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IN THIS ISSUE

State Budget Process Quality Index

A good budget process gives people confidence that their state is run in an orderly, efficient, and open manner. *Reports* periodically updates its Index of State Budget Process Quality, timed to coincide with updates of the National Association of State Budget Officers publication on budget processes. Several of the components are items that states seldom change but others cover areas that have been the subject of revisions in recent years.

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STATE BUDGET PROCESS QUALITY INDEX

States are similar in many respects and different in others. One area where their differences are pronounced is the process by which they develop and manage their state budgets. Each accords a different role to the governor, legislature, and professional staff in the budget process. They estimate revenues differently, they allot funds differently, they prepare budget requests differently and they have different structures for managing and reducing state spending.

To provide a perspective from which to view these differences, *Reports* recently updated the Index of State Budget Process Quality, a project first undertaken by its founding editor, Hal Hovey. The index uses some widely agreed-upon measures of good budget practices—as reported by the National Association of State Budget Officers (NASBO)—and uses them to rank states on the quality of their budget processes.
The 2015 results are listed on the right.

HOW THE INDEX WORKS

The index awards high scores to states with:

- Strong requirements for balanced budgets, particularly mandates in state constitutions for all stages in the budget process
- Extensive powers for governors to constrain spending, including item-veto authority and the ability not to spend appropriated funds
- Large reserves
- Understandable budgets that reveal the impacts of current decisions on future budgets, recognition of pension liabilities, coverage of all state money, and disclosure of why and on what money is being spent

The numbers shown in the table are scores, with a perfect score of 100. The scores range from 86 in **Michigan** to 25.9 in **New Hampshire**. The

Budget Process Quality Index, 2015

Rank	State	Score
1	Michigan	86.0
2	Georgia	84.0
3	Minnesota	83.0
4	Missouri	82.0
5	New York	81.8
6	West Virginia	81.0
7	Rhode Island	78.0
7	Tennessee	78.0
9	Hawaii	77.0
9	Louisiana	77.0
9	Oregon	77.0
12	Maryland	76.0
13	Florida	75.0
13	North Dakota	75.0
15	Oklahoma	73.0
15	South Dakota	73.0
17	California	72.7
18	New Mexico	72.0
18	South Carolina	72.0
20	Maine	71.5
20	Wisconsin	71.5
22	New Jersey	70.7
23	Colorado	69.0
	U.S. average	**68.8**
24	Washington	68.4
25	Idaho	68.0
26	Delaware	67.0
26	Nebraska	67.0
28	Ohio	66.0
29	Connecticut	65.3
30	Arizona	65.0
31	Kansas	64.0
31	Texas	64.0
33	Alabama	63.2
34	Kentucky	62.8
35	Indiana	62.0
35	Iowa	62.0
37	Wyoming	61.0
38	Alaska	60.0
39	Montana	59.0
40	Nevada	56.0
41	Massachusetts	55.7
42	Arkansas	55.0
43	Pennsylvania	53.9
44	North Carolina	51.8
45	Vermont	51.0
46	Illinois	49.6
47	Utah	49.0
48	Mississippi	48.0
49	Virginia	43.1
50	New Hampshire	25.9

U.S. average is 68.8 points, down from 70.4 points in the last index (2008).

The table below summarizes the individual measures used in the index and shows the weight attached to each of them. Categorically, the index places the heaviest weight on efforts to make the state budget transparent and understandable, although the individual measure with the most weight is state balances. Specifically, any state holding at least 5% of general fund spending receives 15 points. Other heavily weighted items include a gubernatorial line-item veto, the ability of a governor to reduce the enacted budget without legislative approval, and reporting the annual required contribution (ARC) for the pension plan in the budget document.

Summary of Budget Process Quality Index Measures and Points

Provisions	Maximum Points
Balanced budget requirements	**20**
Submit balanced budget (constitutional)	7
Enact balanced budget (constitutional)	8
Sign balanced budget (constitutional)	5
Ability to reduce spending	**25**
Line-item veto	10
Reduce enacted budget	10
Allotment frequency	5
Stabilization funds	**20**
Rainy day funds	5
Balances	15
Understandable finances	**35**
Program descriptions	2
Caseloads	2
Number of employees	2
Performance measures	2
Capital budget	2
Annual retirement contribution	10
Multi-year spending forecasts	5
Publish spending forecasts	5
Appropriate all non-federal funds	3
Legislative approval to spend unanticipated funds	2
	100

BALANCED BUDGET REQUIREMENTS

Requirements that states balance their budgets are often said to be a major difference between state and federal budgeting. They can be either constitutional or statutory, but if they are

