



Winter 1980

# State Government

*Published Quarterly by  
The Council of State Governments*

- MINERAL DEVELOPMENT
- ZERO-BASE BUDGETING
- GOVERNMENT CONTRACTING
- GUBERNATORIAL CLEMENCY
- BUDGETING FOR PRODUCTIVITY
- STATE VEHICLE SELF-INSURANCE
- EDUCATION POLICYMAKING
- JUDICIAL ADMINISTRATION
- WEATHER MODIFICATION
- AMERICAN FEDERALISM
- GRADUATE EDUCATION

# Montana's Experiment with Zero-Base Budgeting

by John S. Fitzpatrick\*

IN 1975, Montana began a four-year experiment with zero-base budgeting (ZBB) by the enactment of House Bill 643 (Chapter 460, Montana Session Laws of 1975). The act required that the "budget director shall implement a program planning and budgeting system . . . for at least one program in representative agencies of state government service such as planning, human service delivery, licensing and regulation, and other programs as determined by the budget director."

Notwithstanding the use of the term "program planning and budgeting system," H.B. 643 introduced ZBB to Montana. The third section of the act revised the statutory content of the Executive Budget by requiring that budget information be submitted in a form consistent with the basic elements of ZBB. H.B. 643 specified:

The biennial budget under this act shall include a departmental analysis summarizing past and proposed spending plans by program and the means of financing the proposed plan. Information presented shall include the following:

(1) A statement of departmental and program objectives, effectiveness measures and program size indicators;

(2) At least three alternative funding levels for each program with effectiveness measures and program size indicators detailed for each alternative funding level; and

(3) A departmental priority listing encompassing all alternative funding levels.

ZBB caught legislative attention because it appeared to offer an alternative to line-item budgeting, which was used to prepare the state budget. An agency budget was built by projecting future expenses in a number of categories

such as wages, employee benefits, travel, utilities, rent, etc., totaling the estimates, and submitting them to the legislature for funding. This process tended to be incremental with each agency using the immediately completed or current fiscal year budget as the base for the next biennium's request. As a result of workload increases, inflation, and proposed program expansions, budget requests and appropriations tended to increase with each succeeding legislative session. Budget justification and review focused primarily on limiting the amount of increase over the existing appropriation. Also, the line-item approach was input-oriented; that is, budget documents showed what it cost to operate an agency with relatively little consideration given to the kind and amount of work the agency provided as output for its appropriation, or whether there was a demonstrated need for the services being provided.

Testimony before the legislative committees in support of H.B. 643 indicated dissatisfaction with the line-item approach. Legislators pointed to the need for more program analysis and wanted information that would help them evaluate agency performance and set budget levels. Finally, there was considerable interest in directing the content of the Executive Budget away from an accounting of state expenditures to an instrument of policy and performance analysis. House Appropriations Committee Chairman Francis Bardanouve looked to H.B. 643 as a means "to orient the budget book to the legislator and not [just] to the Governor's Office."

\*Mr. Fitzpatrick is Deputy Director, Montana Office of Budget and Program Planning.

### ZBB: IN PRACTICE

ZBB is a budget technique whereby each program, regardless of whether it is a new or existing program, must be justified in its entirety each time a new budget is formulated.<sup>2</sup> Contained within the ZBB approach is the assumption that all activities have some sort of effective life span and that activities should be constantly reviewed with an eye toward changing or deleting those which have become unnecessary or ineffective.

Montana implemented ZBB on a pilot basis with seven program areas submitting budgets using ZBB procedures. The remaining state agencies used the standard line-item format. In Montana, ZBB was termed the Priority Budgeting System.<sup>3</sup> The pilot agencies included the Department of Fish, Wildlife and Parks; Department of Business Regulation; Highway Maintenance Division; Crime Control Division; Health Services Division; Montana Historical Society; and Youth Services program area consisting of two reform schools, Pine Hills and Mountain View, and the Aftercare Bureau in the Department of Institutions and Youth Development Bureau within the Department of Social and Rehabilitation Services.

