Minutes of the Advisory Panel to DEFAC
TAB Conference Room, Carvel Building, Wilmington – May 2nd, 2018

Attendance: Chairperson, Mr. Michael Houghton P

K. Lewis	P	H. McDowell	A
E. Ratledge	P	Q. Johnson	P
K. Simpler	P	M. Ramone	P
J. Bullock	P	A. DelCollo	P
R. Geisenberger	P	R. Johnson	P
M. Jackson	P	S. Malfitano	P
M. Morton	A	D. Smits	A

Support and Staff Present:
A. Aka, S. Bailey, B. Fahey, R. Goldsmith, J. Johnstone, A. Loiaconi, N. Roby, D. Roose, B. Scoglietti, S. Scola, S. Steward

Members of the Public:

B. Doolittle, E. Golder, P. Morrill, J. Young

1. Introduction

Chairman Houghton indicated his hope that this be the final meeting of this Panel and that a final report will be provided to the legislature and the executive administration in the near future. Chairman Houghton thanked Pew for their assistance and asked the Treasurer and the Secretary of Finance for preliminary comments.

Secretary Geisenberger discussed the draft executive summary and the plan to circulate a final report to the Panel in the next ten days.

Treasurer Simpler stated that the revenue reform proposal remains less refined than other aspects of the proposal and encouraged Panel members to comment specifically on that aspect.

Chairman Houghton stated that the Panel's role should be to present a range of alternative revenue reform options for policymakers to consider. Chairman Houghton thanked the Treasurer and the Secretary of Finance and their respective staffs for negotiating common ground on proposed mechanisms.

2. Review of Prior Meeting Minutes

Chairman Houghton asked for a motion to approve the March 23rd meeting minutes. Minutes were approved unanimously.

3. Staff Presentation

Treasurer Simpler asked if the draft executive summary was in line with Panel members' expectations.

Mr. Johnson commented that the executive summary was topically thorough and should be clear for laymen readers.

Chairman Houghton stated his hope to approve the draft executive summary as the basis for the final report.

Director Jackson previewed staff discussion on including recurring capital appropriations in the proposed Benchmark Budget calculation.

Robert Scoglietti, Director of Policy and External Affairs with the Office of Management and Budget, presented on the composition and typical size of recurring General Fund cash to the bond bill. Mr. Scoglietti noted that these projects may not be appropriately funded through General Obligation bonds, but fit the three-quarters supermajority requirement which is already imposed on other bond bill appropriations. This category averages roughly $40 million annually or roughly 1% of appropriations.

Director Jackson stated that prior proposals included a Benchmark Budget that only captured changes to the operating budget and the Grant-in-Aid budget, and that some level of fixed funding for recurring bond bill expenses also should be included.

Secretary Geisenberger suggested this provision should be in the draft constitutional amendment.

Mr. Johnstone noted that the definition of the Benchmark Budget could be part of the proposed constitutional amendment, or could be required by the amendment and set in statute. Whatever the method of establishment, this consideration needs to carefully crafted.

Treasurer Simpler stated many of these funds are required to be in a bill with a three-quarter majority vote threshold as they are payments to non-state agencies.

Representative Johnson asked if the average presented included Open Space and Agricultural Preservation funding.

Director Jackson stated these have dedicated revenue from the Realty Transfer Tax and do not rely on cash to the bond bill.

Mr. Ratledge asked if this process creates an earmark in the budget process for cash to the bond bill.

Treasurer Simpler noted that the funding for these recurring appropriations does not always come from General Fund revenues.

Director Jackson noted that there is a minimum amount of cash to the bond bill built into long term budget planning and used to fund these particular appropriations.

Secretary Geisenberger asked that Panel members consider highlighted language in the draft executive summary addressing this change.

Mr. Ratledge asked if including this figure in the Benchmark Budget would reduce budgetary flexibility to spend available funds on the operating budget.

Treasurer Simpler stated that the proposal creates additional dollars in the Benchmark Budget, but does not require the General Assembly to appropriate those monies to the bond bill.

Secretary Bullock stated the practical actions used to fund a budget in a bad revenue year end up being different from the conceptual concerns being discussed.

Mr. Ratledge stated that fixing a minimum dollar amount in a constitutional amendment is not recommended.

Secretary Geisenberger and Chairman Houghton both noted that the specific structure of this concern should be left up to policymakers.

Treasurer Simpler stated that language needs to be carefully crafted to ensure not all of cash to the bond bill is considered part of the Budget Benchmark.

Chairman Houghton suggested that staff circulate more specific language on this topic to be approved by the Panel and inserted in the final executive summary.

