

SUMMER 2009

THE
Connecticut**Economy**
A UNIVERSITY OF CONNECTICUT QUARTERLY REVIEW



Light at the Tunnel's End?

What's Driving Connecticut's Recession?

Government Yardsticks

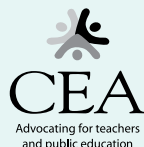
UConn's Health Center Hospital Problem

Parsing Family Income Inequality in the State

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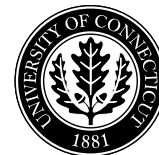
Thanks for the Help

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THE Connecticut Economy

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TAKING STOCK

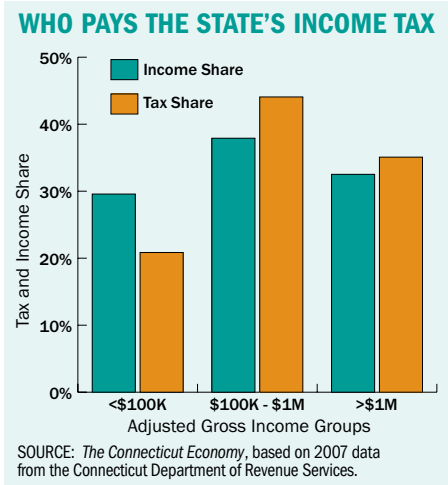
Into the Abyss

The economy's plunge into the abyss accelerated in 2009-Q1, as employment in Connecticut and the U.S. fell at near-record paces: 5.9% at an annual rate nationally and 5.5% state-wide. It was the second-worst performance for the U.S., and third-worst for Connecticut, since 1975-Q1.

Jobs in the state are down 50,000 on the year (and from their peak), with the heaviest losses in services, particularly retailing and professional & business services. Government—usually a stabilizing force—aggravated matters, as both federal and local workforces were pared.

The slumping economy has made Connecticut's budget front-page news. Through April state revenues are down nearly 20% from a year ago, while surging demands for public assistance, including unemployment benefits, have governments at all levels stretched thin. The projected \$8-9 billion biennial state deficit won't be easy to close without significant tax increases and spending cuts.

That's all making the state income tax a prime target for restructuring. The nominally flat tax is progressive in effect (see chart), thanks to credits and exemptions for lower-income fil-



ers. Making the tax more progressive at the high end would boost revenue but also increase our reliance on high-income earners whose plummeting tax payments—following vanishing capital gains, dividends and bonuses—are a factor in the current budget crisis.

Finding hopeful news among the quarter's indicators (sidebar) has become rare as a day in June. Most have deteriorated since our last issue; a particular disappointment is personal income, estimated to have ended a 23-quarter winning streak. Granted, the labor force is growing, but that's likely because layoffs are forcing more family members to look for work.

So is it time to throw in the towel? Not yet. Stocks, a leading indicator of future activity, are up smartly off their March 2009 lows, and consumer confidence is on the rebound. Household consumption also added significantly to 2009-Q1 GDP, and inventories have been drawn so low that many businesses will have little choice but to ramp up future production, even to meet tepid demand.

Most macro forecasters expect positive GDP growth in the second half of the year, but jobs, as our own forecast anticipates (page 22), will respond more slowly. The state's labor market may begin bouncing back in mid-2010, but it will probably take years to make a full recovery.

The recession raises serious questions about the nature of the slump and our policy responses to it. This issue explores the impact of collapsing asset prices on Connecticut GDP, the size of government in the Nutmeg state, the question of a new UConn hospital, and the determinants of income inequality across the state. Our back page offers contrasting insights on the state budget by Representatives Merrill and Cafero.

CONNECTICUT ECONOMIC INDICATORS

(Percent change: 2008-Q1 to 2009-Q1)

Indicators of Current Economic Activity

Total Nonfarm Jobs	-3.0%
Number Unemployed	+48.7%
Labor Force	+1.2%
Manufacturing	
Jobs	-4.5%
Avg. Weekly Hours	-2.1%
CT Mfg. Prod. Index	-0.4%
Avg. Hourly Earnings	+5.6%
New Auto Registrations	-33.6%
Travel and Tourism Index	-5.3%
Bradley Airport	
Passengers	-13.0%
Freight	-21.2%
State Tax Receipts	
Income	-10.8%
Sales	-8.8%
Real Estate Conveyance	-43.4%
Normalized Electricity Use	-3.2%
State Exports	-1.6%
Personal Income (est.)	-0.1%
Coincident GDI	-1.9%

Indicators of Future Economic Activity

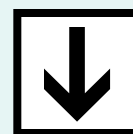
Initial Unemp. Claims	+65.4%
Housing Permits	-54.2%
Net New Business Starts	-31.5%
Leading GDI	-9.0%



GOOD NEWS

+5.6%

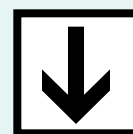
Avg. Hourly Earnings



BAD NEWS

-2.1%

Avg. Weekly Hours



ALSO BAD

-10.8%

Income Tax Receipts

How Big a Hangover from the Stock and Housing Benders?

BY STEVEN P. LANZA

Collapsing home prices will affect Connecticut less than many other states, but evaporating equity values will hit us disproportionately.

Collapsing housing and stock market wealth has reduced households' willingness to consume and businesses' motivation to invest, in the process spawning the worst recession since the Great Depression. But the twin disasters may not affect all states equally. The evidence suggests that the implosion of home prices will have a smaller effect than average on Connecticut's economy, but the impact of evaporating equity values will be disproportionately large here.

For years, the economy got high on soaring asset values. Climbing even during the 2001 recession, housing prices doubled between 2000 and 2006, while stocks shot up by nearly as much in even less time. During the last expansion, jobs grew at a 1.5% annual clip, while real GDP sprinted ahead at rates that reached 7.5% (2003-Q3). Then the financial perfect storm made land. Home prices caved in, stocks indexes were cut in half, and jobs and GDP each headed toward a free fall.

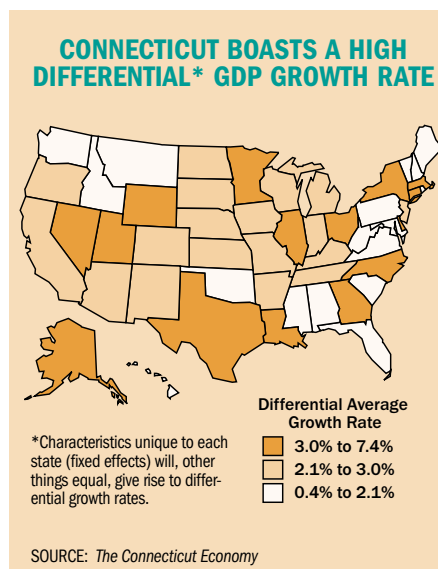
Our addictions to the housing and stock markets had taken us to new economic heights. How low will going cold turkey now make us feel?

CAUSE OR COINCIDENCE?

Analysts agree that a strong correspondence exists between asset markets and the broader economy, but they differ over whether the association is coincidental or causal. It may be, for example, that the same lack of confidence that hobbles household consumption and business investment also leads to declines in housing and equity markets. Perhaps the asset markets are simply subject to the same underlying forces that buffet the overall economy.

But there are reasons to believe that asset markets directly trigger changes in aggregate economic activity. Lower share prices, for example, may make creditors less eager to lend, raising businesses' capital costs at the same time that the reduced share prices make it more difficult for them to generate cash in equity markets. Stockholders may also pressure company managers to trim workforces and cut costs in an effort to restore firms' profitability and revive stock prices.

Sliding equity values may crimp economic activity through a so-called wealth effect, too. Households base consumption decisions on both current and prospective future incomes—what Milton Friedman called “permanent income.” Falling stock prices erode the value of investment portfolios, so households feel poorer and are likely to spend less. Firms with flagging share prices may also be less apt to pay dividends, so stockholders may suffer a simultaneous reduction in current income.



Another, often the major, source of accumulated wealth for many households is home equity. Modern financial markets provide ample opportunity for homeowners to tap this wealth through home equity loans and lines of credit. But as sinking home prices strip owners of the unencumbered interest in their properties, those opportunities are fast disappearing, leaving households with little choice but to rein in their spending.

A SIMPLE FRAMEWORK OF ANALYSIS

The current economic slump reflects severe erosion in demand for the economy's output, or gross domestic product (GDP). In equilibrium, the supply of output will equal the sum of the demand components: consumption, investment, exports less imports, and government spending. But when demand slumps, production slows, and the economy slides into recession.

The factors influencing demand vary with the component in question. In simplest form, consumption is a function of "disposable" (after-tax) income. Investment is influenced by the interest rate, and net exports by the exchange value of the dollar. Public spending is basically the result of political decisions, so to make the analysis more tractable I subtracted government from both sides of the supply-demand equality and focused more narrowly on the determinants of private-sector GDP.

The central question is this: after controlling for income, interest rates, and the value of the dollar, what effects do housing and stock prices have on the economy's performance?

To find out, I set up a simple regression model using a panel data set of all fifty states for the period 1975 to 2007—a total of 1600 observations. The regression modeled per-capita private GDP by state as a function of per capita disposable income, interest rates, and the exchange value of the dollar. But, key to the analysis, the model also included two other variables: a unique home price index (HPI) for each state as tracked by the Federal Housing Finance Agency (formerly OFHEO), and equity values as measured by the S&P 500 index. I adjusted all variables (except the exchange rate) for the changing level of prices over time.

Besides the variables included in the model, other unobserved or omitted factors specific to each state—such as the tax or regulatory climate—may affect economic performance. To control for these influences, I used a so-called fixed-effects model, which enables the regression to capture the influence of the omitted factors that change little over time, along with the more variable factors that are explicitly included.

YOUR NUMBER'S UP

The map on page 4 shows the distribution of these unobserved, fixed effects across states, from high to medium to low. Unobserved factors account for as much as a 7 percentage point difference in GDP performance across states. Connecticut falls into the group where fixed factors boost average GDP growth the most. Other things being equal across states (as measured by the variables explicitly in the model), we would expect output growth in Connecticut to exceed the rates of the lowest-tiered states by 1.8

percentage points, and of the mid-tier states by 0.8 points, on average.

The accompanying table shows the influence of the independent variables on the average economic performance of a state, after allowing for differential fixed effects. As expected, per capita disposable income exerts a strong and statistically significant effect on GDP: a 10 percent increase in income raises GDP by 8 percent. The effect likely works both directly (by boosting consumption), and indirectly (as higher consumption spurs business confidence and encourages investment).

Also, as expected, exchange rates are inversely related to GDP (with a one-year lag), although the effect is relatively small. With a p-value of 35%, the coefficient on interest rates was not significant.

The model also includes factors that capture some of the dynamics operating in the economy since the mid-1970s. The negative time trend suggests that GDP growth slowed from 1975 to 2007. A strongly significant coefficient on the gap between GDP

THE AVERAGE STATE IS SENSITIVE TO HOUSING, CONNECTICUT RESPONDS MORE TO STOCK PRICES

Variable	Coefficient	P-value
Per Capita Income	0.8033	0.0000
Home Prices	0.1368	0.0000
Stock Prices	0.0255	0.0001
Exchange Rate	-0.0007	0.0002
Interest Rate	-0.0009	0.3455
Trend	-0.0004	0.0003
GDP-Income Gap	0.1304	0.0000
CT Stocks	0.0616	0.0060
CT Home Prices	-0.0871	0.0597

Coefficient values measure the change in GDP associated with a change in the independent variables listed above. The p-values are estimates of the likelihood that these coefficient values occurred by chance. The smaller the p-value, the more statistically significant the result.

and disposable income suggests a constant proportionality between the two: over the long haul, these two variables tend to move pretty much in sync.

Of primary interest here, of course, are the values of the highly significant coefficients on home and stock prices. On average, a 10 percent decrease in current home prices is associated with a 1.4 percent decrease in GDP. A similar decline (lagged one year) in stock prices, however, only reduces GDP by 0.26 percent.

