DEFICIT MITIGATION

SENATE & HOUSE REPUBLICAN

OPTIONS FOR CONSIDERATION

NOVEMBER 12, 2015

The Time to Act is Now

- **The state of Connecticut is at a crossroads.** We have an opportunity to put our state on a new path towards fiscal sustainability, predictability and positive growth.

- **We have a choice.** Either we continue to live in a state of permanent fiscal crisis, or we take on a holistic approach to rethink our budget in both the short and long term. We have an obligation not to pass a two-year reelection budget, but an obligation to pass a plan to help future generations.

An Unsustainable Path

Perpetual Deficits

- Connecticut ended last fiscal year with a deficit of $113.2 million.
- As enacted, the budget this year had significant holes from the start.
- Today, we are facing a shortfall hundreds of millions of dollars deep coupled with uncertainties that can add to this deficit.
- Fiscal year 2017 will already need to be adjusted by $399.4 million as a result of revenue deterioration.
- The upcoming biennium is already in deficit by at least $2.9 billion, which begs for the fiscal responsibility of needing to address this deficit now.

All of this is after the <u>two largest tax increases</u> in state history.

An Unsustainable Path

Rampant Spending

- Over the past four years over **$1.6 billion** of what was once operating expenses has been moved to bonding (see attached list).

- Over the same time period, bonded indebtedness has increased by over **$3 billion** due to rampant utilization of state bond commission allocations.

- This past enacted budget alone is spending over **22.4%** more than what is reflected on paper, a direct result of moving budget items outside of the General Fund.

As a result…

- Small businesses including many of those in our cities are struggling, and large companies like GE are considering leaving.
- **Connecticut is not growing the high paying jobs our families need to survive and care for their loved ones.**
- **People are leaving Connecticut for other states**. According to a March 2015 U.S. Census Bureau report, Hartford, New Haven and Fairfield counties lost 7,090, 6,725 and 6,506 people respectively due to "domestic migration" from July 2013 to July 2014.

As more people and employers move out of the state, the burden of paying taxes will start to shift more and more to those who remain and those who can least afford it, or social services for the poor, elderly and disabled will have to be cut.

Paving a New Path

Together we can create a strong state that:

- Demonstrates Republicans and Democrats understand that challenging times demand action, and both groups are willing to put aside our differences to improve our state.
- Keep our vital services for the poor, elderly and disabled funded
- Supports working and middle class families
- Creates environments where all people have access to opportunities to be successful no matter how humble
- Supports and protects the most vulnerable
- Is accountable not only to the current generation but also to future generations who will suffer from a government that refuses to live within its means and put people before political rhetoric and election cycles.

To get there, we must not only repair the budget today, we must plan for a brighter future with **long-term structural changes** to restore **<u>stability</u>** and **<u>predictability</u>** to our state.

The following proposal does NOT cut from those most in need

- We do NOT cut from hospitals.
- We do NOT cut from Medicaid.
- We do NOT cut from services for those with developmental disabilities.
- We do NOT cut from services for those who need mental health and substance abuse treatment.
- We do NOT hurt the poor, the sick or the elderly.

First, Short-Term Initiatives

Solving the immediate need

- In addition to a long-term, holistic, structural approach, Connecticut is in need of help to close the immediate deficit before us today.

- Our calculations, along with data provided by the Office of Fiscal Analysis and the state Treasurer, show a deficit of approximately $350 million - $370 million for Fiscal Year 2016. Moreover, Fiscal Year 2017 is already in deficit by at least $400 million.

- The following list of options offers a total savings of at least $372.8 million in Fiscal Year 2016 and at least $166.8 million in Fiscal Year 2017.

Solving the immediate need

1) Enact the Republicans' Prioritize Progress transportation initiative which provides over $37 billion in bonding dollars for transportation over the next 20 years.

- The Republican's Prioritize Progress would provide the state with a reliable source of funding for vital transportation upgrades over the next two decades. It would entirely fund the $21 billion in projects detailed by DOT taking care of critical safety needs. Our plan would then provide at least an additional $40 billion for other projects all within current funding sources without the imposition of any additional taxes.
- We cannot ignore that the funding source dedicated to the governor's $100 billion initiative is only sufficient to support this initiative until FY 2020.
- Enacting the Republican transportation plan allows the $158.6 million in FY 2016 and $260.6 million in FY 2017 that is now being deposited in the STF to increase the amount of debt service that the STF can support and thereby increase the amount of STO bonds that can be supported by the STF thus increasing the total funding available for capital improvements over the $67 billion as originally presented.

