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NCSL FISCAL BRIEF: ZERO-BASE BUDGETING IN THE STATES

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Zero-base budgeting (ZBB) is a term currently used to describe a couple of methods of budgeting. Originally, however, it was used specifically to describe a system of budgeting that begins every budget cycle at zero, rejecting any assumption that the activities that were funded in the last budget will continue in the coming one. It requires a rationale for each activity that will be funded in the new budget. It was intended to foster thorough analysis and prioritization of every program and activity, with an emphasis on cost-effectiveness and economy.

Businesses first began using zero-base budgeting in the early 1970s. Jimmy Carter—its first prominent public sector advocate—started promoting it in the mid-1970s, as governor of Georgia and then as president. By 1978, the federal Office of Management and Budget had developed detailed procedures for using the method for developing the federal budget.

Proponents believed zero-base budgeting would:

- Eliminate the assumption that current activities and funding would automatically continue with only minor (or incremental) changes by forcing reconsideration of every activity and demand for resources.
- Encourage the termination of ineffective programs, through its emphasis on analysis and comparison of programs.
- Reallocate resources from lower priority programs or activities to those with higher importance.

- Improve managers' skills at all levels, enrich their communications with policymakers and foster discussion of key issues and problems.¹

Modified forms of zero-base budgeting have seen widespread use in state and local governments, but no state has used any one form for an extended period of time. The modified forms in use today are:

- **Alternative budgeting**, which requires agencies to make budget requests at various levels below and above their current level, along with comparisons of the consequences of each level.
- **Periodic agency review budgeting**, which requires each agency—over a number of years, usually five to eight—to review, from the ground up, their budgets, responsibilities, strategies and performance.

1. The Original Form

Zero-base budgeting was designed to control expenditures by identifying the purposes and measuring the effectiveness and efficiency of all activities. The form the federal government used in the late 1970s required these steps:²

- Identify logical “decision units” within an agency’s budget, which are programs, activities or organizational entities small enough for good analysis, but not so numerous that altogether they would overwhelm the budgeting process.
- Create a “decision package” for each decision unit that included: statements of intended agency results, preferably quantified; measures of workload, efficiency and effectiveness; and budget requests. The package comprised four funding levels:
 - ✓ The minimum amount necessary for viability;
 - ✓ The current or maintenance level;
 - ✓ An intermediate amount, between the minimum and current levels; and
 - ✓ An increased level to provide additional services.
- Rank decision packages within each manager’s jurisdiction according to policy directives from the manager’s’ supervisors.
- Advance decision packages up the administrative chain for additional review, prioritization, revision, consolidation or deletion.
- Consolidate the decision packages for budget requests.

The process the federal government actually put in place was paper-intensive (in the pre-computer days of the late 1970s) and relatively light in critical analysis. In

1979, the U.S. Government Accounting Office found little evidence that zero-base budgeting had improved the process. It recommended less paperwork and rigidity, fewer decision packages and funding options, and more analysis. The Reagan administration, which succeeded the Carter administration in 1981, preserved some elements of zero-base budgeting as agency budgets were reduced, such as requiring alternative funding options from agencies and focusing on prioritization of activities.³

The original form of zero-base budgeting from the 1970s, however, has been widely criticized as unworkable. Even the advantages President Carter claimed it brought to Georgia appear to have been exaggerated. The method's focus on decision packages was impossible to assimilate into the state budget process, and its techniques were impractical for allocating resources. Federal efforts have been termed "an exercise in futility."⁴ Some of the criticisms are that the process can:

- Be difficult to apply usefully to entitlement programs and to other continuing functions of government like public education.
- Create extreme competition and conflict among and within agencies over resource allocation.
- Be time consuming and expensive.⁵

2. Alternative Budgeting

By the early 1980s, use of the original form of zero-base budgeting had all but disappeared. States had developed a simplified form of it to address the fiscal difficulties of the time, which omitted decision units, decision packages and the numerous rankings required as the process moved through agencies.