Therefore, changes in asset values have significant impacts on economic performance, but the influence of home prices is much larger on average than that of equity values. Why? Because home ownership is more widespread than stock ownership, and home price appreciation may have been viewed as relatively permanent, while stock market gains seemed less so. At any rate, these findings are broadly consistent with other studies in the literature (e.g., Case, *et al.*, *Advances in Macroeconomics*, 2005, Issue 1).

THE LAND OF DISTINCTIVE HABITS

We know how states “typically” respond to changes in asset values, but does Connecticut follow the crowd or march to a different drumbeat? To answer that, the model contains one final layer of complexity: differential coefficient estimates of the housing and stock market variables in Connecticut.

As the table shows, the differential for current house prices in the Nutmeg State is -0.087. That means Connecticut’s full reaction to changing house prices is only 0.0491, the sum of the average effect across all states (0.1368) and this differential (-0.0871). Therefore, a 10 percent decrease in home values will lower Connecticut GDP not by the average 1.4 percent nationally, but by only 0.5 percent, instead.

The stock market effect introduces another distinction. For all states, equity values enter the model with a lag; for example, a decrease in equity prices of 10 percent this year would lower GDP by 0.255 percent next year. But in Connecticut, that drop in stock prices this year would affect current-year GDP as well, by 0.616 percent. Thus, the long-run effect of changing equity prices is the sum of the variable’s lagged (0.0255) and current (0.0616) coefficient values, or 0.0871. Therefore, Connecticut is more than three times as responsive to changing equity values as is the 50-state average.

What do these estimates imply for state GDP growth around the U.S.? Nationally, the HPI declined about 8 percent last year, while the S&P 500 lost about 20 percent in real terms. Thus across all states, reductions of these magnitudes will, over time, trim about 1.6 percentage points off real GDP growth. Two-thirds of the effect will trace to house prices and one-third to stock prices. And given the historic

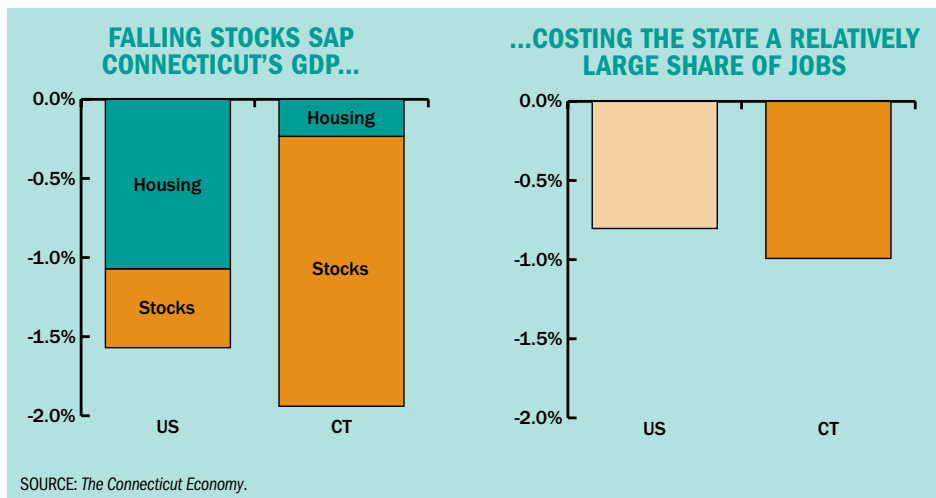
relation between GDP and jobs, states will on average lose 0.8 percent of their workers. That’s just from plunging asset values; weakness on other economic fronts will only add to the total.

Connecticut’s actual GDP hit would be more on the order of 1.9 percentage points, as the state’s heightened sensitivity to stocks more than offsets its reduced sensitivity to home prices and the smaller relative decline (not quite 5%) in real estate values. Fully 90 percent of that change would stem from stocks, and only 10 percent from housing. These declines in asset values are also likely to cost Connecticut upwards of one percent of its workers (see bar graph).

What makes Connecticut less responsive to house prices but more responsive to the stock market? A greater share of Nutmeggers may hold stocks than the U.S. average, and state residents may have more money at stake in the market, too. Connecticut’s economy is also more closely tied to Wall Street, with a relatively large concentration of jobs in insurance, banking and brokerage services—industries that have taken a beating of late.

Housing also plays less of a role in Connecticut’s economy than it does elsewhere. It has been fully two business cycles since Connecticut last saw the kind of frenzied home building that gripped much of the nation until recently. Nutmeggers’ high incomes may also have reduced their need to rely on home equity gains to finance consumer purchases.

In the end, the current economic downturn may well produce a worse economic hangover in Connecticut than in the rest of the country. Not that the party here was any bigger—we just differ from the mean in our dependence on the twin elixirs of booming home and equity markets.



Sizing-Up Connecticut's Public Sector

BY DENNIS HEFFLEY AND MARYJANE LENON

Is non-federal government in Connecticut too large? Many think so and are happy to see state and local governments scaling back to balance their budgets in the face of a major recession and a drop in tax collections. But is government here as big as the critics contend? And, if so, is this strategically the right time to rein in public spending?

CAUGHT IN THE HEADLIGHTS

Like a herd of startled but remarkably sluggish deer, state and local governments across the U.S. are still trying to figure out which way to leap. Those that choose the right path might avoid becoming fiscal road-kill, but for all of them it's proving to be a stressful, if not downright painful, process.

The recession has focused new attention on the economic role of the public sector, but the messages conveyed to public officials are mixed. Tax revenues have shrunk, while social support payments for displaced workers have risen, causing governments at all levels to cut costs through employee layoffs, furloughs, and wage concessions. Facing a projected deficit of \$8-9 billion in the coming biennium, the State of Connecticut recently renegotiated public collective bargaining agreements to the tune of about \$700 million. Such cost cutting is seen as essential, not only because state law requires some semblance of a balanced budget, but also to help retain or attract businesses and jobs.

At the same time, the recession, or at least the federal response to it, has also sent a very different signal to state and local governments. With dysfunc-

tional capital markets and little incentive for private businesses to invest during a sharp downturn, government spending at all levels—federal, state, and local—has been seen as the most immediate, perhaps only, channel for rapid economic stimulus. Fiscal stimulus, priming the pump, call it what you will, the common prescription is for *more*, not less, government spending...and preferably without raising tax rates. No wonder state and local governments are confused about the best course of action and their broader role in reviving the economy.

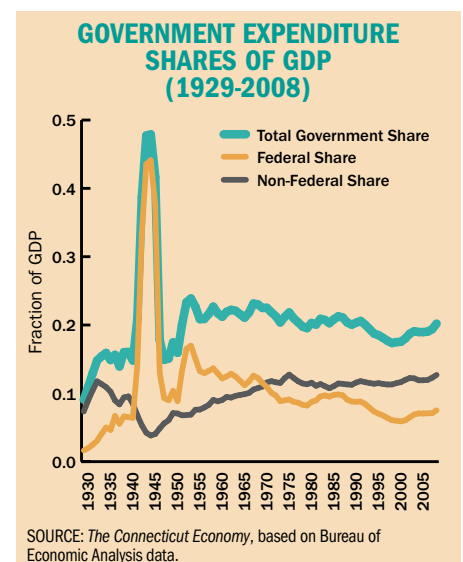
The debate over the proper size and role of government—reflected in our *Forward Look* on page 24 by State Representatives Cafero and Merrill—is hardly new, but the recession has brought it to the fore and raised the stakes of “getting it right.” Though this contentious issue often is driven by ideology rather than facts about spending patterns, the data needed to inform this debate are readily available.

TRACKING GOVERNMENT SIZE OVER TIME

The National Income and Product Accounts, maintained by the Bureau of Economic Analysis, include data on government spending—consumption outlays as well as gross investment—subdivided into its federal and non-federal components. The non-federal category (identified as “state and local” in the data bases) includes all state, county, and municipal governments. The nearby graph shows total government spending, and its federal and non-federal subcomponents, as shares of U.S. gross domestic product (GDP) from 1929 to 2008. Some of the patterns over this 80-year span are con-

sistent with our sense of history and personal perceptions; others may not be.

Some may argue that federal or non-federal government spending is “too big” in absolute terms, but the notion that the relative size of government in the U.S. has steadily increased over time is not supported by the GDP data. During the Great Depression, both the federal and non-federal expenditure shares of GDP rose. Even so, the combined share did not hit 20% until 1941, the year we entered World War II. Effects of the war effort are quite visible, with the federal share of GDP jumping to more than 44% by 1944. Some of this increase came at the expense of non-federal government spending, but much of it also reflected a shift away from private consumption. A similar, but much smaller, jump in the relative size of the federal government occurred during the Korean War (1950-1953). Thereafter, the federal GDP share generally declined, despite the Vietnam build-up, to a low of 5.9% in 2000. Since then it



has grown, but in 2008 the federal share was just 7.5%. Going forward, it will likely jump with the recent bailouts, economic stimulus programs, and the Obama administration's switch to more transparent federal accounting methods.

The other notable pattern in the graph is the relatively stable non-

federal share of GDP. There was a sharp downturn during World War II, when resources were diverted from sub-national governments to support the war effort. But then a persistent increase from 1945 to 1975 restored the non-federal share to its 1932 level of about 12% of GDP, where it has remained, more or less, ever since.

INTERSTATE SPENDING COMPARISONS

Even if government, relative to GDP, isn't growing that much, it's certainly conceivable that non-federal spending in some states is disproportionately high or low. Connecticut and Massachusetts, for example, have the regional reputation of being fast and loose with the taxpayer's dollar, while nearby New Hampshire is reported to have adopted Scrooge McDuck as its state bird. Let's see what the data say about these perceptions of various states' spending habits.

In comparing almost anything across states, it's necessary to control for differences in socioeconomic factors such as population, income, and size of the economy. For example, southern states will probably exhibit lower per capita government spending than northeastern states, if only because the incomes of workers, including public employees, are considerably lower in the south. To address this problem, we consider some *relative* measures of non-federal government size in each of the 50 states. We also make these calculations for two years, about a decade apart, to see how state rankings by government size have changed.

For each state, the table shows a relative spending measure of government size—non-federal spending as a percent of state GDP, in 1997 and 2006—as well as an employment-based measure of government size—non-federal full-time equivalent (FTE) employees per 10,000 persons (hereafter, 10K), in 1997 and 2007. For each measure of government size, states are ranked, in the far-left column, from largest (1) to smallest (50).

