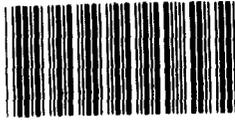


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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



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FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 a.m.
May 5, 1983,

TESTIMONY OF
CHARLES A. BOWSER
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON
PERSPECTIVES ON BUDGETING FOR STATE AND LOCAL NEEDS
AND BIENNIAL BUDGETING

Mr. Chairman and Members of the Committee:

I am very pleased to appear before you today to discuss perspectives on budgeting for State and local needs. More specifically, I will be discussing our work both on advance budgeting of Federal assistance to State and local governments and on State biennial budgeting experiences.

State and local government planning and budgeting processes have been straining under the rapid growth of the Federal grant system during the late 1960s and early 1970s, the increased complexity of these programs, the recent shift to greater decisionmaking responsibility by these governments, and, most recently, reduced Federal funding. In view of the critical role of these governments, it behooves the

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Federal Government to assure that whatever resources we provide can be used as efficiently as possible.

STUDY ON ADVANCE BUDGETING

In view of this concern, we undertook a study of the interrelationships of Federal, State and local budgeting cycles. In this study, we set out to determine what problems are caused by the different budget cycles and whether those cycles can be better coordinated. Differences such as calendar year versus fiscal year versus program year point out the potential for confusion when State and local governments use Federal funds. Our study is not yet complete, but we are happy to share the preliminary results with you at this time.

In the early stages of our work, State and local government officials told us that although they had concerns about various budget cycle-related problems, of much greater concern to them was the resulting uncertainty of the Federal funding levels and the negative effect this has on their own budget process. Reacting to this concern, we examined the characteristics, extent, and effects of Federal funding uncertainties by analyzing the budget processes in six States--California, Colorado, Georgia, Michigan, Montana, and Ohio--, 18 local government units within the States (including a city, county and school district in each State), and 10 Federal grant programs.

There is a basic timing conflict between Federal, State, and local budget processes. Most State and local governments start making budget decisions in January for the

upcoming fiscal year which, for most of them, will start the next July 1. These decisions will be affected, often profoundly, by Federal funding decisions. Ideally, the States and localities should have information about Federal decisions before making their own. In actuality, however, the Federal decisions are not made until late Summer or Fall, and may be delayed well beyond this point. This means that most Federal decisions, from a State and local government point of view, are made at least 9 months too late.

This conflict in cycles, and the resulting uncertainty faced by State and local governments can cause them to operate inefficiently. They may have to make abrupt reductions in services, initiate programs without adequate time for planning and coordination, or carry out programs in an inappropriately shortened period. In addition, they may have to spend their own funds or borrow funds to operate programs which were initiated on the basis of a reasonable expectation of continued Federal funding. The existence of these problems suggests that Federal funding be relatively stable, if possible, and even more important, that it be predictable. State and local governments need to know when they will receive funding, and at what level, so that this information can be incorporated into their own planning and budgeting processes.

The timing problem could be relieved by having the Federal Government budget for these programs in advance. This would assure that State and local governments have definitive information about Federal funding early in their decisionmaking processes.

From the Federal standpoint, however, this approach has the disadvantage of reducing, at least slightly, the opportunities to alter the budget in the short run in response to unexpected conditions, changes in the economy, or changing priorities. There is an unavoidable tradeoff between the conflicting objectives of short run flexibility and long run stability and predictability. There is no easy way to resolve that tradeoff, but we believe that the objective of predictability should be given special weight in certain types of programs, such as those involving major capital investments and those which are implemented through other levels of government. In both cases, abrupt, unanticipated changes in funding levels can lead to serious losses in overall efficiency.

STUDY ON STATE BIENNIAL BUDGETING

In addition to our review of advance budgeting, we were asked to study the feasibility and advisability of lengthening the Federal budget cycle, specifically to a 2-year period. This study includes an identification of Congressional workload and timetable problems that have surfaced in the existing budget process, examples of State biennial budgeting experience, and alternatives for implementing a biennial budget. We have completed the analysis for our biennial budgeting study, and the draft report was released for comment to the Office of Management and Budget and the Congressional Budget Office.

On December 23, 1982, we issued part of our overall biennial budgeting study, "Biennial Budgeting: The State

Examples--Summary of the Major Issues,". This summary briefly discusses the biennial budgeting processes of Ohio, Wisconsin, and Florida.

These States were selected for biennial budgeting analysis because they had the following characteristics:

- large budgets and economies;
- legislatures that convene annually;
- rapidly growing outlays and uncontrollable sections of their budgets;
- a high level of competition for limited resources;
- significant recent debate as to whether biennial budgeting is appropriate;
- various ways of implementing a biennial budget; and
- different (1) provisions for legislative oversight, (2) annual budget adjustment mechanisms, and (3) authorization/appropriation processes.

