Connecticut's Shrinking Economy: Is there a pathway to growth?

Good news! Connecticut's economy grew during the first six months this year—it is now about *as big as it was in 2005!* The state's economy ended 2017 smaller than it was in 2004. This is not the first time Connecticut has enjoyed two quarters of growth, but since 2008 bad quarters have overwhelmed good ones.

The result has been an economy steadily shrinking—with 2015 carving out miniscule growth—at almost a negative one percent annual compound rate for a decade. It is the worst performance of any state in the nation, by a significant margin.

Two of Connecticut's leading sectors in 2008 took heavy hits. Nondurable Goods Manufacturing, the 3rd largest sector in 2008, was annihilated, shrinking 75%, losing more than $20 billion in value, and falling to 10th; Finance and Insurance lost over $10 billion in value, nearly a 30% contraction.

Overall, nine economic sectors in Connecticut's economy shrank between 2008 and 2018. Among other sectors, only the Information sector enjoyed robust growth, but at a rate slower than the national rate and its share of the state's economy remains smaller than the national share. So even our strongest growth lagged the national pattern.

In contrast, our neighboring states have done well: they now enjoy employment and real output well above their previous peaks. Nationally, every sector, except government, expanded 2008-2018, underlining the poor, anomalous performance of Connecticut's economy.

Is There a Pathway to Growth?

Connecticut faces the twin challenges of addressing a daunting fiscal crisis while adopting policies and initiatives that will restore real growth in the economy. Without a determined effort on both fronts, the state's economy is unlikely to enjoy any significant growth.

There are two areas in which the State can address at least in part the fiscal challenge.

1) Making a concerted effort to secure as many federal dollars as possible; Connecticut loses out on tens, perhaps hundreds of millions in federal transfers.
2) Restructuring the revenue system, where raising rates has been undermined by selective cuts and employment dynamics—in 2017, the revenue loss was more than $700 million.

Connecticut is unusually reliant on own-source revenues because it has historically little attention to the federal dollars to which it is entitled or for which it might compete. Other states make an institutionally focused effort to secure those dollars; Connecticut likely foregoes hundreds of millions, perhaps even a billion, because of its lack of effort in this arena.

The Legislature has been raising tax *rates*, but it has simultaneously eroded revenue through selective exemptions (tax expenditures). Sales tax revenue as a percentage of household consumption has declined annually since 2011; revenue in 2017 was about $220 million lower than it would be if the collections were the same share of aggregate consumption expenditures.

The sales tax applies to a mere 36% of total consumption because of the hundreds of exemptions. (E.g., an egregious example is the exemption for UConn staff and students for food purchases on campus.) Worse, the income tax in 2017 generated $490 million less revenue, measured as share of total personal income, than in 2013.[1] *Thus the two main drives of state revenue were down in 2017 by over $700 million relative to what they generated in earlier years!*

Two obvious strategies for quickly driving real growth in the state's economy are:

1) Unleashing stranded tax credits to fund major capital projects. Done correctly, the State forfeits no net revenue, but could generate tens of thousands of net new permanent jobs.
2) Engaging our institutions of higher education in powerful collaborative efforts. *We have seen this done only once*: the very successful stem initiative under Governor Rell.

Governor-elect New Lamont should personally bring together the leaders of higher education to facilitate similar collaboration in aerospace engineering, biomedical research (especially genomics), and information technologies. Such an effort would help address the critical education/research/workforce pipeline that is fundamental to the state's future competitiveness.

There is some hope that Connecticut is beginning to bend the curve. The massive fuel cell and data center development in New Britain has the potential to be a "game-changer" for the state, as is the arrival of InfoSys in Hartford.

There is also an initial effort among state agencies to strengthen efforts to secure federal funds, as well as a small opening for the use of stranded tax credits.

But to date the Legislative leadership has barely acknowledged the reality of our shrinking economy and have not yet to make it a top priority. Yet without a focused effort to drive real growth, Connecticut faces continuing weak or non-existent growth and thus a nearly endless fiscal crisis.

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[1] This may result in part from the surge in the number of residents now working out-of-state; we pay our income taxes to the state where we work, now where we live.