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Fiscal Architecture of Connecticut  
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State/Local Tax Study Panel  
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Sally Wallace

Georgia State University

Dept of Economics and Fiscal Research Center



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# Overview

- Concept and scope of report
- Summary of economic and demographic trends
- Impact on Connecticut's revenues
- “What-if”-sensitivity of trends and impacts

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# Fiscal Architecture

- Revenue and expenditures are driven by many factors including economic and demographic characteristics
  - For example: Population size, age distribution, concentration of type of economic activity
- These factors change over time and may affect the natural growth of revenues and the basket of expenditure needs
  - Growth in service sector (loss of tax handles?), growth in very elderly (increased demand for transportation and housing?)
- Institutional context may affect ability to respond to these changes
- What makes *Fiscal Sense* as Connecticut looks ahead?

# Concept

- Simple premise:

*Revenue collection (receipts) = tax rate \* tax base \*  
administrative/compliance efficiency*

- Similar case for expenditures (though not as much a focus in this report):

*Expenditure need = client population \* per unit cost of  
production*

# Drivers of Fiscal Architecture

- Factors affecting these relationships or any component affect revenues and expenditures in the short and long-term
- Factors studied include:

| <b>Demographic</b>    | <b>Economic</b>       | <b>Institutional</b>         |
|-----------------------|-----------------------|------------------------------|
| Age Distribution      | Employment and output | Intergovernmental Landscape  |
| Population growth     | Personal income       | State-Local Fiscal Structure |
| Race/ethnic diversity | Globalization         | Debt                         |
| Health                | Existing industries   | Pensions                     |

# Highlights in Connecticut Trends

- Population:
  - Slower growth than U.S.
  - Growth in elderly; older than average state
- Income
  - High median income
  - Disparity in income
- Relatively homogeneous population
- Employment and output
  - Growth in service sector
  - Growth in education/health sectors
  - Change in capital/labor mix
  - Loss of finance/insurance dominance

### Table 3. Projections of Connecticut's Population by Age (percent of total)

Source: Office of Policy and Management, February 2015

| Age Group    | 2015              | 2020              | 2025              |
|--------------|-------------------|-------------------|-------------------|
| 0-19         | 891.8<br>(24.5)   | 852.5<br>(23.0)   | 822.9<br>(22.0)   |
| 20-44        | 1,107.6<br>(30.4) | 1,129.4<br>(30.5) | 1,143.9<br>(30.5) |
| 45-64        | 1,062.9<br>(26.2) | 1,049.7<br>(28.4) | 996.5<br>(26.6)   |
| 65 and over  | 582.2<br>(16.0)   | 671.0<br>(18.1)   | 782.8<br>(20.9)   |
| 85 and over  | 94.6<br>(2.6)     | 94.9<br>(2.6)     | 96.4<br>(2.6)     |
| <b>Total</b> | <b>3,644.5</b>    | <b>3,702.5</b>    | <b>3,746.2</b>    |



## Table 6: Connecticut Concentration of Employment by Industry 2012 and 2022

Source: Calculations based on Connecticut Department of Labor Industry Projections

<http://www1.ctdol.state.ct.us/lmi/ctindustry2012.asp>

|      | Construction | Manufacturing | Retail Trade | Finance/<br>Insurance | Prof/Tech<br>Services | Educational<br>Services | Healthcare<br>Services | Accommodation<br>and Food Service | Government |
|------|--------------|---------------|--------------|-----------------------|-----------------------|-------------------------|------------------------|-----------------------------------|------------|
| 2012 | 2.91%        | 9.31%         | 10.26%       | 6.45%                 | 5.04%                 | 10.29%                  | 15.56%                 | 6.63%                             | 4.80%      |
| 2022 | 3.26%        | 8.57%         | 9.90%        | 6.08%                 | 5.51%                 | 10.33%                  | 17.06%                 | 6.61%                             | 4.44%      |



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# Trends, con't.

- Globalization and technology
  - Continued competition for capital and labor
  - Growth in internet based activity for development, production, and dissemination
- Institutional issues
  - Heavy debt and pension overhang
  - Lack of local government fiscal space and autonomy

# Where is Connecticut Headed and What-ifs

- Population growth and employment mix
  - Population growth expected to be relatively slow
  - Projected job growth is in lower paid sectors of health and education, reducing natural growth in income tax revenue
- OPTIONS TO ADDRESS:
  - Natural growth in income and sales tax bases will reflect slow population growth
  - Pressures associated with increased income disparity
- What if?
  - Population becomes more heterogeneous?

# What to expect, con't.

- Service sector growth in employment and output
  - Reduces tax handles, service-based industries are more difficult to identify and possibly to value
  - Employment in sector is less defined by location than by skill (outsourcing), reducing growth in income tax
  - OPTIONS TO ADDRESS:
    - Adapting tax administration skills and procedures for new economy
    - How far can local governments tax?
  - What if?
    - Investments in knowledge-industry pays off?

# What to expect, con't.

- Increase in share of elderly
  - Greater portion of their income is tax-exempt (Social security, pensions)
  - Greater share of consumption is tax-exempt (health care, food at home)
  - Demands for transportation, and health infrastructure
  - OPTIONS TO ADDRESS:
    - Diversification of tax base
    - Continued pension liability with smaller work force
  - What if?
    - Economic base expansions do not catch on?

