



Approaches to Establishing the Starting Point for the State Budget

by Talmadge Heflin, Visiting Research Fellow

A common misconception is that Texas' state budget—the General Appropriations Act (GAA)—is merely a document allocating funds to agencies so they may carry out their respective missions within state government. In today's budgeting climate, though, the GAA is a much more comprehensive document.

“The state budget process is central to the administration of state government. Budgets allocate resources, set policy, review and evaluate policy, and lay the foundation for future planning and program review.”¹ Critical to the path of the budgeting process is the beginning point for the state's budget. Determining the numbers around which budget discussions are initially based, in many respects, determines the fundamental basis for the policy document that is the budget.

When government budgeting is discussed it is common to hear terms like “Zero-Based,” “Program Based,” “Performance Based,” “Traditional/Incremental” and “Current Services” as descriptive terms for various approaches to establish a base to begin the detailed budgeting process.² These terms are used almost interchangeably as spending discussions move from systems or procedures to actual dollars. When looking at state budgets around the country, it becomes apparent that many states use a combination of these approaches.

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Budget Types

Zero-based budgeting: Building a budget from zero, forcing each line item of expenditure to be justified with each new budget. This method makes no assumptions about the necessity of services and scrutinizes expenditures closely for taxpayer value.

Current-services budgeting: Building a budget beginning with funds sufficient to guarantee levels of service are maintained. This approach begins with the assumption that all services are necessary and justified.

Program-based budgeting: Building a budget for the sake of programs. This approach is focused on maintaining government for its own sake.

Traditional/incremental budgeting: Building a budget by beginning with the previous budget and automatically increasing expenditures by a certain percentage. This also assumes all expenditures are justified and necessary.

Performance-based budgeting: Requiring agencies and programs to meet performance criteria. This is a necessary ingredient of zero-based budgeting or any approach to budgeting that seeks to require justification for the expenditure of taxpayer funds.

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Types of Budgeting Concepts

Zero-based Budgeting

Zero-based budgeting is intended to disregard current spending and agency operation levels as a basis for beginning discussions on the next budget. Instead, the idea is to conceptually build the budget from scratch, beginning at zero and building incrementally from that point. This process is intended to force policymakers to analyze and evaluate each budget item as it is considered for addition to the budget. Budget writers gain thorough knowledge of how and why every taxpayer dollar is spent. The downside is the tremendous time and effort required by agency administrators to construct a budget from zero, as well as the time commitment on the part of legislators to analyze numerous and sometimes complex details. On the other hand, it is more likely priorities will be determined, contrasting and ranking budget items in terms of importance.

The only place true zero-based budgeting is still used in its original form is the Northern Mariana Islands.³ However, during the late seventies and early eighties the zero-based concept was designated the official process in Texas although the commitment to true zero-based budgeting was not strong. In reality the starting point was a 10 percent increment below the previous budget level. The closest the state has come to true zero-based budgeting was during the 2003 session when the Legislature faced a \$10 billion shortfall. Then, all agencies were required to start their budgets at zero and increase from that point by using “building blocks” representing the core functions of their agencies, beginning with the most important ones.

Also in 2003, Governor Perry submitted a budget to the Legislature with zeros assigned to each agency’s appropriations, in support of a legislative process that would be more detailed than previous ones. Governors’ budgets in Texas have traditionally been “policy” documents rather than detailed proposals similar to the format of appropriations bills written by the Legislature. Most governors have chosen to discuss budget issues at a high level by recommending funding for major items or new initiatives, leaving the details of specific agency expenditures and programs to the Legislature. By contrast, the zero-based budget Governor Perry presented allowed for a fresh look at old spending habits.

Current Services Approach

The *current services approach* for determining the beginning GAA numbers was used in Texas for some years. The starting point in this approach is the amount of money to maintain current government activity. The presumption is that government will require more money just to keep doing what it has done in the past. In Texas, the process started with the most recent expenditure levels—which are not necessarily the same as numbers budgeted in the previous regular session⁴—and then extended them for two more years, adding funds to account for growth in population, inflation and other cost drivers such as agency employees’ salary increases and retirement benefits. It should come as no surprise that Texas’ budget realized significant growth from one biennium to the next under this approach. The presumption is that everything government is doing must continue to be funded, so there is no place to go but up in terms of spending.

Program-based Budgeting

A *program-based* budgeting philosophy is similar to the current services approach. It looks at programs and funds them for continuation at current levels, giving agencies flexibility in how they spend the money in order to continue the programs. Usually, agencies are expected to achieve a set of goals under each program. Inputs, rather than outcomes, however, are most often used to determine the necessity of spending.⁵

Three General Comments and Recommendations Regarding Zero-Based Budgeting

By Michael LaFaive, Director of Fiscal Policy, Mackinac Center for Public Policy

Zero-based budgeting can be useful for shaking up a process that may have grown stale and counter-productive over time. But I must offer three serious warnings.

