# Commission on Fiscal Stability and Economic Growth

October 2, 2018

# The Charge to the Commission:

***"Develop and recommend policies to achieve state government fiscal stability and promote economic growth and competitiveness within the state. Study and make recommendations regarding state tax revenues, tax structures, spending, debt, administrative and organizational actions and related activities, to:***

***(1) achieve consistently balanced and timely budgets that are supportive of the interests of families and businesses and the revitalization of major cities within the state, and***

***(2) materially improve the attractiveness of the state for existing and future businesses and residents."***

## Commission Activities:

- 14 Commissioners were appointed, effective December 15, 2017, eight by Governor Malloy, including the Co-chairs and Vice-chair, and six, one each, by the legislative leadership
- Mandated vote by Committees / Legislature on Commission's recommendations
- Commission members are private sector appointees from varied backgrounds and are diverse in gender, age, ethnicity, race and geography
- Commission held eight public hearings and heard from over 40 witnesses
- Reviewed thousands of pages of submitted testimony and research
- Report completed in 76 days on time, delivered on March 1
- Complimentary review by Governor
- Wide support from editorial boards throughout the state
- Extensive hearings and meetings with legislative leaders and most members of the General Assembly
- Dozens of external speaking engagements

# A “strawman” vision for CT

**A long-term vision is required to propel our state back to greatness...**

Target CT economic **growth rate of 3%+** *(vs. flattish today)*

Achieve fiscal stability
- Sustainably balanced budget
- Manageable debt levels & unfunded liabilities

**Achieve Sustainable High Quality of Life For All Connecticut Residents**

Raise key **competitiveness factors** from bottom quartile to **above median within 3-5 years** and achieve **top quartile competitiveness by 2025**

**Maintain** critical services while **protecting vulnerable populations**

***Commission recommends short-term, medium-term and long-term actions that will enable improved competitiveness and higher growth***

# Connecticut’s Burning Platform

Commission on Fiscal Stability and
Economic Development

# We Are Standing on a Burning Platform – Core Issues To Remember

1. Connecticut's economy (real GSP) has shrunk by 9.1% over 10 Years, in contrast to our New England neighbors who grew 12.9% excluding CT

2. Connecticut personal income growth ranked 44th in the nation in 2017, and ranked in bottom 1/3 for last five years

3. Connecticut's economic competitiveness has collapsed from 8th to 43rd from 2001-2016

4. Out year general fund deficits are $2-3 billion, growing at $500 million per year

## We Are Standing on a Burning Platform – Core Issues To Remember

5. Fixed expenditures are growing at over 5% and accelerating; will be 53% of general fund expenditures in 2020, crowding out important spending and investment

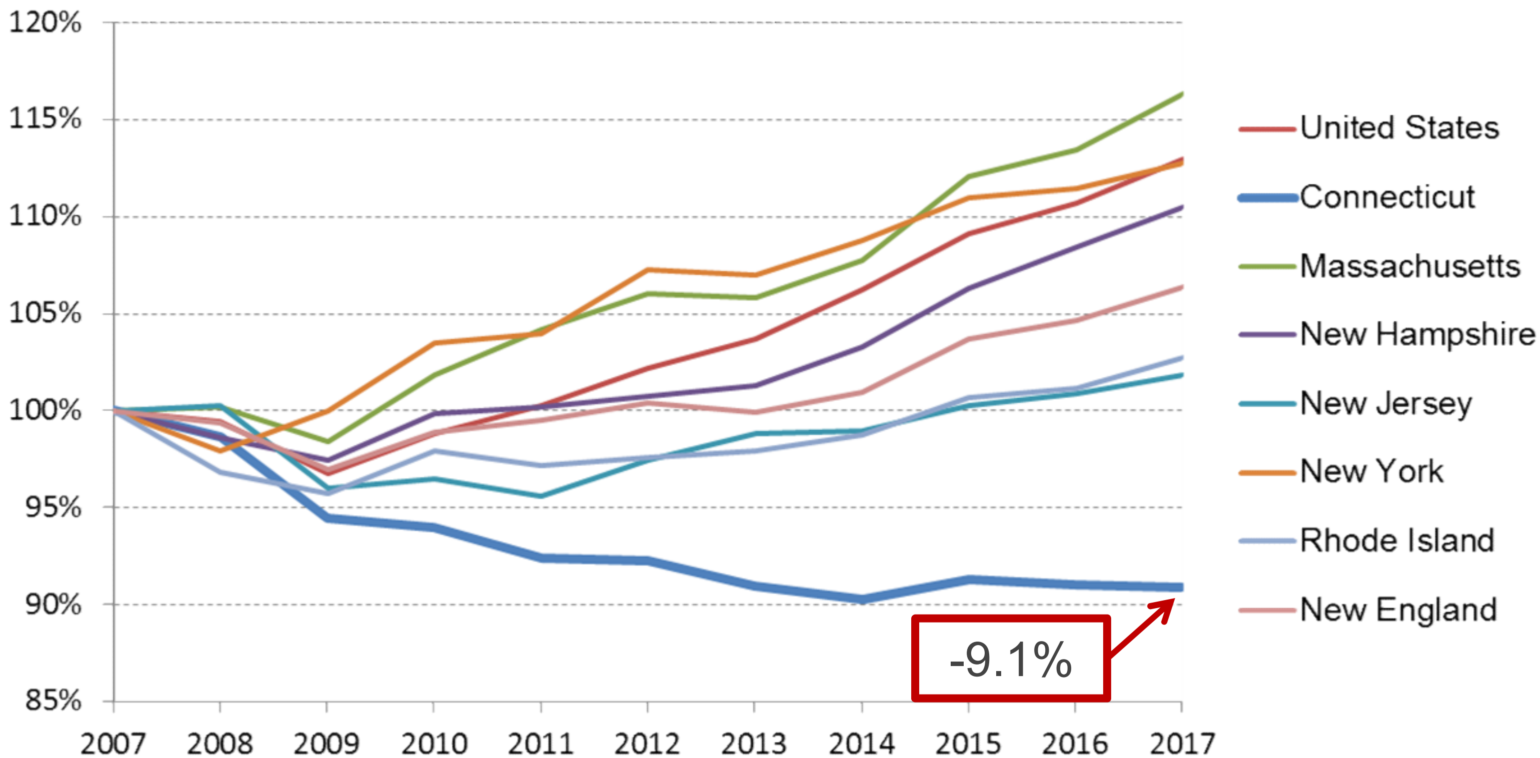
6. Connecticut has $100 billion in unfunded liabilities and debt using proper assumptions; $100K per Connecticut homeowner

7. Protracted underinvestment in Connecticut's transportation infrastructure is a fundamental impediment to economic growth

8. Connecticut cities' reliance on property taxes generates insufficient revenue to develop vibrant urban cores that are critical to the state's economic growth and well-being