The 50-state average figure for non-federal government spending as a share of state GDP rose only slightly between 1997 and 2006, from 9.06% to 9.11%. But the range of non-federal shares of state GDP widened slightly. In 1997, values ranged from 6.39% in Delaware to 11.17% in West Virginia, a difference of 4.78 percentage points. In 2006, figures for the same two

TWO MEASURES OF GOVERNMENT SIZE

RANK 1 = largest 50 = smallest	Non-Federal Spending Share of State GDP (%)		Non-Federal FTE Employment per 10,000 Persons					
	1997	2006	1997	2007				
1	WV	11.17	WV	12.61	WY	800.9	WY	918.3
2	MT	11.15	NM	12.30	AK	747.2	AK	766.0
3	NM	11.15	MS	11.93	NM	644.1	NM	680.4
4	WY	10.77	SC	11.87	MS	635.4	KS	676.7
5	OK	10.72	MT	10.74	NE	634.7	ND	649.5
6	MS	10.70	ND	10.66	KS	622.2	MS	647.7
7	SC	10.66	OK	10.52	NY	611.9	NE	642.0
8	NE	10.53	VT	10.33	OK	608.1	VT	641.0
9	AK	10.49	NE	10.28	LA	607.8	NY	634.5
10	ID	10.39	ID	10.25	AL	593.6	AL	615.3
11	AL	10.11	AL	10.21	IA	590.4	IA	611.2
12	UT	10.10	AR	10.20	SC	585.0	LA	605.1
13	ND	10.06	KS	10.19	GA	582.3	NC	599.7
14	WA	9.94	IA	9.86	MT	579.5	DE	598.8
15	OR	9.90	MI	9.85	TX	574.7	OK	597.9
16	KS	9.72	OR	9.63	ND	571.1	NJ	593.0
17	ME	9.54	ME	9.58	ID	566.4	AR	585.3
18	SD	9.44	KY	9.51	NC	559.7	MT	585.2
19	HI	9.44	WY	9.51	MN	555.2	KY	582.7
20	AZ	9.42	WA	9.37	HI	554.9	ME	580.7
21	VT	9.32	HI	9.15	DE	554.3	SC	577.2
22	FL	9.30	SD	9.10	AR	552.2	VA	574.0
23	IA	9.30	RI	8.86	CO	546.3	TX	563.9
24	LA	9.22	WI	8.83	SD	545.1	HI	559.8
25	AR	9.14	NY	8.82	MO	537.2	WV	558.5
26	KY	9.10	UT	8.81	ME	533.1	MO	557.3
27	WI	8.90	AZ	8.81	VA	532.8	NH	550.0
28	MI	8.90	OH	8.79	OR	529.4	SD	545.7
29	NY	8.83	CA	8.71	KY	528.1	GA	545.7
30	MN	8.60	MO	8.63	UT	527.9	CO	541.9
31	RI	8.60	NJ	8.53	IN	523.4	MN	541.8
32	NC	8.57	MN	8.50	WA	523.3	ID	538.6
33	NJ	8.54	FL	8.48	NJ	523.1	CT	537.4
34	CO	8.54	NC	8.46	VT	514.1	IN	536.3
35	MD	8.36	GA	8.42	TN	513.2	MD	535.2
36	OH	8.35	AK	8.38	WI	512.2	OH	534.6
37	TX	8.34	VA	8.17	WV	508.2	TN	527.8
38	CA	8.29	MD	8.11	CT	502.1	WA	527.3
39	VA	8.12	IN	8.05	OH	500.5	MA	517.5
40	GA	7.97	CO	8.04	IL	500.3	RI	510.8
41	IN	7.90	TN	7.88	RI	499.3	OR	509.2
42	TN	7.84	TX	7.82	FL	497.8	CA	504.6
43	NV	7.69	LA	7.57	AZ	497.7	IL	503.1
44	PA	7.67	IL	7.55	MA	496.6	WI	503.0
45	MO	7.64	NH	7.50	MD	494.2	UT	494.9
46	MA	7.35	NV	7.40	MI	480.9	MI	491.0
47	IL	7.16	CT	7.33	NH	476.1	FL	489.5
48	CT	6.93	PA	7.29	NV	474.9	PA	478.4
49	NH	6.87	MA	7.19	CA	474.8	AZ	473.1
50	DE	6.39	DE	6.71	PA	429.4	NV	431.9
50-state mean		9.06	9.11			551.1	571.4	

SOURCE: *The Connecticut Economy*, based on Bureau of Economic Analysis and Census data.

states—still lowest and highest—were 6.71% and 12.61%, a 5.90-point difference.

By this first measure of non-federal government size, the public sectors in New Hampshire, Connecticut, and Massachusetts looked quite lean in 1997, ranking 49th, 48th, and 46th, respectively. While Connecticut moved up a notch to 47th in 2006, three other New England states climbed even further up the government spending ladder: New Hampshire, from 49th to 45th; Rhode Island, 31st to 23rd; and Vermont, 21st to 8th. Maine held its 17th-ranked position, while Massachusetts dropped from 46th to 49th. Perhaps the Bay State was just “saving up” for its recently adopted health insurance program. If so, it may now be climbing back up the ladder.

INTERSTATE EMPLOYMENT COMPARISONS

Many Western states would hate to be seen as havens of “big government,” but relative to their populations, Wyoming (800.9), Alaska (747.2) and New Mexico (644.1) topped the 1997 list for the number of non-federal FTE employees per 10K. These figures were substantially above the 50-state mean (551.1). At 502.1, Connecticut ranked 38th in 1997. Pennsylvania ranked 50th, at 429.4—less than 54% of Wyoming’s extravagant figure.

From 1997 to 2007, no state saw an absolute drop in non-federal government employment, but in 14 states non-federal employees grew more slowly than population, leading to a decline in the number of non-federal employees per 10K. In the other 36 states, non-federal public employment outpaced population growth, causing the number of non-federal employees per 10K to rise. This can be seen readily in the accompanying graph, which shows percent changes in population (the numerator of our relative employment measure) *versus* percent changes in non-federal employment (the denominator) over the period 1997-2007. The 14 states with reductions in

non-federal employees per 10K in the preceding table lie below the 45-degree line in the graph. All six New England states, including Connecticut, were above the line, resulting in an increase in non-federal government employment per 10K in the preceding table.

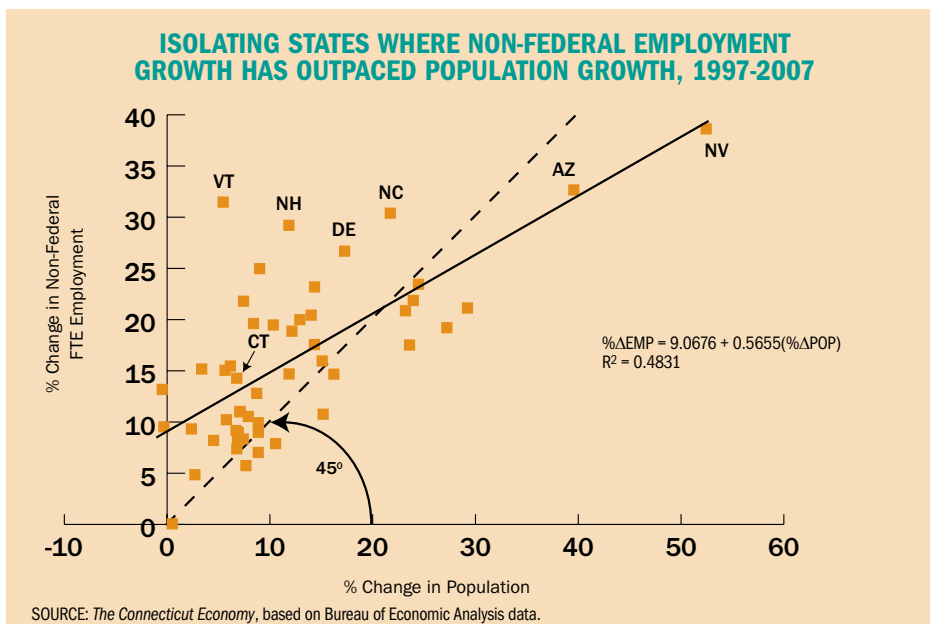
But just how atypical or “excessive” was the expansion in Connecticut’s non-federal government employment? The darker regression line in the graph indicates a relatively strong positive relationship between population growth and non-federal government employment growth ($R^2 = 0.48$). Based on this “best fit” relationship, we would have expected Connecticut’s 6.8% growth in population to be accompanied by a 12.9% growth in non-federal employment. The state’s actual growth in non-federal employment (14.3%) over the 10-year period was somewhat higher, lending credence to the notion that state policymakers may need to monitor this trend. Keep in mind, however, that much of this non-federal government employment is at the town level, and therefore subject to the decentralized decisions of local officials and their constituents rather than state officials.

CONNECTICUT’S “PROPER PATH”

So what do all these numbers have to say about public spending

in Connecticut? First, when evaluated by reasonable measures of government size—either the non-federal government share of state GDP or government employment relative to population size—Connecticut looks fairly trim. It ranked only 47th largest by the GDP share measure in 2006, and 33rd largest by the employment-based measure in 2007. In both cases, however, the state is higher up the big-government list now than it was in 1997. This entails a mixed, but not inconsistent, message. First, non-federal government in Connecticut, based on relative spending or relative employment measures, is not disproportionately large. At the same time, by either measure non-federal government in Connecticut has grown in relative size over the last ten years. If one sees this as a barrier to economic growth, we may be heading down the wrong path. But if state and local government spending are critical to a rapid economic recovery, and even to longer-term economic growth, maybe we chose the right path even before the truck rounded the bend.

MaryJane Lenon is an associate professor of Economics at Providence College.



A New UConn Hospital?: Hard Questions in Need of Answers

BY ARTHUR W. WRIGHT

Governor Jodi Rell put the kibosh on the proposed new “University Hospital”, on fiscal austerity grounds, before the public debate had barely started. Nonetheless, the joint proposal by the UConn Health Center and Hartford Hospital (hereafter: UC/HH) raised some hard questions that elected officials will have to grapple with in coming years. Apparently, we do need to do something about the Health Center’s John Dempsey Hospital. But should that “something” entail building a new hospital? And should we “do something” in Farmington rather than in Hartford? Definitive answers ought to turn on the relative costs and benefits of different strategies.

In this article, I probe the rationale for what Governor Rell termed an “intriguing proposal”. I examine UC/HH not in terms of the red herring of “jobs creation”, but rather in the context of the effects on the UConn Medical School and on the quality

and cost of health care in north-central Connecticut. Among other things, I look at how UC/HH stacks up against feasible alternatives.

At stake are the planning processes of hospitals across north-central Connecticut. Until policy decisions about UC/HH or an alternative plan, with commitments and funds, are in place, private and public decision makers could be paralyzed waiting for the other shoe to drop.

BUILD POLITICALLY, REPENT IN PERPETUITY

The genesis of UC/HH lies in the persistent deficits that have plagued Dempsey Hospital for some time, requiring the University to come hat in hand to the legislature for regular bailouts—an estimated \$12 million in the fiscal year ending June 30, 2009. Dempsey’s structural deficit traces to political decisions, some dating to the 1960s, others of more recent vintage. First, the then-new Health Center complex was sited on donated land in Farmington, a suburb 10 miles from Hartford, in part to enhance faculty recruiting. Second, Dempsey was built too small for a medical-school hospital, so as not to compete with existing hospitals. Third, as the years went by, the State stinted on maintenance and investments needed to keep Dempsey up to date both operationally and technologically. And fourth, the hospital has wound up offering an array of services that yield what UConn President Hogan has termed a “bad payer mix”—long on charity and State patients, short on privately-insured ones.

Whatever we do about Dempsey, a key goal should be not repeating the

mistakes that have led to the hospital’s structural deficit.

UC/HH would swap the stream of probably rising future deficits for the cost of replacing Dempsey (224 beds) with a new hospital (250 beds) in Farmington, for an estimated \$475 million, plus the extra labor costs of more generous State benefits paid to existing Health Center employees, estimated currently at \$13 million a year. Would it be an even swap? That depends on how one does the math (present values?), and what numbers one plugs in for future Dempsey deficits on the one hand, and construction costs and future State benefits on the other.

For its part, Hartford Hospital would operate the new facility, jointly with a new “patient tower” at its south-end Hartford campus, as the “University Hospital;” pick up any operating deficits of the combined operation; and pony up \$425-565 million for the new patient tower, academic support, new technology and research. Also part of the bargain, of course, would be the costs of upgrading both teaching and research at UConn Medical School, and the benefits from the resulting enhancement of health care in the region.

A MEDICAL SCHOOL FOR HARTFORD?

The decision to locate the Health Center in a suburb 10 miles from Hartford created an anomaly. Using 2005-2007 U.S. Census data from the 39 other Metropolitan Statistical Areas (MSA) the same size as Greater Hartford (750,000-2 million people), I estimated the probability that a medical school would be located in the

PROBABILITY OF A MEDICAL SCHOOL IN MAIN CITY OF A METROPOLITAN AREA (2005-2007)

Variable	Coefficient	P-value
Intercept	-18.98	0.0001
Population	2.65E-06	0.0345
% > 65 Years Old	0.27	0.1410
% In Poverty	0.34	0.1080
% Disabled	1.35	0.0001
% African-American	-0.14	0.0018
Unemployment Rate	-1.19	0.0276
Yrs. w/ Cert. of Need Law	0.09	0.0002
# Med. Schools in State	-0.04	0.0002

The P-values are the likelihoods that these coefficient values occurred by chance; the smaller the P-value, the more statistically significant the result. Coefficients for characteristics not shown were not significant.

