

Spending Cap Commission

July 7, 2016

Meeting Notes

Attendees:

Members:

Commission Co-Chairperson William Cibes, Commission Co-Chairperson Patricia Widlitz, Suzanne Bates, Rep. Jeff Berger, Sen. Steve Cassano, Tom Fiore, Robert Frankel, Sen. Scott Frantz, Roberto Hunter, Sen. Rob Kane, Representative Jonathan Steinberg, Rep. Melissa Ziobron (Note: Rep. Richard Smith participated by phone)

Staff:

Susan Keane

Guests:

Stanley McMillen, Ph.D., Visiting Assistant Professor at Trinity College and UConn
Richard Benham (on behalf of Lori Pelletier)

Call to Order

Chairperson Cibes called the meeting to order at 10:09 am

Acceptance of the June 20 Meeting Notes

Chairperson Cibes asked for a motion to accept the June 20 meeting notes. The motion was made by Rep. Berger, seconded by Roberto Hunter. The Chairperson asked if there were any modifications or discussion.

Rep. Ziobron asked Chairperson Cibes to explain his remarks on page 7 regarding the voting threshold.

Chairperson Cibes responded that his remarks were intended to suggest that the commission look at the overall context of the spending cap, including the issue of majoritarian rule, which he thinks the spending cap undercuts. Further, while he understands the voting threshold language is in both the statute and the Constitution, he believes the threshold is an overarching issue that should be looked at along with other specific elements of the spending cap.

Rep. Ziobron asked Chairperson Cibes if he meant the issue to be a topic of conversation or was he looking for the commission to influence the voting threshold.

Chairperson Cibes responded that unless the commission was looking at recommending changes to the Constitution, he was not seeking to recommend a change.

Seeing no further discussion, the meeting notes were approved by voice vote, with Sen. Kane and Rep. Ziobron abstaining.

Chairperson Cibes then introduced Stanley McMillen, who gave a presentation on Connecticut's Spending Cap. Dr. McMillen, a Visiting Assistant Professor at Trinity College and the University of Connecticut, was the lead researcher on the CT Center for Economic Analysis (CCEA) 2005 report on CT's spending cap. (Dr. McMillen's PowerPoint presentation is located on the Spending Cap Commission website).

Following Dr. McMillen's presentation, Chairperson Cibes raised another implication of Baumol's cost disease that he believed was offered by Baumol in a subsequent paper. He stated it was his understanding that while wages in productive industries rise, there is a tendency for wages in stagnant industries to rise as rapidly as in the productive sectors of the economy. Relatively, that means the cost of services rises more than the cost of goods in the productive sector. He asked Dr. McMillen if that was correct.

Dr. McMillen responded that they do rise and they grow in tandem. He added that the question is "are consumers getting more value from the services than they did before". They may be getting the same service, but they are paying more for it.

Chairperson Cibes referenced *Digital Deflation*, which he believes argues that in digital industries (where there is higher productivity because of digitization) the costs of goods in that sector decreases. He stated that was not the case in person-to-person services, such as education and healthcare, so that there isn't a deflation in the cost of much of what government does. Further, he stated that in order to see that kind of deflation, there would have to be a decrease or stagnation in the wages paid to services providers, and if so, workers would abandon the service industries to go into high productive industries.

Dr. McMillen concurred with Chairperson Cibes' remarks.

Rep. Steinberg stated that the commission's challenge is to choose a basis for the spending cap that is as accurate as possible. Given the various models the commission is reviewing, he asked Dr. McMillen for guidance on choosing a model or models that address Connecticut's perspective.

Dr. McMillen replied that it would depend on whether the model limits revenue or limits spending. He stated that some states limit revenue, which limits spending implicitly, while others limit spending explicitly. For limiting revenue, he would recommend using the adjusted personal income as the measure, which is what Massachusetts used. He stated that personal income, which is the measure the state is using now, omits realized capital gains and the residence adjustment. For limiting spending for goods and services government purchases, he would recommend using the implicit price deflator. He suggested perhaps augmenting the measure with a medical cost deflator or the growth of Medicaid costs as a way to grow expenditures for those things that government has to pay for.

