How Did Rich Connecticut Morph Into One Of America's Worst Performing Economies?

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Connecticut has so many advantages that it might be hard to understand how it became one of America's worst-performing state economies.

As we know, Connecticut is located along an important commercial corridor between New York and Boston. It's well-served by railroads and highways. Major airports are accessible. Connecticut has many charming towns, historic sights, stylish shops and nice beaches. CNN determined that of America's 25 towns with the highest median family incomes, four are in Connecticut – New Canaan (#1), Darien (#2), Westport (#5) and Greenwich (#14). The most expensive American home ever offered for sale is Copper Beech Farm which, with an asking price of $190 million, has 50 acres of waterfront property in Greenwich.

Although Connecticut lacks a major high tech region, there's a concentration of executive talent capable of managing large organizations. Many are in financial services.

Despite these attractions, during the past two decades some 300,000 more Connecticut residents have moved out of the state than have moved in. This compares with the current population of about 3.5 million.

Why the exodus?

Dismal performance

Perhaps with the complacency of old money, Connecticut policymakers came to believe they didn't need to compete for investors and entrepreneurs – the key people who make prosperity happen. Keep in mind that government basically doesn't have any money other than what it extracts from the private sector via taxation.

As a columnist for the *Hartford Courant* remarked, "businesses here have become vulnerable to appeals from places [like Florida and Texas] that Connecticut leaders once thought they could safely hold in low regard."

When investors and entrepreneurs consider important decisions like where to establish a residence, where to operate a business and, yes, where to die, they compare their options. From a financial point of view, Connecticut turns out not to be a great option. For instance:

- Connecticut ranks #50 – the worst — in annual economic growth. According to the Department of Commerce's Bureau of Economic Analysis, Connecticut's economy contracted for the second year in a row. "Connecticut is the laggard," reported Connecticut Department of Labor economist Daniel Kennedy.
- Between 1996 and 2006 – *before* the financial meltdown and recession — the number of Connecticut small businesses declined by 2.2 percent, while the average experience of all 50 states was a 10 percent increase. Only Ohio and West Virginia did worse than Connecticut. Its small businesses account for about half of the state's private sector jobs.
- Government spending is out of control. Two years ago, Connecticut Governor Dannell P. Malloy signed a $1.8 billion tax hike, the biggest in the state's history, that supposedly would generate enough. But it wasn't enough for the next budget, enacted this year. It was balanced mainly with gimmicks like shifting some $6 billion of Medicaid spending off-budget.
- State Budget Solutions, a think tank monitoring state finances, reported that among the 50 states Connecticut has run up the fourth largest pile of debts per capita — $27,540. This includes unfunded liabilities for government employee pension funds. The total is almost double the per capita debts of financially-strapped California. Higher debts imply higher taxes in the future.
- *Barron's* considered Connecticut to be in the worst financial shape – with debt and pension liabilities a higher percentage of GDP (17.1) than any other state. The financially strongest state: South Dakota where debt and pension liabilities are only 1 percent of GDP.
- Connecticut has one of the worst business climates in the country. Factors affecting a state's business climate include the individual income tax, corporate income tax, sales tax, property tax, unemployment insurance tax and security of private property. For example, as the Tax Foundation reported, "Connecticut imposed a temporary 20 percent surtax on top of its flat 7.5 percent corporate income tax, in effect raising its rate to 9 percent. This 20 percent surcharge is an increase on a supposedly temporary 10 percent surcharge that has been in place since 2009."
- The American Legislative Council, in its annual *Rich States, Poor States* study, ranks states two ways – economic performance and economic outlook. The economic performance ranking is based on a state's GDP trend, migration trend (in or out) and non-farm payroll enrollment trend. The economic outlook ranking is based on 15 factors including the top marginal personal income tax rate, the top marginal corporate income tax rate, property tax burden, estate tax burden, public employees per 100,000 population, state liability system survey and whether a state has a right-to-work law. Connecticut is ranked #46 for economic performance and #43 for economic outlook.
- The Connecticut Business & Industry Association reported that "70 percent of executives believe the value they receive for their tax dollars is extremely low considering the amount they pay in taxes."
- The Cato Institute gives Connecticut Governor Dannel P. Malloy an F grade for his economic policies that throttle investors and entrepreneurs. Malloy "creates a more hostile climate for business, but then tries to compensate for the damage with tax incentives."
- Connecticut's probate court system seems to have gained a reputation for loading unnecessary costs on estates and sometimes arbitrarily nullifying wills, a practice that's hard to distinguish from looting. Yale Law School professor John H. Langbein declared that "Connecticut probate is a national scandal."

