

Spending Cap Commission  
Monday, June 20, 2016  
Meeting Notes

**Attendees:**

Members:

Commission Co-Chairperson William Cibes, Commission Co-Chairperson Patricia Widlitz, Suzanne Bates, Tom Fiore, Sen. Scott Frantz, Sen. Michael McLachlan, Richard Porth, Ellen Shemitz, Bart Shuldman, Representative Richard Smith, Representative Jonathan Steinberg, Ron Van Winkle (Note: Roberto Hunter participated via Skype)

Staff:

Susan Keane, Committee Administrator, Appropriations

Guests:

Kevin Lembo, State Comptroller

Josh Wojcik, Policy Director, Office of the State Comptroller

John Clark, Budget and Financial Analysis Division, Office of the State Comptroller

Bob Gribbon, Budget and Financial Analysis Division, Office of the State Comptroller

**Call to Order by Chairperson Widlitz**

Chairperson Widlitz called the meeting to order at 1:08 P.M.

**Approval of the June 6 Minutes**

Chairperson Widlitz called for a motion to approve the minutes of the June 6, 2016 meeting. The motion was made by Chairperson Widlitz, seconded by Chairperson Cibes. Commission members decided that from this point forward, the term “minutes” will be used when recording actions taken by the commission. Notations of other commission discussions and presentations will be deemed “meeting notes”.

The following revisions to the June 6 meeting were offered:

On page 5, delete language of paragraph 4, and insert the following:

- *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. (offered by Chairperson Cibes)*

- On page 8, paragraph 5, line 9 – Delete “spending” and insert “economic growth” (offered by Ms. Shemitz)

Seeing no further discussion, Chairperson Widlitz called for a vote on the minutes as revised. By voice vote the revised minutes were adopted.

State Comptroller Kevin Lembo gave a presentation on the state spending cap and budget stability (copy can be found on the Spending Cap website). Among the topics he discussed were:

- The Budget Reserve Fund and the Spending Cap
- Defining Personal Income
- Defining Inflation
- Combining Changes to the Personal Income Measure and the Inflation Measure

Chairperson Widlitz expressed concern regarding using as a measure the inflation on government-related expenses, such as education. She remarked that the measure was quite different from what taxpayers experience in their consumer inflation costs. She wondered how those two concerns would be blended, as the costs of providing government services are not what the taxpayers experience on a consumer level. She asked Comptroller Lembo if he was suggesting a blend or was he suggesting using just the cost of government as the measure.

Comptroller Lembo replied that Chairperson Widlitz’s comments get to the heart of the issue when looking at a measure of the taxpayers’ ability to fund the government, and what obligations the government has and how those obligations are growing. He remarked on the Governor’s efforts to hold spending at a certain level for a period of time, even though certain elements of the “market basket” of spending don’t grow at rates of 2%, 3% or 4%; rather, healthcare, for example, is 25% of the budget. He stressed the importance of clearly defining the calculation and blending of those two elements or some other measures.

John Clark commented that extending the number of years used to calculate the measures provides stability to out-year growth rates and the ability to know what the total spending level can be in a more predictable way that captures the ups and downs of the business cycle. He remarked that it probably more reasonably reflects the “household” in the state.

Ms. Shemitz remarked on the availability of timely data. She observed that the Comptroller’s data was through 2014 and asked if that was the result of a lag time in available data.

Comptroller Lembo confirmed that was the case.

Ms. Shemitz then asked the Comptroller if the spending cap should be based on actual spending, which reflects rescissions, or allowable spending, which reflects what was originally passed.

Mr. Clark responded that he found merit in looking at actual outlays, rather than what was imagined to happen.

Comptroller Lembo added that it was a fair, but tough question to consider, one that is debated on a regular basis.

Bart Shuldman commented on Comptroller Lembo's remarks regarding developing a measure to fund government. He posited that such a measure would be based on available revenue, the reality of the current fiscal situation, and matching those elements to state expenses.

