 billion, unfunded liabilities for state employee post-retirement health and life insurance are almost $20 billion, and unfunded liabilities for teachers' post-retirement health and life insurance add another $2.4 billion.

1980s (estimated at $9.3 billion); (2) inadequate contributions ($4.7 billion); (3) differences between actual and assumed investment returns (actually a windfall of $5.4 billion from 1985-2000, but a shortfall of $8.9 billion since 2000); and (4) changes in retirement behavior, partially in response to early retirement incentive programs ($4.1 billion, with roughly $1.5 billion due to the early retirement incentive programs). Aubry, Jean-Pierre and Munnel, Alicia. Center for Retirement Research at Boston College. *Final Report on Connecticut's State Employees Retirement System and Teachers' Retirement System.* November, 2015. Retrieved from: http://crr.bc.edu/wp-content/uploads/2015/11/Final-Report-on-CT-SERS-and-TRS_November-2015.pdf

[25] Governor Malloy's proposal would spread payments out over a longer period by splitting the pension program into two funds: one for those state employees hired before 1984 and another for those hired after. The governor would then convert the former into a "pay as you go" plan, allowing contributions to be made only when they are needed to pay retirees. This would stretch contributions all the way into the 2040s and, potentially, the mid-2050s, although at a lower annual rate than current plans (see http://ctmirror.org/2015/10/28/malloy-calls-for-pension-changes-business-tax-cuts/).

[26] State Treasurer Nappier would continue to work towards pre-funding state pension obligations, allowing Connecticut to benefit from investment returns. Her analysis disagrees with the governor's on the likely investment earnings that the state could anticipate, with her estimates more optimistic than the Governor's (see https://www.documentcloud.org/documents/2646513-Funding-CT-s-Pension-Liabilities-Analysis-of.html; http://ctmirror.org/2015/12/10/treasurer-offers-alternative-vision-for-state-pension-fix/).

[27] State Comptroller Lembo offers a compromise approach, getting ahead of projected contributions by about $550 million in the next few years, then reducing payments below current projections in the 2020s and early 2030s. Finally, Connecticut would pay $8 billion extra between 2033 and 2041 (see http://www.osc.ct.gov/pension/docs/PensionFunding_Whitepaper.pdf; http://ctmirror.org/2016/01/14/lembo-offers-a-detailed-plan-to-cope-with-pension-costs/).

[28] Phaneuf, Keith. CT Mirror. *Lembo Offers Detailed Plan to Cope With Pension Costs.* January, 2016. Retrieved from: http://ctmirror.org/2016/01/14/lembo-offers-a-detailed-plan-to-cope-with-pension-costs/

Part of the reason that these liabilities have snowballed is the skewed incentive structure created by the state's "balanced budget" laws. Because bonded debt and long-term pension and health liabilities do not fall under the annual operating budget, they provide a short-term release valve for budgetary pressures, albeit with gradually increasing long-term consequences.

3) Persistent social, racial, geographic, and economic inequalities

Though state and local investments in high-quality public services, such as health care and education, contribute to overall levels of prosperity that compare well to the rest of the nation, the story is vastly different for many residents. [29]

Poverty rates for black residents (20.8 percent) and Hispanic residents (26.5 percent) are three to four times that of white residents (6.1 percent). Among children, the disparity is even wider: 5.6 percent of white children live in poverty, and, alarmingly, 30.5 percent of black children and 33.5 percent of Hispanic children live in poverty. Across town lines, more than a third of all individuals and nearly half of Hartford's children live in poverty (three times the state child poverty rate of 14.8 percent and 25 times that of some of the state's wealthiest towns). Even *within* towns, racial disparities exist: in West Hartford, the poverty rate for blacks is more than 23 percentage points higher than that of whites. Statewide, Connecticut's income gap is the second largest in the nation just behind New York – the average income of the highest 1 percent of earners is 51 times greater than the average income of everyone else.[30,31]