States turned the old system into what is now called *alternative budgeting* (also called *target budgeting*), in which agencies make budget requests at various percentages of their previous funding—for example, at 90 percent, 100 percent and 110 percent—and analyze what effects those levels would have on their programs.

This highly simplified version of the old zero-base budgeting was widespread in state budgeting at the time. Since it was not a radical departure from traditional state budget processes, it was found to be a useful tool when budgets had to be cut or resources reallocated from agency to agency. The nominal link to zero-base budgeting gave alternative budgeting prestige, without requiring difficult or extensive changes in well-established procedures. It eliminated the numerous rankings that had been a major feature (and encumbrance) of the original federal version, so it did not greatly increase bureaucratic work. In practice, alternative

budgeting was used mainly to evaluate the ways agencies and programs would adapt to fewer resources.

What had started out as a state model of zero-base budgeting had evolved into a form of budgeting probably as old as budgeting itself—the consideration of alternatives. Whatever it may be called, this is (and always has been) a fundamental responsibility of executive and legislative budgeting. For a time it was formalized with specific levels of alternative proposals and given the name of zero-base budgeting, but the useful practice continues even without the name.⁶

3. Periodic Agency Review

State governments found it impossible to adapt to a budgeting process that required annual or biennial justification of every activity and program. They do not have the time or resources to apply a zero-base budget to subsidies for school districts or Medicaid support, for example. The apparatus of ZBB involved so many layers of description, analysis and recommendations that even the smallest state governments—let alone those with annual spending of \$50 billion, \$60 billion or \$70 billion—found it unwieldy. The required analysis was just too time-consuming for agencies, legislative staff and legislators.

For those reasons, most recent efforts to adopt some form of zero-base budgeting in state governments have called for a four- to eight-year periodic, rather than annual, analysis of state agencies.

Florida was one of the first states to enact an eight-year cycle of agency reviews in 2000. The Florida legislation established a joint legislative-executive process for when the Legislature was not in session. In 2001, legislators and teams of analysts from the House, the Senate, the Legislature's program analysis agency and the executive budget agency began a fundamental examination of each of the scheduled agencies. Although Florida's experiment with this form of zero-base budgeting produced reports of great thoroughness and usefulness, the process was expensive and time-consuming, and was discontinued after the third round of reviews.

Oklahoma lawmakers also adapted a periodic review process under legislation passed in 2003 that required a four-year cycle of zero-base legislative reviews of state budgets. The Oklahoma process was driven legislatively, in keeping with the state's strong legislature/weak governor approach to budgeting. The legislation directed a joint interim committee to conduct the ground-up reviews of state agencies, assisted by fiscal staff from both chambers.

The Department of Education, which distributes and oversees aid to school districts, was one of the first agencies to be reviewed. The process was valuable, but so time-consuming legislators never reached the point of considering the budget. Since that time, the Legislature has replaced its periodic review version of zero-base budgeting with performance budgeting.

4. Zero-Base Reviews in Action in Idaho and New Hampshire

Although both Florida and Oklahoma have abandoned their experiments with periodic, zero-base budgeting reviews, New Hampshire Governor John Lynch and Idaho Governor C. L. “Butch” Otter recently have instituted them for budget analysis and planning.

Zero-base agency reviews are primarily an executive branch responsibility in both states, where they shape the budget recommendations made to the legislatures. The practice does not significantly affect legislative budgeting processes, however, except as agency directors refer to the findings or results of a zero-base analysis in order to submit recommendations to legislators.⁷

Budgeting in New Hampshire is built within the framework of statutory requirements that the executive budget proposal begin with a maintenance-level budget. Governor Lynch instructed all state agencies to build their budget requests for FY 2008 and FY 2009 from the bottom up, using a zero-base budgeting approach. For FY 2012 and FY 2013 he requested a similar approach, but without using the term “zero-base budgeting,” in his directions.

