



Fiscal Policy BULLETIN

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Strengthening the Indiana Budget Process

Perhaps the most important activity regularly undertaken by state government is the allocation of state resources among the various competing demands made on those resources—in other words, budgeting.

Budgetary decisions are influenced by a wide array of factors, political and technical. One of those factors is the actual process of budget development, itself. A budget development process that is based on an adequate level of relevant budgetary information and which accommodates major new budgetary directions in a reasonably systematic fashion is more likely to serve the needs of the State better than one that does not. The present Indiana budget process is weak on both accounts.

The Indiana budget process differs from the typical state budget process in two ways: First, development of the state budget is the responsibility of a joint legislative-executive committee, rather than of the governor. Second, the state adopts a general appropriations act every two years, rather than annually.

In light of the time limits on legislative sessions in Indiana, these two devices should permit much budgetary decision-making and oversight to occur between budget

sessions and permit reasonably expeditious adoption of the budget. Unfortunately, "expeditious" is not the term that comes to mind in considering the adoption of the state appropriations act in recent budget sessions.

Budget Preparation in Indiana.

Development of the Indiana budget occurs under the aegis of the State Budget Committee, composed of the State Budget Director, majority and minority party members from both the House and the Senate, and their alternates. Staff work is

handled primarily by the State Budget Agency, the Legislative Services Agency, and staff of the House Ways and Means Committee and the Senate Finance Committee.

The Budget Committee meets periodically between legislative sessions, often to approve capital spending or to inspect state facilities. Its most concentrated work occurs, however, in the last three months of each even-numbered year. During this period, the committee meets frequently in order to hear presentations of the

The Report in Brief

The State of Indiana fails to take advantage of its biennial budget cycle by leaving major budgetary initiatives to the legislative budget sessions and by producing budgets based on inadequate program review and evaluation.

As a result, major new budgetary proposals do not receive the more measured consideration available during the budget development process and many budgetary decisions are made on the basis of little or no information on the level of effectiveness or efficiency achieved by state programs.

The Indiana budget process could be materially improved by:

- 1) Establishing a process of multi-year budget forecasting (both revenues and expenditures) in which the long-term budgetary implications of current trends and decisions could be assessed;
- 2) Creating a consensus forecasting process for Medicaid and other open-ended appropriations in order to shift the focus of debate on Medicaid from the projected expenditures to policy issues; and
- 3) Increasing the level of program evaluation performed by the State and integrating it with the process of budget development so that program review is more likely to be taken into consideration when budgetary decisions are made.

various state agencies respecting their needs for the coming biennium. These hearings presumably offer members of the committee the opportunity to explore funding issues and to review program performance, without the deadlines and relative tumult of a legislative session.

Following the budget hearings and the release of the consensus revenue forecast in December, the committee develops its recommendations and compiles the proposed spending for each appropriation item into a report. The budget of the State of Indiana, then, is actually a report of the State Budget Committee to the Governor, who in turn submits an appropriations bill (which may incorporate changes to the Budget Committee report) to the General Assembly for its approval.

In contrast to a more usual "strong executive" budget process, which presents the fiscal plan of the governor and which may receive little legislative support, the Indiana Budget Committee approach is intended to be a consensus-building process aimed at producing a set of figures that has the maximum amount of support in each branch.

Is the Indiana Budget Really a Budget?

The Government Finance Officers Association (GFOA) defines a budget as:

A plan of financial operation embodying an estimate of proposed expenditures for a given period and the proposed means of financing them. (GFOA, *Governmental Accounting, Auditing and Financial Reporting*, 1988.)

Simply put, a budget process is a device for making the projections

and trade-offs necessary to come up with a financial "plan."

Viewed in this light, the Indiana Budget Committee does not produce a "budget" in the strict sense of the term (namely, a financial *plan*). Instead, it produces a set of numbers that, with few exceptions, reflects the cost of continuing state expenditures in an essentially static configuration. It does not represent a proposed response to changing fiscal conditions in that it does not embody major new program initiatives or revenue proposals. These occur outside the deliberations of the Budget Committee and are, in addition to, rather than part of, the budget process. For example:

- In 1987, the A+ plan for education and its associated tax increases were proposed by the Governor outside of the budget process and adopted in separate legislation.
- In 1991, in the face of flat revenue projections, the Budget Committee could not agree on a budget report that kept proposed expenditures within forecast revenue. The report was submitted unilaterally by the State Budget Director.
- In 1993, despite existence of projections of Medicaid expenditures far exceeding those in previous forecasts, the amount proposed as the Medicaid "expenditure" in the budget report was, in fact, a plug number representing an amalgam of projected Medicaid expenditures and yet-to-be-determined revenues and cost reductions associated with Medicaid. Much of the 1993 budget discussion was a debate over the size of the Medicaid problem.

