

Testimony for the Commission on Fiscal Stability and Economic Development
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February 9, 2018

Good afternoon, Chairmen Smith and Patricelli, and members of the Commission on Fiscal Stability and Economic Growth. My name is Donald Williams; I am the Executive Director of the Connecticut Education Association, and formerly served as President of the State Senate. I have had the opportunity to work with some of you in the past, and I want to thank you for your commitment to the improvement of our state.

First off, I would like to discuss Connecticut's outdated tax system.

As you know, a cornerstone for Connecticut's future stability and growth is a stable and predictable revenue stream. Connecticut has one of the best school systems in the country, but there are still pockets of significant need and inequality, and we need the resources to support all of our schools and students. Our state needs stable and reliable revenue to support critical state services, and a quality education for our children.

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 of 2009. The economy rebounded, but in the years since, revenues have remained hard to predict and generally in decline. Connecticut faces a challenge similar to 1991, when economic change and a broken and outdated revenue structure demanded broad reform.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. Yet services are rarely captured by the sales tax.

In 1991, the Internet barely existed. Today, brick-and-mortar retail stores have been hurt significantly by tax-free online sales, which in turn have reduced the number of 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 significant economic recovery since 2009.

Some of the decline in income tax revenue can be attributed to the other 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 shelter schemes 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 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.”

I mention all of this because it's important to go beyond the numbers when looking at the effectiveness of Connecticut's tax structure. Declining revenue is not necessarily a sign of a failing economy. Today, Connecticut loses hundreds of millions of dollars it would have 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.

In 1991, business leaders helped lead the fight for real reform and the creation of the income tax. They made a positive difference and set our state on a better fiscal path for many years. You can be partners in that fight again today. I would make the following five suggestions for tax reform:

1. 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.
2. Re-evaluate and modernize the income tax so as to eliminate loopholes that allow the wealthy to shelter and hide their income.
3. Join the state compact to close the ‘carried interest’ tax loophole that allows private-equity fund managers to avoid paying billions in taxes. Wealthy fund managers cut their tax bills almost by half by paying a capital gains rate of 23.8% instead of the top ordinary income tax rate of 37%. The compact legislation would take effect when Connecticut, New York, New Jersey, Massachusetts and Pennsylvania all enact it. Last month, Governor Andrew Cuomo of New York endorsed the bill and has proposed it in New York’s 2018 legislative session.
4. Engage in a top-to-bottom re-assessment of all tax expenditures and credits, and eliminate those that unnecessarily benefit or enrich a corporate client. These have been sacred cows for too long, in large part because the state could afford it, and because powerful private interests were successful in creating and preserving them on behalf of corporate clients.
5. 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.

Savings Through Economies of Scale

If you look closely at a map of Connecticut, one of the smallest states in America, you see the boundaries of 169 separate towns. That division of governmental authority was an excellent model for efficiency and economic development—in the year 1768. You could mount a horse in the center of town, ride to the edge of town and return, before sunset.

This model has been largely unchanged in 250 years. Some have said before this Commission that collective bargaining—the right of working men and women to have a say in their wages, benefits and working conditions—has been the main obstacle. This is false.

As a former first selectman, I can tell you that the main obstacle to regionalization and economies of scale has been the state's tradition of home rule—the inability of towns to relinquish local control. This is true for decisions large and small. On the positive side of the equation, we have many regional school districts in Connecticut. This came about not through eliminating collective bargaining, but by incorporating it into the process. By law, collective bargaining cannot stand in the way of towns deciding to regionalize their school systems. When towns decide to regionalize, the affected workers have a voice as to their treatment and working conditions in the new district. This has worked well and not prohibited regional school districts.

Another example concerns legislation I helped draft a number of years ago that allows cities and towns to cooperatively create and operate industrial parks and commercial office parks. It provides a means of sharing property tax revenue, and eliminating the town-by-town competition for business development. It makes enormous sense on paper, but in the years since there has been almost no interest by towns. Collective bargaining has nothing to do with the inertia—the obstacle is home rule, and the reluctance to divide the fiscal benefits and responsibilities among multiple towns.

One area of great potential savings is health insurance. Most towns could save thousands and in some cases millions of dollars by providing health insurance to their employees through the state health insurance plan, and taking advantage of the significant economies of scale. A number of towns have done so. But others pay more than they should because of ties to a local brokerage, or a reluctance to investigate a change. Collective bargaining has not been an obstacle to these savings—workers have encouraged towns to take advantage of the savings.

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 made billions and bought control of the government. In this back-to-the-future environment there are those who 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 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 helps to preserve a strong middle class, and benefits our economic future.

Teachers' Retirement System and Fund

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

As you probably know, Connecticut teachers do not receive Social Security—the Teachers' Retirement Fund is their sole retirement benefit. This is beneficial, however, to teachers, the state and the towns. Teachers receive better benefits than Social Security, and the state and towns do not have to pay 6.2 percent of each teacher's salary into Social Security.

Over the decades, this has saved the state and municipalities billions of dollars. It is also important to acknowledge that the benefit structure of the Teachers' Retirement System is not overly rich or out of step with benefits provided by teacher retirement systems in other states. When compared with other states, the Connecticut Teachers' Retirement System provides a solid but not overly rich level of benefits for a non-social security system.

Teachers have always paid more than their fair share into their retirement. For many decades going back to the 1950s, however, the state has under-funded its share. As a result, liabilities grew. In 2007, the state bonded \$2 billion to shore up the fund, and the bond covenants require that the state contribute its full share as determined by an independent actuary.

The level of state contributions over the next ten to fifteen years will grow, although not as dramatically as assumed in the well-publicized report from the Boston College Center for Retirement Security.

The increases in payments can be best addressed in the same manner that the legislature addressed such concerns for the State Employee System. Reamortizing and restructuring the future pension payments in an actuarially sound manner, and consistent with state statutes will provide the most efficient and appropriate solution to maintaining the viability of the Teachers' Retirement System. It makes sense to smooth out the payments so that the state's contributions are more manageable.

On page 13 of the presentation that the Millstein Company made to this Commission on January 31st, the significant cliffs for the Teachers' Retirement Fund are shown as projected by the Boston College study. What is also shown on the same page is the result of restructuring the State Employee System payments—a steady, flat payment that supports the fund, and is manageable for the state. This same result can be achieved for the Teachers' Retirement Fund.

I would also note that while this Commission is deliberating, another new committee—the Teachers' Retirement System Viability Commission is working on recommendations for the fund. I would respectfully request that in the interest of your own limited time to consider a wide variety of critical issues that you reference the work of that commission which is focusing solely on the future viability of the Teachers' Retirement Fund.

Finally, I would recommend against any shift in the state's liability to fund the Teachers' Retirement System to the cities and towns. This was a responsibility the state assumed many decades ago. The state is best positioned to collect revenue in a fair and equitable manner, as opposed to shifting this burden to the regressive property tax, which treats towns differently based on their grand list. The idea floated by some, that towns do not have "skin in the game" when it comes to negotiations is false and easily disproven. The incentive to avoid increases in property tax rates on a yearly basis has been and will always be a strong incentive to bargain hard. By shifting the state's responsibility to the towns, the state will break its promise. The result will be cuts to school budgets, town services, and increases in the property tax.

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

At a time when the number of teachers leaving the profession is increasing, and 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. Thank you.