

Spending Cap Commission
Monday, June 6, 2016
Minutes

Attendees:

Members:

Commission Co-Chairperson William Cibes, Commission Co-Chairperson Patricia Widlitz, Suzanne Bates, Representative Christopher Davis, Tom Fiore, Roberto Hunter, Ellen Shemitz, Bart Shuldman, Representative Jonathan Steinberg, Ron Van Winkle, Representative Melissa Ziobron

Staff:

Susan Keane, Committee Administrator, Appropriations
Amanda Zabel, Committee Clerk, Appropriations

Call to Order by Chairperson Cibes

Chairperson Cibes called the meeting to order at 1:03 P.M.

Approval of the May 9 and May 25 Minutes

Chairperson Cibes called for a motion to approve the minutes of the May 9, 2016 meeting. The motion was made by Chairperson Widlitz, seconded by Roberto Hunter. Mr. Hunter moved acceptance of his revisions; the motion was seconded by Rep. Ziobron. By voice vote, the revisions were accepted. Chairperson Cibes then asked for vote on the minutes as revised. By voice vote, the revised minutes were accepted.

Chairperson Cibes asked for a motion to approve the May 25 minutes. The motion was made by Chairperson Widlitz, seconded by Robert Frankel.

Bart Shuldman asked if the commission should be setting dates by which requested information is provided to members.

Chairperson Cibes responded that unless a specific timeframe is determined at a meeting, receipt of information will be subsequent to a review of the minutes. Susan Keane, Appropriations Committee Administrator, will ensure that requested information is gathered and distributed to members.

Mr. Shuldman stated that he had requested at the May 25 meeting the targeted amount of savings that must be achieved in the FY 17 budget by the Executive Branch. Mr. Fiore was to provide the information to members.

Mr. Fiore replied that the bottom line General Fund lapse is \$189.3 million. Typically, the bottom line lapse is between \$100 million and \$110 million. He stated that the Executive Branch has, therefore, been charged in realizing \$89 million in net new savings.

Hearing no further discussion, Chairperson Cibes asked for a voice vote on the May 25 minutes. By voice vote, the minutes were accepted. Ms. Keane advised the Chair that Mr. Hunter had shared a few typographical errors, which she will correct before the minutes are posted.

Follow-up to Questions Posed at Previous Commission Events – Yankee Institute Responses

Suzanne Bates reviewed the Yankee Institute’s responses to questions posed during the April 18 public hearing (document is posted on the Commission website under “May 25”).

Regarding the issue of including the full cost of pensions under the spending cap, Ms. Bates referred to the JP Morgan report that had been distributed to members (located on the Commission website). She shared that she had spoken to the author, Michael Cembalest, to get his perspective on Connecticut and to receive his permission to copy and distribute the report. Mr. Cembalest told her that the report is an internal document that had been prepared for JP Morgan employees to help them understand which states are a “good bet” or not, as the firm buys a lot of municipal and state bonds. Ms. Bates pointed out the graph that shows how much states spend on debt, pensions and retiree healthcare. She explained that states listed above the red line, which includes Connecticut, will struggle over the next few years to meet their growing debts.

Ms. Bates further shared that the report illustrates what percent of state revenue would need to be dedicated to paying down the state’s various evidences of indebtedness, amortized over 30 years. Connecticut’s percentage of dedicated revenue would need to be 35%; Ms. Bates stated that the state is currently paying 22%. She further stated that in order to achieve the 35%, Connecticut would have to adopt one of three remedies – increase taxes by 14%, reduce spending by 14%, or increase employee contributions to their pensions and healthcare by 700%.

Ms. Bates expressed her concerns regarding moving pension debt outside the cap. She believes that moving items outside the cap will incentivize those items to grow at a much faster rate than items that are under the cap. Further, she believes that the state needs to look at the true costs of pensions and commit to paying them. She does not want to see future generations set up to face similar challenges to those currently being experienced by the state.

With regard to the question of whether to include debt service under the spending cap, Ms. Bates expressed her view that everything should be included under the cap, especially given the practice of moving expenditures to bonding in order to exempt those items from the cap. However, given the language of the Constitutional Amendment regarding evidences of indebtedness, she is not sure what changes could be made regarding the treatment of debt service. Should the commission want to engage in that discussion, she advised consulting with attorneys on what the Constitutional Amendment language really means.