The conclusion to be drawn from this record is that the current

process of budget development in Indiana does not accommodate significant deviations from "normal" budgetary trends. If revenues are down, if an expenditure item is out of control, or if a major new initiative is proposed, the normal budget development process has not been the vehicle of choice for moving the issue into the legislative process.

This does not mean that an appropriations act is not ultimately adopted (although the act in 1993 was adopted with only a few hours remaining before the end of FY93). What it does mean is that after the budget report is submitted, major changes that might have been proposed and considered during the construction of the budget may be initiated. Whatever advantage may have been achieved by the deliberative processes of the Budget Committee during the period of budget development is either lost or seriously diminished.

In short, the Indiana budget, at the time of submission to the Governor, is not a "plan" in any meaningful sense of the word. When the task is to produce a continuation budget under reasonably stable conditions, the current approach may have much to recommend it, including the opportunity it affords committee members to develop better working relationships. If, however, significant budgetary decisions are required, they do not occur in the budget development process as it is now constituted.

Key alterations to the budget are proposed, debated, and carried out during the legislative session and do not receive the more paced review accorded the remainder of the budget during the budget development process. Since such

alterations are likely to be controversial, loss of this lead time helps to produce a crisis atmosphere. The tendency for the General Assembly to pass the appropriation bill in the last hours of the legislative session is strong enough without adding to the problem.

Strengthening the Indiana Budget Process.

Allocating scarce state resources is the task of the budget. This task is made more effective by adequate planning and evaluation. Planning and evaluation activities will tend to be sterile unless they are integrated into the budget process. Similarly, a budget process that does not foster planning and evaluation will be little more than an accounting exercise.

A biennial budget should provide Indiana with the right conditions for planning and evaluation. Ideally, the twenty months from the passage of the appropriations act to the beginning of the next budget session affords ample opportunity to analyze budget trends and to review the organization, operation, and impact of state programs in preparation for the next budget cycle. This is not carried out effectively under present Budget Committee procedures.

Three changes in current Budget Committee policy could significantly improve the process of budget development:

1. *Multi-year Budget Forecasting.* A biennial budget has an advantage over an annual budget in that it forces policymakers to look forward at least two years in making appropriations. This advantage could be multiplied by a process involving longer-range forecasts, the basic purpose of which would be to

identify the longer-term consequences of current budgetary decisions.

For example, much attention is being paid to efforts to reduce Medicaid expenditures by \$490 million from previously forecast levels in the 1993-95 biennium. Should this effort fail, or if tax collections do not meet expectations, an increase in taxes will be very likely.

Two important questions must be answered in making decisions concerning Medicaid spending and its impact on the state budget. First, to the extent that the spending reductions are successful, will they bring about a slower rate of growth in the future or will Medicaid spending simply resume its double-digit growth rate, albeit from a somewhat lower base?

Second, if a tax increase is deemed necessary, what are the implications of Medicaid spending for such an increase? One proposal has been an increase in the Indiana cigarette tax. The cigarette tax, however, is a declining source of revenue and, while a cigarette tax increase could be used to close a gap between revenues and spending over the course of a biennium, it would be inadequate to that task over the long run, especially if Medicaid were to resume its rapid increases. The result would be that another tax increase would be on the state agenda very shortly.

The dimensions of such choices would be more evident if forecasts of state revenues and expenditures going out at least two biennia were available. The purpose of long-run forecasts is not to pinpoint precisely the level of revenue and expenditure, but to obtain some

indication of the likely result of current trends and the impact on the budget of certain spending items or revenues that may be growing at rates (either higher or lower) significantly different from the budget as a whole.

Of particular interest is the impact of new or substantially revised programs. A typical program is small when first adopted and may be easily funded by the existing revenue stream. By the time the program matures, however, it may be many times as large and create enough pressure to result in increased taxes.

