TESTIMONY OF
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VICE PRESIDENT & ECONOMIST
CONNECTICUT BUSINESS AND INDUSTRY ASSOCIATION
SUBMITTED TO THE
APPROPRIATIONS COMMITTEE
FEBRUARY 20, 2013
LEGISLATIVE OFFICE BUILDING
STATE CAPITOL
HARTFORD, CONNECTICUT

Good day. My name is Peter M. Gioia. I am the economist for the Connecticut Business and Industry Association (CBIA).. CBIA represents about 10,000 firms, which employ approximately 700,000 women and men in Connecticut. Our membership includes firms of all sizes and types, the vast majority of which are small businesses with fewer than 50 people.

CBIA wishes to comment upon **H.B. No. 6350 AN ACT CONCERNING THE BUDGET FOR THE BIENNIUM ENDING JUNE 30, 2015, AND OTHER PROVISIONS RELATING TO REVENUE.** Before I comment on the bill itself I'd like to say as an observer of the state economy and the state budget for over 30 years the only way the state will get itself out of its fiscal predicament is to grow our economy. Therefore, focusing upon what you as legislators can do to help our economy recover stronger and faster will ultimately help your work on the committee.

CBIA believes that substantial adjustments are required to improve this bill. CBIA urges a bipartisan effort working with the Governor to identify additional savings so the budget can be modified without tax increases or an overall increase in spending above the current, rather than proposed and modified spending cap which would create a better budget. It is imperative that the original spending cap be respected in the budget process. Our attached *Government Affairs Report* article – "Why Connecticut Has (and Must Protect) a Spending Cap," details our concerns on this issue. We urge the committee to explore more areas to obtain efficiencies and restructure service provision to get sustainable savings for this and future budget years. We have attached a summary version of our, *Turning the Tide* report to assist you with suggestion in that area.

Connecticut must effectively manage its state budget to provide confidence for investors to create jobs that will have a positive effect on our economy. The more effective and efficient that government is, the better our business climate will be and the sooner we will see new good jobs created. In addition, Connecticut will be better able to compete with other states to grow and retain existing businesses as well as bring new companies into our state.

Policies that help and not hinder the recovering economy are essential to solving our state's long-term budget problems. Only a strong economy and confidence in our government can provide the jobs people need and the revenues necessary to underwrite essential state services now and in the future.

Therefore, making Connecticut government more efficient isn't just a desired goal--it's essential to building and sustaining a healthy economy and an improved quality of life. While the economy is improving we still see some firms struggling and few are confident enough to add significant numbers of jobs. Substantial downside risks remain to the economy with federal sequester and debt ceiling issues, implementation of the Affordable Care Act, financial issues in the European Union and unrest in the Near East and Africa.

Connecticut's fiscal situation has come out of a severe crisis, but serious problems still remain. Now is still the time to be prudent in spending and to seek out and seize opportunities for cost savings. It's also the time for careful and calculated investments that enhance recovery. Some areas of the recommended budget that we think are especially noteworthy include:

- Initiatives to continue to enhance educational achievement and further recent significant educational reform
- Ongoing support of the special "jobs session" initiatives
- Continued efforts at corrections' reforms and long-term care reforms
- Measures to improve efficiency and restructure agencies

But, we think more cuts are essential to reduce the budget to under the original cap, likely deficiencies in some entitlement areas, and concerns raised by "present level" out year spending.

These reductions could come in many areas but we'd like to cite five. First, cost savings from union members due to a "suggestion box" and information technology suggestion have yet to be realized. We think it's imperative that the legislature vigorously press for these agreed upon cost savings responsibilities to be realized. The administration has lived up to its no layoffs pledge, but the SEBAC has yet to provide millions in savings it promised. The recommended budget provides $269 million in union raises but doesn't sunset corporate, insurance or energy producer business taxes. The legislature should *DEMAND* the union savings.

Second, the revised plan continues some initiatives to increase the use of home care vs. nursing home care where appropriate. We agree with these efforts but would appreciate a more comprehensive effort at easing home care options as outlined in the CT 21 report on long term care (see: http://www.ct21.org/) The potential to save millions of dollars exists with a more concerted, major effort in this area.

Third, it continues to enhance and support the efforts at prison reform and recidivism reduction in corrections. A solid effort is underway here but the committee should see if strategic investments or changes might produce both cost savings now and more over the long term.

Fourth, we were pleased that the Governor recommended and the General Assembly passed LEAN initiatives in several agencies to speed permitting during the special October 2011 session. But, a lot more can be done with LEAN management techniques. Expanding a comprehensive LEAN effort to all the major agencies ought to improve effectiveness and customer service, increase efficiency and over time see substantial cost savings. As fore mentioned we are not out of the woods on fiscal challenges, efforts here could preserve vital programs in future years by LEANing waste.

Fifth, more needs to be done to better use non-profits to provide services. A report from CT-21 will be shortly forthcoming on this.

Finally we are encouraged that the Governor wants to increase agency consolidation. We hope through reassignment and attrition he can achieve better economies of scale with such consolidations.

