

Zero-Based Regulation

By James Broughel

Zero-based budgeting is a technique that requires departmental managers to propose and justify their entire budget for the year. It is a planning system that assumes the starting point for each year is no budget, rather than the traditional method of using the previous year's budget as the baseline.

- A Dictionary of Human Resource Management¹

Introduction

A common way of imposing fiscal discipline in private companies, as well as in some governments, is a practice called zero-based budgeting (ZBB). The idea behind ZBB is simple: require that all expenditures be justified anew each period. There is no assumption that spending set at a particular level in a previous year means the same level of spending or more spending will be authorized the next period. Instead, a zero-base is the relevant baseline from which spending levels are set during the budgeting process.

This chapter discusses a counterpart to ZBB in the regulatory sphere, namely zero-based regulation (ZBR). The idea behind ZBR is that regulations must periodically be justified anew, just as spending authorizations are periodically reevaluated under ZBB. A ZBR system will have two central pillars: sunset provisions and regulatory impact analysis requirements. Sunset provisions are automatic expiration dates built into regulations. These trigger reevaluation of rules and ensure the default is that rules go away, i.e., return to zero. Regulatory impact analysis requirements, meanwhile, are a form of economic analysis, which can be used as a means to rank and prioritize regulations according to their effectiveness. Taken together, these reforms have the potential to reduce costs substantially while also improving regulatory efficiency.

This chapter is organized as follows. Section I explains zero-based budgeting. Section II describes how the logic of ZBB can be carried over into the realm of regulation. Section III provides a case study of Idaho, a state that is argued to have a ZBR regulatory approach. Section IV includes discussion of some of the challenges likely to arise with a ZBR system. The chapter concludes that governments, especially those struggling with constraining the accumulation of regulations over time, might want to adopt a ZBR approach as a means to streamline the regulatory state and improve regulatory effectiveness.

¹ Zero-based budgeting, definition. *A Dictionary of Human Resource Management* (3 ed.), Edmund Henry and Mike Noon (eds), (Oxford, UK: Oxford University Press, 2017).

I. Background on Zero-Based Budgeting

Zero-based budgeting is a budgeting process that was invented in the late 1960s by Peter Pyhrr, who at that time was a manager at the technology firm Texas Instruments.² The idea behind ZBB is simple enough: periodically managers should build the budget for their division from the ground up, as if starting from zero. With the traditional form of budgeting, sometimes referred to as *incremental budgeting*, budgets are set with the previous year's budget as a starting off point. Under that system, managers of a division simply request a certain percentage point increase, decrease, or no change from the previous year's budget.

A report from the consulting firm Deloitte defines zero-based budgeting as “a budgeting process that allocates funding based on program efficiency and necessity rather than budget history. Unlike incremental budgeting, no item is automatically included in the next budget.”³ The default changes from assuming programs should continue to exist to an assumption that they should go away unless there is a good reason to keep them. In this way, programs are routinely reevaluated for their effectiveness, and also routinely ended.

The National Conference of State Legislatures identifies three advantages to ZBB, which are 1) eliminating the assumption that current activities and funding will automatically continue with only minor (or incremental) changes, 2) encouraging the termination of ineffective programs, and 3) reallocating resources from lower priority programs or activities to those with higher importance.⁴

Another potential advantage is reducing gamesmanship and perverse incentives built into the budget process. There is often an incentive for managers to spend all of their budgets each year so as not to be punished with a smaller budget the following year. This has the potential to create considerable waste. It is a phenomenon well documented in the federal government,⁵ where spending surges are witnessed as the fiscal year reaches a close. However, the phenomenon exists in the private sector as well.

Perhaps ZBB's greatest strength is with respect to cost containment. The consulting firm McKinsey has stated that ZBB helps build a “culture of cost management” among employees.⁶ Therefore, it is not surprising that ZBB is often implemented in companies during “times of economic problems, when you need to make reductions, or when you have significant and rapid

² David Kesmodel, “Meet the Father of Zero-Based Budgeting,” *The Wall Street Journal* (March 26, 2015).

³ Deloitte, “Zero-Based Budgeting: Zero or Hero?” (2015).

⁴ Ronald Snell, “NCSL Fiscal Brief: Zero-base Budgeting in the States,” National Conference of State Legislatures (2012).

