EXECUTIVE SUMMARY – Commission on Fiscal Stability and Economic Growth

Public Act 17-2 at Sec. 250 established a Commission on Fiscal Stability and Economic Growth to develop and recommend policies to achieve state government fiscal stability and promote economic growth and competitiveness within the state. The 14 private citizens appointed to the Commission present these recommendations based on a sober recognition that Connecticut is in quiet crisis by every measure: consistent budget imbalances, growing unfunded liabilities, falling bond ratings, stagnant economic growth, competitive disadvantages compared to neighboring states on most important indices, and increasing outmigration. The legislature must act, and we believe it wants to do so. The legislature needs a plan, and we are presenting one that we believe can appeal to all segments and build a stronger and more prosperous future for Connecticut. Through our hearings and many conversations across the state, we believe there will be support for this plan. The time to act is now.

KEY FINDINGS:

- While neighboring states and the United States as a whole have economies that are growing, our economy is shrinking—it is actually smaller than it was in 2004;
- We are losing ground on numerous key measures of competitiveness: tax climate, business climate, transportation quality, vitality of cities, and more;
- We are facing ongoing budget deficits of $2 billion - $3 billion in FY 2020 and beyond, growing by $500 million per year.

State government's fiscal instability is itself a root cause of our poor economic growth because it leads to a lack of confidence by the business community and among state residents. Re-igniting economic growth requires Connecticut to regain fiscal stability. The Commission's recommendations offer a roadmap for legislative action starting this session. This plan will not improve the situation overnight, but it does put Connecticut on a sustainable path.

KEY RECOMMENDATIONS:

In this report, the Commission will propose ten major recommendations:

1. Enact a revenue neutral rebalancing of state taxes (which becomes revenue positive when coupled with economic growth) that reduces income taxes in every bracket, selectively raises taxes on business, raises the sales tax rate by less than 1%, cuts exemptions and exclusions from all taxes by 14%, and eliminates the dwindling estate and gift taxes.
2. Raise the gas tax to fund transportation projects and produce a plan for eventual implementation of electronic tolls.
3. Create a Joint Budget Committee of the legislature with the power to set limits on revenues and expenses.
4. Have the legislature assume the responsibility to define state employee fringe benefits by removing them from collective bargaining for new contracts.
5. Amend binding arbitration laws to permit award of compromise outcomes.
6. Develop and implement a plan to cut $1 billion out of annual operating expenses.
7. Reform the Teachers' Retirement System to lower costs and to make it sustainable by paying down unfunded liabilities.
8. Reinvest in transportation and cities, and build a major new STEM campus in one city in partnership with a major research university.
9. Undertake a series of growth initiatives, led by the executive branch, with the funding and support from the legislature to (1) develop and retain the workforce Connecticut needs, (2) support the growth of Connecticut's highest-potential economic sectors and (3) transform the business environment for entrepreneurship and innovation.
10. Diversify municipal revenue streams beyond the regressive property tax and stimulate regional service delivery.

The Commission also proposes linkage in the phasing of several of these proposals to ensure balance across all sectors for the above recommendations.

SUMMARY OF TAXES, SPENDING AND INVESTMENTS

TAX REFORM

Our tax reform proposal is based on re-balancing the income tax, sales tax, and business taxes—by approximately $2.3 billion in total when fully implemented:

- **Personal Income Tax:** Dramatically reduce personal income tax rates, phased in over three years starting in FY 2020, by 18% in the top bracket (from 6.99% to 5.75%), by similar or greater amounts in lower brackets, and to zero for incomes below $10,000. Reduced by $2.1 billion when fully implemented in 2023.
- **Sales Tax:** Starting in FY 2020, increase the sales tax rate from 6.35% to 7.25% to help balance the loss of revenue from the income tax reduction (adding $1.0 billion). Connecticut is currently quite low- 41st in the nation-in terms of sales tax burden as a percent of total personal income.
- **Corporation Tax:** Increase business taxes starting in FY 2020 by approximately $475 million as a target. This would be accomplished by adding a tiered payroll tax of 0.8% on payrolls, but with a full credit (exemption) for the first nine employees, and a half credit for the next 10 through 99 employees.
- **Exemptions:** Starting in FY 2020, eliminate a significant proportion of the current "tax expenditures" (exemptions and deductions) that have proliferated over the years in connection with the sales tax, the income tax, the corporation tax, and a variety of special purpose taxes. We recommend removal of approximately 14% of the value of these exemptions in order to produce additional sales tax and other revenues on the order of $750 million per year.
- **Estate and Gift Taxes:** These taxes should be repealed effective immediately.
- **Increase the Minimum Wage:** While not a tax proposal, Connecticut should increase its statutory minimum wage in annual steps from the current $10.10 to $15 per hour by 2022 to help address the issue of income disparity.
- **Provide Municipalities With Authority:** Allow municipalities to raise fees and an additional 0.5% sales tax to augment the existing property tax system. This new sales tax authority should be tied to policies promoting regional service delivery at the local level.

