

## Spending Cap Commission

September 7, 2016

### Meeting Notes

#### **Attendees:**

Commission Co-Chairperson William Cibes, Commission Co-Chairperson Patricia Widlitz, Suzanne Bates, Rep. Jeff Berger, Sen. Beth Bye, Sen. Steve Cassano, Rep. Christopher Davis, Tom Fiore, Robert Frankel, Sen. Scott Frantz, Sen. Joan Hartley, Roberto Hunter, Sen. Rob Kane, Sen. Michael McLachlan, Richard Porth, Ellen Shemitz, Bart Shuldman, Rep. Richard Smith, Rep. Jonathan Steinberg, Ron Van Winkle, Rep. Melissa Ziobron

#### Staff:

Susan Keane, Administrator  
Amanda Zabel, Appropriations Committee Clerk  
Chris Wetzel, Office of Fiscal Analysis (OFA)

#### Guests:

Anthony Randazzo, Managing Director, Pension Integrity Project, Reason Foundation  
James C. Smith, Chairman and CEO, Webster Bank

#### **Call to Order**

Chairperson Widlitz called the meeting to order at 10:00 am.

#### **Anthony Randazzo, Managing Director, Pension Integrity Project, Reason Foundation**

Mr. Randazzo gave a presentation on “Pension Finance and Connecticut’s Spending Cap” (Mr. Randazzo’s PowerPoint slides and written testimony are available on the Spending Cap Commission website).

Chairperson Widlitz thanked Mr. Randazzo for appearing before the commission. Remarking on his presentation, she stated that the commission was considering whether or not the unfunded liability of the state employees’ pension system should be included under general budget expenditures. She explained that the commission was working to develop a recommendation to the legislature that will guide them in defining the terms of the spending cap. If they were starting from “ground zero” with no indebtedness associated with the pension system, she would agree that unfunded liabilities should be considered general budget expenditures. Given the fiscal challenges the state faces and

the enormity of the unfunded pension liability, she questioned how the state could function and provide basic needs (education, public health, public safety, etc.) if the pension liability was considered a general budget expenditure. She asked Mr. Randazzo to comment on how the state should face such a challenge.

Mr. Randazzo replied that his project has looked at this issue across the country. He remarked that the “crowding out” situation stated by Chairperson Widlitz is a real concern. He added that Connecticut’s pension plans are among the worst funded in the country. From an employee’s perspective, he believes an employee would want the unfunded liability to be under the cap to ensure that their pension is paid. Mr. Randazzo stated that either way, it is a policy question that is separate from the discussion of how to treat unfunded liabilities. If the debate is about whether unfunded pension liabilities are evidences of indebtedness, he would say that categorically they are not because they are not general obligation bonds, tax revenue bonds or fixed debt of any kind. He believes that they are an accounting metric. If the commission chose not to include unfunded liabilities under general budget expenditures, he suggested the language would need to be written in such a way that they are not called evidences of indebtedness, as he believes to consider them as such would be inaccurate.

Chairwoman Widlitz then asked Mr. Randazzo to consider the effect of bonding payments on the unfunded liability, thereby making those payments an evidence of indebtedness. She remarked that the cap on bonding would, to an extent, control the level of bonding issued for the unfunded liability. She reiterated her concern regarding the effect that including the unfunded pension liability under the cap will have on funding other items.

Sen. Bye remarked that in Connecticut, whether an item is considered to be under or outside the spending cap does not affect the legislature’s ability to fund it or not fund it. She then observed that Mr. Randazzo seemed to be distinguishing between fixed obligations and those obligations that may change. She shared that during discussions on how to treat unfunded pension obligations, policymakers considered the new GASB rules that require that pension liabilities be included as a liability on the balance sheet. Further, she stated that GASB asks that all debt be treated equally. Sen. Bye remarked that lawmakers determined that liabilities are debt and should be treated as debt. She asked Mr. Randazzo to share his perspective.

Mr. Randazzo responded that the “liabilities” of the system are not the unfunded liabilities; rather, it is what has been promised to employees, and the evidences of indebtedness would be the \$26 billion in promised pension checks. He stated that it is his contention that retirement benefits are compensation, that they are debt to employees in the same way that a promised salary is a debt to an employee. He added that the fixed bonded debt is different from the fixed promised pension benefits because the pension benefits are an accounting concept and are not fixed costs. The true costs of pension benefits can’t be determined because of unknowns – how long people are going to work, how long they are going to live, changes in marital status and eligibility for disability benefits.

Mr. Shuldman discussed the discount rate used on the pension systems. He stated that although the state uses a discount rate of 8%, the realized rate over the past 12 months was 0.35%, which resulted in the state earning \$873 million less than anticipated. He remarked that over the next 5 years, the state would have to realize a rate of 9.9% each year to make up for the shortfall. He posited that given that the state is not realizing the discount rate, that less is being put away in the ARC, and that the unfunded liability has been put outside the cap, pension items should all be “under the budget” so the public has an honest view of the pension systems.

Mr. Randazzo remarked that Mr. Shuldman raised important issues for the public to understand. He discussed the decline in the returns on bond investments over the years and lower rates of return on the state employees’ and teachers’ pension funds. He shared that markets have changed, and that US equities, European equities, US bonds, municipal bonds, etc. (with the exception of emerging markets traded securities) are forecasted to be lower than they have over the past 30 years, which will make it highly unlikely for the state of Connecticut will earn 7%, 8% or 9% on its assets. Mr. Randazzo offered that it was his personal opinion that on a financing basis and on an accounting basis, it was inappropriate and irresponsible to use a higher rate of return. He added that while this was an important issue for a discussion of pension reform, it was irrelevant to the commission’s discussions regarding evidences of indebtedness.

Mr. Shuldman expressed his concerns regarding keeping the unfunded pension liabilities outside the spending cap. He remarked that is important to know all the costs of state government, including what is owed to state employees, so that decisions can be made on how to spend the state’s revenue resources.

Mr. Randazzo commented on the policy and political issues around what is included under the spending cap. He reiterated his position that the unfunded liability is not an evidence of indebtedness.

Rep. Ziobron asked how Connecticut’s discount rate was determined, and if the process was similar to practices in other states.

