Review of Budget Process

House Appropriations Subcommittee on Multi-Year Budgeting

October 25, 2011

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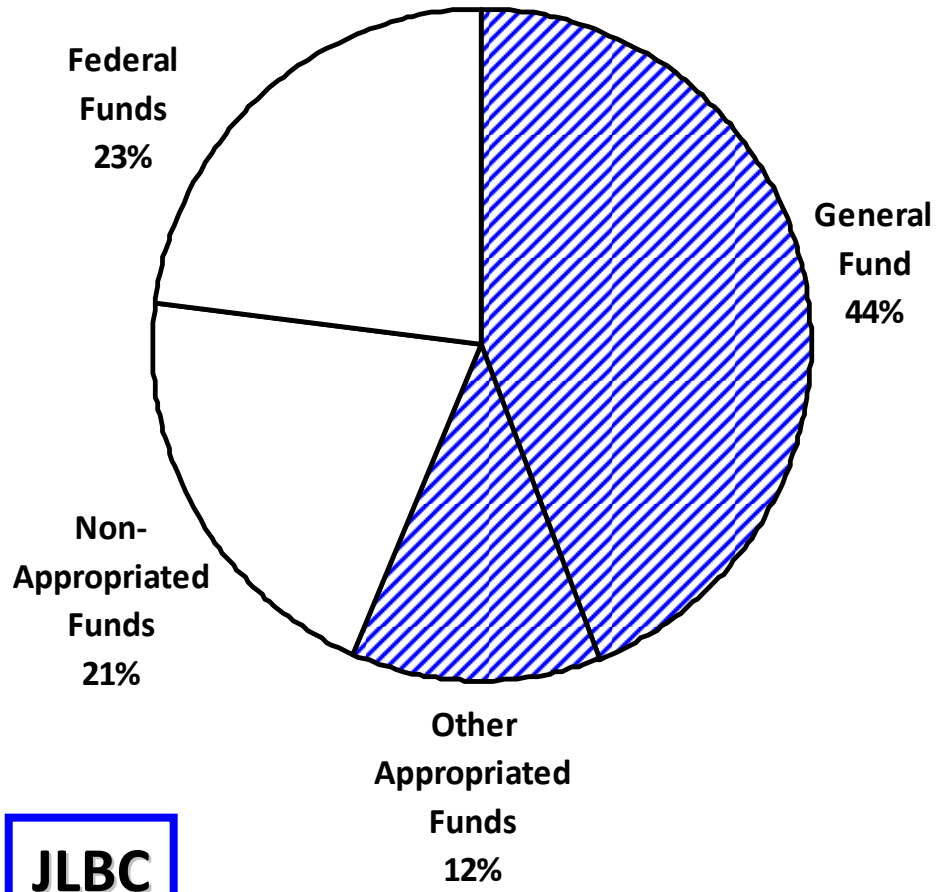
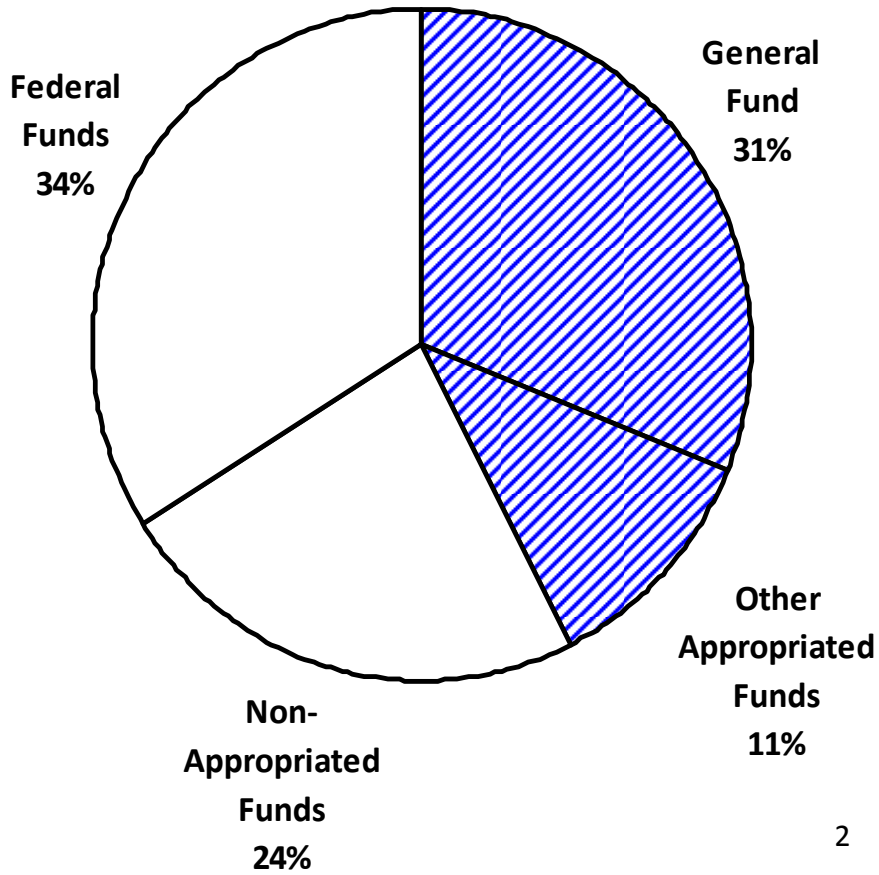
Legislative Oversight is Declining

- Appropriated % of Budget Has Fallen From 56% in FY 2000 to 42% in FY 2012

FY 2000



FY 2012



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Legislative Oversight Is Also Declining As More Dedicated Funds Are Established

- Even if appropriated, dedicated funds receive less review
- The number of dedicated funds increased from 520 in FY ’02 to 631 in FY ’12
- Of 111 new funds created in the last 10 years, 24 are appropriated and 87 are non-appropriated
- In last session, Legislature eliminated oversight of Commerce Authority and dedicated funds of Department of Agriculture

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Arizona Has a Combination Annual-Biennial Budget Process in Statute

- 12 Large Agencies are Annual Budget Units, Remainder are Biennial
- Annual Budget Units are:
  - ADOA
  - AHCCCS
  - Community Colleges
  - Corrections
  - DES
  - ADE
  - DHS
  - Judiciary
  - Juvenile Corrections
  - SFB
  - ADOT
  - Universities

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Arizona Has Suspended its Bifurcated Approach Since FY ’10

- Biennial Budget means separate annual appropriations for the 2 years beginning in July of odd-numbered years.
- In the FY 2010-2011 and 2012-2013 bienniums, however, the Legislature appropriated all agencies annually due to budget shortfalls.

