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## FISCAL IMPACT REPORT

SPONSOR Moore DATE TYPED 3/10/05 HB 404/aSPAC

SHORT TITLE Biennial State Budgets SB \_\_\_\_\_

ANALYST Hadwiger

### APPROPRIATION (in \$000s)

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
	NFI				

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to SB211.

### SOURCES OF INFORMATION

LFC Files

“Annual and Biennial Budgeting: The Experience of State Governments” (NCSL, October 2004)

#### Responses Received From

Department of Finance and Administration (DFA)

Department of Transportation (DOT)

Administrative Office of the District Attorneys (AODA)

### SUMMARY

#### Synopsis of SPAC Amendment

The SPAC amendment is effectively a substitute for the original bill, amending the title and striking the entirety of the remaining text of the original bill. The amendment creates an eight-year (four biennia) “Biennial Budget Pilot Project,” beginning with the proposed budget considered by the first session of the forty-eighth legislature.

The pilot project would be administered by the Governor’s office in consultation with a Biennial Budget Pilot Project Oversight Subcommittee (the Subcommittee) of the Legislative Council (LCS). The pilot project would include the Department of Finance and Administration (DFA), Regulation and Licensing Department, Economic Development Department, Department of Health, and up to 35 executive agencies with budgets under \$5 million chosen by the Governor’s office in coordination with the Subcommittee and Legislative Finance Committee (LFC).

The Governor's office would determine baseline data from the last five years for each of the participating agencies including:

1. success in meeting budget performance measures
2. number of budget analysts employed by the agency, job titles of other agency personnel who devote time to preparing annual budget proposals and number of hours spent by each in its preparation
3. estimated cost of supplies and materials used to prepare annual budget proposals
4. agency cost for overtime salary or compensatory time for annual budget preparation
5. estimated savings by each agency in FTEs, overtime/comp time, equipment, supplies and other costs that will accrue because of biennial budgeting, and
6. number and types and amounts of budget adjustment requests required by each budget program.

The DFA and LFC would provide similar baseline data with respect to their operations.

The Governor's office and Subcommittee would determine evaluation criteria including how well pilot project agencies met their performance measures and number and amount of supplemental and deficiency appropriations requested by pilot project agencies during off-years of each biennium and reasons for the requests.

The Subcommittee would have six members appointed by the LCS to oversee implementation of the pilot project and to study constitutional, statutory, organizational and technical issues of biennial budgeting. The Subcommittee would be staffed by LCS and LFC staff and would seek advice from the National Conference of State Legislatures and from other states. The Subcommittee would provide interim reports and a final report by the end of the fifty-first legislature, second session.

### Synopsis of Original Bill

House Bill 404, introduced for the Legislative Finance Committee, amends existing budget statutes to establish a biennial budget process for the State of New Mexico beginning on July 1, 2007. The biennial budget would be approved, implemented and modified according to the schedule below:

<b><i>ODD-NUMBERED YEARS</i></b>	<b><i>BUDGET ACTIVITY</i></b>
By January 10	Governor submits biennial budget request to legislature.
January-March	Legislature adopts biennial budget
By May 1	Each agency submits operating budget to the Department of Finance and Administration (DFA) to implement the approved budget for the ensuing two years.
By June 15	DFA sends supplemental budget forms to be submitted by state agencies that plan to request a deficiency or supplemental appropriation.

June 30	Close of biennium; unexpended general fund appropriations revert to the general fund.
By September 1	Agencies submit requests for supplemental and deficiency appropriations.
<b><u>EVEN-NUMBERED YEARS</u></b>	
By January 5	Governor submits supplemental and deficiency budget to legislature.
By June 15	DFA sends biennial budget request forms to agencies
By September 1	Agencies submit performance-based biennial budget requests to DFA and the LFC

Significant Issues

The primary differences between the SPAC amendment and original bill are:

1. The original bill would adopt biennial budgeting for all agencies; the SPAC amendment would adopt a biennial budgeting pilot project for up to 39 agencies.
2. The original bill would integrate the biennial budgeting into existing statutes governing the state budget process with detailed provisions for implementation of biennial budgeting; the SPAC amendment is not integrated into existing statutes governing the state budget process and does not include provisions for implementation of biennial budgeting.
3. The original bill would permanently implement biennial budgeting pending amendment by subsequent legislatures; the SPAC amendment would implement an eight-year pilot project.
4. The original bill contains no provisions for evaluation of improved performance and cost savings from implementation of biennial budgeting; the SPAC amendment sets up a procedure and data elements for evaluating improved performance and cost savings in the budget process from implementation of biennial budgeting.

