CHAPTER ONE

The Challenge of Economic Growth

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The Connecticut economy faces many challenges as it and its citizens move deeper into the twenty-first century. Greatly influenced by the New York City economy, Connecticut was very much affected by the tragic events of September 11, 2001. In earlier years, Connecticut suffered through the pains of several New York City financial crises, but it also benefitted greatly from the stock market boom of the 1990s and other periods when New York City-centered financial-services industries were riding high. However, Connecticut, while strongly influenced by developments in its neighbor to the south, has an economic life of its own. This life is composed of a strong, indigenous financial center, a still viable manufacturing base, a well-established defense business, an excellent educational system, and a thriving tourist and entertainment industry. Connecticut's economic fate will be as dependent on developments in these and other home-grown areas as it will be by the fortunes of New York City and the national economy.

The Connecticut Economy at a Glance

For its size, Connecticut's economy is quite diverse. Ranked thirty-ninth nationwide in population size, the state depends on many different kinds of industries for employment, income generation, and tax receipts. Even today, after many years of decline, manufacturing still accounts for 11.8% of nonagricultural jobs. Table 1 provides a breakdown of Connecticut's employment by sector as defined by the U.S. Bureau of Labor Statistics. The data in the table mirror earlier data and shows that since the overall economy officially hit bottom in 2001, the employment situation in Connecticut continues to be very difficult, with employment gains in the construction and the leisure and hospitality industries just offsetting employment declines in manufacturing and business services in 2003.

Table 1
Connecticut Nonfarm Employment May 2004
Seasonally Adjusted, in Thousands

	Number	Percent	Annual % Change
Total State	1,653.6	100.0	0.0
Construction	64.1	3.9	1.9
Manufacturing	194.7	11.8	-3.0
Trade, Transportation, Utilities	305.7	18.5	0.5
Information	39.3	2.4	-0.8
Financial Services	142.8	8.6	-0.5
Professional and Business Services	194.9	11.8	-1.2
Education, Health	266.8	16.1	0.9
Government	249.2	15.1	-0.9
Leisure, Hospitality	133.1	8.0	4.0
Other Services	63.0	3.8	1.1

Sources: Connecticut Department of Labor, Office of Research; U.S. Department of Labor, Bureau of Labor Statistics

Strategically located between two major financial centers—Boston and New York—and housing a strong financial sector in its own right, Connecticut's citizens have enjoyed one of the highest standards of living in the U.S. over the years. In 2003, with a per capita income of $43,173, Connecticut ranked first in the nation among the fifty states, a position it has held for at least fifteen consecutive years.[1] Employment rates have also consistently held above the national average, while the state's 4.6% unemployment rate in mid-2004 was one full percentage point below the U.S. average. The state also boasts a strong and growing tourist industry—recently stimulated by the founding of Indian casinos—some of the best higher educational facilities in the nation, a world-class health care system, and an outward looking and innovative, albeit challenged, industrial base. In national surveys of the best places to live, Connecticut contributes its fair share of preferred towns and communities.

Surmounting Challenges Through the Years

Manufacturing has always been a mainstay of the Connecticut economy. Small-scale industries were established well before the American Revolution to supply the needs of the early colonists. The ability to meet these ever-changing needs stimulated an inventive class of business people, and with the effective use of water power, Connecticut manufacturing provided the principal means by which the state's citizens fostered and enjoyed a steadily rising standard of living. In 2002, the state's labor force averaged 1,773,000 workers, of which 195,000 were classified as manufacturing workers. The historical importance of manufacturing to the state's economy also shows up in union participation. In 2002, 17% of Connecticut's labor force belonged to an official union. Nationally, only about 13% of the total U.S. work force in 2002 was unionized and only ten states had higher unionization rates than Connecticut.[2] Declines in both manufacturing and unionism in Connecticut over the years reflects the rapid growth in service jobs, a steady flow of manufacturing jobs emigrating abroad, the growing importance of women and teenagers in the work force, a strong anti-union movement within the state, and a dramatic rise in manufactured imports.

Despite the declining trend in employment, manufacturing continues to make a major contribution to the viability of the state's overall economy. Connecticut's manufacturing portfolio is composed of such diverse products as industrial machinery, office machines, turbines and engines, transportation equipment, and defense products, including helicopters and submarines. The state also has a viable chemical industry, including pharmaceuticals, as well as thriving businesses in the manufacture of medical equipment, lenses and measuring equipment.