History of Budget Cycle in Arizona

- Early 1950's – Convert to annual budgeting when Arizona begins annual legislative sessions
- 1994 – 26 small agencies biennially budgeted
- 1996 – All but 15 large agencies biennially budgeted
- 2000 to 2003 – All agencies biennially budgeted
  - Most 2003 budgets subsequently redone due to budget shortfall
- 2004 – Return to bifurcated approach
- 2010 to now – Bifurcated approach not repealed, but all agencies budgeted annually

Other State Practices

- In 1940, 44 states enacted biennial budgets
  - Now, 19 states have biennial budgets
- During same time, states moved to annual sessions
  - In 1940, only 4 states held annual sessions compared to 46 now
- Arizona and Kansas are only states using bifurcated approach
- Appendix A provides a list of all states

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Biennial Budgeting Considerations

- Based on NCSL review, inconclusive whether biennial budgeting promotes long-term planning.
- Reduces Legislative oversight unless “freed up” time is used for program review and evaluation.
- Reduces some budget preparation costs for Executive agencies.
- Within 2 year window, agencies have greater certainty of resources.
- Forecasting is likely to be less accurate, both in terms of revenue and funding formulas.

Beyond Biennial Budgeting, Do States Prepare Multi-Year Forecasts?

- JLBC Staff publishes 4-year Baseline estimates
  - Represents consensus revenues and funding formula requirements
  - The Executive does not publish comparable estimates
- Arizona appears to be one of 9 states publishing comprehensive long-term Baseline forecasts
- While estimates are subject to considerable change, a best "guess" is better than no "guess" at all
- The use of ranges or alternative scenarios would be useful given the inherent uncertainty of long-range forecasts.

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What is Zero Based Budgeting?

- Zero Based Budgeting implemented in late 1970's at the Federal level
  - Identify a decision unit
    - A program or organizational entity
  - Establish different possible funding level for each unit
  - Rank order all the decision units within an agency
- U.S. General Accounting Office found that ZBB did not improve Federal budget process and was paperwork intensive.

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Variations on Zero Based Budgeting

- Agencies make budget requests at various percentages of their previous budget
  - For example: 90%, 100%, 110%
  - Executive Branch would need to take lead
- Periodic in-depth review of state agencies on a scheduled basis (Florida, Oklahoma)
  - Unlike Auditor General's Sunset process, legislators are actively involved in reviews
  - Neither state continued due to time commitment
  - Needs Executive cooperation to respond to inquiries

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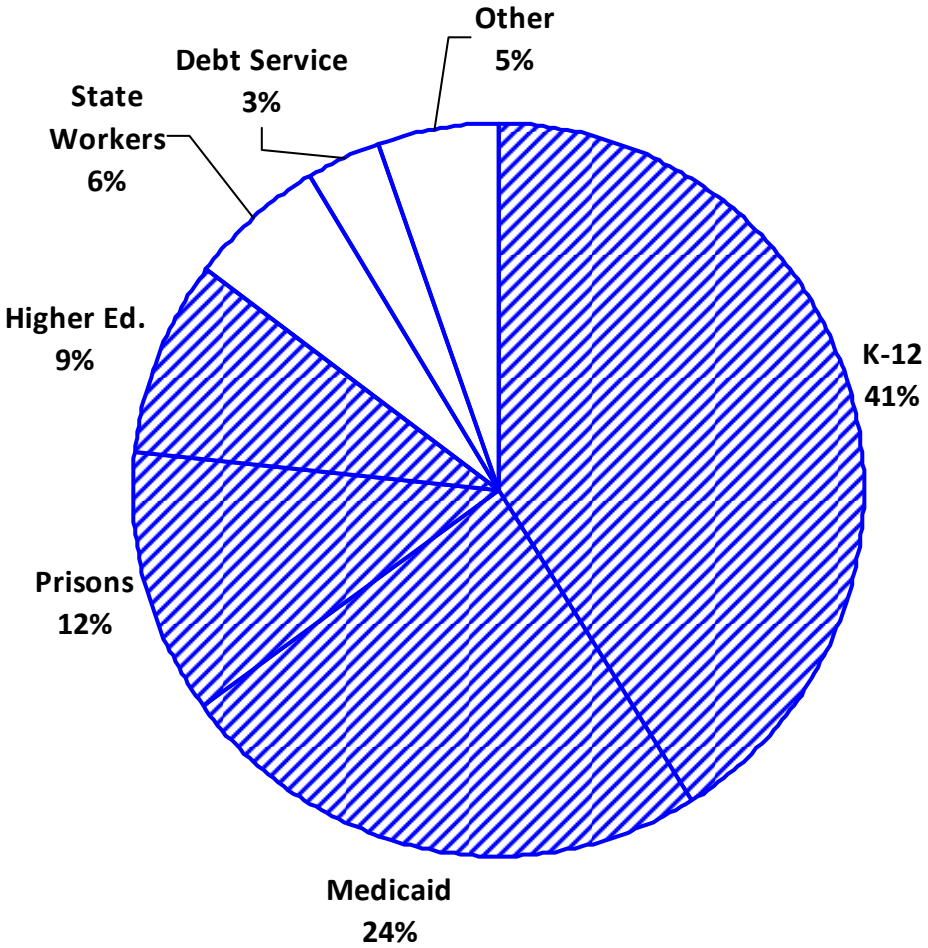
Zero Based Budgeting Considerations

- Promotes greater in-depth knowledge of agency activities but depends on Executive commitment to process -- will agencies provide useful inputs?
- Requires substantial increased time commitment on the part of legislators to be successful.
- Creates more value if targeted rather than applied statewide -- General Fund spending is focused on 3 main activities.
- According to NCSL, no state Legislature currently uses ZBB as its primary budgeting technique (see Appendix B).

