Remarks

on the

# Final Report of the Commission on Fiscal Stability and Economic Growth

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**for**

**1000 Friends of Connecticut**

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The Commission on Fiscal Stability and Economic Growth has performed a signal public service by developing a comprehensive outline for addressing the state's economic and fiscal problems. The Commission has identified several policy changes which it believes will get the state's fiscal house in order and stimulate economic growth. To its credit, its recommendations seemingly avoid pushing the state into an austere fiscal regime, which in the end would damage the economy.

In this regard, the Commission's report reflects the general principle articulated by David Osborne and Peter Hutchinson in The Price of Government:

> "just as driving the price of government too high can damage an economy, so driving the price too low can undermine its viability. In the Information Age, the keys to economic success are education levels, quality of life, and connectivity (the ability to reliably move information, goods and people) – and these things cost money."[1]

However, many of the Commission's recommendations lack sufficient detail to be implemented without a more thorough investigation, which should "vet" the assumptions and calculations on which its conclusions are based, and make sure that the proposed changes fit together into a coherent whole.

It would make sense, for example, to integrate the work of this Commission with that of the Tax Study Panel, which reported to the General Assembly in early 2015. And further analysis by an independent "think tank" like the New England Public Policy Center at the Federal Reserve Bank of Boston would provide additional insight into the ramifications of the Commission's proposals. In any case, the state should take advantage of the perspective which the Commission has brought to the economic and fiscal issues facing the state. Is there a way to move this process forward over the next few months without losing the value which members of the Commission have provided and without losing their continued participation, but allowing other players to participate?

**I. Many of the recommendations of the Commission deserve widespread support.**

**II. However, parts of the Commission's report are internally inconsistent with, or even contradictory to, other portions of the report.**

**III. The detailed analysis of how $1 Bn in spending reductions can be achieved appears to be flawed.**

**IV. The Commission's proposed revamping of the revenue structure is predicated on a very shaky analysis – involving some widely held, but incorrect, beliefs and assumptions.**

## I. Recommendations which deserve widespread support.

- Invest in modernizing transportation infrastructure

    [Potentially undermined, however, by a suggested reduction in STF spending of $300MM to $500MM on the $1.6B base.]

[1] Osborne and Hutchinson, The Price of Government, (New York: Basic Books, 2004), pp. 57-58.

- Revitalize cities
    - Property tax relief

        *[But the only concrete recommendation is to increase PILOT for state property. There is only a slight reference to the need to close the "need-capacity gap" in cities over the long term.]*

    - Development
    - Education assistance

        *[But only recommends a "reevaluation" of the current school aid funding formula.]*

- Support regional shared services to reduce municipal expenses and improve service delivery
- Undertake growth initiatives
    - Develop and train the workforce of the future

        *[But undermined by recommended spending reductions in higher ed, and reduced use of tax credits]*

    - Support the growth of high-potential sectors (Mfg, insurance/finance, care delivery, biotech)

        *[But undermined by recommended spending reductions in higher education, and reduced use of tax credits]*

    - Support entrepreneurs and small business

        *[But undermined by recommended spending reductions for improving processes and one-stop shopping.]*

- Restructure the amortization schedule for payment of the unfunded liability of the TRS

    *[But committing lottery revenue to support the TRS amortization reduces General Fund revenue for FY 2020 to FY 2022 by nearly $400 million annually – with no apparent replacement for those years.]*

- Increase the minimum wage
- Postpone implementation of the "bond lock" and other cap provisions embedded in the FY 2018-2019 budget without public hearings
- Create a Joint Budget Committee in the General Assembly
- Undertake revenue enhancement initiatives
    - Increased compliance with existing taxes

        [But should be wary of using one-shot revenue sources (tax amnesties) to support ongoing spending.]