According to the state budget director, John Beardmore, the process includes a full review of agency missions, legal requirements, organizational charts and consideration of alternatives to existing practices. The review asks: What does the agency do? Why does it do it? How is it staffed? What legal requirements must the agency meet?⁸

Beardmore reports that such reviews have helped streamline agency responsibilities. In the recent past, executive orders have reduced New Hampshire agency budgets by 5 percent. For the next biennium, agencies must comply with a legislative directive to present proposals for cutting spending by 10 percent.⁹ Zero-base budgeting can help clarify the central missions and priorities of agencies and eliminate programs that no longer match current priorities.

Idaho’s use of zero-base budgeting is similar to New Hampshire’s, with perhaps more emphasis on clarifying the priorities and strategic plans of state agencies. Governor C. L. “Butch” Otter laid out agency reviews on a six-year schedule,

starting in 2008. The challenge, according to David Hahn of the Idaho Division of Financial Management, was to avoid the excessive paperwork and overemphasis on alternative decision packages and funding levels of the original zero-base budgeting model of the 1970s.

The Idaho Budget Bureau is reviewing 10 to 15 agencies each year, with a goal of identifying gaps between agency activities and statutory requirements. Over time, agencies may have acquired legal responsibilities that are only distantly connected to or even disconnected from their central mission. Agencies are reviewing their activities, identifying those not in line with their mission and recommending whether such activities should be continued, eliminated or moved to another agency. Activities that don't align with central missions are placed at the bottom of the list of priorities.

Idaho has also emphasized keeping zero-base budgeting in the context of strategic planning. Agency strategic plans are essential in prioritizing agency functions. With a strategic plan and functions rank by importance, agencies have been better-situated to make recommendations in line with the required budget reductions of recent years.

Hahn is confident that management techniques exist to extend zero-base budgeting from small agencies to large ones like the Idaho Transportation Department and the Department of Health and Welfare. He cautions that this form of zero-base budgeting will not result in huge cost-savings. It is merely a tool for cost containment, used in Idaho to streamline agencies, focus them on their core missions and implement their strategic plans. It is a management tool as well as a budgetary tool.¹⁰

5. The Appeal Continues

In recent years, 17 states have used zero-base budgeting in some form and several more have made serious efforts to do so. Fifteen state legislatures considered bills calling for some form of zero-base budgeting in 2009, two did so in 2010, and at least nine considered legislation in 2011. They include a mix of small and large states: Iowa, Kansas, Rhode Island and South Carolina among the smaller ones, and California, Georgia, Illinois and Ohio among the larger ones. Despite this widespread interest, none of the enabling legislation has been enacted between 2009 and 2011.

In analyzing proposals for its legislature, the Illinois Legislative Research Unit found no real evidence of actual application of zero-base budgeting in most of the 17 states that report using it.¹¹ Aside from the recent executive orders in Idaho

and New Hampshire, it is unclear that any state uses zero-base budgeting as a primary budgeting technique.

6. Lessons Learned

Disadvantages aside, zero-base budgeting appeals to a serious and widespread desire to look at public budgeting in a fresh new way, free of old assumptions, not letting past experiences control the future. So, what can be learned from the kinds of experiences related here?

- A proposal to adopt zero-base budgeting should be clear on whether it is expected to be an analysis of all government, a tool to respond to a fiscal crisis, or a periodic, revolving review of state agency operations and budgets.
- In any of its forms, zero-base budgeting is likely to be an elaborate and time-consuming process, and can add complexity to the current budget process.
- Continued commitment from leadership and a commitment of time from legislators immediately involved are essential to make it useful to a legislature.

APPENDIX 1: 2011 STATE LEGISLATION PROPOSING ZERO-BASE BUDGETING

Except for SB 33 in Georgia and HB 627 in North Carolina, none of the measures listed proceeded to a floor vote in either chamber.