The seven program areas preparing their budgets under the Priority Budgeting System used the traditional components of the ZBB system. Each program was separated into discrete "decision units" or "activity packages." An activity package consisted of a function or group of functions used by management for planning and analysis. This level normally constituted the lowest level for which budget decisions were made. For example, the Youth Development Bureau of the Department of Social and Rehabilitation Services divided its program into 10 activity packages. One package reflected the output and costs of central office administration, another package was created for foster parent training, a third package covered the operation of the Big Brothers and Sisters program, etc. For each activity package, three alternative budgets were prepared, each reflecting a different level of funding. One budget level identified the current level of service, a second budget level reflected the impact of a 20 percent reduction in funding,<sup>4</sup> and the third level of funding, designated as the agency request level, showed what the agency considered to be the optimum budget level.

Following preparation of the alternative budget levels, all activity packages were ranked in order of priority, first by the program manager and then up through the chain of command until an agency ranking was established for the final budget. Since Montana limited the use of ZBB to seven pilot test areas, a statewide ranking of priorities was not practical. The final step in the ZBB process was to present the budget recommendation to the legislature which, in turn, was to review the proposed costs, service levels, and priority ranking to establish the agency appropriation.

Under ZBB, the amount of budget and program information presented the legislature was substantially greater than provided through the standard line-item format. In addition to describing past and projected revenues and expenditures, ZBB included performance measures which identified the programmatic impact of funding each of the three alternative budget levels. A priority ranking of all agency activity packages by funding level provided the legislature with the executive branch's estimation of the relative importance of each agency activity. Figures 1 and 2 contain examples of a typical activity package budget recommendation and a priority ranking table for all agency activity packages.

### ZBB: SOME PROBLEMS

The benefits received from ZBB were marginal compared with the problems encountered in implementing the system. ZBB theory was fundamentally incompatible with actual conditions experienced in state government budgeting.<sup>5</sup>

When first implemented, ZBB appeared to offer substantial opportunity to reallocate funds not only within agency budgets but also between agency budgets. ZBB theory suggests that by dividing programs into discrete decision units (activity packages) and developing a priority ranking of such units, it is possible to move funds from low- to high-priority activities. For example, program X in agency 1, which had high costs in relation to the benefits received, could be deleted to fund program Y in agency 2 which had a more favorable ratio of costs to benefits. The opportunity to fund such trade-offs never materialized in Montana's ZBB experience, and it appears that such a situation would be a rare occurrence within state government budgeting. This conclusion is reached for two reasons. First, the ability to trade off funds in the state budget

is closely circumscribed by statutory requirements designating the use of certain funds (earmarking) and by matching requirements for participation in programs funded by the federal government. Funds from hunting and fishing license fees can be used only to support the activities of the Department of Fish, Wildlife and Parks. They cannot be transferred for use by the university system, institutions, or other state departments. Likewise, in order to receive federal Title XX funds for social services, the state must provide a 25 percent match to the federal revenue. A budgetary trade-off moving state funds from a Title XX service to a non-Title XX service would reduce the amount of federal revenue by three dollars for every state dollar traded off. To find a program from which funds can be moved across agency lines, without violating state or federal earmarking restrictions, is the exception rather than the rule.

A second problem with funding trade-offs is that the decisionmaker's abilities to precisely measure and compare cost-benefit ratios are overestimated. Trade-offs, or priority ranking, assume that cost-benefit comparisons are the major, if not the only, criteria in establishing budget levels. Such an assumption largely ignores the reality of budgetmaking by public bodies, where budget decisions are influenced by political, personal, and philosophical criteria as much as by cost-benefit ratios.

