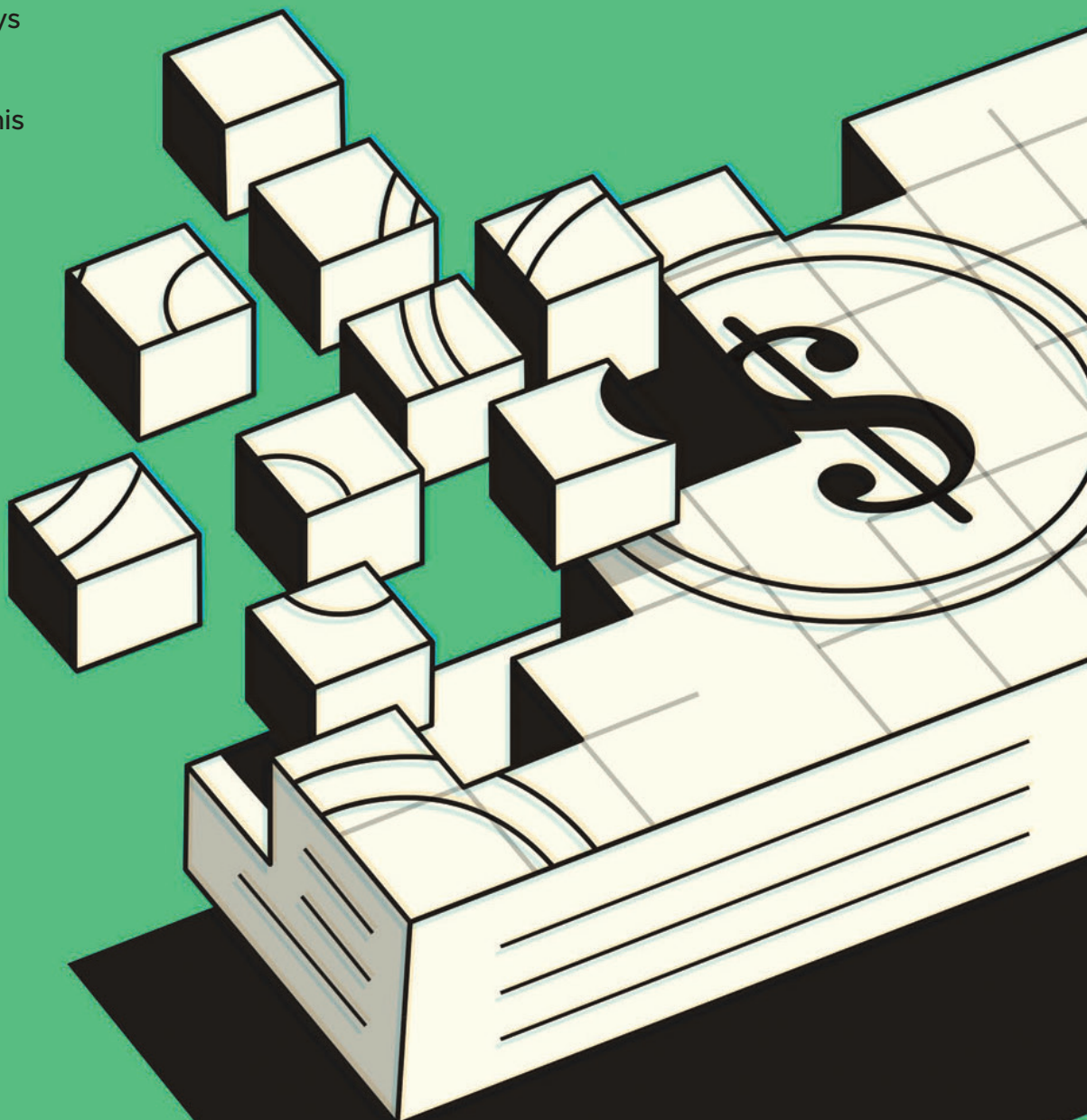


Point / Counterpoint

Zero-Base Budgeting

BY SHAYNE C. KAVANAGH

What are the pros and cons of Zero-Based Budgeting, especially during such tumultuous times? Using takeaways from recent research, we present both sides so you can decide if this approach is right for your government.



Zero-base budgeting (ZBB) is a budgeting process that asks managers to build a budget from the ground up, starting from zero. Though the apex of ZBB's popularity in the late 1970s is long past, there has been renewed interest in ZBB in today's environment of fiscal constraint, not least because the "zero" in zero-base budgeting sends a powerful message that taxes and spending will be held in check. ZBB won't fit all situations, but it is a potentially valuable tool.