State Balanced Budget Requirements

Rank	State	Score
1	California	20
1	Colorado	20
1	Connecticut	20
1	Georgia	20
1	Idaho	20
1	Louisiana	20
1	Maine	20
1	Michigan	20
1	Minnesota	20
1	New Jersey	20
1	North Dakota	20
1	Ohio	20
1	Oklahoma	20
1	Oregon	20
1	Rhode Island	20
1	South Carolina	20
1	South Dakota	20
1	Tennessee	20
1	Wisconsin	20
1	Wyoming	20
21	Delaware	16
21	Florida	16
21	Kentucky	16
21	Nevada	16
21	Utah	16
26	Illinois	15
26	Maryland	15
26	North Carolina	15
	U.S. Average	**14**
29	Nebraska	13
29	Texas	13
29	West Virginia	13
32	Hawaii	12
32	Missouri	12
32	Pennsylvania	12
35	Kansas	11
35	Montana	11
37	New York	10
38	Alaska	9
38	Iowa	9
39	Massachusetts	9
39	Mississippi	9
39	New Hampshire	9
43	Alabama	6
43	New Mexico	6
43	Washington	6
46	Arkansas	3
47	Arizona	0
47	Indiana	0
47	Vermont	0
47	Virginia	0

constitutional they are more rigorous, as they are not subject to legislative amendment. The index rewards constitutional requirements, awarding seven points for a requirement that the governor submit a balanced budget, eight points for a requirement that the legislature pass a balanced budget, and five points for a requirement that the governor sign a balanced budget. If a state does not have one of these constitutional requirements, it is given three points for statutes requiring any of the same three things (for nine total points).

All states except **Vermont** are generally recognized to have a legal requirement to balance the state budget. Three other states also receive no points on this measure. **Arizona** and **Indiana** have restrictions on assuming debt, which serve as their balanced budget requirements. **Virginia's** governor is charged with "executing" a balanced budget, rather than submitting or signing one.

The scores for the balanced budget component are shown on page 3. Twenty states tie for first with perfect scores of 20, meaning they have constitutional requirements governing the submission, adoption, and signing of a balanced budget. Other states may have a constitutional provision for one or two of the three conditions, but not all of them. Still others have no constitutional provisions, but do have statutes relating to balanced budgets.

In the last several years, intense interest in state balanced budget requirements as a model for a potential federal requirement has led to more study of the specific nature of state requirements. As the table shows, there is considerably more variation in them than is commonly recognized.

Do states ever change their balanced budget requirements one way or the other? Probably not. The index uses data submitted by state budget officers and reported in NASBO's *Budget Processes in the States* publication, which is updated periodically. Interpreting the nature of state balanced budget requirements is as much art as science. Constitutional language is vague and state practice can evolve into an understanding of a balanced budget requirement that is quite different from the actual legal requirement. Thus, the information NASBO reports may reflect a new interpretation, without any underlying change in state statutes or constitutions.

ABILITY TO REDUCE SPENDING

Another major difference between states and the federal government lies in the ability of the chief executive to reduce spending. This category awards states 10 points for having a gubernatorial line-item veto, 10 points for explicit authority for the executive branch to reduce the budget without legislative approval (reduced to five if there are restrictions on this power), and five points for having an allotment process that divides agency spending into quarters or months (rather than one or two allotments per year).

The results are shown on the next page. Eight states—**Alabama**, **Arkansas**, **Georgia**, **Hawaii**, **Louisiana**, **Missouri**, **New York**, **Oklahoma**, **Oregon**, and **West Virginia**—receive a perfect score of 25 points.

Line-item veto. Most governors have the power to veto individual line items in the budget. Many of them have even greater powers because they can reduce, as well as eliminate, line-item appropriations, and some can veto particular words in appropriation bills. Governors are reported to have no line-item veto authority in nine states: **Connecticut**, **Indiana**, **Maine**, **Nevada**, **New Hampshire**, **North Carolina**, **Rhode Island**, **Vermont**, and **Washington**. **Maryland's** governor does not have veto power *per se*, but the state legislature may not add to the budget proposed by the governor, greatly enhancing gubernatorial budget powers.

Authority not to spend. The executive branch in 35 states has the power to make budget reductions without legislative approval. In many states, the governor is responsible for monitoring spending and is required to make reductions if spending exceeds revenues.

Twenty-two states limit this power, for instance by requiring that all reductions be of equal percentages or by exempting certain programs, such as school aid. Governors in the following 13 states may make unrestricted budget reductions without legislative approval: **Alabama**, **Arkansas**, **Georgia**, **Hawaii**, **Indiana**, **Louisiana**, **Minnesota**, **Missouri**, **Nevada**, **New York**, **Oklahoma**, **Oregon**, **Washington**, **West Virginia** and **Wisconsin**.

