

# DEFAC Benchmark Evaluation and Review Panel



February 27, 2023

# Benchmark Evaluation and Review

## Panel Roster

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**Mike Houghton, Chair**

DEFAC Chair

**Senator Trey Paradee**

**Ed Ratledge**

DEFAC Expenditure Subcommittee Chair

**Senator Brian Pettyjohn**

**Lindsay Davis-Burnham**

DEFAC Revenue Subcommittee Chair

**Representative Bill Carson**

**Colleen Davis**

State Treasurer

**Representative Danny Short**

**Rick Geisenberger**

Secretary, Department of Finance

**Ruth Ann Jones**

Controller General

**Jeff Bullock**

Secretary of State

**Dave Gillan**

DEFAC Member

**Cerron Cade**

Director, OMB

# Charge of Panel

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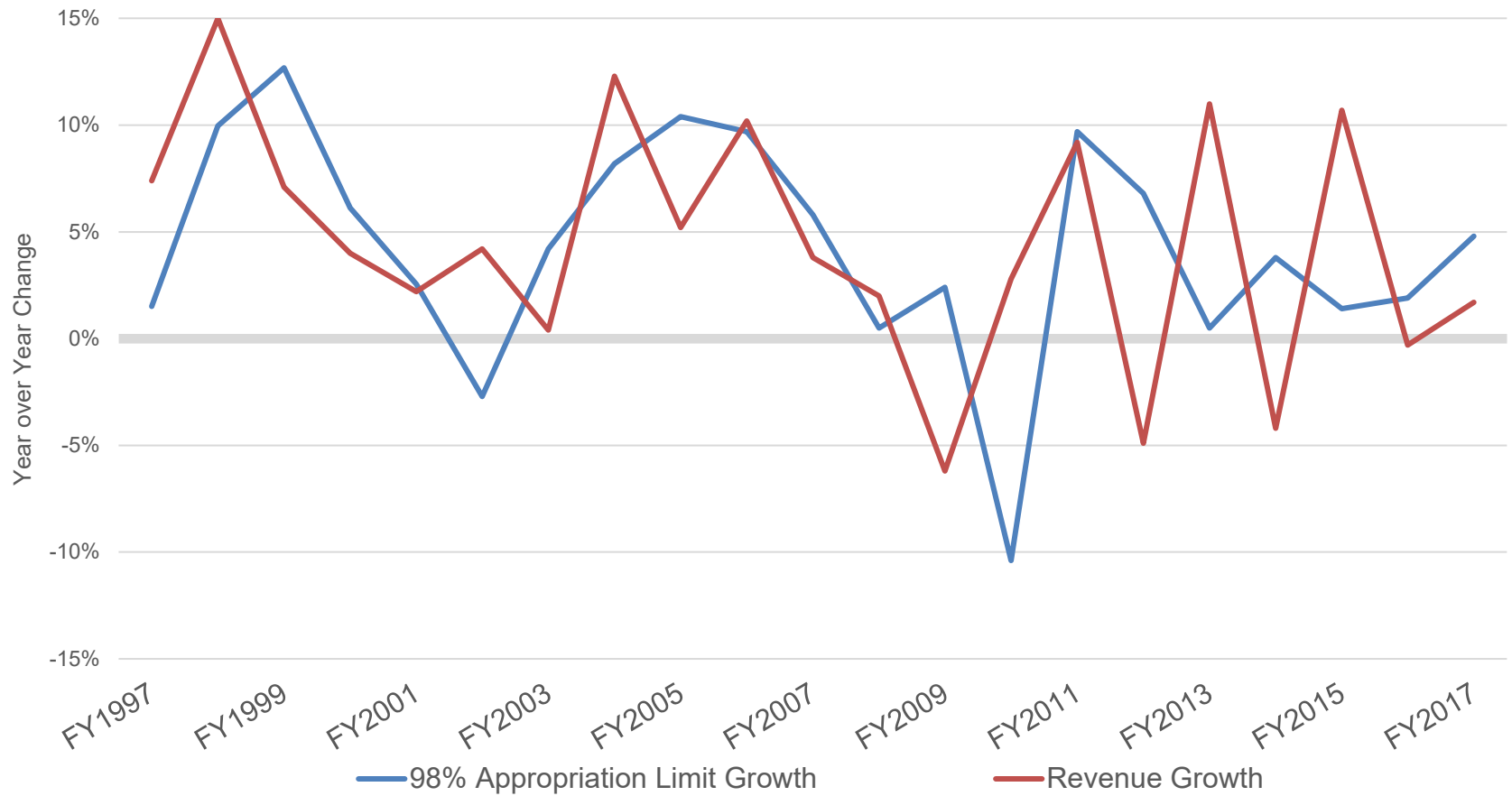
## DEFAC shall