⁵ Jason Fichtner, “Curbing Wasteful Year-End Federal Government Spending: Reforming “Use It or Lose It” Rules”, Testimony before the Senate Committee on Homeland Security and Governmental Affairs (September 20, 2017).

⁶ Shaun Callaghan, Kyle Hawke, and Carey Mignerey, “Five myths (and realities) about zero-based Budgeting,” *McKinsey & Company* (2014).

technological change.”⁷ However, even when times are relatively good, it can make sense to emphasize a culture of cost minimization. Pressure from rivals can exert itself at any time, and a culture of cost-cutting is a good way to maintain competitiveness.

Zero-based budgeting also includes a rigorous evaluation process for projects. According to a 2012 textbook chapter, written by Phyr, ZBB evaluation includes five key elements,⁸ which are:

1. Identification of objectives
2. Evaluation of alternative means of accomplishing each activity
3. Evaluation of alternative funding levels (elimination, lower levels, current level, and increased levels)
4. Evaluation of workload and performance measures
5. Establishment of priorities

In one form of ZBB, projects are divided into “decision packages”, which are in turn subdivided into “decision units”. Each decision unit in a decision package needs to be analyzed, and overall decision packages are evaluated as a whole and ranked. Funding requests are then made based on this information.

Evaluation of decision packages will consider factors such as the purpose or objective of the decision package, the actions to be undertaken, the costs and benefits of the package, performance measures to evaluate success, alternatives means of achieving the same objectives, and how much benefit is achieved at various levels of cost.⁹

Henry Wray and Maurice McTigue argue that “evidence-based budgeting” is an integral part of ZBB.¹⁰ Without rigorous analysis of projects, the ranking and prioritization of projects that is at the core of ZBB is impossible. This does, however, create a tension within ZBB. ZBB is, in part, a cost reduction process. However, rigorous analysis can itself be time consuming and costly to produce. At what point does analysis itself fail to pass a cost-benefit analysis?

As a result of this tension, it is likely that a full-blown ZBB evaluation of each and every decision package may be something that takes place only periodically, perhaps once every few years. Moreover, it’s possible that not every package needs to be reviewed with the same level of analytical scrutiny. It might make sense to evaluate large projects that require the most resources with a higher degree of analytical rigor than smaller projects, for example.

While ZBB has been commonly employed in the private sector, it also has its proponents in the public sector, and indeed it gained prominence largely due its support by politicians. The most notable advocate of ZBB was former President Jimmy Carter. Carter first implemented a zero-

⁷ David Kesmodel, “Meet the Father of Zero-Based Budgeting,”

⁸ Peter Phyr, “Zero-based budgeting.” *Handbook of Budgeting*, Sixth Edition. ed. William R. Lalli (2012).

⁹ Phyr, “Zero-based budgeting.”

¹⁰ Henry Wray and Maurice McTigue, “A Process for Examining the Budget of an Agency within a Federal Department,” *Mercatus on Policy* (Arlington, VA: Mercatus Center at George Mason University, 2015).

based budgeting scheme when he was governor of Georgia in the mid-1970s. Indeed, Carter even tapped Peter Phyrre as a consultant as part of that effort. Then, in 1977 when Carter was president, he announced he would use the system in the federal government as well. By 1978, the Office of Management and Budget had even developed procedural guidelines for using the method in the federal budgeting process.¹¹

Although ZBB was subsequently abandoned by the Reagan administration, a number of states have experimented with ZBB in the years since that time. Beginning in 2012, Georgia has experimented with a revived form of ZBB,¹² with annual ZBB reports now issued by the state Office of Planning and Budget.¹³ Other states, including Florida, Oklahoma, New Hampshire and Idaho have utilized some version of the management tool. A 2012 report from the NCSL noted that 17 states have used zero-based budgeting in some form over the years, and others have seriously considered it, for example by introducing legislation.¹⁴ All told, ZBB has been used in numerous states as well as private sector companies all over the world.¹⁵ This suggests that the method is a well-accepted budgeting, management, and prioritization process, with adherents in both the private and public sectors.

II. Zero-Based Regulation

Henry Wray and Maurice McTigue are correct to point out that a necessary condition for a zero-based budget is also having an evidence-based budget. Indeed, without high-quality information about the effectiveness of projects, it will be difficult, if not impossible, to ascertain whether projects should be continued or not. This is true under incremental as well as zero-based budgeting approaches, and is why a fairly sophisticated system of program evaluation is usually recommended as a complement or component of ZBB.