Comptroller Lembo replied that as a general matter, Mr. Shuldman's view was true as a top line discussion. He remarked, though, that when considering the elements of the budget, such as contractual obligations and federal requirements, policymakers lose some discretion in setting a spending plan. Further, he observed that once the revenues and expenditure requirements no longer match, the "non-discretionary" items still need to be funded and all of the cuts are borne by those items considered "discretionary". Comptroller Lembo stated that he understands Mr. Shuldman's view of the "living within our means" question and he agrees with it. He stated that the "flip side" is at what point would the allowable resources paid by taxpayers to fund the government leave government unable to fund critical needs. He remarked that the question is how to balance the will of the people to provide services with their tolerance for taxation and distribution of their resources.

Mr. Shuldman posited that the issue facing the state is the will of people to spend money we don't have, and the will of government not to fund its obligations as it should. He noted that the situation is further complicated by the decrease in income tax revenue. He spoke to the importance of establishing expenditure parameters so policymakers know what they can spend.

Comptroller Lembo replied that the group could theoretically discuss that we can't afford to fund "that" anymore. He stated it is the "it" that matters, for once the "it" is defined, supporters will decry the cuts. He does not believe that it is the will of the legislature to spend "because they can". He shared that he has seen the effect that making difficult cuts has had on legislators, particularly in light of the impact those cuts have had on their communities. Comptroller Lembo acknowledged that government has made a number of irresponsible decisions over the years, some of which he believes have destabilized significant portions of the state budget. Further, he believes those decisions have created a situation where the large "non-discretionary" items are crowding out everything else. He commented that there are two questions that need to be addressed – 1) how to right the situation, and 2) what impact does that action have on those items that are funded because they represent collective values.

Mr. Shuldman posed two follow-up questions to Comptroller Lembo – 1) doesn't the spending cap allow legislators to look at available revenue and determine how the revenue should be expended? He stated that if additional requests for funding are made, the spending cap gives legislators the ability to say that those requests cannot be considered; 2) isn't it appropriate to set state spending based on the goods and basket that businesses and others have to spend, as that will give the government an idea of the amount that should be expended versus government making the claim that its costs are higher, therefore government can spend more.

Comptroller Lembo replied that the issue is to find a way to keep the intent of the spending cap in place, while making sure the indicators make more sense, thereby making compliance easier

to achieve. He cited his success in achieving bi-partisan support, as well as the support of organizations having various points of view, for the Budget Reserve Fund changes in 2015. He believes that there is a desire and will in the legislature to “do the right thing” if legislators are offered an alternative that makes sense and is well researched.

Josh Wojcik commented on the effects the unfunded liabilities have on the budget and the need for the commission to look at the issues. Sometimes in the past, when unfunded pension liabilities were under the cap, the choice was made not to fund those costs in order to fund other expenses – thus creating higher costs that we face now. Regarding Mr. Shuldman’s question concerning the market basket of goods and inflation, Mr. Wojcik explained that using the price deflator (with a 10-year average) as an inflation measure becomes a factor in the years immediately following a recession. It allows for a redistribution of spending, rather than the practice of spending up to the level of what revenues allow during good economic times. He stated the result of the current practice is significant deficits when revenues fall, requiring tax increases and spending cuts. Mr. Wojcik added if the distribution of spending can be changed rolling into a recession, expenditure levels would be lower, while the budget reserves would be higher, allowing lawmakers to provide funding when needs are very high.

Ms. Bates expressed her concern about including capital gains in the definition of income. She believes that even with a 10-year lookback, there would be volatility.

Comptroller Lembo remarked that he understood Ms. Bates’ concern. He stated that a closer look and further discussion were warranted.

Ms. Bates referenced the information provided by OPM showing the volatility of the Bureau of Economic Analysis definition of income versus capital gains, which was significant between the two. She believes the solution is to put any capital gains windfall into the Budget Reserve Fund, rather than include them in regular appropriations.

Tom Fiore sought clarification regarding the “Lessons Learned” slide (slide 3) of the Comptroller’s presentation. He asked if the “lesson learned” referred to a 10-year lookback period being preferable for just the Budget Reserve Fund or for personal income as well, to see how it related to revenue growth from all revenue sources.

Comptroller Lembo replied that it referred to both issues. He stated that initially the “lesson learned” was from the discussions on the Budget Reserve Fund. He said it was then applied to this discussion of personal income.