Most ZBB systems, including Montana's, require an examination of alternative funding levels and alternative ways of providing an existing service. H.B. 643 mandated the identification of three alternative levels of funding, but this action did not substantially contribute to improved budget decisionmaking in Montana's experience. The minimum budget level established at 80 percent of the current budget was viewed with great trepidation by the agencies. Information generated to support the 80 percent budget request tended to document the need for more funds. Likewise, the agency's analyses of alternative methods of providing service supported retaining the status quo. ZBB does not adequately acknowledge the actual conditions faced by managers who are expected to take the lead in setting agency budget levels. For example, collective bargaining agreements can impose constraints which limit potential cost savings, as can pressure from groups opposing reductions in service levels. As a result, the

manager's support of ZBB was relatively restrained.

House Bill 643, which added performance measurements to the ZBB portion of Montana's budget process, contributed little to the Executive Budget recommendations. It was difficult to identify performance measures which truly reflected a relationship between budgeted resources and the amount and kind of services delivered. Indicators that were developed tended to be either measurements of workload (e.g., banks to examine, miles of highway to maintain, children to educate), or resources used in the conduct of the program (e.g., tons of chemical de-icer applied, man-hours of work). Some programs, particularly those in human service agencies, possess an ambiguous mission, and it is difficult to describe their program goals and performance in quantitative terms.

For other measures, the data base was inadequate and rendered the measurement meaningless. For example, the state reform schools used recidivism as a performance measure, but the indicator showed only the number of individuals returned to the institution who had been incarcerated there. It did not measure how many children became law-abiding citizens once having resided in that institution.

Much, if not most, of the performance measurement exercise was make-work generated solely for the budget process. Agency managers consistently indicated they did not use the collected information in the day-to-day management of their program. Their reasons for not doing so varied, but contained a common theme paraphrased below:

Performance measurement is a good idea; more of it should be done. But, and even though some measures look good on paper, they really don't describe what this program does.

Implementing ZBB in Montana on a pilot basis required the state to operate two budget systems. More important, after reviewing the ZBB experience, it did not appear that the state could divorce itself easily from the traditional line-item budget system, even if full conversion to ZBB was desirable. The statewide budgeting and accounting system, auditing procedures, and reporting requirements for federally funded programs are geared to a line-item budget. Although it is possible to adapt most of these structures to fit ZBB, the conversion would be costly and time consuming. Until such a conversion was made, any agency using ZBB would have had to follow a course similar to that of the