Possible advantages of the SPAC amendment:

1. The proposal is structured as an experiment that could provide useful information to evaluate the benefits of biennial budgeting. It sets up a rigorous process to identify savings and performance improvements and for a terminal evaluation of the biennial budget process after eight years, the results of which would be used to decide whether to continue, expand or terminate biennial budgeting.
2. The SPAC amendment provides for a transition to implement biennial budgeting by affecting only a portion of state agencies.
3. The SPAC amendment is closer to the proposal preferred by Governor Richardson than the original bill. Governor Richardson recommended that biennial budgeting be implemented only for the 72 agencies with budgets under \$5 million.

Possible disadvantages of the SPAC amendment:

1. The SPAC amendment would not measure the primary source of cost savings from biennial budgeting. The amendment focuses on costs of administering the budget process. The major financial benefit of biennial budgeting derives from improved oversight of total agency operations to produce improved outcomes at lower costs. The most significant savings of the pilot project could be generated in agencies that would not be part of the pilot project but would be benefited by the additional time for oversight.
2. There are significant drafting problems in the SPAC amendment. It does not specify that participating agencies would be required to prepare biennial budgets. It does not set forth procedures for how biennial budgets would be prepared or implemented. It requires oversight of the pilot project by agencies (governor and LCS) that lack staff and expertise for this purpose. It sets out baseline data on six criteria, but evaluates the pilot program based on only one of those criteria and one additional criterion for which no baseline would be gathered. Participating agencies are likely to have much of the workload to track cost and staff savings, but these agencies (smaller than \$5 million) are most likely to lack staff to perform this tracking and are least likely to experience significant savings in budget preparation. Incorrect statutory names are used in the amendment. The final report deadline does not provide sufficient time for legislative extension of biennial budgeting if the legislature decides to do so.
3. The bill conflicts with existing statutes governing the budget process, which could create ambiguity in implementation. For example, existing statute prohibits an agency from spending more than one-half of its annual appropriation in the first half of a fiscal year. This is done, among other reasons, to protect a newly elected official from entering office with more than one-half of their annual budget spent by their predecessor. The SPAC amendment does not clarify how this provision would be applied. There are many other statutory provisions that require annual budgets that are modified in the original bill but not addressed in the SPAC amendment.
4. The SPAC amendment would require two separate budget processes in even-numbered years. Participating agencies would be allowed to submit supplemental and deficiency requests which would be reviewed in the context of their biennial budget; non-participating agencies would follow the annual budget guidelines.

### ***General Comments on Biennial Budgeting***

Proponents indicate that biennial budgeting would improve the New Mexico budget process by reducing time devoted to crunching the numbers for annual budgets and increasing the time available for consideration for policy and performance aspects of budgets and for agency oversight by the legislature and Department of Finance and Administration (DFA). Biennial budgeting may also reduce government spending, by reducing the need to process volumes of paper for annual budget requests, possibly reducing the need for overtime, per diem, supplies and other costs related to annual budget preparation. Proponents of biennial budgeting also indicate that this reform will increase predictability for state agencies, providing long-term commitments to programs and policies.

According to DFA, the current annual budgeting process has been seen as time-consuming for state agencies; biennial budgeting would 'free up' time for those involved in the process to manage for outcomes because agencies would only have to build a budget every two years and supplement the appropriated budget with requests for a deficiency and/or supplemental during the

interim year.

Prior to 1940, 44 states used biennial budgets. According to a study by the National Conference of State Legislatures (NCSL), the number of states with biennial budgets declined through the 1970s, primarily because legislatures shifted from biennial sessions to annual sessions and adjusted their budget cycles accordingly. In the last decade, this trend has reversed somewhat. Connecticut returned to biennial budgeting in 1991; Arizona enacted a biennial budget in 1999, now limited to smaller state agencies. In all, today 21 states adopt budgets biennially. Both President Bill Clinton and President George W. Bush recommended biennial budgeting at the federal level in their FY2001 and FY2002 budget submissions to Congress.