# What to expect, con't.

- Globalization and Technology increase competition and decrease labor's share of output
  - Capital's share of output and tax base increases, but capital provides a difficult “tax handle”
  - Internet based activity will increase ability to evade/avoid taxes
  - OPTIONS TO ADDRESS:
    - Reduced reliance on corporate income/profits base
    - Reassess areas to substitute fees and charges for income taxes

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# What to expect, con't.

- Disparities among the population
  - Income is increasing disparate
  - Pressure on services (low income support)
  - Growth in diversity in needs
  - OPTIONS TO ADDRESS:
    - Balance between revenues and government services
    - Buoyancy of tax bases

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# Wrap-Up

- Institutions will play an important role in Connecticut's plan of what makes fiscal sense:
  - Overall structure of state-local finance in Connecticut
  - How much room do local governments have?
  - Implications of debt and pension overhang

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# Overall Landscape

- See Table 11



|                        | Trend                                                                                        | Revenue Implications                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Impact of Institutions                                                                                                                                                                                                                   | What if?                                                                                                                                                     |
|------------------------|----------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Demographic</b>     |                                                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                          |                                                                                                                                                              |
| <b>Age composition</b> | Decline in school-aged, increase in 20-44, and continued growth in retirement aged           | <p>Income Tax ↑: Working age population will positively affect income tax</p> <p>Property Tax ↓: fewer young children and transitions in retirement reduce demand for large houses; slow population growth and increased income disparities reduce demand for large properties</p> <p>Sales Tax ↑: Sales tax revenue will see growth from consumption expenditures of the 20-44 age group but this is tempered by the decline in school aged children over the next 10 to 15 years</p> <p>Income and Sales Tax ↓: Longer term the elderly dynamic will reduce buoyancy of both taxes</p> | <p>Income tax growth is affected by the cross-border tax treatment (NY)</p> <p>The relatively large amount of pension liability and debt constraint options for Connecticut to deal with potential slowing of natural revenue growth</p> | Previous growth in education expenditures will increasingly be in competition with support for elderly and public welfare.                                   |
| <b>Population size</b> | Slow growth                                                                                  | All Taxes ↑ →: Population growth will in general lead to increased revenue but the growth will be slower than for the average state; Connecticut has dealt with this slow growth for the last decade                                                                                                                                                                                                                                                                                                                                                                                     | Not directly relevant                                                                                                                                                                                                                    | Population growth has been relatively slow; if efforts to attract knowledge industry development population growth could increase as well as the income base |
| <b>Health status</b>   | Relatively health; rates of obesity lower than U.S. average; high by international standards | <p>Little direct effect on tax revenues expected over the next 10 to 15 years</p> <p>Increases in medical expenditures</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Pressure on health care costs expected to grow                                                                                                                                                                                           | Connecticut's expansion into bio-tech and other knowledge industries could lead to gains in healthcare research and status in the state                      |

Economic

|                                            |                                                                                                                                                                                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                                                                                                                                                                      |                                                                                                                                                                                                                          |
|--------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Employment and output</b></p>        | <p>Increase in service sectors including health/education/accommodation<br/>Lower wage jobs<br/><br/>Uncertainty around defense spending</p>                                                        | <p>Income Tax ↓: The mix of activity toward services and lower wage jobs will reduce the natural growth of the income tax<br/><br/>Corporate Tax ↓: Service sector is less transparent and provides a weaker paper trail for tax administration<br/><br/>Property Tax ↓: Service sector activities by nature use less property</p>                                                                                                                                                                                                                                 | <p>Ability for state to compete in knowledge industries a function of existing high tech manufacturing and higher education institutions</p>                                         | <p>Investments in knowledge industries including bio-tech and advanced manufacturing could mitigate the negative impacts on public finances associated with the status quo growth of lower paid service sector jobs.</p> |
| <p><b>Personal Income</b></p>              | <p>High median income<br/><br/><br/><br/><br/><br/><br/>Increasing disparity in income; Growth in lower wage jobs<br/>Growth in transfer payments (including TANF and SNAP and Social Security)</p> | <p>Income Tax ↑: Increased share of income tax from higher income earners ↓↑: Potential for volatility associated with capital income for high income earners<br/><br/>Income Tax ↓: Reduction in wage relative to transfer income will reduce the income tax base; Lower income individuals will have a larger portion of income tax exempt (standard deduction plus exemptions) reducing the elasticity of revenue<br/><br/>Sales Tax ↓: Large concentration of low income jobs will increase relative consumption of food and housing (largely non-taxable)</p> | <p>Increased burden on high income earners could have backlash in terms of payment of “fair share” for services provided</p>                                                         | <p>Growth in relatively low wage industries could lead to a reduction in median income and reduced growth in income taxes; if focus on knowledge industries pays off, such a trend would be mitigated</p>                |
| <p><b>Globalization and Technology</b></p> | <p>Continued competitive pressure from globalization and increased use of technology</p>                                                                                                            | <p>Income Tax ↓: Shift from labor to capital inputs reduces the income tax handle.<br/><br/>Corporate Tax ↓: Competition in factor and output markets should increase the tax minimization strategies of companies</p>                                                                                                                                                                                                                                                                                                                                             | <p>Internet sales legislation increasingly possible to stem the sales tax loss<br/><br/>Local governments have less room to maneuver to deal with these pressures in Connecticut</p> | <p>If Connecticut is successful in the knowledge industry, the state could play a role in the production of the new technology and bolster its economic situation</p>                                                    |