## 1 Connecticut's Economy Has Shrunk By 9.1% Over 10 Years, In Contrast to Our Neighbors

**Indexed Real GDP by state (millions of chained 2007 dollars)**



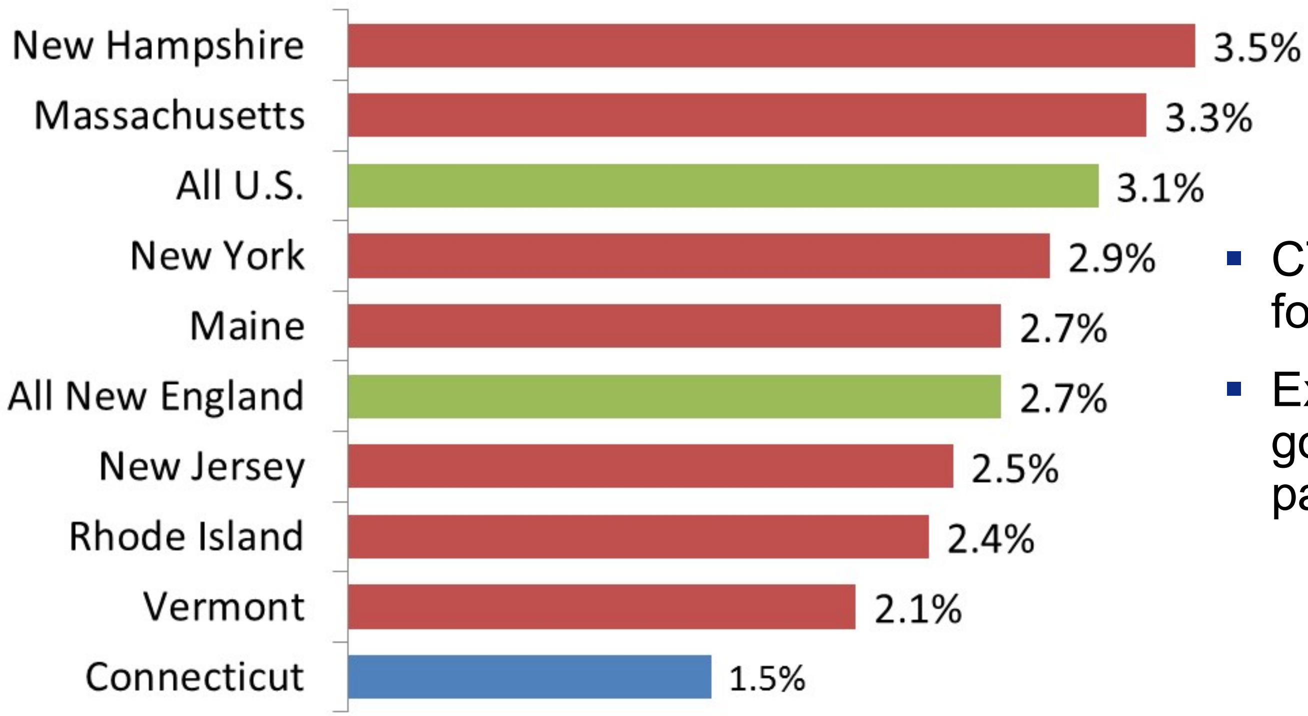

- Adjusted for inflation Connecticut's economy is the same size as in 2004
- Connecticut real GDP down 9 out of the past 10 years (year over year)
- Connecticut's 2017 shrinkage of 0.2% ranked 49th nationally

Source: Bureau of Economic Analysis, Gross State Product

# 2 Connecticut's personal income grew at the slowest pace among Neighboring States in 2017

- From 2012 – 2016 Connecticut personal income growth ranked 33rd to 49th

**Percent change in personal income, 2016 – 2017**

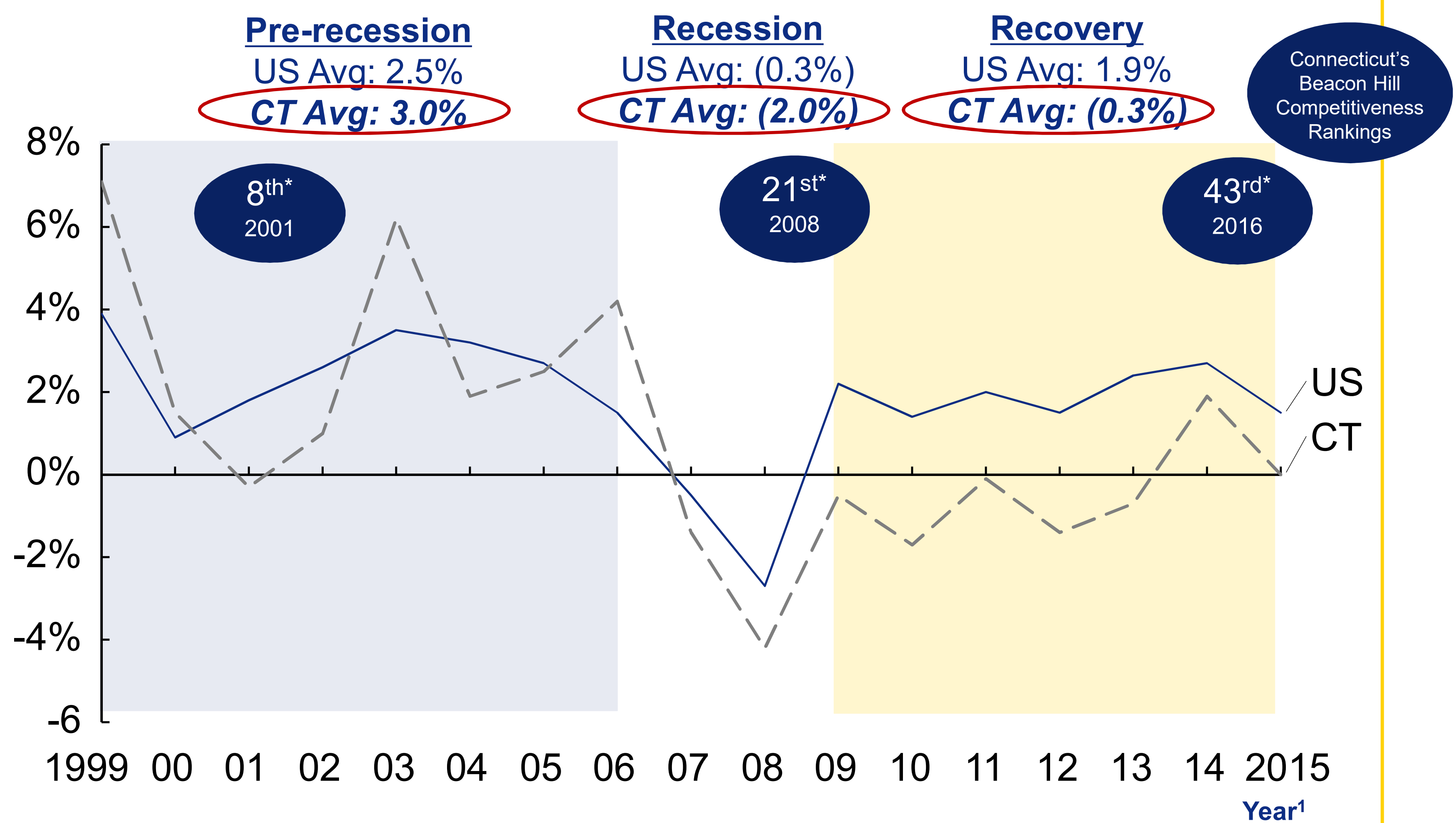



- CT ranked 44th in nation for 2017
- Excluding dividends and government transfer payments:
  - United States: 3.3%
  - CT: 0.1% - 2nd worst in nation