Connecticut still has a presence in the agricultural industry, although fewer than 2% of the state's workers actively make a living in this sector. Similarly, the state's small fisheries industry is a faint shadow of what it was in the nineteenth century. However, the state has taken aggressive action in recent years to protect the fisheries industry by implementing programs aimed at improving water quality and habitats. In addition, Connecticut was an early innovator in the private leasing of oyster and hard-shell clam beds. These activities and others have helped the fisheries industry to stabilize in recent years. They are also *important to the future of the state's tourism industry and to the* recreational activities of citizens.

Offsetting to a significant degree the decline in manufacturing employment, the state's service industries have increased their share of employment from 27% of total employment in 1991 to 38% by mid-2004. While some of this growth has been in low-paying jobs in the food-service industry and other occupations requiring low-skill levels, the principal areas of employment strength have been in the high-paying professions of business services, education, engineering, health care, and management services. Connecticut has also participated in the technology boom of recent years, ranking fifth nationally in the percentage of workers involved in all aspects of hi-tech, including software development.

Of all the service sectors, Connecticut is perhaps best known for its insurance industry. Dating back to 1810, insurance underwriting today by Connecticut firms covers the full array of insurance needs. However, like all industries in the state, the insurance sector has seen its share of changes over the years. After many decades of steady growth, insurance industry employment fell by 13% during the 1990s.[3] All of the decline was centered in the life insurance component of the industry. Other areas, namely health insurance and casualty insurance, continued to grow, but only to the extent of covering one-half of the positions lost in the life insurance segment. The factors behind these shifts within the industry are not fully understood but, overall, the industry continues to be important to the state's economy, accounting for roughly 7% of the state's Gross Domestic Product.

Where We Stand Now

Not suprisingly, given the diversity of its industry, Connecticut's economy closely follows trends in the national economy. Connecticut was negatively affected by the mild U.S. recession of 2001 and like the national economy, has seen a very disappointing recovery during the past two-and-one-half years, particularly in the creation of new jobs. Like the national economy, the state has failed to gain significant momentum despite large federal tax cuts, rapidly rising defense spending associated with the situation in Iraq and homeland security, and the lowest interest rates in forty years. The impact of the 2001 recession, the outsourcing phenomenon, and subsequent sluggish growth has lead to 58,000 lost jobs since 2000 and a total employed workforce in mid-2004 about level with 1998.[4]

What separates Connecticut's economy from the national picture is its key position in the manufacture of expensive defense items, like helicopters made by Sikorsky and submarines manufactured by the Electric Boat Company. The state's economy is also the beneficiary of a sharp rise in gambling activity at two Indian casino complexes.

Unfortunately, gains in these areas are being threatened by significant problems in other areas. Like many other states, Connecticut's fiscal situation is precarious at best. The large budget deficit in 2002 was covered by eliminating the "rainy day" fund and also by pushing some $220 million of spending into 2003. Tight spending controls and some pickup in tax revenues translated into a budget surplus of $200 million for the fiscal year ending in June, 2004. However, all of the recent surplus is being earmarked for the "rainy day" fund, which had been depleted going into 2004.[5] In other words, these surplus funds are not now available to help rebuild the state's stressed infrastructure or to fund other worthwhile projects. While the current surplus is welcome news, the recent tendency to spend more than is available suggests that future spending initiatives will likely be covered by higher taxes and/or additional cuts in existing state programs.[6]

A more serious problem facing the state relates to the labor force. Currently, Connecticut's unemployment rate is running a full percentage point below the national average. This encouraging statistic reflects the mildness of the 2001 recession but it also reflects a net migration of potential workers to other states, reducing the size of the potential labor force. In other words, Connecticut's below average unemployment rate is more the result of people leaving the state than it is to the creation of new jobs for the unemployed and new entrants into the labor market. An employed or unemployed worker leaving Connecticut is no longer counted in the state's labor statistics. If this trend of outmigration is not reversed, Connecticut's economy will have a difficult time regaining the growth rates of the 1980s and 1990s simply because the workers needed to fuel economic growth will not be available.