Secretary Bullock asked if the constitutional language would allow for any of these rules to be overridden in certain circumstances.

Secretary Geisenberger stated that, just like current budget rules, overriding any proposed restriction would require a three-fifths vote.

Secretary Bullock noted that the bond bill already requires a three-quarters vote.

Mr. Roose presented on the price measures that could be used as part of gauging the progress of Delaware's economy. The presentation covered the differences in definitions and trends between the Consumer Price Index (CPI) and the State & Local Government Implicit Price Deflator (Deflator)

Chairman Houghton asked if CPI measures the economy as a whole and the Deflator is a measure of what government spends.

Mr. Roose answered that CPI is a measure of consumer prices and the Deflator is a measure of state and local government prices.

Treasurer Simpler noted some circularity in measuring the State's purchasing needs with a price index directly influenced by the purchasing decisions of all states.

Secretary Geisenberger noted that the Deflator accounts for all of the spending in the United States and represents a weighted average of all purchasing decisions across the country. Governments do not spend much on housing like consumers.

Mr. Ratledge noted that federal spending decisions may influence the Deflator over time.

Representative Ramone suggested using the CPI because it is less volatile, less easily influenced by federal government decisions, and more familiar to the public.

Secretary Geisenberger noted that CPI does not represent the basket of goods and services typically purchased by governments.

Senator DelCollo stated that using any outside economic factor to create a benchmark should stimulate greater consideration around the sufficiency and efficacy of any particular spending decision.

Secretary Geisenberger stated that the Deflator is more related to demographic trends that will greatly influence Delaware's spending decisions into the future.

Chairman Houghton noted that the recommended process will allow for this economic measure to be changed occasionally following periodic review from DEFAC.

Secretary Bullock stated that the existence of a benchmark should incentivize greater scrutiny of the shift in the role of government over time. The benchmark should both parallel what government does and allow questioning of what government does.

Mr. Lewis noted that the Deflator's emphasis on services is more in line with the current evolution of the broader economy.

Mr. Roose reviewed the proposed changes to the budget process, the super-majority criteria for deviating from the proposed rules, and the results of simulations incorporating some portion of recurring cash to the bond bill and using the Deflator as the economic measure in the Budget Benchmark.

Mr. Ratledge asked about the current rules that dictate Budget Reserve Account (BRA) deposits and whether the Budget Stabilization Fund (BSF) would include different definitions.

Mr. Johnstone affirmed that the calculation of the proposed cap would include the same definitions for both the BRA and BSF.

Mr. Ratledge asked how the proposed mechanism would handle a multi-year revenue downturn.

Mr. Roose replied that this mechanism would leave you no worse off than would be seen currently. The new BSF mechanism would give the State a cushion and allow time to make more reasoned and prudent policy decisions.

Treasurer Simpler asked whether one-time spending should be defined more specifically.

Secretary Geisenberger stated that language currently broadly defines this as reductions in long-term liabilities or one-time capital expenditures. This broad language leaves policymakers a means to provide specificity when necessary.

Representative Ramone asked if overriding super-majorities should be three-quarters instead of three-fifths.

Chairman Houghton expressed a reluctance to go toward three-quarters.

Treasurer Simpler noted that DEFAC should occasionally make recommendations about changes to the economic measure.

Secretary Geisenberger stated that this process will likely require passage of two legs of the constitutional amendment, statute to define the economic measure, and revenue legislation. The proposal assumes that both the defining statute and revenue legislation would require a three-fifths vote to pass.

Secretary Geisenberger commented on the simulations presented, noting that using the Deflator produced results where the average level of spending is not that different than under current budget rules and budget growth is less volatile. It is not the Panel's role to comment on the level of spending in periods of average revenue growth. Secretary Geisenberger stated that the additional features discussed today improve the proposal.

Mr. Ratledge asked where the BSF funds would be stored.

Mr. Johnstone stated that the BSF would reside in the General Fund, as the BRA does under current rules.

Mr. Johnstone presented two examples representing the range of possibilities for adopting Personal Income Tax reform that included base broadening and rate reductions in the spirit of recommendations from the 2015 DEFAC Advisory Council on Revenues.

Secretary Geisenberger noted that each proposal would have little to no effect on age-based preferences for households with less income than the proposed means-test thresholds.

Treasurer Simpler asked if the rate tables presented in the example labelled "Rate Focused" were of proportional size in each bracket.

Mr. Johnstone answered that rate changes were first enacted to reduce rates in the top two brackets and offset some of the costs to taxpayers resulting from the proposed repeal of itemization. Beyond that caveat, rate changes were relatively proportional.