The Governor's plan is therefore a starting point for continuing budget adjustments. It is imperative that the legislature build on his recommendations with solid initiatives to save additional dollars and create the frame work to undertake critical analysis of agency and program spending so adjustment can continue in the following years.

While controlling state spending is a substantial and difficult task, we hope the committee and the General Assembly will make the necessary difficult decisions that will provide an improved fiscal climate for our state while fully protecting our fragile economy. CBIA trusts that the General Assembly will see to it that the budget is used as a tool to help create future economic growth that will lead to higher personal income and ensuring greater budget flexibility in future years. Thank you for the opportunity to present this testimony.

Attachments: GAR Spending Cap article, Summary of Turning the Tide report

CBIA Government Affairs

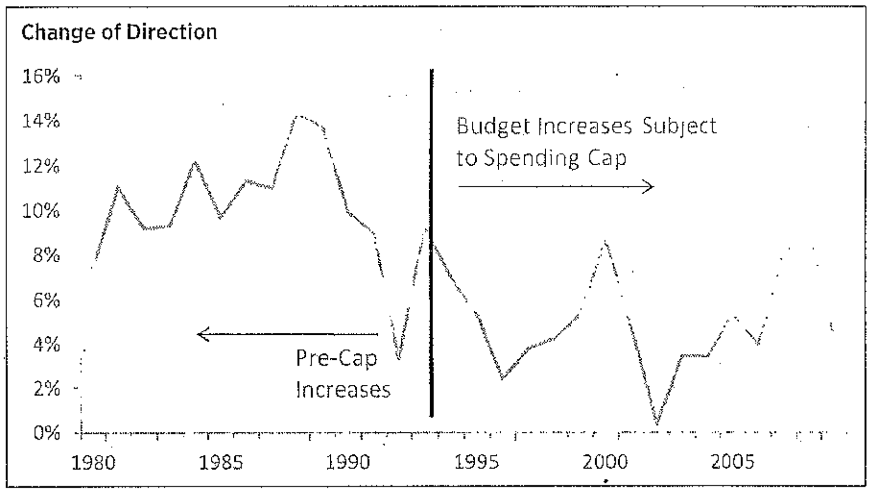
TURNING THE TIDE ON STATE SPENDING

Why Connecticut Has (and Must Protect) a Spending Cap

The first thing you have to know about the state's constitutional spending cap is that over its 20-year history it hasn't stopped the state budget from growing, but it has slowed it down.

In fact, since the cap was put in place in 1992, state spending has increased 153%, outpacing Connecticut's population growth andthe inflation rate.

More to the point is trying to imagine where we'd be without the cap. And why we need to protect it.



Big trouble

Connecticut was in big trouble in the late 1980s. "Black Monday" hit in October 1987, signaling the end of a bullish economy. And when the Berlin Wall came down in 1989-90, it was great political news that nonetheless caused a major reduction in defense spending—a cornerstone of Connecticut's economy.

Meanwhile, Connecticut was in the midst of a major spending binge. Double-digit percentage increases in state spending were routine in the 1980s—with an average growth rate of 11% during the decade.

Year-Over-Year Budget Increases

Massive state program expansions fueled spending hikes, produced a mountain of state liabilities, and created the state's first billion-dollar budget deficits in the early 1990s.

Business confidence, the economy, jobs, and the state's finances were all, like the Berlin Wall, falling down.

'Enough!'

Part of then-Gov. Lowell Weicker's response to the crisis was to propose a broad-based income tax, the state's first. Opposition from both sides of the political aisle was fierce, to say the least.

And saying they had had enough, taxpayers demanded a way to keep state spending within their ability to pay for it.

A compromise was reached in which the income tax came in with major strings attached—a spending cap along with other spending controls that included biennial budgeting, mandatory five-year revenue forecasting, the governor's rescission authority, and reorganizations within state government.

"The cap was intended to be tough and designed to give future governors and the legislature fits in managing to stay within it," says Pete Gioia, CBIA economist. "It was pain for pain, quid pro quo—taxpayers would have to face an income tax but policymakers would forever be forced to control state spending."

Loud and clear

In a very loud statement, more than 81% of Connecticut residents voted for the spending cap in 1992 in the deal that included the income tax.

The cap ties state spending to the growth in personal income in Connecticut—as determined by the greater of the current of rate of inflation or five-year average of the annual personal income growth for the state (as compiled by the federal Bureau of Economic Analysis).

Some called it "the taxpayers' savior."

Confidence Boost

The cap and the tightened controls helped put Connecticut back on a sounder fiscal foundation, restrained the growth of state spending, and over the years even produced periodic surpluses that were used for significant state projects.

Best of all, Connecticut's individual taxpayers and businesses were right on the money—the cap restored business confidence in the state and produced a renewal of economic growth and job creation.

Then and Now

Back then, everybody recognized the crisis and realized they had to respond. It was a very tumultuous time that riveted the attention of taxpayers and policymakers.