How did Connecticut end up in this mess?

Some perspective: early success, great potential

Like other states, Connecticut started out with agriculture, then expanded with trade and boomed with manufacturing – ships, railroads, saddles, sewing machines, carriages, brass fittings, corsets, guns, on and on. Such enterprise displayed a lot of Yankee ingenuity.

Fast-growing industries attracted thousands and thousands of immigrants as well as native-born people looking for jobs. Connecticut's population grew mightily.

During the 1920s, however, Connecticut began to feel competitive pressures as 14 of its 47 textile mills moved to less costly locations in the South.

Democrats gained control of Connecticut during the Great Depression, but neither they nor their "progressive" comrades at the federal level were able to banish depression era high unemployment. It persisted throughout FDR's New Deal, in part because the New Deal tripled taxes, which meant employers had less money for hiring and consumers had less money for spending. Depression era unemployment didn't come down until the government began conscripting millions of young men for military service during World War II.

American factories switched from the production of civilian goods to the production of war materials. Living standards, though, weren't much different than they had been during the depression, since civilian goods were unavailable, and food consumption was limited by rationing.

After the war, many military contracts ended, but the Cold War began almost immediately, and Connecticut's politically-connected Democratic representatives helped win new military contracts for Pratt & Whitney (airplane engines), Hamilton Standard (propellers), Cheney (parachutes), Electric Boat (submarines), Sikorsky (helicopters) and other government contractors.

When the civilian economy revived after the war, often it involved technologies that developed in unexpected places that weren't on Connecticut's radar. For example, during the 1940s Stanford University's dean of engineering Frederick Terman encouraged students and graduates to establish new businesses. That was the humble beginning of Silicon Valley.

More business burdens, less business hiring

During the last century, Connecticut's state government became bigger, raising taxes and in other ways making it more costly to do business. Connecticut certainly wasn't the only state to have adopted such policies, but many states avoided them and prospered.

Connecticut economic regulations multiplied, further increasing the cost of doing business. Steven P. Lanza, reporting in *The Connecticut Economy*, published quarterly by the University of Connecticut, found that "excessive regulation plays a role in hamstringing business owners and entrepreneurs who simply don't have the resources of larger firms to cope with these constraints."

Former U.S. Senator and Democratic presidential candidate George McGovern learned all this the hard way. In 1988, he bought, renovated and operated a 150-room hotel and conference center in Stratford, Connecticut. The business went bankrupt two years later. McGovern reflected on his experience in the *Wall Street Journal*: "My business associates and I lived with federal, state and local rules that were all passed with the objective of helping employees, protecting the environment, raising tax dollars for schools, protecting our customers from fire hazards, etc. While I never have doubted the worthiness of these goals, the concept that most often eludes legislators is: 'Can we make consumers pay the higher prices for increased operating costs that accompany public regulation and government reporting requirements with reams of red tape.' It is a simple concern that is nonetheless often ignored by legislators."

In addition, state land use restrictions have limited the number of suitable business locations and often made it harder to establish a business. "Land use litigation pervades the dockets of state and federal courts," noted Cardozo School of Law professor Stewart E. Sterk. "What is remarkable is that so many [land use] controversies – major and minor – are litigated to final judgment, and often reach appellate courts. Whereas the overwhelming majority of cases filed end with settlement rather than judgment, land use cases tend not to settle. Broad standing rules often permit neighbors, community groups and other governmental entities to challenge any settlement. Zoning law also provides a variety of grounds, both procedural and substantive, on which to attack any settlement."