Revised programs can also have a significant budgetary impact. The Indiana school funding formula was restructured in 1993 for the first time in 20 years. Because of its likely impact on certain school corporations, a six-year phase-in period was adopted. No explicit projections exist, however, for the period following FY95. As a result, the long-run implications of the changes adopted in 1993 are not well understood. K-12 school funding is the largest item in the state budget but is relatively easy to forecast. Decisions on school funding should not be made without the benefit of a long-term forecast.

2. *Consensus Forecasting of Open-ended Appropriations.* Nearly every appropriation item establishes a statutory limit on the amount that may be spent for that item. Certain items, however, are "open-ended," in that the language in the appropriation act specifically provides that if the appropriation is insufficient, there is automatically appropriated whatever additional sums may be necessary.

For the 1993-95 biennium, there are three open-ended appropriations: 1) County jail maintenance of state offenders; 2) Public assistance (including AFDC) and IMPACT; and 3) Medicaid. (Certain appropriations to the General Assembly are also open-ended, but these are relatively controllable.) These appropriations are open-ended because the state has agreed to pay whatever costs are incurred in these programs. AFDC and Medicaid are entitlements, which means that the state is legally bound to pay any legitimate claim arising under those programs.

Since the state cannot simply curtail spending when these programs reach their appropriated levels, it is important to produce accurate expenditure forecasts for them. This is especially true for Medicaid, because it represents such a large portion of General Fund/Property Tax Replacement Fund (GF/PTRF) spending.

It is also important to produce expenditure forecasts to which all parties will agree so that budget negotiations will focus on issues and solutions rather than on the size of the problem. Unfortunately, during the 1993 sessions, policymakers failed to reach an early agreement on the projected level of Medicaid expenditures. This was in part responsible for the late passage of the appropriation bill.

Similar disagreements involving the projected level of state revenues in the mid-1970s led to the adoption of the consensus revenue forecast, a process that has served the state well by eliminating debates over the expected level of available resources.

The consensus revenue forecast involves 1) the Indiana Economic Forum, leading economists appointed by the Governor, and 2) the Revenue Technical Committee. Each member of the Budget Committee appoints a member to the Revenue Technical Committee. The Forum prepares forecasts of the economic variables relevant to state revenues and the Revenue Technical Committee applies econometric models to those forecasts to derive a forecast of state revenues.

The consensus revenue forecast has removed the anticipated level of revenues from the debate, not only because both parties and both branches of government agree to abide by the forecast, but also because the process normally has produced reasonably accurate numbers on which to base state spending decisions.

Medicaid is the expenditure equivalent of state revenues. First, as with revenues, the state cannot directly control the level of Medicaid expenditures. Medicaid expenditures are determined by the number of recipients, their utilization of covered services, and the level of payment to the providers of those services. Medicaid expenditures may be controlled only by limiting one or more of these components.

Second, Medicaid is also responsive to economic conditions. The number of Medicaid recipients will be larger or smaller according to the strength of the economy, and the prices of Medicaid services will reflect both general and medical care inflation.

A process analogous to the consensus revenue forecast could be used to forecast open-ended expenditures, in particular Medicaid. At

present, Medicaid expenditures for providers, other than long-term care providers, are forecast by an actuary. A consensus Medicaid forecasting process could build on the projections of the actuary and could develop a mutually acceptable methodology for projecting long-term care expenditures, as well.

3. *Program Review and Evaluation Integrated with the Budget Process.* Much budgetary policymaking takes place in an informational and analytical vacuum. For many state programs, either little information exists or the available information is irrelevant to budgetary decisionmaking. Budget Committee deliberations seldom concern themselves with the extent to which state programs are achieving their objectives, or even what those objectives might be. Analysis of underlying program costs is seldom undertaken, nor is there often any analysis of the relationship between costs and program accomplishments.

The result is that the focus of the Budget Committee during the development phase of the budget process is on inputs and is heavily incremental; how many dollars next year as compared to last year, and where those dollars will come from.

Program analysis can create discomfort, both bureaucratic and legislative, particularly when it involves politically sensitive programs. Few policymakers relish the thought of dealing with negative review and analysis of programs such as special education or assistance to the elderly. Nor do they usually enjoy confrontations with influential interest groups bent on protecting "their" programs.