This year, Connecticut faces another

Continued

Why We Have (and Must Protect) a Spending Cap

Continued from Page 1

multibillion-dollar state budget deficit as revenues continue to drop. A struggling economy and changing state tax base have made even the current rate of state spending unaffordable for taxpayers.

While it has helped apply the brakes, the cap hasn't stopped the budget, or state government programs, from growing.
We again face a fiscal crisis.

Yet the response from some policymakers is not to address state spending, but to explore ways to circumvent the cap.

The cap can be exceeded, and has been, if the governor declares an emergency or the existence of extraordinary circumstances and if a minimum of three-fifths of each chamber of the General Assembly agrees.

It can also be modified with the same three-fifths legislative agreement.

To Exempt or Not to Exempt

The governor's budget proposes to modify the cap to allow for new requirements the state is facing under the Affordable Care Act. That's the kind of exception that was envisioned, and exempted, when the cap was adopted.

However, the governor also wants to exempt certain spending on state debt, for teachers' and state employees' retirement accounts.

But that's not what the cap's creators envisioned.

"There was a lot of debate over what was to be in and what was to be out of the cap as it was being developed," says Gioia.
"An area discussed and explicitly not excluded was state employee and teacher pensions and other-than-pension retirement benefits.

That's because, he explains, "the crafters of the cap knew this could become a problem—at the time, the administration had just negotiated with the unions to forego two pension payments so that his budget could balance.

"Legislators did not want to reward or encourage this kind of budgeting in the future, so they made sure it came in under the cap," says Gioia.

Keep the Cap

Ultimately, the answer isn't to lift, limit, or modify the cap. State spending, once again, must be reduced and state government made more effective, efficient, and affordable.

There are many ways to accomplish that and CBIA has offered some that would address Connecticut's long-term fiscal health and viability in its Turning the Tide report.

The governor's message was the first step in a long budget-approval process. Over the next few months, the legislature and administration will negotiate the content of the final budget before bringing it to a vote later in the session.

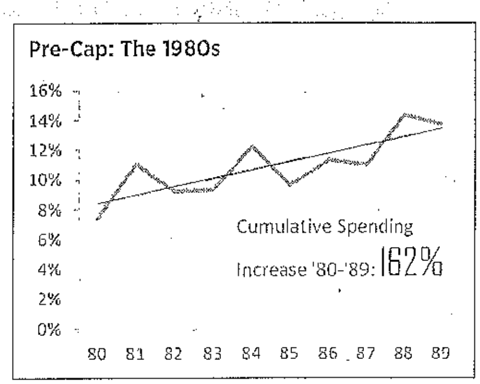
CBIA is urging the General Assembly to enact further spending cuts, take immediate steps toward resolving the current budget deficit and address the state's long term fiscal obligations.

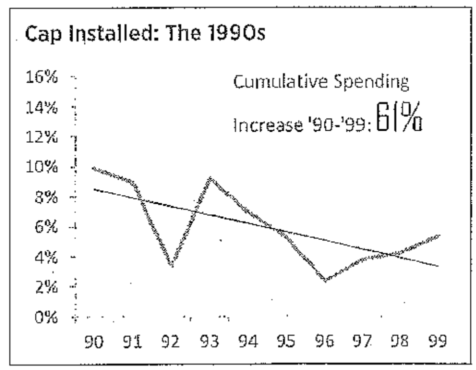
Lawmakers should also pursue policies that will grow the state's economy.

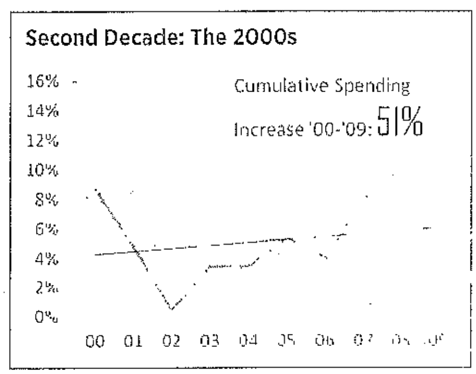
There's no better economic development tool than making the changes needed to control spending, demonstrate fiscal discipline, and make government more efficient.

For more information, contact CBIA's Pete Gioia at 860.244.1945 or pete.gioia@cbia.com. ■