Mr. Randazzo offered the caveat that he has not talked to the actuaries for the plan or members of the retirement board. He shared that in his academic career he looks at how discount rates are calculated. He stated that his understanding is that Connecticut is within the standard practices for the rest of the country in how it determines its discount rate. However, he believes that the way discount rates are calculated nationwide is problematic. He went on to explain how discount rates are currently determined.

Rep. Ziobron shared that she has heard that Connecticut’s discount rate is tied to the SEBAC agreement. She asked if any of the commission members knew that to be the case or was it determined as explained by Mr. Randazzo.

Mr. Fiore replied that he was not sure if the SEBAC agreement prescribes the discount rate. He stated that he is aware that the discount rate is set by the State Employees Retirement Commission and the Teachers Retirement Board for their respective plans.

Mr. Hunter cited two remarks in Mr. Randazzo's testimony – "Therefore, because unfunded liabilities are simply an accounting metric, and not a fixed debt instrument, they should not be counted among Connecticut's evidences of indebtedness" and "effectively deferred compensation in lieu of certain salary today". He stated that he takes issue with the idea that, because the pension obligations are owed to state workers, they shouldn't be considered debt. He shared that while he appreciates that pension obligations are a different kind of obligation, he considers them to be indebtedness. In reviewing the statutory language and language of the Constitutional amendment, he does not see any limitation on considering pension obligations as evidences of indebtedness.

Mr. Randazzo replied that compensation is different from contractual debt. He added that he believes it is not an irrational leap of logic to associate pension obligations as a kind of debt, nor is it irrational to associate pension debt with unfunded liabilities. He stated that he is making a very technical argument – if the promise of a salary is considered debt, then deferred compensation is debt; if compensation is not considered debt, then deferred compensation should not be considered debt. He also clarified that he did understand the "crowding out" effect of the unfunded liabilities.

Mr. Hunter then cited Mr. Randazzo's prepared remarks regarding how much the government chooses to contribute towards pension plans today in the form of normal cost versus in the future in the form of unfunded liability amortization payments being an accounting policy choice. Mr. Hunter stated his belief that the contributions are a budget choice that policymakers made over a number of years.

Mr. Randazzo replied that the unrealistic rate of return that is being used is the accounting policy choice, in the same way that depreciation modes are an accounting choice. He clarified that the level of pension contributions is an accounting choice based on budget policy choices. In addition, he shared that there is no law requiring Connecticut to use GASB's rules in setting its contribution rates. He added that GASB rules are a reporting standard that states voluntarily choose to use.

Mr. Shuldman remarked that Mr. Hunter raised an interesting argument. However, in his view if the state had assembled the right policies to fund the pension system, the pension obligation would be zero. Further, he views the contractual obligation to state employees as similar to the state's contractual agreement with a vendor, such as a software company, and does not see that as debt. He cited the steps that Westport implemented to right its pension system.

Ms. Bates remarked that there are two issues being considered – are the unfunded pension liabilities evidences of indebtedness, and if not, should they be considered general budget expenditures in the definition to be developed by the commission. She expressed the concern that items not considered general budget expenditures are growing

at a higher rate than those items under the spending cap, and that pension liabilities should not be allowed to grow at a higher rate.

Chairperson Cibes asked Mr. Randazzo to comment on converting the pension debt into pension obligation bonds, as was done for the Teachers' Retirement System.

Mr. Randazzo replied that a pension obligation bond would be different because it would be a tradable security financed on a fixed basis, with a specific yield that is not malleable to any accounting or budgetary choices that would define what the debt is. Further, he stated that pension obligation bonds effectively change where the state is hedging its risk by moving the risk from the taxpayers to the private sector.

Chairperson Cibes remarked that the state gambled when it issued the pension obligation bonds for the Teachers' Retirement System because it assumed that it would be able to make more money on the \$2 billion than it was paying in interest. He stated that was not the case. He added that it is better to make a rational judgment about the rate of return rather than gambling with pension obligation bonds. Chairperson Cibes stated that he believes that unfunded liabilities are evidences of indebtedness.

Chairperson Cibes then stated that every year the legislature has to estimate the expenditures it will have to make in the next fiscal year. There are times that those costs are underestimated, particularly Medicaid costs. He observed that sometimes, revenues are overestimated, resulting in a budget deficit that must be addressed. He shared that one remedy to addressing a deficit has been the issuance of economic recovery notes. He asked Mr. Randazzo to share his thoughts on the difference, apart from a debt being a fixed obligation and a pension is not a fixed obligation, between the situation just outlined and the situation in which the annual required contribution for pension funding is not made. Is not an indebtedness incurred in both situations?

Mr. Randazzo shared the following: accrued liabilities are monies that have been promised in deferred compensation to employees; that is the obligation. Unfunded liabilities are the recognized funded level of those promised benefits/compensation to employees. A pension obligation bond is money that is owed to a private sector, third party individual not just on a fixed basis, but on a tradable basis; it is an entirely different financial instrument. That can't be done with an individual on their promised benefit because their benefit is however long they work, whatever their salary is, however long they live.

Chairperson Cibes then remarked on Mr. Hunter's observation regarding the language of the constitutional spending cap, stating that he would "parse" it as Mr. Hunter did. He noted that there seems to be a distinction between the payment of principle and interest on bonds and notes and, on the other hand, expenditures for payments of evidences of indebtedness. He added that there may be two different kinds of things – bonds and notes on one hand, and evidences of indebtedness on the other hand. The unfunded liabilities could be considered an evidence of indebtedness if the General Assembly defines it as such. Chairperson Cibes also noted that Mr. Randazzo had remarked that "Unfunded

actuarially accrued liabilities are not technically debt that is owed to a person or institution”. Mr. Cibes stated that he disagreed with that statement. He believes that the liability is owed to a person (the retiree) to whom the state has promised to pay a defined benefit.

Mr. Randazzo replied that the accrued liability is the promise. The unfunded accrued liability is not debt that is owed to an institution. He added that the accrued liability is the promise to the individual, and if assets are available to pay for it, there is no unfunded liability.