Solving the immediate need

2) Divert excess funding from the Municipal Revenue Sharing Account without reducing any funding for municipalities.

- The Office of Fiscal Analysis has estimated that the revenues being diverted to the account are in excess of projected expenditures by $94.6 million in FY 2016.
- In deference to the legislative leaders, we are recommending that an additional $30 million be diverted to the MRSA in FY 2017 in order to ensure that municipalities are truly held harmless.

3) Enact legislation that allows the governor to hold back $93.1 million in specified areas as bottom-line savings target that is currently designated as an unallocated lapse.

- The enacted budget contained an additional $68.5 million in lapses above what was targeted last year in addition to completely eliminating the usually-significant lapse in the debt service account, therefore the likelihood of natural lapses occurring are unlikely.
- For example, if 10% was held back from "Other Expense" appropriations not yet expended the state would save $50 million.

Solving the immediate need

4) Eliminate funding for 39 new general fund positions from the budget.

- This figure does not include those positions that are located in schools or those positions that are supported by a revenue stream such as pool licensing.
- This provides a savings of $4.3 million in FY 2016 and $4.5 million in FY 2017.

5) Remove funding for the additional $4.8 million that was unilaterally given to union nursing home employees via a memo. This would have no impact on the $13 million granted to union and non-union nursing home employees by the state legislature in the state budget.

6) Consolidate all juvenile justice functions currently under DCF to the Judicial Court Support Services Division. Utilizing the Governor's estimate when he proposed moving the functions in the opposite direction, assuming full implementation in April, this will save the state $2.5 million in FY 2016 and $9.9 million thereafter according to OPM's analysis. According to OFA's analysis this will save $800,000 in FY 2016 and $2.5 million in FY 2017.

Solving the immediate need

7) Eliminate state support of legislative commissions saving $900,000 in FY 2016 and $2.8 million in FY 2017.

8) Reduce or eliminate various appropriations and single-taxpayer specific exemptions totaling $51.6 million in FY 2016 and $35 million in FY 2017.

9) Reduce funding for legislative franking for an annual savings of $1 million.

10) Create an Office of Overtime Accountability and require specific approval for overtime expenditures by state agencies resulting in an estimated $10 million savings in FY 2016 and coupled with modifications to individual labor contracts at least $50 million savings in FY 2017 for total overtime cost savings.

Solving the immediate need

11) Identify savings from the governor's delay of managers raises totaling $5.9 million annually for the next two fiscal years.

12) Require increased efficiencies at Southbury Training School totaling $5 million in FY 2016 and $7.5 million in FY 2017.

13) Reduce Citizen's Election Program grants by 20% for a savings of $2.2 million in FY 2016 and $6.6 million in FY 2017.

14) Accept a portion of the Governor's Rescissions - all non-hospital, non-development disabled, and non-mental health services rescissions.

Solving the immediate need

15) Eliminate Energy Star Sales Tax Exemption effective 1/1/2016 for a savings of $3.6 million in FY 2016 and $7.5 million in FY 2017. Given the large amount of Energy Star products on the market this exemption does not serve as a large incentive.

16) Offer a Retirement Incentive Program with three years of credit.

- We are proposing a RIP for those employees that are currently eligible to retire that must also be paired with a long-term plan to better manage labor costs and pension payments. If we can implement a solid, affordable plan for long term savings, the state will be better prepared to handle costs associated with state employee retirees. This proposal would enable Connecticut to find immediate savings of $79.9 million in FY 2016 and $95.6 million in FY 2017.

Tax Relief

- We are also proposing to make immediate changes to improve Connecticut's business and tax environment including the following:
  - **Eliminate Unitary Combined Reporting**.
  - **Undo the recent restriction on the use of R&D, R&E and URA tax credits** and phase in a restoration to the 70% cap.
  - **Modify Corporation Tax to sales only single factor apportionment** for all "C" corporations as proposed by governor but using the former definition of unitary reporting.
  - **Exempt employees in the state for less than 15 days** by providing a Personal Income Tax short term exemption.
  - **Modify the implementer** to make $6 billion exemption effective retroactive to 1/1/2015.
  - **Enact legislation to fix the Propane Gross Receipts tax exemption for residents with emergency generators.**