Year-Over-Year Budget Increases





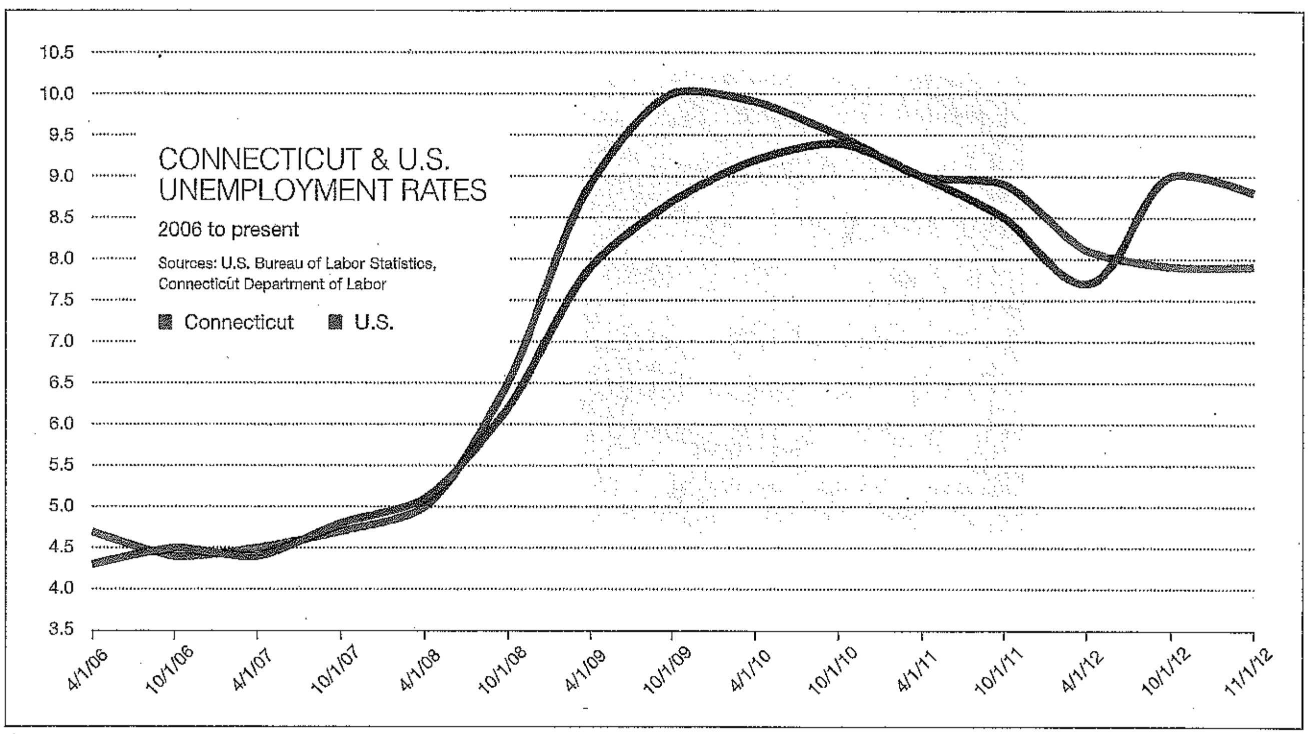


WHERE WE STAND

More than five years after the Great Recession of 2007 began, and two years since Connecticut technically exited it, the state continues to face serious economic and financial challenges.

The state's unemployment rate is 8.8%, well above the national rate of 7.9% (Nov. 2012, seasonally adjusted); Connecticut's unemployment rate has been above 8% since May 2009 (with the exception of February-May, 2012).[1] Job growth is essentially flat, and some economists believe that it will be several more years before Connecticut regains all of the jobs lost during the recession.

Adding to the recession's impact on Connecticut's economy have been the state's fiscal problems. Policymakers in 2011 plugged a multibillion-dollar projected state budget deficit with the largest tax increase in state history, along with some reduced spending, introductory efficiency measures, and modest reforms.



[1] U.S. Department of Labor, Bureau of Labor Statistics

Yet even those efforts—including a budgeted but missed $1.6 billion in cost savings identified in a state employee union agreement[2]—fell short. The state experienced a (much smaller) deficit in fiscal year 2012, another budget gap is projected for fiscal year 2013 (although the December 2012 special session closed most of it),[3] and projections are for billion-dollar deficits in fiscal years 2014 and 2015.

Connecticut's fiscal problems extend beyond the biennial budget. Underfunded obligations for state employee retiree benefits and other long-term commitments weigh heavily on state taxpayers, concern both the business community and national ratings agencies, and divert funding from ongoing programs. Connecticut's debt-plus-pension liabilities to GDP ratio is the worst in the nation and 11 times worse than the best-performing state.[4]

"The state's fiscal shortfalls are not simply a function of an underperforming economy but also the product of state spending policy."

It's Not Just the Economy

The quick reappearance of budget deficits in the wake of $1.5 billion[5] in tax increases indicates that the state's fiscal shortfalls are not simply a function of an underperforming economy but also the product of state spending policy. Connecticut continues to spend beyond its means.

When confronting deficits over the years, the state's approach has often been to increase or expand taxes, or create or hike fees, or both, to fill the gap. Any "cuts" have been, in reality, usually just a slowing in the rate of spending growth.

The truth is that Connecticut has a spending problem that's been exacerbated by tax revenues not being used as effectively as possible. Taxpayers, including employers, have seen few efforts to make the tough fiscal decisions in the short term, such as truly reducing spending and evaluating how well tax dollars are being spent. Nor have policymakers implemented long-term, structural changes to improve the state's fiscal condition.

There are, however, ways to get Connecticut firmly back on the right fiscal track.