    - Increased use of licenses, fines and fees

[However, such increased use would likely undermine Connecticut's favorable position as one of the states with the lowest "price of government." Defined as the overall "own source revenue" of state and local governments (including licenses, fees and other charges) as a share of the state's aggregate personal income, the "price of government" was used by Osborne and Hutchinson as a better measure of available revenue than total state and local taxes as a share of personal income.[2]]

## II. **Internal inconsistencies and contradictions.**

The goals listed above are certainly laudable. But they cannot be achieved in the absence of adequate funding. As Osborne and Hutchinson have said, driving the price of government too low can undermine the viability of the economy. Unfortunately, many of the Commission's recommendations for economic growth are inconsistent with, and/or contradictory to, some of its recommendations for expenditure reduction.

a. Although the Commission recommends the use of tax credits for several commendable economic growth initiatives, it also recommends a 14% reduction in tax credits and tax expenditures.[3]

b. Although the Commission recommends new programs in higher education, it also recommends $100 million in cuts to higher education.[4]

c. Although the Commission recognizes the need for a new funding formula to support K-12 education in cities,[5] it does not make legislative proposals to provide meaningful support for urban education,[6] and by virtue of its recommendation to cut $1 billion from General Fund expenditures, makes it very difficult for any future formula to be funded.

d. Although the Commission recognizes the regressive nature of the property tax, and its adverse impact on central cities, it only recommends funding for state property PILOT, and its recommendation for $1 billion in cuts to the General Fund makes it very difficult to find funding for implementation of a formula to close the "need-capacity gap."

e. Although the Commission offers a quite reasonable proposal to fund the Teachers Retirement unfunded liability, a proposal which would dedicate revenue from the lottery for this purpose, the first three years of using lottery money to fund the TRS liability removes $400 million in revenue from funding the rest of the General Fund.[7]

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[2] "Own source revenue" of both state and local government, as a share of aggregate personal income in the state, is the metric used by David Osborne and Peter Hutchinson in The Price of Government to assess whether a state's spending supports an appropriate level of public services. See below.

[3] Commission Report, pp. 8, 44. OFA has projected that, of the total $5.26 billion in revenue gain that would result if all tax expenditures it identified for FY 2019 were to be repealed, $338 million is for tax credits against the corporation tax. See OFA, Connecticut Tax Expenditure Report, February 2018, linked at https://www.cga.ct.gov/ofa/ pp. 5-15.

[4] Commission Report, pp. 85-86.

[5] Commission Report, p. 119.

[6] Commission Report, p. 55

[7] See the chart on p. 82 of the Commission's report.

f. The Commission's recommendation for the necessary investment in transportation infrastructure is undermined by its suggestion that $300 million to $500 million can be cut from the DOT budget.[8]

Additional details may be found in the table below:

| Laudable Recommendation | Inconsistent with / Contradicts Other Recommendations |
|---|---|
| A reevaluation of the current school funding formula should occur, to better incorporate dynamic factors including special services needs and to achieve more equitable allocation among wealthy and urban school systems and provide urban schools with the resources they need. (p. 119) | Cutting $1 billion in expenditures makes it nearly impossible to fund a meaningful school funding formula which addresses urban schools. |
| In the short-term, the Commission suggests to more fully fund the PILOT program with respect to state-owned property in central cities. (p. 56)<br>The legislature should *fully fund PILOT* and establish for Connecticut's cities a reliable and predictable aid municipal amount so that cities are able to plan and manage their budgets. (p. 116) | Funding for PILOT for state property is in OPM's budget, which could be subject to at least a 9.4% cut under the Commission's recommendations. |
| In the longer-term, Connecticut needs a thorough review of the state's municipal aid formulas with a view to mitigating the property tax "need-capacity gap" between its central cities and their suburbs. (p. 56) | Cutting $1 billion in expenditures makes it nearly impossible to fund a meaningful formula to close this gap. |
| The state should continue to provide *incentives* for municipal shared service agreements to reduce the cost of local government. (p. 117) | But the Commission has recommended cuts of $1 billion. |
| Re CRDA-like development boards:<br>funding, *while largely from the state coffers*, should be allocated by the local boards. Because of the importance of this effort to economic growth in the state, the commission recommends the legislature consider *initial investments on the order of $100 million annually* once this entity is functioning. (p.118) | Presumably this $100 million would come from bonding, This would increase debt service costs. |
| Connecticut should authorize the creation of a new, nationally competitive STEM campus in Hartford, New Haven or Stamford. The governor should launch an RFP process to recruit an in- or out-of-state university to lead this effort to enhance the advances already being made in STEM by Yale, UConn, and the state universities. (p. 57)<br>[This approach was successful in NYC.] The prize consisted of $*400 million in combined land value and infrastructure grants* from the city, (p. 94) | Would grants come from bonding?  If so, would increase debt service.<br><br>Or from higher ed appropriations, which would be cut $100 milliion. |

[8] Page 86 of the Commission's report.