In discussing lowering the discount rate on the State Employees Retirement System (SERS) and Teachers Retirement System (TRS), she shared that the state uses a discount of 8% for SERS and 8.5% on TRS, while the actual rate of return over the past 10 years has been 5%.

Rep. Steinberg thanked Ms. Bates for sharing her remarks and insights. He remarked that had the state taken each of the actions addressed in her responses, we would not be experiencing the current situation. Rep. Steinberg referenced Rep. Smith's comments from a previous meeting regarding a phase-in process for bringing items back under the cap, and commented that a phase-in process may be the only way to resolve the challenges. Further, he expressed concern regarding the ramification of putting all government spending under the cap, and the impact on government spending in the short term. He believes the commission needs to see those numbers so members will know the full impact of what taking such action would mean. Rep. Steinberg wondered if government could continue to provide basic core services. He reiterated that he would like to see the numbers to evaluate the impact of certain scenarios on the state moving forward, given that the current fiscal situation is tight.

Ms. Bates responded that ideas such as rebasing, creating a hold harmless provision, and a roll out of the process could all be part of a conversation so that spending would not have to be drastically reduced. She stated that the emergency measures built into the spending cap language can be used in the future to get over some of the hurdles. Ms. Bates expressed her concern that putting certain incentives into the law long term would create similar fiscal challenges in the future. She believes the definition should be crafted to set up the best possible outcomes.

Chairperson Widlitz commented on the discussion regarding the discount rates on the retirement funds. She acknowledged that the discount rates are a piece of the puzzle that will have to be addressed. However, she stated that the rates are not "pulled out of the air"; rather, the State Treasurer's Office develops the rates using the best information available to them. The Treasurer briefs the Finance, Revenue and Bonding Committee on the rates and how they were arrived at. Chairperson Widlitz further commented that while she sees the discount rates as being a valid area of concern, she believes the topic is outside the commission's purview. She shared members' frustrations in wanting to solve all of the problems identified. However, she expressed her concern that by focusing on areas that are outside the commission's purview, they will not reach a solution to the charge before them.

Ms. Bates responded that she sees the discount rates as part of the pension debt under the spending cap. She believes it is an issue that should be discussed, as the discount rates will impact the growing costs of pensions in future years.

Mr. Shuldman commented that he sees the issues being discussed as not starting and ending twenty years ago. Rather, he sees them as on-going because they have not been addressed by lawmakers. He also respectfully disagreed with Chairperson Widlitz's view regarding the purview of the commission. Mr. Shuldman shared Westport's examination of the discount rate being used by the town. After consulting with an actuary, they arrived at a better, more realistic discount rate. He stated that if the commission has the real numbers, members will have a real idea of how bad the state's pension liabilities are. Further, he believes that it should be within the commission's role to get the real facts.

Regarding the JP Morgan report, Mr. Shuldman remarked that the situation regarding the additional revenue needs was worse than Ms. Bates indicated. He stated that the report does not break out various revenue components. If the revenue increase was applied to just the income

tax, the increase would be 28%, not 14% as cited in the report. The 28% would be predicated on the increase being applied to everyone who gets taxed.

Mr. Hunter stated that he thinks the discount rate is an important issue and is within the purview of the commission. He believes that to the extent the discount rate the state is using is not realistic and needs to be lowered, that action will have a tremendous effect on how much revenue will have to be allocated to the unfunded pension liability. Further, he remarked that if everything is under the cap and pension costs continue to grow rapidly, there will be a constraint on how much will be available to support other programs.

With regard to the JP Morgan report, Mr. Hunter questioned whether it was an “apples to apples” comparison of states, as not all states fund their indebtedness the same way. He remarked that a number of states have county level indebtedness, which fund the costs of schools and other items. He observed that in Connecticut those costs are absorbed by the state. He asked Tom Fiore to share his perspective.

Mr. Fiore remarked that if one looks at Connecticut’s debt as a percent of personal income, the state generally ranks very high nationally. However, when state and local governments are looked at together, Connecticut’s ranking changes to somewhere between 25th and 27th. He shared that the state incurs many debts on behalf of municipalities, with school construction being the largest.

Mr. Hunter added that he was not diminishing the current budgetary stress. Rather, he was pointing out that the JP Morgan analysis was not necessarily an “apples to apples” comparison.