[2] *"Governor Malloy Statement on Agreement with State Union Leaders," Connecticut Gov. Dannel Malloy, May 13, 2011;* [3] *"Comptroller Lembo Projects $40-Million Deficit for Fiscal Year 2013," Connecticut Comptroller Kevin Lembo, Jan. 2, 2013;* [4] *Andrew Bary, "State of the States," Barron's, August 27, 2012;* [5] *State of Connecticut, 2012-2013 Budget*

HOW WE GOT HERE

Spending Problem

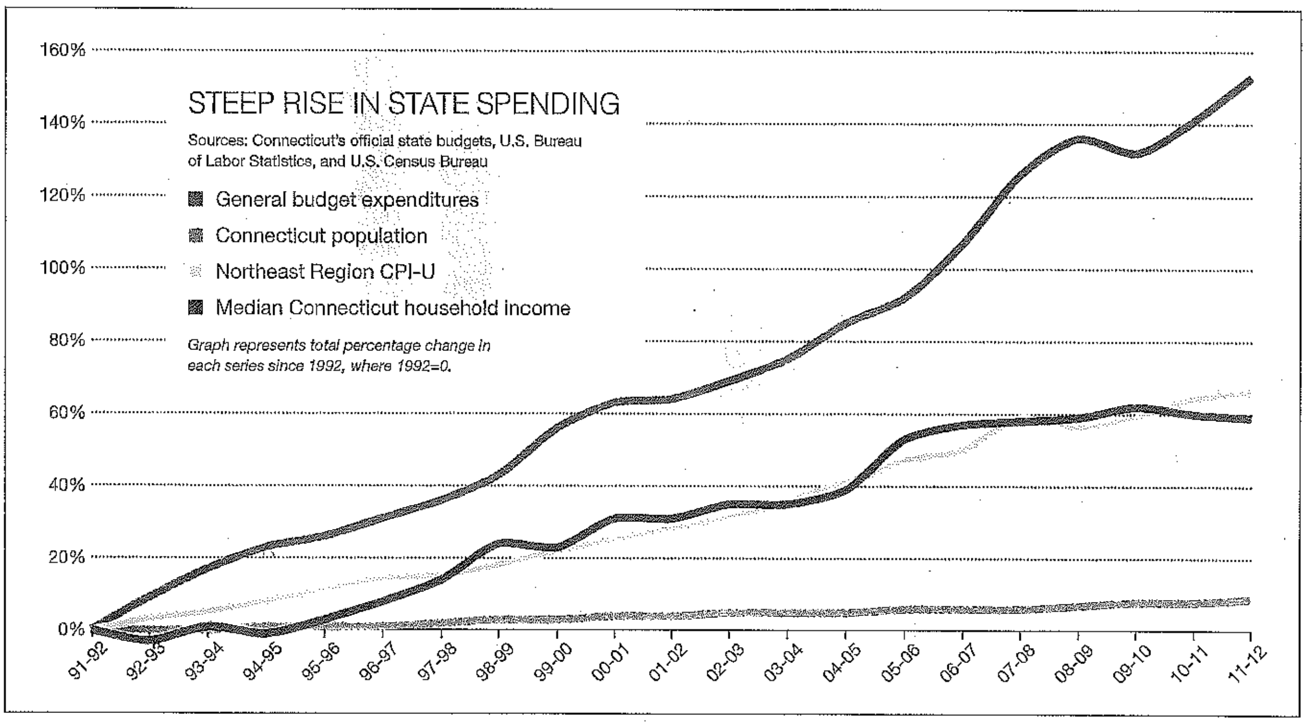
While Connecticut has not experienced significant changes in population or private-sector job growth over the past 20 years, the cost of state government has grown dramatically.

Since 1992, Connecticut's population has increased by 9% while state spending has grown by more than 153%, despite the state's spending cap. This chart shows how state spending growth has easily surpassed the inflation rate, state population growth, and median household income.