SOURCE: *The Connecticut Economy*, based on U.S. Census data.

MSA's principal city. Controlling for a wide range of other factors (see results on page 10), the model explains 2/3 of the variation. Plugging variable values for Greater Hartford into the estimated equation yields a 93% probability that a medical school would be located in the City of Hartford—not 10 miles away. For comparison, Massachusetts General Hospital—the most distant of the three hospitals closely affiliated with Harvard Medical School—is only 4 miles by car from the campus; taking the “T” requires one change, from the Red to the Green Line.

Note that the same results also imply a 94% chance that a medical school will be located in New Haven (one is), but only a 0.4% probability for Bridgeport.

Arguably, UC/HH would give the medical school a presence in downtown Hartford. But building a new hospital in Farmington, and expanding classroom teaching and research into the vacated Dempsey building, would mean that the UConn medical school would still be based 10 miles from Hartford.

One alternative to UC/HH would be to close down Dempsey, not build a new UConn Hospital, and instead relocate the medical school to downtown Hartford, taking further advantage of the proximity to the existing hospitals. This alternative would follow the “Harvard-model”, in which a medical school has no hospital of its own but rather partners with nearby facilities.

True, it would mean abandoning (or selling off) the Farmington campus, perhaps devaluing the private health-care-related real estate that now nestles around it. But UC/HH would

cost a cool billion dollars or more—\$600 million in Farmington, inclusive of the present value of the debt service and fringe benefit costs, plus the \$425-\$565 million at Hartford Hospital. Could that much money cover a new medical school in Hartford plus the costs of closing the Farmington campus?

Interestingly, both Hartford and St. Francis Hospitals have “excess” licensed beds beyond what they now “staff”—118 in the former, 129 in the latter. The sum?: 247 beds, just 3 fewer than the targeted capacity of the proposed new Farmington hospital. So they could in theory expand to replace the beds lost by closing Dempsey.

WHAT'S WRONG WITH DEMPSEY HOSPITAL?

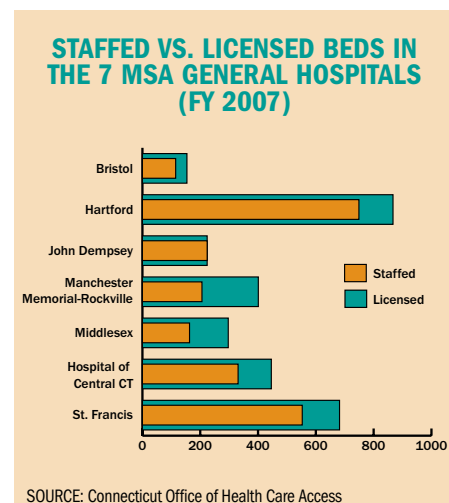
Why could we not simply fix up Dempsey Hospital instead of building a brand-new, not much bigger hospital? That the proposed replacement would have 250 beds, only 12% more than its current 224, seems to scotch the claim that Dempsey is “too small” to serve a medical school or avoid deficits.

In fact, it is the 4th largest of the 7 general hospitals in the Greater Hartford MSA. (The figure is 9 if you count locations: Rockville has merged with Manchester Memorial, and Bradley Memorial in Southington has merged with New Britain General to form the Hospital of Central Connecticut. Dempsey's size rank is not affected.) This finding is consistent with empirical evidence that the minimum efficient scale of hospitals is relatively small, with constant returns to scale thereafter for many hundreds of additional beds.

The answer seems to be the prohibitive cost of bringing Dempsey up to snuff: in the time-honored tradition of public projects, it was easier to raise the money (through bonding) to build the monument than to secure yearly-budget funds to scrape the pigeon droppings off it, so to speak. Converting Dempsey for medical-school teaching and research, and building a new, state-of-the-art hospital, may well be cheaper than fixing up Dempsey and building new medical-school space.

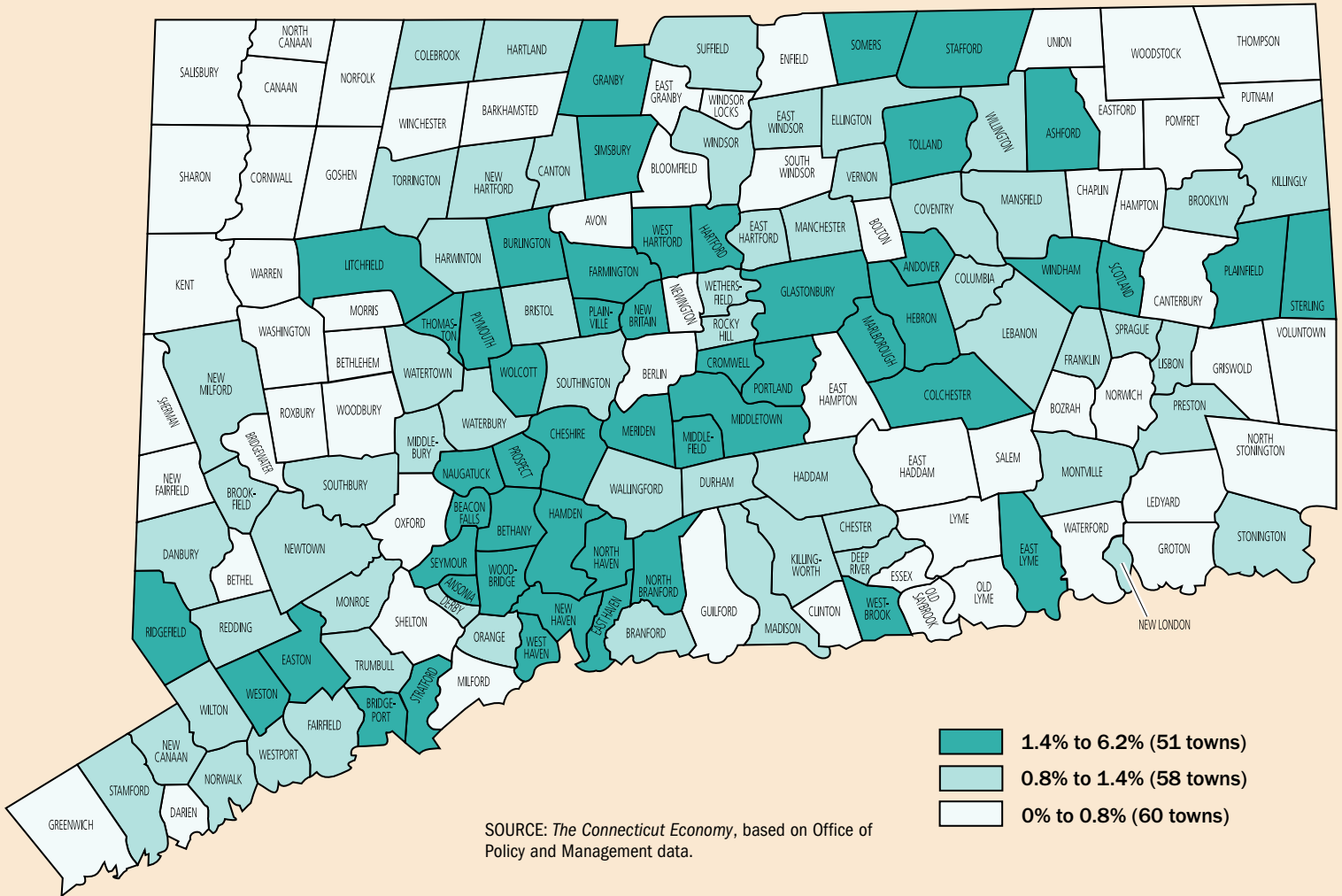
Which raises an important related matter: Under UC/HH, the State would continue to own (but not operate) the Farmington branch of the proposed new University Hospital. Presumably, then, the State would be responsible for maintaining and (as medical technology advances) improving it. Could Hartford Hospital insert enforceable language into the agreement mandating State outlays for maintenance and improvements, without threatening the State's sovereignty—in effect, binding future legislatures to honor a past legislature's commitments?

(continued on page 14)



THE CENTERFOLD

Debt to ENGL ratios, FY 2007



SOURCE: *The Connecticut Economy*, based on Office of Policy and Management data.

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Bridgeport - Stamford LMA			
Ansonia	1,908	14.98	2.0
Bridgeport	5,244	19.3	6.2
Darien	4,176	6.86	0.7
Derby	1,328	17.28	1.3
Easton	6,538	13.45	2.0
Fairfield	3,709	11.51	1.3
Greenwich	861	5.25	0.1
Milford	1,244	12.53	0.7
Monroe	2,544	14.01	1.3
New Canaan	7,462	7.68	1.2
Newtown	2,445	14.51	1.2
Norwalk	2,205	11.46	1.0

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Oxford	573	13.55	0.4
Redding	3,307	11.63	1.0
Ridgefield	5,191	11.94	1.5
Seymour	2,370	16.82	2.0
Shelton	1,518	10.11	0.7
Southbury	1,930	13.02	1.0
Stamford	2,720	9.49	0.9
Stratford	2,919	16.17	1.8
Trumbull	2,325	15.04	1.1
Weston	7,543	13.3	1.8
Westport	6,257	9.02	1.1
Wilton	3,939	11.46	0.9
Woodbridge	3,777	17.73	1.8

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Danbury LMA			
Bethel	1,282	13.53	0.7
Bridgewater	322	9.71	0.1
Brookfield	2,631	11.49	1.1
Danbury	1,279	10.69	0.8
New Fairfield	1,021	12.08	0.5
New Milford	1,526	14.51	1.0
Sherman	1,443	8.63	0.5
Enfield LMA			
East Windsor	1,290	14.94	1.0
Enfield	500	15.65	0.5
Somers	1,863	12.65	1.7
Suffield	1,469	14.15	1.1
Windsor Locks	1,222	12.54	0.7

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Hartford LMA			
Andover	2,168	18.38	1.7
Ashford	2,100	15.91	1.9
Avon	1,084	14.01	0.5
Barkhamsted	755	14.91	0.5
Berlin	487	15.13	0.3
Bloomfield	847	17.84	0.6
Bolton	994	17.27	0.7
Bristol	981	15.83	0.9
Burlington	2,422	15.56	1.6
Canton	1,852	16.14	1.2
Colchester	1,798	15.2	1.5
Columbia	1,108	13.71	0.8
Coventry	1,540	15.93	1.3
Cromwell	1,958	16.61	1.4
East Granby	515	15.59	0.3
East Haddam	533	13.41	0.3
East Hampton	867	15.76	0.7
East Hartford	966	21.34	1.0
Ellington	1,375	17.1	1.2
Farmington	2,894	13.02	1.4
Glastonbury	2,891	17.71	1.6
Granby	3,257	18.46	2.4
Haddam	1,804	18.15	1.2
Hartford	2,417	24.93	3.3
Hartland	1,200	14.94	0.9
Harwinton	1,463	13.5	0.9
Hebron	2,770	17.58	2.1
Lebanon	1,135	13.04	0.9
Manchester	948	17.68	0.8
Mansfield	559	13.5	0.9
Marlborough	3,460	17.46	2.5
Middlefield	2,293	14.22	1.4
Middletown	1,701	15.96	1.4
New Britain	2,592	20.86	4.0
New Hartford	1,545	14.76	1.0
Newington	711	17.77	0.6
Plainville	2,635	16.03	2.1
Plymouth	2,097	19.23	2.1
Portland	2,834	18.06	2.2
Rocky Hill	1,336	15.16	0.8
Simsbury	2,476	18.08	1.5