Chairperson Cibes replied that there are no assets to pay for the unfunded liability, therefore the state owes it and must pay it. He reminded members of Sen. Bye’s statement that payments on the unfunded liability are accounted for in the state budget. He stated that for 25 years, at least some payment has been made. He pointed out that when it has been under the cap, the state has not met the actuarially required contribution. He suggested that it might be better for the unfunded liabilities to be outside the cap where it would be more likely that the payments wouldn’t have to compete with the expenditures that are under the cap.

Mr. Randazzo replied that it was not his intention for any of his comments to suggest that it would be more likely for the unfunded liability to be paid one way or another. He added that paying at least 100% of the actuarial requirements is an absolutely essential public policy choice for every state to make. Further, he stated that it was his professional opinion that most states’ actuarial determinations are too low. He stated that if it was more likely for the payments to be made outside the cap than under the cap, then from the perspective of solvency one would encourage that. However, he reiterated that from his professional interpretation of the language, the unfunded liability is not an evidence of indebtedness.

Chairperson Cibes then discussed the rate of return and its implications on payments to the retirement system. In addition, he stated that he favored keeping the normal cost of the pension system under the cap, as he views it as a current decision about current compensation.

Mr. Randazzo added a point of clarification regarding the normal costs. He stated that the normal cost for the retirement plans should be whatever is necessary to pay all benefits.

Seeing no further question or comments, Chairperson Widlitz thanked Mr. Randazzo for his presentation.

### **Presentation by James Smith, Chairman and CEO, Webster Bank**

Chairperson Widlitz introduced James Smith, Chairman and CEO of Webster Bank (Mr. Smith’s testimony is located on the Spending Cap Commission website).

Opening the floor to questions, Chairperson Widlitz asked Mr. Smith if he thought tax credits, such as R & D credits, should be included under the spending cap.

Mr. Smith replied that he believes that every expenditure, with the exception of debt service, should be under the spending cap. He added the R & D credits are not a net cost to taxpayers, unlike other credits that might be a current period cost.

Chairperson Widlitz remarked that there might be more scrutiny of tax credits if they were considered tax expenditures under the cap.

Sen. McLachlan and Mr. Smith discussed Webster Bank's expansion into Boston. Mr. Smith spoke of the assets in the Greater Boston area that do not exist in Connecticut. He also believes that Massachusetts has been more successful in balancing revenue and expenses.

Sen. McLachlan asked Mr. Smith to share his views on how court decisions should be treated with regard to the spending cap. He cited the recent court decision regarding education funding.

Mr. Smith responded that court decisions should not be outside the cap. He stated that the Governor and legislature have the ability to handle emergency situations without excluding items from the spending cap.

Rep. Steinberg shared that he agreed with Mr. Smith's assertion that the right signals are sent to the public and the business community when people are clear about what the spending cap represents. He asked Mr. Smith to comment on moving federal pass-through funds, such as Medicaid funding, outside the cap.

Mr. Smith reiterated his position that there are ways for policymakers to deal with special situations. He commented that as more things are taken outside the spending cap, the spending cap loses its value.

Rep. Steinberg commented that federal funds, like Medicaid, are not emergency or one-time-only funds, so he is not sure an emergency declaration would be the appropriate course of action. He remarked that he did see Mr. Smith's point of view regarding keeping everything under the spending cap.

Sen. Kane thanked Mr. Smith for appearing before the commission. He shared that he was taken with one of Mr. Smith's remarks – "as Connecticut goes, so goes Webster, since our balance sheet is a reflection of the well-being of the customers and communities we serve". Sen. Kane said it was an important line, as it speaks to the sentiment he has been noticing in communities and among business that state government is anti-business. He asked Mr. Smith if senses a similar frustration among the customers Webster Bank services and the business community.

Mr. Smith replied that his customers and businesses seemed concerned regarding predictability and stability in state budgeting. He shared his belief that the state can be as competitive as it ever was if there is a focus on creating a sense of stability, predictability and competitiveness and restoring fiscal responsibility.

Sen. Kane then cited another comment in Mr. Smith's testimony – "I'm confident that we can turn it around if we adopt a "control our destiny" approach to solving our fiscal problems..." He asked Mr. Smith if he had any other suggestions to "control our destiny".

Mr. Smith replied that the spending cap creates the discipline that will ultimately create the opportunity to invest in infrastructure. He spoke of the importance in investing in the infrastructure and the opportunities it creates. He also spoke of other steps that could be taken to enhance the business environment.

Rep. Ziobron asked Mr. Smith to comment on his recommendation that the spending cap include a mechanism for judicial review.

Mr. Smith replied that judicial review would allow for people to challenge changes in interpretation of the spending cap or any ambiguities in the language of the cap.

Rep. Ziobron commented on Mr. Smith's remarks regarding the decline of business confidence. She asked Mr. Smith if he could cite some examples.

Mr. Smith replied that 1) businesses are not investing at the rate they once did, therefore capital is not as much in play and jobs are not being created at the same rate as before; 2) many more small and midsize businesses are being acquired, rather than acquiring other business entities; 3) people are making the choice to leave the state because of their overall concern regarding fiscal stability and taxes. He shared that in the last 3 years, the total amount of net income to leave the state is \$5 billion.

Mr. Shuldman commented on the lack of attention by the press and the public on the issues being discussed by the Spending Cap Commission. He spoke to the policies that have influenced businesses on how and if they choose to conduct business in the state. He also spoke on the effects that state taxes are making on people's decisions to stay or leave the state. He asked Mr. Smith to comment on how his customers feel about Connecticut.

Mr. Smith spoke to the affect that corporations leaving the state has had on customers in Fairfield County.

Mr. Hunter asked Mr. Smith to comment on tax credits and if he would be open to tax expenditures generally being on the table for reconsideration.

Mr. Smith replied that tax credits ought to serve the purpose for which they were intended. He remarked that the state needs to make good, solid strategic choices in how



to use tax credits and create clear goals regarding job creation that need to be achieved by the businesses receiving the credits. In addition, Mr. Smith commented that unfunded pension liabilities are human resources expenses and should be under the spending cap.

Sen. Frantz asked Mr. Smith if the people that his business serves are aware of the lack of discipline regarding the spending cap.