Connecticut's disparities stretch beyond just income, as they also affect residents' health and education. The state's poor-non-poor K-12 education achievement gaps are among the nation's worst, levels of educational attainment differ significantly by race,[32] and student performance varies by school and school district.[33] Health outcomes also vary significantly by race, ethnicity, income, place of birth, and place of residence.[34] These disparities represent more than lost opportunities for individual low income parents and children. They also create an overall drag on the economy by limiting the productive potential of swaths of the population.[35] Children in Bridgeport whose parents' earnings are in the bottom income quintile have a slim 7.9 percent chance of growing up to earn in the top quintile, representing clear untapped productive potential – not to mention an inherently unfair situation.[36,37]

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[29] See our *Mapping Disparities by Race and Place Maps*: http://www.ctvoices.org/publications/mapping-disparities-race-and-place

[30] Sommeiller, Estelle and Price, Mark. Economic Policy Institute. *The Increasingly Unequal States of America.* January, 2015. Retrieved from: http://www.epi.org/publication/income-inequality-by-state-1917-to-2012/

[31] U.S. Census Bureau, American Fact Finder. *1 Year Estimate of Gini Index Of Income Inequality.* Retrieved from: http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_14_1YR_B19083&prodTyp e=table

[32] United States Department of Education, National Center for Education Statistics, NAEP (National Assessment of Educational Progress) Data Explorer. Retrieved from: http://nces.ed.gov/nationsreportcard/naepdata/

[33] Connecticut Department of Education. *Data Interaction for Connecticut Mastery Test (4th Generation).* Retrieved from: http://solutions1.emetric.net/cmtpublic/Index.aspx; Connecticut Council for Education Reform. *Gap in Your District.* Retrieved from: http://ctedreform.org/gap-in-your-district/

[34] Connecticut Department of Public Health. *Healthy Connecticut 2020: State Health Assessment.* March 2014. www.ct.gov/dph/lib/dph/state_health_planning/sha-ship/hct2020/hct2020_state_hlth_assmt_032514.pdf

[35] The Economist. *The Economist Explains: How Inequality Affects Growth.* June 2015. Retrieved from: http://www.economist.com/blogs/economist-explains/2015/06/economist-explains-11; Poulin, Stephanie. Connecticut Department of Public Health. *Cost of Disparity Analysis.* April, 2014. Retrieved from: www.ct.gov/dph/lib/dph/hems/health_equity/ct_costdisparity_apr2014_web.pdf; LaVeist et al. International Journal of Health Services. *Estimating the economic burden of racial health inequalities in the United States.* 2011, 41(2): 231-238; Woolf et al. American Journal of Public Health. *The health impact of resolving racial disparities: An analysis of US mortality data.* 2004, 94(12): 2078-2081

[36] Harvard Equality of Opportunity Project. *Causal effects of the 100 Largest Counties on Household Income in Adulthood.* Retrieved from: http://www.equality-of-opportunity.org/index.php/city-rankings/city-rankings-all

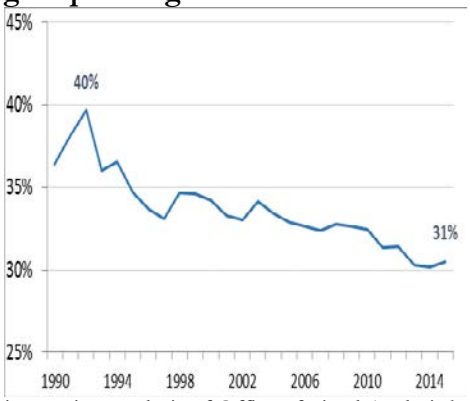
These gaps in income, wealth, mobility, and well-being are not the result of mere chance. Rather, they are the result of longstanding policy decisions, particularly an over reliance on the property tax to finance all local functions - a decision that has contributed to vast discrepancies in opportunity, massive inefficiencies, residential segregation, and decreased economic competitiveness as a state.[38]

4) Under-investment in areas critical to long-term prosperity

A decline in human and infrastructure investments may further harm Connecticut's long-term potential.