| Laudable Recommendation | Inconsistent with / Contradicts Other Recommendations |
|---|---|
| The importance of enhancing The University of Connecticut's (UConn) status as a leading national research university cannot be overemphasized. While a lot of legislative attention has been devoted to reducing UConn's budget and the number of highly paid professors, *not enough effort has been spent on building its stature as a great public research institution* and to measuring the ongoing success of the University's board and leadership. (p. 58) | Reducing UConn's budget, and limiting the number of highly paid professors will substantially impede the goal of enhancing UConn as a leading national research university. Yet the Commission anticipates that funding for higher education can be reduced by $100 million annually (p. 85-86) without undercutting this goal. Not possible. |
| Connecticut needs *new state financial incentives* to attract and retain STEM graduates and millennials in general. This could take the form of *student loan payments or forgiveness, tax credits, or mortgage subsidies*. (p. 58) | These subsidies would most likely take the form of tax expenditures, which the Commission recommends cutting by 14%. |
| Deploy advanced analytics to help identify the highest-potential students [who have dropped out] to proactively reach out to. These could be enticed back with *tuition deferral plans*, for example. Their *coursework could also be specifically designed* to meet the short-term needs of local employers. | Nearly impossible with cut of $100 million in higher ed spending. (pp. 85-86) |
| [To meet the demand for technically trained workers] Develop dynamic curricula and learning pathways for priority sectors: Support a portfolio of new 4-year, 2-year, and certificate programs that are codesigned with employers and deployed by public and private institutions with the necessary teaching capabilities. (p. 91)<br>New levels of cooperation and new programs will be required to meet this demand. Too many of the programs are one-off – for example, between a single employer and a local community college or even a single professor – and sub-scale. (p.92) | Developing new curricula, particularly in technical fields, is very expensive. Likely not possible with $100 million cut in higher education. |
| [To retain and attract critical talent,] Convince more talent to move to or stay in Connecticut *through financial incentives (e.g., grants, tax credits, loan forgiveness)* and innovative branding campaigns. (p. 90)<br>(T)he most direct model would be to *provide financial incentives* targeted at specific talent bands, such as computer science graduates. There are many different ways to structure an incentive, for example: *loan forgiveness, tax credits, mortgage subsidies*.<br>Rhode Island has an example of such a program, with their "Wavemaker" fellowship aimed at retaining STEM graduates through an income tax credit that varies by level of education. Since 2015, Rhode Island has awarded 427 fellowships at a cost of *$3.3 million.* (pp. 96-97) | Tax credits and loan forgiveness reduce revenues. |

| Laudable Recommendation | Inconsistent with / Contradicts Other Recommendations |
|---|---|
| [Develop a strategy to attract outbound talent]<br>The State could launch a creative initiative to identify specific populations likely looking for what Connecticut has to offer, and then experiment with tactics to reach and win them over. For example, *focus groups and consumer research* could identify the priority segments where Connecticut's value proposition would resonate the most, . . . A *database of potential new residents could then be developed* using existing data, and a series of different win tactics could be tested. Examples of such tactics could range from the very affordable, (e.g., a Google AdWords campaign on job search sites), to *monetary incentives*, (e.g., two nights at a Connecticut hotel to encourage visits), or *to pay-for result payouts*, (e.g., *$5,000 in tax credits* for first two years if they move back to the State and are employed in a STEM field). (p. 97) | Creative initiatives, including databases and focus groups, cost money.<br><br>Monetary incentives cost money, as do tax credits (in the form of revenue reduction.) |
| [Modernize a manufacturing supply chain] Many public and private initiatives are dedicated to growing the sector; for example, UConn has *invested* more than $180 million in an advanced manufacturing ecosystem at its Tech Park. (p. 98) | An additional investment on the order of $180 million would greatly increase debt service costs. |
| [Scale up startup accelerators in insurance and finance] through *additional funding*. A variety of funding models could be used to achieve this, including: a public private partnership (e.g., MassChallenge, *where State resources were combined* with $2 million in funding from corporates and universities) (p. 102) | "Additional funding" requires either appropriations or bonding. |
| [Modernize the healthcare workforce] Offer *incentives* for health professionals who stay and practice in the State for a given number of years. These could include *scholarships or debt forgivenes*s for doctors. . .<br>– Work broadly with the State University system to *tailor nursing curriculum* to emphasize healthcare innovation, including digital health and care in non-traditional settings (<br>– *Explore targeted expansion of nursing education* at Connecticut community colleges and universities (pp. 104-105) | Revising and expanding existing curricula is very expensive, especially in nursing. Very hard to do with cuts of $100 million in higher ed. |
| [To expand accelerators and incubators] Connecticut could *make public co-investments* with corporations and other partners, including philanthropists, . . (p. 115) | Requires additional appropriations or bonding., |
| Connecticut needs to focus and *fund* DECD efforts to support incubators, accelerators, and analytics to assist the four key sectors, and *to optimize the use of stranded tax credits* as part of this effort. (p.58) | Using stranded tax credits reduces revenue. |