Rep. Steinberg asked if any state or entity tried a blended approach that takes into account both aspects.

Dr. McMillen replied that Appendix 1 of the CCEA report describes the spending rules of other states. He shared that some states have either a revenue limit or a spending limit and that some states have both.

Chairperson Cibes stated he had two comments to share. First, Connecticut has a spending cap, not a revenue cap. The spending cap is the Constitutional provision and the commission is charged with recommending definitions for the elements of the cap. Second, he reminded members that early in the process an NCSL paper had been distributed, which summarizes tax and expenditure limitations (TELS) imposed by states. He added that the NCSL paper analyzes the benefits and costs of TELS.

Rep. Steinberg expressed the hope that the commission's recommendations don't experience the same outcome as the Tax Panel's recommendations, as the panel's recommendations did not result in policy changes. He believes that while an important part of the process is for members to understand the assumptions and choices that the commission needs to make, equally important is that there be some mechanism that leads to conversations once the commission's recommendations have been submitted. He observed that Dr. McMillen's comments indicate that both spending and revenues need to be addressed in some coordinated fashion in order to achieve a sustainable budget. In addition, Rep. Steinberg expressed his frustration that the commission is looking at different factors that are going to exist somewhat in a vacuum, but that will need some practical application.

Chairperson Widlitz agreed with Rep. Steinberg's comments regarding the need for tax policy and spending policy to be looked at together. She remarked that the commission is charged with looking at the spending cap and a way to allow state government to meet the needs of state residents, yet not overburden state taxpayers. Further, she commented that after each presentation to the commission, members come back to the question of "how do we address both needs".

Dr. McMillen suggested that one way might be to combine indices for revenue and expenditures, thereby creating a blended index.

Chairperson Cibes replied that the Constitution addresses both revenue and expenditures, as the cap on spending should be the greater of the 5 year average growth in personal income or the 1 year growth in inflation. He stated that it is definition of personal income and the definition of inflation that the commission is charged with examining. He commented that as corporate income and other income are not included in the measure of personal income, they are outside the bounds of the commission.

Dr. McMillen responded that the Constitution does not define the measure of personal income. He remarked that there are many measures of personal income. Without there

being specifics, he offered that the commission may be free to choose what measure to use, both for personal income and inflation.

Rep. Steinberg suggested that the commission might recommend a constitutional change if it thought that was appropriate.

Tom Fiore and Dr. McMillen discussed aspects of Baumol's cost disease and the implications of having an economy based on low growth industries and the effect on revenue raising capacity.

Mr. Fiore then commented that the spending cap has two components – a spending limit and a balanced budget requirement. He remarked that perhaps Baumol's cost disease applies more toward the balanced budget requirement to the extent that the revenue necessary to support state government would be generated if the state had industries that were in high productive areas.

Dr. McMillen replied that Baumol talked about the structure of the economy and the interplay between service producing sectors and goods producing sectors. He spoke of the evolution of the economy, citing agriculture as an example of a goods producing sector that has been dramatically changed due to mechanization and scientific and technological advancements. On the other hand, service producing sectors, such as hair cutting and artistic performances, are not impacted by similar advancements. Further, he stated that as the shares of service producing industries grow, productivity growth slows because service producing sectors are slow growing. If an economy was entirely service producing, he advised that an entity would want the highest value added services industries, like financial services and technology services, to support the tax base.

Mr. Fiore noted that in the 2005 CCEA paper the team added two factors to the state and local government index – Medicaid expenditures in Connecticut and Connecticut enrollment growth in Medicaid. He asked Dr. McMillen to comment on why Connecticut data was chosen, rather than nationwide growth data.

Dr. McMillen replied that the study was Connecticut-centric, and pointed out that the team looked at personal income in Connecticut. He stated that the implicit price deflator exists only on the national level; however, Vermont found that it closely tracks the composition of their spending. Further, he commented that to be realistic, revenues and/or expenditures for the state should be tracked, as the national picture might be very different. He explained that one reason for the difference might be demographics. That would be a reason to be Connecticut-centric.