Solving the immediate need

Prioritize the State's Expenditures
Republican Options for Consideration
Fall Deficit Mitigation Special Session - 2015
(in millions)

Option	FY 2016	FY 2017
Divert the excess funding from the MRSA without reducing funding to municipalities by one cent	94.6	(30.0)
Give the Governor the authority to the $93.1 million unallocated executive lapse	93.1	-
Offer a Retirement Incentive Program with three years of credit	79.9	95.6
Reduce funding for various appropriations	41.2	29.3
Accept a portion of the Governor's Rescissions (all non-hospital, non-development disabled, and non-mental health services)	26.6	-
Create an Office of Overtime Accountability	10.0	50.0
Reduce various accounts by 4%	7.5	-
Modify Corporation Tax to sales only single factor apportionment for all "C" corporations	6.2	10.3
Identify savings from Governor's delay of managers raises	5.9	5.9
Require Increased Efficiencies at Southbury Training School	5.0	7.5
Remove OPM independently provided additional funding for nursing home enhancements	4.8	4.8
Remove funding for 39 new GF positions created in the budget that are not school related nor supported with revenue	4.3	4.5
Eliminate Energy Star Sales Tax Exemption eff. 1/1/2016	3.6	7.5
Reduce Citizens Election Program grants by 20%	2.2	6.6
Eliminate single taxpayer exemption under the Public Utilities Control Tax	1.9	3.7
Reduce funding for legislative franking	1.0	1.0
Eliminate venue specific admissions tax exemptions (XL Center, Bridgeport Harbor Yard and Webster Bank Arena) eff. 1/1/2016	1.0	2.0
Eliminate state support of legislative commissions - effectively state taxpayer-funded lobbyists eff. 4/1/2016	0.9	2.8
Consolidate juvenile justice functions currently under DCF into Judicial's Court Support Services Division	0.8	2.5
Exempt employees in the state for less than 15 days by providing a Personal Income Tax short term exemption	-	-
Modify the implementer to make the $6 billion exemption effective retroactive to 1/1/2015	-	-
Enact legislation explicitly stating that propane generators are exempt from the Petroleum Gross Receipts Tax	(0.1)	(0.1)
Implement the Governor's Tax Credit proposal R&D, R&E and URA tax credits	(2.7)	(13.5)
Eliminate Unitary Combined Reporting	(14.9)	(23.7)
Total Potential Options	372.8	166.8

Second, and arguably the more important challenge:

Long-Term Initiatives

Long-Term Initiatives

- **Transportation:** Enact constitutional transportation lockbox language that prevents reductions in funding to the Special Transportation Fund.

- **Spending:** Enact definitions for the constitutional spending cap.
  - The spirit of the spending cap that was overwhelmingly supported by voters in 1992 has been directly and indirectly violated since 2012.
  - In this past session alone over $1.8 billion of pension liability was moved from under the cap and the formula for calculating the cap was modified for the sole purpose of spending more money than what the taxpayers believe they have authorized.

Long-Term Initiatives

- **Bonding:** Legislatively cap annual allocations that can be made by the State Bond Commission to $1.8 billion.
  - This proposal will result in significant reductions in debt service in the General Fund as compared to if the allocations are uncapped and remain at the all-time record high of $2.5 billion annually.
  - Reduction in debt service will allow future legislators to have more money to spend on social services.

- **Competitively bid the Correctional Managed Healthcare contract.**
  - The state spends approximately $92 million annually to provide healthcare services to inmates.
  - The provision of this service has never been competitively bid. This will allow the state to determine if a lesser cost is feasible.

Long-Term Initiatives

- **Municipal Aid:** Allow for expenditure reductions by the state and municipalities by revising current prevailing wage laws.
  - Revise the new construction threshold from $400,000 to $1 million.
  - Revise the remodeling and alteration threshold from the current $100,000 to $400,000.
  - These modifications aim to provide real property tax relief to municipalities and residents.

- **Conduct in-depth review of each state appropriation:**
  - Identify inefficiencies and potential waste by reviewing each state appropriation to ensure that its purpose is being fulfilled.
  - Aim to reduce duplication of efforts among multiple appropriations or programs.