| Laudable Recommendation | Inconsistent with / Contradicts Other Recommendations |
|---|---|
| • Authorize *new state funding sources* and Public Private Partnership legislation that will enable Connecticut to utilize new federal or privately funded infrastructure programs, specifically to address limitations of the current 20-year Special Transportation Fund bond program.<br>• The budget should provide CONNDOT, the CAA, and the CT Port Authority with *adequate human resources to plan and execute the capital projects* the Commission recommends above.<br>• Current projections indicate that without a change in capital needs or *without enhanced revenue streams, revenues in the out years (8 years+) will be insufficient* to cover debt service for all the transportation projects currently contemplated. . . .<br>(T)he governor and the legislature in particular must approach the state's transportation needs with a longer-term perspective. This *entails providing revenues to CONNDOT* that will support a bonding program and pay-as-you-go investments in critical projects, with a multi-year view as to what revenues will be allocated to CONNDOT. (p. 55) | Very difficult to achieve with \$300 to \$500 million in cuts in the Special Transportation Fund. Even with increased revenues from gas tax and tolls. |

## III. **Analysis of projected \$1 Billion in expenditure reduction is flawed.**

It is comparatively easy to recommend that major cuts in governmental budgets be made. Easy, that is, until policy-makers begin to grapple with the details of programs to be cut. Experience in recent years has shown that legislators have not been able to agree on specific cuts to specific programs, so they have handed the responsibility for making cuts over to the Executive Branch, by demanding that the Governor achieve several hundred million dollars in "forced lapses." And then, when the Governor makes some unpopular cuts in order to achieve the target number, there is a huge hue and cry that those particular programs should not have been cut. (Examples: cuts in Medicaid and in ECS after the FY 2018-19 budget was passed)

A similar scenario can be expected if any entity or consultant is charged with the task of recommending a billion dollars in reductions to the General Fund and the Special Transportation Fund. This is especially the case after decades of spending reductions to agencies – which have frankly left many of them with inadequate resources to achieve what they have been charged to do.

It may well be that "a bold and comprehensive review led by a nationally prominent third party consultant such as Bain, Boston Consulting Group or McKinsey & Co. would likely result in expense optimization plans and actions to reduce the non-fixed costs by another \$1 billion without adversely impacting the social service outcomes of the state."[9]

But the sketchy outline of the potential ways to achieve that magnitude of reductions provides little confidence that the goal can be realized, because it appears to be based on a flawed set of assumptions, and a flawed set of calculations.

[9] Commission Report, p. 49.

### A. Flawed assumptions

The Report asserts that all that is necessary to achieve $1 billion in annual savings is to cut 3% in annual spending out of what it asserts is a $32 billion biennial base.[10]

However, the FY 2019 General Fund budget is $18.9 billion, as adopted by the General Assembly (after lapses and collective bargaining savings are subtracted). So a 3% cut on that base is only $567 million, not a billion.

To achieve a $1 billion reduction in the General Fund would require a 5.3 % reduction across the board.[11]

But fixed costs in the General Fund are about $10.3 billion.[12] So to reduce $1 Billion of the remaining $8.6 billion requires about 11.6% reduction in the rest of expenditures.

Realizing that magnitude of reduction appears to be very difficult.

### B. Flawed calculations

1. The Commission Report thinks that $100 million can be cut in higher education appropriations, out of a $10 billion base. But the appropriation for higher ed in FY 2010 is $754 million, not $10 Billion. So to achieve a $100 million cut would require a reduction of 13.3%, on top of major reductions in higher ed over the last few years. From experience, I can assert that a reduction of that magnitude would make it impossible to achieve curricular reform required to support the future workforce. (In fact, the cuts to higher education which have already occurred have decimated the capacity of these institutions to revamp their curricula.)