Ms. Bates responded that the report shows for each state the amount of revenue available to pay down the state’s debt compared to their debt load. She stated that when looking at the percentage of the state budget devoted to debt, it is an “apples to apples” comparison.

Mr. Hunter replied that a better analysis would be to take all the revenue, state and county, state by state and take the ratio to see what level of indebtedness there is overall and compare those ratios in total, rather than in isolation.

Mr. Fiore commented that the pertinent conversation for the commission regarding the discount rates is how reforms will be handled. Some questions the commission may want to consider are: 1) if a lower rate is adopted and phased in over time, should it be accommodated under the cap or is it to be considered among all expenditures; 2) should there be a carve-out to handle the increased costs. He remarked that the discount rates will ultimately be decided by the State Employees’ Retirement Commission and the Teachers’ Retirement Board. The question before the commission is how the impact of those decisions will be handled with regard to the spending cap.

Ron Van Winkle commented that there will always be a struggle regarding the question of how much we can afford as a state and how to measure income. He believes the issue with which members struggle is what the future will look like and how to ensure the state expends its money wisely within some bound. He referenced the discussion regarding a phase-in approach to

bringing items under the cap. He commented that to bring all items under the cap at once will result in the state being hurt quite substantially. He believes there is some blend in approach that could be fashioned. Mr. Van Winkle stated that the issue before the commission is how to get to the best spending number to put spending within the bound of affordability.

Ms. Bates remarked that there is an “escape valve” built into the spending cap through the emergency declaration language that would allow lawmakers to exceed the cap should an issue arise in providing government services. She believes the commission should take a long term view to determine what parts of general government should be capped and what should not be allowed to grow outside the cap.

Mr. Shuldman expressed his frustration regarding the impact of using the current discount rates and the on-going challenges of the pension liabilities. He stated his desire to obtain the facts so commission members can fully understand the scope of the problem in order to craft a workable solution. He also expressed concern over the impact of the state’s fiscal condition, including the cost of its pension liabilities, on people choosing to leave the state.

Chairperson Cibes agreed that someone needs to get to the truth of the matter regarding these issues, and that the truth may affect the commission’s deliberations. He believes it would be helpful to invite the State Treasurer or other investment advisers to address the commission on the discount rates. In addition, he pointed out that in 2010, Governor Rell created a post-employment benefits commission. He shared that he found the report to be excellent and suggested it would be very useful to commission members. Chairperson Cibes asked the administrator to disseminate the report, which is located on the OPM website.

Rep. Steinberg commented that he thought Mr. Shuldman is correct that it is important to assemble the facts in order for the commission to conduct its deliberations. He also agreed with Mr. Shuldman that using a high rate of return is probably not serving our interests. Westport adopted a conservative rate of return which has served the town well. He also shared that when he speaks with people in Westport, from either political party and unaffiliated voters, the first thing they talk about is not leaving the town: they are very glad to live in the town, enjoy its amenities, and want the state to prosper.

In response to the migration issue raised by Mr. Shuldman, Chairperson Cibes informed members that there is a plethora of migration analyses. While they are not Connecticut specific, he stated they were conducted in a scientific manner. He cited a recent report by Stanford researchers, which he will provide to the members.

Rep. Ziobron shared with members her interaction with constituents regarding their desire to leave Connecticut. She informed members that she had shared the work of the commission with her constituents. While she expressed her appreciation for all of the data members have received, Rep. Ziobron expressed concern that the commission is getting further and further “into the weeds” at each meeting. She questioned how much more data the commission needs to amass, and urged her colleagues to get to the task before them.

Chairperson Cibes responded that getting into the data is critical to making a good decision. He stated that one of the failings of the 1991 legislature was that the spending cap language was negotiated with very little discussion or concern for consequences.

Chairperson Cibes then turned his remarks to the Yankee Institute responses regarding capital gains as a part of personal income growth. He urged the commission to look at realized capital gains, despite their volatility. He stated that there were issues to consider that would dampen the volatility, such as using adjusted gross income as a measure of personal income and/or using an average of realized capital gains over a longer period of time. Chairperson Cibes observed that the Budget Reserve Fund plan adopted in 2015 might create a better use for capital gains. He would like the commission to explore that idea as an option. He added that the commission should look at the state's overall revenue base. He expressed his personal view that realized capital gains are part of the revenue base, even with their volatility. He pointed out that the Bureau of Economic Analysis excludes capital gains from their definition of personal income because, they say, in order to spend a capital gain the asset that has appreciated must first be sold. Therefore, in order to make it part of the revenue base, it needs to be realized.