SPENDING

- More effectively control state spending by establishing a Joint Budget Committee with responsibility for the establishment of revenue and spending policy. The current two-committee process lacks coherence and favors over-spending.
- Join the large majority of states that vest the power to determine pension and retiree health benefit formulas and funding policies for state employees with the legislature, rather than in collective bargaining.
- Immediately address the unsustainable burden of the Teachers' Retirement System (TRS) and the state Employee Retirement System (SERS) unfunded liabilities.
- Create a cost-management initiative within the executive branch that will produce savings of at least $1 billion annually.

INVESTMENTS IN TRANSPORTATION AND CITIES

- Connecticut must invest in transportation and provide a stable funding source to pay for transportation investments that cannot be raided by the legislature for non-transportation expenditures. Priorities include: congestion-reducing highway improvements, higher speed rail service from Hartford, New Haven and Stamford to New York City, improved service at Bradley International Airport, repeal legislation limiting runway length at Tweed Airport and investment in Connecticut's deep-water ports.
- With respect to central cities, the Commission recommends **the expansion of the Capital Region Economic Development Authority** model in two additional cities, and enhanced funding of the Payment in Lieu of Taxes (PILOT) program for state owned property in the state's largest cities.

ECONOMIC GROWTH

- Undertake a series of growth initiatives, led by the executive branch, with the funding and support from the legislature to
  - (1) develop and retain the workforce Connecticut needs,
  - (2) support the growth of Connecticut's highest-potential economic sectors and
  - (3) transform the business environment for entrepreneurship and innovation.
- As part of this growth investment, the Commission **recommends the creation of a new, nationally competitive Science, Technology, Engineering and Math (STEM) campus** in Hartford, New Haven or Stamford, following the Roosevelt Island model in New York City. The objective should be to recruit a major research university through a request for proposal (RFP) process to partner in the project.

LINKAGE

- Implementation of several of these measures must be closely linked to the enactment or executive branch achievement of others. For example, while the tax changes would be enacted in 2018, their implementation at the July 2019 start of FY 2020 would be conditioned upon enactment in 2018 of the proposed changes in state employee collective bargaining and binding arbitration, and the submission by the executive branch of specific proposals to reduce core spending by $1 billion before July 1, 2019.

BUDGET IMPACT

- The Commission's economic model suggests that the plan for Connecticut will produce balanced General Fund budgets through the next biennium (FY 2021). If the plan is successful in raising rates of economic growth and tax revenues by FY 2022 and beyond or if further cost saving measures are taken, those balanced budgets can be sustainable.

Vision and goals are not mere verbiage and platitudes. They translate into a social and political compact among interest groups. For example, business needs to be committed to a fair deal with labor, and labor needs to be committed to fiscal stability and economic growth. The towns and their elected representatives who control the legislature must be committed to building vital cities, which is a prerequisite to getting more companies to start, move and stay in Connecticut to generate the economic growth that will lead to increased state tax revenue to help all the towns. Connecticut and its representatives need to sign up to a common vision and goals, not a zero sum game of "we win, you lose".

Beyond vision/goals, key principles have guided the formation of our recommendations. We must:

- Be sensitive to, but not intimidated by, political repercussions-in fact, we may serve a useful purpose for political leaders by helping to "carry some of the water" for conventionally unpopular ideas;
- Be bold—the state is in dire straits, the time for half measures is behind us;
- Be fair—if there is sacrifice, it must be shared; Any increased spending must be balanced by spending cuts—at least until growth dividends kick in;
- Be focused—let's get the big picture and the important things right and not get distracted by small issues, past arguments, and special interests;
- Produce some quick wins to achieve fiscal stability and re-inspire economic growth and wealth retention.

Commission on Fiscal Stability and Economic Growth co-chairs Jim Smith, left, and Robert Patricelli.

Co-Chair Jim Smith and Vice Chair Patricia Widlitz at the presentation of a report by the Commission on Fiscal Stability and Economic Growth recommending sweeping tax changes.