Advise 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.

—Executive Order 21

# Review of Work of Advisory Panel on Fiscal Controls & Budget Smoothing

# General Fund Volatility



# Impetus for Advisory Panel

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- For fiscal year 2018, the State was facing a \$400 million structural budget deficit
- No recession—reasonable economic growth
- Increases in realty transfer tax, alcohol taxes, and tobacco taxes required to balance fiscal year 2018 budget with very modest operating budget growth
- HJR 8 enacted at end of 2017 session

# HJR 8 Mandate

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- Review May 2015 DEFAC Advisory Council on Revenue Report Recommendations
- By May 1<sup>st</sup>, 2018 issue an advisory report addressing:
  - DE's adherence to 98% appropriation limit and use of Budget Reserve Account
  - The need for reasonable restrictions on use of surpluses
  - The benefits of budget stabilization funds
  - Other matters as Advisory Panel deems appropriate
- Identify constitutional or legislative changes required for implementation of Advisory Panel's recommendations

# Existing Fiscal Controls

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- The 98% Rule—appropriations cannot exceed 98% of estimated net general fund revenue from all sources including unencumbered funds of prior year
- Budget Reserve Account (Rainy Day Fund)—must equal 5% of gross general fund revenues, and requires 3/5 vote to appropriate for unanticipated deficit or as a result of any statutory revenue reduction

*Rainy Day Fund has never been used*

- Debt Limitations—5% rule, 15% rule and cumulative cash rule (not directly relevant for budget benchmark)



# Extraordinary Revenues

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- A fundamental cause of revenue instability
- Defining “extraordinary revenues”
  - Capital gains
  - Settlements and audits
  - GF growth relative to long-term trends
- Limiting budgetary impact of extraordinary revenues
  - Deposit in current BRA and change withdrawal rules
  - Create new Budget Smoothing Account
  - Limit expenditure of extraordinary revenues to debt reduction, capital, pension/OPEB, other one-times

# Managing Revenue Volatility

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- Revenue Portfolio Reform
  - Detailed analysis from recent council
  - Reduced volatility may also harm adequacy
- Fiscal Controls
  - Keep budget growth in-line with historical measures
- Budget Smoothing Fund
  - An additional option for keeping budget growth more stable in the face of volatility

# Work of Panel

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- Reviewed rainy day funds, usage, and fiscal control measures of representative states
- Modeled selected states' rules with respect to Delaware budget history
  - Percentage of revenues when growth exceeds threshold
  - Percentage of revenue growth
  - Half of revenue growth over six-year average growth
- Considered various provisions in hypothetical economic/revenue circumstances

# Panel Recommendations

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- Important context of building on existing, tested and trusted framework of fiscal controls
- Amend 98% appropriation limit by tying growth in the budget to objective measure of the State's economic growth—the Budget Benchmark Index
- Convert the Budget Reserve Account into a Budget Stabilization Fund (BSF)
- Broaden the PIT base, in line with 2015 report
- All as constitutional amendment and statutory changes