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The alternative to program review and evaluation, however, is budgeting that fails to distinguish between programs that may be achieving some valid public purpose and those that are not. The amount of state money spent inappropriately or inefficiently can only be guessed at, in part because the budget process does not force systematic consideration of these questions.

It is not that program evaluation has not occurred. In 1978, the General Assembly adopted a "sunset review" process, the original intent of which was to eliminate those agencies that were unable to document their effectiveness before a preset termination date. Over the years, the Legislative Services Agency prepared numerous sunset reviews, many of high quality, yet the impact on state spending decisions must be judged to have been marginal.

Sunset review was itself terminated by Senate Enrolled Act No. 225 (1993) and replaced by a Legislative Evaluation and Oversight Policy Subcommittee of the Legislative Council consisting of four members, one from each party in the House and one from each party in the Senate.

The Evaluation and Oversight Policy Subcommittee is charged with making many of the same kinds of determinations that were made under sunset review (objectives, impact, budget requirements, and so on), but without the program termination dates, which had proved to be meaningless.

SEA 225 prescribes a 15-year schedule for reviewing state agencies that can best be described as leisurely:

- 1994 - Highways and transportation
- 1995 - Occupational licensing
- 1996 - Commerce
- 1997 - Agriculture
- 1998 - Human res. & Econ. security
- 1999 - Management & administration
- 2000 - Corrections & judiciary
- 2001 - Public safety
- 2002 - Education
- 2003 - Human services
- 2004 - Labor
- 2005 - Taxation & finance
- 2006 - Business regulation
- 2007 - Health
- 2008 - Natural resources

All of the agencies to be reviewed in the first eight years together constitute only slightly more than one-tenth of GF/PTRF spending. Under the timetable in SEA 225, it will not be until 2002 that a major portion of the budget will be subject to review, and the function that is causing most of the pressure on the current budget (health) will not be reviewed until 2007.

The basic problem with the new evaluation and policy oversight process, however, is not the timetable, which could easily be accelerated. The flaw that will make it little more than a scholastic exercise is that it is not integrated into the development of the budget. Nothing in SEA 225 or in the current procedures of the Budget Committee requires that the results of evaluation and policy oversight flow through the deliberations of the Budget Committee. Although members of the Budget Committee undoubtedly were familiar with the sunset reviews, those reports did not systematically find their way into the budget process and did not have the effect that they might have had.

The entire budget process would be better served if the amount of budget-related program review were increased and integrated into the development of the budget. The staffs of the State Budget Agency and the Legislative Services Agency could coordinate their analytical efforts in order to produce "consensus reviews" the timing of which would be structured to assure that the reviews were available for consideration during the development of the budget report. Short sessions of the General Assembly could be structured to include reviews of program evaluations in preparation for the next budget session.

In addition, the membership of the Evaluation and Policy Oversight Subcommittee could be expanded to include members of the Budget Committee. Overlap of this sort would help to assure that a degree of exposure to the evaluation process would be available to the Budget Committee and increase the likelihood that the Budget Committee would use the analyses.

Conclusion.

The current method of budget development in Indiana results in a budget proposal that does not comprise responses to serious fiscal problems. Initiatives in such cases are handled by entities other than the Budget Committee, frequently in less deliberative settings.

The work of the Budget Committee between legislative budget sessions does not take full advantage of Indiana's short legislative sessions and biennial budget cycle. Many of the meetings of the Committee consist of inspection tours of state facilities and approval of spending for capital projects, most of which

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are very small. Budget hearings with state agencies in the months before the delivery of the budget report infrequently get into serious discussions of the value of the state programs under review and possible alternatives that might be adopted.

While the Indiana budget committee process has virtues that probably make wholesale changes undesirable, it has not performed its function well in recent budget cycles. The recommendations contained in this report are aimed at two objectives: 1) Increasing the amount of information and analysis relevant to budgetary decisions, and 2) bringing major new departures in state taxing and spending

within the process of budget development, rather than postponing their consideration until the legislative session is underway.

While no restructuring of the budget process can be expected to solve every budget problem, the Indiana process could be materially improved by:

1. Establishing a process of multi-year budget forecasting that would help to identify long-term trends and the future impact of current budgetary decisions.
2. Establishing for Medicaid and other open-ended appropriations a consensus expenditure forecast that would be analogous to the consensus revenue forecast.

3. Increasing the amount of relevant program analysis and evaluation and assuring that it becomes part of the process of budget development.

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