Significant numbers of low-income blacks and Hispanics moved into Connecticut's major cities. In the name of "urban renewal," local governments used their power of eminent domain to seize private property, promote the demolition of low-income housing and the construction of new housing, but it was a while before anybody noticed that (1) more housing units were being demolished than built, and (2) the housing built was more expensive – not intended for the displaced poor people who were forced to bid against other poor people for a reduced supply of low-income housing. That's why urban renewal became known as "Negro removal" and made urban problems worse.

One of government's most basic responsibilities is keeping people safe, yet Connecticut's urban crime rates worsened during the 1960s and 1970s. This increased the cost of doing business in affected areas. At the same time, many customers fled to suburbs for greater personal safety and more affordable living space.

Fortunately for Connecticut, things were even worse for its tri-state rivals New York and New Jersey. Moreover, Connecticut had an important advantage – no income tax. Connecticut's less unfavorable business climate for investors and entrepreneurs helped spur a corporate exodus to Connecticut. Among those moving headquarters to the nutmeg state were American Brands, General Electric and Union Carbide.

But these moves mainly benefited Connecticut cities closest to New York, like Fairfield, Greenwich and Stamford.

Other Connecticut cities declined amidst high taxes, high crime rates and "progressive" policies that made it harder for entrepreneurs to start businesses and hire people. For example:

- Bridgeport, Connecticut's largest city, is estimated to have about 146,000 (2012) – fewer than it had in 1930 (146,716).
- New Haven, Connecticut's second largest city, is estimated to have about 131,000 people (2012) – fewer than in 1910 (133,000).
- Hartford, Connecticut's third largest city, is estimated to have about 125,000 people (2012) – fewer than in 1920 (138,036).

Waterbury, Connecticut's fifth largest city (Stamford is #4), appears to be the exception, an old Connecticut manufacturing center whose population is actually near a peak – approximately 110,000 in 2012 vs the peak of 110,366 recorded in 2010. This is mainly because of government and hospital jobs. But few people seem to give Waterbury high marks for the quality of life there.

For instance, in 1992 *Money Magazine* surveyed 300 U.S. metropolitan areas and considered Waterbury to be the worst.

Waterbury made the *Places Rated Almanac* list of the "10 Worst Places to Live in America."

In April 2008, *Forbes* considered Waterbury one of the "Worst Places for Businesses and Careers in America."

In 2013, *Atlantic Magazine* analyzed 10 million tweets by place of origin and concluded that Waterbury was one of the saddest American cities.

Many politicians like to blame Connecticut's decline on things beyond their control like factory closings, but there's nothing new about losing employers. Change has been the natural order of things since the beginning of time. Employers go away because better technologies come along, old businesses weren't managed as effectively as new competitors, businesses have been acquired or merged with operations located elsewhere, labor unions priced themselves out of world markets, consumer preferences changed, other jurisdictions offered better business climates – on and on.

What Connecticut politicians failed to do was focus on making their jurisdictions as attractive as possible to investors and entrepreneurs, so there would be a continuing influx of new jobs. Among other things, this means reducing the cost of doing business for everyone, large and small – prospective newcomers as well as investors and entrepreneurs already in the state.

Instead of doing that, Connecticut politicians have gone on spending sprees in an effort to enhance their re-election prospects. The spending sprees necessitated higher taxes that increased the cost of doing business and helped drive away potential investors and entrepreneurs.

Of course, politicians can be counted on to say that they must spend ever larger amounts of money because of all the poor people who need help. But more than anything else, poor people need a real private sector job – a means of sustaining their financial independence and helping to produce goods or services other people are willing to pay for. The more costly it is to do business, the fewer jobs there will be, and the more people will stay poor.

Often government is costly because of corruption. Among the Connecticut officials who became felons: Bridgeport Mayor Joseph P. Ganim (bribery), Danbury Mayor James E. Dyer (tax evasion), Hartford Mayor Eddie Perez (bribery), Waterbury Mayor Philip Giordano (sex offenses) and Connecticut State Senator Ernie Newton (fraud).

"For the record," the *New York Times* declared, "not everyone in Connecticut is a crook. But this is no longer obvious."