Mr. Smith responded that he thinks there are degrees of awareness. He stated that while the people most close to policy know the most about it, the message trickles out to businesses and that the spending cap is not working.

Sen. Frantz asked if the Spending Cap Commission issued a very clear statement about respecting the originally intended discipline of the spending cap would such a statement a difference in the general attitude of business leaders.

Mr. Smith replied that it would make a signal difference.

Sen. Bye comment that she has spoken to small businesses in the area that are growing. She shared that while the businesses are excited about their growth, they also express that they are worried, which speaks to the malaise referenced by Mr. Smith. Sen. Bye remarked that a newspaper article reported that Webster Bank had experienced record net profits and other areas of growth, yet Mr. Smith expressed the same kinds of concerns about doing business in the state that were raised by the small business owners. She asked Mr. Smith to comment on the situation.

Mr. Smith responded that most of Webster Bank's growth is coming from outside Connecticut, including most of its profitable growth. He shared that Webster Bank had to look at other areas in which to grow because Connecticut was not growing. He then spoke of the fiscal discipline needed to instill confidence in Connecticut.

Sen. Hartley remarked that as a legislator who was serving when the spending cap language was first crafted, she is concerned that the spending cap has morphed into something different than what was adopted. She discussed the recent education funding court case cited by Sen. McLachlan and the effect of court-ordered mandates on the spending cap. Sen. Hartley then discussed the emergency circumstances language referenced by Mr. Smith and her observation that it has allowed previous governors and legislatures to "blow through" the cap. She shared that she is struggling how to deal with the spending cap – whether to clearly identify and define exceptions or to rely on the emergency circumstances mechanism.

Mr. Smith responded that he feels the only way to ensure that the spending cap functions properly is to put everything but debt services under the cap. He stated that while he recognizes that doing so poses some challenges, he thinks it would provide a higher level of visibility and accountability to the choices made when the emergency circumstances mechanism is employed.

Sen. Hartley replied that the problem is that by not being very narrow in defining the exemptions, the emergency circumstances mechanism has become more commonplace than it should. She stated that this has resulted in having a spending cap that is continually breached.

Mr. Smith responded that while he understands Sen. Hartley's concerns, he sees the emergency circumstances mechanism as being better than the alternative.

Sen. Cassano remarked that the spending cap has not met its goals on a regular basis. He discussed the budget cuts that have been made and additional cuts that may be needed should everything be put under the spending cap. In addition, he remarked on how other states have used bonding to deal with their long-term debt. He asked Mr. Smith to comment on how in the next year the state can make up for the years that nothing was done to address its long-term fiscal challenges.

Mr. Smith advised that decisions shouldn't be made that are so draconian as to push overall spending significantly below the growth in personal income over time.

Chairperson Cibes expressed concern about the misperception that businesses may have about the state of public policy in Connecticut. He referenced a remark in Mr. Smith's testimony regarding people "apparently accepting our fate as a second tier state". Mr. Cibes asserted that Connecticut is not a second tier state and that every study that has been done legitimately demonstrates that. He shared that the Business Council of Fairfield County, which did a study on economic competitiveness, pointed out that in measure after measure the state ranks in the top 3 to 5. Further, he stated that Connecticut is still in the top five for productivity per capita, and cited other indices that list the state in the top tier among states. He added that the state certainly could do better, and cited Massachusetts as a "hot bed" of innovation, but that residents should not think that Connecticut is not doing well. He then cited a reference in Mr. Smith's testimony to the State Business Tax Climate Index, which ranked the state 44<sup>th</sup> among the 50 states. Mr. Cibes stated that Caroline Boudreau, a nonpartisan, impartial analyst for the State Tax Panel, found significant difficulties with the State Business Tax Climate Index, saying it was questionable in the way it was conducted. He added that Ms. Boudreau pointed out the state tax climate that is conducted by Ernst and Young, which was prepared for the Council on State Taxation, which showed that Connecticut's taxes on business are the lowest in the country and have been the first or second lowest for several years. He emphasized that the misperception that the state is not doing well should not cloud how that state is doing.

Chairperson Cibes then shared that for the 25 years the spending cap has been in place, the state has not, in terms of the total appropriations, exceeded the growth in personal income, even when the spending cap has been exceeded. He offered that data provided to the commission by OPM shows that from 1991 through FY 2017 the total appropriations, including the uncapped appropriations for debt service and the unfunded liabilities in SERS and TRS, has increased by 3.83%. Further, when adjusted by taking out the federal funds for Medicaid, the percentage is 4.19%. He stated that at the same time the

spending cap has grown over 25 years at a rate of 4.29%, and that total appropriations have grown by less than the cumulative spending cap growth. He added that almost all of the cap growth, with the exception of the first year, was in the growth of personal income. Mr. Cibes stated that the data needs to be looked at closely, and it should not be concluded that the state has excessively overspent. He acknowledged that taxes have gone up, but he does not see tax increases as necessarily reflecting anything associated with the spending cap. He believes it may be that the state's "business" situation has required more revenue and revenue projections have not measured up to expectations. He does not see that as having much to do with the spending cap.

With regard to exempting debt service from the spending cap, Chairperson Cibes commented that Mr. Smith rightly pointed out that "placing debt service under the cap could unsettle the credit markets, raise the state's cost of borrowing and possibly lead the state to postpone needed infrastructure improvements". He shared that another consideration is that the state does need to invest in other areas to develop a real, positive economic environment. He spoke of two particular areas – education, in order to provide the capacity of new workers entering the state's workforce to be as innovative and productive as workers in other states, and infrastructure, as Mr. Smith pointed out. He shared his concern that there may be other areas where necessary investments are to be made, and it may be difficult to make those investments as other expenditures are competing with those investments for funding.

Mr. Smith replied that while he did not dispute Chairperson Cibes' number, he has spoken to many people regarding the growth in spending relative to personal income and the inflation rate, and the information he has received differs from the information shared by Mr. Cibes. He stated that there is one thing of which he is certain – if the state had actually accrued for what should have been the payments for the unfunded pension liabilities the growth in spending would have been way over the personal income growth. Mr. Smith shared that he does think that people in the state want to allow for investments, and to the extent that comes through direct expenses, the state has a responsibility to manage spending accordingly. Further, he believes there is a lot that could be done by the state to improve efficiency and productivity, and that the business community is "four square" behind that point of view.