Regarding the JP Morgan report, Chairperson Cibes remarked that the report has content that is important for the commission to look at. He referred members to the bottom of page 1, which contained language regarding the right of employees to receive, and a state's obligation to pay, pension benefits that have been earned. He believes it is a fundamental principle that is true. Further, he believes the commission members recognize that the unfunded liability has to be paid. It is the commission's job to figure out how to craft a spending cap definition that permits the state to do that.

Chairperson Cibes then pointed out that the chart on page 1 assumes a 6% return on plan assets. He stated that using an 8% return would diminish the overall liability a bit, while using a 6% return makes it look worse than it might be. He cautioned that the commission will need to look carefully at the assumptions presented on materials reviewed.

Regarding Ms. Bates' comments on including the full cost of pensions under the spending cap, Chairperson Cibes stated he had difficulty with the notion that excluding pension costs creates an incentive to underfund them. He observed that when full pension costs were under the cap, there was an incentive to underfund the retirement systems in order to fund needed services. In addition, Chairperson Cibes asked the members to consider the distinction between the past service liability and the normal pension cost. He believes the commission should look at separating the costs associated with the past service liability from the normal cost. He stated it is his belief that the normal cost should be under the cap, as it is controllable by the legislature and the collective bargaining process, and he would support that recommendation when the commission begins making decisions. Further, he believes that doing so would provide an incentive to control costs for current and future employees. He also remarked on how the creation of Tier 2A and Tier 3 have controlled costs.

Chairperson Cibes then remarked on the argument that the state should go to a defined contribution plan, rather than a defined benefit plan. He cited the 2010 Rell OPEB Commission

finding that the defined benefit plan for state employees under Tier 2A was less than the defined contribution plan for higher education employees.

With regard to the issue of lowering the discount rate to 5%, Chairperson Cibes expressed support for asking the State Treasurer or others to discuss what an appropriate level might be. He does not think 5% is an appropriate level, but wondered what higher number might be more appropriate. He believes that the commission needs to look at the discount rate relative to the calculation of what the normal costs will be in the future.

Ms. Bates responded to Chairperson Cibes' remarks regarding capital gains. She believes that the legislature did a smart thing in the 2015 Budget Reserve Fund legislation by treating capital gains as an asset and setting up a mechanism to capture capital gains in windfall years and depositing those funds in the Budget Reserve Fund. She expressed her concern that if capital gains are included in the revenue stream there would be an incentive to spend that money, rather than putting it in the Budget Reserve Fund. For that reason she believes that capital gains should be excluded from the definition of personal income.

Regarding a defined contribution plan versus a defined benefit plan, Ms. Bates expressed her belief that there is a deep political incentive to underfund defined benefit plans, through such means as setting the discount rate or state employee unions and administrations signing an agreement to do so. She believes that when pensions are underfunded all the risk is put on the taxpayers, who are liable down the road for past mistakes. Ms. Bates shared that the federal government, under ERISA, told businesses they couldn't underfund their pension plans. Further, they were told that they had to use a discount rate relative to the Treasury note, which is about 4%. That rate is considered safe and risk free for shareholders. Ms. Bates expressed that she would like to see the state use a discount rate for the pension plans that is also safe and risk free.

Chairperson Cibes responded that he feels there should be a realistic discount rate assumed with respect to the capped portion of the normal costs. He does not believe that 8% is a realistic assumption at this time; however, he does not believe 4% is appropriate. He stated that experience has shown that investment returns have been far higher than 4%, and that he expects returns to be far higher in the future. He discussed the obligation that the state has to pay employees for retirement benefits they have earned.

Mr. Shuldman reiterated his view that all pension-related costs should be dealt with under the spending cap. He also expressed a differing view than Chairperson Cibes regarding defined contribution plans versus defined benefit plans.

Chairperson Cibes responded that the members would be receiving the Rell commission report for their review, which includes the analysis of the two plans.

Chairperson Widlitz stated that she shares Rep. Ziobron's concerns regarding the direction that the discussion is taking. She stated that pensions are not under the purview of the commission; rather, they are subject to collective bargaining. She acknowledged that the pension costs will impact decisions the commission will make; however, she does not find it appropriate for the commission to get into every detail that is negotiated by the state of Connecticut. Chairperson

Widlitz agreed with Rep. Ziobron's observation that the commission is getting further away from its charge at every meeting, and the more they engage in ancillary discussions the further they are getting from making decisions. She reminded the members that the commission's job is to make recommendations to the legislature on the definitions that were not completed by the legislature to implement the Constitutional Amendment.

