OHIO CONSTITUTIONAL MODERNIZATION COMMISSION

MINUTES OF THE
FINANCE, TAXATION, AND ECONOMIC DEVELOPMENT COMMITTEE

FOR THE MEETING HELD
THURSDAY, JUNE 4, 2015

Call to Order:

Chair Douglas Cole called the meeting of the Finance, Taxation, and Economic Development Committee to order at 1:30 p.m.

Members Present:

A quorum was present with Chair Cole and committee members Amstutz, Asher, Davidson, Mills, Peterson, Tavares, and Trafford in attendance. Vice-chair Karla Bell attended via tele-conferencing.

Approval of Minutes:

The minutes of the March 12, 2015 meeting of the committee were approved.

Presentation:

Chair Cole began the meeting stating that the committee has been dealing with the question of how Ohio compares to other states in relation to debt provisions in its constitution. He then introduced Professor Richard Briffault, of the Columbia Law School, an expert on state debt and state constitutions, to give a presentation on how Ohio compares to other states in the nation on these two issues.

"State Constitutional Debt Limitation: A Wide Range of Options"

Professor Richard Briffault
Joseph P. Chamberlain Professor of Legislation
Columbia Law School

Prof. Briffault began by stating that there were no debt provisions in state constitutions in 1787, and there are none in the United States Constitution. However, in the 1840s, these provisions began to be included in the state constitutions as a result of the canal movement, as well as the construction of turnpikes and railroads. At that time, states were making a major investment in transportation infrastructure and had to borrow heavily. He said as a result of this borrowing, as well as other factors, there was a panic in 1837. The economy of the United States fell apart, and there ensued a severe economic depression. He said states stopped making money, some went bankrupt, and others had to pay off their loans to foreign banks and investors. Because a significant number of states failed to make their obligations, in the 1840s states began to address the question of debt in their state constitutions. Provisions were adopted which limited state governments in their financial transactions, including limiting their ability to invest, to take an equity share in private enterprises, on lending credit, and on acting as a surety. Limitations were also placed on the amount of debt that could be accumulated, as well as the procedures for entering into that debt. He said that the kinds of restrictions have changed over time, but some of the forms are still around, and many states still have dollar caps on debt that are the same as they were in the 1840s or 1850s.

In his research, Prof. Briffault said he has found a variety of approaches to debt among the states, recognizing that each individual state will have its own details. He provided the committee with an outline indicating the different ways states have dealt with the subject of state debt and then described those approaches.

One approach is a constitutional ban on debt. Some states impose a ban, saying there may be debt, or no debt, above a very low limit. Prof. Briffault observed that those limits are considered low today, but perhaps weren't low at the time the provisions were adopted. Such states allow exceptions for invasion, wartime, or emergencies. He said these limitations generally apply to long-term debt, which doesn't have to be paid within the year in which it was issued. He said that, in those provisions, short term debt is exempt from the limitations. He said that these limitations also do not apply to revenue bonds or other nonguaranteed debt. He said every state has some exception for revenue bonds in which the state does not pledge its full faith and credit but pledges some specific source of revenue. He identified one example of this as being where a state issues a revenue bond for building a bridge and indicates that the bond would be paid back by the bridge tolls but not from the general revenue. He said those types of arrangements do not require the state to apply its full faith and credit to the funding. He continued that one consequence of using revenue bonds, where the state only pledges the revenue of the facility that was created with the debt, is that this approach avoids the enactment of many constitutional amendments, because an amendment is needed for each new project.

With respect to general obligation bonds, he noted that Ohio seems to have amended its constitution to avoid the debt limit 18 times. Alabama possibly has done this more often. He said no state has learned to live without debt. If the state constitution prohibits debt, states will amend their constitutions to allow it. This then requires procedures for amending the constitution, but the complicated nature of enacting a constitutional amendment then becomes the real debt limit, rather than the low-level dollar limitation on state debt.

