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Testimony for the Combined Hearing of the Appropriations, Finance, Planning & Development, and Commerce Committees Regarding Recommendations by the Commission on Fiscal Stability and Economic Development

Donald E. Williams, Jr.
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March 23, 2018

Good afternoon, legislators. My name is Donald Williams; I am the Executive Director of the Connecticut Education Association.

The Fiscal Stability and Economic Growth Commission was given an enormous task to complete in a few short weeks. Some of their suggestions have merit, but others fall short or point the state in the wrong direction.

I. The Commission's proposal to take away the right of state and municipal employees to have a voice regarding their health insurance and working conditions is wrong, unfair, and will hurt the state.

Substituting the legislature as the decision-maker for these issues will open the process to intense political pressure from the right and the left. More importantly, it will take away the freedom of employees to have a voice in their own health insurance and working conditions. It will deny the people who are most directly affected by the decision their own right to be heard.

> **Recommendation:**
> To achieve real savings at the municipal level, the state should encourage municipalities to join the state health insurance plan, where most cities and towns would save hundreds of thousands and in some cases millions of dollars. If the obstacle is that there are connections to a local brokerage that charges more than the state, that is unacceptable and must change.

II. The Commission's plan for tax reform must be more visionary than increasing the sales tax, eliminating the estate tax, and cutting the income tax in a way that primarily benefits the wealthy.

This will not result in the reform needed to bring the state's revenue system into the 21st century and will hurt the state's economy. The commission's proposal fails to create the stable and reliable revenue stream that is critical to meet the state's responsibility for essential services such as education, transportation, social services, and investments in our communities.

Recommendations:

a) Modernize the sales tax to capture more online sales. Connecticut should adopt legislation similar to the Minnesota Marketplace Sales Tax Law passed last year. This would tax all third-party sales through large online retailers such as Amazon, Etsy, and eBay. The state should also tax digital downloads at the full sales tax rate. Connecticut should also work with other states to secure a decision either through Congress or the courts to tax all online sales in the same manner as retail store sales.

b) Require that the State Department of Revenue Services and the legislature's Office of Fiscal Analysis analyze income tax receipts from 1992 through 2017 similar to the federal analysis referenced in the addendum below. Re-evaluate and modernize the income tax so as to eliminate loopholes that allow the wealthy to shelter and hide their income. If necessary, create a multi-state compact similar to the proposal in (c), below.

c) Join the state compact (New England states plus New York, New Jersey, and Pennsylvania) to close the 'carried interest' tax loophole that allows private-equity fund managers to avoid paying billions in taxes. By closing the carried interest loophole, it has been estimated that Connecticut could recover approximately $500 million in revenue. This year, Governor Andrew Cuomo of New York endorsed the interstate compact idea.

d) Engage in a top-to-bottom evaluation of all tax expenditures and credits, and eliminate those that unnecessarily benefit or enrich a corporate client. The Fiscal Stability Commission has proposed cutting all exemptions by 14%; a more thorough analysis should yield greater savings. These have been sacred cows for too long because powerful private interests were successful in creating and preserving them on behalf of corporate clients.

e) Require transparency in remaining tax credits and expenditures. Ensure that they are clearly identified in each biennial budget, given a price tag, and subject to the same scrutiny and regular renewal, reduction, or elimination as every other line item of spending.

III. Strengthen the Teacher Retirement Fund

The health of Connecticut's Teacher Retirement Fund requires that the state honor its responsibility to keep the fund solvent and to keep the promise it made to teachers.

Teachers have always paid more than their fair share into their retirement. For many decades, going back to the 1950s, however, the state has underfunded its share. As a result, liabilities grew. In 2007, the state bonded $2 billion to shore up the fund, and since then the bond covenants have required that the state contribute its full share, including a percentage toward the unfunded liability, as determined by an independent actuary.