# Budget Benchmark Index

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- Index is equal weightings of three-year average of
  - Growth in DE personal income and
  - Sum of DE population growth and inflation (implicit price deflator for state and local government purchases)
- Benchmark Appropriation is sum of
  - The product of (one plus) the Index and the sum of the prior year's operating budget and grants-in-aid, plus
  - 1% of the prior year's operating budget, only if that amount is a supplemental appropriation to the bond bill
- Difference between 98% appropriation limit and Benchmark Appropriation is extraordinary revenues (if positive) or shortfall (if negative)

# Rationale & Source for Components

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- Personal Income
  - Measure of ability to support government services
  - Also, a measure of demand for government services
  - Historical data from the US Bureau of Economic Analysis (BEA), forecast from Department of Finance
- S&L Government Implicit Price Deflator
  - Measure of price changes specifically for goods and services purchased by state and local governments
  - Historical data from BEA, forecast from S&P Global
- Population
  - Measure of demand for government services
  - Historical data and forecast from Delaware Population Consortium

# Budget Stabilization Fund

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- Intended to be used
- Deposit rules
  - Half of extraordinary revenues to BSF until full (10% of gross GF revenue), then can be used for any purpose
  - Half is available for one-time expenses
- Withdrawal rules
  - In the case of a shortfall or current-year operating deficit greater than the 2% set-aside, half of the shortfall can come from BSF, up to half of the BSF balance
  - Withdrawal requires simple majority vote
- 3/5 vote required to bring BSF below 3% of gross GF revenues or bypass deposit or withdrawal rules

# Executive Order 21 Benchmark Process



# Executive Order 21

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- Recommendations of the Advisory Panel adopted for the Governor's Recommended Budget in the form of Executive Order 21
- For reporting and budget planning purposes only created a Budget Stabilization Fund (BSF)
- Requires unencumbered funds in excess of 2% set-aside to reported as allocated to the fund for planning purposes
- Created Budget Benchmark Index and Appropriation process

# Benchmark As Recommended

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- Index is equal weightings of three-year average of
  - Growth in DE personal income and
  - Sum of DE population growth and inflation (implicit price deflator for state and local government purchases)
- Benchmark Appropriation is sum of
  - The product of (one plus) the Index and the sum of the prior year's operating budget and grants-in-aid, plus
  - 1% of the prior year's operating budget, only if that amount is a supplemental appropriation to the bond bill
- Difference between 98% appropriation limit and Benchmark Appropriation is extraordinary revenues (if positive) or shortfall (if negative)

# EO 21 BSF is Different than Panel's

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- No explicit withdrawal rules—Director of OMB to “provide the Governor the amounts recommended to be allocated to, and/or withdrawn from, the Stabilization Fund”
- No explicit floor or cap for the BSF
- No direction as to use of extraordinary revenues when BSF is determined to be appropriate size
- No consolidation with Budget Reserve Account
- Not as binding or durable as statutory or constitutional change

# Subsequent Developments

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- Beginning in FY 2020 budget, extraordinary revenues credited to BSF, though can be withdrawn through regular appropriation process (majority vote)
- Executive Order 52 added to the Benchmark Appropriation additional one percent carve-out for other post-employment benefits (OPEB) trust fund, beginning with FY 2023 cycle

# DEFAC's Role Under EO 21

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- Calculating in December and May the
  - Advisory Benchmark Index,
  - Advisory Benchmark Appropriation, and
  - Extraordinary revenues or shortfalls
- Advising on any information necessary for the ongoing evaluation of the Advisory Panel's recommendations
- Reviewing and recommending changes to the Benchmark Index at least every five years

# Components

(calculated based on E.O. 21)

## December 2021

FY	Income	Deflator	Population	Annual
2022	1.7%	5.6%	0.6%	4.0%
2021	6.1%	2.6%	0.8%	4.8%
2020	4.1%	1.4%	1.0%	3.2%
<b>Benchmark Index: 4.0%</b>				