Connecticut's human capital is one area of concern. Every year, Connecticut Voices for Children tracks trends in the state's spending on education and health and human services (the "Children's Budget"). Two decades ago, nearly 40 percent of the budget went to young people. Today, that is down to 30 percent. Diminished investment in the education and health of today's children – particularly at a time of still-increasing and record-high poverty – puts tomorrow's prosperity at risk.[39]

Figure 5: Children's Budget Spending Has Declined as a Share of the General Fund



Source: Connecticut Voices analysis of Office of Fiscal Analysis budget books

Connecticut's higher education system has suffered from a similar de-prioritization. In 1998, the state funded almost 45 percent of the UConn system's operating costs, a number that dropped to 30 percent by 2015.[40] This has required students to foot more and more of the bill, with in-state tuition currently at almost $14,000 per year, roughly double what it was in 1998, after adjusting for inflation.[41] Out of state students, meanwhile, now pay almost $35 thousand per year in tuition, 75 percent more than they did in 1998. The rest of the state's higher education system has faced similar financial challenges, though with less ability to relieve some of that burden through charging out-of-state students more.[42]

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[37] Chetty et. al.. NBER Working Paper No. 19843. *Where is the Land of Opportunity? The Geography if Intergenerational Mobility in the United States*. Retrieved from: http://www.nber.org/papers/w19843 (p.

[38] Lemar, Anika Singh. Hartford Courant. *CT Blowing Chance to Fix Property Tax Problem.* April 2016. Retrieved from: http://www.courant.com/opinion/op-ed/hc-op-lemar-reform-ct-property-tax-0403-20160401-story.html

[39] See our issue brief, "The Children's Budget: Investing in Our Future": http://www.ctvoices.org/publications/childrens-budget-investing-our-future

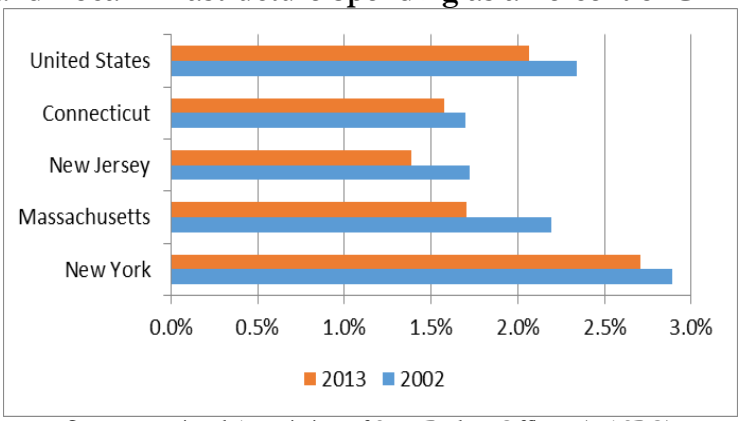
[40] Thomas, Jacqueline. CT Mirror. *Higher Education Cut, Local School Aid Flat in Malloy Budget.* February 2015. Retrieved from: http://ctmirror.org/2015/02/18/higher-education-cut-local-school-aid-flat-in-malloy-budget/

[41] Thomas, Jacqueline and Chang, Alvin. CT Mirror. *The State of UConn in 15 Charts*. June, 2015. Retrieved from: http://ctmirror.org/2015/06/29/the-state-of-uconn-in-15-charts/

[42] See, e.g.: Megan, Kathleen. Hartford Courant. *Plan Would Hike Tuition Again at Connecticut State Universities, Community Colleges*. March 28, 2016. Retrieved from: http://www.courant.com/education/hc-state-universities-tuition-increase-0324-20160323-story.html

Notwithstanding recent investments, Connecticut has also consistently under-invested in other forms of capital, particularly its physical infrastructure. State and local infrastructure spending as a share of state GDP have consistently trailed both the national average and peer states, while declining further in recent years.[43, 44]

Figure 6: State and Local Infrastructure Spending as a Percent of GDP, 2002 - 2013



Source: National Association of State Budget Officers (NASBO)

This spending decline has contrasted with the state's growing need for infrastructure investments. According to the American Society of Civil Engineers' (ASCE) 2013 Report Card, 41 percent of Connecticut's roads are in poor condition (costing motorists $1.6 billion a year).[45,46] In addition, the ASCE's report card identifies $2.6 billion in school infrastructure funding needs, $3.6 billion in wastewater infrastructure, and $84 million in park system improvements. National research shows that neglected infrastructure can have a disproportionate impact on the state's poorest residents, exacerbating existing geographic inequalities.[47,48]