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
South Windsor	1,064	17.43	0.7
Southington	1,103	14.73	0.8
Stafford	1,976	16.88	2.1
Thomaston	2,864	15.5	2.2
Tolland	2,898	17.65	2.2
Union	705	12.66	0.4
Vernon	1,096	17.05	1.1
West Hartford	2,580	18.6	1.7
Wethersfield	1,343	17.33	0.9
Willington	1,459	14	1.3
Windsor	1,538	16.38	1.1

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
New Haven LMA			
Bethany	3,660	15.26	2.1
Branford	1,834	12.55	0.9
Cheshire	2,757	15.1	1.8
Chester	1,845	12.13	0.9
Clinton	1,031	13.59	0.6
Deep River	1,710	14.47	1.1
Durham	1,671	18.19	1.2
East Haven	2,042	14.33	1.8
Essex	1,628	9.24	0.6
Guilford	1,144	11.07	0.5
Hamden	1,826	19.58	1.7
Killingworth	2,278	13.99	1.3
Madison	2,196	11.61	0.9
Meriden	1,397	18.27	1.5
New Haven	4,121	17.96	5.1
North Branford	2,093	15.88	1.7
North Haven	2,891	19.8	2.1
Old Saybrook	2,249	8.58	0.7
Orange	3,068	14.59	1.3
Wallingford	1,114	14.69	0.8
West Haven	3,327	19.47	4.0
Westbrook	4,968	9.4	1.7

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Norwich - New London LMA			
Bozrah	922	11.65	0.6
Canterbury	357	11.58	0.3
East Lyme	2,502	11.99	1.4
Franklin	1,276	13.28	0.8
Griswold	465	11.17	0.4

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Groton	734	10.25	0.5
Ledyard	255	17.44	0.2
Lisbon	1,178	8.9	0.8
Lyme	2,870	7.93	0.7
Montville	1,608	13.03	1.3
New London	1,108	13.55	1.0
North Stonington	786	13.08	0.5
Norwich	689	13.91	0.7
Old Lyme	2,048	10.59	0.6
Preston	1,206	11.54	0.9
Salem	535	14.74	0.3
Sprague	951	13.5	0.8
Stonington	2,478	9.63	1.0
Voluntown	527	12.59	0.4
Waterford	0	10.4	0.0

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Torrington LMA			
Bethlehem	724	12.02	0.4
Canaan	1,400	13.14	0.6
Colebrook	1,430	15.84	0.8
Cornwall	2,406	8.36	0.6
Goshen	878	9.99	0.3
Kent	2,381	8.43	0.7
Litchfield	3,616	12.16	1.8
Morris	1,099	12.18	0.5
Norfolk	707	12.57	0.3
North Canaan	616	11.66	0.4
Roxbury	329	7.84	0.1
Salisbury	574	6.1	0.1
Sharon	899	8.06	0.3
Torrington	1,124	17.97	1.1
Warren	951	8.52	0.3
Washington	405	6.26	0.1
Winchester	150	17.13	0.1
Woodbury	930	12.1	0.5

	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Waterbury LMA			
Beacon Falls	2,602	14.05	1.9
Middlebury	1,868	14.36	0.9
Naugatuck	3,192	17.99	3.3
Prospect	2,435	16.72	2.0
Waterbury	998	24.32	1.3
Watertown	1,856	11.98	1.3
Wolcott	2,436	13.75	1.9

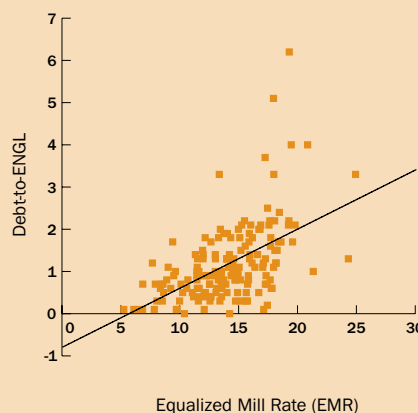
	DEBT PER CAPITA (\$)	EQUALIZED MILL RATE	DEBT TO ENGL (%)
Willimantic - Danielson LMA			
Brooklyn	1,017	12.21	0.9
Chaplin	509	16.71	0.5
Eastford	0	14.24	0.0
Hampton	305	15.75	0.3
Killingly	936	11.46	0.8
Plainfield	1,512	11.33	1.4
Pomfret	66	12.08	0.1
Putnam	58	6.84	0.1
Scotland	3,945	17.25	3.7
Sterling	3,785	13.36	3.3
Thompson	76	9.76	0.1
Windham	1,191	19.27	2.2
Woodstock	764	11.49	0.6

169-Town Average 1,843 14.01 1.2

ABOUT THE CENTERFOLD

The centerfold maps town debt as a percent of equalized net grand list (ENGL)—a standardized measure of property wealth across communities. The debt-to-ENGL ratio is a gauge of financial risk: the lower, the better. Debt-to-ENGL ratios are lowest in the extreme western and eastern parts of the state, and highest in central Connecticut, where high population densities increase the demand for roads, schools, and other capital projects.

The scatterplot relates debt-to-ENGL ratios to towns' equalized mill rates. EMRs measure tax effort: towns with higher EMRs tax property more intensively. As the graph shows, rather than substituting borrowing for taxes, towns that borrow more tend to tax more, too.



A BETTER “PAYER MIX” FOR UCONN’S HOSPITAL?

John Dempsey Hospital may be “too small” in one sense that critically affects its ability to cover costs out of revenues. Given the State policy of having Dempsey provide hospital treatment for the indigent, the incarcerated, and the committed, plus the difficulty of obtaining budgeted funds for new technology, the hospital has found it difficult to compete in providing the broad array of in-patient services demanded by people covered under private and public-employee health insurance plans.

UC/HH would address the payer-mix problem in two ways. One, having the State pick up the tab for the new hospital and for the extra costs of State employee benefits could make it possible for Hartford Hospital to operate the University Hospital without deficits even with the existing payer mix. But as a private entity Hartford Hospital might be able to tilt the payer mix of the two-campus University Hospital more in the direction of the well-insured patient population that it already serves. More on this point in the next section.

But first: what would happen to the special-needs patients who now receive cut-rate or free treatment at Dempsey? It would seem essential that any final agreement explicitly recognize

those patients and how their treatment costs would be paid for.

FEAR AND LOATHING AMONG HOSPITAL ADMINISTRATORS

St. Francis, Bristol, and other hospitals in north-central Connecticut bristle at proposals like UC/HH. One concern is competition from the new hospital beds. The bar chart on page 11 shows “staffed” and “licensed” (potential) hospital beds for the 7 hospitals in the Greater Hartford MSA. Depending on the size of the new downtown patient tower, UC/HH would add relatively few new beds; the alternative of a Harvard-model, Hartford-based medical school might well add even fewer.

A regression of staffed beds per capita, using the same data source as in the earlier regression (see the table of results below), yielded robust results. Applied to the Greater Hartford MSA, the predicted number of beds per 100,000 peoples is 223. The actual number, 227, is not statistically different. Thus, as of 2005-2007, north-central Connecticut had about the “right” number of hospital beds, using comparable Metropolitan Statistical Areas as a benchmark.

A second, more pressing concern, however, is competition for better-insured patients whose payments cross-subsidize a hospital’s losses sustained in treating charity and institutional patients. To the extent UC/HH enabled the new University Hospital to claim more well-insured patients, it would have to come at the expense of existing hospitals. Of course, to reduce or eliminate the structural deficit at UConn’s hospital will likely require attracting more well-insured patients—at the expense of other facilities—no matter what. Unless the State resigns itself to covering the deficits in annual budgets as a matter of policy, only the Harvard-model alternative, with no medical-school hospital, would pose less of a threat to the longer-term financial viability of the rest of the region’s hospitals.

AND DON’T FORGET...

In the euphoria surrounding the announcement of UC/HH, a couple more mundane problems were glossed over. Ignoring them now could give rise to regrets later.

First, a new University Hospital would have to resolve the likely “clash of cultures” from combining staffs from Hartford and Dempsey Hospitals. Academic and non-academic professionals do not naturally mix well, even within the same job descriptions. The Harvard-model alternative might avoid much of this problem, though at the expense of laying off existing Dempsey staff.

Second, trying to maintain two separate classes of University Hospital employees, even with State subsidies for the extra costs of its more generous fringe benefits, would not be easy for Hartford Hospital management. Many workers doing the same jobs would be paid differently; you can bet that the workers and their different union representatives would run the numbers and make comparisons, jeopardizing morale. It might be well, in any final agreement, to grandfather in the *existing* State employees, but require that any future hires for replacement or expansion be non-State. Otherwise, there will be constant pressure from the operator, Hartford Hospital, to make all University Hospital staff State employees, thereby solving the morale problem—but also shifting benefit costs onto the State and allowing it to pay lower salaries.

NUMBER OF HOSPITAL BEDS PER 100,000 PEOPLE IN AN MSA (2005-2007)

Variable	Coefficient	P-value
Intercept	-1476.33	0.0294
Population	-3.98E-05	0.0740
% > 65 Yrs. Old	31.18	0.0081
% < 18 Yrs. Old	24.06	0.0240
% In Poverty	20.11	0.0049
% Female	-9.76	0.0795
% Hispanic	-3.16	0.0010
Per Capita Income	0.06	0.0176
Per Capita Income ^2	-7.74E-07	0.0193

The P-values are the likelihoods that these coefficient values occurred by chance; the smaller the P-value, the more statistically significant the result. Coefficients for characteristics not shown were not significant.

SOURCE: *The Connecticut Economy*, based on U.S. Census data.

What Drives Income Inequality Among Connecticut's Families?

BY SUSAN RANDOLPH AND WILLIAM LOTT

Connecticut's per capita income and mean family income are the highest in the nation. Unfortunately, that doesn't mean all Connecticut families are doing well. In our earlier article (Fall 2008), we found stark differences in living standards both within and across Connecticut's regions. In this article, we examine the sources of the Nutmeg State's unequal incomes. Education turns out to be the single most important variable.

Social justice aside, there are reasons to be concerned about the prevalence of income inequality in Connecticut. Studies in the April 20, 1996, *British Medical Journal*, by researchers at Harvard (B. Kennedy *et al.*), and UC-Berkeley (G. Kaplan *et al.*), found that greater inequality brings with it higher death rates for all age and income groups, as well as a plethora of other problems (higher rates of homicide, violent crime, infant mortality, heart disease and cancer, plus poorer educational performance). Also, there is evidence that (contrary to received wisdom) inequality may repress economic growth and increase macroeconomic volatility.

So, what drives inequality in Connecticut, and what sorts of measures might attenuate it?

BACK TO THE DRAWING BOARD

To address those questions, we again turned to the U.S. Census Bureau's 2006 American Community Survey (ACS). The ACS collects information not only on family income, but also on a range of factors that might be expected to influence it. The same information also allows us to decon-

struct the relative importance of each factor in explaining the inequality of family incomes in Connecticut.

To measure the quantitative determinants of family income inequality, we undertook an ordinary least squares regression of (the natural logarithm of) family income on sets of binary (dummy) variables reflecting household characteristics. The ACS measures family income as the sum of eight different types of income received by all family members 15 and older, over the past 12 months.

As the regression results below make clear, most of the variables included in our model proved significant at the

10% level of probability or better. The constant term in the lower right corner of the table, 10.4683, is the natural log of the average income of families when all dummy variables equal zero. Those families constitute our "control group:" white married couples born in the U.S., with a high school education or less, living in Eastern Connecticut, speaking English at home and with both husband and wife in the labor force but not currently employed. (The ACS defines five more large regions—of 400,000 persons each—in the state: North Central, Hartford area, South Central, Northwest, and Gold Coast.)