## May 2022

FY	Income	Deflator	Population	Annual
2022	3.2%	7.4%	0.6%	5.6%
2021	6.2%	2.6%	0.8%	4.8%
2020	3.8%	1.4%	1.0%	3.1%
<b>Benchmark Index: 4.5%</b>				

## December 2022

FY	Income	Deflator	Population	Annual
2023	5.1%	6.9%	0.7%	6.4%
2022	3.3%	8.7%	0.7%	6.4%
2021	6.4%	3.9%	0.9%	5.6%
<b>Benchmark Index: 6.1%</b>				

*Most likely to change*

*Might change*

*Not likely to change*

# Benchmark Calculations

FY 2023 Budget	a	\$5,099.7
FY 2023 Grants-in-Aid	b	69.4
Operating Spending in Bond Bill	c	51.0
OPEB Set Aside	d	51.0
<b>FY 2024 Benchmark App.</b>	$(a + b) * 1.061 + c + d$	<b>5,586.4</b>
FY 2024 98% Appropriation Limit	f	6,574.9
<b>FY 2024 Extraordinary Revenues/(Shortfall)</b>	f - e	<b>988.5</b>

# Budget Stabilization Fund

*(For Budget and Planning Purposes Only)*

FY 2023 100% Appropriation Limit	a	\$6,700.2
FY 2023 98% Appropriation Limit	b	6,566.2
2% Set-Aside	$c = a - b$	134.0
FY 2023 Unencumbered Forecast	d	662.3
Budget Stabilization Fund Increment	$e = \max: (d - c) \text{ or } 0$	528.3
SB 250 Budget Stabilization Fund	f	402.6
<b>Total Budget Stabilization Fund</b>	<b><math>g = e + f</math></b>	<b>930.9</b>