Long-Term Initiatives

- **Legislatively Create an Efficiency Planning Committee** which would be a small working group of various stakeholders to identify additional opportunities for non-profit providers to assume services that are currently managed by the state in the future.
  - The committee will be immediately tasked with identifying and evaluating those services which cost the state more than $250,000 per person on an annual basis.
  - Any reduction in workforce as a result of this shift will be accomplished through attrition over time.
  - Once appropriate opportunities are identified, those services and/or functions should be competitively bid to private companies.
  - Savings to the state will then be used to increase rates to our private provider community.
  - This committee will not be tasked with examining the state's penal institutions.

Long-Term Initiatives

- **Close the Connecticut Juvenile Training School including Pueblo Unit** in favor of utilizing community programs run by non-profit providers.
  - It costs the state $52.9 million annually to operate CJTS.
  - This equates to an annual cost of $545,671 per resident in FY 2015.
  - These children are not getting the therapeutic treatment they need at CJTS. One can argue that many of these children leave the program worse off than when they entered.
  - Various non-profit and advocacy organizations feel that these children can be better served in the community.
  - The population of CJTS would be grouped based on type of offense and would be either placed in a secure residential facility, residential group home, or at home with intensive community supports.

Long-Term Initiatives

- **Enact bill 1088 of the 2015 legislative session which implemented a long-term plan to provide efficiencies with the provision of services to individuals with intellectual disabilities**.
  - The non-partisan Program Review and Investigations Committee found that not only do non-profits provide care to our developmentally disabled community for lower costs, they also provide better care. Therefore, care at all state funded facilities should be closely reviewed.

- **Designate the Investment Advisory Council** as the entity that establishes the assumed rate of return for the state's pension plans in lieu of the current structure which allows the retirement commissions to set their own rates. This modification will take at least some of the politics out of the process and will allow the state to fund its retirement systems responsibly.

Long-Term Initiatives – Labor

Long-Term Initiatives – Labor

- The Office of Fiscal Analysis has found that not all of the labor savings the state was promised in the FY 2012/2013 budget were achieved. As a result, taxpayers were shorted at least $250 million in the "shared sacrifice" negotiations.

- Republicans previously proposed to seek out these owed savings from labor in our Blueprint for Prosperity plan released in April of this year.

- **Today we are not looking at that number**. Instead, we are proposing to make basic modifications to highly lucrative benefits for state employees, while also protecting individual employees from potentially more harmful changes. The following slides detail the options we are proposing.

Long-Term Initiatives – Labor

Modifications to State Employee Pension & Health Benefits

Long-Term Initiatives – Labor

- **Increase Current Employee Pension Contributions**
  - Currently, hazardous duty employees in Tiers II and IIA contribute 4% and 5%, respectively, towards the State Employees Retirement System (SERS) Plan, while other non-hazardous Tier II employees contribute **nothing** and Tier IIA employees contribute **2%**.
  - In other New England states employees contribute an average of **7%**.
  - This proposal recommends making all non-hazardous state employees regardless of what tier they are in to pay **4%** of their salary towards their pension benefit.
  - OFA estimates that this requirement would increase employee contributions to the SERS fund by $74.8 million in FY 2017.

Actuaries would need to determine the reduction to the ARC as a result of this increased revenue source.

Long-Term Initiatives – Labor

- **Cap Cost of Living Adjustments**
  - For future retirees set COLAs with a minimum of 0% up to a maximum of 3%
- **Calculate Final Average Salary Using Base Pay Only**
  - The Office of Fiscal Analysis estimates that had pension payments been excluded from the Final Average Salary calculation for those that retired in FY 2015, pension benefits would have been reduced by $7.3 million (this number reflects only overtime, it does not include vacation pay).

Actuaries would need to determine the reduction to the ARC as a result of this increased revenue source.

Long-Term Initiatives – Labor

- **Transition Part-Time, Temporary, and Seasonal Workers to the FICA Alternate Retirement Program**
  - Savings: $2.25 million in Fiscal Year 2016, $9 million in Fiscal Year 2017

- **Suspend Longevity Payments in April 2016 and thereafter**
  - Savings: $9.9 million in Fiscal Year 2016, $19.8 million in Fiscal Year 2017.