Chairperson Cibes remarked that the definition of what constitutes a general budget expenditure is under the purview of the commission. He stated that the discussion could involve looking at whether the normal cost of pensions or all pension costs are general budget expenditures. He commented that the commission would want to be discriminating and specific regarding what are deemed to be evidences of indebtedness.

Follow-up to Questions Posed at Previous Commission Events – CT Voices for Children Responses

Ellen Shemitz reviewed the responses submitted by Jesse Marks and Nick Defiesta on behalf of CT Voices for Children to questions posed during the April 18 public hearing (document is posted on the Commission website under "May 25").

In response to Mr. Shuldman's question regarding whether the current spending cap would be considered "flexible", CT Voices for Children responded that they find the current spending cap to be restrictive, which they laid out in their letter to the commission. Ms. Shemitz discussed the 5 year look-back period as a factor in curbing growth in the years after the recessions. She stated that the impact of the recession has extended longer than it would have if there had been a longer look-back period. Further, she offered that there is literature that suggests using either a 1 year look-back or a 10 year look-back. Having the longer averaging over 10 years wouldn't have allowed the recession to have the same pull. She referenced Chairperson Cibes' remarks regarding including unearned income and using a 10 year look-back as a means to dampen volatility. Ms. Shemitz also discussed the practice of basing the growth rate on actual spending, rather than allowable spending. She stated if cuts or rescissions are made in a particular year, those rescissions reduce the base in subsequent years.

The respondents also find the spending cap to be ambiguous due to the lack of definitions. Ms. Shemitz remarked that rebasing adds to the ambiguity, as it is not required in either the statutory language or the Constitutional Amendment.

Ms. Shemitz then addressed Ms. Bates' question on whether pensions and bonded debt should be included under the spending cap. She stated that bonded debt that has been incurred should not be included under the cap, as bonding is based on the state's decision regarding long-term investment and should not be constrained by the cap. She believes that there is consensus among commission members regarding this view. With regard to including bonded debt service under the cap, Ms. Shemitz believes doing so would unnecessarily constrain spending in a way that would limit the state's ability to meet current needs and would hinder economic competitiveness. She referenced the UConn study that had been distributed to members, and cited the concern expressed in the report that too tight a rate of growth would harm state economic growth by

preventing the state from making the kinds of investments that are critical in terms of short-term spending and long-term investments in infrastructure.

Ms. Shemitz shared two recent news items that she thought were timely. The first was a report of the federal investigation of the Department of Developmental Services for failure to protect its clients. She commented that the situation shows that when there is a constraint on spending and the cap is preventing growth, there are real costs to the public today, as well as the possibility of budgetary consequences when judgments come down in the future. The second report was on the condition of the state's infrastructure. She commented that this was another example of the impact of a spending cap that is too restrictive to allow critical investments to be made in infrastructure and the long-term consequences for the state's economic competitiveness.

Regarding the discussion of pension liabilities, Ms. Shemitz shared the concern of others that some of the discussion has gotten far afield. She remarked that there are a number of avenues that can address the pension liability issues that do not necessarily come under the spending cap. Further, she shared her view that the spending cap should not be used as an answer to all the ills faced in the state budget.

Ms. Shemitz believes there is consensus that the normal cost of pensions should be a capped expenditure as a part of the cost of current personnel. She referenced the previous discussion regarding the federal requirement that private sector businesses pay the current costs of pension plans in the current year. She suggested if members found that to be an idea that should be pursued on the state level, the commission could include it in the recommendations. However, she stated that the policy does not go to the issue of the spending cap.

With regard to accrued unfunded liability, Ms. Shemitz remarked that she was struck by the comment Rep. Steinberg had made at a previous meeting, where he referred to the accrued unfunded liability as "an egregious failure of past administrations". She believes those failures created a problem that, if forced to be dealt with under the current budget, will create further downward pressure on both investment spending and spending for critical services. Ms. Shemitz referenced the previous discussion regarding the change in GASB rules. GASB now distinguishes between current cost and accrued unfunded liability and calls for the accrued unfunded liability to be listed as a liability distinctly separate on the balance sheet. She believes there is good financial reason, as well as policy reason, to treat the accrued unfunded liability separately, which the legislature has done.