[43] See our blog post, "Building Connecticut's Future:" http://www.ctvoices.org/blog/20160318/building-connecticuts-future

[44] The Federal Highway Administration estimates that 34% of CT bridges are either "structurally deficient" or "functionally obsolete." (see http://ctbythenumbers.info/2016/03/23/ct-ranks-10th-in-percentage-of-structurally-deficient-functionally-obsolete-bridges/)

[45] American Society of Civil Engineers. *2013 Report Card*: http://www.infrastructurereportcard.org/connecticut/connecticut-overview/

[46] Additionally, the Federal Highway Administration estimates that 34% of Connecticut's bridges are either "structurally deficient" or "functionally obsolete." (see http://ctbythenumbers.info/2016/03/23/ct-ranks-10th-in-percentage-of-structurally-deficient-functionally-obsolete-bridges/)

[47] Nationally, in areas where 75% or more of students are eligible for free and reduced lunch, 60%of schools are in need of repair. Low-income neighborhoods often also have a higher share of potentially poisonous lead pipes. In most cases, these disparities are best addressed at the state level, since the municipalities themselves are usually poorer. This is particularly true where municipalities are reliant on property taxes to fund infrastructure investment and upkeep. Center on Budget and Policy Priorities. *It's Time for States to Invest in Infrastructure*. February 2016. Retrieved from: http://www.cbpp.org/research/state-budget-and-tax/its-time-for-states-to-invest-in-infrastructure

[48] Connecticut has started to make progress in addressing its infrastructure needs. The Governor's "Let's Go CT!" plan sets a long-term vision for infrastructure improvements, including a new rail connection between New Haven an Hartford, expansion of bus systems, highway improvements, and enhancements to municipal transportation infrastructure. This program has yet to attain full funding, however, and only addresses the state's needs within transportation – not other critical infrastructure areas, such as schools, housing, water, and energy.

SECTION 2: Lawmakers Should Leverage and Build Upon Existing Advantages

Connecticut lawmakers face difficult choices as they seek to address the state's long-term, structural challenges. Fortunately, many of the building blocks for a sustainable recovery are already in place: Connecticut remains one of the country's most prosperous states, with several competitive advantages to help it retain that status for years to come. Any proposal to address Connecticut's long-term challenges should keep these economic strengths in mind.

Connecticut leads the nation in economic prosperity and human well-being: Years of economic prosperity have helped the state attain one of the highest standards of living and best access to economic opportunity in the country.[49, 50] For example: per capita income is more than $61,000 per year, compared to a national average of approximately $45,000[51]; life expectancy is the third highest in the nation; the percentage of the population holding a bachelor's degree or higher is the fifth highest in the country (and fourth highest for holding a graduate or professional degree)[52]; the state's 10.8 percent poverty rate is the third lowest in the nation and the child poverty rate of 14.4 percent is the sixth lowest.[53] Connecticut's remarkable progress in human development is indicative of the vast economic resources that can be brought to bear to make its residents' lives better.

Connecticut is one of the most attractive places to do business in the country: Companies seeking to put the state's well-educated and highly productive workforce to use can do so relatively cheaply. Business taxes of 3.4 percent of gross state product are the third lowest in the country, trailing only Oregon and North Carolina, and significantly lower than Massachusetts (4.1 percent), New York (5.7 percent), New Jersey (5.1 percent), Texas (4.9 percent), and California (4.4 percent).[54] Connecticut also reinvests more of those business tax dollars in infrastructure, public safety, and education than any state in the country except Maryland – in turn supporting local business.[55]

Connecticut remains a strongly rated borrower: Connecticut can use its strong credit ratings and historic low interest rates to make strategic investments in the state's physical and human capital which will fuel long-term economic growth. Connecticut holds strong credit ratings with all four ratings agencies[56] and is currently financing its investments with exceptionally low interest rates. For example, last December Connecticut completed a $650 million bond sale with a 3.26 percent interest rate and "strong interest" from investors.[57] As anyone financing a home, taking out loans to buy a car, or paying off student debt knows, 3.26 percent is an exceptionally low interest rate.