Rep. Smith asked Comptroller Lembo if he was aware of any contractual agreements in state government that contain the language “subject to the availability of funds” to allow for flexibility.

Comptroller Lembo replied that such language is in contracts his office has with third party vendors. He thought it was likely that there are types of contracts that do not contain such language, but he couldn’t identify them at this time.

Rep. Smith commented that the state is struggling with the contracts it currently has. He believes that having such language in contracts would allow the state to free up funds during times of economic distress. He asked Comptroller Lembo to forward contract information if he should come upon it.

Chairperson Cibes sought confirmation that the Budget Reserve Fund deposit rule will apply only after it is determined at the end of the fiscal year that a surplus exists of the corporation income tax and the personal income tax's estimated and final payments.

Mr. Wojcik replied that while it is true that the deposit doesn't occur until the close of the fiscal year, there are provisions in the law that call for the estimates of those revenues to be considered in the January and April consensus revenue calculations. If the consensus revenue assumptions project higher than anticipated amounts, the excess will go into a restricted grant account until the close of the fiscal year. If, at the end of the fiscal year, a surplus still exists, the funds will be deposited into the Budget Reserve Fund.

Chairperson Cibes remarked that he would like further explication at a future meeting regarding the impact the Budget Reserve Fund process will have on the budget process, as well as on spending cap calculations. In addition, he asked Comptroller Lembo and his staff if they could produce a chart regarding a combination of personal income and realized capital gains, since the chart on slide 4 of the Comptroller's presentation relates only to personal income.

Comptroller Lembo remarked that they would.

Chairperson Cibes remarked that the commission will need further analysis and explication regarding the price deflator. He thanked the Comptroller and his staff for raising the issue for the commission's consideration.

Mr. Shuldman commented on the Comptroller's plan regarding pension reform. He then asked Comptroller Lembo to comment on the implications of not designing a spending cap that will put a "firm box" around spending.

Comptroller Lembo responded that it would be helpful to create a "box" around spending, as it creates a different dialogue in future years when there is revenue to address budget problems. He referenced the negotiations regarding the Budget Reserve Fund language, which led to legislators agreeing to "tie their hands" regarding increasing the Budget Reserve Fund in good economic times. Regarding the various pension reform plans proposed, he noted that all of the plans rely on the availability of revenue.

Chairperson Cibes commented that until tax expenditures and tax credits are examined to determine their effect on the revenue base, he believes it is hard to say that the level of revenues limits what the state can spend. He discussed the digital and film credits, which were \$91.5 million in FY 15, thereby reducing the revenue base by that amount. He offered that those funds could have been used to fund programs, such as the Office of Early Childhood, or to reduce recent budget cuts. He also referenced the Small Business Express program, a bonding program that provided over \$232 million to help 1,505 businesses. Chairperson Cibes posited that

perhaps the funding could have supported higher priority items. Further, he stated that when looking at the overall context, the revenue base should be considered, both with and without tax expenditures, because if those tax expenditures were kept in the revenue base, important programs could be funded.

Comptroller Lembo stated that he includes not only revenue and appropriations, but tax expenditures and bonded indebtedness in his discussions, as they all fit together. He believes that they should all be examined to determine if they are achieving the desired results.

Chairperson Widlitz remarked that this discussion highlighted the commission's deliberations concerning what should be considered general budget expenditures and if tax expenditures should be included as general budget expenditures. She thanked Comptroller Lembo and his staff for the presentation and their willingness to address additional questions from commission members.

Chairperson Widlitz then asked if there were any other items members wanted to review or any comments members wished to make.

Mr. Shuldman replied that he had two comments. He remarked that he found Chairperson Cibes' comments regarding tax credits to be "spot on". He stated that the discussion goes to issue of putting everything under the spending cap to exert fiscal control. He then asked how the commission will go to the next level in its deliberations. He wondered what additional information his colleagues thought should be gathered to assist in developing a final product.

