December 19, 2008

AFSCME Report to the Treasury Transition Team

Fiscal Policy Priorities

State and local aid is necessary to help pull the nation out of this economic crisis.

- State and local deficits of $180 billion or more are projected between the current fiscal year and next year. Resolving $180 billion in state budget shortfalls through cuts would have a contractionary impact of $245 billion, causing an estimated 2.5 million jobs to be lost from the economy.
- Aid to state and local governments is one of the most effective stimulus mechanisms, along with unemployment insurance extension, food stamps, and infrastructure grants (which AFSCME also supports), all of which are more efficient than further tax cuts.
- AFSCME believes state and local fiscal relief of at least $100 billion to $150 billion is needed over two years. This includes a major increase in federal funds for Medicaid, which will move money quickly into states and save them from dropping health coverage from millions of Americans.
- Fiscal relief should also include a countercyclical, flexible grant package for states and local governments.
- The Treasury Department should establish a study group to determine a formula for distributing a designated portion of the countercyclical aid to local governments within 60 days.

Revenue Raising Priorities

The federal government must refocus on generating sufficient revenues to support its many commitments. The new administration should mark a break with failed fiscal policies of the past that sought only to shrink government. Over the long term, the administration should seek stable and expanded revenue sources.

- Chronic federal deficits caused by ideologically motivated tax cuts have put unceasing pressure on state and local grants, which diminishes the funding available to carry out federal programs.
- The Bush income tax cuts should be eliminated. The first priority should be to restore rates on incomes above $200,000 per year, but all rate cuts should be reviewed for their affordability. Tax loopholes must also be addressed, for example, the executive deferred compensation loophole allows CEOs to shelter unlimited retirement dollars while most Americans can defer only $16,500.
- Capital gains and dividend income should be treated the same as earned income for tax purposes and taxed at individual income tax rates.

- The Estate Tax should be restored in part, to an exemption level of $2 million with a top tax rate of at least 45 percent. The $2 million exemption level would generate substantial revenue and is justifiable given the increasing wealth inequality of recent decades.

- AFSCME supports the concept of the "Making Work Pay" credit for Social Security payroll taxes, as long as Social Security funds are kept whole.

- AFSCME strongly supports maintaining the corporate tax rate at 35 percent, closing loopholes and cracking down on corporate tax evasion. For example, we support closing the carried interest loophole for private equity firms that costs the federal government $4 billion to $6 billion per year.

<u>State and Local Impact Review</u>

- Federal tax law changes such as the "Bonus Depreciation" and "QPAI" tax breaks have a negative impact on state revenues because many states are coupled in various ways to the federal tax code.

- The Treasury Department should establish a state impact review and state consultation requirement to accompany any tax changes that would have a negative impact on state revenues.

- The Treasury Department should appoint a task force to examine all tax law interpretations and policy decisions of the previous administration. The task force should identify for reversal decisions not consistent with sound fiscal policy.

<u>Financial Markets Regulatory Policy</u>

Revitalize and enhance the consumer and investment protection functions of the SEC.

- Recent discussions about the need for a new regulatory framework have not addressed the question of consumer and investor protection. While the prudential regulation of the capital must remain a high focus, the need for an independent investor protection agency is equally strong. Subsuming these important activities within a larger regulatory body such as the Federal Reserve will only further erode important investor protection functions. The SEC should be retained as a free standing regulatory body (perhaps absorbing the functions of the CFTC) with greater resources for enforcement and oversight.

- The agency has a history of being substantially underfunded given its broad mandate for enforcement and disclosure reviews. The budget needs to be revised with a substantial increase.

- Most Americans now own stock through IRAs and 401k plans, so a "voice" and agenda that is "on their side" is vital to rebuilding popular confidence in future financial security. The next chairman might consider constituting an Investor Advisory Committee that would allow regular communication with a cross section on investors on policy issues.