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[49] Connecticut's residents enjoy some of the strongest economic opportunities in the country, earning the state third place on the 2015 Opportunity Index Score, a composite index of 16 economic, education, and community indicators by the Social Science Research Council & Opportunity Nation. Measure America. *The Opportunity Index*. http://opportunityindex.org/#4.00/40.00/-97.00/

[50] For more on Connecticut's competitive advantages, see, for example: Connecticut Department of Economic and Community Development. *2015 Strategy*. Retrieved from: http://www.ct.gov/ecd/lib/ecd/2015_strategic_plan_final.pdf

[51] *FY 2016-2017 Biennium Economic Report of the Governor*. Retrieved from: http://www.ct.gov/opm/lib/opm/budget/2016_2017_biennial_budget/budget/economicreportofthegovernor.pdf

[52] Measure of America. Measuring America. Retrieved from: http://www.measureofamerica.org/maps/

[53] United States Census Bureau, American Community Survey Data

[54] Ernst & Young "Total State and Business Taxes." October, 2015: http://www.cost.org/WorkArea/DownloadAsset.aspx?id=91531 (p. 13)

[55] Ernst & Young (p. 18) – if considering the index that counts 50% of education expenditures as "benefiting business," although Connecticut performs well even in the index that excludes education spending.

[56] Connecticut holds an "AA" rating from Fitch (https://www.fitchratings.com/site/fitch-home/pressrelease?id=988426), an "AA" from Kroll (https://www.krollbondratings.com/announcements/2121), an "AA3" from Moody's (https://www.moodys.com/research/Moodys-assigns-Aa3-to-650M-State-of-Connecticut-GO-bonds--PR_338346) and an "AA" rating from Standard & Poor's: (http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/06/09/sp-ratings-2014). Note that some agencies have recently given Connecticut a negative outlook, primarily driven by uncertainties about long-term fiscal policies and the need for Connecticut to show a clear long-term path to fiscal sustainability, not due to the state's absolute levels of bonded indebtedness. For more, see, e.g.: Stuart, Christine. CT News Junkie. *3 of the 4 Wall Street Ratings Agencies Have a "Negative Outlook" of Connecticut Bonds*. March 2016: http://www.ctnewsjunkie.com/archives/entry/3_of_the_4_wall_street_rating_agencies_have_a_negative_outlook_of_connectic/

[57] CT Treasurer's Office Press Release, "Treasurer Nappier Announces Bond sale Achieves Strong Retail Interest, Attractive Interest Rate," December 2015: http://www.ott.ct.gov/pressreleases/press2015/PR120315TreasuryAnnouncesSuccessfulBondSale.pdf

SECTION 3: Address Long-Term Challenges Head-On, Avoid "Quick-Fixes"

Lawmakers should adopt a budget for Fiscal Year 2017 that avoids short-term austerity and instead focuses on addressing Connecticut's long-term, structural challenges. Although the specifics of that budget will require significantly more discussion and compromise, below are a few guiding principles to set the stage for that conversation.[58]

Principle 1: Adopt a balanced approach to the State's budget
In confronting the fiscal crisis looming over state budget decisions, the common-sense choice for Connecticut should be a balanced approach that includes revenue, rather than a cuts-only approach that threatens an already fragile economic recovery. A balanced approach to addressing the deficit would not center on cutting services for struggling families and their children. On the revenue side, there are opportunities to invest in Connecticut's future by closing tax loopholes, modernizing outdated tax laws, and calling upon the wealthiest to pay a fair share.

Likewise, to make our public budgeting system more accountable and transparent, we must hold the $7.24 billion lost annually to tax expenditures to the same standard as spending on education, health, and social safety net programs by performing regular review and holding public hearings.