DETERMINANTS OF FAMILY INCOME ACROSS CONNECTICUT, 2006

	Coefficient	P-value		Coefficient	P-value
Region			Family Structure		
Hartford Area	0.0416	0.01025	Marr. Husband in LF	0.1551	<0.00001
Gold Coast	0.3957	<0.00001	Marr. Wife in LF	-0.1910	<0.00001
North Central	0.1474	<0.00001	Marr., Neither in LF	-0.1335	<0.00001
Northwest	0.0927	<0.00001	Unmarr. Male in LF	-0.2989	<0.00001
South Central	0.0588	0.00002	Unmarr. Male Not in LF	-0.5494	<0.00001
Race			Unmarr. Female in LF	-0.5848	<0.00001
Black	-0.3332	<0.00001	Unmarr. Female Not in LF	-0.6917	<0.00001
Native American	-0.1365	0.14257	Citizenship		
Asian/Pacific	-0.0164	0.59423	Born Puerto Rico	-0.2335	<0.00001
Other	-0.1733	<0.00001	Born Abroad U.S. Parents	0.1015	0.03644
Two or more	-0.0307	0.33067	Naturalized	0.0331	0.07589
Home Language			NonCitizen	-0.2793	<0.00001
Spanish	-0.1290	<0.00001	Family Workers		
Other Indo-Eur. (ex-Eng.)	-0.1146	<0.00001	One	0.5352	<0.00001
Asian-Pacific	-0.0713	0.0532	Two	0.8728	<0.00001
Other	0.0462	0.33725	Three or more	1.1290	<0.00001
Education			Hispanic		
Some Coll. or Associates	0.0490	<0.00001	Hispanic	-0.3253	<0.00001
Bachelors	0.3148	<0.00001	Constant Term		
Masters	0.4813	<0.00001	Const	10.4683	<0.00001
Professional or Doctorate	0.6355	<0.00001			

The coefficients measure the percent change in family income from the baseline associated with that family characteristic. The P-values are the likelihoods that these coefficient values occurred by chance; the smaller the P-value, the more statistically significant the result.

SOURCE: *The Connecticut Economy*, based on U.S. Census Bureau's American Community Survey.

Among Connecticut regions, there's the Gold Coast and then there's everybody else.

Taking the antilog, the control group's average family income is \$35,182.

The coefficient on each of the dummy variables shown gives the percentage increase in family income for that family characteristic, compared with the family income of the control group. For example, sampled families living in the Hartford region, but otherwise like the control group, averaged 4.16% higher incomes than the control group, or \$36,646. A negative sign on a coefficient indicates that the family characteristic is associated with a decrease in family income, relative to that for the control group. For instance, the average income of families that speak Spanish at home, but are otherwise like the control group, was 12.9% lower than that of the control group, or \$30,644. The lack of any sign on a coefficient means its effect is positive.

AS EXPECTED...

Taken as a whole, our family income regression results are not that surprising. Among Connecticut regions, there's the Gold Coast (lower Fairfield County) and then there's everybody else; the Hartford area comes in only a distant fifth. And non-white ethnic groups trail whites in average family incomes, holding other things constant. The same is true of non-English languages spoken at home. (We're not sure what the "Other" people speak, but it seems to be working.) "Stay in school!" seems like excellent advice, if you believe the positive and strongly significant effects on the "education" dummies. And the more workers a family has, the higher its family income tends to be.

Further, our results are consistent with the persistence of discrimination in the workplace as a pernicious influence on family income. By themselves, they cannot "prove" discrimination, but, taken together, the negative and large coefficients on the "Black" race variable, the "Spanish-spoken-here" variable, the "born-in-Puerto-Rico" variable, and the "Hispanic" ethnicity

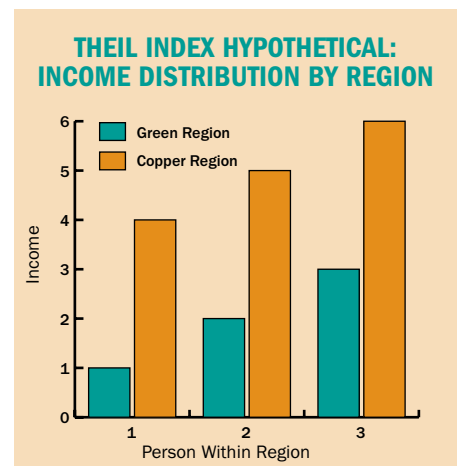
variable indicate how high the barriers to increasing family incomes are for families with those characteristics.

RESOLVING OUR FAMILY-INCOME DIFFERENCES

Our regression results tell only part of the story. In fact, all those dummy variables in our regression explain just 43% of the variation in Nutmeggers' family incomes. Missing are the apparently sizeable effects of other factors that are not readily measured, such as personal initiative, contacts, or just plain luck.

We can, however, learn something about the sources of income inequality in Connecticut from our regression results, using just observable characteristics. To do this, we separated total family-income inequality into two categories: that which traces to differences between groups, and that which traces to differences within groups.

Consider as an example the observable variable of the region of the state where a family lives. It is possible to distinguish between how much of total inequality in the state results from differences in average family incomes *between* regions (say, between the Gold Coast and the Hartford area), compared with how much results from differences *within* the Gold Coast or Hartford area. If the "between" effect of a characteristic explains a greater share of total inequality in the state, that means the characteristic is a cause of the inequality. But if the "within" effect dominates, then controlling for



the characteristic adds little to our understanding of inequality.

THE THEIL INDEX

To decompose family-income inequality in this fashion, we made use of the Theil index of inequality, named for the Dutch econometrician, Henri Theil, whose 1967 book made a seminal contribution to the measurement of income distribution. (An uplink to a concise discussion of the Theil index by Frank Cowell is available at the Wikipedia page for Henri Theil.) The Theil index is zero when income is distributed evenly and increases as income disparities rise.

Consider a state composed of two regions, each with three people—say, a green and a copper region. (See the diagram on page 16.) The green people receive annual incomes of \$1, \$2, and \$3, while the copper people receive \$4, \$5, and \$6. The copper folks are richer than the green, but the distributions of income in each region look quite similar.

In fact, income is distributed *less* evenly in the poorer, green region, than in the richer, copper one. The Theil index in the former is $T_G = 0.0872$, but in the latter $T_C = 0.0134$. Because $T_G > T_C$, income is less equally distributed in the poorer than in the richer region.

Why the difference? Because the *relative* difference in income is greater in the green than in the copper region. The richest green person's income is three times that of the poorest, while it

is only 1.5 times greater in the copper region.

Now suppose the green and copper regions together make up a state. We can use the Theil index to divide income inequality in this two-region state into two segments: that due to differences within each of the regions, and that due to differences between the two.

Let us begin by computing the overall Theil index of inequality for the entire state: $T_S = 0.1294$. We construct the interregional component of the state index by comparing the regions using their average incomes: \$5 in the copper region, \$2 in the green. The resulting constructive state then has six people, half with \$2 each of income and the other half with \$5 each. This constructive state's Theil index is then 0.0949. Thus, 73.3% of inequality in the state is due to the difference between the average incomes of the green and copper regions: The ratio of the constructive state Theil index, 0.0949, to the actual statewide Theil index, 0.1294, is equal to 0.733.

The remainder of the statewide index, 0.0345, is the intraregional component of the statewide index. Thus, 26.7% of the actual statewide inequality is traceable to the differences in family income within each region, without regard to the difference between the two regions' average incomes.

DECOMPOSING INEQUALITY IN CONNECTICUT

The nearby table shows the results of applying the decomposition of the Theil index for the Nutmeg State, for each of the characteristics in our regression. Within-group differences predominate over between-group characteristics in all cases. For education and family structure, however, the “between” effects are relatively large. Interestingly, applying the same Theil index decomposition to family income inequality in Massachusetts yielded very similar results.

The most obvious lessons for public policy are to focus on education and family structure, the real equalizers. In a nasty recession, it is tempting to cut State support for education; resist doing so if at all possible! Education spending not only helps reduce income inequality; it also shores up Connecticut's competitive position in the world economy. And policies aimed at strengthening intact families, and supporting single-parents' efforts to maintain full-time jobs, warrant a high priority as well. Finally, essential as it is to continue to fight racial and gender discrimination, the reasons do not seem to include the reduction in family-income inequality.

William Lott and Susan Randolph are associate professors of Economics at the University of Connecticut.

DECOMPOSING CONNECTICUT'S THEIL INDEX		
Characteristic	Within	Between
Region	91.70%	8.30%
Race	94.10%	5.90%
Home Language	97.20%	2.80%
Education	78.10%	21.90%
Family Structure	82.50%	17.50%
Citizenship	97.40%	2.60%
Family Workers	93.40%	6.60%
Hispanic	95.20%	4.80%

SOURCE: *The Connecticut Economy*, based on U.S. Census Bureau's American Community Survey.



LABOR MARKET OUTLOOK

Updates and Forecasts for Key Labor Market Areas

BY STEVEN P. LANZA

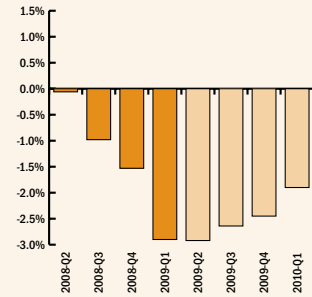
BRIDGEPORT-STAMFORD

Bridgeport-Stamford's pace of job loss doubled to 2.9% in 2009-Q1, from a revised 1.5% the previous quarter, marking a year-over-year decline of 12,000 posts. Fully half that number came from the professional and business services sector. Financial activities, meanwhile, slipped by a surprisingly modest 2.1%. The unemployment rate surged to 7.3% between quarters but remains lowest among the major regions. Expect jobs to fall at 2009-Q1's rate next quarter, before the pace slows in the second half of this year

and early next. Unemployment, however, will continue to inch higher and could creep past 9% in 2010-Q1.

Price declines for mid-sized, constant-quality homes eased by 2 percentage points in 2009-Q1, to 10.6 percent. Unfortunately, the cards appear stacked against further moderation of slumping prices during the forecast period. The outlook for housing permits, which dropped 60% in the quarter, appears just as dicey.

JOBS

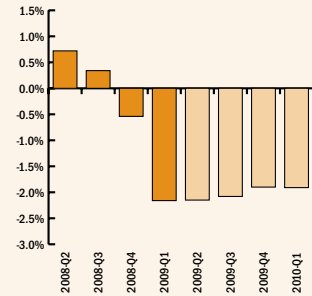


HARTFORD

Hartford area jobs dropped by 2.1% in the four quarters ending 2009-Q1, four times faster than they had the quarter before. Unfortunately, hopes are dim that the pace of decline will slow during the forecast period. The quarter's cuts were split evenly between the goods and services sectors; and in the latter, most of the pruning was concentrated in retail, finance, and professional & business services. The jobless share of the labor force jumped 1.7 percentage points between 2008-

Q4 and 2009-Q1, and could soar to nearly 10% by 2010-Q1.

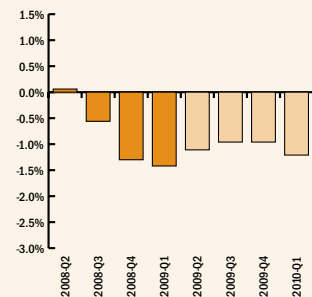
Prices for constant-quality homes dropped more than 14% in the first quarter. That may be about as bad as the market gets, but do not expect significant improvement, either. Double-digit price declines are on tap for the next four quarters. Tumbling prices will continue to discourage new home building, but 2009-Q1's record drop in permits is unlikely to be repeated.



NEW HAVEN

New Haven nonfarm jobs slipped by 1.4% percent in 2009-Q1, the gentlest rate of decline among the major regions. For every four jobs given up in construction or manufacturing, the service sector shed three, with retail trade and government suffering the heaviest casualties. Job losses could ease in coming quarters, but any actual recovery likely lies beyond the forecast period. The area's middling 7.7% percent unemployment rate is on track to climb higher, but not quite at the pace of the other regions.