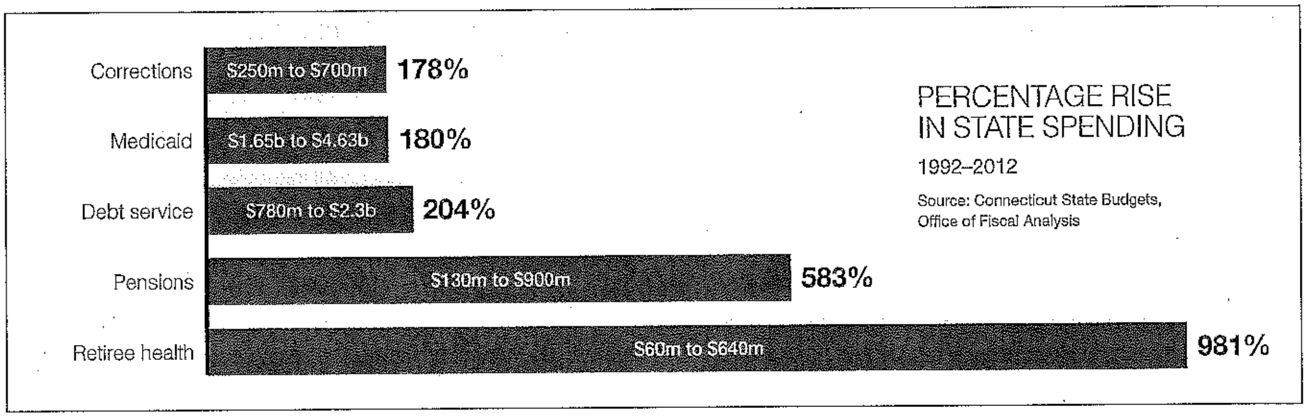
Long-Term Spending

Spending for state employee retiree health benefits has grown an unfathomable 981% since 1992; debt service (paying off state borrowing) has increased 204%; Medicaid spending is up 180%; state employee pensions, 583%; and spending on the state's corrections system has increased 178%.[6]

While these big-ticket items are growing at a faster rate than the overall budget, other areas of state spending vital to

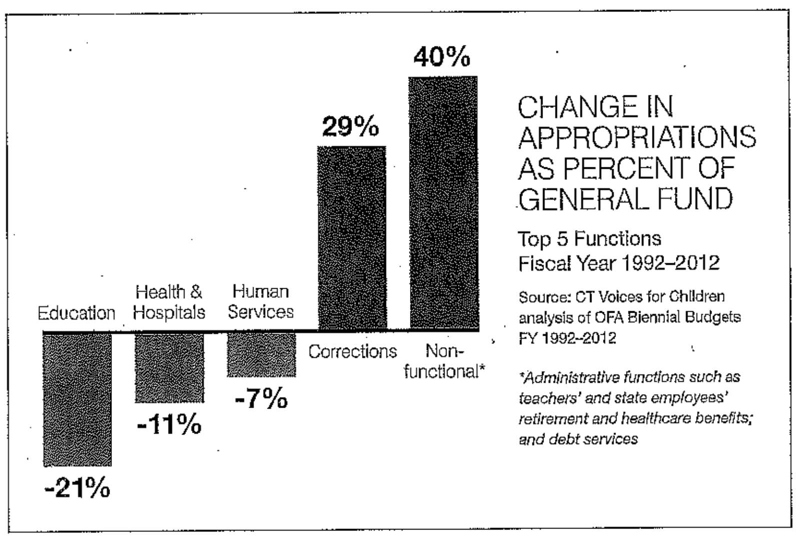


[6] Connecticut State Budgets, 2006-2012, Office of Fiscal Analysis



Connecticut's economic viability and quality of life have seen disinvestment by the state.[7]

When state spending continues to rise, it also drains dollars from our economy and discourages job creation and business investment in the state.



Structural Problem

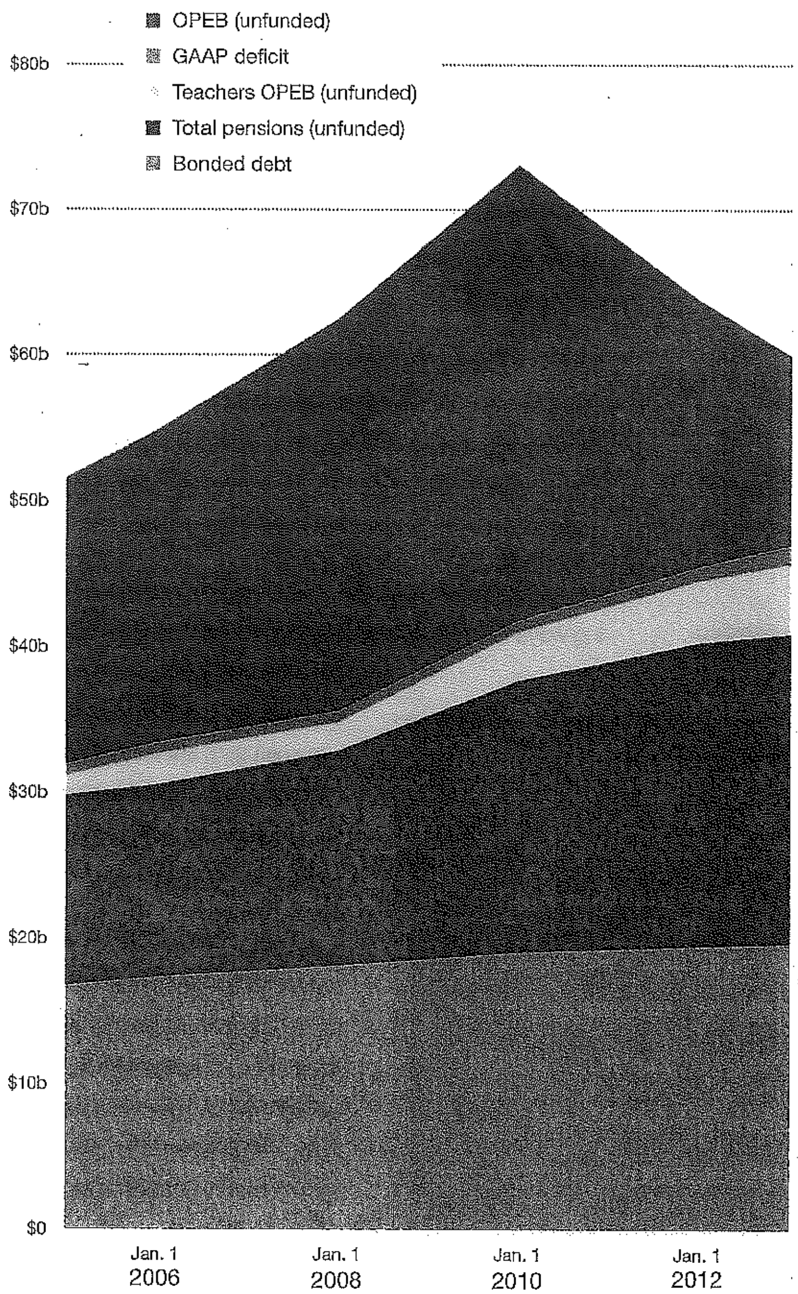
To be sure, much of the rise in state spending is a response to greater needs for vital, safety-net social services that have been stretched by a poor economy. Healthcare costs also have risen dramatically for the at-risk and aging population served by the state.