A second approach is on the other end of the spectrum, where states have no constitutional debt limit. In these states, the legislative body amends the debt limit, rather than the voters. As an example of this model, he noted this is the federal model. He said this approach is subject to statutory procedures. He said Vermont has this model, and still follows its eighteenth century constitution, which requires just an ordinary statute to issue debt in Vermont. He said in this model, the issue doesn't go to the voters and there is no dollar cap. He said even in Delaware, it only applies to guaranteed long-term debt.

A third approach is in the center of the spectrum, in which there is legislative approval, requiring no super-majority or special vote, followed by voter approval by a simple majority. Prof. Briffault said in this model, the procedure is for classic guaranteed debt, and doesn't cover short-term debt, revenue bonds, or non-guaranteed debt. He said this is the procedure for general obligation, guaranteed debt. He said there are other ways of raising money without going through that procedure, however. One mainstream model is the voter-approval model. He remarked that there is no one model used by a majority of the states.

Another approach is where states impose a flexible limit on debt, which Prof. Briffault described as the "carrying capacity" model. In that model, the constitution makers think the state can carry a certain amount of debt and that voter approval is not needed. He said one way states calculate this "carrying capacity" is by considering debt service as a percentage of state revenues based upon a rolling 3 or 5 year average. These states cap the amount the state is allowed to pay, with examples of states following this model being Hawaii, Georgia, South Carolina, and Texas. He said the numerator varies based on what the state thinks is appropriate. He noted that one could also think about this model in terms of the amount of debt as opposed to the amount of the revenue.

A final approach identified by Prof. Briffault is where a state calculates the acceptable amount of debt or debt service based upon a percentage of state revenues, and then requires voter approval to go beyond that limit. He said an example of this model would be Pennsylvania and Washington. He commented that, in some sense, voter approval is a safety hatch because one can always amend the constitution. As Ohio and other states have shown, no matter what the constitutional procedure, there is always the possibility of a constitutional amendment, requiring a three-fifths vote by the legislature, plus voter approval.

Prof. Briffault summarized these approaches by indicating there are two "big pictures." One approach is where the legislature proposes and voters decide. That model draws on the notion that debt is long term, meaning that if the state borrows this year, it will be paying for the next 30 years. As a result, incurring debt is so significant that the decision to do so requires a constitutional amendment.

The other model, the "carrying capacity" approach, is binding but recognizes that some of these financial arrangements are very technical, and maybe should not be decided by voters on a ballot proposition basis. This model recognizes that it may be better to leave it to the legislature to decide how much debt to devote to roads and how much to prisons. He said that, as some states show, these two models can be combined.

Chair Cole then thanked Prof. Briffault for his remarks and posed a question. He said that in the flexible limits model there is no pre-designation as to how much spending will occur, asking whether Prof. Briffault has any empirical evidence as to whether there is a different mix of spending in those states where they do it differently. Prof. Briffault said he has no good empirical data, but that the model does play to the preferences of the voters in any given year, and that the focus of the spending may change over time. He said there was a time when prison bond issues got approved, then that changed.

Chair Cole then asked whether there is any information that would inform someone as to whether these different models end up in there being a different total debt obligation of the state. Prof. Briffault said that many states have developed hybrid versions in which debt is legally non-guaranteed but de facto guaranteed. He said a common device is for the borrowing to be done by a public authority, but then the state will appropriate the public authority funds that are earmarked for the purpose of obligating debt. He said this is technically non-guaranteed debt, but in an appraisal it will be looked on as part of the state's debt obligation. He said that approach generally affects the form of the debt, and who is the issuer, but does not affect the amount of the debt. He said in those cases it is more of a connection between the level of the debt and the political culture of the state, or a relationship between the political culture and the constitution.

Chair Cole then asked whether, as a practical matter, states may be more likely to default on revenue debts than guaranteed debts, saying his understanding is that there is an interest premium you pay if there is non-guaranteed debt. Prof. Briffault said the premium is usually small, and that states don't default, although local governments do sometimes default. He said states hardly ever default, even for debts on which they are not obligated, saying they do what they have to do to pay off the debt.