The 3 Main Drivers of General Fund Spending Are Education, Health, and Prisons

- Represents 86% of On-Going General Fund Budget

	(FY '12 $ in Millions)
Education (K-12)	$ 3,448.7
Medicaid	1,957.8
Prisons	975.0
Higher Education	718.9
Other State Workers	486.6
Debt Service	272.9
Other	451.5
TOTAL	$ 8,311.4



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STATE EXPERIENCES WITH ANNUAL AND BIENNIAL BUDGETING:

Ronald K. Snell
National Conference of State Legislatures

April 2011

INTRODUCTION

The trend among state governments for the past 70 years has been to abandon biennial budgeting for annual budgeting. Forty-four states enacted biennial budgets in 1940. Only 19 do now.

One reason for the change was the resurgence of state legislative power in the middle of the 20th century. Legislatures' growing role in state government can be measured by the shift from biennial to annual legislative sessions. In 1940 only four state legislatures held annual sessions—and Alabama's legislature met only once every four years. In 2011, only four states still have biennial sessions—Montana, Nevada, North Dakota and Texas. Two changes came recently: Arkansas with its first annual session in 2009, and Oregon with its first in 2011.

A shift to annual budgeting followed the move to annual sessions, as state budgets grew larger and more complicated and as federal grant-in-aid programs to state and local governments became increasingly prominent in the 1960s and 1970s. The move to annual budgeting also coincided with the greater volatility in state revenues that resulted from increasing reliance on sales and personal income taxes. Although such historic changes have not moved all states to annual budgeting, the trend has been clear. One surprising complaint about biennial budgets is that they are time-consuming. An editorial writer in Maine opined in 2010 that:

> The state's two-year budget format is an incredible time-waster. Executive departments spend endless hours charting spending over two years (really almost three, from the start of planning), and rarely find numbers that stick. The Legislature spends many more hours trying to make the document work, and instead ends up crafting multiple supplemental budgets to fix the first one.
>
> Two-year budgets are a historical accident—at one time the Legislature didn't meet every year. And no other entity the state deals with—federal, county, municipal or business—uses the biennial format. Scrap it, except for capital investment.[1]

In Oregon, plans for the state's first annual session in 2011 included a plan to revise its biennial budget during the Legislative Assembly's second annual session in 2012. The budget chairs wrote:

> We are using the tool of the February session in 2012 that the voters have provided for us by setting out what comes down to a hybrid—a two-year budget with a plan for significant revision, if required, in year two. By holding back $310 million in a supplemental ending balance from the second year funding levels, we maintain the flexibility needed to address

> another financial downturn should it occur between June 30 of this year and the start of the February 2012 session. If revenue is stable or up, the supplemental ending balance can be returned to the funding levels for year two of the budget, with flexibility to adjust if needed to address specific needs. If revenue is down, the supplemental ending balance will serve as a financial reserve to provide stability to the state's programs and services.[2]

The Oregon leaders' concern for the accuracy of their state's revenue forecasts is not unusual. Speaker Robbie Wills of Arkansas attributed his state's change to annual budgeting in 2009 partly to the difficulties of forecasting revenues as far in advance as biennial budgeting requires. Speaker Wills noted the special problems term-limited legislators encountered with biennial legislative sessions and budgets: inadequate opportunity to familiarize themselves with the budget and the process.[3]

Changes have not all been in one direction, however. A few states have moved from annual to biennial budgeting over the past 20 years or have changed back and forth, because of partisan politics, uncertainty as to which worked better, or both. Connecticut returned to biennial budgeting in 1991, reversing the decision lawmakers made to adopt annual budgeting when the state began annual legislative sessions in 1971. Arizona made a gradual transition from annual to biennial budgeting in the 1990s, and completed the process with the enactment of a biennial budget in 1999. Then, in 2002, it shifted to a bifurcated system under which larger agencies receive annual budgets while biennial budgeting continues for smaller agencies. Kansas uses a similar system. All changes are listed in Appendix 1.

Biennial budgeting states generally enact separate budgets for two fiscal years at once. True biennial budgeting—enacting a single two-year budget—is rare, although still practiced in North Dakota and Wyoming (table 1). North Dakota has biennial sessions as well. Although the Wyoming legislature meets annually, in the non-budget year its session is scheduled for only 20 days. Oregon also has enacted a consolidated biennial budget in the recent past, but the co-chairs' proposal for the 2011-2013 biennium breaks out proposed appropriations for the two fiscal years separately.[4]

Table 1 classifies states according to their budget schedules. It includes Arizona and Kansas as annual budget states based on the preponderance of their budget.

TABLE 1. ANNUAL AND BIENNIAL BUDGETING STATES
(**Boldface** indicates the 10 most populous states in 2010.)

ANNUAL SESSION ANNUAL BUDGET (31 states)	ANNUAL SESSION BIENNIAL BUDGET (15 states)	BIENNIAL SESSION BIENNIAL BUDGET (4 states)
Arizona+	Connecticut	Montana
Alabama	Hawaii	Nevada
Alaska	Indiana	North Dakota*
Arkansas	Kentucky	**Texas**
California	Maine	
Colorado	Minnesota	
Delaware	Nebraska	
Florida	New Hampshire	
Georgia	**North Carolina**	
Idaho	**Ohio**	
Illinois	Oregon	
Iowa	Virginia	
Kansas+	Washington	
Louisiana	Wisconsin	
Maryland	Wyoming*	
Massachusetts		
Michigan		
Mississippi		
Missouri		
New Jersey		
New Mexico		
New York		
Oklahoma		
Pennsylvania		
Rhode Island		
South Carolina		
South Dakota		
Tennessee		
Utah		
Vermont		
West Virginia		

*Biennial budget states that enact a consolidated two-year budget. Other biennial budget states enact two annual budgets at one time.
+Annual budget states where smaller agencies receive biennial budgets.