2. The Commission Report projects that there can be a $250 million cut in health and human services on a $10 Billion base. But the appropriations for health and human service agencies (DCF, DSS (non-Medicaid), DMHAS, DDS, and DOH) for FY 2019 total $3.7 billion. So a cut of services in this area must be 6.7%, in order to "save" $250 million.

3. The $150 million cut in the rest of the General Fund is not on a $10 Billion base, but on appropriations for FY 2019 of $4.1 Billion remaining after the base is decreased as noted above in #1 and #2. (Accordingly, the reduction of $150 million would appear to be a more manageable 3.7%). But the "rest of the General Fund" includes Judiciary, DOC, OEC, SDE (non-ECS) and DESPP. If those agencies (with total appropriations of $2.5 billion) are excluded from cuts, then the cut of $150 million would be across remaining $1.6 billion in appropriations. That would require a 9.4% reduction for those agencies.

4. In order to reach a total reduction of $1 billion, the Commission must be assuming that the Special Transportation Fund is part of the overall base. So it projects that $300 to $500 million can be cut from the STF. Total appropriations for FY 2019 for the STF, however, are

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[10] See p. 84, and note 3 on page 84, of the Commission report.

[11] Suppose I have misinterpreted the analysis of the Commission, and it meant to include both the GF and the STF, for a total annual budget in FY 2019 of $20.5 billion. Then 3% would be $615 million, not $1 billion.

[12] This assumes debt service of $2.2 B, TRS of $1.35 B, ECS not reduced at $2.0 B, state share of Medicaid at $2.7 B, and fringe benefits (after lapses) of $2.1 B, all as appropriated in the FY 2019 budget.

$1.6 billion. So reductions of $300 million to $500 million must be taken from the $1.6 billion base, not the $2.5 billion base assumed by the Commission's Report. That means the percentage reduction must range from 18.7% to 31.1% in a fund which must support the improved transportation infrastructure which the Commission recommends. Highly unlikely, given the cuts already made in the STF over the years.

Observe that the $1 Billion in cuts envisioned by the Commission apparently includes both the GF and the STF. But if cuts can't be achieved as calculated for the STF, the GF would have to absorb another $500 million in cuts – and all of that in the areas not in higher ed and health and human services. So the total reduction in the "rest" of the GF would need to be $650 million on a $4.1 Billion base, or 15.9%.

IV. **The Commission's proposed revamping of the revenue structure is predicated on a very shaky analysis – involving some widely held, but incorrect, beliefs and assumptions.**

A. The proposed reduction in income tax rates, ultimately reducing revenue by $2.1 billion, is in part justified by the flawed assumption that the income tax on upper income filers is a cause of outmigration of upper-income filers.

- Extensive scholarly analysis has concluded that millionaire tax flight is a myth.[13] As one reviewer of the foremost book in this field has said, the study "debunks the widely-held myth that raising taxes on the wealthy inevitably prompts their out-migration and ultimately reduces tax revenue. (Its) sophisticated analysis convincingly demonstrates the opposite."[14]
- The number of high-income filers in Connecticut (with CT AGI greater than $500 thousand) actually INCREASED over the period from tax year 2010 through tax year 2016.[15]
- Lower income filers tend to out-migrate at a higher rate than higher income filers.[16]
- Filers do not necessarily take their income with them: when people move, their job and/or business may remain in the state and their earnings just transfer to the new job-holder or businessperson.

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[13] See especially, Cristobal Young, The Myth of Millionaire Tax Flight, Stanford University Press, 2018.

[14] Douglas Massey, Princeton University. Comments on Young's book.

[15] Data from DRS "Individual Income Tax Data Reports" for the requisite tax years, linked at http://www.ct.gov/drs/cwp/view.asp?a=1445&q=471966 Filers in the $500K to $1M cohort increased from 13,444 to 17,984, or 33.8%. Filers in the $1M to $2M cohort increased from 5,215 to 6,521, or 25%. Filers in the cohort above $2M increased from 3,545 to 4,213, or 18.8%. This analysis is supported by data for tax years 2010 through 2015 reported in Connecticut's Population and Migration Trends: A Multi-Source Data Dive, published by the Connecticut Data Collaborative, May 2017, and updated August 2017, p. 33. This study is linked at http://ctdata.org/news/migration-and-population-trends-ct/

[16] Connecticut's Population and Migration Trends, pp. 34, 36-37.