Georgia SB 2, 33	SB 2 would have established a sunset review process. SB 33 called for phasing in zero-base budgeting and creating a joint budget office for the legislature. SB 33 passed the Senate, was significantly amended in House and was left in conference committee at the end of session.
Illinois HB 33 and SB 212	These bills consisted of only a short title.
Minnesota H File 2 and S File 146	HF 2 would have established principles and requirements for use of zero-base budgeting, and also would have established a sunset review process, principles and practices, and a schedule for state agency sunset reviews. SF 146 would have required priority-based budgets beginning with FY 2014 and included the provisions of HF 2 regarding a sunset process.
North Carolina HB 627	The bill would establish a joint legislative study commission to use a zero-base budgeting review process to identify obsolete programs, cost-reduction opportunities in state government, and instances where funds could be redirected to other purposes. The commission would have served in 2011 and 2012. The House passed the bill, and it will be carried over to the 2012 session of the General Assembly.
Rhode Island HB 5325 and SB 298	These identical bills called for zero-base budgeting to be phased in over five years beginning in FY 2012. They would have established a joint committee to examine the governor’s budget proposal to make recommendations for cost savings and alternative agency tactics before the budget goes to the House appropriations committee.
South Carolina HBs 3528 and 3641 and SBs 15 and 68	These companion bills called for the appropriations committees to use a zero-base budgeting process over a four-year cycle beginning in FY 2010. HB 3641 contained more details about practice, and also called for biennial budgeting. SB 68 called for outside auditors to use zero-base budgeting for state agencies in their reviews.
South Dakota HB 1103	This bill called for the joint committee on appropriations to establish a schedule whereby each state agency uses a zero-base budgeting format once every 10 years.
Virginia SJR 355	This resolution recommended that the governor include

	zero-base budgeting as one of the reforms to be considered by the Commission on Government Reform and Restructuring.
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APPENDIX 2: DEFINITIONS OF AND REQUIREMENTS FOR ZERO-BASE BUDGETING

Policymakers' understanding of zero-base budgeting has evolved since it was introduced to the federal government in the 1970s, as recently introduced state legislation indicates. In a number of instances, bill drafters' definitions of or goals for it focus as much on information about agency purposes and operations as they do on a system of allocating resources.

One 2011 bill stands out, both for advancing a legislatively centered zero-base budgeting process and for adhering to the original form of zero-base budgeting. North Carolina House Bill 627 passed the House of Representatives and was carried over to the 2012 session of the General Assembly. It proposes a joint legislative study commission to meet for two years using a zero-base budgeting review process to find obsolete programs and opportunities for savings and redirect existing funding. After deciding what agencies to review, the commission could require them to identify decision packages representing either agency objectives or agency programs. Each decision unit would then be divided into four separate decision packages that would document the effects of minimum, reduced, current or enhanced funding on the services identified in the decision unit. Attention is to be given to the possibility of the private sector replacing agency services, either through simply shedding a service or outsourcing, and to arrangements for current state employees to establish non-governmental organizations to compete for outsourcing opportunities.¹²

Another detailed description of zero-base budgeting in 2011 legislation appeared in Minnesota House File 2, which failed to pass but would have required the governor's budget submission to the legislature to include a variety of activities in addition to classic zero-base budgeting:

- A description of each budget activity for which the agency or entity receives an appropriation in the current biennium or for which the agency or entity requests an appropriation in the next biennium.
- For each budget activity: three alternative funding levels or ways of performing the budget activity, at least one of which is less than the previous biennium's actual expenditures for that budget activity; a summary of the priorities that would be accomplished within each level compared with a zero budget; and the additional increments of value that would be added by the higher funding levels compared with what would be accomplished if there were no funding for the activity.

- For each budget activity: performance data; the predicted effect of the three alternative funding levels on future performance; and one or more measures of cost efficiency and effectiveness of program delivery, which must include comparisons with other states or entities with similar programs.

The bill also would have required the governor to rank budget activities within an agency or program area, and if activities in more than one agency or program were meeting the same goals, the prioritization was to extend across all of them, including agencies or programs not scheduled for zero-base budgeting reviews in that biennium.