Ms. Shemitz then addressed Chairperson Cibes' question. He had asked Messrs. Marks and Defiesta if they would further distinguish between bonding for capital projects and bonding that would otherwise be categorized as "general budget expenditures". Ms. Shemitz replied that CT Voices for Children agrees that bonding should be for long-term capital investments. However CT Voices for Children does not support making the spending cap more restrictive or creating more ambiguity by making further distinctions in the definition.

Lastly, Ms. Shemitz responded to Mr. Porth's question as to whether other states include capital gains in their calculations of personal income. She stated that while other states do include capital gains as personal income, it is done so to assess income, not for the purposes of assessing

a spending cap. She shared that her staff did not find any data that addressed whether or not AGI as opposed to person income without realized capital gains were included.

Mr. Shuldman asked Ms. Shemitz if pension and debt are taken outside the cap, would she consider setting a cap lower than 100% of revenue to allow for the remaining revenue to pay for the state's liabilities.

Ms. Shemitz responded by expressing concerns regarding so constricting the ability of the state to make important investments in its personal and physical infrastructure that the state could not be economically competitive. She asked Mr. Shuldman, by putting everything under the cap, would he want to prevent the state from being friendly to business by having safe roads and bridges and an IT infrastructure. Ms. Shemitz stated that for the longest time pension and debt were under the cap; however, they artificially constricted what the state had available to spend. She cited the tax rebates that were given instead of using the full amount of revenue available at the time. She believes those failures have put the state in its current situation. Further, she believes the problem was not created because items were outside the cap; rather, those items were considered under the cap, which created further problems. Ms. Shemitz commented that she found Mr. Shuldman's question to be unfair, as it does not look at the full scope of the problem. She expressed concern about the state's competitiveness and its ability to make critical investments.

Mr. Shuldman responded that he believes whatever the state has been doing didn't keep GE from leaving the state. He stated that other businesses are being lost in Fairfield County as well. He believes it is important that all of the expenses that have to be paid go under the spending cap. Mr. Shuldman shared that he has not yet made a decision on how to set the spending cap. He would rather understand the whole problem and then try to set a solution against that. Further, he commented that he is having a hard time with the idea of putting expenses owed "to the side" because eventually they have to be paid for. He stated that he would like to see what it would look like to put all expenses under the cap, as he would like to see a spending cap that will get the state out of from under its current problems.

Ms. Shemitz expressed her view that referencing GE leaving is a "red herring". She stated that GE was clear that their departure had a lot to do with the business climate in terms of infrastructure and the other types of businesses that were in the area. She said she feels strongly that raising GE's decision to leave as somehow related to decisions regarding the spending cap is mixing "apples to oranges".

Ms. Shemitz stated that she thinks Mr. Shuldman raised a legitimate point that there is a question of revenue; however, she does not think the answer is to put debt under the spending cap. She said there are other options that create room for the state to pay off its debt, such as tax expenditures. She explained that over \$7 billion is spent each biennium on tax expenditures. These tax expenditures are not reviewed on a regular basis and some of them have been on the books for over 20 years. Ms. Shemitz believes that commission members need to be very clear that the state has a number of problems, but trying to use the spending cap as a tool by which to solve all of them is going to create more problems and tie the hands of the legislature when setting a budget that meets current needs each year.

Mr. Shuldman wondered if by putting everything under the cap the legislature, in fact, looks smarter, as legislators would be prioritizing what needs should be funded. He believes having items outside the cap does not encourage keeping spending under control. He shared that he did not expand his business in the state because there is no certainty right now. He does not know what the tax situation is going to be, or if the software services tax is going to be enacted. He believes it is important to show people that there is certainty. Mr. Shuldman agreed that budgets were passed year after year without addressing the problems. He believes it is important for the commission to craft a solution that puts everything under the cap, but that is implemented in a way that does not crush the state.

Ms. Shemitz urged commission members to ground their decision-making in data, not in anecdote. She stated that while there may be people leaving the state, there are people moving into the state. She shared that CT Voices for Children received more resumes from out-of-state applicants than in-state. She added that there are clear studies that show there is a small correlation between taxes and out-migration.