## FIGURE I PRIORITY BUDGETING SYSTEM BUDGET RECOMMENDATION

DEPARTMENT OF BUSINESS REGULATION Consumer Protection												
<p><b>Statutory Authority:</b> Title 18, Chapter 5/Title 51, Chapter 1, Title 75, Chapter 92/Title 85, Chapter 4</p> <p><b>SubProgram Description:</b> It is the responsibility of the Consumer Protection SubProgram to protect the citizens of the state from unfair, illegal or deceptive business practices and transactions. The SubProgram performs supervision of of investigation, licensing, enforcement and educational activities in accomplishing the administration of consumer protection laws. The overall goal is to continue to maintain close supervision and to exercise efficient control over Consumer Protection functions of present and newly created legislative programs. It is estimated this SubProgram will generate approximately \$124,000 to the General Fund in the next biennium.</p> <p><b>External Trends:</b> The trend toward consumer awareness and the associated legislative recognition of the desirability of consumer assistance by state government will place increasing burdens on the SubProgram. This demand is reflected in the substantial increase in consumer utilization of the services</p>			<p>provided by the program in each year of its existence.</p> <p><b>Past Effectiveness:</b> A measure of success can be attributable to increasingly effective communication and cooperation between this SubProgram and related agencies in this and other states against transient violators and the increasing monetary recovery for the consumer in each fiscal year since the SubProgram's inception. (\$157,966 for FY 76).</p> <p><b>Future Trends:</b> Proposed changes in the Unfair Practices Act will, if adopted, put increased demands on the administrative support, investigation and enforcement aspects of the SubProgram.</p> <p><b>Recommended Funding Level:</b> It is recommended the Consumer Protection SubProgram be funded at the current level.</p>								<p style="text-align: center;">FY 78 \$143,157</p> <p style="text-align: center;">FY 79 \$147,019</p>	
Alternative Funding Levels	Current Biennium		Alternative A (80% or less)		Alternative B (current level inflated)		Alternative C (Agency Request)		Governor's Recommended			
Program Costs	FY 76 Actual	FY 77 Est.	FY 1978	FY 1979	FY 1978	FY 1979	FY 1978	FY 1979	FY 1978	FY 1979		
Full Time Equivalent	7.00	7.00	4.80	4.80	7.00	7.00	9.00	9.00	7.00	7.00		
Personal Services	95,337	104,345	76,205	77,949	107,103	109,590	134,183	138,080	107,103	109,590		
Operating Expenses	15,517	33,528	27,751	28,438	34,683	36,058	42,880	44,437	34,683	36,058		
Equipment & Livestock	2,149	1,371	1,211	1,211	1,371	1,371	3,061	1,871	1,371	1,371		
<b>TOTAL OPERATING COSTS</b>	<b>113,003</b>	<b>139,244</b>	<b>105,167</b>	<b>107,598</b>	<b>143,157</b>	<b>147,019</b>	<b>180,124</b>	<b>184,388</b>	<b>143,157</b>	<b>147,019</b>		
Transfers	-	-	-	-	-	-	-	-	-	-		
Grant	-	-	-	-	-	-	-	-	-	-		
<b>TOTAL PROGRAM</b>	<b>113,003</b>	<b>139,244</b>	<b>105,167</b>	<b>107,598</b>	<b>143,157</b>	<b>147,019</b>	<b>180,124</b>	<b>184,388</b>	<b>143,157</b>	<b>147,019</b>		
<b>FUNDING DETAIL:</b>												
General Fund	80,447	94,692	65,804	67,371	97,583	100,465	134,550	137,834	97,583	100,465		
Earmarked Revenue Fund	22,556	44,552	39,363	40,277	45,574	46,554	45,574	46,554	45,574	46,554		
Federal & Private Revenue Fund	-	-	-	-	-	-	-	-	-	-		
Revolving Fund	-	-	-	-	-	-	-	-	-	-		
<b>TOTAL FUNDING</b>	<b>113,003</b>	<b>139,244</b>	<b>105,167</b>	<b>107,598</b>	<b>143,157</b>	<b>147,019</b>	<b>180,124</b>	<b>184,388</b>	<b>143,157</b>	<b>147,019</b>		

DEPARTMENT OF BUSINESS REGULATION Consumer Protection SubProgram										
Alternative Funding Levels	Current Biennium		Alternative A (80% or less)		Alternative B (current level inflated)		Alternative C (Agency Request)		Governor's Recommended	
Program Measures	FY 76 Actual	FY 1977 Est.	FY 1978	FY 1979	FY 1978	FY 1979	FY 1978	FY 1979	FY 1978	FY 1979
<b>Workload and/or Demand Estimators</b>										
Estimated investigations	1,145	1,525	1,890	2,318	1,890	2,318	1,890	2,318	1,890	2,318
Legal Actions Required	28	35	52	70	52	70	52	70	52	70
Requests for appearances	27	40	60	80	60	80	60	80	60	80
Estimated licenses issued	61	80	90	100	90	100	90	100	90	100
<b>Output Measures</b>										
Investigations conducted	1,145	1,525	1,550	1,550	1,890	2,318	2,100	2,600	1,890	2,318
Lawsuits initiated	9	13	17	20	18	21	18	21	18	21
Workshops conducted	16	23	0	0	35	50	70	115	35	50
Seminars attended	4	6	0	0	8	10	16	20	8	10
Consumer alerts	23	30	0	0	40	50	40	50	40	50
Licenses issued	60	70	75	80	75	80	75	80	75	80
Enforcement proceedings	24	35	52	70	52	70	55	75	52	70
<b>Effectiveness Indicators</b>										
Est. Rev. generated to General Fund (\$)	63,000	59,000	62,000	62,000	62,000	62,000	62,000	62,000	62,000	62,000
Licenses denied	1	1	2	2	2	2	2	2	2	2
Permanent injunctions	7	10	13	17	14	18	15	19	14	18
Complaint cases closed	1,115	1,485	1,450	1,450	1,840	2,258	2,050	2,525	1,840	2,258
Assurance of compliance	3	5	7	11	8	12	10	15	8	12
Monetary recovery (\$)	157,966	204,000	210,000	275,000	265,000	344,000	300,000	400,000	265,000	344,000
Hours of consumer education	Data Not Currently Available									

