

## **Connecticut's Budget Outlook: Balancing Demand and Supply in a Period of Structural Deficits**

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*"There are other ways of minimizing the appearance of a structural deficit. Connecticut uses an accounting system that recognizes revenues as quickly as possible while slowing down the budgetary acknowledgement of expenditures. This doesn't just disguise bad times, it can actually create them. Since we haven't corrected our fiscal idiosyncrasies when we have a seeming surplus of revenues, we have chosen to cut taxes or improve programs," says one high-ranking state official.* <http://results.gpponline.org/CategorySummary.aspx?id=2>

The Legislature's Office of Fiscal Analysis (OFA) recently released its state budget outlook for the next few years and the news is not good. The OFA estimates a \$235 billion shortfall in the current services budget in FY 2008 growing to a \$691 billion deficit, or 4 percent, by FY 2010. Expenditures in the current services budget represent the current baseline demand for public goods and services, while state revenue represents the available supply of public goods. The budget deficit represents the imbalance between the projected supply of public goods and the projected demand for public goods.

Unlike the federal government, most states, including Connecticut, have a statutory or constitutional requirement for a balanced budget and so must confront these projected deficits on an annual basis. Like any family or business facing a similar situation, certain choices need to be made regarding cutting expenditures, raising revenues or, most likely, some combination of both. Therein lays the rub.

### **State Spending and Taxation**

There is perhaps no topic that elicits more widespread opinion and acrimony than that of taxation. Unfortunately, much of the never-ending debate produces more heat than light as zealous anti-government types spar with staunch re-distributionists over the size and role of government. The debate is further complicated by the devolution over the past few decades of many traditional federal responsibilities to state and local government, frequently with few, if any, resources to carry out the mandates.

Devolution has effectively increased the cost of state and local government, and hence the tax bill of both businesses and households. If there were offsetting savings on federal expenditures it would be one thing, but that is not the reality. The federal tax cuts of the past several years have not been matched with reduced federal spending. Instead federal expenditures have increased significantly even as revenues have gone down.

The growing gap between federal revenues and expenditures has been filled by unsustainable levels of borrowing. In essence, the federal government is passing on an increasing share of its annual operating costs to succeeding generations. That is, an increasing share of today's tax bill will be paid for by tomorrow's taxpayers who will have had no voice in those earlier spending decisions; analogous to leaving little but credit card and mortgage debt to one's heirs—a most unwelcome legacy and a particularly egregious example of *taxation without representation*.

## **Assessing Government Size**

There are numerous ways to compare the size and growth of the public sector and the concomitant tax burden. Depending on one's agenda and method of analysis, the data can tell a few different stories.

*Employment:* For example, if one were to look at the total FTE employment ratio of state and local (S&L) government (because Connecticut does not have regional government it is necessary to combine state and local government to draw fair comparisons with those states where regional government has many of the responsibilities that state government has in Connecticut ) per 10,000 population one would find that in 2004 Connecticut, at 518, ranked 31<sup>st</sup> in the country, up 0.5 percent from 516 in 1994. The U.S. ratio in 1994 was 529 and increased to 538, or 1.7 percent, by 2004. New Hampshire ranked first on this scale with an increase of 25 percent from 1994 to 2004. With a ratio of 527 in 2004, New Hampshire had a higher level of relative government employment than Connecticut.

A variation on the preceding involves looking at the concentration of S&L employment relative to total employment. Any such analysis, however, is clouded in Connecticut since the more than 20,000 jobs associated with the two Indian casinos are classified as government positions, effectively skewing any employment-based comparisons.

Looking simply at the total size of government employment one finds that between 1994 and 2004 total S&L government employment in Connecticut grew by 11,000, or 6.2 percent. Connecticut's growth rate ranked 42<sup>nd</sup> among all states on this metric. At the national level total state and local employment increased by 13.5 percent. At 40.2 percent Nevada posted the fastest growth rate of any state during this period.

Finally, comparing the ratio of state and local government employment to total employment provides yet another perspective on the relative size of government in Connecticut. In 1990 state and local government employment accounted for 16.7 percent of total employment in the country and 13.0 percent of employment in Connecticut. By the end of 2006 those ratios had risen to 17.0 percent and 15.9 percent, respectively.