Regarding the issue of productivity, Mr. Smith stated that Connecticut is one of the most productive states on a unit basis in the country, and that the state has a great education system that needs to be made better. He expressed his concern regarding the state declining in rankings. With regard to his testimony regarding accepting our fate as a second tier state, he stated that fate is future. He added that he is not saying that Connecticut is second tier; rather, he believes that the state is first tier and needs to stay as such. He believes that the choices and recommendations the Spending Cap Commission makes will enable the state to remain first tier.

Chairperson Widlitz thanked Mr. Smith for his presentation and comments.

Following a brief recess, Chairperson Widlitz reconvened the meeting.

## **Adoption of Rules**

Chairperson Widlitz asked for a motion to adopt the 2000 edition of Mason's Manual of Legislative Procedure as the commission's rules document. The motion was made by Mr. Frankel, seconded by Chairperson Cibes.

Sen. Cassano asked as the commission was a creation of the legislature, wouldn't it automatically following the rules created by the legislature. Mr. Frankel responded that the Joint Rules contain language to the effect that the various legislative committees can establish their own rules. He believes that in recent times, the committees have not done so and have relied on Mason's Manual, which typically the House and the Senate adopt for their own rules.

Members discussed leaving the votes open. Chairperson Cibes recommended that votes be taken by roll, and that the votes not be left open.

Mr. Van Winkle offered an amendment to allow for telephone voting, seconded by Chairperson Cibes. In response to Mr. Frankel's request for the specific language of the amendment, Chairperson Cibes offered the following:

The Commission may meet by telephonic, video, or other conferencing process, and members may vote on issues considered during a meeting, provided they have all materials considered by the Commission before them and they are able to participate in the meeting through the electronic means and are able to ask questions and have their questions responded to and that they have fully informed themselves of the issues being considered.

Rep. Ziobron asked for confirmation or language that votes will not be held open through telephonic means.

Chairperson Widlitz confirmed that holding votes open was not part of the amendment.

The members discussed Section 538 of Mason's Manual, which prohibits members who are not present from voting. It was decided that the amendment will limit Section 538 and allow members to vote who are participating by electronic means.

Mr. Frankel asked if members would not be allowed to vote if they had not fully participated in the discussion and did not have all of the materials before them prior to the vote.

Mr. Van Winkle responded that the intent of his amendment was members were to be participants in the debate, and that members not just call in to vote.

Mr. Frankel asked how the Chair would be able to satisfy that a member had satisfied all of the conditions laid out in the amendment. He asked if there would have to be a voir dire before they were allowed to vote.

Mr. Van Winkle responded that the Chair would have to know that the member was on the line before the debate begins. He suggested that members should state that they have reviewed the documents and are prepared to vote on the item before the commission.

Mr. Frankel stated that the situation creates a double standard, as a member could vote in person without having participated in the debate, but not so if a member participated by telephone.

Mr. Van Winkle shared that he would say a member could not vote in person if they hadn't participated in the debate, and that members can't walk into the meeting room, vote "yes" and walk out.

Mr. Frankel stated that he begged to differ with Mr. Van Winkle, as that is how the legislature and almost all committees operate. He added that there is no prerequisite that a member has participated in the debate, and that members cast a vote based on the knowledge that they have. He stated that he was uncomfortable with the preconditions prescribed in the amendment.

Rep. Berger shared his thoughts that either a member was present to vote, and if they were not, then they missed the vote. He concurred with the points Mr. Frankel raised regarding establishing a double standard for voting.

Chairperson Widlitz commented that her initial reaction to telephonic voting was to not allow it and that members should be in attendance to participate in the discussion and then to vote. She stated that since her forming her initial thoughts, the Co-Chairs have observed that there have been members who have participated in almost all of the commission meetings, sometimes telephonically. She shared that the intent of the Co-Chairs is to not disenfranchise any member who has been informed and participating. While she continues to have misgivings, she pointed to Rep. Smith, who has participated in meetings either in person or by phone. She believes that his participation level and the work he has put into understanding the issues warrants giving him the ability to vote by telephone. She acknowledged that the amendment creates a double standard. She invited members to share their thoughts on the matter.

Rep. Smith stated that he has some concerns regarding the potential voir dire process that the commission was discussing. He shared that he believed that commission members understand the obligations to be informed and to participate, and establishing a voir dire process is misplaced. In addition, he stated that he does not want to see a double standard for voting. He added that if the commission decides it will allow telephonic voting that the voting occur in real time.

Sen. McLachlan concurred with the remarks made by Mr. Frankel and Rep. Smith. In addition, he shared that the "watchdog" agencies allow for telephonic voting. It is his understanding that the telephonic participant is on the telephone when the meeting is

convened and remains on the telephone through the discussion and voting until the meeting is adjourned. He recommended that the commission follow that process.

Sen. Cassano voiced his support for allowing members who actively participate in the commission's deliberations to vote by telephone.

Chairperson Widlitz asked Chairperson Cibes to state the language of the amendment. Chairperson Cibes stated the following:

The members of the Commission may participate in the meeting by telephonic, video or other conferencing process, and may vote on the issues presented provided they have fully participated in the meeting and have heard the debate prior to the vote.

Members discussed the implications of participating via video. It was decided that "video" be deleted from the amendment.

Mr. Hunter suggested striking "fully" and inserting "been able to" and to change "participated" to "participate"; the language would now read "provided they have been able to participate". He explained that the language currently before the commission would require some sort of confirmation of full participation. As members sometimes come and go during the course of a meeting due to other meeting commitments, they would not be fully participating in the meeting, but would have been able to participate.

Mr. Shuldman raised a concern regarding a member being able to participate, but choosing not to and then wanting to cast a vote.

Mr. Hunter replied that "fully participated" is a standard. He cautioned that the commission should be careful using that phrase.

Mr. Frankel observed that it didn't appear that members were fully satisfied with the language of the proposed amendment. He suggested that the members vote on the main motion and delay a vote on an amendment to allow some commission members to confer on language that could be considered at another date.