Interestingly, program evaluation under ZBB mirrors many aspects of what is known as regulatory impact analysis (RIA). RIA is a tool used by regulatory economists to evaluate the effectiveness of regulations, and it usually consists of several subcomponents. These include, an assessment of the problem the regulator is intending to address,¹⁶ identification of different alternative ways of solving that problem, and an evaluation of the costs and benefits of those alternatives so as to identify the alternative that maximizes benefits over costs.¹⁷ The many

¹¹ Ronald Snell, "NCSL Fiscal Brief: Zero-base Budgeting in the States."

¹² Walter C. Jones, "First year of zero-based budgeting in Georgia impressed some, not others," *Rome News-Tribune* (March 17, 2012).

¹³ Governor's Office of Planning and Budget. "Zero-Based Budgeting". Available at <https://opb.georgia.gov/budget-information/budget-documents/zero-based-budgeting>. Accessed May 5, 2020.

¹⁴ Ronald Snell, "NCSL Fiscal Brief: Zero-base Budgeting in the States."

¹⁵ Deloitte, "Zero-based budgeting Global perspectives and lessons learned" 2018.

¹⁶ In economics jargon, this is known as the "market failure" the regulation is addressing.

¹⁷ For a more in-depth description of regulatory impact analysis, see John Morrall and James Broughel, "The Role of Regulatory Impact Analysis in Federal Rulemaking," *Mercatus Research* (Arlington, VA: Mercatus Center at George Mason University, 2014).

similarities between the key elements of project evaluation under ZBB described above in section I (identification of objectives; evaluation of alternative means of accomplishing each activity; establishment of priorities, etc.) and the key elements of a regulatory impact analysis are striking.

Regulatory impact analysis has been commonplace in the US federal government since the mid-1970s. Gerald Ford issued the first executive order requiring economic analysis for “major” regulations, which are regulations expected to have an annual impact of \$100 million or more.¹⁸ Ronald Reagan formally required cost-benefit analysis (not just economic analysis) for regulations through an executive order in 1981.¹⁹ The order institutionalized a review process for regulations and their accompanying analysis overseen by the Office of Information and Regulatory Affairs, a small office within the Office of Management and Budget. President Clinton later repealed Reagan’s executive order, but left its key elements in place through an executive order of his own.²⁰ Clinton’s order has governed the regulatory impact analysis and OIRA review process in the federal government since 1993.

The concept of a “regulatory budget” has also gain prominence in recent years, especially among academics and some politicians,²¹ although until recently it had never been tried in the federal government. The idea behind a regulatory budget is that a cap is placed on overall costs, such that regulatory agencies can only impose so much burden on the public and no more.²² No one would argue it would be sensible to allow regulatory agencies unfettered spending authority, which is why we have fiscal budgets set by elected representatives. However, such common sense has until recently eluded the domain of regulation, where agencies can in essence “spend” unlimited amounts of the public’s money by forcing them to comply with costly regulations.

President Trump instituted the first regulatory budget in the US federal government soon after taking office.²³ Since 2017, the Office of Management and Budget has allocated a set amount of cost to each executive branch department. Regulators are not supposed to exceed this amount of cost for the year, although in practice sometimes they do.²⁴ Although the durability of this reform remains unclear—it was implemented via an executive order and could easily be undone by a future administration—even if temporary, the creation of a US federal regulatory budget is

¹⁸ Exec. Order No. 11821, 3 C.F.R. 926 (1975); Exec. Order No. 11949, 3 C.F.R. 161 (1977).

¹⁹ Exec. Order No. 12991, 46 Fed. Reg. 13193 (February 17, 1981).

²⁰ Exec. Order No. 12866, 58 Fed. Reg. 190 (1993).

²¹ Senator Lloyd Bentsen, a democratic senator from Texas, introduced the first regulatory budget bill in Congress in 1978. See S. 3550, 95th Congress (1978).

²² For more information on a regulatory budget, see Christopher Demuth, “The Regulatory Budget,” *Regulation* March/April 1980; Jeffrey Rosen and Brian Callahan, “The Regulatory Budget Revisited,” *Administrative Law Review* (66:4): 835-860; and Jim Tozzi. 2020. “Office of Information and Regulatory Affairs: Past, Present, and Future.” *Journal of Benefit-Cost Analysis*, 11(1): 2-37.

