



# Analytics

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**RE: DEFAC WANDERS**

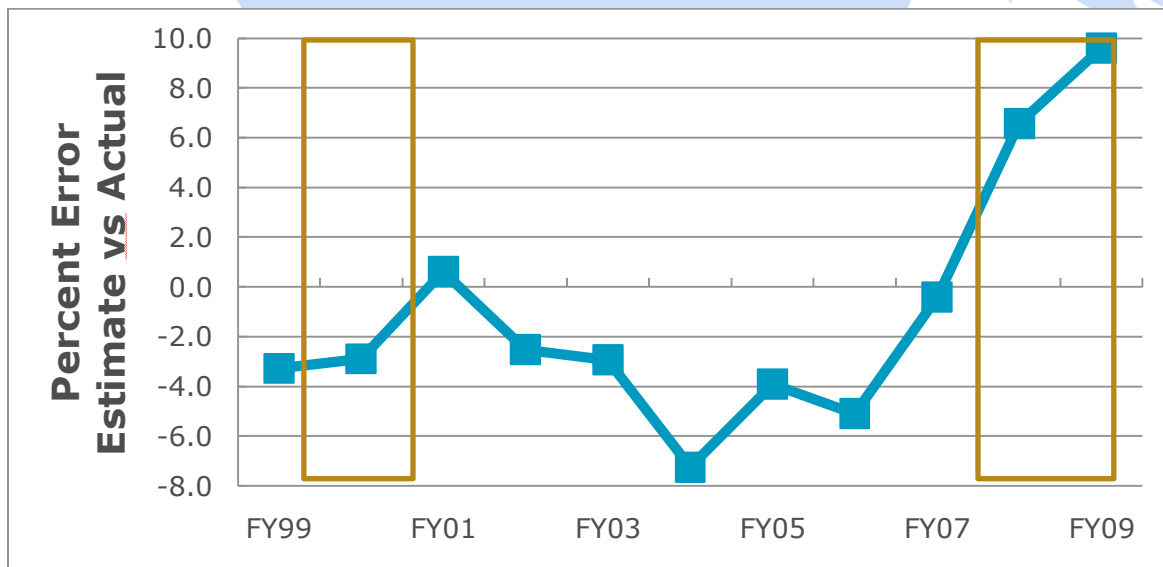
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The constraining influence of the Delaware Economic and Financial Advisory Committee (DEFAC) has been a major factor in maintaining the state of Delaware's high bond ratings. Recently, however, DEFAC has drifted.

Over the past decade the mean absolute percentage error in DEFAC's one year ahead forecast of revenues has been 4.1% and the two year ahead error has been 6.7%. This is not stellar but is understandable given all the many factors that impact state revenues. And, DEFAC has typically erred on the low side (conservative forecasts).

Unfortunately, going into the current recession, DEFAC's forecasts suddenly became overly optimistic. The one year ahead forecasts of revenues were high by 6.6%, or \$221 million for FY 08, and high by 9.6%, or \$303 million for FY 09. High forecasts going into a recession simply encourage legislators to dig a deeper deficit hole.

## THE ERROR IN DEFAC'S ONE-YEAR AHEAD PROJECTIONS



Source: Delaware Dept of Finance

The high forecasts were made despite a wide range of warning clouds on the horizon. The four quarter moving average percent change in state revenues had been declining since early 2005. The Philadelphia Fed's leading indicator for Delaware started falling in mid-2006. Seasonally adjusted weekly claims for unemployment began rising in mid-2006. The value of residential permits in Delaware peaked in mid-2005.

Finally, the percentage change in seasonally adjusted real Delaware retail sales dropped below average in early 2006 before eventually turning negative.

What explains the recent wanderings of DEFAC? There are a number of possibilities.

- DEFAC forgot its full mandate. DEFAC is legislatively charged with producing nonpartisan, objective revenue projects. It is also, however, charged with tracking expenditures, tax policy and debt management issues. One factor behind DEFAC's over estimate of revenues might have been that DEFAC neglected to recognize the trend in recent years for state government to cover the shortfall between revenue and expenditures by issuing debt. Debt per capita in Delaware is at a 20 year high.
- Robert Byrd, one of the top lobbyists to the state legislature, was chair of DEFAC.
- Other than state officials, almost no new, young blood has joined DEFAC in years.

The good news is that DEFAC now seems to be returning to its roots. With Joshua Martin as chair, input from the highly competent and professional staff of the Delaware Department of Finance will be given more weight. Ed Ratledge, a seasoned veteran economist with the University of Delaware, has been given the mandate to focus on state government expenditures. And, hopefully, younger persons with experience in finance and economics will be joining DEFAC.

The state has done a credible job thus far in adjusting expenditures and revenues to this most difficult recession. Sustaining the operations of DEFAC is also essential to retaining Delaware's top debt rating.

**Dr. John E. Stapleford, Director  
Center for Economic Policy and Analysis**