Allotment frequency. Appropriations are provided for a year or a biennium. Theoretically, an agency could spend its entire appropriation in the first few months, or it could backload spending (forcing an increase in the following year to maintain services). Agencies administering entitlement programs, such as Medicaid, could also spend at a rate that requires supplemental appropriations. To prevent these situations, 24 states allot appropriations more frequently than once or twice per year, typically monthly or quarterly.

STABILIZATION FUNDS

Like households and businesses, states experience periods of boom and bust. Some states are especially sensitive to financial fluctuations associated with industries such as oil and gas, mining, motor vehicles, and agriculture. But because they must balance their budgets, states use stabilization (or “rainy day”) funds to supplement their revenues during recessions. In addition, they may constrain spending during economic expansions to avoid a cycle of spending cutbacks followed by spending sprees.

This category awards states five points for having a rainy day fund and 15 points proportional to the total amount held as reserves (rainy day and other balances). For example, **Iowa** receives a

Governor's Ability to Reduce Spending

Rank	State	Score
1	Alabama	25
1	Arkansas	25
1	Georgia	25
1	Hawaii	25
1	Louisiana	25
1	Missouri	25
1	New York	25
1	Oklahoma	25
1	Oregon	25
1	West Virginia	25
11	Florida	20
11	Maryland	20
11	Massachusetts	20
11	Minnesota	20
11	Wisconsin	20
	U.S. Average	**16**
16	Arizona	15
16	California	15
16	Colorado	15
16	Idaho	15
16	Indiana	15
16	Iowa	15
16	Kansas	15
16	Kentucky	15
16	Michigan	15
16	Mississippi	15
16	Montana	15
16	Nebraska	15
16	New Jersey	15
16	New Mexico	15
16	North Dakota	15
16	Ohio	15
16	Pennsylvania	15
16	South Carolina	15
16	Tennessee	15
16	Virginia	15
16	Washington	15
37	Alaska	10
37	Connecticut	10
37	Delaware	10
37	Illinois	10
37	Maine	10
37	Nevada	10
37	South Dakota	10
37	Texas	10
37	Utah	10
37	Wyoming	10
47	North Carolina	5
47	Rhode Island	5
47	Vermont	5
50	New Hampshire	0

perfect score of 20 because it has a rainy day fund (five points) and its balance as a percent of expenditures equals or exceeds 5% (15 points).

It is widely accepted that states should hold balances of at least 5% (although recent recessions have led to some calls for greater reserve levels). The index multiplies a state's balance as a percent of general fund spending by three, to give greater weight to the actual balance amounts than to whether or not states have a rainy day fund. The table on the right shows the scores for this category.

Thirty-one states receive a perfect score on this component. **Arkansas** has the lowest score, owing to its unusual budgeting system. Only a base budget, affordable under any conceivable economic situation, is initially available for spending. As the year progresses, additional appropriation tiers are released if fiscal circumstances permit. This largely mitigates the need for a rainy day fund or a surplus, although the state reports having such a fund (with a zero balance).

Montana is the only state reporting no rainy day mechanism. Rather than a fund that receives budget surpluses at the end of a fiscal year, **Colorado** and **Kansas** directly appropriate funds into a reserve, which serves as their rainy day fund.

UNDERSTANDABLE FINANCES

Some state budget practices can make state finances more understandable to elected officials and the public. Among these are a comprehensive budget document, strong reporting practices, the use of multi-year forecasts, and legislative consideration of all the funds for which the state is responsible. The results for understandable finances are listed on the next page.

This category awards a maximum of 10 points to states with budgets that provide information on five subjects (two points each):