Secretary Geisenberger noted that the “Rate Focused” proposal generates roughly $20 million less than previous iterations as the package is now adjusted to account for itemization reform resulting from the Tax Cuts and Jobs Act.

Chairman Houghton asked about the purpose behind the tax illustrations.

Secretary Geisenberger stated that these illustrations would define a range of possible, base-broadening Personal Income Tax reforms, but that the specifics of the reform would likely depend on the budget situation in years to come.

4. Open Panel Discussion

Representative Johnson noted that the Panel should specify the importance of broadening the base over generating revenue changes with increased rates.

Chairman Houghton stated that the BSF mechanism and the revenue enhancement package are to be inextricably connected in the Panel’s report.

Representative Ramone noted that the proposal is focused on simplifying the tax code and consolidating loopholes to make things fairer for everyone.

Chairman Houghton noted that this is consistent with the proposal of the 2015 Advisory Council.

Representative Johnson stated that these changes are shifting the burden of revenue generation toward the Personal Income Tax and compensating for declines in more volatile revenues, rather than generating revenue for new, more expansive programs.

Treasurer Simpler stated that it is best to parse the revenue proposal in honest, but general language. The Benchmark and revenue proposals should work together such that a large revenue increase would be fairly constrained by the BSF mechanisms. Treasurer Simpler noted the two extremes presented are fairly different in terms of revenue generated and that his personal preference would be for the “Rate Focused” case. Regardless of that preference, the Panel should not go farther than noting the existence of two examples.

Secretary Geisenberger stated that the definition of a significant rate reduction is something that will be defined down the road by the General Assembly.

Chairman Houghton entertained a motion to approve and endorse the Executive Summary as the findings of this Panel. The motion passed unanimously.

Secretary Geisenberger asked Panel members for comments on the Executive Summary within the next week.

Mr. Malfitano asked whether the proposal would become legislation through the legislators on the Panel or through leadership.

Sen. DelCollo noted a Town Hall the prior night to roll out this proposal to the public, and stated a hope to see further Town Halls on the topic in the near future.

Chairman Houghton stated that the most likely movement, if any, on this issue would be for the first leg of a constitutional amendment to pass out of this General Assembly.

Representative Johnson vowed to see something introduced this session.

Representative Ramone suggested the constitutional amendment legislation might get better consideration if it were introduced as soon as possible following the upcoming legislative break.

Senator DelCollo agreed that this amendment deserves a thorough discussion.

5. Public Comment

Mr. Doolittle noted that the State has been limping along with Band-Aid solutions to important needs, such as education, for nearly forty years. Among stakeholders engaged with Mr. Doolittle, there is near universal consensus that budget smoothing is necessary to enable long-term, strategic planning from the State. Mr. Doolittle noted his concern about the definition of one-time spending not including long-term, strategic planning initiatives.

Ms. Goldner, a member of the public, seconded Mr. Doolittle's concerns about one-time funding definitions and cautioned that an ill-defined term would leave space for politically savvy individuals to undermine the spirit of the proposal. Ms. Goldner asked if the Panel's hope was for the BSF to reach its cap within 10 years.

Chairman Houghton stated that reaching the cap and the ability to use funds would depend on economic cycles, and not much on the specifics of the proposal.

Ms. Goldner proposed that some financial difficulties experienced by the State, both since 2007 and last year specifically, might be related to changes in the housing and bond markets. Ms. Goldner emphasized the importance of transparency in regards to Delaware's bond market activities and interest earnings.

Mr. Young thanked the panel for their effort and asked that members prepare a well-developed "sell" to help the public understand the final proposal. Mr. Young stated that this work is a major step for the State.

Treasurer Simpler asked about ensuring the presentations of this Panel are posted in public facing spaces.

Chairman Houghton noted that there is currently not a final product to circulate, but that unanimity is key for the success of the Panel's final report. As such, Chairman Houghton asked that all members offer some response once the final report is distributed.

Mr. Bailey thanked the Panel for inviting Pew to work on this project. He noted that Pew had a report coming out soon covering how states define non-recurring revenues.

Mr. Morrill, of the Committee of 100, stated that there is nothing more important going on in Delaware than this Panel's work. He suggested the proposed structure might serve Delaware well, much as the current structure has molded prudent budgeting since the days of Pete DuPont. Mr. Morrill appreciated the bipartisan effort of the Panel.

Mr. Johnson noted that mechanisms such as this might also be useful if enacted by local governance as well.

6. Adjournment