Recommendations:

a) Reamortize and restructure the fund to achieve greater stability and to make the year-to-year contributions by the state more manageable. This was achieved by the legislature and the governor last year for the state employee retirement fund. The Millstein Group's analysis shows that because of that reform, state employee retirement payments by the state will remain stable and manageable for the decades ahead (see page 13 of the Millstein Powerpoint presentation to the Fiscal Stability Commission). Reamortization for teacher retirement may depend, however, upon lowering the unfunded liability of the teacher retirement system.

b) Lower the unfunded liability of Teacher Retirement by following the recommendations of both the Fiscal Stability Commission and the Teachers' Retirement System Viability Commission and placing the Connecticut Lottery into the Teacher Retirement Fund. The lottery is valued at about $5 billion overall and contributes about $300 million to the general fund each year. Teacher Retirement in Connecticut would go from 56-percent funded to over 70-percent funded. Crossing this important threshold would dramatically reduce the state's unfunded liability and would permit the governor and the legislature to reamortize the fund.

c) Consider and reconcile both Governor Malloy's and Treasurer Nappier's concerns. Governor Malloy has correctly noted that future payments into teacher retirement—without restructuring and reamortization—will place increasing burdens upon the state because of the state's unfunded liability. Treasurer Nappier has correctly noted that the requirements that accompanied a $2 billion bonding contribution in 2007 require lowering the state's unfunded liability. Placing the Connecticut Lottery into the Teacher Retirement Fund will dramatically lower the state's unfunded liability and address a major concern for the governor, the treasurer, and the legislature.

d) Do not undermine teacher retirement for new teachers with a lesser 'tier' for retirement. At a time when the number of college students pursuing a career in teaching is declining, I respectfully ask that you avoid creating disincentives to becoming a teacher, and instead enhance what is a great and essential profession for our social and economic future.

The Connecticut Education Association remains determined to ensure that the Teacher Retirement System provides teachers with a reliable, defined benefit pension so that past, current, and future teachers have the retirement security they deserve.

Thank you.

(See Addendum, below)

Addendum to Testimony
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I. Workers' Rights and Collective Bargaining:

Attacking the rights of men and women to earn a decent living undermines the future of Connecticut. The decades that we regard as particularly prosperous for the state—from the 1950s through the 1990s—were years of strong union membership. Those years saw tremendous growth of the middle class and what we would regard as the American Dream. Families earned enough to buy a house, pay for a child's college education, and be assured of a decent retirement. Those families supported businesses that kept our economy strong and growing.

Today, we are experiencing wage disparity and inequality at a scale not seen since the late 1800s—the era of robber barons who bought control of the government. In today's back-to-the-future environment, there are groups that would take away the remaining worker rights that created America's middle class. These groups are always financed by the modern-day robber barons—the wealthiest elite who seek only to add to their profits.

It must be noted, however, that the states making the greatest progress both economically and socially—where jobs are growing and the majority of citizens are benefitting—are not states where working men and women have no rights, but are states such as Minnesota, Massachusetts, and California, where the freedom to bargain and be heard is protected.

The future of our state and our country is better served by protecting the freedom of workers to negotiate for fair wages, benefits and working conditions. That preserves a strong middle class and benefits our economic future.

II. The Need for Tax Reform:

A cornerstone of Connecticut's future stability and growth is a stable and predictable revenue stream. Connecticut enjoyed a 17-year period of revenue stability from 1992 through 2009. During that time, normal cycles of occasional recession were followed by economic recovery and strong revenue gain.

This pattern was broken after the great recession. The economy rebounded at a very slow rate, and revenues have remained hard to predict and generally in decline.

Connecticut faces a challenge today similar to 1991, when economic change and a broken and outdated revenue structure demanded broad reform.

Compared to 1991, Connecticut's economy has transformed greatly. There has been a major shift in the manufacturing sector—low-skill manufacturing has largely exited the state, and the United States. Today's precision manufacturing is growing but relies on far fewer employees and managers. The overall reduction in manufacturing output has impacted both income and sales tax revenue at multiple levels.

Compared to 1991, the service economy has expanded greatly in Connecticut. Services, however, are rarely captured by the sales tax.

In 1991, the Internet barely existed. Today, brick-and-mortar retail stores have been hurt or destroyed by tax-free online sales, which in turn have reduced jobs, weakened the base of municipal grand lists and property tax revenue, and lessened state income and sales tax revenue.

Compared to 1991 and especially after the downturn in 2009, revenue from the state's income tax has transformed from being highly predictable and reliable, to being predictably unreliable. In recent years the income tax has almost always underperformed estimates. This has been true despite a dramatic economic rebound in the financial markets since 2009.

Some of the decline in income tax revenue can be attributed to the factors mentioned above. But since the inception of the state's income tax, the income tax avoidance industry for the wealthiest taxpayers has flourished nationally. Success in shielding or hiding income from taxation has affected the national treasury as well as Connecticut's coffers.