Chairperson Widlitz replied that she thought Mr. Frankel's suggestion was a good one. Mr. Van Winkle then withdrew his motion, and Mr. Cibes withdrew his second.

Chairperson Widlitz then called for a vote on the motion to adopt the 2000 edition of Mason's Manual of Legislative Procedure as the commission's rules.

Rep. Ziobron asked if the motion should include "except Section 538", as the amendment allowing telephonic voting was no longer before the commission.

Chairperson Widlitz replied that it would be inappropriate to assume that an amendment would be adopted in the future that would change the rule. Therefore, the motion should stand as presented.

Chairperson called for a vote on the motion. By voice vote, the motion carried, with Senator McLachlan voting in the negative.

Mr. Hunter asked if the Chairs or Mr. Van Winkle would be presenting an amendment for consideration at the next meeting.

Chairperson Widlitz responded that an amendment would be offered, in writing.

Mr. Van Winkle commented that the perspective regarding participation on the local level is different from the state level. He shared that has read all of the material presented to the commission in order to understand what is being considered. He has listened to the debate and the perspectives of his fellow commission members to understand their points of view. He remarked that he finds the notion that a member could “pop up” to vote offensive, given the time he has spent trying the issues before the commission. He added that on the local level, participants need to understand the issues before them and the debate on both sides before a vote. He believes to do otherwise is not a good way to operate.

Mr. Shuldman thanked Mr. Van Winkle for expressing his concerns. He concurred with Mr. Van Winkles remarks.

Chairperson Widlitz commented that the Co-Chairs will work on the issue of telephonic voting. She shared that she wants to avoid members being brought into a meeting in order to swing a vote.

### **Acceptance of the August 1 Meeting Notes**

Chairperson Widlitz asked for a motion to accept the August 1 meeting notes. The motion was made by Chairperson Cibes, seconded by Mr. Porth. The meeting notes were accepted by voice vote, with Chairperson Widlitz and Rep. Ziobron abstaining.

### **Acceptance of the August 15 Meeting Notes**

Chairperson Widlitz asked for a motion to accept the August 15 meeting notes. The motion was made by Rep. Ziobron, seconded by Ms. Bates. The following changes were recommended:

- Page 2 – change “flexible” to “adjusted”
- Page 14 – change “cufflinks” to “handcuffs”

The meeting notes were accepted as adjusted, with Mr. Frankel abstaining.

## **Approval of a Definition of “Increase in Personal Income”**

Chairperson Widlitz directed members to the proposed options before them. She asked Chairperson Cibes to direct the discussion.

Chairperson Cibes reiterated his comments conveyed in the email sent to members that these are options and that nothing is “locked in stone”. He stated that he does believe that there is consensus the increase in personal income would reflect the unadjusted Bureau of Economic Analysis personal income definition and not be modified by the change in capital gains, the geographic location of the income or imputed rent to homeowners.

Mr. Cibes remarked that the current statutory definition, which refers to the average increase in personal income over a number of years, might be subject to misinterpretation. He shared that his wife, a statistician, commented that the language could be interpreted to mean the arithmetic mean, as opposed to the geometric mean, which Mr. Fiore has confirmed. To avoid that interpretation, Chairperson Cibes suggested that the current statutory language, “the average of the annual increase in personal income in the state for personal income in the state”, be replaced with “the compound annual growth rate of personal income in the state”. He added that his wife advised him that the proposed language does not make the cap “looser” because the arithmetic mean is always greater than or equal to the geometric mean. This was confirmed by computations done by OPM staff. Further, Chairperson Cibes stated that the compound annual growth rate has been the method of computation used over the past 25 years, as confirmed by OFA staff. He remarked that the proposal is more specific than the current definition and is the historical practice that has been used.

Chairperson Cibes remarked that there were two options that needed to be considered – a lookback period of 5 years or 10 years, and the use of calendar year or fiscal year. In his commentary he had observed that the lookback period for 10 years is less volatile than for 5 years. He commented that either one would be equally transparent. He shared that two things might favor a 5 year lookback – 1) it more reflects the personal income of a comparatively more recent time, and 2) in the near future, using a 5 year period would avoid the dampening effect of the great recession because a 10 year lookback for the next few years would include the years of the great recession.

Regarding calendar year versus fiscal year, Chairperson Cibes noted in part IV of the commentary “The existing statutory spending cap does not specify whether the reference year should be the preceding calendar year or the preceding fiscal year. In the first fiscal year under the cap, OPM used fiscal years and OFA used calendar years. In the year since, until the legislature specified otherwise, both OPM and OFA used fiscal years as the reference. Per legislative directive, calendar years are now used.” He observed that if in using the preceding fiscal year, OFA and OPM would be using the same reference year – the fiscal year ending June 30 of the year preceding the construction of the budget. He further commented that the most recent data would be the calendar year, as it runs through December 31 of the year prior to the year being budgeted. He pointed out that the difficulty in using the calendar year might be that the last quarter would be a



projection when the Governor's budget was being developed; however, by the time OFA gets the data, they would have the full calendar year on which to make a judgment.

Regarding the discussion personal income, Mr. Shuldman asked for confirmation of which data the commission was looking at on the August 15 charts submitted by OPM. Chairperson Cibes replied that members should be referencing Exhibits C and D. Exhibit C, Column C reflects that 5 year compound annual growth rate; Exhibit D, Column C reflects the 10 year compound annual growth rate.

Regarding the procedure for consideration of the options, Mr. Frankel suggested that the commission entertain a main motion to adopt Option 1.

Following that motion, a motion for an amendment to change the year from calendar to fiscal (Option 2) could be entertained. If that amendment passes, a second amendment could be entertained regarding the lookback period.

Chairperson Widlitz thanked Mr. Frankel for his suggestions. She asked for a motion to approve Option 1. The motion to do so was made and seconded.

Option 1:

As used in this section, "increase in personal income" means the compound annual growth rate of personal income in the state over the preceding five calendar years, according to United States Bureau of Economic Analysis data;

She then asked for a motion on an amendment – Option 2. The motion was made and seconded.