Throughout the course of each State study, the majority of our interviews dealt with the portions of the State budget process that might relate to the congressional budget process. We knew that certain information would help us understand how the biennial budget process works; how the budget is adjusted, expenditures are controlled, and estimates are made. The State studies also provided us with information on what oversight, program evaluation, and planning activities take place.

Budgeting at the State level is tailored to the unique needs and characteristics of the State. Thus State practices may not be transferable to the Federal sector. At the

same time, certain underlying principles in the budget processes of the States we visited, might be both relevant and adaptable to Federal budgeting. The first of these is an effective control and adjustment mechanism. With the installation of a 2-year budget cycle, it is necessary to provide for making budget changes, especially during the off-budget year. At the State level, these changes, which can include moving funds between accounts, programs, or agencies, are made in various ways. The three States we visited each had a different way of making these adjustments. A second factor is early consensus on revenue estimates by the executive and legislative branches. This can allow the budget debate to focus on policy issues rather than technical estimating differences. Florida, for example, derives its revenue estimates through revenue estimation conferences.

Sentiment varied in the three States as to the relative advantages and disadvantages of biennial budgeting. The process received overwhelming support in Ohio, general satisfaction in Wisconsin, and mixed reviews in Florida. The people we talked to mentioned some problems, but they felt the benefits outweighed the problems. In these three States, the principal benefits of biennial budgeting appear to be:

--Biennial budgeting does not require the State government's (legislative and executive level) full-time attention for budget review every year. Therefore, more time is available for non-budget activities in both the legislature and the agencies.

--Biennial budgeting lends itself to a more planned and deliberate approach to developing the budget, including the budget preparation process, analysis of policy issues, and review of major budget proposals. It also provides time for longer range planning, if the State chooses to do so.

The most frequently cited disadvantages of biennial budgeting are

- the increased difficulty in estimating accurately revenues and expenditures in the second year and budgeting for "uncontrollable" items, such as entitlement programs; and
- the legislature's perceived loss of control over the executive and State agencies, since there are fewer opportunities to make program and budget decisions.

Budgeting trends

While looking at the biennial budgeting processes in the three States, we also examined budgeting trends in all 50 States. Since the beginning of this century, many States have changed the frequency of legislative sessions, their budget cycle, or both.

Since 1940, States have been switching from biennial to annual budget cycles. As of early 1982, twenty States had biennial budgets compared to 44 in 1940.

We interviewed officials in the six States which have shifted to an annual cycle in the last 18 years. The ability to respond more rapidly to changing conditions appeared to be the principal reason for the shift. In a

slight variation on this point, one official commented that the change to annual budgeting was the result of an increase in supplemental appropriations. In the second year of the biennium, supplemental appropriations were so numerous that off-year activities began to closely resemble the budget year.

The changes also occurred because of legislative reforms that began in the 1960s and continued into the 1970s. These caused State legislatures to reassert their role as equal partners with the executive branch in the management of State policies and programs. During the early 1970s, the State legislature became more active in the budget process. An increase in legislative committees and the growth and professionalization of legislative staff contributed to this. According to officials in two of the States contacted, these were major factors in their switch from biennial to annual budgeting.

On the surface, there is a strong State trend toward annual budgets. However, of the 29 States with annual budgets, 3 that had switched from biennial to annual are at least considering switching back. In addition, one other large State that has always had an annual budgeting cycle is considering a change to biennial budgeting. In actuality, therefore, the trends are mixed.

BIENNIAL BUDGETING ISSUES

Timetable and workload problems

The review of State experience is only a part of our overall biennial budgeting study. In addition, we sought to

identify congressional workload and timetable problems. Our analysis of traditional indices of congressional workload-- such as the number of bills passed--does not bear out the contention of increased workload. However, Members' and staffs' perceptions of an increase in overall activity remain. Given the fact that a true measure of workload remains elusive, these perceptions are significant. The perceptions are that the current annual budget process is too time-consuming and cumbersome, has an unrealistic timetable, lacks the means to assure compliance, and crowds out time for oversight and other legislative activities. For example, despite the Congress' efforts to work with the process, only 1 of the 13 appropriation bills for fiscal year 1983 had been signed into law before the fiscal year began.

Budget estimates

Another area of concern about the current budget process is that of budget estimates and their accuracy. Many of the people we spoke to both in and out of Congress, are disturbed by the numerous sets of budget estimates being debated, by the ambiguity surrounding their differences, and by the need for frequent revision. Such concern merits serious consideration since reliable revenue and expenditure estimates are critical to the success of any budget process. The longer the period these projections cover, the greater the possibility for deviation. Thus, while the estimating process is already a matter of concern, it be-

comes even more of an issue in the context of proposals for a biennial budget.

