A New Role for DEFAC

BY MICHAEL HOUGHTON

THE HISTORY AND PURPOSE of the Delaware Economic and Financial Advisory Council (DEFAC) is well known. It was established in 1977 by Executive Order by Governor Pete du Pont to provide oversight, review and non-partisan recommendations regarding State revenues and expenditures. Its membership has been a mix of business and community leaders, academics, and government professionals knowledgeable about the State budget and economy. I have been fortunate to serve as chair of DEFAC for about 15 months. I am impressed by the diligence and thoughtfulness applied to difficult budget issues by all members of the Council.

When I became Chair, I was vocal about DEFAC serving a role beyond testing and questioning revenue forecast information provided by State financial officials. I have spoken to many members of DEFAC about an expanded role, and one of the many suggestions I have received includes diving deeper into specific business segments through corresponding subcommittees, such as health care, which is increasingly shaping a large portion of the Delaware economy. As DEFAC enters the new fiscal year, this and other suggestions will be explored and implemented. This will benefit the public and ensure more robust engagement by Council members and constituencies impacted by its work. Additionally, DEFAC will take on a very important budgeting role going forward.

Pursuant to House Joint Resolution 8 signed by Governor John Carney last summer, an Advisory Panel to DEFAC was formed to study "potential fiscal controls and budget smoothing mechanisms." The Advisory Panel – which I chaired – met regularly for a nine-month period and closely examined ways Delaware could improve its budget process. The impetus for its creation was the June 2017 experience of the Delaware General Assembly and Governor. Last spring, the State faced a nearly $400 million budget shortfall, resolved after much consternation, program cutting, sharp elbows and political negotiation, by passing a combination of corporate franchise and alcohol and tobacco tax increases, along with an increase in the State's realty transfer tax. The optics of Delaware not having a budget until July 3, a situation not experienced for some 40 years, moved policy makers to commission a group to examine how to avoid the roller coaster ride of such conflict and unpredictability in the next budget cycle.

Year 2018 became another fiscal roller coaster ride when, partly because of the referenced tax increases but also due to upward swings in other revenue sources, Delaware went from a nearly $400 million budget deficit to a nearly $390 million surplus.

The Governor and Legislature this year have acted responsibly, setting aside almost $50 million as a buffer for next year and what could be an economic downturn. But the Advisory Panel recommended more than a one-year fix. We advocated permanent, systematic modifications designed to avoid this "feast or famine" phenomena. We recommended creating a Budget Benchmark to constrain State spending to a sustainable economic level – roughly three to four percent growth, based on recent indicators. One half of these excess revenues beyond the benchmark would be for one-time non-recurring expenditures, and the other half would seed a Budget Stabilization Fund. We recommended moving the current Rainy Day Fund – approximately $250 million which has never been used – into this new Budget Stabilization Fund, and making the combined fund accessible under certain circumstances and within certain limits, if the State should encounter a revenue significant shortfall such as last year. Finally, we endorsed linking this structural spending reform, memorialized in the constitutional amendment, with passing certain structural reforms to the Personal Income Tax ("PIT").

Despite the enthusiasm of most members of the Council and the Governor for these recommendations, and the introduction of legislation advancing a constitutional amendment in the Delaware House of Representatives, the process died on the vine this year for reasons I will not explore in this piece. While the required constitutional amendment did not advance, the work of the Advisory Panel will proceed. On June 30, 2018, Governor Carney signed Executive Order No. 21, implementing key recommendations of the Advisory Panel. With this, the Director of the Office of Management and Budget is directed to establish, for budget planning purposes, the Budget Stabilization Fund within the General Fund as an account to be used in putting together the Governor's proposed budget. The account should be treated in essentially the same way, implementing the same metrics and calculations, as recommended by the Advisory Panel.

Significantly, DEFAC is given the role of calculating the advisory "Benchmark Index" and the advisory "Benchmark Appropriations," using tools and metrics laid out by the Advisory Panel. This is important because it implements critical elements of the Budget Smoothing initiative that Governor Carney and others have sought to advance. Make no mistake, this Executive Order does not purport to establish a Fund that can only be established by act of the Legislature. But it does recognize and mandate use of the Budget Stabilization Fund concept, and the calculations around it, in constructing the Governor's annual proposed budget. In doing so, Governor Carney has confirmed his commitment to this fiscally prudent process and empowered DEFAC to perform a vital new role in Delaware's budgeting process.

I hope that in 2019 the Delaware General Assembly will better understand and support the Budget Smoothing process, ultimately adopting the legislation. Fiscal unpredictability is not good for those constituencies – and there are many – who rely on government funding to run their programs, assist those in need and pay their people. The next year will be telling and important. There is much more – and new – work to be done by DEFAC. ■