- *Revenue Options are Crucial to Maintaining Public Investments that Promote Prosperity*: http://www.ctvoices.org/publications/revenue-options-are-crucial-maintaining-public-investments-promote-prosperity
- *Reviewing Tax Expenditures: Improving Transparency and Accountability in Over $7 Billion of Off-the-Books Public Spending:* http://www.ctvoices.org/publications/reviewing-tax-expenditures-improving-transparency-and-accountability-over-7-billion-boo
- *Why Connecticut's Business Climate is About More than Corporate Taxation*: http://www.ctvoices.org/blog/20151124/why-connecticut%E2%80%99s-business-climate-about-more-corporate-taxation

Principle 2: Protect human and physical infrastructure investments
Investments in health care, human services, and education to support the next generation are critical to ensuring our children grow up ready to meet their full potential. Already, less than one-third of Connecticut's General Fund spending supports programs that benefit children and families – down from 40 percent in the early 1990s.

Similarly, by capitalizing on current low interest rates, Connecticut infrastructure investments can improve the state's economy now and in the future. In the short term, infrastructure investments support employment, such as construction jobs, which are still below pre-recession levels. In the longer term, investments in education, the social safety net, and work support programs, and infrastructure not only support job growth and improve well-being, but also stimulate the economy by yielding high economic returns.[59,60] Targeted infrastructure investments are also crucial in addressing inequality, as poorer areas often have worse infrastructure.

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[58] We are encouraged to see lawmakers and advocacy groups already taking a broad and thoughtful approach. For example, the 2015 Project B.E.S.T. Summit brought together 175-plus leaders to discuss common pathways for Connecticut's economic future. We share the conference attendees' interest in bridging the economic growth and income gaps, improving investments in public education and helping towns to attain revenue diversification options, among other things: See: http://www.ccm-ct.org/best-summit

[59] Wasylenko, Michael. Syracuse University. Presentation to Connecticut State Tax Panel: *Competiveness: Connecticut's Economy and the Role of Fiscal Variables in Growth*. September 2015: https://www.cga.ct.gov/fin/taskforce.asp?TF=20140929_State%20Tax%20Panel

- *Impact of the Governor's Proposed FY 2017 Budget on Children and Families:* http://www.ctvoices.org/publications/impact-governors-proposed-fy-2017-budget-children-and-families
- *Impact of the Governor's Proposed FY 17 Midterm Budget Adjustment on Early Care and Education:* http://www.ctvoices.org/publications/impact-governor%E2%80%99s-proposed-fy-17-midterm-budget-adjustment-early-care-and-education
- *The Children's Budget: Investing in Our Future:* http://www.ctvoices.org/publications/childrens-budget-investing-our-future
- *Independent Performance Monitoring in the HUSKY Program: Ensuring Accountability for Scarce State Dollars:* *http://www.ctvoices.org/publications/independent-performance-monitoring-husky-program-ensuring-accountability-scarce-state-2*
- *Restoring State's Earned Income Tax Credit Makes Sense:* http://www.ctvoices.org/publications/restoring-connecticuts-earned-income-tax-credit-makes-sense
- *Time is Right for Investing in Connecticut's Wobbly Infrastructure:* http://www.ctvoices.org/blog/20160318/building-connecticuts-future

Principle 3: Equalize tax burden and resources across towns and cities
At present, the array of social and educational services in any given town differs dramatically based on local wealth. Property tax reform provides an enormous opportunity to reduce the yawning fiscal gaps among towns, help all children in all places get an equal opportunity to succeed, encourage economic growth, and retain families, who, in the wake of a low-wage economic recovery, have seen housing costs escalate.

- *Policy Primer: Reforming Our Property Tax System:* http://www.ctvoices.org/publications/policy-primer-reforming-our-property-tax-system
- *Mapping Disparities by Race and Place:* *http://www.ctvoices.org/publications/mapping-disparities-race-and-place*
- *State of Working Connecticut:* *http://www.ctvoices.org/stateofwork*

By addressing the state's structural challenges through these principles, lawmakers can use Connecticut's advantages to ensure long-term growth, without resorting to short-sighted measures.

[60] Burket, Allison. Results. *Return on Government Investment: Key Programs Come Out On Top!* July 2012. Retrieved from: http://www.results.org/blog/return_on_government_investment_key_program_come_out_on_top/