Suzanne Bates remarked that technological advances are not only affecting manufacturing, but are starting to affect service industries. She commented that technological changes don't seem to have affected government in the same way or produced efficiencies in government spending. She thinks there are some barriers to changing government that don't necessarily exist in the private sector, such as a low trust factor to change in government, while the private sector embraces change more easily.

She believes that the public should be able to have a level of expectation that efficiencies can be realized in government.

Chairperson Cibes remarked that he wanted to follow-up on Ms. Bates remarks by shifting the focus of the discussion from the economy in general to applying Baumol's cost disease to the cost of government. He stated that Ms. Bates comments were "right on", and agreed that government should always be seeking efficiencies. He cautioned that sometimes the cost of implementing digitization is great and doesn't always produce the desired outcomes. He cited the attempts by the Department of Motor Vehicles and the Department of Social Services to upgrade their computer systems that were not particularly productive or efficient. In addition, Chairperson Cibes stated that in terms of the cost of services government provides (face-to-face services, such as education and health care), Baumol's subsequent analysis concluded (hypothetically – and Professor Nordhaus' analysis perhaps confirms) that the cost of government services continues to increase faster than the rate of inflation. He believes that may have an impact on the types of limitations on expenditures the commission would suggest, and that perhaps the limitations can't be as strict with respect to inflation because of the basket of goods and services government provides. He suggested that the commission needs to look at the issue closely.

Dr. McMillen agreed: inflation has been almost zero in recent years, but education and health care costs continue to grow. However, he asserted that there is definitely room for efficiency improvements in government.

Chairperson Cibes remarked that there have been a number of attempts to achieve efficiency improvements in recent years – not all of them successful.

Rep. Steinberg remarked that he has seen some limited success by agencies in achieving efficiencies. He shared that the Department of Energy and Environmental Protection went through a LEAN analysis in an effort to streamline its regulatory process. He posited that there are opportunities for the legislature to mandate similar "introspection" regarding agency processes. He thanked Dr. McMillen for his comments.

Chairperson Cibes commented that the number of reports Dr. McMillen provided to the commission gives it a number of opportunities for further discussion. He said that he thought the 2005 CCEA report made a good point of including state and local government in the deflator index. He believes it was important to distinguish the basket of goods and services that consumers buy and the basket of goods and services that government buys. Further, he believes that the commission needs to look more carefully at the memo from the New England Public Policy Center (NEPPC) regarding the pros and cons of various measures of personal income. He remarked that the memo points to a number of areas where the personal income measure can be adjusted. Chairperson Cibes noted that he thinks it makes a lot of sense to include realized capital gains. He also believes that the source of income – the residence adjustment – should be considered because the BEA measure of personal income includes the income of residents wherever earned. That measure would include income earned by Connecticut residents who work

in New York State. Those wages cannot be captured by Connecticut, as they are taxed by New York. In the case of Massachusetts, it made sense to include the source of revenue adjustment, as it would result in a net increase in the revenue base. In the case of Connecticut, the adjustment would result in a decrease in the revenue base. However, Chairperson Cibes believes that it is honest to recognize that the income will not be subject to taxation in Connecticut, and so ought to be excluded from the measure of personal income. Further, he thinks the commission should look at whether it is possible to exclude from the measure imputed value of rent from homeowners, although he doesn't know if there is an easy way to do so. He would also like the commission to examine the question of the ability to gather information in a timely way – is there too great a lag time of data for certain measures of personal income or inflation?

Chairperson Cibes remarked to Dr. McMillen that he was pleased to see the “Comparison of BEA Estimates of Personal Income and IRS Estimates of Adjusted Gross Income” paper that Dr. McMillen had provided to the commission. He noted that the paper addressed other adjustments to BEA personal income that he and other members hadn't known. He encouraged commission members to take a close look at the paper.

Regarding future presentations, Chairperson Cibes announced that the July 18 meeting would include a presentation by Dan Kennedy on the state and local government deflator, and the August 1 meeting would include a presentation by Elizabeth McNichol from the Center on Budget and Policy Priorities. Ms. McNichol will speak on various topics she addressed in the May 9 testimony she submitted to the commission. He reminded commission members that they should contact the Co-Chairpersons if they have suggestions for additional presenters. Presenters should provide information to assist the commission in making progress on the definition of personal income, the definition of inflation, and what should be included the measure of general budget expenditures.

