DISCUSSION DRAFT – June 2, 2023
REPORT OF THE DEFAC BENCHMARK EVALUATION AND REVIEW PANEL

I. Background

House Joint Resolution 8 of the 149th General Assembly created an advisory panel (the "2018 Advisory Panel") under the Delaware Economic and Financial Advisory Council (DEFAC) to study fiscal controls and budget smoothing mechanisms that could be added to Delaware's financial framework to better address systemic fiscal difficulties and long-term budget challenges. The work of the 2018 Advisory Panel to DEFAC culminated in Executive Order 21 (EO 21), promulgated by Governor Carney on June 30, 2018, requiring DEFAC to

> [a]dvise the Governor and General Assembly on any other information that may be necessary for the ongoing evaluation of the Advisory Panel's recommendations and periodically review and make any recommendations, no less frequently than every five (5) years, regarding the components and weightings of the Benchmark Index.

Accordingly, DEFAC created the Benchmark Evaluation and Review Panel (the "2023 Review Panel") to advise DEFAC with regard to the Budget Benchmark process. This new Panel held 3 meetings to review the work of the 2018 Advisory Panel, the rationale and composition of the Budget Benchmark Index, whether the Budget Benchmark process has met its goals, and whether the process can and should be further institutionalized.

II. Work of the 2023 Review Panel

The review of the 2018 Advisory Panel's work focused on the recommended budget benchmark process, especially the composition of the Budget Benchmark Index. The Budget Benchmark Index is intended to provide policy makers with an independent economic metric for sustainable budget growth. The 2018 Advisory Panel recommended that the Benchmark Index initially be constructed as an equally-weighted, three-year rolling average of the growth rate of total Delaware personal income and the sum of Delaware population growth and inflation (as measured by the implicit price deflator for state and local government purchases). The 2018 Advisory Panel further recommended constitutional and statutory changes that would set a budgetary spending cap with operating budget growth (including Grants-in-Aid) permitted to grow at the Budget Benchmark Index plus an additional one percent of the prior year's budget to the extent operating spending was included in the Bond Bill (the "Benchmark Appropriation"). If the existing 98% appropriation limit exceeded the Benchmark Appropriation, half of the "extraordinary revenues" above the Benchmark Appropriation would be credited to a newly created Budget Stabilization Fund (the "BSF") (a repurposed Budget Reserve Account that was intended to be used), and the other half could be used for one-time expenditures. If the BSF reached 10% of gross general fund revenues, the half of extraordinary revenues that would otherwise have been deposited in the BSF could be used for any purpose including appropriations in the operating budget.

The 2018 Advisory Panel also recommended creating withdrawal rules for the BSF. If the 98% appropriation limit was less than the Benchmark Appropriation, half of the shortfall could be resolved with an appropriation from the BSF, up to half of the balance in the BSF. Funds could also be appropriated from the BSF for the current year if the shortfall was in excess of the 2% set-aside. In those cases, an appropriation from the BSF would generally require a simple majority vote. Any reduction of the BSF below 3% of gross general fund revenues or deviation from the general withdrawal rules would require a three-fifths vote of the General Assembly.

When constitutional amendment and statutory changes were not enacted, Governor Carney issued Executive Order 21, which created a BSF for reporting and budget planning purposes only. The Budget Benchmark Index and Benchmark Appropriation was identical to those proposed by the Advisory Panel, but there were no explicit deposit or withdrawal rules. Since the fiscal year 2020 budget, the Governor's Recommended Budget has adhered closely, but not perfectly, to the Index.

The 2023 Review Panel considered several alternative components for the Index including:

1) using wage and salary income growth rather than total personal income growth to avoid perceived distortions from a significant increase in transfer payments occasioned by the COVID pandemic;

2) using the Consumer Price Index (CPI) rather than the implicit price deflator for state and local government purchases;