Option 2:

As used in this section, "increase in personal income" means the compound annual growth rate of personal income in the state over the preceding five state fiscal years ending twelve months and one day prior to the start of the fiscal year being calculated, according to United States Bureau of Economic Analysis data;

Regarding Option 2, Chairperson Cibes remarked that OFA had looked at initial language of the five state fiscal years. OFA staff pointed out that the language was ambiguous and needed to reference the fiscal year ending 12 months and 1 day prior to the start of the fiscal year being calculated. He cited as an example that in creating a budget for FY 17, OFA would use as a reference the fiscal year ending June 30, 2015.

Mr. Shuldman recommended using calendar year. He stated that OPM would have figures through December and could forecast the coming quarter. As the budget is not approved until May or June, the figures could be updated and the most current data possible would be used. He observed that a lot of things can happen in the economy over 12 months, and the state should budget to the best, most current numbers available in order to budget accurately.

Mr. Hunter shared that he largely agreed with Mr. Shuldman's remarks. He then asked Mr. Fiore if OPM has been able to forward test the data in Exhibits A through E either formally or informally to ascertain what the impact would be regarding rates of permitted growth for the 5 year and 10 year lookback periods.

Mr. Fiore replied that OPM has not done any forward testing, as that would be based on an economic forecast from one of OPM's outside vendors and would be subject to change depending on the number of years used.

Mr. Hunter then asked as a calendar year is currently being used is OPM's calculation limited to one quarter worth of projection, and does OPM update that projection for actuals before the budget is passed. Further, he asked if that then went into setting the spending cap with all actual information.

Mr. Fiore replied that this has been the first time the calendar year was used. When the Governor presented a 2 year budget, the calculations were done on a fiscal year basis, and when it was finally passed, OFA calculated it on a calendar year basis. He remarked that there was not a discrepancy between the use of the fiscal year and the calendar year; therefore no forecasting was necessary. He added that for a biennial budget, forecast data is always used in developing the 2<sup>nd</sup> year of the budget, as there is no actual data to use. Mr. Fiore commented that if the switch was made to a calendar year, OPM would use one quarter of forecast data, and by the time the budget is passed, OFA will have the advantage of having all actual data for that calendar year. He confirmed that the actual data would set the spending cap.

Mr. Hunter asked for confirmation that in the 2<sup>nd</sup> year of the biennium, the forecast data would be changed to actual data at some point, and the projected spending cap would become an actual spending cap, with adjustment being made to the budget in order to comply with the actual spending cap.

Mr. Fiore confirmed Mr. Hunter's understanding of the process for the 2<sup>nd</sup> year. He added that that process applies to calculating on a fiscal year, as well.

Rep. Davis asked OFA what scenario would work best for their calculations.

Chris Wetzel replied that as long as regular personal income was used, without adjustments, there shouldn't be any issues regarding time of the calculations, as the data is published and readily available.

Rep. Davis asked then the data is available.

Mr. Wetzel responded that it is available in March.

Rep. Davis asked Mr. Wetzel if by using a calendar year, although the Governor's proposed budget would be affected, the budget passed by the legislature would be calculated using accurate, concrete data for the 1<sup>st</sup> fiscal year.

Mr. Wetzel replied that Rep. Davis' statement was accurate. He added that when using the most recent data downloaded in March, there could be a scenario by which the Governor's proposed budget is spending cap compliant when submitted in February, but could be over the spending cap when the calculations are updated. The same scenario could be applied to the budget at the committee level.

Rep. Davis asked when the spending cap is calculated. He stated he would be comfortable using the calendar year if the spending cap is calculated when the legislature votes, using the most recent data.

Mr. Wetzel replied that he calculates the spending cap right before the legislature votes on the budget bill.

Rep. Davis then asked if there was language that specified when the spending cap calculation needed to be done.

Mr. Wetzel replied that he was not aware of any such guidelines.

Mr. Fiore shared his thoughts regarding Option 2. He remarked that as the commission has looked at the three issues considered – personal income, calendar versus fiscal year, and the lookback years, personal income represented 60% of what the problem the commission is trying to answer, with the lookback period representing 30%. He sees deciding on calendar year versus fiscal year as the smallest component of the discussion. He referred to the scenario discussed by Mr. Wetzel for the potential of the Governor's budget not being allowable under the spending cap once the 4<sup>th</sup> quarter data was updated, necessitating cuts that the legislature might not have contemplated. He stated that he favors Option 2, as it would put OPM and OFA on the same level playing field in using the same data.

Mr. Shuldman remarked that when a business sets its budget, it recognizes that adjustments may need to be made during the course of the year. He believes it is important for the state to set the most accurate budget it can, and using a calendar year provides the opportunity to have discussions based on current information.

Mr. Hunter concurred with Mr. Shuldman's remarks. He asked if it is clear, either in the statutory language or in the Constitutional amendment, which branch of government is accountable for the determination of the spending cap.

Mr. Fiore responded that the General Assembly is ultimately responsible for determining the spending cap and that OFA provides the calculation to the General Assembly.

Mr. Shuldman asked Mr. Fiore if by using a calendar year, there would be 2 quarters of data available.

Mr. Fiore concurred with Mr. Shuldman's remark. He added that although he can see the advantages of using a calendar year, in using a fiscal year, what the Governor sees when proposing a budget is the same as what the legislature sees in adopting a budget.

Chairperson Cibes stated that he agreed with Mr. Shuldman. Therefore, he would be opposed to the adoption of Option 2.

Chairperson Widlitz called for the vote on the amendment. The amendment failed, with 1 voting yea and 16 voting nay.

Chairperson Cibes then turned to Option 3 – using the preceding 10 calendar years or preceding 5 calendar years:

Option 3:

As used in this section, “increase in personal income” means the compound annual growth rate of personal income in the state over the preceding ten calendar years, according to United States Bureau of Economic Analysis data;

He noted that Ms. Shemitz had requested Exhibit E, which looked at the compound annual growth rate over one year, the preceding calendar year. He informed members that he had received the exhibit after he had constructed the option before them; however based on the volatility involved, it did not appear to him that the commission members would be interested in pursuing that option.

Chairperson Widlitz asked for a motion on Option 3. Mr. Shuldman made the motion, seconded by Rep. Berger.