ZBB has been the subject of a fair amount of controversy over the years, however, primarily because of questions about the value derived from ZBB analysis versus the cost required to put ZBB into practice. GFOA's research found that "textbook" ZBB or ZBB systems that conform to the theoretical ideal are almost unheard of in present day financial management. But an increasing number of governments that exhibit leadership in budgeting practices (albeit still a minority) are considering elements of ZBB and incorporating them into their budget processes.

GFOA's research has led us to several major conclusions about ZBB:

- **Practical uses of ZBB streamline ZBB theory** to focus on either detailed examination of expenditures or selecting between different levels of service.
- **ZBB isn't for everyone.** ZBB, or concepts inspired by ZBB theory, may be useful in certain situations. Ultimately, public officials must decide if the benefits of ZBB outweigh the disadvantages.
- **Alternatives to ZBB exist.** These alternatives can answer many of the same cut-back budgeting questions as ZBB, while sidestepping some of its disadvantages.

POINT

Original-Flavor ZBB

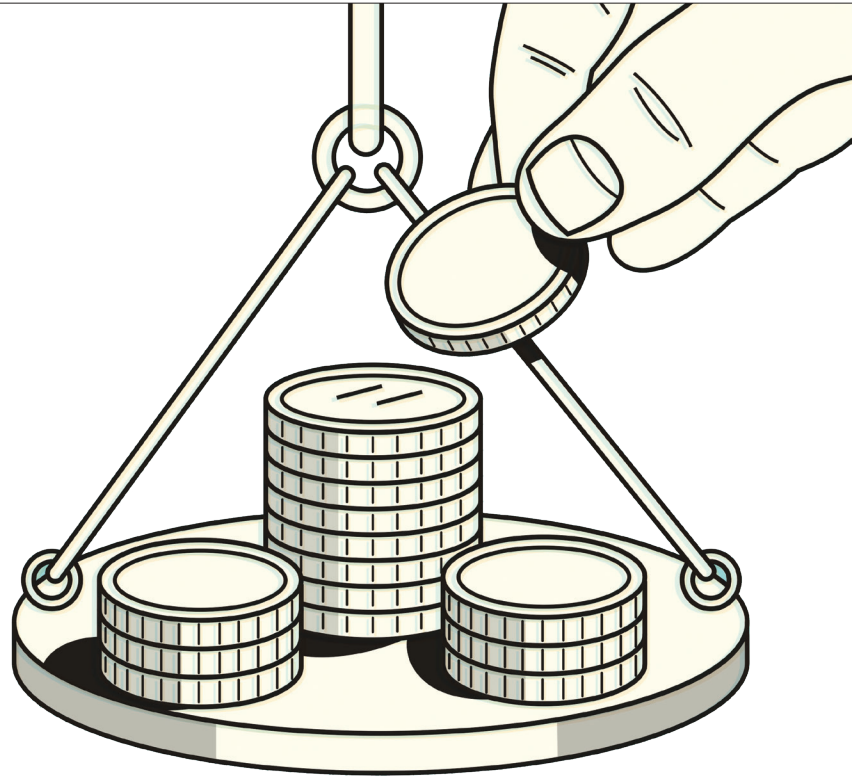
ZBB promises to move the organization away from incremental budgeting, where last year's budget is the starting point. Instead, the starting point becomes zero, with the implication that past patterns of spending are no longer taken as a given. To deliver on this promise, the organization is first divided up into "decision units"—the lowest level at which budget decisions are made.

Decision units could be formed along functional or organizational lines—for example, a division of a department is a common decision unit, but programs could be used as well. Managers in each decision unit then prepare a detailed description and evaluation of all the activities it performs, including alternatives to current service delivery methods and the spending plans necessary to achieve the decision unit's goals. This information is used to create a number of decision packages, which show marginal spending level differences that represent varying levels of effort and cost.

Given the issues with ZBB, how can it help in an environment of fiscal constraint, where budget cutbacks are required? First, consider three essential questions of planning and budgeting. These questions are especially germane in a time when budget cuts are required, because they allow for a more rational and comprehensive approach to reducing budgets.

The first question asks, in the planning stage, what the community's priorities are and how government might make a positive difference in the lives of constituents. Ideally, this invites the government to consider entirely new ways of meeting community needs. With respect to budgeting, the first question asks what programs or services the government should fund in the first place. Under a traditional budgeting system, the answer is simple: The same ones that were funded last year. Ideally, though, the answer will stem from a consideration of what the community's priorities are and what programs will be most effective in reaching those outcomes.