The bill proposed amending statutory language setting the format for performance data in budget proposals to require: a description of the goals and objectives of each program and activity within an agency; and that performance measures be objective and outcome-based (as well as indicating outputs, efficiency and other measures as in existing law). It also would have strengthened the requirement for setting targets for future performance.¹³

Georgia's 2011 legislation went further than the Minnesota bills in presenting zero-base budgeting as a variation of performance reporting and budgeting. The bill would have required agencies to prepare a zero-based budget at least once every six years and included these specific requirements:

- A statement of the budget unit's departmental and program purposes; effectiveness, efficiency, and equity measures; and program size indicators; and
- A priority listing encompassing all alternative funding levels for all programs.¹⁴

Although these broad directives can be interpreted to include most of the elements of the original form of zero-base budgeting, they lack its focus on decision packages and their rankings by various levels of administrative staff. This version of zero-base budgeting appears to be a mixture of performance reporting (which does not by itself entail performance budgeting) and alternative or target budgeting (which requires agencies to present various possible budget amounts with their policy and service implications).

Massachusetts' Senate Bill 1619 of 2011 stuck closer to the original definition of zero-base budgeting as defined for the federal government in the 1970s, and stayed away from details: The bill specifies that:

...Zero-based budget shall reflect the amount of funding deemed necessary to achieve the most cost-effective performance of each agency or

department pursuant to an accompanying narrative delineating the tasks to be performed by that agency or department, together with goals and objectives for each agency or department for a period not to exceed four years. Said budget shall have a zero dollar amount as its basis, and shall not reflect any prior appropriation amount, adjusted or otherwise.

Zero-based budgeting shall mean ... a means of developing appropriations based on the cost-effective achievement of the tasks and goals of a particular agency or department without regard to prior appropriations, adjusted for inflation or otherwise. Any appropriation so developed shall to the extent possible, be accompanied by a brief description of said tasks and goals together with the performance measure of the achievement of those tasks and goals.¹⁵

Rhode Island's 2011 proposal was almost as brief, but emphasized descriptions of the functions and operations of agencies.

The budget request shall be accompanied by a statement giving facts and explanations of reasons for each item requested. It shall include a brief explanation of the functions of each of the divisions, boards, commissions, officers, bureaus, institutions or agencies of the state included within the department and comments on its policies and plans, with such descriptive, quantitative, comparative and other data as to work done and other information as is considered necessary or desirable. "Zero based budget" requests so-called, requests for appropriations based upon a justification of a department from a zero base as if the budget for the department was being initiated for the first time shall be required [based upon a multi-year schedule].¹⁶

In contrast to legislation that seems to meld zero-base budgeting with performance reporting, performance-based budgeting and priority budgeting, Idaho's current practice of zero-base budgeting focuses on clarifying agencies' statutory responsibilities and prioritizing tasks by how well they support the agency's mission. The two main goals of zero-base budgeting in Idaho are to:

- Identify an agency's core mission and any gaps that exist between what it is required to do, what it is doing, and what it should be doing as a result of a thorough review of its legal mandates;
- Ensure that every resource is used to its maximum potential to create the most efficient and effective organization possible with the money appropriated to it.

Agencies review their activities and identify those not in line with their central mission. Known as "gap analysis," it includes asking these questions:

- Does the program and its services support and contribute to the mission of the agency?
- Do they meet their constituents' needs?
- Is there any measureable evidence of the value of the service or program under review?
- Are goals and objectives of the program important enough to warrant the expenditures made?
- What would happen if the program and its services were not provided at all?
- Are there other less costly, more efficient ways of achieving these objectives?
- Would benefits be greater if all or part of the funds spent was used for other programs?

When gaps between authority and activities are identified in Idaho, agencies decide whether such activities should be allowed or eliminated (which might require a change in law), or moved to an agency where the activity would be a better fit. This process is part of the agencies' zero-base budgeting responsibility to prioritize their programs and activities. Activities that do not align with their agency's central mission can be placed at the bottom of the list of priorities.¹⁷

Taken together, the bills that defined zero-base budgeting in 2011 suggest legislators' concerns are only partly to begin budgeting anew, as zero-base budgeting originally promised to do. The bills show, in various ways, a greater desire for information on how state agencies operate and how their work can be evaluated, and reflect lawmakers' concerns that their budget enactments be well-informed.