Constant-quality home prices were down just 1.2%, moderate both by the standard of other LMA's and by New Haven's recent history. And the four-quarter outlook suggests this more tempered erosion in real estate values may be here to stay. Meanwhile, housing permits, off 40% over four quarters, have been driven to such low levels that they may have nowhere to go but up by early next year.

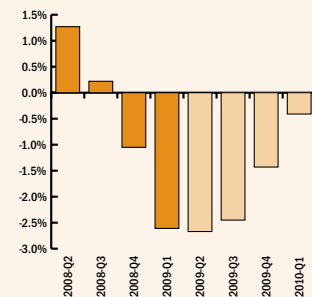


NORWICH-NEW LONDON

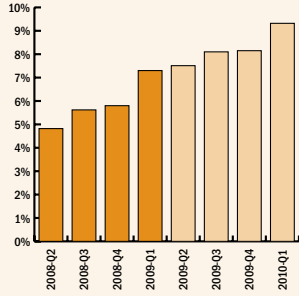
New London shed jobs in 2009-Q1 nearly as quickly as harder-hit Bridgeport-Stamford, but the area has better prospects for staunching the bleeding within the forecast period. The quarter's job losses were skewed slightly toward the services, particularly in retail, professional & business services, and government. But the trend points to progressively smaller decreases in coming quarters. Unemployment, now worst among the large areas, will inch higher in the near future, but as conditions worsen statewide, other regions

could easily overtake New London in the jobless category.

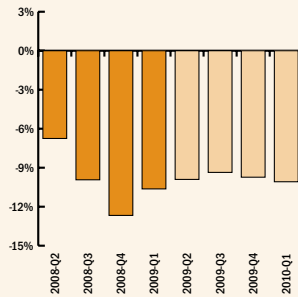
The drop in home prices eased substantially in 2009-Q1, presaging possible price gains in the second half of the year. Alone among regions, New London actually beat last year's same-quarter total for the number of housing permits issued. The forecast looks touch and go, but signs point toward a gradual improvement in the New London area housing market.



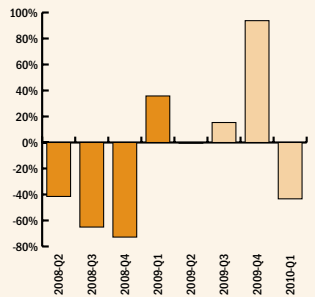
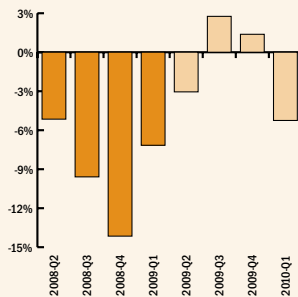
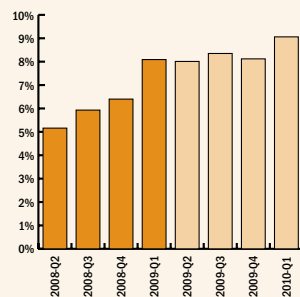
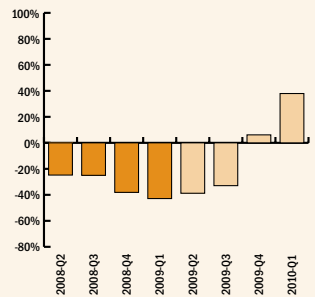
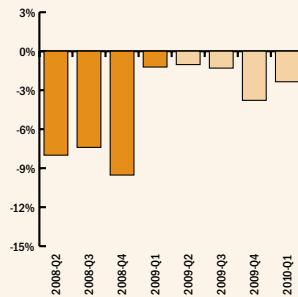
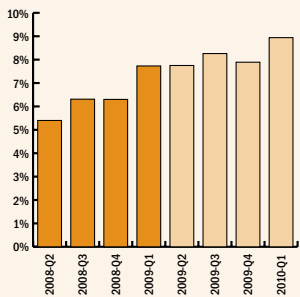
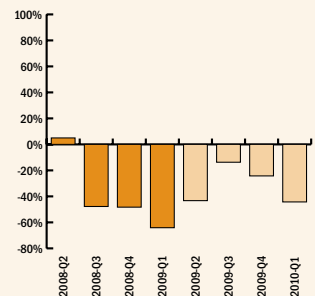
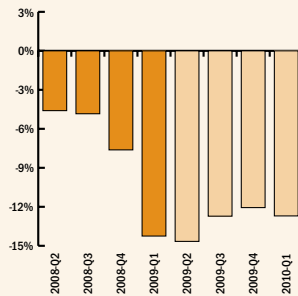
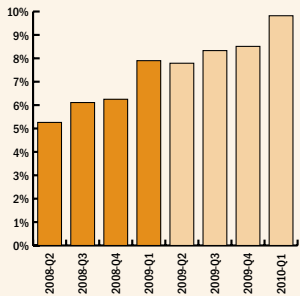
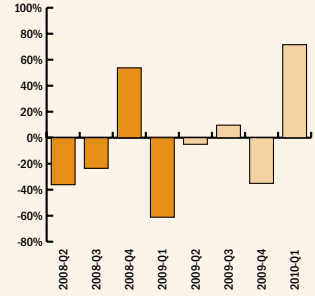
UNEMPLOYMENT RATE



HOUSING PRICES



HOUSING PERMITS



LABOR MARKET DATA

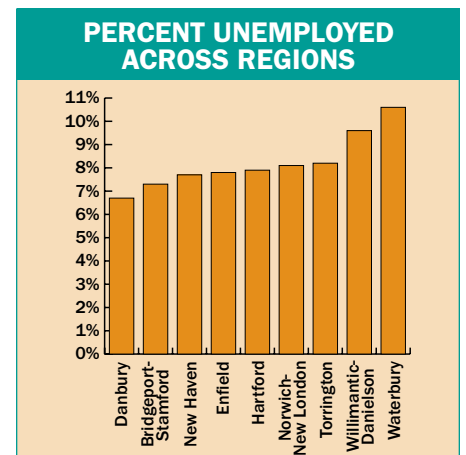
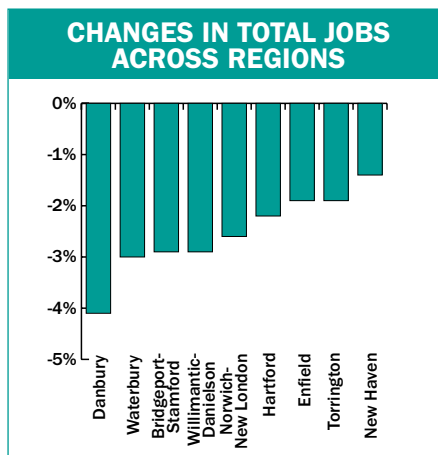
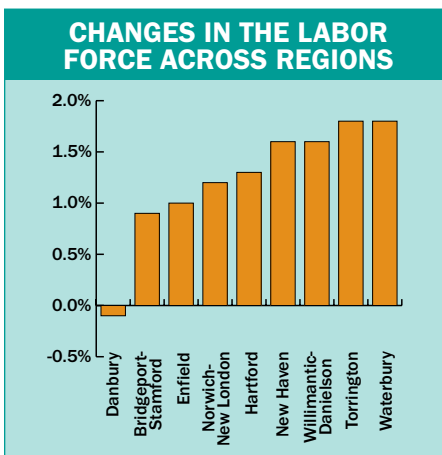
What recession, you ask? The unemployment rate just jumped by half.

Labor Market Area	LABOR FORCE		NONFARM JOBS		UNEMPLOYMENT RATE	
	2009-Q1 (000)	% Change Year Ago	2009-Q1 (000)	% Change Year Ago	2009-Q1 (%)	2008-Q1 (%)
Bridgeport-Stamford	472.5	0.9	402.3	-2.9	7.3	4.8
Danbury	91.2	-0.1	66.6	-4.1	6.7	4.3
Enfield	49.5	1.0	47.2	-1.9	7.8	5.5
Hartford	591.6	1.3	542.8	-2.2	7.9	5.5
New Haven	314.3	1.6	273.2	-1.4	7.7	5.5
Norwich-New London	150.9	1.2	130.4	-2.6	8.1	5.2
Torrington	54.9	1.8	35.7	-1.9	8.2	5.6
Waterbury	102.4	1.8	65.0	-3.0	10.6	7.4
Willimantic-Danielson	58.8	1.6	36.5	-2.9	9.6	6.6
Statewide	1,872.7	1.2	1638.2	-3.0	7.9	5.3

The construction job declines are spread with a trowel.

Labor Market Area	MANUFACTURING JOBS		CONSTRUCTION JOBS		BUSINESS SERVICE* JOBS	
	2009-Q1 (000)	% Change Year Ago	2009-Q1 (000)	% Change Year Ago	2009-Q1 (000)	% Change Year Ago
Bridgeport-Stamford	38.8	-2.2	12.8	-9.8	61.5	-8.6
Danbury	-	-	-	-	7.8	-3.3
Enfield	-	-	-	-	-	-
Hartford	61.5	-3.7	16.2	-19.9	58.8	-4.4
New Haven	30.3	-3.3	9.7	-11.0	26.3	-1.0
Norwich-New London	15.2	-4.2	3.4	-21.1	9.4	-5.1
Torrington	-	-	-	-	-	-
Waterbury	9.5	-4.7	2.4	-7.7	4.7	-17.5
Willimantic-Danielson	-	-	-	-	-	-
Statewide	179.7	-4.5	49.8	-21.3	189.6	-7.0

*Includes Professional Jobs



Labor Market Area	EDUCATION & HEALTH JOBS		TTU* JOBS		FINANCIAL JOBS	
	2009-Q1 (000)	% Change Year Ago	2009-Q1 (000)	% Change Year Ago	2009-Q1 (000)	% Change Year Ago
Bridgeport-Stamford	65.9	4.1	71.6	-5.7	44.4	-2.1
Danbury	-	-	14.9	-6.3	-	-
Enfield	-	-	-	-	-	-
Hartford	94.6	3.3	88.2	-2.5	64.2	-2.9
New Haven	71.1	2.5	49.9	-2.2	12.6	-5.3
Norwich-New London	20.0	0.7	22.2	-3.6	3.0	-7.3
Torrington	-	-	-	-	-	-
Waterbury	15.0	0.7	12.8	-3.0	2.2	-2.9
Willimantic-Danielson	-	-	-	-	-	-
Statewide	299.6	1.9	297.9	-4.1	139.6	-2.7

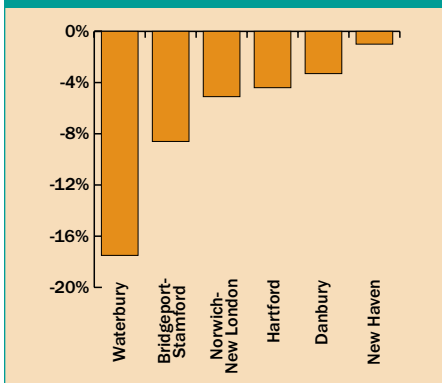
Save for education & health, jobs have tumbled since 2008-Q1...

Labor Market Area	GOVERNMENT JOBS		HOUSING PERMITS		HOUSING PRICES	
	2009-Q1 (000)	% Change Year Ago	2009-Q1	% Change Year Ago	2009-Q1 (\$000)	% Change Year Ago
Bridgeport-Stamford	47.3	-1.9	184	-61.2	584.9	-10.6
Danbury	8.5	2.4	21	-25.0	328.4	-7.5
Enfield	-	-	7	-78.1	158.8	-13.1
Hartford	87.7	-1.4	103	-64.1	272.5	-14.3
New Haven	34.5	-2.9	40	-42.9	276.8	-1.2
Norwich-New London	39.3	-0.9	110	35.8	253.6	-7.2
Torrington	-	-	7	-74.1	161.0	-14.4
Waterbury	10.0	-2.6	15	-68.8	180.5	-
Willimantic-Danielson	-	-	13	-70.5	179.7	-
Statewide	254.0	-0.7	500	-54.2	357.0	-10.4

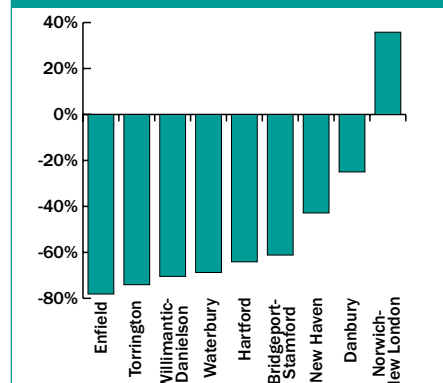
...and housing numbers took a nosedive. Even government jobs were mostly down.