Politicians have made Connecticut's state and local governments more costly by promoting unionized construction companies for public projects. Governor Malloy has backed "project labor agreements" to help do that. The Hartford Board of Education has required that bidders agree to "perform all project work with union labor." A 2007 study by economists Paul Bachman and Jonathan Haughton showed that project labor agreements increased public school construction costs between 9 percent and 15 percent. Remember that the next time you pay a property tax bill.

One of the most important ways Connecticut politicians have accelerated spending and taxes was to expand the number of unionized government employees. According to a Yankee Institute study, between 1970 and 2000 Connecticut's state payrolls grew 6 times faster than the overall population. Connecticut's municipal payrolls were reported to have grown 4 times faster.

Throwing away an important competitive advantage

Connecticut's downhill slide seems to have speeded up after 1990. That year, former Connecticut Senator Lowell P. Weicker Jr. campaigned for the governorship by vowing to resolve the state's financial problems without introducing an income tax. After he was elected, he revealed his true colors and signed an income tax into law. Perhaps some Ivy League arrogance (Weicker went to Yale) impaired his ability to understand how incentives like lower taxes stimulate enterprising spirits.

The income tax failed to achieve the wonders Weicker claimed. By siphoning more money out of the private sector, the Connecticut income tax reduced the amount of money available for private sector hiring and reduced the amount of money available for consumer spending. The Federal Deposit Insurance Corporation reported, "no other state in the country has had such stagnation of employment."

Ironically, while Connecticut's income tax generated more revenue than the state had before, it undermined efforts to control spending. The last Connecticut annual budget before the income tax was about $7.5 billion, and state spending since then has nearly tripled – not counting all of the state's spending on Medicaid. Connecticut's runaway spending spree has meant more deficits and debt.

Income tax revenue hasn't resulted in property tax relief. Connecticut property taxes went up.

Nor has there been gasoline tax relief. Connecticut has the highest gasoline taxes in New England (45 cents per gallon), compared with Rhode Island's 33 cents per gallon, Maine's 31.5 cents, Vermont's 26.7 cents, Massachusetts' 23.5 cents and New Hampshire's 19.6 cents.

Introducing an income tax made Weicker unpopular, and he served only one term. His successor, Republican John G. Rowland, vowed he would get rid of the income tax, but somehow he never got around to doing that. He campaigned for a second term, promising to do what he had promised the first time around. His second term came and went, and in December 2003, during Roland's third term, he admitted receiving improper favors from a lobbyist, and he subsequently served time in the slammer.

Meanwhile, Connecticut income taxes continue to go up, and Connecticut taxes generally are multiplying. According to the Yankee Institute, 2011 was a banner year when Democrats – who now control both the governor's mansion and the legislature – pushed through 77 tax hikes. For instance:

- The personal income tax rate went up for individuals making as little as $50,000
- The highest marginal income tax rate went up from 6.5 percent to 6.7 percent.
- The corporate tax rate went from 8.25 percent to 9 percent.
- Higher taxes were retroactive to January 1, 2011.
- Property tax credits were reduced to $300 (and to nothing for individuals making over $100,000).
- Estate taxes started kicking in at $2 million instead of $3.5 million.
- The real estate conveyance tax went up from 0.5 percent to 0.75 percent on the first $800,000 of the sale price of one's home.
- Luxury goods tax – 7 percent on clothing costing over $1,000, jewelry over $5,000, motor vehicles over $50,000 and boats over $100,000.
- There's a new tax of .25 of one cent per kilowatt hour of electricity from the most reliable sources (like nuclear power, natural gas and coal) – not applicable to subsidized solar or wind power.
- Sales taxes went up to 6.35 percent.
- Sales tax exemptions were eliminated for non-prescription medicines, yoga instruction, airport valet parking, stop-smoking products and shoes costing less than $50.
- The Amazon.com tax – sellers without a physical presence in Connecticut must collect sales taxes on orders originating in Connecticut.
- Hotel taxes went from 12 percent to 15 percent.
- The rent-a-car tax went from 6.35 percent to 9.35 percent.
- The hospital tax – 4.6 percent quarterly on net hospital revenue from patients.
- Nursing home resident user fee – up from 5.5 percent to 6 percent.
- Cremation taxes, up from $100 to $150.