In response to Mr. Shuldman's question regarding next steps for the commission, Chairperson Cibes announced that he and Chairperson Widlitz anticipated presentations/discussions on the following:

- Stan McMillen, principle author of the CT Center for Economic Analysis report, will give a presentation at the July 7 meeting. Among the topics anticipated to be discussed will be use of the CPI versus the deflator, personal income, realized capital gains versus other measures of personal income, and Baumol's cost disease as related to general budget expenditures.
- Discussion of the New England Public Policy Center (NEPPC) 2008 report regarding alternative measures of state income. While the paper is not available for citation, Chairperson Cibes hopes to reach a positive outcome with NEPPC staff that will allow for distribution of the paper to commission members. He will also seek guidance from NEPPC staff to assist the commission in its deliberations.
- Presentation by Dan Kennedy on the deflator.
- Discussion of questions raised regarding general budget expenditures, such as unfunded pension liabilities (to include or exclude), federal revenues (treat as budgeted or non-budgeted), tax expenditures and bonding.

Chairperson Cibes remarked that the commission is drilling down to a greater depth in looking at issues than did the spending cap negotiators in 1991. He believes it is important to drill down into these issues to address the concerns laid out in the commission's charge. He noted that an overarching question he believes should be discussed is the voting threshold – should a minority (40%, plus 1) of legislators have the ability to prevent the majority of legislators from responding to the current level of needs in the state.

Chairperson Widlitz commented that she believes the commission will be receiving presentations at least through August. She encouraged members to begin compiling their thoughts on what they think should be in or out of the spending cap. She suggested that once the commission members are ready to share and discuss their ideas, it might be helpful to ask a facilitator to lead them through the sorting process. Chairperson Widlitz concurred with Chairperson Cibes' remarks regarding the amount of research and analysis the commission has undertaken in order to produce valuable recommendations to the legislature.

Ms. Shemitz requested that the issue of rebasing be added to the list of topics to be discussed, especially as it relates to actual versus allowable spending in the prior year.

Richard Porth discussed the potential for the state to invest in towns by providing more aid to municipalities to combat an over-reliance on the property tax, and the implications that would have on the spending cap. He suggested that issue be added to the discussion.

Chairperson Cibes suggested that infrastructure and educational equity be added to the list. He also remarked that the definition of a distressed municipality be considered.

Mr. Shuldman expressed concern about the commission getting into public policy issues like municipal aid, as he does not see such discussion being the role of the commission.

Chairperson Widlitz remarked that she did not see this particular discussion of municipal aid as defining public policy. She stated that she sees it more as an issue of addressing a potential extreme circumstance and how that would be handled within the spending cap. She agreed with Mr. Shuldman that it is not the role of the commission to micromanage policy decisions or look at line items.

Mr. Shuldman responded that he would consider some sort of statement regarding how to handle emergencies; however he reiterated that the commission should not engage in developing public policy regarding municipalities.

Chairperson Cibes stated that while he agreed with Chairperson Widlitz regarding looking into line items, aid to distressed municipalities is a matter to be considered when discussing general budget expenditures, as it is currently exempt from the definition.

Chairperson Widlitz reminded members to forward any additional questions regarding Comptroller Lembo's presentation to Susan Keane. She then drew members' attention to the joint OPM/OFA paper on revenue intercepts that was prepared in response to a request by Representative Ziobron (paper is located on the commission website).

Ms. Bates asked how experts will be chosen to give presentations and if members should be making suggestions to the Co-Chairpersons. In addition, she requested that a timeline be developed to guide the commission's deliberations to its reporting deadline.

Chairperson Widlitz agreed with Ms. Bates' comments regarding a timeline. She stated that she and Chairperson Cibes would develop a proposal to share with members.

Chairperson Cibes remarked that the Co-Chairpersons would be pleased to consider suggestions for additional presenters. He then offered comments on the following items:

- Stanford study on the effects of taxation on migration – it is now only available for sale. It cannot be circulated to members.
- *Digital Deflation* – he has begun to read it and finds it supportive of Baumol's thesis regarding the cost disease.
- *American Amnesia* – new book by Jacob Hacker, which he recommends.

Chairperson Widlitz reminded members that the next commission meeting will be held on Thursday, July 7 at 10:00 am.

Seeing no further discussion, Chairperson Widlitz adjourned the meeting at 2:37 pm.

Respectfully submitted,

Susan Keane  
Appropriations Committee Administrator