Notes

¹ NCSL, "What is Zero-base Budgeting?" at <http://www.ncsl.org/default.aspx?tabid=12578>; Irene Rubin, *The Politics of Public Budgeting*, 6th edn. (Washington, D.C.: CQ Press: 2010), 82-83.

² This discussion is based on Donald Axelrod, *Budgeting for Modern Government*, 2nd edn. (New York: St Martin's Press, 1995), 305-320.

³ Thomas P. Lauth, "Georgia: Shared Power and Fiscal Conservatism," in Edward J. Clynch and Thomas P. Lauth, *Budgeting in the States: Institutions, Processes, and Politics* (Westport, Conn.: Praeger Publishers, 2006), 47-48.

⁴ George S. Minmier. *An Evaluation of the Zero-base Budgeting Systems in Governmental Institutions* (Atlanta, Ga., School of Business Administration, University of Georgia: 1975), 131, 157, cited in Axelrod, 311.

⁵ NCSL; Rubin.

⁶ Axelrod, 312-313.

⁷ Interview with Cathy Holland-Smith, Division Manager, Budget and Policy Analysis, Idaho Legislative Services Office, September 1, 2011; interview with Jeff Pattison, New Hampshire Legislative Budget Assistant, October 4, 2011.

⁸ Interview with John Beardmore, New Hampshire State Budget Director, October 5, 2011.

⁹ 2011 N.H. Laws, Chap. 229.

¹⁰ Interview with David Hahn, Idaho Division of Financial Management, October 6, 2011. Also see the Idaho Division of Financial Management's resources on zero-based budgeting, at http://dfm.idaho.gov/st_agency_guide/zbb.html

¹¹ Illinois General Assembly, Legislative Research Unit, *Zero-Based Budgeting in Other States* (November 20, 2008). <http://www.ilga.gov/commission/lru/34.ZeroBasedBudgets.pdf>

¹¹ Minnesota House File 2 of 2011 (remained in committee at the end of session). <https://www.revisor.mn.gov/bin/bldbill.php?bill=H0002.2.html&session=ls87>

¹¹ Georgia Senate Bill 33 of 2011 (remained in conference committee at the end of the 2011 session). <http://www.legis.ga.gov/Legislation/en-US/display.aspx?Legislation=32266>

¹¹ Massachusetts Senate Bill 1619 of the 187th General Court. <http://www.malegislature.gov/Bills/187/Senate/S01619>

¹¹ Rhode Island House Bill 5235 of 2011 (held in committee at the end of the regular session). <http://www.rilin.state.ri.us/BillText/BillText11/HouseText11/H5325.pdf>

¹¹ Interview with David Hahn, Budget Bureau, Idaho Division of Financial Management, October 6, 2011, and information on the division's website: http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_QuestionsGapAnalysis.pdf
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_Presentation.pdf

¹² North Carolina House Bill 627 of 2011 (carried over to the 2012 session). <http://www.ncleg.net/Sessions/2011/Bills/House/PDF/H627v2.pdf>

¹³ Minnesota House File 2 of 2011 (remained in committee at the end of session). <https://www.revisor.mn.gov/bin/bldbill.php?bill=H0002.2.html&session=ls87>

¹⁴Georgia Senate Bill 33 of 2011 (remained in conference committee at the end of the 2011 session).
<http://www.legis.ga.gov/Legislation/en-US/display.aspx?Legislation=32266>

¹⁵Massachusetts Senate Bill 1619 of the 187th General Court.
<http://www.malegislature.gov/Bills/187/Senate/S01619>

¹⁶Rhode Island House Bill 5235 of 2011 (held in committee at the end of the regular session).
<http://www.rilin.state.ri.us/BillText/BillText11/HouseText11/H5325.pdf>

¹⁷Interview with David Hahn, Budget Bureau, Idaho Division of Financial Management, October 6, 2011, and information on the division's website:
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_QuestionsGapAnalysis.pdf
http://dfm.idaho.gov/st_agency_guide/zbb/ZBB_Presentation.pdf