Source: U.S. Bureau of Economic Analysis; WSJ: The Regressive State of America

# 3 Connecticut's Economic Competitiveness Has Collapsed from 8th to 43rd from 2001 to 2016

**CT GDP growth rate** % change from preceding period



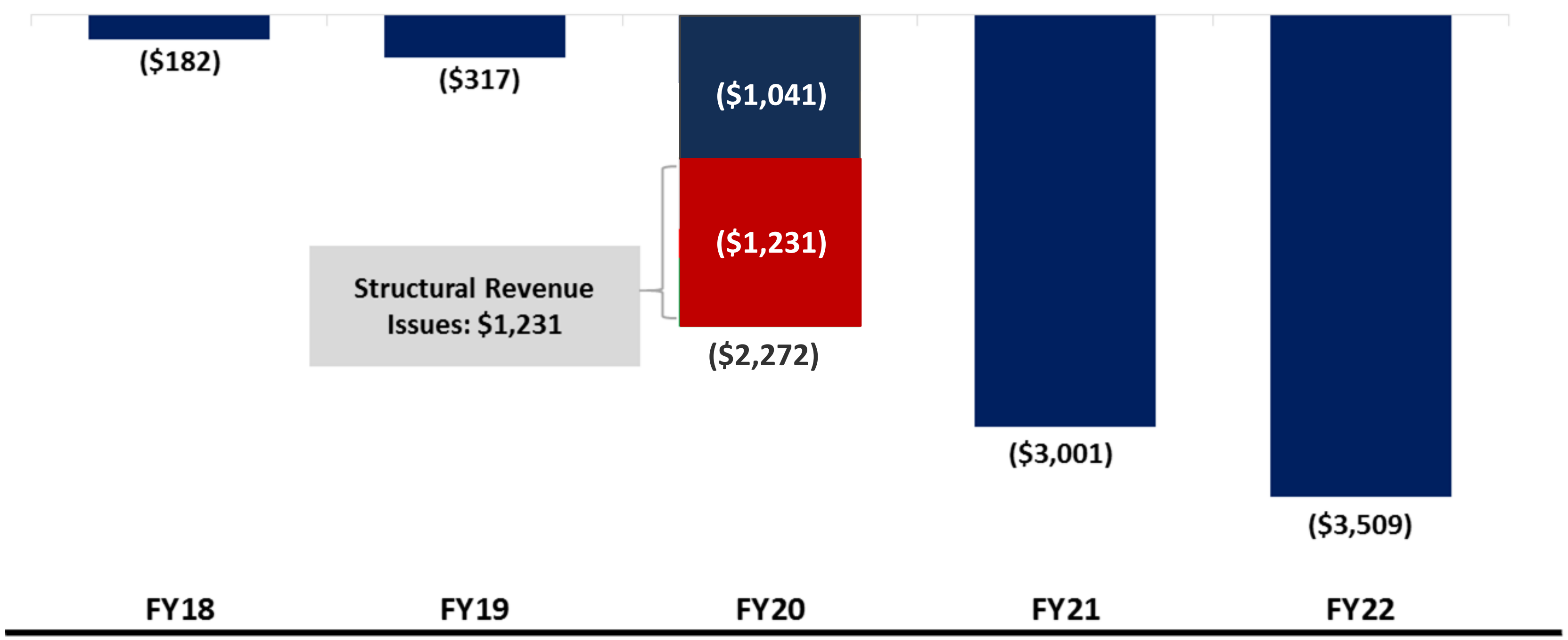

1 Each year represents the calculation between two years. For example, "1999" was calculated between "1999-2000"

SOURCE: Bureau of Economic Analysis

* Beacon Hill Competitiveness Rankings

# Despite achieving a bipartisan budget in 2017, significant out year deficits loom

**Connecticut State Forecasted Budget Balances ($ in millions)[1]**




(1) Source: FY18-19 Biennial Budget, January 2018 Consensus Revenue Estimates, January 2018 OPM Budget Estimates, OFA Out Year Estimates

# 5 Fixed expenditure growth is accelerating and is crowding out important spending and investment

**Projected General Fund Expenditure Growth[1]**

| Category ($ in millions) | Actual FY06[2] | FY17[3] | Projected FY20 | Annual Growth '06 to '20 | Annual Growth '17 to '20 |
|---|---|---|---|---|---|
| Pension | $884 | $2,161 | $2,640 | 8.1% | 6.9% |
| Retiree Healthcare | $411 | $751 | $1,077 | 7.1% | 12.8% |
| Debt Service | $1,306 | $2,076 | $2,410 | 4.5% | 5.1% |
| Entitlement Programs[4] | $2,813 | $3,787 | $4,322 | 3.1% | 4.5% |
| **General Fund Fixed Expenditures** | **$5,420** | **$8,796** | **$10,458** | **4.8%** | **5.9%** |

**Projected average annual fixed expenditure increases of 5.9% from FY 2017 to 2020**

Source: OFA Fiscal Accountability Report FY17 – FY 20. Connecticut CAFR. 2017 Annual Report of the State Comptroller. OFA Fiscal Note to Enacted Biennium Budget. OPM and OFA January 16, 2018 Consensus Revenue Estimates. OPM January 19, 2018 Budget Letter.

(1) Fixed cost data from OFA Fiscal Accountability Report dated Nov 15, 2016 and is not reflective of enacted budget and projections.

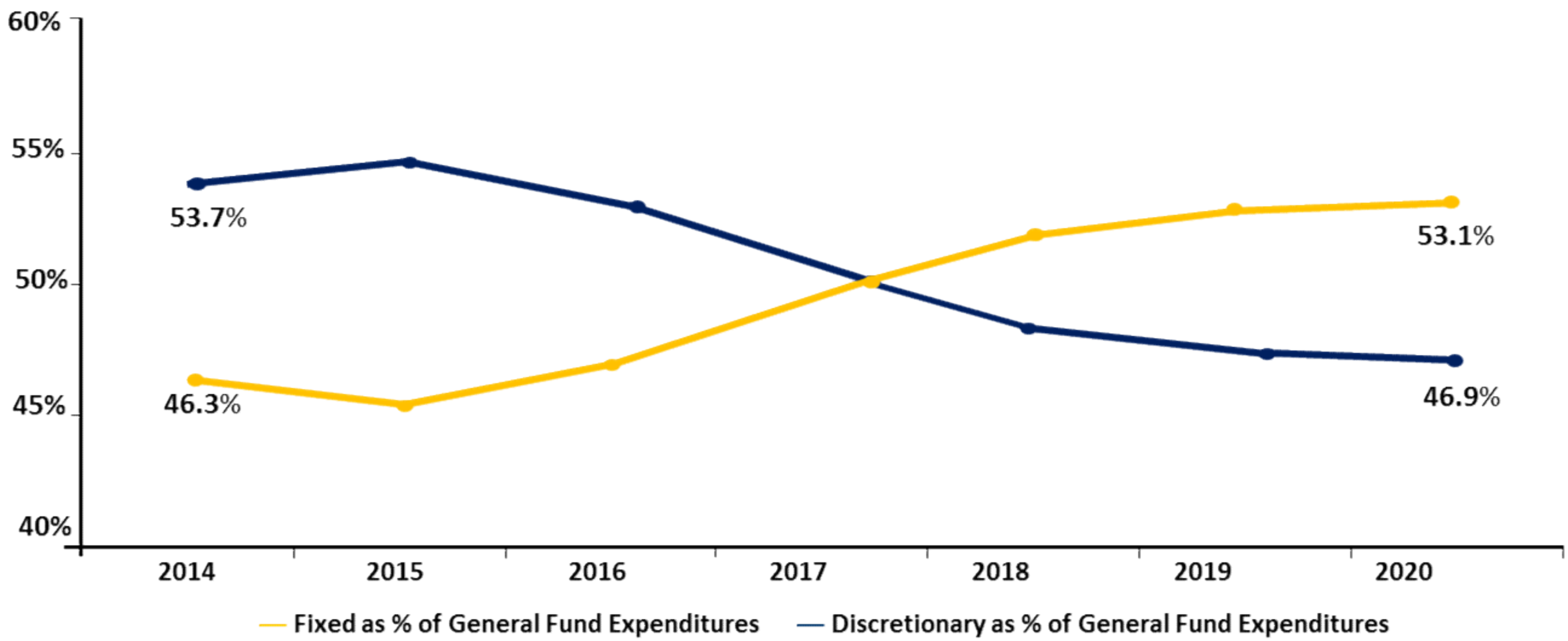
(2) FY06 General Fund revenues and expenditures based on gross funding of Medicaid (includes both federal and local portion).