Another concern relates to the substantial inequality that exists among Connecticut families. During the decade of the 1980s, the real incomes of all Connecticut families increased, but during the 1990s, the real incomes of the poorest 20% of families fell by nearly 20%. Only twelve other states experienced a similar falloff in the fortunes of its poorest citizens. For all of the fifty states, the real income of the poorest 20% of families increased by 12.3% in the 1990s. The next poorest 20% of Connecticut's families fared little better, with their real incomes falling by 5.8% over the decade of the 1990s. At the other end of the spectrum, the wealthiest 20% of Connecticut's families did exceedingly well in both the 1980s and 1990s. During the 1980s, this group saw real incomes rise by nearly 35% and then by a further 21% in the 1990s.[7]

Clearly, some portion of the growing gap between the rich and the poor during the 1990s can be attributed to the stock market boom during the second half of the decade. Some of these gains undoubtedly were given back in the 2000-02 period. The decline in manufacturing employment also contributed to the growing income disparity in the state. Manufacturing jobs tend to pay more than service jobs. The changing mix in Connecticut hiring trends away from manufacturing towards services has put downward pressure on average pay scales of workers as a whole.

However, an even more important factor may relate to the high educational requirements Connecticut companies are demanding from job candidates. High-skill and high-paying positions are not open to a large percentage of the state's under-educated labor force. This gap between what companies demand in skill levels and what Connecticut workers have to offer may become even more acute in the years ahead if the needed educational opportunities are not offered by the state's learning institutions and/or if new entrants to the state's labor force otherwise fail to acquire the needed skills.

Where Are We Going?

The biggest challenge facing Connecticut's future revolves around its labor force. With the southern and western parts of the United States experiencing rapid growth in recent years, Connecticut suffers from a barely growing population. In the decade of the 1990s, for example, the U.S. population grew by 9% but Connecticut's population expanded by only 4%. These numbers are no surprise; population and job growth in Connecticut and the other New England states have trailed the national averages for the past 30 years.[8] As a consequence, labor-force growth has also been below average—a negative 0.2% per year versus a national average of a positive 1%—and below what employers need in order to sustain growth. Because of the way the numbers are calculated, weak labor force growth has also translated into below-average unemployment rates for Connecticut and other northeastern states. Thus, at times, Connecticut has experienced the atypical combination of a tight labor market and slow employment growth. In other words, Connecticut's relatively low sub-5% unemployment masks a darker side of the state's employment picture: there simply aren't enough workers to go around when companies are trying to expand.

Ironically, Connecticut's workers are among the most productive in the nation, with productivity levels one-third above the national average.[9] Unfortunately, Connecticut companies can't take maximum advantage of these highly skilled workers simply because there aren't enough of them to meet the needs of fast-growing companies. Again, the solution to this endemic problem lies with the educational system. The state needs to lead and support the effort to train and re-train more of Connecticut's citizens in those skills most in demand. Relevant training programs may not halt the long-term decline in manufacturing employment, but training can help keep the overall employment numbers high, along with living standards, by improving the match between what organizations need and what Connecticut workers have to offer.

As mentioned, the long-term decline in traditional manufacturing is projected to continue well into the foreseeable future. This will not necessarily mean that manufacturing jobs will disappear completely from the state, but it does mean that manufacturing jobs are likely to become increasingly technical in nature. Very specifically defined segments of manufacturing have the capacity to grow steadily in the years ahead. These include the aerospace industry, shipbuilding, optics and instrumentation, fuel cell applications, and medical instruments to name an important few. If the needed workers are not available, the risk is that a growing number of Connecticut companies will be forced to migrate to other parts of the nation where workers of all types are in greater supply.

Encouragingly, Connecticut policymakers are now actively nurturing the state's manufacturing sector. Back in 1997, state officials adopted the concept of industry clustering as a way to open a channel for direct support to specific segments of the economy that hold the best promise for growth and jobs. State support to date has ranged from establishing grants for university research in neuroscience and precision manufacturing to providing seed capital to small, technology-oriented companies. Since 1997, six cluster groups have been identified for special attention. These clusters are made up of firms that produce similar products and are located closely to one another. They also tend to be export-oriented and have extensive business dealings with one another. Representing nearly half of the state's output in any given year, the clusters are: Tourism and Entertainment; Health and Biomedical services; Aerospace and Advanced Manufacturing;

Communication, Information, and Education; Business Services; and Financial Services. While some of these clusters are not running at top speed at the moment, it is becoming increasingly clear that the state's economic success will be closely tied to how these clusters perform in the future.[10]

Within clusters, Information Technology (IT) occupations are expected to have the fastest growth over the next ten years, assuming, of course, that an adequate supply of high-trained candidates is available. Today, IT accounts for only about 2% of the state's 1.65 million filled positions, but it is expected that new IT jobs will account for 12% of all new hirings in the years ahead. For all of the technology industries, current employment represents 16% of the state's total number of jobs with new job creation growing faster than the average of all other occupations by 25% or more.