# Budget Benchmark Results

# Big Picture

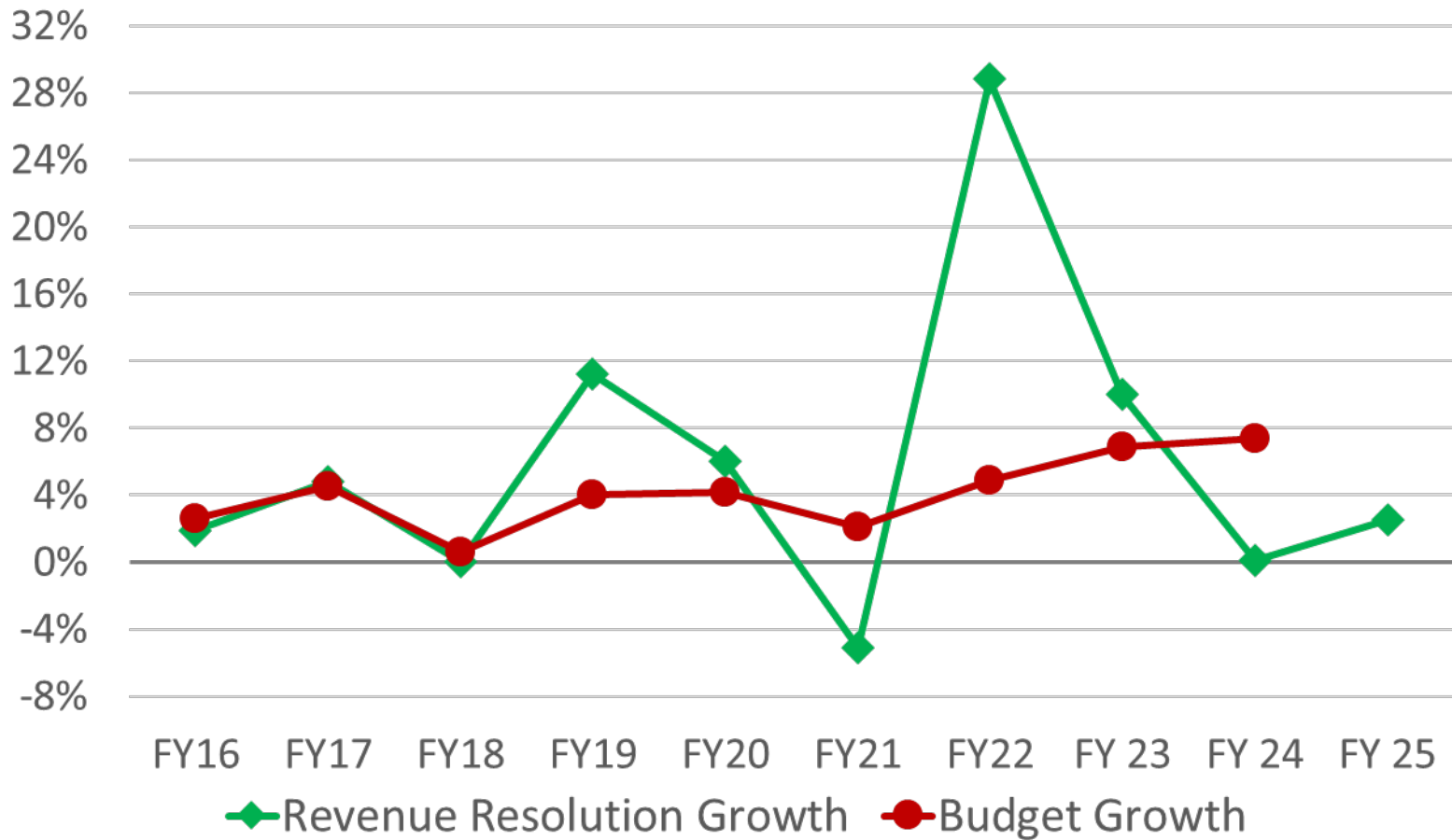
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- Then—\$400 million structural deficit in 2017
- Today—\$988 million projected surplus above benchmark growth of \$315 million (6.1%) and \$102 million of set-asides
- Governor Carney’s FY 24 Budget Proposal
  - Base budget above benchmark (7.4%) \$ 56M
  - Cash to bond bill (excl. 1% set-aside) \$614M
  - One-time supplemental (excl. 1% OPEB) \$274M
  - BSF deposit (balance to \$421 million) \$ 19M
  - Tax cuts (annualized cut of \$56 million) \$ 25M