Referring to Prof. Briffault's outline, committee member Representative Amstutz said his impression is that Ohio has numbers 1, 6, and some mix of limitations for special purposes. Rep. Amstutz asked whether a lot of states have restrictions on the amount for a non-guaranteed revenue bond. Prof. Briffault said not that many states do, but those that do tend to be states that have revised their constitutions recently. He said Hawaii's constitution has given detailed attention to revenue bonds, which other states don't do because revenue bonds are creatures of the bond lawyers and the courts. He said there have been debates among the courts as to what is a true revenue bond and when the state will be held responsible for them. Some courts lately have held that as long as the state protects itself it is "non-debt debt" and not subject to these restrictions.

Chair Cole commented that debt totals are higher now than 50 years ago. Prof. Briffault agreed that debt is higher, and that government does much more, and that infrastructure such as highways, transit, water and sewer, all need attention and are a major source of cost. He said at the same time, the base has grown, the Gross Domestic Product has grown, and that states have increased revenue rates and capacity. He said that state debt has gone up but that he is not sure whether it has gone up in relation to state economy. He said his impression is that there has been more political attention paid to state spending in the last 20 years, so that it is more controlled.

Chair Cole asked whether Prof. Briffault has a view about Ohio's state debt constitutional provisions, whether it fits within a pattern seen in other states. Prof. Briffault answered that he understands it looks messy, but that Ohio is in the middle in terms of its debt load, maybe even has a lower debt load than some comparably-sized states. He said he is not sure what that reflects. He noted that the Council of State Governments collects the data, which is three years old, and that Ohio compares to Michigan, but has a lower load than Illinois and Pennsylvania. He said he has a strong normative view on this, noting that in a perfect world he would be inclined to advocate the flexible limit or the carrying capacity model, which trusts the legislatures as versus the voters, but that he does recognize the need to have a check on legislative spending. He said the hard part in terms of flexible limits is where the target number comes from. One would have to figure out what the share of revenue going to debt service ought to be. He said this could be done by looking at past years and data from sister states.

Prof. Briffault noted an experience he had with a citizen group that tried to determine what was the ideal number to reach between too much debt or too little debt. He said the group's goal was to be in the middle of the debt load relative to the state's revenue base, but that a provision that would achieve that goal proved impossible to write. He said it might be possible to write it as a statute or a guide, but that it was hard to turn it into constitutional language.

Chair Cole asked about whether it was possible to determine an "actuarially correct" debt load, and whether any states are looking at that. Prof. Briffault said he is not aware of any state that has done that in legal form, although the lenders and bond writers look at it. As an example, he cited state pensions, which are not considered to be bonded indebtedness, but are contractual obligations that are not treated as debt. Another example would be leased space, which is an obligation but that the state is getting something each year in the form of usable space. He said pensions are deferred compensation, and are not treated as debt in this sense but rather as a long-term obligation of the state.

Rep. Amstutz said the committee has been asked to look at the clutter in the debt article of the constitution, commenting that more than half the words in the constitution are associated with this. He asked what Prof. Briffault's advice or prediction is, if the committee is to address this question in terms of satisfying the bond underwriters and the voters.

Prof. Briffault said any change would have to account for obligations that continue to exist pursuant to commitments made long ago. He said he is not sure it is possible to take it all out but the state could continue to preserve the obligation by a provision that would allow the special procedure, the cap, and all obligations in prior amendments to continue to be honored. He said it is questionable whether that would work, but it could be preserved by reference. As far as what voters would approve, Prof. Briffault said he doesn't know. He said that in the 1970s they wanted to go to the floating cap without the prohibition, and it was rejected. He said going to a simple voter approval requirement may be more popular with voters; in that instance, the legislature would adopt a bond issue and voters would approve the spending as a bond issue and not as a constitutional amendment. Prof. Briffault continued that some states do have the flexible limit provision as an amendment, as opposed to a general constitutional provision. He said he doesn't see how that approach wouldn't be approved, but that would depend on the nature of the debate and how it is put together.