Mr. Shuldman remarked that he views Option 3 as a math equation. He offered an example – the state has entered a recession and is in year 2 of that recession. If a 5 year calculation is used, those 2 years represent 40% of the calculation and the preceding 3 years would represent 60%. The recession will have a bigger effect in a 5 year calculation, which will be a better reflection of the 2 years of decline. In using a 10 year calculation, the 2 years of decline would represent 20%, with 80% representing good economic times. He stated that he feels that 10 years is too long, and that 5 years would accurately reflect what is going on in the economy.

Sen. Cassano remarked that he supports using 5 years, given the ever-changing economic circumstances in the world.

Mr. Fiore concurred with Sen. Cassano's position. He added that he thought that Mr. Shuldman's mathematical approach was a good one. He shared that he has thought of issue as it being a question of is our economy what it was 10 years ago. He thinks it is

not reflective of the economy 10 years ago and that 5 years is the more appropriate period of time.

Chairperson Widlitz called for a vote on the amendment. The amendment failed, with 0 voting yea, 17 voting nay.

Chairperson Widlitz then called for a motion on the main motion. The motion passed, with 17 voting yea, 0 voting nay.

### **Further discussion of “increase in inflation”**

Chairperson Widlitz recommended holding the discussion on “increase in inflation” until the next meeting.

### **Timetable**

Rep. Ziobron expressed her concerns regarding the public hearing schedule. She stated that strongly believes that the hearings should be conducted before the commission makes its recommendations. Further, she commented that she has concerns regarding holding the five hearings (one in each Congressional district) in one week. She believes it is important to bring choice and transparency to the public. She asked for a discussion of the commission’s schedule of deliberations and hearings.

Chairperson Widlitz responded that the public hearings were tentatively targeted for the week of November 14 to give the commission that maximum amount of time for its deliberations. She acknowledged the challenges in holding 5 hearings in one week, and agreed that the commission must focus on getting to its target. She also concurred with Rep. Ziobron that the most difficult issue before the commission is the definition of general budget expenditure. She suggested that the commission may want to look at scheduling more meeting dates. Ms. Widlitz told Rep. Ziobron that she could not give the members a schedule today, as the Chairs needed to look at the timing of deliberations and a vote on the definition of “increase in inflation”. She asked Chairperson Cibes to comment.

Chairperson Cibes remarked that the commission should try to vote on the inflation definition at the next meeting. He added that he would have liked to have talked about the cost disease of personal services; he has a handout that he will circulate for consideration. Further, he remarked that given the menu of items left to be considered, he believes there will be controversy around of number of them. He stated he is not certain that all of the issues before the commission can be dealt with in 3 meetings.

Rep. Ziobron stated that she understood the need for setting productive goals. She expressed the concern that having the public hearings after the election is bad policy and not transparent for the public. In addition, she shared that she is concerned that voters will not want to participate after the presidential election, and it is important to hold the hearings while the public is still paying attention. She expressed the hope that the agenda

for the next meeting will include a discussion of a timeline, even if the end result is scheduling more meeting.

Chairperson Widlitz replied that she agrees that there is a need for more meetings. She stated that she does not want to make the process political by tying it to the election, as she does not think the election is relevant to the commission's work and should have no bearing on the timing of the commission's deliberations.

Rep. Ziobron replied that she was not saying that the timing of the hearings have a political bent. Rather, she was commenting on the exhaustive effect of the election process on the public. She reiterated her concern that the public will "turn off" and not pay attention to the work of the commission.

Chairperson Widlitz shared that she heard a discussion of the spending cap that morning during an NPR program. She added that she's had discussions with the League of Women Voters, who have expressed interest in the commission's work.

Rep. Steinberg recommended that the commission expand its meeting schedule by meeting weekly.

Chairperson Widlitz stated that the Chairs would have a meeting and have a hearing schedule proposal for the next meeting.

Ms. Bates expressed her concern that should the commission issue a report the week following the hearings, it will appear that the public hearings were an afterthought, rather than part of the process. She stated that she would like to make the public feel as much a part of the process as possible.

Mr. Shuldman agreed with Ms. Bates regarding public participation. He added that the commission can take the public's thoughts into consideration during deliberations.

Chairperson Widlitz stated that she was reluctant to invite the public to hearings and not have something to present to them that had been agreed upon the commission, even if it is a draft document. She added that the commission can always come back together to consider the valuable input gathered at the public hearings.

Ms. Bates offered that more meetings should be scheduled in order to get the report done sooner.

With regard to the price index for the increase in inflation, Mr. Hunter suggested that a proposal with various options be developed and circulated prior to the next meeting.

Sen. McLachlan suggested that the commission stop its deliberations and begin public hearings. He remarked that commission members who have been around the legislature could probably predict what the public will say – those who want the legislature to stop the current level of spending will want a spending cap that only excludes debt service,

and those who want to continue the current spending levels or to spend more will want their spending concerns excluded from the spending cap. He encouraged the commission to begin gathering public feedback.

Sen. Cassano offered that he believes that after the election there will be a “breath of fresh air” and that the public will focus on the commission’s work. He expressed concern that the commission will not have access to the same level of information if it meets weekly. He urged members not to rush the process.

Chairperson Cibes remarked that there had been consideration of holding hearings in early summer, but that the hearings were deferred because members had thought there should be at least a draft document to take to the public. He added that there is a menu of options now that perhaps could be taken to public hearing. He commented that the commission has been very responsible in its deliberation. He shared his thoughts regarding the work of the State Tax Panel, believing that they pushed things along too quickly and waited too long at the end to have good considerations of the various options. Chairperson Cibes stated that he is pleased that the Spending Cap Commission’s deliberations have been substantive and have dealt with major issues; he would like to see that continued.

Regarding the option considered today, Chairperson Cibes asked members to take a look at the commentary presented. He remarked that the commentary is not “written in stone”, but was written with the intension of serving as a basis for a final report. He stated that he envisions that when the commission adopts a set of recommended definitions, it will be accompanied by a report that embodies many of the considerations that the commission looked at. He added that he looked at the process of drafting commentary as a way of starting the process on the final report, and that it should reflect the actions taken by the commission.

Seeing no further discussion, Chairperson Widlitz adjourned the meeting at 3:09 pm.

Respectfully submitted,

Susan Keane  
Administrator