Ms. Shemitz further commented that the spending cap is not the only tool to constrain spending. She cited the balanced budget amendment and the bonding cap. She believes there was a reason why the distinction was made between debt and current expenses, which was to make sure there wasn't an unfair or dangerous constriction on the amount of spending in any given current year. She urged members to be mindful of the other tools available and that they should be applied as they should be. Further, she stated that the spending cap should be kept to current expenditures in a way that protects the taxpayer and allows legislators to make important decisions and investments.

Mr. Shuldman posited that if moneys have to go into a fund, which are then invested by the Treasurer, to allow payment of the pension plans, isn't that a current expenditure.

Mr. Fiore replied that both the current costs and past service liabilities for the teachers' and state employees' retirement systems, totaling \$2.4 billion, were accommodated in the budget.

Mr. Shuldman then asked if that was a current expense.

Chairperson Cibes replied that is was.

Rep. Davis commented that the purpose of the spending cap is to tie the hands of the legislature. It is what the taxpayers wanted when the income tax was enacted. He believes it is important to recognize that the commission is trying to develop a mechanism to tie the hands of the legislature. Further, he remarked that to say that all state revenue can be spent any way the legislature wants and only restrict spending in narrow ways is not the intention of the spending cap. Rather, Rep. Davis believes that the intention was to encompass as much spending as possible, not to exclude items from the cap. He stated that saying there is a revenue problem is a misnomer, as the state has more revenue than ever before. He believes the idea of putting past mistakes behind and moving on, while continuing to spend without recognizing past mistakes should be avoided. In his view, the spending cap is the only way to restrict spending. Rep.

Davis then discussed the issue of intent and how it plays a major role in a person's decision to stay in the state or to move. He stated that polls and surveys often do not reflect a person's intent, based on the way questions are framed. Lastly, he stated his belief that commission members' intention is to set up a brighter future. The question, in his mind, is how to do that.

Ms. Shemitz asked Rep. Davis what his understanding is of why debt was specifically excluded from the cap.

Rep. Davis replied that he was not sure what the true intent was of the crafters of the legislation. He suggested that perhaps commission members should look at carving out specific types of debt that should be included and others that should be outside the cap.

Chairperson Cibes suggested that one of the reasons debt was excluded from the spending cap was to guarantee that actions of the legislature would not limit the payment of debt service on bonds. He stated it was important to assure the bond community that debt services would be paid rather than be arbitrarily curbed by a spending cap.

Chairperson Cibes then called members' attention to the OFA responses to questions that had been raised regarding bonding, which were prepared in response to questions posed at earlier meetings by Rep. Ziobron and Mr. Shuldman.

Rep. Ziobron thanked OFA for compiling the data. She asked if the Community Investment Act (CIA) is under the spending cap.

Michael Murphy, OFA Section Chief, replied that CIA has been an off-budget item since its inception. Therefore, it has not been under the spending cap.

Rep. Ziobron commented that CIA should be added to the commission discussions, as well as tax credits.

Mr. Shuldman asked for an explanation of the tables presented in OFA's document.

Mr. Murphy replied that the document was prepared in response to a request that stemmed from OFA's fiscal accountability report in November 2015. The question related to looking at the growth in General Fund expenditures, including and excluding the impact of borrowing and how that might reduce General Fund expenditures through various line items. He explained that Table 1 breaks out the types of borrowing that would reduce General Fund expenditures in any given year. Table 2 shows the operating budget programs that shifted to bonding.

Mr. Shuldman asked if, in 2016, the sum total of using \$145 million in bond premiums, moving \$109 million into bonded debt that otherwise would have been appropriated, and delaying payment of \$22 million related to Economic Recovery Notes was \$276 million.

Mr. Murphy responded that was what the table is meant to represent, with the understanding that it reflects the General Fund only. Members received an email that reflects the Special Transportation Fund.

Rep. Davis remarked that, although he understood that Table 2 did not encompass everything, it was missing a significant piece, which is the bonding for General Accepted Accounting Principles (GAAP).

Mr. Murphy replied that OFA considered including the GAAP bonding in the table, but made the decision not to include it because they were showing the operating budget impacts. He recalled seeing one of the credit rating agency's analysis of the GAAP borrowing, which considered it to be borrowing for operating expenses. He stated, however, that OFA looked at it more strictly from the standpoint of the General Fund balancing, which at that point did not include the GAAP accumulated deficit.