In *Moving New Mexico Forward: Further Along*, which was released in August 2004, Governor Bill Richardson's administration recommended adoption of a biennial budget model similar to that used in Arizona and Kansas, whereby biennial budgets would be adopted for smaller

agencies and annual budgets would be prepared for large agencies. In Governor Richardson's proposal, biennial budgeting would be used for 72 agencies with budgets under \$5 million.

The primary concern raised by biennial budgeting is the need to address rapid changes in agency budgets driven by changes in federal funding, state revenues, client populations, federal regulations, etc. DFA indicated concern that biennial budgeting might create difficulties in those agencies that have volatile revenue sources (i.e. Medicaid) and are driven by unforeseen circumstances (i.e. the Department of Corrections' inmate population growth). State agencies that typically have little growth from year-to-year and that have steady sources of revenue would be more apt to succeed in the biennial budgeting process due to their ability to forecast their future expenditure and FTE needs. For example, the Administrative Office of District Attorneys noted that, while a biennial budget process would reduce the work associated with preparing, submitting and justifying an annual budget request, it would also make the district attorneys less able to respond to emerging crime trends and changes in federal grant status which can have significant fiscal implications. The provision for supplemental and deficiency appropriations in the middle of the biennium would help to address this concern.

## **PERFORMANCE IMPLICATIONS**

DFA noted that the biennial budget process would assist the smaller agencies by only requiring the time consuming budget development process on alternate years. The agency would have more time to manage, implement and measure their performance goals. The two budget agencies (State Budget Division of DFA and Legislative Finance Committee - LFC) would not need to review every state agency's budget annually, but would have to review the budget for the supplemental and deficiency requests which could be significant for some agencies. Review of all agencies would be required and assistance throughout both years, however, those agencies that maintain level operating budgets would require less time for review compared to the amount of time that the annual budget process requires now. The process would allow for more time for the management and oversight of budgets.

## **FISCAL IMPLICATIONS**

There would be savings from reduced paperwork and staff time devoted to preparation, review, and implementation of annual budgets. To the extent that DFA and LFC staff devote greater time to performance and policy activities, these savings may be partially offset.

DFA commented that expenditures will decrease in budget preparation time and resources for state agencies as well as the State Budget Division, and Legislative Finance Committee every other year. Decreases may be seen in overtime, comp time, office supplies, and per diem rates in years without a budget request. However, funds could be then reallocated for training, site visits and other activities related to management and oversight.

### **ADMINISTRATIVE IMPLICATIONS**

DFA noted that the administration of HB404 will occur at the agency level, State Budget Division and the Legislature. Currently, both the State Budget Division and the Legislative Finance Committee have responsibilities during the request, appropriation and operating aspects of the budget process. These aspects include the statutory deadlines for the budget submissions and performance measures development and release of budget recommendations, and the hearings that the Legislative Finance Committee schedules with each agency. DFA indicated that each agency involved in the budgeting process has sufficient staff and resources to carry out the legislation.

The resources and staff would have to reallocate the work hours and associated costs for the tasks associated with each year of the biennial budget.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

This bill relates to Senate Bill 211.

### **OTHER SUBSTANTIVE ISSUES**

The Department of Transportation identified several ideas which should be considered in evaluating HB404, including:

- Agencies would continue to require budget adjustment authority and may require greater flexibility to implement a biennial budget.
- The DFA and LFC may need to develop a process, in addition to supplemental and deficiency appropriations, to evaluate policy initiatives that the legislature or executive may wish to undertake in the middle of a biennium.
- The bill does not address capital outlay budgeting.

DFA noted that consideration should be given to agencies headed by elected officials to assure that newly elected officers don't take over an agency with one year left on a depleted budget.

### **ALTERNATIVES**

DFA favored the approach included in *Moving New Mexico Forward: Further Along*. According to DFA, by implementing the process statewide, several of the larger agencies will experience difficulty with biennial budgeting due to the size and volatility of the associated revenues and expenditures.

### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?**

The state would continue to adopt annual budgets.