*Trade, Transportation and Utilities

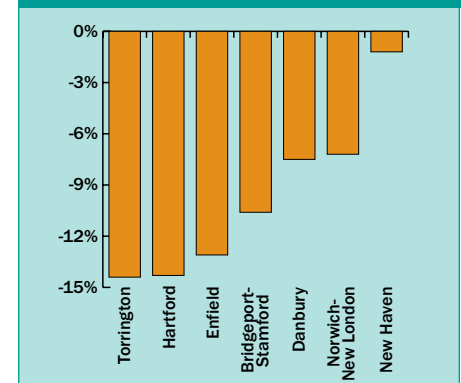
CHANGES IN BUSINESS SERVICE JOBS ACROSS REGIONS



CHANGES IN HOUSING PERMITS ACROSS REGIONS



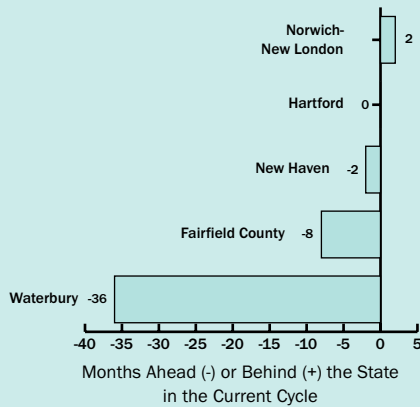
CHANGES IN HOUSING PRICES ACROSS REGIONS



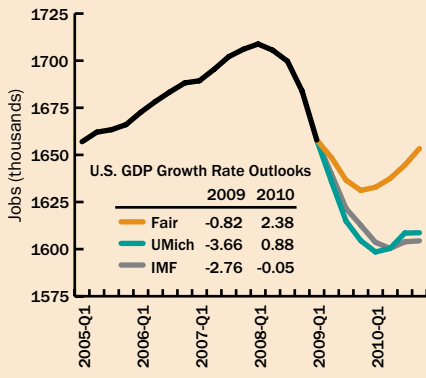
THE QUARTERLY FORECAST

Timing Is Everything

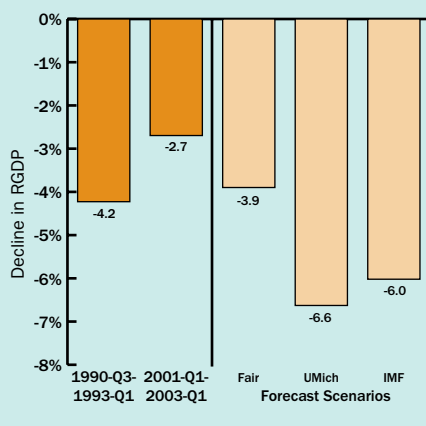
ECONOMIC PEAKS BY REGION RELATIVE TO THE STATE



THREE RECOVERY SCENARIOS FOR CONNECTICUT JOBS



PEAK-TO-TROUGH DECLINES IN STATE REAL GDP: PAST AND FUTURE?



BY DANIEL W. KENNEDY

Connecticut's economy peaked in March 2008, three months after the U.S. slipped into recession, according to the Connecticut Labor Department's 2009 benchmarking of non-farm employment. This was clearly a role reversal: Connecticut led the U.S. into recession by 17 months in 1989 and by eight months in 2000. Our forecasted peak-to-trough Connecticut job loss—about 105,000—would put the severity of this downturn midway between those previous two post-Cold War recessions.

Despite the recession's late appearance in Connecticut, it did not debut simultaneously in all regions. The first graph marks the timing of regional job peaks relative to the entire state (the vertical, zero axis). Waterbury, whose secular decline in jobs was held in check during the recent expansion, started slipping first—in March 2005, 36 months ahead of the state. Next came Fairfield County (the Bridgeport-Stamford-Norwalk and Danbury metros), followed by New Haven. Hartford's cycle coincided exactly with that of the state as a whole, while New London-Norwich did not decline until two months later.

To read the tea leaves for job prospects statewide, three U.S. macroeconomic forecasts served as the basis for three forecast scenarios (see line graph).

The state's economy bottoms out in 2009-Q4 under the Fair scenario, 2010-Q1 under the University of Michigan, and 2010-Q2 under the IMF. In every case, the recession's end comes one quarter sooner than we anticipated in our previous forecast.

Measured from the economy's 2008-Q1 peak to the expected trough, Connecticut will lose 78,000 jobs over eight quarters of recession under the relatively optimistic Fair scenario. The IMF scenario foresees the state losing 108,000 jobs over ten quarters of recession, while the Michigan track has the state shedding 110,000 jobs over a nine-quarter downturn.

The Fair outlook seems extraordinarily upbeat. My own view is that chances are the state will post job losses in the 100,000 to 110,000 range. Further, the trough will probably be followed by a "jobless recovery" like those after the previous two post-Cold War recessions. That means that, though a bottom will have technically occurred, it is apt to be followed by a protracted period of weak job growth.

The final graph compares projected declines in state GDP with our experience in the last two recessions. The Fair scenario has Connecticut's GDP contracting by 3.9% this time, while the decline under the IMF and University of Michigan outlooks would exceed 6%.

One final note: the forecast does not include any effects on Connecticut from the federal stimulus package, as hard numbers on job creation were unavailable at press time. To the extent that the stimulus plan saves or creates jobs, the IMF and Michigan forecast scenarios, especially, could be overly pessimistic. In that case, the Pollyannaish Fair scenario might be right after all.

Dr. Kennedy, Senior Economist with the Connecticut Department of Labor, Office of Research, manages *The Connecticut Economy's* economic forecast. His views are not necessarily those of the Department of Labor.

MERRILL (continued from page 24)

we don't adjust our tax and spending patterns. Ideally, the Legislature and Governor will craft a biennial budget that achieves this balance.

After the smoke clears from this crisis, long-term fiscal challenges will remain. Connecticut has had no meaningful net job creation in 20 years. This decade, even as average income rose, median household income declined, the result of a steady erosion of high-wage, high-skill jobs.

The solution is to build a more vibrant state economy, expanding from its historic base in financial services and manufacturing. Connecticut, for example, is already a national leader in stem cell research. Yale's acquisi-

tion of the Bayer research campus, the arrival of the NIH oncology research center, and the state's established strength in pharmaceuticals create a foundation for potentially dramatic growth. Connecticut also is preeminent in aerospace, a sector with high-skill, high-wage jobs. There is a similar opportunity to build a major cluster around the film industry.

The challenges are to craft tax policies that facilitate growth, strengthen the necessary workforce pipeline, and make strategic investments in life sciences, including a new UConn hospital and a central Connecticut research collaborative. This means more investment in education at all levels.

Community colleges and vocational-technical high schools must prepare students to enter these fields. Four-year and graduate institutions must continue to produce research that leads to new ideas and technologies.

The current crisis lays bare the inadequacy of our tax system and demands that we develop a strong policy framework supporting major strategic investments to restore Connecticut's economic vitality. Failing that, Connecticut will face recurring fiscal crisis.

CAFERO (continued from page 24)

Instead, it has been subverted repeatedly.

In April, Republicans in the General Assembly proposed a balanced budget without raising taxes, despite the state's projected \$8 billion shortfall. Democrats chose a different course, opting for the largest tax increase in history, \$3.3 billion.

Republicans relied on the three Cs: Consolidation of state agencies, Concessions from state employees, and Cost cutting. We incorporated ideas from the executive branch and both Republicans and Democrats in the legislature. We worked off Gov. Rell's model of a no-tax-increase budget coupled with early retirement for

state employees, saving hundreds of millions. Senate Democrats proposed merging 11 state agencies into 4; we went further, consolidating 23 entities into 6.

In January of this year there was broad agreement that raising taxes during a fiscal crisis was a bad idea. We still agree. Repeated crises are inevitable, unless we address spending growth.

Raising taxes will drive more people from Connecticut and further erode revenue. In 2006-07 some 2,800 Connecticut residents fled for Florida, taking with them more than \$404 million in adjusted gross income. That is permanent lost revenue for the state of Connecticut.

Connecticut's aging population will further tax our health care systems. Retiring workers and the continued exodus of college graduates will leave fewer workers to support government.

Many of the jobs on Wall Street, to which Fairfield County residents have commuted daily, may never return. And manufacturing jobs have been traded for automated distribution centers.

Attempts to streamline government trace back to 1937 and Governor Cross. But current trends and the future outlook make it imperative that we act now if we are to prevent the fiscal crisis of 2009 from becoming a recurring nightmare.

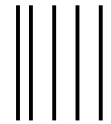
THE CONNECTICUT TRAVEL AND TOURISM INDEX



The overall index decreased 5.3% in 2009-Q1 compared with the same quarter the year before. The index consists of room occupancy, slot machine revenues, attendance at six major tourist attractions, and traffic on five tourist roads.

Room Occupancy	▼ -13.2%
Slot Machine Revenue	▼ -6.7%
Attendance	▲ +1.6%
Traffic	▼ -3.0%
Overall	▼ -5.3%

FRS # 430032



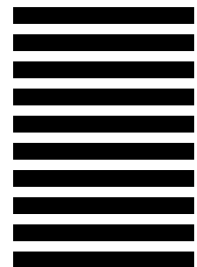
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A FORWARD LOOK

Erasing the State's Red Ink



DENISE MERRILL
HOUSE MAJORITY
LEADER, CON-
NECTICUT GENERAL
ASSEMBLY

Every state is facing a budget shortfall, but Connecticut is at the head of the pack, with one of the largest percentage deficits among the fifty states. Proposed solutions vary, but one thing is clear: Connecticut's fiscal health—

both short- and long-term—depends not just on the design of its tax system but also on the vitality of its economy.

Connecticut's current crisis results from a tax system overly reliant on discretionary spending, capital gains, and bonuses. While the state's gross state product is shrinking by perhaps 4%, tax revenues have plummeted far more. We are falling off a fiscal cliff of monumental height, with repercussions that will be felt in every area of State endeavor.

The resulting deficit is so massive—approaching \$10 billion over three fiscal years—that only a balance of revenue enhancements, program reductions, and employee givebacks offers hope of addressing the shortfall without doing permanent damage to public services and long-term economic competitiveness. Reliance on significant one-time sources such as the budget reserve fund (it's raining!) and federal stimulus funding will only leave us in a deeper hole in 2012 if

(continued on page 23)



LAWRENCE F. CAFERO JR.
HOUSE MINORITY
LEADER, CON-
NECTICUT GENERAL
ASSEMBLY

If you think Connecticut's budget problems began last September when the bears started running on Wall Street, think again. The path to the precipice of fiscal insolvency was staked out over the last two decades.

Our budgets have been built on wildly volatile revenues—income and capital gains taxes—and assumptions that housing values will spiral ever higher. And total spending has grown 70 percent over the last 10 years, outpacing the 30 percent increase in the price level.

Our last fiscal crisis emerged from the double-digit growth of spending in the late 1980s, paired with the savings and loan crisis and a previous real

estate meltdown. That crisis led to the adoption of the income tax in 1991.

Since 1991, spending has increased nearly threefold and state government has never been bigger: 61,000 workers at last count. The constitutional spending cap, the companion piece to the income tax, was sold to voters as the firewall against future spending sprees. But the cap was never really implemented, even though 81 percent of the voters, including me, approved it.

(continued on page 23)

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