(3) FY17 General Fund fixed expenditures per OFA Fiscal Accountability Report FY17 – FY20. FY17 total General Fund expenditures and revenues per 2017 State Comptroller's Annual Report.

(4) Includes Medicaid and other services provided by the Department of Social Services, Department of Children and Families, Department of Mental Health and Addiction Services, and Office of Early Childhood.

# Fixed costs have grown to over 50% of the general fund

**General Fund Fixed vs. Discretionary Costs (% of General Fund Expenditures)**

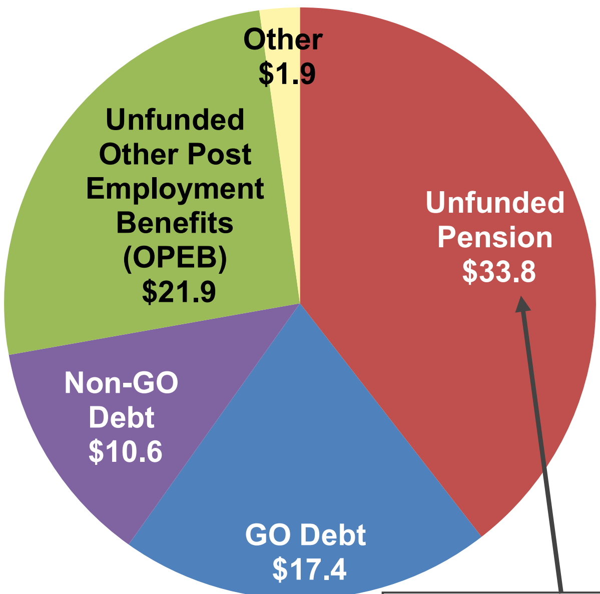



Source: 2014-2016 Annual Reports of the State Comptroller, OFA Fiscal Accountability Report FY17 – FY 20

# 6 CT's unfunded liabilities are growing 3x faster than the economy over the last 15 years

- The State's $86 billion of total liabilities would increase to nearly $100 billion if the State's pension systems reduced their investment return assumption to 6%[1]

**Total Liabilities[2] ($ billions)**
$85.5B as of 6/16




| | |
|---|---|
| State Employees | $20.4 |
| Teachers | 13.1 |
| Judicial | 0.2 |
| **Total** | **$33.8** |

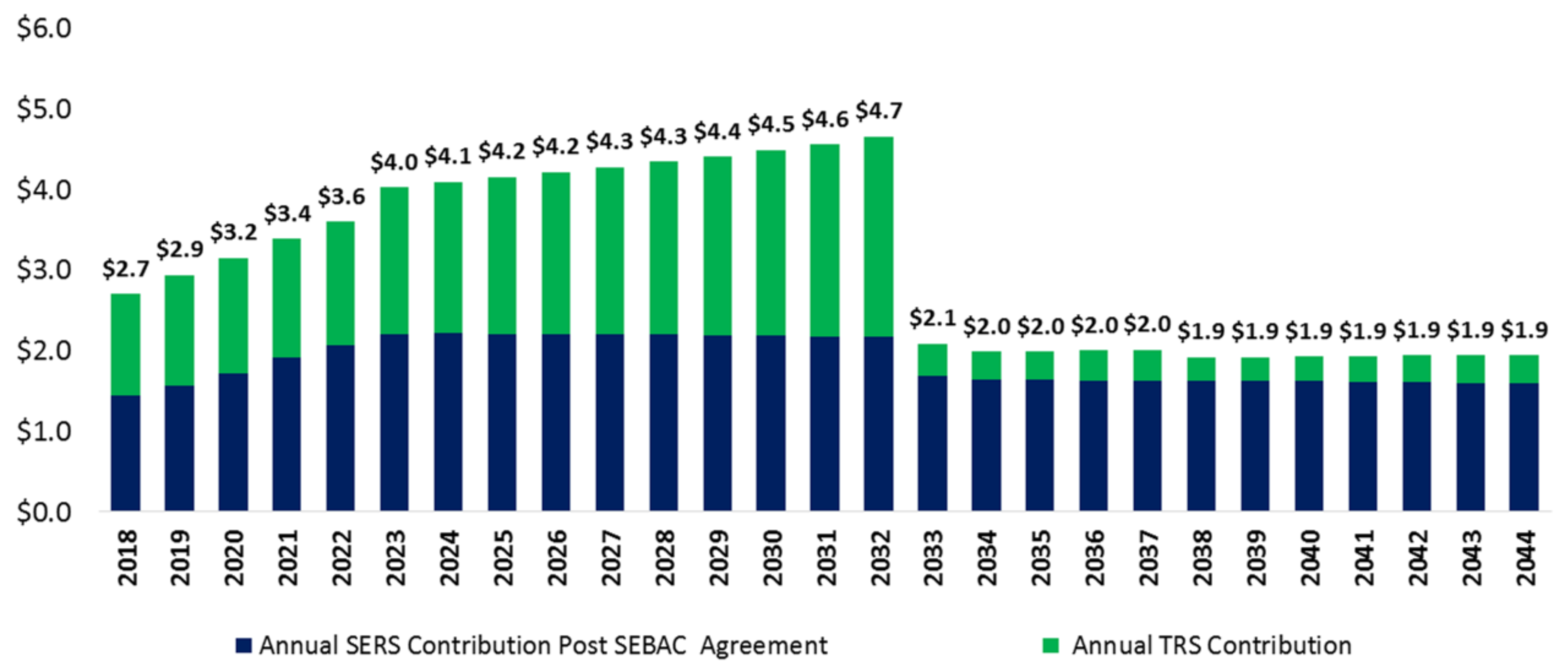
- Debt service to revenue ratio of 13.3% is **highest in the US[3]**
  - 3.0x US mean / 3.2x US median
- Moody's adjusted net pension liability (ANPL) is 20.4% of GDP, **3rd highest in the US[3]**
  - 2.8x US mean / 4.2x US median
- Pension contributions and debt service at 26.5% of revenue is **highest in the US[3]**
  - 3.0x US mean / 3.6x US median
- Net tax supported debt as a % of personal income is 9.7%, **3rd highest in the US[3]**

(1) Sensitivity analysis of pension liabilities per The Pew Charitable Trusts.
(2) State of Connecticut Comprehensive Annual Financial Report, 2016. Debt includes component units. Unfunded pension and OPEB liabilities represent unfunded actuarial accrued liabilities ("UAAL") based on actuarial reports for the State's pension and OPEB systems.
(3) Moody's Investor Service. These ratios have been calculated based on Moody's definitions of debt, pension liabilities, debt service, contributions and own-source governmental revenues (revenues less federal funding), and in most cases will differ from a state's own published calculations or the calculations of other institutions.