A budgeting process focuses on **inputs and outputs**, asking if the inputs requested to provide a given service level are reasonable given the expected output.



The second question asks: Assuming we are going to provide a given program or service, how much/ what quality of service should we provide? Under a conventional system the answer is typically, again, the same level as last year. In a cutback environment, a traditional budgeting system often seeks to preserve the same service level by making marginal cuts to “non-essential” expenditures such as training, travel, etc. But a planning and budget system should be more circumspect, considering if a basic level of service, a premium level, or something in between is best (i.e., best suited to need, most affordable, etc.). On the planning side, a government should examine community need and preferences when deciding how much and what quality of service to provide. On the budgeting side, departments and programs are allocated funding according to the level of service that is deemed most appropriate.

The third question asks directly about the efficiency with which a service is provided. A planning process should look at everything that determines efficiency: the processes followed to deliver a service, the knowledge, skills, and abilities of the people involved, and the technology used to facilitate the work. When it comes to efficiency, a budgeting process focuses on inputs and outputs, asking if the inputs requested to provide a given service level are reasonable given

the expected output. A traditional line-item budget system is focused exclusively on inputs, with little consideration given to the output being funded.

Finally, all three questions are preceded by a question of affordability—planning and budgeting decisions should be informed by knowledge of how much money is available and what the true costs of service are. ZBB is of the greatest potential use in answering the second question, and also can provide value for the budgeting portion of the third question. Decision packages present different service levels for budget authorities to choose from. The decision packages include performance metrics to specify the outputs produced and contain detailed resource estimates, allowing budget authorities to get a sense of whether the requested inputs are reasonable in light of the outputs.

Finally, ZBB theory does not place much emphasis on starting the ZBB process with a sense of what is affordable. It is not necessary, for example, to start the ZBB process with a forecast of revenues. Rather, the process begins with decision units developing their decision packages. These are forwarded to central budget authorities who, then, take account of available revenues to decide which decision packages to recommend to the board in order to reach a balanced budget.

COUNTERPOINT

Why Nobody Uses It—And What They Use Instead

The governments that report using ZBB are using “practical” versions of ZBB that are less intensive than the theoretical model. In fact, GFOA’s research found that use of “textbook” ZBB is almost unheard of in local government today. The attraction of ZBB, for many, is that the “zero” in ZBB sends a powerful message to all stakeholders that the line will be held on spending and that nothing will be taken for granted. Applying the ZBB label to the budgeting process makes this statement, even if the actual budget process doesn’t conform fully to ZBB theory.

Governments that describe themselves as using ZBB tend to fall into two major categories. The first budgeting question, “Are inputs reasonable given the expected output?” This method seeks to create greater transparency in how line items are arrived at by requiring detailed justifications of line-item requests in lieu of pointing to prior years’ allocations as the justification.

The second group, which we’ll refer to as “service level budgeting,” presents decision makers with different service levels and asks them to choose, thus focusing on question 2, “Assuming we are going to provide a given program or service, how much/what quality of service should we provide?” In this method, departments concentrate on presenting decision packages and service levels with associated metrics, while there is less emphasis on detailed input estimate. This method of budgeting does not start with last year’s budget. Rather, departments are given a blank budget request form with zeros filled in for each line item, instead of last year’s budget or actual expenditures as the starting point. Departments then rebuild their budgets from the ground up, justifying each line item. Where possible, departments are asked to provide drivers of cost.

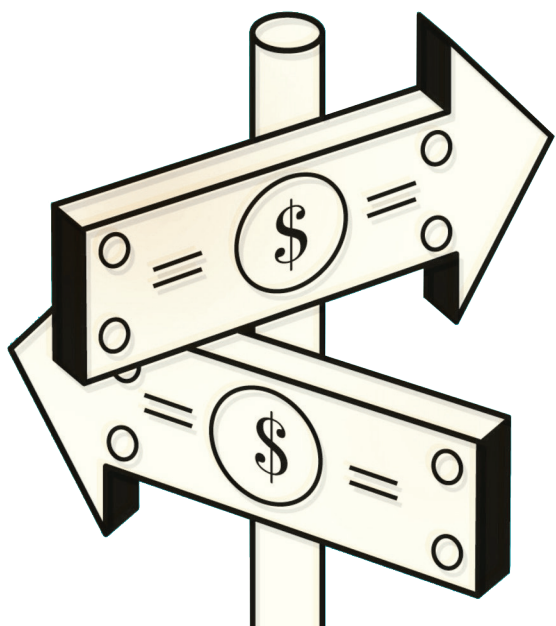
Like most budget reforms that promise to bring more rationality and comprehensive decision making to cut-back budgeting, ZBB has limitations. Budgeting is always art as much as it is science, and it is up to public officials to decide the extent to which ZBB, or at least elements of it, facilitate the presentation of financial and service

information to decision makers in a way that will help them reach a structurally balanced budget that meets the needs of the community.