pilot agencies—first building a line-item budget to reconcile actual and proposed expenditures, and then converting the line-item budget to the ZBB format.

The increase in paperwork generated by ZBB was substantial. The line-item budget used the program as a basic budget entity. In 1977, a program budget request required completion of nine forms plus five forms for each requested budget modification. Under ZBB, an agency divided its programs into activity packages and submitted six forms for each activity package (two forms per budget level) plus an agency ranking table. An activity package could be the equivalent of a program but, following ZBB theory, each activity package should only include one basic activity or group of closely affiliated functions. When Montana implemented ZBB, the agencies followed the system's theory and subdivided the programs into activity packages, creating a large number of entities with each requiring budget documentation. For example, the Youth Development Bureau, which formerly constituted one program in the line-item system, was divided into 10 activity packages under ZBB. The bureau's budget request under ZBB totaled 62 pages, compared with approximately 15 pages under line-item budgeting. In addition, because ZBB was only being used on an experimental basis, the bureau had to submit the standard line-item materials as

well. It was estimated that ZBB required four times as much paperwork as the traditional system.

Perhaps the most disheartening aspect of ZBB was legislative disinterest in the system even though it was legislative initiative which led to development of the system. A survey of the pilot agencies found only two respondents who felt the ZBB analysis was used to determine the agency appropriation.

An instrumental factor in the neglect of ZBB by legislative committees was the action of the Legislative Fiscal Analyst toward ZBB. When the Montana legislature convenes in session, it receives two different budget recommendations—the Executive Budget from the governor and an alternative budget from the Legislative Fiscal Analyst. The final appropriation is drawn by using recommendations from both budgets as well as determinations made by the legislature itself. When the Executive Budget presented ZBB to the 1977 legislature, the fiscal analyst followed with recommendations in the line-item format. For most legislators, ZBB was new and more complicated than the traditional system. As a consequence, legislators worked from the familiar line-item presentation and shunted ZBB to the background.

ZBB cannot be used productively by the state unless the legislature will work with it. In turn, it is unlikely the legislature will use ZBB unless its