The dominant service-sector component of Connecticut's economy faces a unique set of challenges. The economic health of much of the southwestern part of the state will be very much influenced by employment trends in the financial services industry, especially by the fortunes of companies operating in New York City. Moreover, given the relative wealth of this part of the state, trends in financial markets will also have an inordinate impact on the net-worth positions of many above-average income households, which in turn, will influence their spending and investing activities.

Connecticut's fiscal health will also be key in assessing the state's economic future. Experiencing the same difficulties as many other states, Connecticut's large 2003 budget deficit resulted in substantial cuts in state spending along with sizeable increases in cigarette and business taxes. Not known as a business-friendly state in the past, the bump-up in business taxes could accelerate the migration of Connecticut companies to more tax friendly areas of the country. The budget problem is also being affected by the state's aging population and growing demands on Medicaid and other state welfare programs. The state also has to find ways to fund the rising costs of health insurance for both state employees and the large number of retirees, past and future.[11]

The recent return to a budget surplus is an encouraging development, but spending these funds today will only make it

Despite its many problems and small size, Connecticut is still an integral part of the national economy. Under the assumption that the national economy grows at a 3.0% rate in the years ahead, it is reasonable to expect that the Connecticut economy will add an average 15,000 new jobs each year over the next decade. In addition, the state Department of Labor estimates that 40,000 positions will become available annually as older workers retire and as others leave the state for jobs elsewhere. The forecasts presented in table 2 assume that Connecticut's economy grows at a slightly below average pace of 2.5% per year through 2013, held back to some degree by labor shortages. The state's unemployment rate should rise no higher than the current 4.6% and gradually drift back down towards 3%. This 3% rate reflects the state's continued slow population growth and a renewed tightening in labor markets, particularly in technologically advanced industries, once the effects of the constraining effects of the 2001-03 business cycle fully run their course.

The major caveat to the projections presented in table 2 is that they will only materialize if expanding companies have an adequate supply of trained candidates. There is a risk that new entrants to the labor force in the decade ahead will not possess the skills demanded by hiring enterprises. And because many of these high-growth organizations are small in size, they will not likely have the resources to provide in-house training. If the state's colleges and universities fail to offer this needed training, many of these small companies will likely expand their employment levels in other parts of the country or leave the state altogether.

Conclusion

All trends point to a sluggish Connecticut economy in the years ahead. The state's lackluster jobs market is expected to improve slowly but only in those sectors requiring highly skilled workers. Low skill positions will still be available in the retail and food service industries, but these are not the kinds of jobs that will keep Connecticut competitive in global markets. Nor will they help the state maintain its leading position in terms of per capita income. In order to sustain Connecticut's competitive edge, state government must act as a catalyst in bringing forth the human and capital resources needed to make sure that Connecticut's future labor force can successively acquire the skills demanded by the business sector. Looking beyond 2005, the nurturing of the identified business clusters holds great promise for a renewal in economic vitality. In concert with a competitive tax and regulatory environment, economic policymakers working closely with current and prospective industry clusters have a golden opportunity to allow Connecticut's citizens to continue to enjoy an above-average standard of living. The forecasts presented in this study assume that these challenges will be met, but they will require hard work and good decision making from all interested players.

Notes

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3. Jeff Blodgett, *Focus on Insurance: Rating the Health of Connecticut's Insurance Industry*, Connecticut Resource Center (CERC), December 2001.

4. Barbara Nagy, "State's Huge Job Loss Raises Eyebrows," *Hartford Courant*, August 19, 2003, p. A1.

5. "Governor Rell Announces Surplus Will Exceed $200 Million for Fiscal Year That Just Ended," press release, Office of Governor, July 20, 2004.

6. Kevin Sullivan, State Senator, "The Budget That Would Not Budge," *District Newsletter*, March 2003.

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8. Roger Therrien, et al., *Connecticut Workforce Demands and the Implications for Education*, Connecticut Department of Labor, July 2003.

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10. *Economic Opportunity*, Office of Policy and Management, October 2001.

11. *Connecticut's Challenge: Living With a Leaner Budget*, Connecticut Business and Industry Association, February 2003.