*Budget:* Similar to employment, government budgets can be viewed from a few different perspectives. Two of the most common methods include the ratio of tax revenues per capita and tax revenues per dollar of income. In the case of Connecticut these two ratios tell somewhat different stories.

In terms of total state and local tax collections per capita Connecticut ranks third among all states at \$4,921 for every man, woman and child living in the state. The U.S. ratio is \$3,440 per capita. Looking at taxes relative to income one finds that Connecticut, at 11.6 percent, is the 11<sup>th</sup> highest in the nation. Considering that the U.S. average is 11.0 percent, Connecticut does not appear to be much of an outlier.

*Fiscal Capacity:* A state's fiscal capacity contrasts revenue capacity to expenditure need. As reported in a recent study from the New England Public Policy Center at the Federal Reserve Bank of Boston, Connecticut ranks first in their fiscal capacity index.

Or, put another way, Connecticut has a high capability of meeting its own expenditure needs using its existing tax base.

As this discussion, and the table below, illustrate there numerous ways to assess the size of government depending on the agenda which is being promoted. However one chooses to assess the size of government, the fact remains that, faced with chronic deficits, choices need to be made and priorities established as to the most critical areas for public investment. Creeping incrementalism, or business as usual, will no longer suffice.

**State and Local (S&L) Government: Selected Indicators**

	<b>CT</b>	<b>CT Rank</b>	<b>U.S.</b>
Total GDP (2005, \$mil)	193,745	23rd	12,409,555
growth 2000-2004	6.7%	43rd	10.1%
S&L government (2004,\$mil)	13,516	30th	1,007,373
growth 1990-2004	41.2%	32nd	43.1%
S&L GDP % total GDP (2004)	7.0%	30th	8.1%
S&L GDP per capita (2004)	\$3,863	12th	\$3,430
S&L FTE employment (000s, 2005)	243,100	31st	15,789,784
Private employment (000s, 2005)	14,190,000	27th	114,542,000
S&L as % private employment	14.5%	41st	16.3%
S&L emp per 10,000 pop (2004)	519	42nd	538
S&L taxes per capita (2002)	\$4,373	2nd	\$3,143
Taxes as % personal income	10.2%	19th	10.2%
Fiscal capacity index (2002)	141	1st	100
S&L expenditures per capita (2003)	\$5,944	6th	\$4,682
S&L revenue per capita (2002)	\$7,179	5th	\$6,278
S&L property tax per capita (2002)	\$1,733	2nd	\$969
Debt outstanding per capita (2002)	\$8,028	4th	\$5,856
State pension solvency (2002)	59.9%	47th	

### **Budget-driven strategy or strategy-driven budget?**

As is the case in many, but not all, states, Connecticut's current budget tends to drive spending decisions. In times of budget surplus, such as the late 1980s, new programs and initiatives were added to take advantage of swelling coffers. As the coffers were depleted, however, there was and is an entrenched reluctance to eliminate any programs.

Over the past few decades, as fiscal deficits have materialized, the automatic response is to cut every agency's budget by a certain percentage, be it three percent, five percent, or even higher. The fact that budget cuts are made across the board suggests that

every agency and every activity has equal priority or, in other words, there are no priorities---every activity and program offered by the public sector is of equal importance—a view that few would accept. In the best of all worlds, the state would have a long-range, overarching strategic plan that would encompass all areas of public sector activity, and the biennial budgets would be driven by that strategy and informed by a continuous performance benchmarking process.

### **Conclusion**

This article has illustrated that, all things considered, the state and local tax burden and the overall size of state and local government in Connecticut may not be as onerous as public perception often suggests. However, this is not to suggest that government spending must or should continue to increase automatically. There will come a point, not far in the future, when a growing public budget will come face-to-face with a declining tax base and some difficult choices will need to be made. By many accounts, Connecticut appears to be on the cusp of a prolonged period of structural deficits. Instead of waiting for a full-blown crisis to emerge, perhaps we should begin today to develop a long-term economic and fiscal strategy for Connecticut---a plan that addresses both the state's immediate and long-term needs in terms of economic growth, urban renewal, human capital and other priority areas. Failure to address these critical problems today will only make them more expensive in the future when the state will be in a weaker fiscal condition.