Costs have also risen, however, because of agreements made over time to guarantee generous retirement benefits for state employees. These guaranteed benefits have created significant and arguably unsustainable long-term obligations

[7] *Matthew Santacroce and Wade Gibson, "Shifting Priorities: Trends in State Appropriations, 1992-2012"; Voices for Children, 2012*

CONNECTICUT'S DEBT MOUNTAIN

Sources: OFA Connecticut State Budgets, 2006–2012; Office of the State Comptroller's Report on OPEB; 2012 OFA Fiscal Accountability Report; Actuarial Valuations of CTRB Retiree Health Care Plan 2006–2012



for state taxpayers. Compounding the budget crisis is the fact that the state has failed to adequately fund its long-term commitments, chiefly for state employee and teachers' pensions and state employee retirement healthcare.

Connecticut has an estimated $63.9 billion in overall long-term obligations. This figure is an improvement over 2010's long-term obligation valuation of $73.1 billion, due in part to concessions negotiated with state employee unions.[8]

However, the lower debt total heavily relies on optimism and estimation. The large drop in OPEB liability (other than pension employee benefits) is in part due to a simple change in the discount rate used to calculate obligations; that is, some of the "savings" came from using different assumptions on the rate of return of the state's invested pension fund, while the balance came from changes negotiated with the state employee unions.

Though the governor and legislature should be credited for taking steps in the right direction, it is likely that the state still has not yet been put on a sustainable path that will consistently lower the baseline in the coming years.

Much more can and needs to be done to bring these benefits and obligations in line with our ability to afford them.

[8] *Fiscal Accountability Report, Office of Fiscal Analysis, Nov. 15, 2012*

Other Critical Factors

- The state's income tax has become more volatile and hits small businesses (who pay their business taxes through the tax) particularly hard; this has hurt our economy.
- The recession substantially changed the state's income tax structure, for example, hitting the financial services industry—a traditionally large source of income tax revenue—particularly hard; many of those jobs, incomes and bonuses did not return.
- Connecticut's population continues to gray, with more baby boomers heading toward retirement and out of the workforce. This demographic migration will strain the state's income-producing population to pay the cost of state government.
- A federal budget sequestration would have a profound impact on Connecticut's finances if a solution is not worked out by Congress before the deadline.[9]

Under sequestration, non-defense discretionary spending could see across-the-board cuts to the tune of $38 billion, forcing Connecticut to do without grants and state aid that it usually relies on to finance priorities such as education and social programs. For example, both Title I money for disadvantaged children and special education funding for states would be cut by over $1 billion. Large portions of educational spending are mandatory as well; when federal funding does not come, the money must be found elsewhere in the budget, leading to further cuts in other areas.

"The state's income tax has become more volatile and hits small businesses (who pay their business taxes through the tax) particularly hard."

Federal aid for state social programs would also be significantly cut, seeing state spending on items like the WIC (women, infants, and children) Program, and energy assistance programs drastically reduced.

Policy Changes

Policymakers must create a state budget and develop long-term solutions that will keep spending within taxpayers' means and restore responsible fiscal policy. State government must become more effective, more accountable, and more affordable.

Several major studies by the Thomas Commission, Harper-Hall Commission, Connecticut Institute for the 21st Century, Commission on Nonprofit Health and Human Services, and others have identified practical solutions for making state government work leaner and better at less cost.

Governor Malloy has committed his administration to finding ways to streamline state government. The state also is beginning to address the largest cost-driving areas of state spending, such as state employee and teacher retirement benefits, the corrections system, medical care, and long-term healthcare.