The Exodus Now

Connecticut's tax base is eroding as more and more people conclude there's a better future someplace else.

For decades, Hartford has been known as a major center of the U.S. insurance business and a bulwark of Connecticut's economy. But many insurance jobs have moved out of Hartford to the suburbs, other insurance jobs have left Connecticut, and some unexpected rivals have emerged as industry leaders.

For example, *Business Wire* called Des Moines, Iowa "the number one spot for U.S. insurance companies." Among the insurance companies headquartered in Des Moines: Aviva, EMC Insurance Companies, Nationwide Mutual Insurance Company, Principal Financial Group and Wellmark Blue Cross Blue Shield. Other insurance companies with a presence in the area include Centurion, Guardian Life, Hartford Life Insurance, MetLife, New York Life, Prudential, Sun Life and TIAA-CREF. In 2010, *Forbes* rated Des Moines as "Best Place for Business."

A terrible tragedy, the December 2012 massacre of 20 children and 6 adults in Sandy Hook, Connecticut, led to the adoption of tougher state gun control laws, even though it isn't clear how those laws would prevent deranged people from killing.

What the laws have done is spur the exodus of companies that account for about one-seventh of U.S. firearms production – a Connecticut industry going back more than a century. The

National Shooting Sports Foundation estimated that Connecticut gun manufacturers provide some 2,900 jobs and generate $1.7 billion within the state. Perhaps the best-known Connecticut gun producer is Colt Manufacturing whose armory, capped with a distinctive blue onion dome, has been a landmark on Hartford's southern skyline since 1867.

The first gun manufacturer to announce plans for moving out was PTR Industries, a Bristol-based manufacturer of military-style rifles. It's going to South Carolina. Stag Arms, in New Britain, Connecticut, is also planning to move out. Sturm Ruger & Company is inclined to retain their headquarters in Connecticut, while expanding production elsewhere. It seems likely other gun manufacturers will leave the state.

The biggest exodus – and the most financially calamitous consequence of Connecticut's personal income and corporate taxes — could involve hedge fund managers. There are reported to be some 200 hedge funds in Connecticut.

For example, Edward Lampert, Chairman of Sears Holding Corporation and the CEO of ESO Investments (a $10 billion hedge fund), used to do business in Greenwich. But after Connecticut's most recent tax hike, he decided that he had enough. Lampert, believed to be worth about $3 billion, moved to Miami.

Thalius Hechsher, who heads global development for Apex Fund, also moved his business to Florida. He said, "There's no need to drag people down here. It's a zero-income-tax jurisdiction."

Since Connecticut no longer has a big tax advantage over New York, and Manhattan real estate prices are much lower than they were before the financial meltdown, many investment managers find it attractive to rent a high-end office in Manhattan. It still has the greatest concentration of hedge fund managers.

For a while back in 2010, there was talk that New York might enact a hedge fund tax. Jodi Rell, Connecticut's governor at the time, was quick to host a Darien reception to show investment managers that they were welcome in Connecticut.

But her successor Malloy threatened a hedge fund tax. He was reportedly shocked when UBS began transferring some of its people back to Manhattan, and other investment managers started to talk about relocating. Malloy was a bit slow to recognize that the bloom was off the rose.

In the dimness of his perception about what it takes to achieve real economic growth – namely, making the business climate attractive for all comers, including the multitude of small businesses without political connections – Malloy has doled out oodles of corporate welfare. Thusfar, his sweetest deal has been a $25 million, "forgivable" 10-year loan at 1 percent interest for Bridgewater Associates, reported to be the largest hedge fund, PLUS — Bridgewater is to get $90 million for job training, alternative energy and assorted tax credits. The idea is to help Bridgewater move from one wealthy town (Westport) to new digs in another wealthy town (Stamford).

It will be interesting to see how this deal looks in a few years.

Meanwhile, Malloy is digging himself deeper into the business of picking winners, the business where President Obama embarrassed himself by backing a succession of green energy losers that finagled government-subsidized loans before going bankrupt.