First, the success of such a change like this hinges strongly on leadership that is dedicated to the task. If those appointed to conduct budget reviews are unwilling to truly assess every item in their budget, word will get out quickly that this new budgeting technique is more symbolism than substance. Indeed, it is incumbent upon proponents of zero-based budgeting to ensure that those reviewing the budget do not have a pecuniary interest in maintaining the status quo. Allowing people who will be most affected by the elimination of programs to conduct their own reviews may be counterproductive, since most people are quick to defend their own interests.

Second, don't attempt to do zero-based budgeting for every department, every year. Such a move may prove impossible to manage. Instead, choose several departments and/or agencies, and rotate

through every facet of state government over time. In Oklahoma, which has recently adopted zero-based budgeting, officials are applying the method to two departments and several agencies each year. Once those reviews are complete, the same departments and agencies will not see another zero-based review for eight years.

Third, ensure that each review is conducted by referencing all aspects of a department, agency or program to what its goals are. This makes the very purpose of the entity being reviewed transparent, and can increase the opportunities available for making objective measurements of a department, agency or program's success rate.

As with most programs or reforms of programs, it must be done right, or it should not be done at all. For example, department, agency or program directors who feel endangered by this kind of scrutiny will be delighted to be placed in charge, so that they can do it wrong, waste everyone's time, and give a cutting-edge management tool like zero-based budgeting a bad name, all at the same time.

¹Excerpted from Michael LaFaive, *The Pros and Cons of Zero-based Budgeting*, Mackinac Center for Public Policy, November 4, 2003, <http://www.mackinac.org/article.aspx?ID=5928>.

Traditional/Incremental Approach

The *traditional/incremental approach* to budgeting is used by many states. Even those that do not officially use this system practice it to some degree. It is manifested by having previous appropriations increased or decreased by small increments. Similarly to the program and current services approaches, underlying this approach is the expectation of continuing current programs, but especially funding previous commitments. This system ties up or commits large amounts of available resources, giving little latitude for real change.

Although Texas' budgeting system is not technically described as traditional/incremental, Texas has used a version of this approach for many budget cycles. Under this approach a major part of the state's previous budget is expected to be continued without any serious review when budget-writers meet. Adjustments in spending are generally expected to be upward, not downward. The end result looks a great deal like the current services approach. However, when the adjustments are made downward, as has been the case in Texas recently, the momentum toward increased spending can be significantly reduced.

Performance-based Budgeting

Performance-based budgeting is a basis for making budgeting decisions once a base is established. Most states have some performance criteria to monitor budgets at various points in the process. Measures related to outputs, outcomes and efficiencies are a part of what is used to monitor agency performance. In the truest sense, the performance-based budget should look at what is actually accomplished with resources committed. If there is not an equal or greater value delivered when compared to the costs involved, the function should be stopped. Unfortunately, far too often the *form* of performance budgeting is followed without the *substance*. So, instead of agencies and programs truly being held to account, more money is usually committed when targets are not met under the assumption that lack of sufficient amounts of money is the reason for missing the target.

True performance-based budgeting is uncomfortable for those in government. It is sometimes difficult to determine accurate short-term outcome measures since many of the activities of government take more than one budget cycle to complete or see the incremental impact of changes in funding. For example, there is an inherent bias against preventative expenditures because the outcome will not be realized until some time in the future. Politicians tend to focus on expenditures that will produce immediate results, meaningful or not. It is also difficult to assess the impact of budget decisions across agencies. Thus, most decisions are made on an individual agency basis rather than evaluating all agencies as a whole in order to prioritize. Finally, while it is generally easy to count the *quantity* of government services provided, it is extremely difficult to assess the *quality* of those services. As a result, too much focus is placed on quantity while quality is largely ignored.

Importance of Initial Budget Numbers

Why is it important to pay attention to the method of determining the starting point for writing a budget? The starting point sets the initial parameters and expectations in decision-making. The focus can either be on taxpayer value or it can be on government programs for their own sake. This can be illustrated by reviewing some additional aspects of Texas' budget-writing history.

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One of the ad hoc methods for determining a starting point for budget discussions in the past was to take the second year of the current budget and multiply that times two for the next biennium. This guarantees a relatively big budget, since the second year amount is almost always the highest of the two years. It continues the spending trends and programs that are in place, without regard to their effectiveness.

Another approach has been to take the actual amount expended in the first year of the most recent biennium, add the estimated or budgeted amount for the second year—which is not complete when the legislature meets—and then reduce this sum by the amount of one-time expenditures—usually capital expenditures. This produces a lower starting amount than the second year times two, but it still asks no critical questions.