**FIGURE II  
PRIORITY TABLE**

DEPARTMENT OF BUSINESS REGULATION													
RANK	SUBPROGRAM NAME AND LEVEL	1976 ACTUAL		1977 ESTIMATED		1978 REQUESTED			1979 REQUESTED				
		DOLLARS	FTE	DOLLARS	FTE	DOLLARS	FTE	CUMULATIVE '77	DOLLARS	FTE	CUMULATIVE '77		
1	Weights & measures (A)	180,817	11.00	209,937	11.00	173,387	4.00	173,387	16	175,284	4.20	175,284	17
2	Financial (A)	272,417	19.00	403,859	19.00	340,617	11.75	514,784	49	360,801	13.75	529,895	57
3	Contracted services (A)	107,743	6.00	128,520	7.00	176,316	5.00	619,100	59	107,838	5.00	647,722	62
4	Mail control (A)	157,938	8.75	166,009	8.75	125,601	6.75	754,701	72	140,085	6.75	787,788	75
5	Consumer protection (A)	113,000	7.00	139,244	7.00	105,167	4.80	856,866	87	107,588	4.80	895,396	90
6	Weights & measures (B)					58,842	3.00	918,710	88	62,370	3.00	957,886	91
7	Contracted Services (B)					26,329	2.00	945,039	90.7	26,959	2.00	984,845	93.8
8	Mail control (B)					26,614	2.00	980,653	92.6	26,011	2.00	1,019,866	97.2
9	Consumer protection (B)					27,980	2.00	1,018,643	97.2	29,421	2.00	1,068,077	101.1
10a	Financial (B) (Governor's Recommendation)					21,048	2.75	1,029,899	99.2	6,968	2.75	1,086,026	101.7
	Governor's Recommended Level					49.75	1,029,899	99.2		49.75	1,086,026	101.7	
10b	Financial - continued (B) (Agency Recommendation)					62,212	3.00	1,101,801	105	78,887	3.00	1,143,522	108
11	W & M/LPG & metric (C)					34,109	2.00	1,136,010	108	34,534	2.00	1,179,886	112
12	W & M/LPG & metric (D)					8,827		1,144,837	109	8,633		1,188,689	113
13	Financial (D)					68,705	3.00	1,213,242	116	70,756	3.00	1,257,444	120
14	Financial (E)					34,478	2.00	1,247,820	118	46,414	2.00	1,302,868	124
15	Contracted services (E)					34,010	2.00	1,281,830	122	34,790	2.00	1,337,808	128
16	Mail control (E)					40,988	2.00	1,322,818	126	40,814	2.00	1,378,522	132
17	Consumer protection (E)					28,987	2.00	1,358,496	130	27,280	2.00	1,415,801	136
18	W & M/LPG & metric (E)					24,300	1.00	1,383,796	132	19,026	1.00	1,433,917	137
19	Weights & measures (E)					82,077	3.00	1,465,872	140	81,214	3.00	1,515,221	145
	TOTALS	937,016	51.75	1,047,980	52.75	1,486,872	88.75	1,486,872	140	1,515,221	88.75	1,515,221	146

own staff is fully committed to implementation. The budget process is complex, and when the executive and legislative branches use different methods of analysis and presentation, the end product is confusion.

#### ZBB: THE FUTURE

In March 1979, at the request of the executive budget office, the legislature enacted House Bill 179 (Chapter 432, Montana Session Laws of 1979)—An Act to Repeal the Program Planning and Budgeting System. With that act, Montana concluded its experiment with ZBB.

ZBB did not prove to be an effective budgeting tool despite a reasonably conscientious implementation effort spanning four years and two legislative sessions. The functional problems of simply sorting through the massive amount of paperwork generated by the ZBB format and attempting to utilize the "performance measurement" requirement of H.B. 643 inhibited rather than stimulated budget analysis. Furthermore, ZBB could not be identified as either the sole or primary factor limiting the size of a program budget increase or causing an actual

budget reduction. Neither its presence nor use appeared to affect the final outcome of the budget appropriation process in one way or the other.

With the demise of ZBB, all Montana agency budgets will be developed using the standard line-item format. Despite the criticism of this approach, it is a system which is sufficient to ensure financial accountability and one which fits within the administrative decisionmaking reality of Montana state government.

#### Footnotes

1. Testimony before the Montana Senate Finance and Claims Committee, Helena, Montana, March 12, 1979.
2. Michael H. Granof and Dale A. Kinzel, "Zero Based Budgeting: Modest Proposal for Reform," *The Federal Accountant*, vol. 23, December 1974, p. 51.
3. See, *A Review of the Priority Budgeting System*, Office of Budget and Program Planning, Helena, Montana, 1980.
4. A zero-base budget does not normally start from zero. Some minimum level, usually on the order of 70 percent to 80 percent of the existing appropriation, is designated as the initial budget level for each activity package.
5. See, *An Evaluation of the Priority Budgeting System*, Office of Budget and Program Planning, Helena, Montana, 1979.