- program descriptions

Stabilization Funds and Reserves

Rank	State	Score
1	Alaska	20.0
1	Arizona	20.0
1	Colorado	20.0
1	Delaware	20.0
1	Florida	20.0
1	Georgia	20.0
1	Hawaii	20.0
1	Idaho	20.0
1	Indiana	20.0
1	Iowa	20.0
1	Kansas	20.0
1	Louisiana	20.0
1	Maryland	20.0
1	Michigan	20.0
1	Minnesota	20.0
1	Missouri	20.0
1	Nebraska	20.0
1	Nevada	20.0
1	New Mexico	20.0
1	North Dakota	20.0
1	Ohio	20.0
1	Oklahoma	20.0
1	Rhode Island	20.0
1	South Carolina	20.0
1	South Dakota	20.0
1	Tennessee	20.0
1	Texas	20.0
1	Utah	20.0
1	Vermont	20.0
1	West Virginia	20.0
1	Wyoming	20.0
	U.S. Average	**19.9**
32	Washington	19.4
33	North Carolina	18.8
34	Alabama	18.2
35	California	16.7
35	Massachusetts	16.7
37	Virginia	16.1
38	New York	15.8
39	Wisconsin	15.5
40	Montana	15.0
41	Connecticut	14.3
42	Mississippi	14.0
42	Oregon	14.0
44	Maine	12.5
45	New Hampshire	11.9
46	Kentucky	9.8
47	New Jersey	7.7
48	Pennsylvania	5.9
49	Illinois	5.6
50	Arkansas	5.0

- caseloads (e.g., school enrollment) that drive major spending
- the number of state employees
- indicators of performance or results expected from spending money
- a separate presentation of capital outlays

In a change from previous years, *Reports* awarded 10 points to states that include the ARC for their state pension systems in the budget document. This measure replaces one that awarded 10 points to states that use generally accepted accounting principles (GAAP) for budgeting.

GAAP budgeting puts states on a common comparative basis and limits artificial mechanisms that can improve the current budget outlook, but NASBO no longer reports the states that use it. As a substitute, *Reports* elected to focus on a budget practice that has been in the spotlight in many states, in large part because the failure to make ARCs has been a primary source of mounting long-term liabilities in many states. Conversely, states that both publish and adhere to their ARCs are in a better long-term fiscal position and also are conducting the state's business in a more transparent fashion. The 17 states that include the ARC in the budget document are: **Arizona**, **Arkansas**, **Connecticut**, **Delaware**, **Indiana**, **Kentucky**, **Maine**, **Michigan**, **New Jersey**, **New Mexico**, **New York**, **Rhode Island**, **Tennessee**, **Texas**, **Vermont**, **Washington**, and **West Virginia**.

The index awards five points for any form of multi-year expenditure forecasting and five points for publishing such forecasts. These practices ensure that states are taking into account and reporting on tomorrow's cost of today's budget decisions. The measure also assigns three points for appropriating all non-federal funds and two points if the governor cannot spend unanticipated federal funds without legislative approval. Both of these policies indicate that the legislature serves as

Understandable Budgets and Finances

Rank	State	Score
1	Rhode Island	33
2	Michigan	31
2	New Mexico	31
2	New York	31
5	Arizona	30
6	Maine	29
7	New Jersey	28
7	Washington	28
9	Indiana	27
10	Vermont	26
11	Missouri	25
12	Minnesota	23
12	South Dakota	23
12	Tennessee	23
12	West Virginia	23
16	Arkansas	22
16	Kentucky	22
18	Alaska	21
18	California	21
18	Connecticut	21
18	Delaware	21
18	Maryland	21
18	Pennsylvania	21
18	Texas	21
25	Hawaii	20
25	North Dakota	20
	U.S. Average	**19**
27	Florida	19
27	Georgia	19
27	Illinois	19
27	Nebraska	19
31	Iowa	18
31	Kansas	18
31	Montana	18
31	Oregon	18
35	South Carolina	17
36	Wisconsin	16
37	Alabama	14
37	Colorado	14
39	Idaho	13
39	North Carolina	13
41	Louisiana	12
41	Virginia	12
43	Ohio	11
43	Wyoming	11
45	Massachusetts	10
45	Mississippi	10
45	Nevada	10
48	Oklahoma	8
49	New Hampshire	5
50	Utah	3

a check on the governor's budget power. The scores are listed on page 7 and range from 33 points in **Rhode Island** to three points in **Utah**.

SUMMARY

State budget processes are fairly stable over time; balanced budget requirements are unlikely to change, as are a governor's ability to veto items in the budget, or implement budget cuts at mid-year. One doesn't hear of legislative debates around changing allotment practices or changing the funds that legislatures do or don't appropriate. States that register substantial changes in any of these categories may be exceptions to the rule or may have simply rethought how they respond to the NASBO survey.

On the other hand, there are areas where a state's results on this index are more likely to change. They include:

- increasing balances in rainy day funds
- moving toward ARC reporting
- incorporating performance measures in the budget document
- improving and expanding expenditure forecasting practices

States wishing to improve the transparency in their budget processes can look to these as areas of potential reform.

TECHNICAL NOTES

Budget Processes. *Budget Processes in the States*, Spring 2015, is available at www.nasbo.org. Total balances for fiscal year 2014 were reported in NASBO's *Fiscal Survey of States*, Fall 2014.

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