## 6 Escalating required pension contributions, especially for TRS, exacerbate the State's fiscal challenges

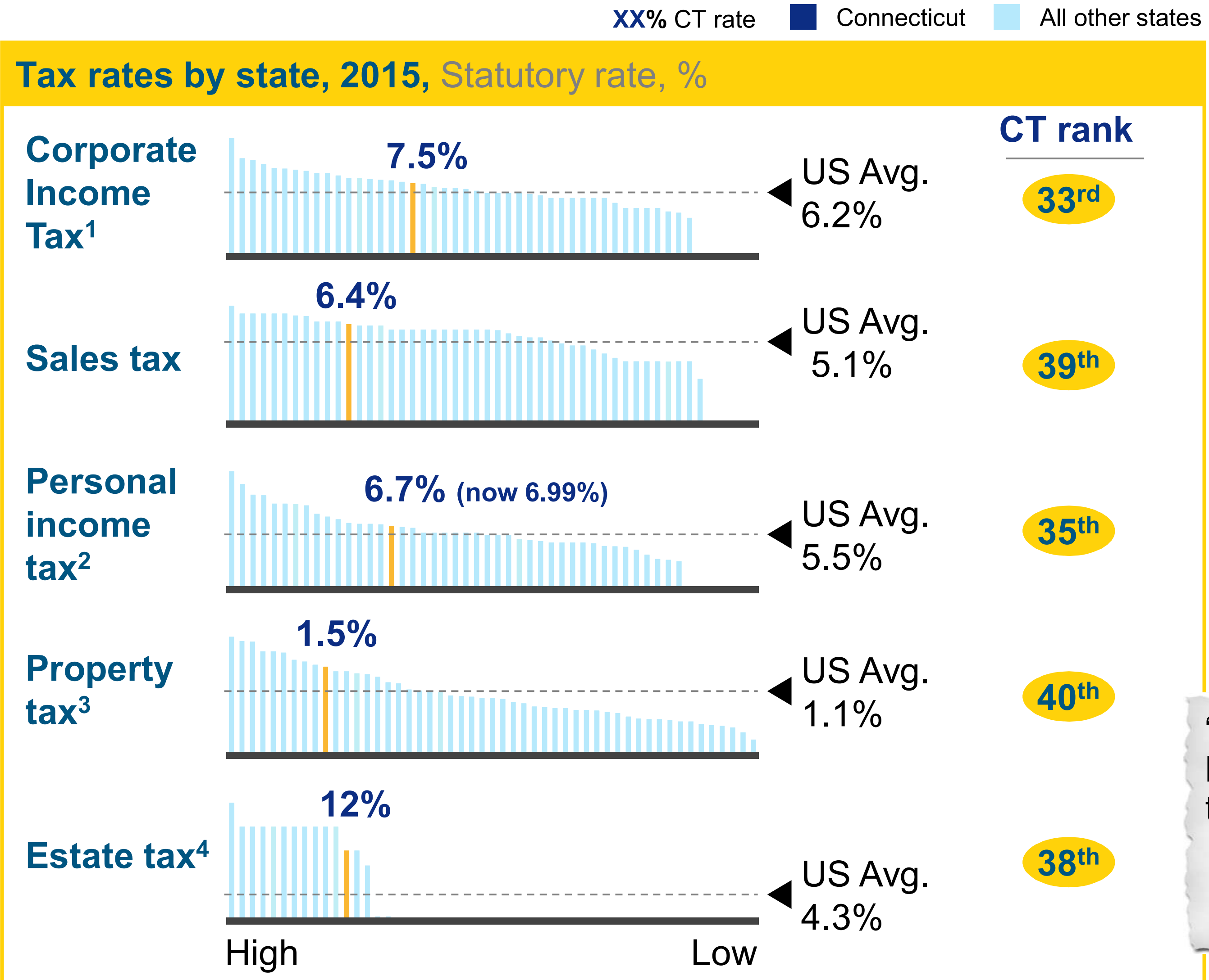
- Utilizing the current discount rate of 8% for TRS, total annual contributions reach $4.7B in 2032

**Projected Annual Pension Contributions (excl. JRS) ($ in billions)[1]**




(1) The Pew Charitable Trusts, State Office Policy Management, May 2017 SEBAC Agreement

# Connecticut's taxes are higher than US averages




"...CT aggregate state tax burden is the 5th highest in the country..."

– Tax Policy Center[5] (2015)

1 Represents the highest marginal corporate tax rate
2 State and Local Sales Tax Rates in 2017, Tax Foundation
3 State Individual Income Tax Rates and Brackets for 2017, Tax Foundation (Highest Marginal Tax Bracket)
4 Mean Effective Property Taxes on Owner-Occupied Housing, Tax Foundation 2015
5 Tax Foundation data

SOURCE: Federation of Tax Administrators (2016); U.S. Census, Hartford Courant

# Connecticut has a Mismatch of Labor Supply and Demand

- Connecticut has recovered only 80% of the jobs lost in the Great Recession vs. 200% recovery nationally…a relative shortfall of 142,000 jobs or ~8.5% of the workforce

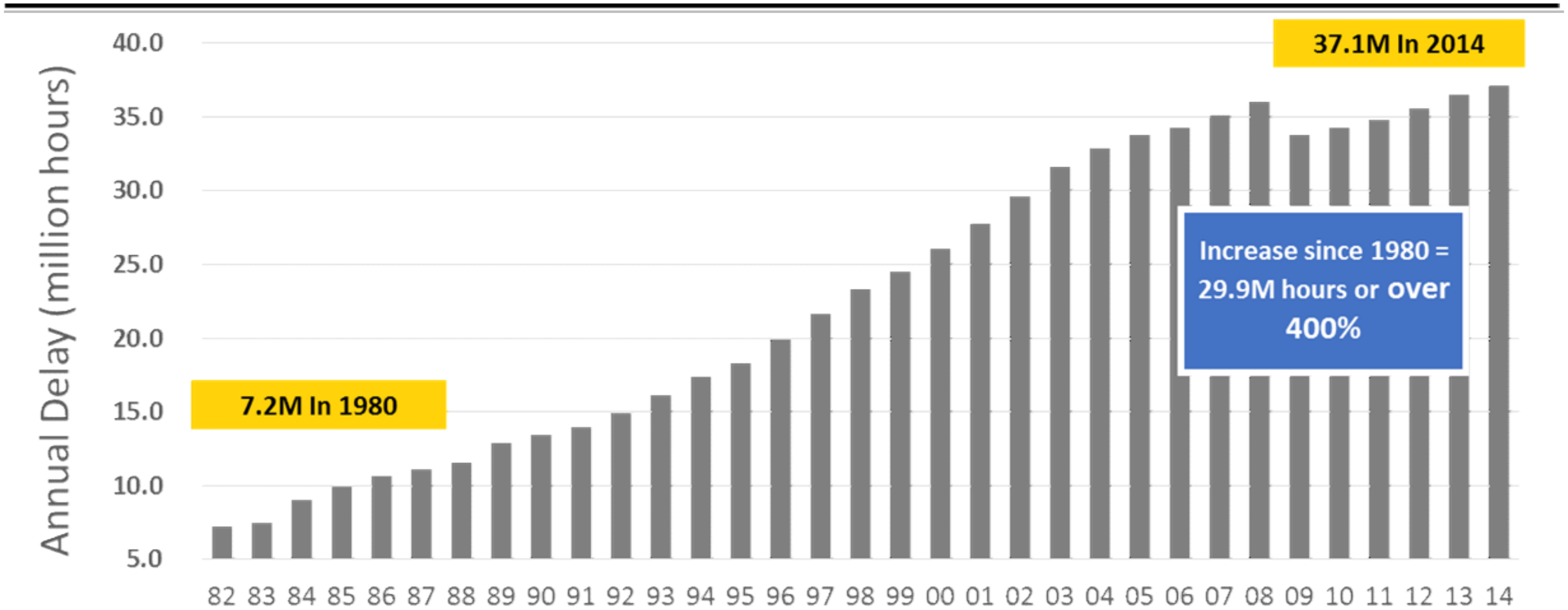
| | Occupation type | Supply/demand ratio, %, 2016 | Unemployment, Ths, Aug. 2017 | Job postings, Ths, Aug 2017 |
|---|---|---|---|---|
| **Oversupply:** Potential to retrain/transfer skills | Construction and Extraction | 12.5 | 7.0 | 0.6 |
| | Cleaning and Maintenance | 4.1 | 4.9 | 1.2 |
| | Production | 2.9 | 5.9 | 2.1 |
| **Potential Poor Matching:** Opportunity to better connect employers with candidates | Education, Training, and Library | 1.0 | 3.2 | 3.2 |
| | Office and Admin. Support | 1.0 | 9.3 | 9.7 |
| **Undersupply:** Need to increase supply of human capital | Architecture and Engineering | 0.3 | 0.9 | 2.8 |
| | Computer and Mathematical | 0.2 | 1.3 | 6.9 |
| | Healthcare Practitioners | 0.1 | 1.5 | 19.1 |

