



# PUBLIC POLICY ADVISOR

## Biennial Budgeting

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### INTRODUCTION

Michigan's budget problems have brought renewed attention to an old issue—annual versus biennial budgeting. In this paper, we examine the pros and cons of this issue and suggest that biennial budgeting could be advantageous for Michigan.

Annual budgeting means that the executive and legislative branches of state government determine appropriations each year for the following fiscal year. A biennial budget is one made every other year to set appropriations for the following two fiscal years. Biennial budgets can be restricted by requiring legislative review after the first year of the biennium and separate appropriations for each year. This is common in states that adopt a two-year budget while keeping annual legislative sessions.

From 1940 until the early 1970s, there was a marked trend toward annual state budgeting. In the early 1940s, only four states adopted budgets each year; by 1971, 33 states had annual budgets. The growing complexity of state governments and the increasing number of states with annual legislative sessions have been cited as reasons for this trend.<sup>2</sup>

A reverse trend toward biennial budgeting began in 1971 when Hawaii shifted to a biennial budget while retaining annual legislative sessions. Since 1971, eight states have shifted to annual budgeting while five have shifted to biennial budgeting. Today, the budget cycle does not appear to be an issue in other states.

At present, 31 states have annual budgets while 19 adopt biennial budgets. (See Exhibit 1.) Iowa is technically a biennial budget state, but only annual budgets have been passed by the legislature since 1983. In Vermont, where the governor can submit an annual or biennial budget, only annual budgets have been submitted and passed for the past 13 years. Of the 19 biennial budget states, only five make appropriations for the full biennium rather than for each fiscal year, and three of these review their budgets annually for necessary changes.

### PROS AND CONS OF BIENNIAL BUDGETING

State legislatures concerned with the lack of opportunity for program review and the growing proportion of each legislative session devoted to budget matters may wish to consider switching to a biennial budget. Following are some common arguments in favor of biennial budgeting.

- 1 Ruth Beier, who was a consultant for Public Sector Consultants in 1987 and coauthored the original report, is currently the Associate Director of the Institute for Public Policy and Social Research at Michigan State University
- 2 Council of State Governments, "Annual or Biennial Budgets?" Lexington, Kentucky, 1972.

## EXHIBIT 1

## State Legislative Session and Budget Cycles

*Annual Sessions and Annual Budgets (31 states)*

Alabama	Illinois	New York
Alaska	Iowa (3)	Oklahoma
Arizona	Kansas	Pennsylvania
California	Louisiana	Rhode Island
Colorado	Maryland	South Carolina
Connecticut (1)	Michigan	South Dakota
Delaware	Mississippi	Tennessee (4)
Florida (2)	Missouri	Utah (1)
Georgia	New Jersey	Vermont (4, 5)
Idaho	New Mexico (1)	West Virginia

*Annual Sessions and Biennial Budgets (12 states)*

Hawaii (6, 7)	Nebraska (6, 7, 10)	Virginia (6, 7)
Indiana (6, 7)	New Hampshire (6, 11)	Washington (7, 8, 12)
Maine (1, 6, 7)	North Carolina (4, 7, 8, 12)	Wisconsin (6, 7, 9)
Minnesota (4, 6, 7)	Ohio (6, 7)	Wyoming (1, 7, 8, 12)

*Biennial Sessions and Biennial Budgets (7 states)*

Arkansas (6)	Nevada (16)	Oregon (8)
Kentucky (6)	North Dakota (8)	Texas (6)
Montana (6)		

SOURCE: National Conference of State Legislatures (NCSL), January 1987. Per phone conversation with NCSL, there have been no changes since 1987.

## NOTES:

1. Second session limited to budgetary/fiscal matters.
2. Between 1979 and 1985, the governor submitted two-year budgets, but the legislature continued to pass annual appropriations only.
3. Iowa is technically a biennial budget state; however, while the governor has submitted biennial budgets since 1983, the legislature has passed annual budgets only.
4. Formally, the legislature meets in biennial sessions, but it actually meets each calendar year via continuous or split session arrangement.
5. The governor can decide whether to submit an annual or biennial budget. For the past eight or nine years, however, annual budgets have been submitted and passed.
6. Usually, appropriations are made separately for each year of the biennium in the biennial budget bill(s).
7. Major annual review or modifications of the biennial budget may take place.
8. Appropriations are made for the full biennium rather than for each year of the biennium.
9. Although it still passes a biennial budget, Wisconsin passed a law in 1987 requiring an update of appropriations in the second year of the biennium.
10. Switched to biennial budget under law passed in 1986.
11. Switched to annual sessions beginning in 1987.
12. Biennial appropriations with annual review.

