
Fiscal Architecture of Connecticut
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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

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:

Demographic	Economic	Institutional
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 (24.5)	852.5 (23.0)	822.9 (22.0)
20-44	1,107.6 (30.4)	1,129.4 (30.5)	1,143.9 (30.5)
45-64	1,062.9 (26.2)	1,049.7 (28.4)	996.5 (26.6)
65 and over	582.2 (16.0)	671.0 (18.1)	782.8 (20.9)
85 and over	94.6 (2.6)	94.9 (2.6)	96.4 (2.6)
Total	3,644.5	3,702.5	3,746.2



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/ Insurance	Prof/Tech Services	Educational Services	Healthcare Services	Accommodation 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%



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

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

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

Overall Landscape

- See Table 11

	Trend	Revenue Implications	Impact of Institutions	What if?
Demographic				
Age composition	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.
Population size	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
Health status	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>Employment and output</p>	<p>Increase in service sectors including health/education/accommodation Lower wage jobs 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 Corporate Tax ↓: Service sector is less transparent and provides a weaker paper trail for tax administration 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>Personal Income</p>	<p>High median income Increasing disparity in income; Growth in lower wage jobs 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 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 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>Globalization and Technology</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. 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 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>