Source: EMSI and BLS data

# 7 CT's Transportation Infrastructure Is A Fundamental Impediment To Economic Growth

- Highway, airway, rail and port all suffer from underinvestment
- Infrastructure issues cause aggravation and disincentivize business investment
- The backbone of Connecticut's economy needs major capital investment to maintain even current inadequate service levels
- The Special Transpiration Fund (STF) must have a steady, reliable revenue stream in order to commit to longer term investments

**Millions of Hours of Delay Annually: Bridgeport-Stamford Metro Area**

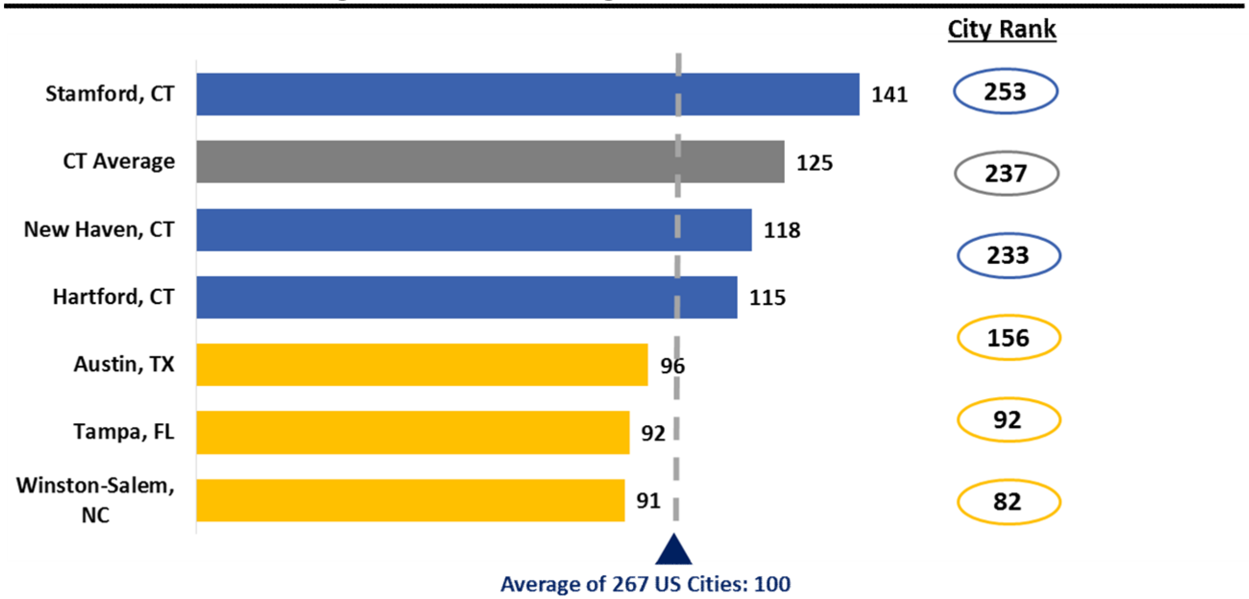



Source: Texas A&M Transportation Institute

# 8 Connecticut cities' reliance on property taxes generates insufficient revenue to develop vibrant urban cores that are critical to the state's economic growth and well-being

- Our Cities are Challenged by Several Structural Factors:
  - Relatively small, little regional support
  - Provide services to the region without sufficient compensation
  - Uniquely burdened by concentration of tax exempt property
  - High property taxes, making it hard to compete for businesses and residents

**The Cost of Living in Cities is Higher in Connecticut[1]**




[1] National Association of Realtors (2015)

## Beyond the core issues discussed, there are additional crucial concerns that must be dealt with:

- Persistent issues of income inequality
- A persistent mismatch between education and training resources and the jobs that are coming on line
- The budget process is deeply flawed and a structural mess, attempting to deal with large problems with no staff for oversight and investigation
- The restrictive regulatory environment constrains investment and raises cost of doing business in Connecticut

## Nevertheless, CT's Problems Can Be Solved!

- We have many strengths on which to build
  - A strategic economic location between NY and Boston, and within 500 miles of one-third of the US population
  - Rich and varied topography and natural resources that support a high quality of life and recreation opportunities
  - Pre-K – 12 schools that are ranked 5th in the country[1]
  - One of the most highly educated work forces in the country, with 42 colleges and universities
  - A new set of legislative constraints to control spending—a spending cap, a bonding cap, revenue cap and a so-called "volatility" cap
- In addition, in the report of the Commission on Fiscal Stability and Economic Growth, we have outlined a holistic plan to save our state by achieving sustainable balanced budgets and re-igniting economic growth

[1] U.S. News Best States, data by McKinsey & Company

# Key Recommendations

Commission on Fiscal Stability and
Economic Development

## 1 Commission Recommended a Pro-Growth, Revenue Neutral Rebalancing of State Taxes

- Commission Recommended:
  - Lower personal income tax rates for all filers
  - Offset by higher sales tax revenue including base broadening
  - Eliminate the gift and estate tax now, offset by increase in business taxes
  - Allow municipalities the power to charge fees, to impose payments for Services in Lieu of Taxes (SILOTS) on nonprofits

- Legislature Enacted:
  - ✓ Created a new private panel to study and make recommendations by January 1st 2019 to rebalance the state's tax mix in order to better stimulate economic growth without raising net new taxes

## 2 Commission Recommended a Study on Revenue and Expense Optimization to save $1B in the General Fund

- Commission Recommended:
  - Save $1B in the General Fund through:
    - Efficiency improvements
    - Enhanced effectiveness in revenue collection
    - Increased privatization of services
  - Without damaging program quality or the social safety net

- Legislature Enacted:
  - ✓ Authorize a consultant-led study of opportunities to save $500M in the General Fund through efficiency/excellence gains in both revenue collection and expense management