As Table 1 indicates, biennial budgets are more likely to be found in the less populous states, as are biennial legislatures. Among the 10 largest states—whether measured by population or by legislative appropriations—only Ohio and Texas use biennial budgets, and only Texas has regular biennial sessions of the legislature.

These are the other questions this report examines:

1. Are there significant differences in budget practices between states with annual and biennial budgets?
2. What are the advantages and disadvantages of a biennial budget?
3. Does a biennial budget improve planning and make budgets more predictable?
4. Do biennial budgets require revisions more frequently than annual budgets?
5. Do biennial budget states spend more money than annual budget states?

1. Are there significant differences in budget practices between states with annual and biennial budgets?

State budgeting practices vary widely for reasons of politics and history, making it difficult to identify one reason for the differences. Biennial and annual budgets, however, do not appear to be the cause of significant differences in budgeting practices.

There does not appear to be any consistent relationship between state budget and legislative cycles and governors' powers to cut budgets or transfer funds among agencies or programs. A governor's power to reduce budgets or make transfers varies greatly from state to state, but it does not appear to be related to the kind of budgets or legislative sessions in the state.

Governors in some states with annual legislatures and budgets have remarkably broad administrative authority over the budget. Governors in Iowa, Indiana, South Carolina and South Dakota have unlimited power to transfer funds among state agencies. Governors in 10 of the states with annual legislative sessions may reduce budgets by unlimited amounts to cope with revenue shortfalls. Governors in only five of the 19 states with biennial budgets have as much power to reduce spending. Thus the budget cycle in itself does not appear to create nor prevent a need for strong executive budget review authority.[5]

2. What are the advantages and disadvantages of a biennial budget cycle?

There is little evidence of clear advantages of either an annual or biennial state budget. In 1972, the Council of State Governments (CSG) examined a number of states that had recently adopted annual budgets for the first time. No clear findings emerged, and the study concluded that:

> In reality, a State can develop a good system of executive and legislative fiscal and program planning and controls under either an annual or biennial budget. The system would work differently with the alternative time spans, but could be effective under either approach.[6]

Analysts at Texas A&M University reviewed the CSG study in the course of their own examination of annual and biennial budgeting in 1984, and came to the same conclusions:

> The arguments used to justify and refute both annual and biennial budgets remain essentially unchanged [since 1972]—and unproven. The success of a budget cycle seems to depend on the commitment of state officials to good implementation rather than on the method itself.[7]

Proponents of biennial budgeting cite the major advantages to be cost and time savings. They argue that biennial budgeting is more conducive to long-term planning and allows more time for program review and evaluation than annual budgeting.

Biennial budgeting may reduce executive branch costs (in terms of staff time and salaries) of preparing budgets, since the process is more consolidated than annual budgeting. State experience appears to bear this out, according to the studies cited above. Annual budgets create greater pressures on all budget staff and policymakers than biennial budgets, since closing the previous year's budget, administering the new year's budget and beginning to plan the following year's budget occur almost simultaneously.

In terms of the time a legislature spends on budgeting, nonetheless, the evidence is inconclusive. As reported earlier, biennial budget states tend to return to their budgets in the second year of a biennial session, and not necessarily because of difficult budget conditions. The Washington State Office of Financial Management has observed that "Since the inception of annual legislative sessions in 1979, it has become common for the Legislature to enact annual revisions to the state's biennial budget."[8] The experience of Connecticut, discussed below, suggests it is difficult for legislators to refrain from acting as though they had an annual budget even after they have made a formal change to a biennial budget.

In 2000, NCSL asked legislative fiscal staff in the 13 biennial budget states with annual sessions "Does the legislature spend a smaller proportion of its time on budget issues in the non-budget session than the budget session?" Eleven states responded. Five said that the legislature spent proportionately less time on the budget and five that it spent about the same amount of time. North Carolina staff reported that the legislature spent proportionately more time on the budget in its short session, due to the brevity of the session—three months—and the restrictions on carry-over and new bills.

Respondents noted, however, that the proportion of time spent on the budget in the non-budget sessions varied greatly from year to year. A budget deficit, a substantial revenue surplus or policy issues with significant fiscal implications can cause a legislature to devote a large amount of time to budget issues. The Ohio respondent said, for example, that in a "normal" session, the legislature spends two weeks on budget amendments and corrections in the non-budget year. In the preceding two bienniums, however, fiscal issues surrounding education finance, tobacco settlement revenues and electric utility deregulation had occupied the entire non-budget sessions.

Long-term planning. Evidence from states that have changed from annual to biennial budgeting over the past 40 years fails to show that biennial budgeting is particularly productive for long-term planning. The CSG study in 1972 produced such conflicting evidence that it could neither confirm nor reject the idea. The Texas A&M study of 1984 was also inconclusive on the point, as was the study done by the U.S. General Accounting Office in 1987.[9] Analysts in Connecticut, however,

emphasized that the governor and legislature greatly improved their long-term budget forecasting and analysis after the state adopted a biennial budget in 1991.

Program Review and Evaluation. A strong argument for biennial budgeting is that it can provide time for administrators and legislators to focus on the results of their decisions and not just the process of budgeting. This was one of the principal arguments that led Connecticut to return to biennial budgeting in 1991. Proponents contended that, "The present system (of annual budgeting) does not allow enough time to review expenditures in depth. Those preparing the budget finish one year and then immediately plunge into the next year's budget."[10] The biennial cycle was intended to focus on making major programmatic and budget decisions in the first year, and to devote the second year to in-depth evaluation of agency programs.