When zero-based budgeting was the “official” method used to begin budget discussions in Texas, it was not used in the truest sense. Instead, it was closer to the program based budgeting concept. It simply required agency representatives and budget writers to have some justification for spending more than an arbitrary spending floor established by leadership for total state spending.

Is one method for selecting a starting point for budget discussions better than the others? Maybe not. If you have leadership that wants to continue services as they have been in the past with little or no disruption, even zero-based budgeting tends to only serve as a smoke screen, providing the impression

that taxpayer value matters. Similarly, if leadership wants to start new programs or services, one way to find the money to finance them is to start budget discussions with a low, seemingly conservative, overall number so more money will be available for the new programs.

An advantage of the two year budget is that it requires planning for a longer period of time, adding stability to government services.

Other Budgeting Considerations

Adding to the complexity of budgeting is the period of time the budget covers. State budgets are either annual (one year) or biennial (two years). Twenty states produce biennial budgets and thirty produce annual budgets. Of those that budget biennially, eleven adopt budgets for two separate fiscal years at once. The other nine adopt true biennial budgets—the method used in Texas.⁶ An obvious problem with a biennial budget, versus an annual budget, is that the further one goes out in time, the more critical is the accuracy of forecasting for such variables as population growth, inflation, and program caseloads. An advantage of the two year budget is that it requires planning for a longer period of time, adding stability to government services.

Virtually any method of budgeting is incomplete in its information requirements. For example, it is impossible to know actual expenditures for the current year while working on the budget for the next year. As the Texas Legislature begins deliberation on the budget for the 2008-2009 biennium in January of 2007, they will have ample information on actual 2006 expenditures and years prior to that, but only partial year expenditures for 2007. Many of those numbers will be estimated rather than actual expenditures. The legislature will have to rely on budgeted numbers for 2007, which will vary from actual expenditures by the time 2007 is complete. Fortunately, the Texas Legislature has a budget execution process that allows the Legislative Budget Board and the Gov-

ernor to make adjustments to appropriations for unforeseen demands during the interim until the next legislative session.

Conclusion

Can an effective budget be written regardless of where you start? In Texas, virtually any budget structure or process can be effective in controlling government growth because the Legislature has the authority to make any changes it chooses, although previous commitments such as bonded indebtedness are honored by the legislature in order to avoid the problems of going into default.

However, budgeting measures which require agencies, lawmakers and the public to examine the justifications for appropriations requests are critical institutional components in the effort ensure proper use of taxpayer funds. These include zero-based budgeting, performance measures that allow expenditures and programs to be critically examined, and incremental reductions in baseline appropriations requests. All of these put the focus where it belongs—on how the money is being and should be spent.

When members are willing to examine each expenditure and seek justification for every program, and when this process is open for public review, both taxpayers and those who benefit from government programs will be better off.

At the end of the day, taxpayer funds will be used wisely only if individual members of the legislature are willing to spend the time and effort to dig into details and seek sufficient justification for funding adjustments. When members are willing to examine each expenditure and seek justification for every program, and when this process is open for public re-

view, both taxpayers and those who benefit from government programs will be better off. This can be very time intensive in a 140-day session, but extremely worthwhile in bringing accountability for taxpayers.⁷

The starting point of a state budget doesn't guarantee where the end point will be. But it does provide substantial momentum that, combined with appropriate political and structural incentives, can go a long way toward ensuring the most efficient use of taxpayers' investment in state government.

However, the rapid increase in the 2005 Texas budget following the limited growth in 2003 shows that additional structural incentives are needed to help lawmakers consistently expend the effort necessary to critically examine the budget. One such structural incentive is a tax and expenditure limitation (TEL). A strong TEL limits the funds available to support different programs, making the examination and prioritization of expenditures a virtual necessity.

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Endnotes

¹National Conference of State Legislatures (NCSL), *Legislative Budget Procedures: A Guide to Appropriations and Budget Processes in States, Commonwealths and Territories*, Executive Summary.

²National Conference of State Legislatures (NCSL), *Predominant Budget Approach Legislative Budget Procedures: Appropriations Bills and Budget Documents*.

³National Conference of State Legislatures (NCSL), *Legislative Budget Procedures*, Executive Summary.

⁴Talmadge Heflin, *Overspending the Biennial Budget in Texas: Appropriation vs. Expenditure*, Texas Public Policy Foundation (Jan. 2006) <http://www.texaspolicy.com/pdf/2006-01-budgetreport1-TH.pdf>.

⁵National Conference of State Legislatures (NCSL), *Legislative Budget Procedures*, Executive Summary.

⁶National Conference of State Legislatures (NCSL), *Budget Cycle, Legislative Budget Procedures: Budget Framework*

⁷Don Green, Director of Budget and Policy, Office of the Speaker, Texas House of Representatives; for assistance with Texas budget history timelines and historical details.

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