There being no further questions, Chair Cole thanked Prof. Briffault for his presentation.

The committee then discussed how it would proceed on the debt provisions. Chair Cole said he will circulate a memorandum indicating the different approaches the committee could adopt. He identified those options as: (1) keep all as it is; (2) remove only obsolete provisions, with the related question of whether the sinking fund is an obsolete provision; and (3) as recommended by Deputy Treasurer Seth Metcalf at the committee's last meeting, rewrite and update Article VIII, Section 1, revising the debt limit so that it becomes the predominant debt limit on the state, imposing a larger general limit that would be an index number, and then retaining the sinking fund because it would again have the relevance that it had when first adopted.

Chair Cole said a preliminary decision should be made about whether to make changes, and then whether to follow the second or the third option he described. He said his plan is to have a vote on the conceptual part of this in the committee's next meeting. He said he would circulate the memo, and then have a discussion and vote. He said once the committee has done that, and adopted language, the committee can move on to a separate discussion of lending, aid, and credit provisions which would allow the committee then to move on to the next subject. Chair Cole asked what the sense of the committee is on that plan.

Committee member Jo Ann Davidson said she would prefer looking at options 2 and 3 as noted by Chair Cole, deciding not only which option is preferred, but what is the most practical. The decision has to be balanced when government debt is one of the huge issues, and the committee has to be pragmatic about that.

Rep. Amstutz agreed with Ms. Davidson that this is what the committee should pursue. He said he recoils at raising the number, and that voters won't like that. He said the voters need something they are comfortable with, and that he would like to push the envelope on option 3 and see how far the committee could get. He said he would like to clean up the article and get Ohio something that works going forward. Ms. Davidson said the committee should perfect option 2 if it does nothing else.

Chair Cole said that Office of Budget and Management Director Tim Keen could also be invited to present to the committee and may have thoughts on these topics. Chair Cole said he is hopeful the committee will reach a resolution on this issue. He noted that there is a significant interdependence between the various sections of Article VIII that must be considered.

Committee member Herb Asher said that, as the committee attempts to de-clutter and then not re-clutter the constitution, he likes Prof. Briffault's point about plans that allow the legislature to authorize debt in a way that would be statutory rather than constitutional. Mr. Asher said that method seems so reasonable but still protects the rights of the voters, at the same time wondering whether he was missing something. Senior Policy Advisor Steven H. Steinglass commented that a similar plan was considered in the 1970s but, for reasons unclear to him, the comment in the report indicated they rejected that kind of referendum approach because it would be too easy to approve debt.

Rep. Amstutz said that method looks like what Ohio does now. Chair Cole said that the difference is that a super majority is not needed. He said the other consideration is that if the legislature authorizes debt, statutory debt provisions could be scattered in the revised code and harder to find, so that it may seem easier to have them in the constitution. Chair Cole said this would be a fourth option as suggested by Mr. Asher, off of the presentation by Prof. Briffault.

He said one could put a supermajority requirement in the constitution and make the rest statutory.

Prof. Briffault referred to a list of constitutional provisions from other states, noting that Article IX, Section 15 of the Michigan Constitution comes closest to what Mr. Asher is referring to. He said that is how Michigan handles what is in Ohio's Sections 1, 2 (a, b, c, etc.), and 17. He said Michigan's is the kind of language one would use for that option.

Committee member Fred Mills commented that if it is done by statute, the legislature would have to involve the governor's office, but if it is a constitutional provision it goes to the voters and the governor is not involved. Chair Cole agreed but noted that issue could be bypassed through a constitutional provision.

Adjournment:

With no further business to come before the committee, the meeting was adjourned at 2:40 p.m.

Approval:

The minutes of the June 4, 2015 meeting of the Finance, Taxation, and Economic Development Committee were approved at the October 8, 2015 meeting of the committee.

/s/ *Douglas R. Cole*

Douglas R. Cole, Chair

/s/ *Karla L. Bell*

Karla L. Bell, Vice-chair