A Connecticut legislative committee that reviewed the biennial budget process in 2003 reported it had not met expectations. "Beginning with the first biennium," the committee observed, "the governor and legislature have proposed new and expanded programs along with significant policy changes in each year of the cycle. As a result, second-year adjustments and revisions are often extensive. There is also no evidence legislators or state agencies give greater attention to program outcomes and performance measures in the second year of the cycle." It recommended, nonetheless, that biennial budgeting be retained to bring a perspective of more than one year to the process and to allow for greater performance evaluation.[11]

In 2000, NCSL asked legislative fiscal analysts in biennial budget states, "Does the legislature increase its oversight or evaluation of agencies in the non-budget year?" Staff in two states reported that the legislature did increase its oversight activities in the non-budget year. Staff in nine states, however, reported that was not the case. Although intuitively it seems likely that biennial budgeting encourages legislative performance evaluation, the evidence is very weak.

3. Does a biennial budget improve planning and make budgets more predictable?

Planning a biennial budget requires a 30-month revenue forecast, compared with 18 months for an annual budget. As Speaker Wills of Arkansas commented, the difference is significant. A 2011 analysis of the accuracy of state revenue estimates from 1987 through 2009 indicates that the average error of estimate for biennial states was 2.18 percent, more than twice the 1.04 percent average for annual budgeting states. The volatility of state revenue sources was the prime cause of miscalculations.[12] Such averages do not mean that revenue forecasts in biennial states are always less accurate than those in annual budget states. Some biennial states have a more accurate forecasting record than some annual states. Overall, though, the statistics suggest the greater difficulty of forecasting revenues accurately in biennial budget states.

Biennial budgeting requires a longer commitment of policy direction and funding than does annual budgeting. It also means that agency personnel may have to spend less time in budget planning and presentations than under a system of annual budgeting. Does this mean more predictability and certainty of planning for them and for legislative committees? The answer is generally yes, but the difference may in fact be small.

State governments tend to budget incrementally, beginning with the current level of expenditures and dividing up any additional resources in proportion to previous program budgets. Unless there is significant economic change, state budgets rarely impose dramatic changes in agency budgets. Sixty percent to 70 percent of most states' general fund appropriations goes to programs not susceptible to sweeping changes in funding or design: elementary, secondary and higher education; corrections; and Medicaid and other entitlement programs. Regardless of the budget cycle, continuity is built in to state budgets.

Even so, economic cycles can disrupt budgets. Seventy percent of state tax revenue comes from sales and income taxes, which are very sensitive to the health of the economy. The recessions of 2000 and 2007-2009 and the slow recovery from the last recession seriously distorted state budgets regardless of the length of their budget cycles. Budget cycles cannot insulate states from external factors such as the condition of the economy.

4. Do biennial budgets require revisions more frequently than annual budgets?

Revisions in enacted budgets, often called supplemental appropriations, declined after a state shifted from biennial to annual budgeting, according to the CSG and Texas A&M studies. But in recent years, supplemental appropriations have been necessary in many states, not just those with biennial budgets, because of fluctuating revenues and cost overruns in state programs.

During the past 20 years, many state budgets have been hit by revenue shortfalls and expenditure overruns. The former tended to occur in the three largest state tax sources—general sales taxes, personal income taxes, and corporate income taxes—in which a small error in the estimate can create a significant effect in dollars. Expenditure overruns have frequently occurred in Medicaid and other social service programs, as well as other programs.

Annual legislative sessions allow for timely responses to such issues and ensure that requests for supplemental appropriations will be reviewed in the context of the entire state budget, which is true regardless of the budget cycle. Legislatures with biennial sessions might have to be called into special session to revise the budget.

NCSL's statistics on the number of legislative special sessions, however, indicate that states with biennial legislative sessions have fewer special sessions than all states, on average. Of the six legislatures that have or until recently had biennial sessions—Arkansas, Montana, Nevada, North Dakota, Oregon and Texas—only Texas had more special sessions than the national average from 1981 through 2010. Texas's special sessions have generally been for non-budgetary reasons, since the governor and Legislative Budget Board have extensive powers of revision over enacted budgets. There is no evidence that biennial budgets are particularly conducive to calls for special sessions.[13]

The extent to which budgets are actually revised during the second year of a biennium varies from state to state and from time to time, largely depending on economic and fiscal conditions. Connecticut's experiences revising and adjusting the budget to account for new programs have been about as time-consuming as enacting the full budget. Ohio's experience has been the opposite: Except for the regularly scheduled enactment of a capital budget in the off-year, the biennial budget usually receives a few adjustments that can be dealt with expeditiously.

5. *Do biennial budget states spend more money than annual budget states?*

The possibility that biennial budgeting results in smaller state budgets than annual budgeting was raised and rejected in NCSL's first study of annual and biennial budgeting.[14] Since then, one researcher, Paula Kearns, found a statistical association between higher state per capita spending and annual budging. Kearns was careful to note that she found only a correlation and not a cause and effect relationship between the two. Also, her measure of state spending omitted state subsidies to local governments, for no stated reason. Since those subsidies constitute, on average, more than 30 percent of state spending, their inclusion could have changed the results. Kearns's research also did not correct for the fact that some states are responsible for a much greater share of total state and local government expenditures than other states. For those reasons, her findings do not settle the question whether one budget cycle or another affects the overall level of state spending.[15]

CONCLUSION

There is little evidence that either annual or biennial state budgets hold clear advantages over the other. The evidence is inconclusive on the question whether biennial budgeting is more conducive to long-term planning than annual budgeting, although some evidence indicates that biennial budgeting is more favorable to program review and evaluation. Biennial budgeting is likely to reduce budgeting costs somewhat for executive agencies, but it also is likely to reduce legislators' familiarity with budgets. States with biennial budgets and biennial legislative sessions do not appear to give greater authority over budget revision to governors than other states. Forecasting is likely to prove more accurate in annual budget states than in biennial budget states, possibly reducing the need for supplemental appropriations and special legislative sessions. This study has found no convincing evidence that the length of the budget cycle, in itself, determines how efficiently a state enacts a budget and whether it requires extensive change during the course of its administration.