Revenue and expenditure estimating is based on the rather complex task of making economic forecasts. These forecasts are predictions of economic behavior and are inherently subject to error and frequent revision.

Three approaches have been proposed to deal with widely divergent sets of economic assumptions, the inexactness of estimates, and the need for frequent revisions:

- agreement between the executive branch and the Congress on a common set of economic forecasts before budget deliberations begin;
- a Board of Revenue Estimators to determine the revenue estimates for the budget resolutions for the next two fiscal years; and
- the use of ranges, rather than point estimates for outlays, revenues, and deficits or surpluses in the budget resolution.

These proposals should be considered in developing more effective estimating procedures for either an annual or biennial process.

Changes in economic behavior could also cause estimates of entitlement costs to be off the mark. Entitlement programs constitute about 47 percent of the Federal budget. However, these costs are difficult to control within the budget period because of the time lags between the time a change is made and the time it affects the outlays.

The question remains whether a 2-year system would affect these budget estimating problems. There is no simple answer to that question. In some ways, estimating for a 2-year period may be a little easier. Errors in gauging a turning point (e.g., when a recovery will begin) may have a less dramatic effect on a 2-year estimate. On the other hand, a 2-year period would allow more time for errors to compound and accumulate. We have no real basis for judging which of these influences would be more significant.

Biennial alternatives

The final segment of our analysis for the biennial budgeting study involves the examination of various biennial alternatives.

GAO has analyzed the four biennial budgeting bills introduced in the 98th Congress. While all stress the need for more time for oversight and budget actions, each proposal is unique.

If Congress decides to switch to a biennial budget process, GAO suggests that it concentrate budget actions in the first year of each new Congress, conduct oversight in the second, and adopt a fiscal period beginning January 1 of even-numbered years (overlapping a Congress). This is the approach you have taken, Mr. Chairman, in S. 20. This timetable is attractive because it

- places difficult budget votes in a non-election year,
- allows the budget to be adopted during the first year of a President's term, providing the opportunity to swiftly implement a new President's program, and

--leaves the second session relatively free for oversight.

CONCLUSION

We share the concerns which underly the several proposals to convert the Federal Government to a biennial budget process. We agree that the problems are serious and need to be solved. At the same time, we believe that there are advantages to an annual process, if we can find other ways of solving its problems.

These advantages relate primarily to the retention of short run budgetary flexibility and annual oversight in programs and activities where those are appropriate. We are a little concerned that if the government switched to a biennial process, there would be a strong tendency to restore flexibility by making extensive adjustments in the second year of the biennium. Given uncertainty about the future course of the economy, we think it would be difficult to resist the pressures for adjustment and flexibility. This might cause congressional and agency workload to be little different from that associated with an annual process. These activities, however, might lack the unifying structure and framework which surround the present annual process.

Because we anticipate problems of this sort, we suggest that these concerns be explored before deciding on the biennial budgeting approach.

As we in GAO have thought about the problems facing Congress in the budget process, we have become increasingly convinced that these are a reflection, at least in part, of

a much larger set of problems affecting the financial management structure of the government as a whole. We suspect that you cannot eliminate the effect on Congress of those broader problems unless they are solved at the same time as Congress grapples with the matter of how it will handle the budget.

It is time to reexamine the entire financial management system of the Federal Government. That system encompasses the processes by which government

- decides on its goals and objectives;
- develops programs to achieve those objectives;
- allocates resources among programs;
- accounts for the resources and controls their use;
- monitors progress toward objectives;
- assesses the continuing relevance of objectives; and
- reviews the effectiveness of programs.

The processes and systems by which we do these things are obsolete, inefficient, and we fear, close to collapse. We can no longer expect to manage government with systems, procedures and concepts designed for an era when government was simpler and smaller.

We need to develop systems and procedures which are both simpler and more effectively integrated. For example, we need to eliminate excessive detail and repetitious decisionmaking, not only for the Congress, but for the executive agencies as well.

If we can develop appropriate systems and procedures, taking advantage of modern technology, we believe the annual

budget process can be made to work more effectively, with substantially less demand on the legislative calendar. Significant components of a redesigned system might well have a multiyear funding cycle, covering programs for which stability and predictability are particularly important.

If we are unable to design and implement more efficient systems and procedures, or if that approach still yields an excessive congressional workload, it may be necessary to shift to biennial budgeting across the board. Under those circumstances, we would prefer the approach reflected in your bill, Mr. Chairman, and particularly the effort to concentrate budget activity in the first year and oversight in the second. However, if a shift to biennial budgeting were accomplished without the needed improvements in the rest of the financial management structure, we suspect you would be disappointed in the results.

That completes our prepared statement. I would be pleased to respond to any questions you may have.