# 3 Commission Recommended Restructuring the Teachers' Retirement System to Reduce Unfunded Liabilities

- Commission Recommended:
  - Contribution of net lottery proceeds improves funded ratio and reduces annual required contribution
  - Existing debt to be re-amortized as currently allowed in 2025
  - Move to hybrid DB/DC plan for new and unvested teachers
  - Shared risk on investment returns, higher Teacher contributions
- Legislature Enacted:
  - Study Commission's framework for reform of the Teachers' Retirement System with proposals by January 1, 2019, including:
    - 30 year Lottery contribution, debt re-amortization, hybrid DB/DC plan with risk sharing on investment returns

# 4 Rebalance Labor Arrangements [Did not address]

- Move the definition of retirement benefits and funding policies for state and municipal employees from collective bargaining to the legislature and local governing bodies (in 2027 or upon reopening of SEBAC)
- Require Comptroller to certify appropriateness of financial and investment return assumptions
- Change binding arbitration procedures at both state and municipal levels to permit compromise awards (instead of “last best offer”) and selection of single neutral arbitrator
- Appoint a private panel of experts to analyze the competitiveness of 2017 SEBAC agreement both within the tiers and compared to other states and to private plans
- Require coalition collective bargaining for shared services arrangements among towns

## 5 Raise the Minimum Wage [No Action Taken]

- Increase to $15/hour in annual steps by 2022
  - Variations based on age, seasonality and full/part time status

## 6 Modify the legislature's budget management process [Did Not Address]

- Legislature to hire an expert consultant to study improvements in budget process including:
  - Creation of a Joint Budget Committee
  - Whether changes are needed in compensation
  - Session length and other legislative processes
- Postpone effective date of bond covenant **[Reduced term from 10 to 5 years]**

## 7 Invest in Select Cities via the Capital Region Development Authority and a STEM Campus [Did Not Address]

- Reserve $50M in FY 2019 and $100M in FY 2020 in bond funding for:
  - Expansion of CRDA concept to two additional cities
  - Seed funding for a new city-based STEM campus developed in a joint venture with a major research university

# 8 Increase Funding for the Special Transportation Fund

- Raise gas tax by 7 cents over 4 years
- ✓ Retain the half cent in sales tax now contributed from the General Fund
- Approve tolls in principle, subject to Legislative approval of an acceptable plan
- ✓ Prioritize / deprioritize projects based on economic impact
- Acceleration of new car sales tax directed into the STF

**[Legislature increased annual bonding to $1B]**

## 9 The Governor or Legislature to Establish a Red Tape Commission [No Action Taken]

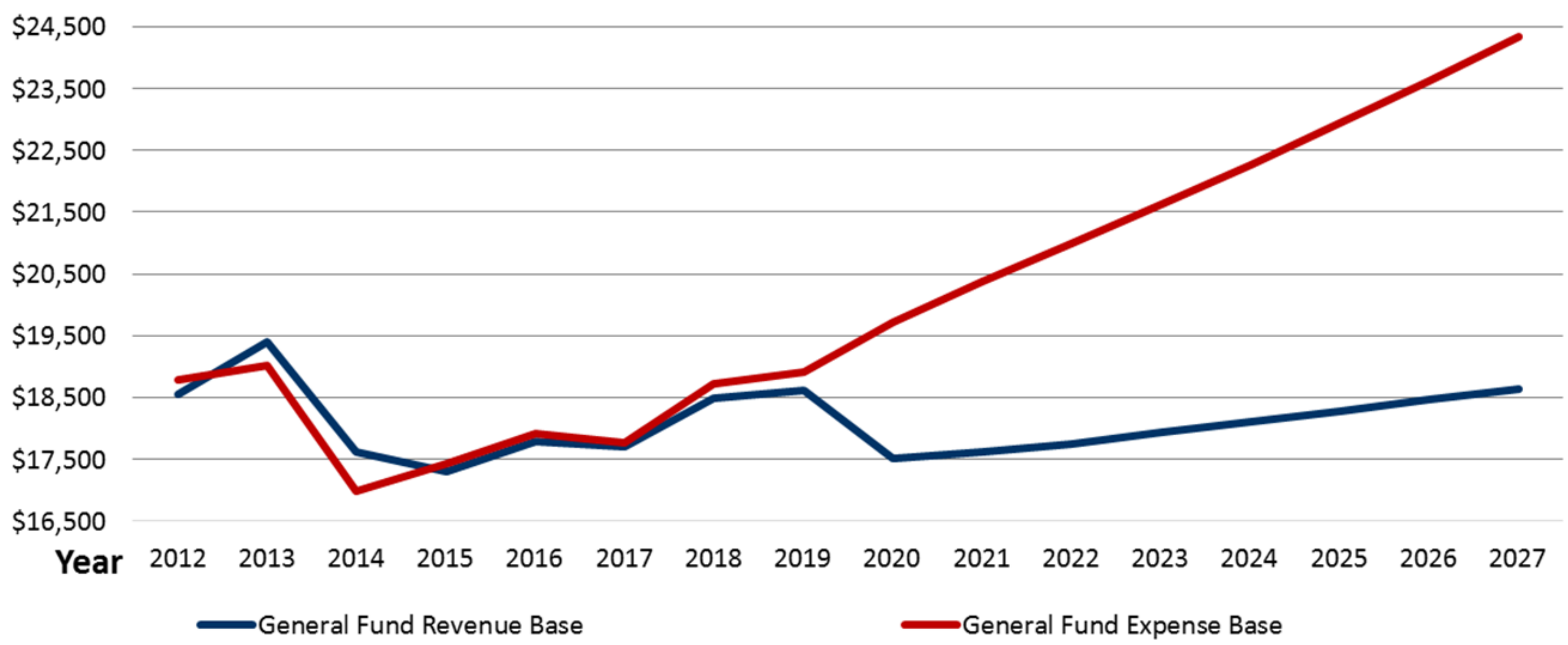
- The goal is to reduce / rationalize existing regulations, as well as set guidelines for future regulations
- To support this effort, a zero-based regulatory policy should be established – any new regulations must be offset by eliminating old ones

## 10 Undertake a Series of Growth Initiatives, Led by the Executive Branch, with the Funding and Support from the Legislature to: [No Action Taken]

1. Develop and retain the workforce Connecticut needs
2. Support the growth of Connecticut's highest-potential economic sectors
3. Transform the business environment for entrepreneurship and innovation