APPENDIX 1. STATES THAT HAVE CHANGED THEIR BUDGET CYCLES SINCE 1968

FROM BIENNIAL TO ANNUAL APPROPRIATIONS

Alabama – 1975
Arkansas -- 2010
Florida -- 1971
Georgia – 1974
Idaho – 1972
Iowa -- 1983
Illinois – 1970
Kentucky -- 2001
Mississippi -- 1971
Missouri – 1972
Oklahoma -- 1968
Tennessee – 1970
Utah -- 1969
Vermont – 1978 .

FROM ANNUAL TO BIENNIAL APPROPRIATIONS

Arizona – 1999
Hawaii – 1968
Nebraska -- 1987

FROM BIENNIAL TO ANNUAL TO BIENNIAL

Connecticut – to annual in 1971, to biennial in 1991.
Indiana – to annual in 1975, to biennial in 1978
Nebraska – to annual in 1972, to biennial in 1987
North Carolina – to annual in 1973, to biennial in 1975

FROM BIENNIAL TO ANNUAL TO BIENNIAL TO ANNUAL

Iowa – to annual in 1975, to biennial in 1979, to annual in 1983

Sources: NCSL surveys of legislative fiscal officers, 1987, 1994; 2008; GAO, 1987.

NOTES:

[1] Douglas Rooks, "Fixing the State's Budget Process, Brunswick, Maine, *Times-Record*, Aug. 19, 2010.

[2] Oregon Legislative Assembly, Joint Committee on Ways and Means, *Oregon's 2011-13 Co-Chairs' Budget*, March 29, 2011; http://www.leg.state.or.us/comm/lfo/2011_13CoChairBudget.pdf.

[3] Speaker Robbie Wills, Arkansas House of Representatives, interview with author, April 23, 2009.

[4] *Oregon's 2011-13 Co-Chairs' Budget.*

[5] See, for example, NCSL, "Executive Authority to Cut the Enacted Budget" (September 2008) at http://www.ncsl.org/default.aspx?tabid=12589; NCSL, "Legislative Role in Cutting the Enacted Budget"(August 2008) at http://www.ncsl.org/default.aspx?tabid=12594; and National Association of State Budget Officers, *Budget Processes in the States: 2008* (Washington, D.C.: NASBO, 2008); http://www.nasbo.org/Publications/BudgetProcessintheStates/tabid/80/Default.aspx.

[6] Council of State Governments, *Annual or Biennial Budgets?* (Lexington, Ky.: CSG., 1972), 23.

[7] Public Affairs Research Council of Louisiana, "Results of PAR Survey on Annual vs. Biennial State Budgeting" (Baton Rouge, La.: PARCL, 1982).

[8] Office of Financial Management, *Washington State Budget Process* (Olympia, Wash.: Office of Financial Management, July 2009), 1.

[9] Charles W. Wiggins and Keith E. Hamm, "Annual Versus Biennial Budgeting?" Public Policy Paper No. 7 (Austin, Texas: Public Policy Resources Laboratory, Texas A&M University, 1984), III-15; U.S. General Accounting Office, *Budget Issues: Current Status and Recent Trends of State Biennial and Annual Budgeting* (Washington, D.C.: U.S. GAO, 1987).

[10] [Connecticut] Commission to Study the Management of State Government, *Final Implementation Report* (Hartford, Conn.: CSCMG, 1991).

[11] Connecticut General Assembly, Legislative Program Review and Investigations Committee, *Connecticut Budget Process: Findings and Recommendations* (Hartford, Conn.: Conn. General Assembly, December 9, 2003).

[12] The median errors of estimate showed a similar but smaller difference: 2.06 percent for biennial states and 1.4 percent for annual budget states. These errors of estimate were calculated separately for the 20 states that had biennial budgets and the 30 that had annual budgets from 1987 to 2009. Arizona and Kansas were counted as annual budget states. The data on which the calculations are based appear in Pew Center on the States and Rockefeller Institute of Government, *States' Revenue Estimating: Cracks in the Crystal Ball* (Washington, D.C.: Pew Center on the States, March, 2011), 41, Appendix B.

[13] Brenda Erickson, NCSL Legislative Management Program, provided the statistics summarized in this paragraph.

[14] Barbara Yondorf, "Annual versus Biennial Budgeting: The Arguments, the Evidence: A Presentation to the Wisconsin Assembly Ways and Means Committee, Jan. 26, 1987," (Denver, Colo.: National Conference of State Legislatures, 1987).

[15] Paula S. Kearns, "The Determinants of State Budget Periodicity: An Empirical Analysis," *Public Budgeting and Finance*, 13, no. 1 (March 1993): 40-58.

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

Zero-Base Budgeting in the States

Ronald Snell
National Conference of State Legislatures
October 2011

Zero-base budgeting (ZBB), in its original form, is 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 for the new budget. It is intended to foster analysis of every activity, prioritization of budget activities, cost-effectiveness and economy.

ZBB appeared in the private sector in the early 1970s. Its first prominent advocate in the public sector was Jimmy Carter. As governor of Georgia and then as president, he advocated its adoption in the mid- and late-1970s. By 1978, the federal Office of Management and Budget had developed detailed procedures for using ZBB for the federal budget.

Proponents say zero-base budgeting has these advantages:

- It forces an end to the assumption that current activities and funding will continue with minor (or incremental) changes by forcing reconsideration of each activity and demand for resources.

- It emphasizes analysis and comparison of programs, and encourages the termination of low-priority programs.

- It encourages the reallocation of resources from lower priority programs or activities to those with higher priorities.