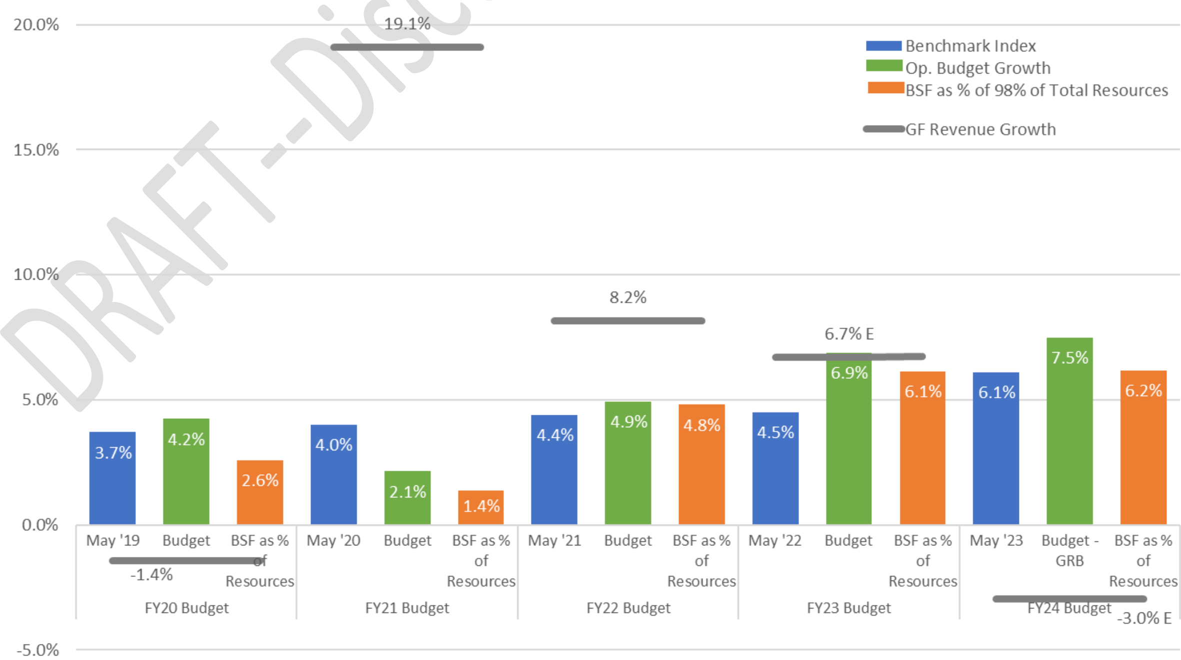
3) doubling the weight of the inflation factor; and

4) using only the most recent year's inflation factor rather than the three-year average.

The effect of these alternatives was compared to the EO 21 Index. The use of the CPI would have resulted in a lower Index in every year since 2017 and based on four decades of data, the index generally, but not always, would be lower. Double-weighting the implicit price deflator would generally result in a higher and more volatile Index. Since the advent of EO 21, the wage-based Index would have resulted in less operating spending than strict adherence to the Index, and the current-year deflator would have resulted in higher operating spending. The results varied for any given year, but the effect on budget volatility was roughly the same as the official Index.

RESULTS OF ALTERNATIVE BENCHMARKS						
	Current	***Current (Strict Adherence)***	**Wage**	**CPI**	**2X Deflator**	**1-Year deflator**
FY 2020	$4,529.9	***$4,477.3***	$4,442.7	$4,460.1	$4,576.7	$4,511.9
FY 2024	$5,586.4	***$5,433.4***	$5,292.1	$5,336.0	$5,969.2	$5,553.4
FY 2024 Operating Budget	More available	***BASE***	Less available	Less available	More available	More available
FY 2024 BSF & One-Times	Less available	***BASE***	More available	More available	Less available	Less available

The Governor's Recommended Budget (GRB) has largely followed the benchmark process. Final enacted budgets have exceeded the Index in every year other than Fiscal Year 2021 when the COVID pandemic had extraordinary impacts on State revenues—a year in which withdrawals from the BSF enabled 2.1% budget growth despite a significant decline in the State's revenue resolution. Nonetheless, it is clear that the benchmark process has restrained ongoing spending growth, resulting in lower operating budgets than likely would have been the case, with significantly higher spending on one-time expenditures and debt reduction and the creation of substantially higher reserves that are available through a simple-majority vote to be used during economic downturns.



III. Recommendations

The 2023 Review Panel recognizes that the flexibility afforded by the current process has benefits relative to the far tighter constraints of the constitutional/statutory construct recommended by the Advisory Panel. The Review Panel also recognizes that the Budget Benchmark process should be further institutionalized beyond EO 21 to ensure the State does not find itself facing future budget crises due to the volatility of the State's major revenue sources and the failure to build appropriate reserves during good times in preparation for more difficult times.

As a result of its evaluation, the Review Panel recommends no change to the current composition of the Benchmark Index. While concerns were raised regarding perceived pandemic-related distortions to personal income and the effect of rapid-onset high inflation, the current process does not have the constraints of the constitutional and statutory construct that had been recommended by the 2018 Advisory Panel, and therefore is flexible enough to adapt to current circumstances while still providing spending discipline.

The Panel also recommends that the Governor and General Assembly consider legislation to establish the Budget Stabilization Fund in Code and to codify the provisions of Executive Order 21 along with deposit and withdrawal rules. Such legislation should place requirements only on the Governor's Recommended Budget (GRB), not on any actions of the General Assembly, and the GRB should be restricted only to the extent that deviation from the codified requirements be explained in the report that accompanies the GRB. The General Assembly may also wish to consider a constitutional amendment that clarifies the removal of the Budget Stabilization Fund from unencumbered funds and addresses perceived ambiguities relative to when appropriations can exceed the 98% limit and when withdrawals from the Budget Reserve Account are allowed.