Rep. Davis commented that he believes it is important to look at the funding of the GAAP deficit, as he stated his support for looking at items or payments that are off-budget or have been delayed. He believes these actions will further drag down available funds that can be spent under any definition of the spending cap.

Chairperson Cibes suggested that there may be other expenses, like the Small Town Economic Assistance Program (STEAP) that could have been appropriated over the years, but were funded in a different manner.

Rep. Ziobron requested that OFA update the information presented based on the budget revisions for FY 17.

Future Topics for Discussion:

Chairperson Cibes reminded members that Comptroller Lembo will be addressing the commission regarding the definitions of personal income and inflation on June 20. He shared that the Co-Chairpersons have been in contact with the principal author of the CT Center for Economic Analysis report on an alternative spending growth rule. He expressed the hope that a presentation could be arranged for a future meeting.

Chairperson Cibes added that other potential topics could be a discussion of the discount rate with the State Treasurer and a discussion regarding the Rell Post-Employment Benefits Commission report. He remarked that Chairperson Widlitz and he would discuss those potential topics.

Chairperson Cibes then offered some other things he is considering that are general contextual matters:

- Looking at the implications of too restrictive a definition of various things, including the spending cap
- Revenue constraint and how recent appropriations decisions have caused revenue hikes in local governments

- The definition of general budget expenditure, including aid to municipalities. He cited indications that budget restrictions on education spending have caused some adverse consequences in education.

He also raised the issue of frequency of meetings. He commented that he wants to make sure that the commission meets its December 1 deadline, which may require the scheduling of additional meetings. Members then discussed an alternative to the July 4 meeting. They settled on Thursday, July 7 at 10:00 am.

Ms. Bates requested that the commission work back from the December 1 deadline in order to set a timeline for deliberations and decisions.

Mr. Hunter asked that the commission research pension liability in general, as well as the discount rate.

Chairperson Cibes responded that it is an issue that the legislature will have to deal with. He cited three plans that have been presented by the Governor, State Treasurer and State Comptroller, respectively. He remarked that he was not sure the commission should delve deeper into pension matters.

Mr. Shuldman shared that Westport asked their actuarial firm to give a presentation on the town's current pension situation. He found the presentation to be very helpful.

Mr. Van Winkle commented that he was not sure the commission needs to go in that direction. He believes the question before the commission is whether the entire cost of pensions should be put under the cap and what to do with past service liability. How large the past service liability is and how to address the cost of it is for the legislature to determine. He shared his view that a debate over the discount rate is not the commission's debate.

Chairperson Cibes shared that the Co-Chairpersons will deliberate to determine a path forward. He urged members to read the Rell Commission report to see if it needs further explication. Further, he offered that the three pension plans could be posted to the commission website.

Ms. Bates stated that she would like to hear from a Republican and a Democrat who were part of the negotiations on the spending cap to learn what they crafters intended to keep under the cap, what they intended to keep outside the cap, and why.

Robert Frankel, who was among the negotiators, commented that Chairperson Cibes' observation was correct that the deliberations were not as lengthy as they should have been and that the crafters were probably naïve regarding the impact of their decisions. He remarked that it was more important to say that it's not so much trying to divine what was in the minds of those in the negotiation room, but that this commission use its best judgement to decide what the cap should be. He encouraged commission members to look forward and to draw upon their own expertise.

Mr. Shuldman recommended that the commission not look at what is happening to towns. He advised that the commission should stay with the “big picture” discussions. He then asked if the commissions proceedings are public and can discussions be shared outside the meetings.

Chairperson Cibes replied that the meetings are televised and archived by CT-N. He agreed with Mr. Shuldman that it is inappropriate to review what 169 towns have done in response to the budgetary actions. He stated that he does believe that contextually the commission needs to recognize that there are some implications for budgetary decision-making that emanate from the spending cap definitions.

Rep. Steinberg advised members that when discussing commission deliberations they should be very careful to say what went on and what the facts are related to those items discussed.

Mr. Hunter asked if the chairpersons were aware of any proposals for definitions of the spending cap that have been submitted.

Chairperson Cibes stated that there have been various proposals offered, including those provided by the Yankee Institute and CT Voices for Children. He stated that various individuals have worked on proposals, some of which may be available.

Seeing no further discussion, Chairperson Cibes adjourned the meeting at 3:13 pm.

Respectfully submitted,

Susan Keane
Appropriations Committee Administrator