Practical ZBB has a number of weaknesses. Some of the issues, such as finding alternative service delivery options and efficiencies, stem from a weakness of theoretical ZBB. Other issues, such as the increased paperwork and the need for good performance measures, are, to some extent, issues with any budget reform that attempts to introduce a more rational, comprehensive perspective.

For example, ZBB is managerially driven. Any form of ZBB entails digging into the details of the budget as a starting point. While there is potential value to this, as the advantages of ZBB attest, it does color the role of elected decision makers. With the zero-line item approach to ZBB, it means that elected officials are asked to use detailed operational information in order to make their budget decisions, rather than using the bigger-picture strategic questions to which elected officials are best suited. In the service-level approach, elected officials primarily respond to staff rankings of services. Because ZBB does not necessarily include a strategic planning element, whether these rankings are reflective of elected officials’ priorities will depend on the extent to which staff has made an effort to understand officials’ priorities and integrate them into the budget process.

ZBB does not directly address whether a government should be in the business of providing a service in the first place. It largely assumes the current mix of programs and services and focuses on the level at which they should be provided. This is partially because the ZBB process is managerially driven, and most managers probably think the government should continue to their program. Managers tend to concentrate on looking for opportunities to make cuts to the current way of doing things, to an extent that will be acceptable to central budget authorities (e.g., find a way to cut 10 percent), rather than looking for ways to spend the bulk of their budget (e.g., 90 percent) in new ways.



A lack of good measures to support decisions means that ZBB is less likely to result in serious examination of significantly **different ways of providing service.**

ZBB is more effective when good performance measures are in place—but few governments have a detailed, quantified understanding of what their service levels are, much less of the relationship between service levels and cost. Therefore, they cannot accurately select a service level and then estimate the cost for that new service level. Rather, they tend to budget by inputs, and then estimate service impacts at different input levels. While lack of good performance measures will be a drag on any budget process that looks to introduce more objective performance information into resourcing decisions, it can be particularly problematic in ZBB. This is because ZBB is predicated on the assumption that decision makers will be able to make choices between detailed service level options, which then will drive sourcing decisions. A lack of good measures to support decisions means that ZBB is less likely to result in serious examination of significantly different ways of providing service.

ZBB is perceived as requiring too much paperwork. Governments that GFOA studied rarely cited paperwork as an important problem in practice, likely because they were using a modified, streamlined approach to ZBB—but the perception is important because it elicits resistance. This challenge is most acute when ZBB is rushed into place in response to financial distress; insufficient planning and preparation result in a less clear and harder to follow process. But even modified ZBB does require substantial documentation, and what is deemed “excessive” is often relative.

ZBB doesn’t address alternative service delivery options. In theory, ZBB does allow and even encourages managers to submit decision packages for alternative service delivery options (i.e., entirely different methods for achieving the same outcome). But this very rarely works in practice. Because the ZBB process is intensive, departments are unlikely to seriously think about alternatives at the same time as they’re putting together spending plans. ZBB also assumes that managers of departments will know the best means of delivering a service. This means that ZBB is really more about managerial preferences than true alternatives. In many cases, managers are likely to believe that they’ve been doing the right things all along, so they’ll concentrate on doing more of the same. Finally, the environment of financial austerity that is often associated with ZBB is not generally conducive to the risk taking associated with proposing alternatives.

ZBB doesn’t directly address the efficiency of services. Making inputs more transparent doesn’t make for more efficiency by itself. Increased scrutiny on inputs may inspire some cost-saving innovations on an ad hoc basis, and reducing budgets does force managers to think of better ways to use their more limited resources—but these are secondary effects. This is important to understand because finding efficiencies is a common motivation for adopting ZBB. Recognizing this problem, some governments adopt efficiency enhancing programs along with ZBB (e.g., an employee suggestion program, managed competition). ■

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