- **Transition New State Employees to a Defined Contribution/Defined Benefit Plan Similar to Rhode Island**

(Estimated Savings Would Need to Be Generated by the Actuaries)

- **Increase State Employee Health Premiums**
  - This proposal would increase the health premiums that active state employee's pay by 10% to approximately 15%.
  - Savings: $1.4 million in Fiscal Year 2016, $5.7 million in Fiscal Year 2017

Source of Estimated Savings: Office of Fiscal Analysis

Long-Term Initiatives – Labor

- **Increase State Employee Dental Cleanings by 10%**
  - Savings: $89,000 in Fiscal Year 2016, $357,000 in Fiscal Year 2017

- **Increase Current Prescription Drug Co-Pays for State Employees**
  - Increase copays from $5, $20, $35 → $10, $30, $40 for non maintenance acute prescriptions.
  - No changes to copayments to treat chronic conditions or diabetes.
  - Savings: $2.8 million in Fiscal Year 2016, $11.2 million in Fiscal Year 2017

- **Only Provide COLAs for State Employees in FY 2017**
  - Under this recommendation, state employees would only receive a COLA increase in FY 2017 and would not receive merit increases, step increases or annual increments.
  - Savings: $34.8 million in Fiscal Year 2017.

Source of Estimated Savings: Office of Fiscal Analysis

Example of Impact to Average Employee

- If a Tier II annual increase in pension contributions was implemented, that would result in the average state employee saving $900 more per year for retirement, increasing contributions by **$2.47 per day**.

- If health premiums were increased as proposed, that same employee would see a $1,896 annual increase for family coverage, an increase equivalent to **$5.19 per day**.

- In total, the average employee would contribute an additional **$7.66 per day** to cover the costs of their health benefits and pension – **in return for a reliable pension system and the peace of mind that their long-term benefits will actually be secure.**

Long-Term Initiatives – Labor

Minimum Total Potential Savings from Modifications to State Employee Health & Pension Benefits

FY 2016: $16.5 million

FY 2017: $80.8 million

(These numbers do not yet include savings from proposals that would need to be estimated by actuaries.)

Long-Term Initiatives – Labor

Modifications to Labor Contracts

The state needs the ability to manage its employees

- Current individual labor contracts have provisions that tie managers hands and prevent them from taking action to prevent unnecessary overtime costs.

- Strict procedures need to be advanced in all departments regarding overtime.

- We need to give the state the ability to manage its employees just like in the private sector, especially concerning overtime, which the state spends over $220 million on annually.

The state needs the ability to manage its employees

- We are proposing to remove 20+ restrictive provisions:
  - For example, state employees are often paid for overtime hours they never worked because of required overtime minimums. Some contracts state that employees who are called back after completing their scheduled work shift must be paid for at least four hours of overtime pay (e.g., a worker who works one extra hour is paid for four hours of overtime). **We are proposing reducing the 4 hour overtime stipulations to 2 hours.**
  - Another example, in the Department of Corrections there is a minimum staffing requirement that requires full staffing regardless of the number of inmates in prison at a single point in time. **We are proposing to modify mandatory staffing requirements.**

The state needs the ability to manage its employees

- A full list of over 20 proposed changes can be found in the attached document.
- These changes will significantly help control costs without hurting state employees:
  - None of these changes result in layoffs
  - None of these changes include a hard hiring freeze
  - None of these changes include salary reduction

These proposals will give the state the tools it needs to reasonably manage employees and overtime.

The state needs the ability to manage its employees

- We are also proposing to institute **mandatory approval of labor contracts** by the General Assembly.

Items NOT included in this proposal

Please note that the Republican deficit mitigation proposal purposefully does **not** include many savings options that were previously discussed. Our goal was to create a budget proposal that truly appeals to all parties at the negotiation table and does not overly burden any one group. **Specifically, our proposal does <u>NOT</u> include:**

- Eliminating COLAs for retirees or setting a low rate like 1% annually
- A hard wage freeze
- Eliminating premium assistance the state gives to retirees for Medicare Part B
- State employee furloughs
- Removing meal allowances from union contracts
- Providing President's Day off as opposed to both Lincoln's birthday and Washington's birthday
- Eliminating ECS Earmarks (W. Hartford, W. Haven, New Haven and Norwalk) which would have saved $2.9 million.
- Immediately eliminating remaining funds for specific earmarks.

Next Steps…

- We are open to discussing in more detail any other proposals put forward by Democrat leaders including the governor's proposals.
- However, any financing changes to the state pension system need to come with an understanding that pension benefits are extraordinarily high in our state and need resizing.

We need to not only fix the immediate problems before us, we have to put Connecticut on a better path for our future.

Next Steps…

Questions?