- Even assuming that income follows the person, the Commission's Report incorrectly fails to account for increased income from in-migration (which, while less than out-migration, significantly decreases the projected income lost through migration).[17]

B. The proposed replacements for the recommended diminished personal income tax income – sales and use taxes, and corporate income tax – are less likely to grow with the economy than the personal income tax. Certainly, the income tax is more elastic than the sales and use tax, as it is more directly tied to the growth in the revenue base (which is personal income).

To be sure, the personal income tax is volatile as applied to unearned income and bonuses – but it is still likely to grow with more elasticity overall. For example, for FY 2018 through February 2018, income tax withholding receipts (i.e. not including estimated and final payments) increased 6.6% from the amount received through February 2017, while sales and use tax receipts increased only 2.9%.[18]

C. If the Commission is assuming (and it's difficult to determine if it is) that the economy will grow at a faster rate if the income tax rate is reduced,[19] that assumption is incorrect.

- Professor Michael Wasylenko, assessing Connecticut's competitiveness, found that reducing the rate of the income tax produced economic growth ONLY if the property tax was simultaneously reduced and spending was increased to support elementary and secondary education.[20] Neither of those conditions is possible under the Commission's recommendations.

- The experience in Kansas, which reduced the income tax rate under Governor Sam Brownback, has conclusively demonstrated that any economic growth will not be sufficient to regenerate the revenue lost by income tax reduction.

D. The recommended reduction in the personal income tax is, to a large extent, "smoke and mirrors." The Commission recommends that it be partially replaced by a "payroll tax,"[21] which is to be applied only to those on payroll.

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[17] Commission's Report, p. 32. The net loss of income is actually $2.7 billion – assuming, despite the last bullet point, that all income follows the person.

[18] See data in the DRS Monthly Comparative Status Reports, linked at http://www.ct.gov/drs/cwp/view.asp?a=1444&q=471972 From FY 2010 through FY 2017, with the exception of FY 2013,the increase in final income tax withholding receipts for each year exceeded the increase in sales and use tax receipts – although changes in rates and base probably affected the total amounts collected..

[19] See the footnote to the chart on page 63 of the Commission's Report. It's hard to tell if the assumption is that the "progrowth tax initiatives" are expected to enable a 3% greater economic growth, or a 3 percentage point greater economic growth. In any case, Wasylenko's analysis (cited below) finds that even with a reduction in property taxes and increases in spending on education, the economic growth is likely to be only 0.21%.

[20] Wasylenko, "Competitiveness: Factors that contribute to economic growth in states with special reference to state and local spending and taxes," Analysis prepared for the Connecticut Tax Study Panel, September 2015, at pp. 52-54 (pages 227-229 in the Report of the Connecticut State Tax Study Report, Volume 2, linked at https://www.cga.ct.gov/fin/taskforce.asp?TF=20140929_State%20Tax%20Panel

[21] Commission Report, pp. 8, 43.

- Assuming that payroll tax gets passed on to employees (in the form of a wage decrease), then what would appear to be on its face a reduction in income tax of 1.24 percentage points [18% of 6.99%] (if applied across the board, which is unlikely) is in large part offset by the proposed payroll tax of 0.8%.

E. The replacement of part of the personal income tax by the proposed payroll tax (assuming that it is passed through to employees) is quite inequitable. Only employees will get hit by this payroll tax, while non-employees (owners and folks with unearned income) will get the full reduction in income tax rates.[22]

F. Reducing the revenue from the personal income tax by a projected $2.1 billion, without firm plans in place for combination of expenditure reductions and revenue increases from other sources of revenue is like buying a "pig in a poke."

Moreover, reducing income tax revenues NOW, without understanding what the impact of expenditure reduction will be on specific programs, raises the real possibility that programs that people need will be eviscerated.