- The legislature would have more time for substantive deliberation and program evaluation. Without program and department budgets to determine each year, legislators could devote every other session entirely to nonbudgetary matters. An oft-cited program of annual budgeting is that program budgets for the next fiscal year must be determined only one or two months into the current fiscal year. A biennial budget would allow programs to be reviewed and future budgets to be determined after they have been in place for a year.
- Program disruptions could be minimized. If the budget for one year is expected to be tighter than that for the next, a biennial budget could reduce program disruptions by spreading cuts or averaging revenue over two years. As discussed below, the proposal under consideration in Michigan would not offer this advantage.

- Biennial budgeting may result in lower state budgets. With half as many opportunities for special interests to push for higher funding and for the legislature to approve increases, state policymakers may more easily hold the line on spending.
- Although departments may receive less money because they would have fewer lobbying opportunities, biennial budgeting would allow long-range planning that could result in more efficient use of state dollars.
- Biennial budgeting would result in lower budget preparation costs by reducing the need for both legislative and executive staff.
- Biennial budgeting would provide more certainty about state funding levels to managers of programs, schools, and local governments.

Following are some common arguments against biennial budgeting.

- A two-year budget might be subject to legislative review half as often as an annual budget, giving the executive branch more power over program and department budgets. Without an annual review, deviations from projections could go unnoticed for a longer period, making later budget adjustments more severe.
- Biennial budgeting might give legislatures less opportunity to exercise control over federal funds, depending on the particulars of the plan. Because they may become available at any time, new federal funds are difficult for legislators to control if the state's budget is adopted once every two years. Federal aid reductions also take effect at different times of the year, and it is difficult for biennial budget states to respond quickly to changes in the availability of federal funds. This may not be a problem with the biennial budget proposal for Michigan.
- Revenue estimates are apt to be less accurate with a two-year budget. Changing economic conditions make revenue estimates for a two-year period less reliable than those for a one-year period. This is especially true in Michigan, where the economy is very susceptible to national economic trends that may have little effect on other state economies.
- Biennial budgeting could increase the need for supplemental appropriations. Legislatures often make a supplemental appropriation when the purpose of a regular appropriation has been expanded or when the funds for a particular program have been exhausted before the end of the budgetary period. Program cost projections are likely to be less accurate under a two-year budget cycle, increasing the need for supplementals. Revenue estimates that are significantly off due to changes in economic conditions may require the legislature to rewrite the budget.

States concerned with the time spent on budgeting and lack of opportunity to consider nonbudget matters each session may opt for a biennial budget, even with its negative features. States concerned with accurate forecasting and the legislature's ability to monitor the budget may prefer an annual budget. A restricted biennial budget in which two-year budgets are passed and then reviewed and amended in the second year of the biennium may reduce the negative aspects of biennial budgeting while preserving its advantages. Under this system, legislators would have more time to concentrate on nonbudgetary matters but would still be involved with the budget each year. Changes in the availability of federal funds could be accommodated by amendment during the entire biennium. Longer range planning and efficient use of funds would be encouraged, while inaccurate projections could be corrected in off-budget years. States with legislatures that meet annually may be well suited for this type of biennial budgeting.

## IMPLICATIONS FOR MICHIGAN

The Michigan legislature meets each year and currently passes an annual budget. Governor Engler, however, is seriously considering moving to a biennial budgeting process. The proposal being considered would contain separate appropriations for each fiscal year and require that each fiscal year budget be balanced and an annual financial report be prepared. The governor would provide an update on the status of the budget in February 1994. New legislation would not be required.

As would be true in any state, a biennial budget would afford Michigan the benefits of longer range planning, lower budget preparation costs, less time spent each year on the budget process, and more time to review programs before budget decisions are made and to discuss nonbudgetary matters.

A true two-year biennial budget could help Michigan policymakers mitigate their most confounding problem: how to deal with the variable state economy and budget. National and international economic changes, such as an increase in the price of oil or a reduction in import taxes, can have extreme effects on Michigan's economy and state tax revenue. Variable revenue translates into variable funding for departments and programs. Department directors cannot count on funding levels for more than one year, making them wary of long-term planning. A biennial budget would allow expected variations in state revenue to be spread over two years. If revenues are expected to be lower in the second year of the biennium, the loss can be spread over two years, avoiding program budget reductions in the second year. Department budgets would be more stable, and longer range planning would be encouraged.

If the state were to switch to biennial budgeting, state policymakers would have to use realistic or conservative estimates of future revenue when constructing the budget. If estimates were overly optimistic, sizable cuts would be necessary in the second year, undermining department directors' confidence in the two-year system.

More often than not, Michigan legislators are faced with scarce resources, growing expenditure demands, and national or international events that result in reduced tax revenue. Biennial budgeting would allow legislators to spread negative economic effects over two years and provide enough planning time to get the most out of each dollar spent by the state. The proposal currently being considered would not have these advantages, however, because the budget would have to be balanced each year and budget shortfalls could not be spread over two years.

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