- It improves managers' skills at all levels, enriches communications with policymakers and fosters discussion of key issues and problems.[1]

Modified forms of ZBB have also emerged in state and local governments. These have seen widespread use in state governments, through not continual use in any state. They are:

- *Alternative budgeting*, in which agencies are required to make budget requests at various levels below and above their current level along with comparisons of the consequences of budgeting at the different levels; and

- *A periodic review* from the ground up of the budgets, responsibilities, strategies and performance of state agencies. Such reviews would occur once for each agency over a number of years, usually five to eight.

1. The Original Form of ZBB

Zero-base budgeting was designed as a tool to control expenditures through identifying the purpose and measuring the effectiveness and efficiency of activities. The form created for the federal government in the late 1970s included these steps:[2]

- Identification decision units within an agency's budget. A decision unit is a program, activity or organizational entity small enough for good analysis, but not so small and numerous that together they would overwhelm the budget process.

- Identification of a decision package for each decision unit. Each decision package would comprise four funding levels:

a) The minimum essential for program viability;
b) The current or maintenance level;
c) An intermediate amount, between the minimum and current levels; and
d) An enhancement level—additional funding for increased services.

Decision packages include statements of intended agency results, preferably quantified; measures of workload, efficiency and effectiveness; and budget requests.

- Ranking of decision packages by order of priority within managers' area of control, guided by policy directives from the managers' supervisors.

- Passage of decision packages up the administrative chain for additional review, prioritization, revision, consolidation or deletion.

- Consolidation of decision packages as the basis 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 could find little evidence that ZBB had improved the federal budget process. It recommended less paperwork, fewer decision packages and more analysis, fewer funding options and less rigidity. The Reagan administration (which succeeded the Carter administration in 1981) preserved some elements of ZBB in the form of alternative funding options from agencies, focusing on prioritization of activities as agency budgets were reduced.[3]

The original form of ZBB has been widely criticized as unworkable. Even the advantages which President Carter claimed it had brought to Georgia when he was governor appear to have been exaggerated. It was not possible to assimilate the ZBB focus or decision packages in the state budget process and its techniques were not useful in allocating resources. Federal efforts have been termed "an

exercise in futility."[4] Some of the disadvantages of ZBB are:

- It is difficult to apply usefully to entitlement programs and to continuing functions of government like public education.
- The process can create extreme competition and conflict over resource allocation.
- The process can be time-consuming and expensive.[5]

2. ZBB as Alternative Budgeting

At the end of the 1970s and in the early 1980s, states developed a simplified form of ZBB to address the fiscal difficulties of the time. This form omitted decision units, decision packages and multiple rankings as decision making rose through agency ranks.

States turned ZBB into *alternative budgeting* (also called *target budgeting*), in which agencies were instructed to make budget requests at various percentages of their previous budget—for example, at 90 percent, 100 percent and 110 percent—and to analyze the effect of those levels on agency programs.

This highly simplified version of ZBB was widespread in state budgeting at the time. It was not a radical departure from traditional state budget processes, and was a useful tool when budgets had to be cut or resources reallocated from agency to agency. The nominal link to ZBB gave alternative budgeting prestige and novelty, but did not involve difficult changes in established procedures or greatly increase bureaucratic work. This form avoided the priority rankings that had been a major feature of the original federal form of ZBB. In practice, alternative budgeting was used mainly to evaluate the ways agencies and programs would adapt to reduced resources.

This meant that the zero-base evaluation of state agencies had disappeared and that what had started out as a state model of ZBB had evolved into a form of budgeting probably

as old as budgeting itself—the consideration of alternatives. Whatever it may be called, this is 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 ZBB, but the useful practice continues without the name.[6]

3. ZBB as a Periodic Agency Review.

State governments have not found it possible to adapt to a budgeting process that calls for justification of every activity and program annually or biennially. They are not in a position to reconsider subsidies to school districts or Medicaid support annually. The apparatus of ZBB involves multiple layers of activity description, analysis and recommendations which would be unwieldy in the smallest state government, let alone a state whose annual spending reaches $50 billion, $60 billion or $70 billion a year. The required analysis is time-consuming for agencies, legislative staff and legislators.

For those reasons, most recent efforts to adopt ZBB in state governments have called for a periodic ZBB analysis of state agencies. They suggest a cycle that would cover from four to eight years, after which it would be repeated.

Florida enacted an eight-year cycle of ZBB agency reviews in 2000 and began the reviews in 2001. The Florida legislation designed a joint legislative-executive process for agency review in the months the legislature was not in session. Legislators and teams of analysts from the House, the Senate, the Legislature's program analysis agency and the executive budget agency worked on a fundamental examination of the scheduled agencies.

Oklahoma legislation in 2003 mandated a four-year cycle of legislative ZBB reviews of state budgets. The Oklahoma process was legislatively driven, in keeping with the state's strong legislature/weak governor approach to budgeting. A joint interim committee was directed to conduct the ZBB reviews, assisted by fiscal staff from both chambers.

Although both Florida and Oklahoma have abandoned ZBB, Governor John Lynch of New Hampshire and Governor C. L. "Butch" Otter of Idaho have instituted zero-based agency reviews as a tool for budget analysis and planning in recent years, as described below.

4. ZBB in Action in Idaho and New Hampshire

Zero-base budgeting is primarily an executive branch procedure in Idaho and New Hampshire, where, in both cases, it shapes the budget recommendations made to the legislatures. Except as agency directors may refer to the findings or results of a ZBB-based analysis, the process does not significantly affect legislative budgeting processes.[7]

Governor John Lynch of New Hampshire instructed all state agencies that their budget requests for fiscal years 2008 and 2009 should be built from the bottom up using a zero-base budgeting approach, and required a similar approach, without the use of the term "zero-base budgeting" in his directions for fiscal years 2012 and 2013. Governor Lynch's budget director has indicated that the governor then goes through agency budgets to review in detail such questions as the legal requirements they must meet, what they do, why it is done and how it is staffed.[8]

ZBB in New Hampshire is built within the framework of statutory requirements that the executive budget proposal begin with a maintenance-level budget. According to the state budget director, John Beardmore, ZBB enters the process through 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 are the legal requirements? The process involves drilling down for complete answers to such questions in limited number of agencies.