The overriding need is to act decisively to restore greater fiscal responsibility and scale back the cost and scope of state government. Ideas are at hand; the question is whether policymakers will have the political will to implement them.

[9] Jake Grovum, "Sequestration: How a Spending Stalemate Would Affect the States," Pew Center on the States, Sept. 20, 2012

TURNING THE TIDE

In the face of new state budget gaps, Office of Policy and Management Secretary Ben Barnes acknowledged that policy changes are needed to address Connecticut's fiscal challenges. In fact, there are many changes that can be made to address the state's largest areas of spending and help state government become more efficient, effective, and fiscally responsible.

Progress has been made in some of these areas, but it has been relatively minor and at too slow a pace to have a significant impact on the state's fiscal condition.

It's time for a rapid and comprehensive use of proven reforms as recommended by the Connecticut Institute for the 21st Century and state commissions over the years, and as seen in the best practices of other states. Connecticut must:

I.	II.	III.	IV.	V.
Continue Streamlining State Government	Rebalance Long-Term Healthcare	Reform the Corrections System	Modify State Employee Retiree Benefits	Expand the Use of Quality Nonprofit Providers

Short-Term: The Next State Budget

In addition, the General Assembly must create a new, two-year state budget that:

- **Reduces** the size and cost of state government while improving its effectiveness
- **Balances** without any new tax increases that would harm economic recovery and job creation
- **Adheres** to the state's Constitutional spending cap
- **Holds** to the phase-in of Generally Accepted Accounting Principles

What's more, new mandates and other statutory provisions that drive up the costs of municipal services should be rejected. Municipalities should also be encouraged to work together to deliver public services more efficiently in order to reduce the need for property tax increases.

POLICY CHANGES: HIGH-REWARD REFORMS

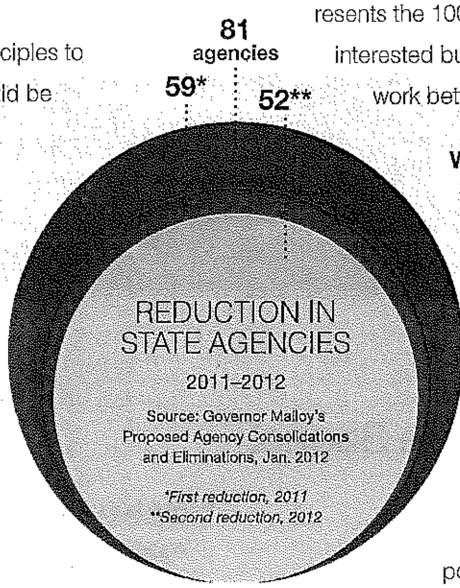
I. Continue Streamlining State Government

Lean

State spending can be controlled by constantly improving the organization of state government and the way it delivers services. Lean is a tool used often in the private sector to create customer value while using the fewest resources possible. It increases efficiency and removes waste.

Some state agencies have used lean principles to streamline operations but much more could be accomplished if lean were to be adopted government-wide. Connecticut's DEEP, DOL, and DRS are in various stages of implementing lean practices, with positive results in many aspects of their operations. Lean can help reduce redundant layers of management, restructure functions, and adopt new ways of budgeting to improve efficiency and effect savings.

In September 2012, the Office of Policy and Management issued a report[10] detailing numerous ways state agencies have been reducing their fiscal footprint. For example, since 2011, the administration has reduced the number of state agencies, through consolidations and eliminations, from 81 to 59. The executive branch trimmed its permanent workforce by approximately 2,500 positions over an 18-month period.



BEST PRACTICES:

Minnesota: "Enterprise Lean" is a coordinated effort with businesses to improve state government. Through it, 200 projects have saved the state $18 million dollars. General Mills has been a key contributor in the effort, training more than 500 state managers on how to optimize their departments. The Minnesota Business Partnership, which represents the 100 biggest companies in the state, pairs interested businesses with state agencies to help them work better and more cost-effectively.[11]

Washington State: Gov. Christine Gregoire viewed lean as central to her effort to transform state operations, and she reached out to Boeing for help. As a "major employer in the state," said a statement from the aerospace company, "we pay taxes and our employees pay taxes. Therefore, we have a vested interest in seeing our state and local governments run as efficiently as possible so they can be successful."[12]

Iowa: This state was first (2003) to launch lean efforts. It established an Office of Lean Enterprise to "promote and facilitate continuous improvement through the use of a specific set of proven tools and methodologies collectively known as Lean." Its website provides a clear accounting of specific programs and results.[13]

[10] "Report to the Governor: Changing How Connecticut State Government Does Business," State of Connecticut, Office of Policy and Management, Sept. 25, 2012; [11] Enterprise Lean, State of Minnesota (http://www.lean.state.mn.us/); [12] Jason Mercier, "Boeing Helps State with Lean Management Reforms," NW Daily Marker, Nov. 2011; [13] Office of Lean Enterprise, Iowa Department of Management (http://lean.iowa.gov/)