In 1992, the 400 highest-earning taxpayers in America paid nearly 27 percent of their income in federal taxes, according to data from the Internal Revenue Service. By 2012, that figure had fallen to less than 17 percent.

Tax shelters have proliferated for the wealthiest taxpayers—many of whom live in Connecticut.

As the *New York Times* reported two years ago, "with inequality at its highest levels in nearly a century, and public debate rising over whether the government should respond to it through higher taxes on the wealthy, the very richest Americans have financed a sophisticated and astonishingly effective apparatus for shielding their fortunes. Some call it the 'income defense industry,' consisting of a high-priced lawyers, estate planners, and lobbyists... who exploit and defend a dizzying array of tax maneuvers, virtually none of them available to taxpayers of more modest means." Associations representing hedge funds and private equity firms spend millions of dollars each year "lobbying on such issues as 'carried interest,' the granddaddy of Wall Street tax loopholes, which makes it possible for fund managers to pay the capital gains rate, rather than the higher standard tax rate on a substantial share of their income for running the fund."

According to Victor Fleischer, a law professor at the University of San Diego who studies tax policy, "We do have two different tax systems, one for normal wage-earners, and another for those who can afford sophisticated tax advice. At the very top of the income distribution, the effective rate of tax goes down, contrary to the principles of a progressive income tax system."

It is important to go beyond the numbers when looking at the effectiveness of Connecticut's tax structure. Connecticut loses hundreds of millions of dollars today that it would have otherwise collected in 1991, in the world before tax-free Internet sales and sophisticated tax-loopholes for the wealthy.

The fact is that Connecticut's tax system was designed in another century, and in a far different economic reality.

What we need today is bold and comprehensive tax reform. Not necessarily more taxes—just a system that is effective and reliable in collecting everyone's fair share of taxes to support our schools, our seniors, transportation, and the services that our state requires.

III. Teacher Retirement and the Connecticut Lottery Proposal:

According to the Teacher's Retirement Viability Commission, created by the legislature last year, placing the Connecticut Lottery into the Teacher Retirement Fund in 2019 would result in an "immediate reduction in the UAAL (unfunded actuarial accrued liability)," and an "improvement to the funded ratio."

Regarding whether placing the lottery into the fund would result in a loss of revenue to the General Fund, the commission concluded that the "ADEC (actuarial determined employer contribution) reduction would be expected to more than offset the loss of revenue to the General Fund."

The Commission also concluded that "the TRS (Teacher Retirement System) assets would benefit by a stable source of significant income" and would permit reducing "the discount rate to 6.9% as of fiscal year 2019 following the transfer."

If structured correctly, this transfer would utilize a public asset for a public purpose, significantly pay down the state's unfunded pension liability, and as a result, reduce the state's yearly financial obligation.

Two potential models include New Jersey's earmarking of lottery revenue into state pension obligations, and the Ontario Teacher's Pension Plan.

New Jersey is not the model to follow. They privatized the fund prior to dedicating the revenue and lost the ability to utilize the value of the entire lottery program. Merely dedicating the income stream from the Connecticut Lottery will not, by itself, reduce the state's unfunded liability. Annual revenue produced by the lottery is approximately $300 million. The state currently is required to contribute about $1.2 billion to the Teacher Retirement Fund, so in a manner of speaking the state is already contributing 100% of the lottery revenue to the fund and more. Most of what the state pays goes toward the unfunded liability.

The Ontario Teacher's Pension Plan is a better model. The plan acquired rights to the Irish and British sweepstakes in Canada, which have been premier lotteries. This provides the benefit of not only the annual revenue stream, but also the greater value of the rights to lotteries that produce reliable revenue over time.

The Connecticut Lottery is valued at approximately $5 billion. By placing the lottery into the Teacher Retirement Fund, the fund would increase in value by $5 billion, and go from about 56% to over 70% funded. This would dramatically reduce the state's unfunded liability. It would also reduce the state's yearly payment, since there would be less unfunded liability to pay off. In addition, when the fund is more than 70% funded, it's possible to reamortize, and reduce the expected investment return from 7.9% to 6.9%.

Overall, transfer of the Connecticut Lottery—if structured as described above—would dramatically reduce the state's unfunded liability in the Teacher Retirement Fund and result in greater predictability and stability for the state.