Such reviews have facilitated the streamlining of agency responsibilities in response to the current fiscal climate. In the recent past, New Hampshire agencies have reduced budgets by 5 percent by executive order, and for the next biennium must comply with a legislative directive to present proposals for cutting spending by 10 percent.[9] ZBB as implemented in the New Hampshire executive branch aids in clarifying the central missions and priorities of agencies, and eliminating programs that no longer match current priorities.

Idaho's use of ZBB 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 ZBB on a six-year schedule in 2008. The Budget Bureau was instructed to examine 10 to 15 agencies a year. The challenge in doing so, according to David Hahn of the Idaho Division of Financial Management, was to avoid the complexities of ZBB of the 1970s—excessive paperwork, too much emphasis on alternative decision packages, and alternative funding levels.

One resulting goal has been to get a grasp of agency compliance with law in order to identify gaps between activities and statutory authority. Over time, agencies may acquire legal responsibilities that are distantly connected to or disconnected from their central mission. Agencies were instructed to review their activities, identify those not in line with their mission and recommend whether such activities should be allowed, eliminated or moved to another agency. Activities that did not align with central missions could be placed at the bottom of the list of priorities.

Idaho has also emphasized keeping ZBB in the context of strategic planning. Agency strategic plans are essential in prioritizing agency functions. With a strategic plan and prioritization of functions in place, agencies have been well-situated to make recommendations in line with the required budget reductions of recent years.

Hahn is confident that management techniques exist to extend ZBB from small agencies to large agencies like the Idaho Transportation Department and the Department of Health and Welfare. He cautions that ZBB will not result in huge cost-savings; it is a tool of cost containment, used in Idaho to streamline agencies, focus them on their core missions and implement their strategic plans. It is a tool of improved management as well as a budgetary tool.[10]

5. The Appeal Of ZBB Continues.

Legislation calling for ZBB was introduced in 15 states in 2009, two in 2010 and at least eight in 2011. They included a mix of small and large states—Iowa, Kansas, Rhode Island and South Carolina among the smaller states, and California, Georgia, Illinois and Ohio among the larger states. Seventeen states have reported its use in some

form, and as already noted, a number of states have made serious efforts to put ZBB into effect in recent years.

On the other side of the coin, none of the enabling legislation was enacted from 2009 through 2011. In analyzing proposals in its legislature, the Illinois Legislative Research Unit has pointed out that is hard to find evidence of ZBB in most of the 17 states that report its use.[11] Aside from the recent executive orders to use ZBB in Idaho and New Hampshire, it is not clear that any state uses ZBB as its primary budgeting technique.

An Iowa ZBB program at the beginning of this century and the Oklahoma ZBB plan have been substantially reshaped into performance budgeting. Florida abandoned zero-based reviews within three years of having begun them in 2001. The Florida ZBB work produced reports of great thoroughness and usefulness, but it was also expensive and time-consuming, and was discontinued after the third round of ZBB reviews.

Oklahoma's experience is instructive as another serious effort to use ZBB as a budgeting tool. After the legislation was adopted in 2003, the legislature set up a joint committee to conduct ground-up reviews of state agencies in a four-year cycle. The Department of Education, which distributes and oversees aid to school districts, was one of the initial agencies. The time it took to explain the structure and responsibilities of the department exhausted the committee. The process was valuable to legislators for all they learned, but it was so time-consuming they never reached the point of considering the budget. Since that time the Legislature has voted three times to repeal ZBB, by bipartisan majorities. In practice, it is not used by either the Legislature or the executive branch.

6. Lessons Learned

ZBB responds to a serious and widespread desire to look at public budgeting in a fresh way, free of old assumptions, and make a new beginning. Past experience does not control the future. What can be learned from the kinds of experience related here?

- A proposal to adopt ZBB 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, ZBB 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.

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[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

APPENDIX 1: 2011 STATE LEGISLATION PROPOSING ZERO-BASE BUDGETING

Except for GA SB 33, none of the measures listed proceeded to a floor vote in either chamber.

GA SB 2, 33	SB 2 would have established a sunset review process. SB 33 passed the Senate, was significantly amended in House and was left in conference committee at the end of session. The Senate version of SB 33 called for phasing in ZBB, and a joint budget office for the legislature.
IL HB 33 IL SB 212	Shell bills as a vehicle to call for ZBB (that is, they consist only of a short title).
MN H File 2 MN S File 146	HF2 established principles for and requires use of ZBB, and also establishes a sunset review process, establishes its principles and practice, and sets a schedule for state agency sunset reviews. SF 146 requires priority-based budgets beginning with FY 2014 and repeats the provisions of HF 2 regarding a sunset process.
RI HB 5325 RI SB 298	Identical bills calling for ZBB to be phased in over five years beginning in FY2012. It would also establish a three-member joint committee of the legislature to examine the governor's budget recommendations and make recommendations for cost savings and alternative ways of doing things before the budget goes to the House appropriations committee.

SC HB 3528, 3641 SC SB 15, 68	SB 15 and HB 3528 are companion bills calling for the appropriations committees to use a ZBB process for the state budget beginning with a group of agencies for FY 2012, moving through all agencies over four years and repeating the cycle thereafter. HB 3641 calls for ZBB with more details about practice, and also calls for biennial budgeting. SB 68 calls for outside auditors to write ZBB budgets for state agencies for their review.
SD HB 1103	Calls for the joint committee on appropriations to establish a schedule whereby each state agency uses a zero based budget format once every 10 years.
VA SJR 355	Recommends that the governor include ZBB as one of the reforms to be considered by the Commission on Government Reform and Restructuring.