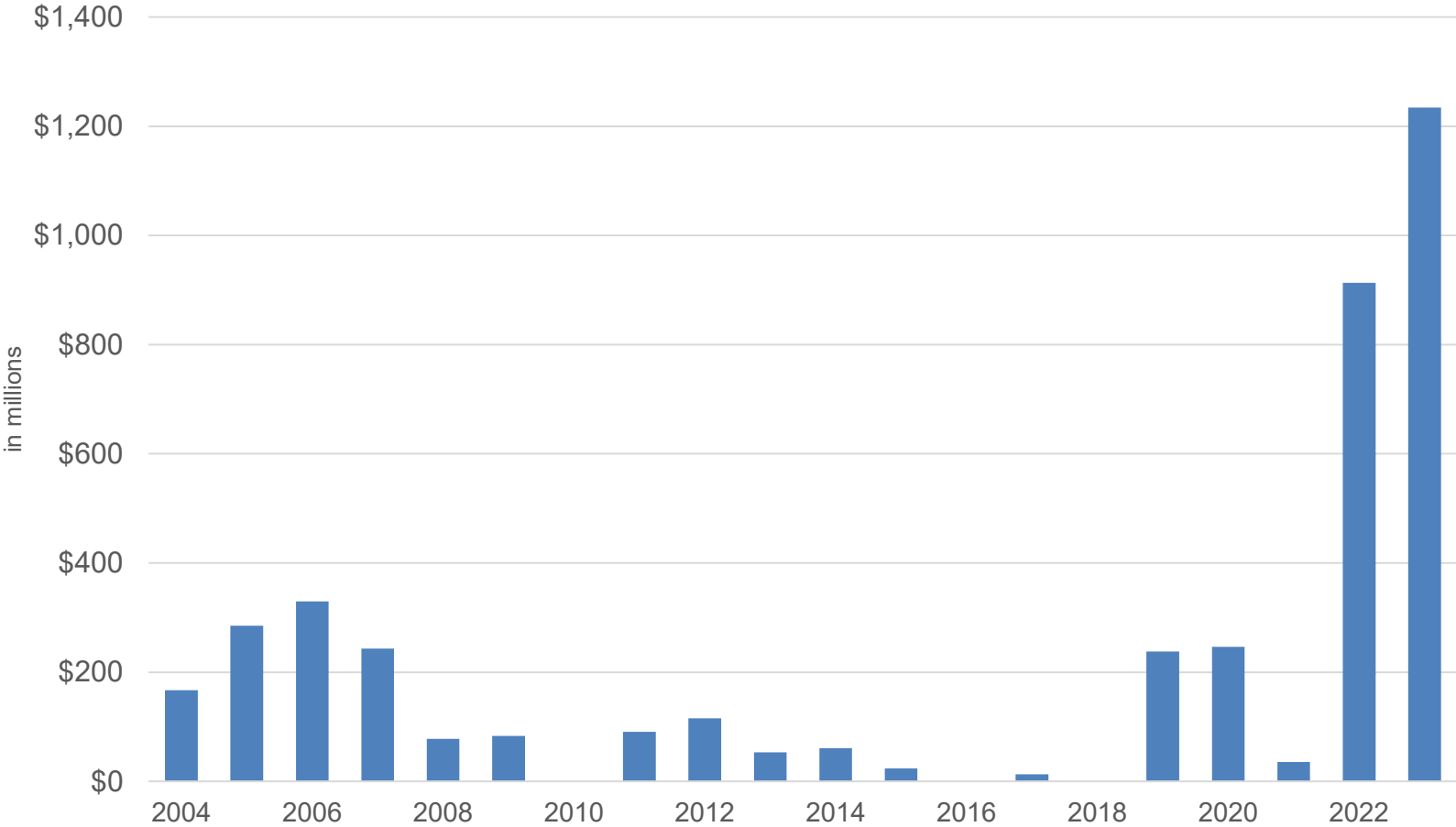
# Budgetary Impact of Benchmark

Budget	GF Revenue Growth	December Benchmark	May Benchmark	Operating Budget Growth
FY 20	(1.4%)	3.8%	3.7%	4.2%
FY 21	19.1%	4.1%	4.0%	2.1%
FY 22	8.2%	3.5%	4.4%	4.9%
FY 23	7.0% (est.)	4.0%	4.5%	6.9%
FY 24	(3.1%) (est.)	6.1%	N/A	7.4% (GRB)