Malloy, for instance, got the idea that Maine-based Jackson Labs might help launch a Connecticut high tech boom. Listen to this: the state, already loaded with excessive debt, will borrow $291 million more, pay the $120 million of interest costs, then pick up all the construction costs to establish a new lab facility in Farmington and finally subsidize the lab's operations for the first 10 years. Only after that is Jackson Labs projected to provide funding. Jackson Labs itself is dependent on public funding, so the whole deal might appear to be a house of cards. Yankee Institute researcher Zachary Janowski reported that Connecticut funding amounts to a $42,327 state subsidy per job per year.

Don't die in Connecticut!

There's another factor that leads people to think seriously about leaving Connecticut: its probate court system. Yale Law School professor John H. Langbein said that "When citizens of our state ask me about Connecticut probate, I give this simple advice: Try not to die in Connecticut. If you are a person of means, you should establish your domicile in some place such as Florida or Maine or Arizona that has a responsible probate system." See Langbein's testimony before the Connecticut Legislature Committee on Program Review & Investigation, October 7, 2005.

Connecticut probate judges work part-time in one town and practice law in other towns. Langbein cited the case of Essex, Connecticut, with a population around 6,700. "I was told that the part-time probate judge took down about $58,000 in compensation plus full health insurance."

Worse than that: Probate judge A is reluctant to reject motions enriching lawyer B who comes before him, because lawyer B serves as probate judge B in another town where probate judge A works as lawyer A and makes motions to enrich himself.

Moreover, Connecticut's probate system enables judges to collect fees for essentially looting estates. According to Langbein, "Filing fees and subsequent charges are far higher than elsewhere. Probate courts have extended their fees to nonprobate transfers such as life insurance and joint tenancy, for which, by definition, no probate services are needed."

That's not all. Connecticut has something called the Duplicate Trial Rule that, as Langbein points out, "allows a litigant who is determined to have a contested probate matter heard by a professional judge to do so, but only after making that person pay for two full trials."

Langbein warned about the arbitrary power of probate judges to dictate "who owns the property of a decedent, and they can decide whether to strip a citizen of his or her liberty by declaring the citizen incompetent. It is far from clear that Connecticut probate could withstand constitutional scrutiny under the Due Process clause of the U.S. Constitution. When liberty and property are at stake, the state has an obligation to operate under procedures commensurate with the seriousness of the affected interests."

The most tempting targets are said to be widows and orphans. For instance, the*Hartford Courant* reported a case involving Josephine Smoron, the last of a family of Polish farmers whose 80-acre property is in Southington. She willed it to Sam Manzo, her long-time caretaker. The property was estimated to be worth about $1.5 million.

According to the *Courant*, when Smoron's health worsened, probate judge Brian Meccariello appointed local lawyer John Nugent as conservator supposedly to protect her interests. Nugent, who never met Smoron ("I don't speak dementia," he was quoted as saying), reportedly made a deal to help a Southington developer gain control of the property. The developer was identified by the *Courant* as Carl Verderame. In May 2009, Meccariello arbitrarily changed Smoron's will, disinheriting Manzo and setting up a legal maneuver that would transfer the property to Verderame. Manzo persisted with efforts to uphold Smoron's original will, and the case went to Superior Court in Hartford. The *Courant* described the judge as struggling to resolve a "circular firing squad of competing interests."

Connecticut probate corruption has been going on for a long time, because judges and lawyers aggressively resist attempted reforms. More than 60 years ago, New York University law professor Thomas Atkinson reported that "Connecticut is just about at the bottom of the list so far as its probate court system is concerned."

This issue, though little talked about outside the world of trusts and estates, could spur an acceleration of the exodus from Connecticut as affluent baby boomers retire where they're less likely to be looted.

TopRetirements.com rated states according to their desirability for retirement. They ranked Connecticut as the worst.

The most fundamental lesson here is simply that investors, entrepreneurs and other productive people want to go where they're welcome. They want to leave when they feel exploited.

Wealthy Connecticut's experience offers us some reminders about why mighty civilizations rise and fall.