**Finally, it should be observed that not all national studies have concluded that Connecticut is in terrible shape.**

A. Although applicable only to taxes on business, the respected accounting firm of Ernst and Young has produced an annual study for the Council on State Taxation, the latest of which reports that Connecticut had the lowest Total Effective Business Tax Rate (total state and local taxes on business as a share of private sector Gross State Product) in the nation in FY 2016, that the business share of total state and local taxes in Connecticut was the lowest in the nation in FY 2016, and that (assuming that 50% of government spending on education benefits business), Connecticut was tied for lowest in the nation in terms of business cost for benefits received.[23]

B. Although the Commission relies heavily on various competitiveness indices, including a report by the Beacon Hill Institute,[24] in her report to the Tax Study Panel on "Connecticut Fiscal Comparisons," Carolyn Bordeaux injects a note of caution about using such indices:

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[22] Assuming that the payroll tax is passed on to the employee by the employer, the projected decrease in the income tax rate of one percentage point (from 4.5% to 3.5%) for filers in the $10 K to $50 K tax bracket, and from 5.5% to 4.5% for filers in the brackets from $50 K to $200 K is 80% offset by the 0.8% projected payroll tax. And for filers in the $200K to $250 K bracket, the reduction from 6.5% to 5.75% is completely offset by the projected 0.8% projected payroll tax. On the other hand, for filers in the highest bracket, the recommended reduction is a full 1.24 percentage points. And the reduction for those in the next highest bracket is 1.15 percentage points. See the chart on p. 43 of the Commission's report.

[23] Ernst and Young and State Tax Research Institute, "Total State and Local Business Taxes: State by State Estimates for Fiscal Year 2016," August 2017. Linked at http://www.cost.org/state-tax-resources/cost-studies-articles-and-reports/

[24] Commission Report, pp. 17-18.

> While the tax and economic competitiveness rankings often receive considerable media attention, to date, **there is no research-based evidence that these indices actually predict economic growth in a state.**[25]

She continues:

> State policy-makers often express concern about a state's rank on a particular index; however, these metrics are typically only one part of a much bigger story. The very features that may cause a state to rank poorly on one index may cause it to rank highly on another. In general, this type of analysis can raise questions and indicate areas for further investigation but does not provide any definitive answers about a state's tax competitiveness.[26]

In particular, Bordeaux is critical of the State Competitiveness Index produced by the Beacon Hill Institute. She makes the point that that the index relies on a multiplicity of measures which may not be grounded on data: "the choice of the different measures and their relative weights are largely grounded on judgment calls." She raises the question of "whether the components of each sub-index are actually appropriate 'proxies' for the concept they are trying to measure." And she notes that "the index includes the actual outcomes that the index intends to predict."[27]

C. Although the Commission focuses on high tax rates in Connecticut,[28] perhaps a better metric for assessing Connecticut's competitiveness is Osborne and Hutchinson's "price of government." That metric compares states on the basis of "own source revenue" – including fees, licenses and other charges, in addition to taxes – as a share of aggregate personal income, instead of taxes alone.[29] On that basis, Connecticut as late as tax year 2014 was ranked ahead of potential competitors like Massachusetts and Florida. (and WAY ahead of New York and New Jersey and Rhode Island)[30]

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[25] Bordeaux and de Zeeuw, "Connecticut Fiscal Comparisons," September 2015, p. 6 (to be found in the Connecticut Tax Study Panel Report Volume 2, at p. 128). This Report is linked at https://www.cga.ct.gov/fin/taskforce.asp?TF=20140929_State%20Tax%20Panel

[26] Bordeaux, at page 9.

[27] Bordeaux, at p.44.

[28] Commission Report, pp. 24-30.

[29] This measure was used by Osborne and Hutchinson in their The Price of Government. It's since been replicated by the NEPPC (in 2010, for 2008) ["Business and Tax Climate in the New England States," at https://www.bostonfed.org/-/media/Documents/neppc/kodrzycki022610.pdf?la=en and the Minnesota Dept of Revenue (annually, most recently for 2014) http://www.revenue.state.mn.us/research_stats/Pages/Rankings_by_Tax_Type.aspx

[30] In FY 2002, Connecticut had the fourth lowest "price of government" in the country (13.1% lower than the national average). (p. 56) In FY 2014, it had the seventh lowest (11.8% lower than the national average) – lower than, among other states frequently mentioned as competing with Connecticut, Florida, Georgia, Texas, Maryland, North Carolina and Massachusetts. In the Northeast, only New Hampshire's "price of government" was lower. (Minnesota Department of Revenue)

## Conclusion

The Commission has put forward a vision for the economic future of the state which includes many laudable goals.

But there is a need for further review and analysis, of the assumptions on which the vision is based, of the internal coherence and consistency of the analysis, and on the desirability of implementing some of the goals.

The Report merits further analysis by an independent, non-partisan think tank – like the New England Public Policy Center at the Federal Reserve Bank of Boston – before the next legislative session.