# Impact on Operating Budget



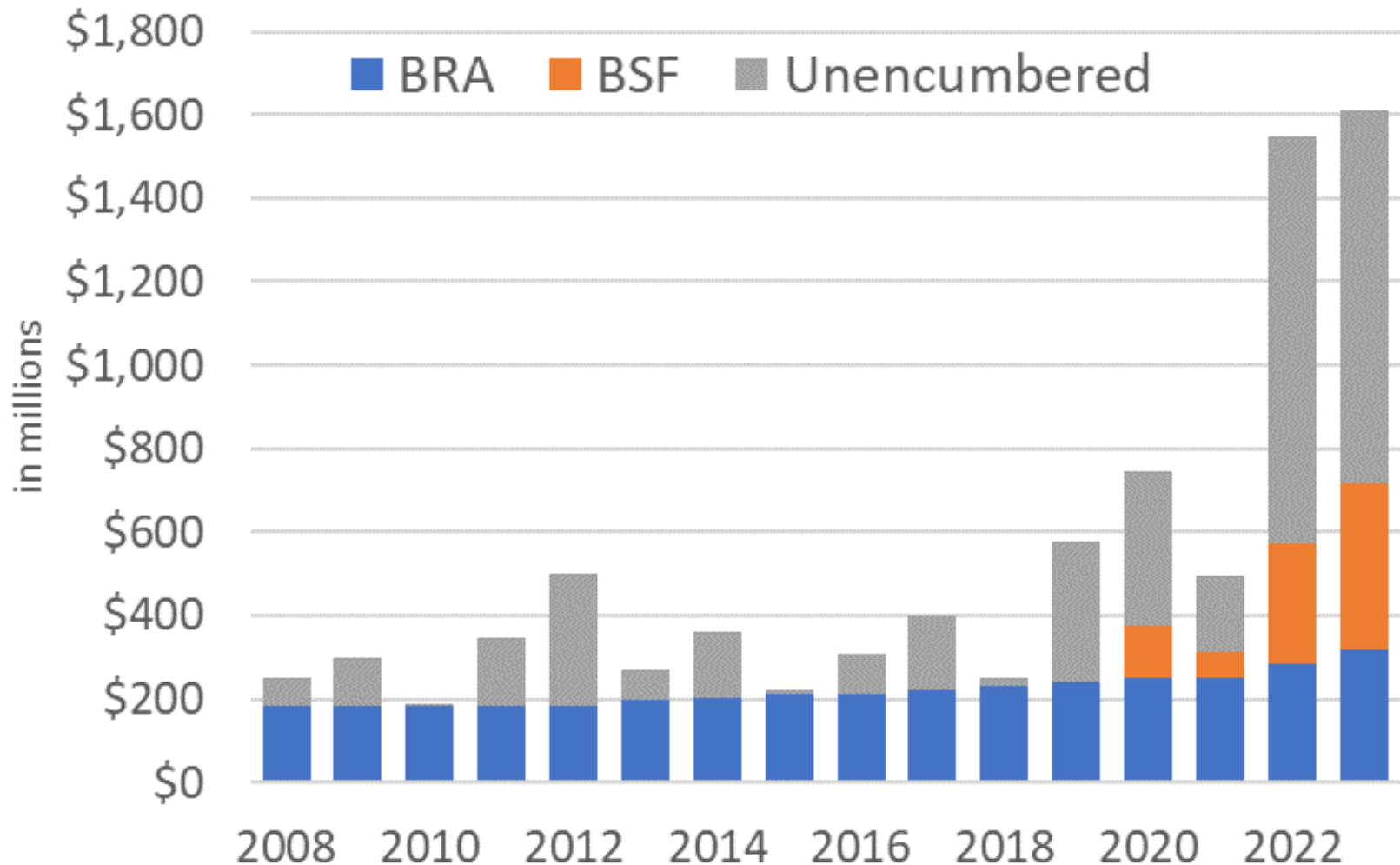
# Cash to Bond Bill & One-Time



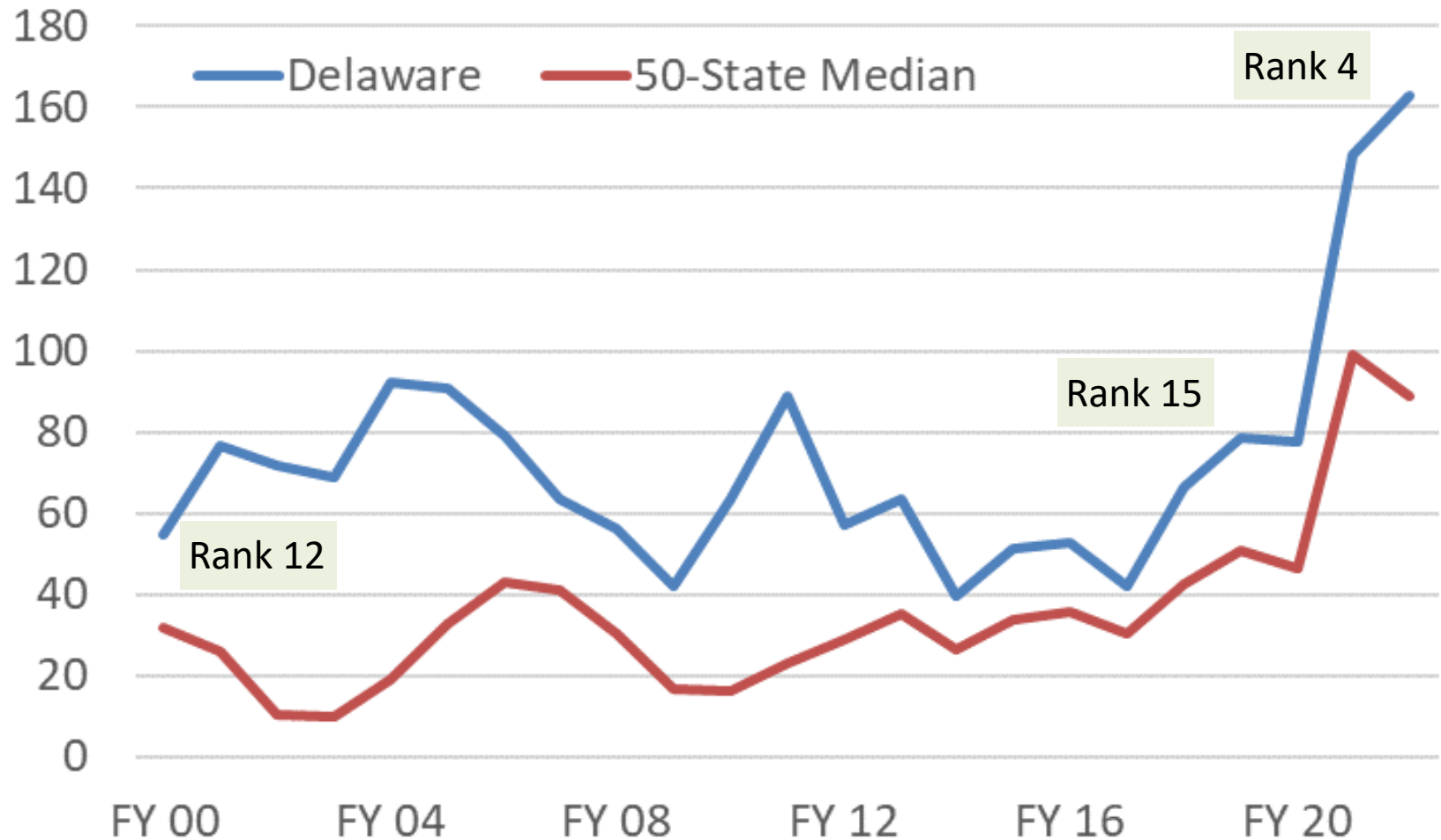
# Growth and Use of BSF

Year	Deposit or Withdrawal	Balance	% of Gross GF Revenue
FY 2020	\$126.3 million	\$126.3 million	2.5%
FY 2021	(\$63.2 million)	\$63.1 million	1.3%
FY 2022	\$224.2 million	\$287.3 million	5.1%
FY 2023	\$115.3 million	\$402.6 million	6.4%
FY 2024 (GRB)	\$18.9 million	\$421.5 million	6.5%

# Substantial Reserves



# Days Spending Covered by Reserves



Source: Pew Charitable Trusts



# Open Discussion

# Among Questions to Consider

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- Do index components accurately reflect Delaware economic growth for these purposes?
- Have the economic disruptions of the pandemic affected the benchmark process? If so, should adjustments be made in the future?
- Has the benchmark process made the operating budget process better?
- Are there drawbacks to the benchmark process?
- Are there better approaches?
- Are there better ways to institutionalize the process?