Chairperson Widlitz thanked Dr. McMillen for his presentation. She and Chairperson Cibes announced that they would defer discussion of the NEPPC paper to the next meeting.

Chairperson Widlitz reviewed a proposed meeting schedule:

- July – Monday, July 18
- August – Monday, August 1
- Monday, August 15
- September – Wednesday, September 7 (adjustment for Labor Day)
- Monday, September 19
- October – Wednesday, October 5 (adjustment for Rosh Hashanah)
- Monday, October 17
- Monday, October 31 (adjustment for November 7 – day before the Election Day)

Rep. Smith suggested that the commission dedicate a meeting to a recap of the materials that have been presented and reviewed and a discussion of what still needs to be addressed. Rep. Steinberg and Chairperson Widlitz concurred with Rep. Smith's

suggestion. In addition, Chairperson Widlitz informed members that she and Chairperson Cibes hoped to have presentations completed in August so there was sufficient time to review all of the information presented.

Chairperson Widlitz then shared the recommendation that the public hearings that are required to be held in each of the Congressional districts be scheduled for the week of November 14.

Ms. Bates suggested holding some of the hearings in mid-October.

Chairperson Widlitz replied that she and Chairperson Cibes believe that the commission needs time to develop the definitions. If consensus is reached ahead of schedule, members can look at moving up the hearing dates.

Ms. Bates noted that the Tax Panel did not have sufficient time to generate ideas and then discuss them. She believes the commission should develop definitions earlier, or at least compile ideas regarding the definitions in early September, so members can discuss the ideas at length and present those thoughts to the public for further input.

Chairperson Cibes reminded members that the commission's charge is to go to the public hearings with at least a tentative product and get a series of comments from the public that are relevant to the commission's charge. He believes it is a good idea to get the definitions as firm as possible in September and October. He's not sure if the commission can have a product before then.

Ms. Bates stated that her preference would be to have working definitions and alternatives that would be presented to the public and to let the public know of the commission's thought process. She believes that transparency and public input are important to the process, given how complex the issues are.

Chairperson Widlitz remarked that the purpose of the public hearings is to allow the public to comment on the recommendations and to ask questions of the commission regarding the process. She expressed concern that providing alternatives along with the recommendations would be self-defeating in regards to providing guidance to the legislature. She commented that legislators will have the responsibility to look at the recommendations and listen to the justification for them. It will be their prerogative to accept the course of action recommended by the commission or to go in a different direction. She believes the record the commission will have established will provide all the background information on the commission's deliberations. Chairperson Widlitz stressed that the process can be flexible.

Mr. Hunter suggested that rather than citing alternatives, the commission can provide enough context to inform the public that other ideas were explored, but there were shortcomings to pursuing them.

Sen. Kane concurred with Ms. Bates' remarks on the need for public input. He expressed the concern that the public might be frustrated if they think the recommendations have been finalized before the public comment period.

Mr. Hunter asked if tax expenditures would have an impact on the definitions being explored. If so, he recommended that the commission schedule a presentation on the topic.

Chairperson Cibes replied that he thinks the consideration of tax expenditures should occur when the commission discusses the topic of general budget expenditures. He stated that expenditures that are bonded also need to be explored. He shared his personal view that the tax expenditures would primarily affect the revenue side of the budget – whether there is revenue available to spend -- rather than the spending side.

Ms. Bates expressed concern that while there will be consensus on some definitions, there may not be consensus on all of them. She asked what information would be put before the public and how the varying positions would be handled.

Chairperson Widlitz responded that if there is a divided opinion, it would be reasonable to include information on what was considered, how the commission reached its conclusion, and that there were other opinions as well. She assured members that the process will be open and inclusive, and will be respectful of members' thoughts.

Seeing no further discussion, Chairperson Cibes adjourned the meeting at 11:47 am.

Respectfully Submitted,

Susan Keane
Administrator