# Current Policy

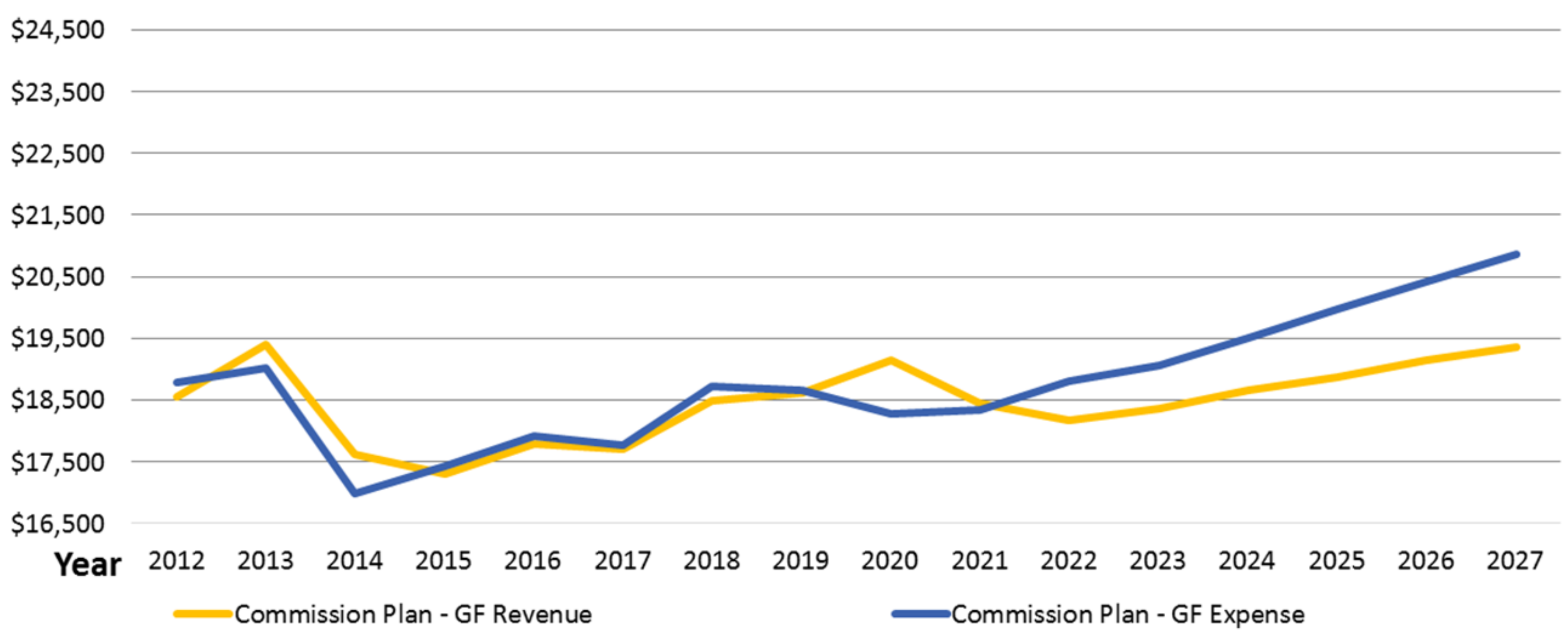
**General Fund Surplus / Deficit Projections – Current Policy**




Source: Revenues – Comptroller's Open Budget FY12 – FY17; OPM Consensus Revenue January 2018 | Expenses – OFA Fiscal Accountability Report FY17 – FY20 & October Out Year Estimates
Key Assumptions: Fixed costs are growing at an average of ~5.5% each year; Total General Fund expenses growing at 3% in future years past 2022

# Commission Plan

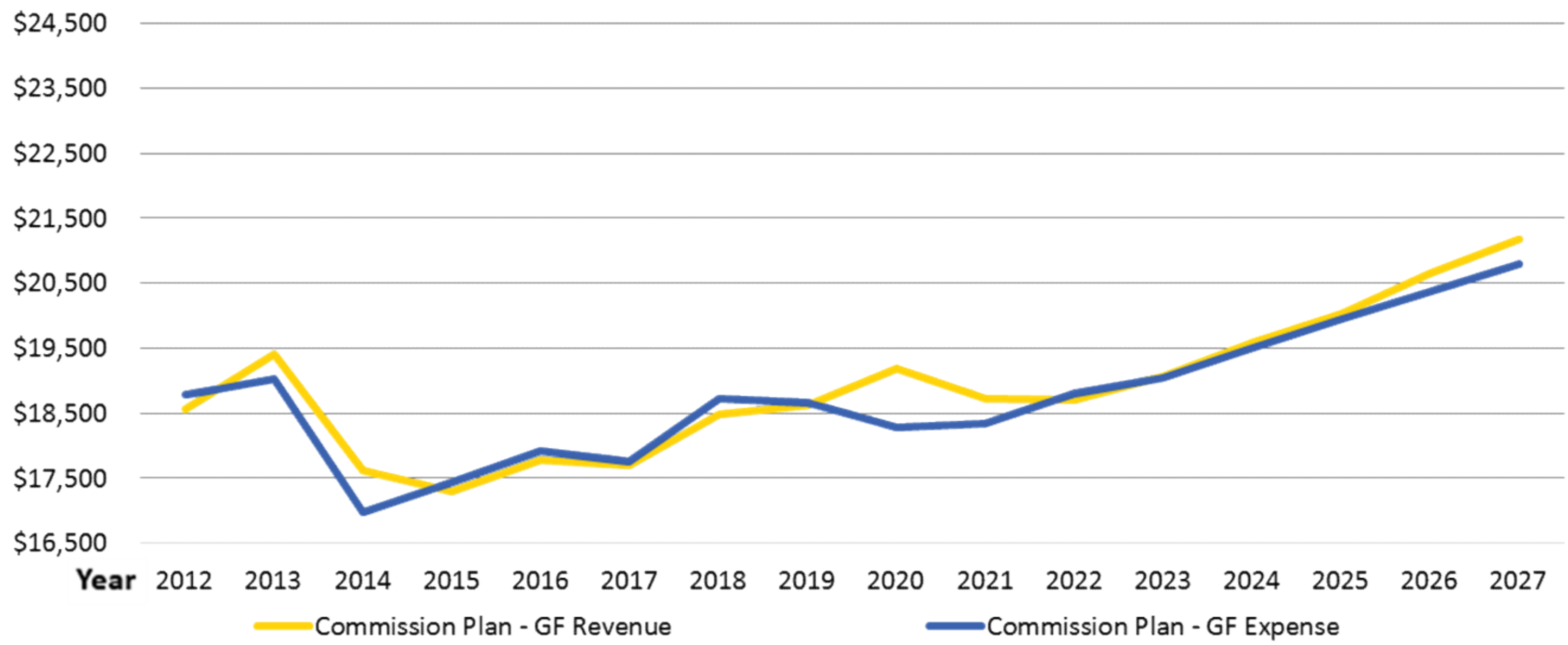
**General Fund Surplus / Deficit Projections – Commission Plan**




Source: Revenues – Comptroller's Open Budget FY12 – FY17; OPM Consensus Revenue January 2018 | Expenses – OFA Fiscal Accountability Report FY17 – FY20 & October Out Year Estimates; CT Tax Expenditure Report February 2018
Key Assumptions: All Tax changes are implemented in 2020 | Payroll Tax – OPM Population data; CT SBA Office of Advocacy

# Commission Plan – Growth Assumption

**General Fund Surplus / Deficit Projections – Commission Plan (Growth Assumption)**




Source: Revenues – Comptroller's Open Budget FY12 – FY17; OPM Consensus Revenue January 2018 | Expenses – OFA Fiscal Accountability Report FY17 – FY20 & October Out Year Estimates; CT Tax Expenditure Report February 2018
Key Assumptions: All Tax changes are implemented in 2020; | Payroll Tax – OPM Population data; CT SBA Office of Advocacy; Assume the pro-growth tax initiatives enable roughly 3% increased basis growth each year achieving our goal of a 3% – 3.5% Average GSP in 5-10 years

## The 2018 Election Must Be A Referendum For Comprehensive Change!

- Every citizen and every candidate for elected office needs to be educated on the core issues facing the state
- Every candidate must articulate his/her solutions
- Every media outlet should focus on these problems and potential solutions
- Every business person, non for profit leader, educator, and municipal official and ever voter should get into the debate

**IT'S OUR STATE, IT'S BROKEN, AND TOGETHER WE CAN FIX IT**