²³ Exec. Order No. 13771, 82 Fed. Reg. 9339 (January 30, 2017).

²⁴ Mark Febrizio and Daniel Perez, “OIRA’s Regulatory Reform Report for Fiscal Year 2019,” *Commentary* (Washington, DC: George Washington University Regulatory Studies Center, December 2019).

historic and sets a powerful precedent. It is now much more likely that experiments of this sort will be repeated by future administrations.

However, to-date there has never been a *zero-based* budget for federal regulations. In fact, the budget Trump created is a classic example of an incremental budget. Cost allocations apply to new regulations only, as the stock of existing federal regulations—no matter how costly—is allowed to remain on the books without any kind of cap in place. To convert the Trump administration's regulatory budget in a ZBB, the budget would have to apply to the total stock of regulations under the control of an agency. Moreover, the regulatory impact analysis requirements at the federal level apply only to new regulations. They would need to be applied to existing regulations as well, to stay true to the spirit of ZBR.

Thus, ZBR can be thought of as having two key pillars: regulatory analysis requirements and a default that rules be eliminated unless they a strong case can be made for their continuation. Fortunately, the shortcomings with the Trump administration's regulatory budget can rather easily be overcome with the implementations of sunset provisions, which are automatic expiration dates built into laws. If a regulation has, for example, a ten-year sunset attached to it, that would mean that ten years after being finalized, the regulation would automatically expire. The regulation could be re-promulgated, but in order for that to happen, a new regulation would have to be written and make its way through the regulatory process as if the previous regulation had never existed. That new regulation would then be subject to cost-benefit analysis requirements. In this way, sunset provisions allow both for making the relevant default a zero-baseline, while also leveraging existing RIA requirements to impose strict analysis of rules and programs.

In the case of the US federal government, procedures have been put in place since the 1970s forcing new regulations to be scrutinized with regulatory impact analysis and to undergo quality control review by the Office of Information and Regulatory Affairs. Once regulations make it through this process, however, they are rarely scrutinized with the same degree of rigor ever again. One 2018 study found that 68 percent of federal regulations have never been updated.²⁵

Sunset provisions could change this. Their key advantage is they force a regulatory reset. Sunsets leverage the existing system for scrutinizing news and apply it to existing ones, which means there doesn't need to be an new review process for regulation piled on top of existing procedures for new regulations. The same set of procedures can apply to both new and existing regulations, so long as rules periodically expire. Regulations refiled as part of a sunset process will often be required to have a cost-benefit analysis. Logically, it makes sense to include in such a cost-benefit analysis an analysis of the effects of the pre-existing regulation. Mandating such a retrospective component to cost-benefit analysis would help ensure a meaningful evaluation of existing rules and programs.

²⁵ William D. Eggers and Mike Turley, "The Future of Regulation: Principles for Regulating Emerging Technologies," *Deloitte Insights*, June 19, 2018.

Instituting a comprehensive system of retrospective review for regulations is something that has eluded reformers for decades, but ZBR and sunsets could be the solution. Jimmy Carter issued an executive order in 1978 directing agencies to “periodically review their existing regulations to determine whether they are achieving” goals.²⁶ Barack Obama issued a similar executive order in 2011, encouraging agencies to identify and analyze “rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.”²⁷ Bill Clinton created the National Performance Review (later named the National Partnership for Reinventing Government) to create a government that “works better, costs less, and gets results that Americans care about.”²⁸ Finally, President Trump’s executive order 13771,²⁹ which established the first federal regulatory budget, could also be viewed as a retrospective review executive order because of its requirement that for every new regulation promulgated, two have to be eliminated.

Despite these efforts at retrospective review, the overall volume of federal regulation has continued to grow at a steady clip. While reducing the overall volume of regulation may not have always been an explicit goal of these reforms efforts, it is nonetheless telling that the level of regulation continues to grow even when programs aiming at reducing regulatory burdens are undertaken. In 1970, there were approximately 400,000 regulatory restrictions in the *US Code of Federal Regulations*, as measured by instances of the terms *shall*, *must*, *may not*, *prohibited*, and *required*. As shown in figure 1, despite numerous attempts at conducting periodic spring cleaning for regulations through retrospective review efforts, the number of regulatory restrictions has grown steadily over time and totaled approximately 1.1 million in 2020.³⁰

Figure 1: Regulatory Accumulation and Retrospective Review

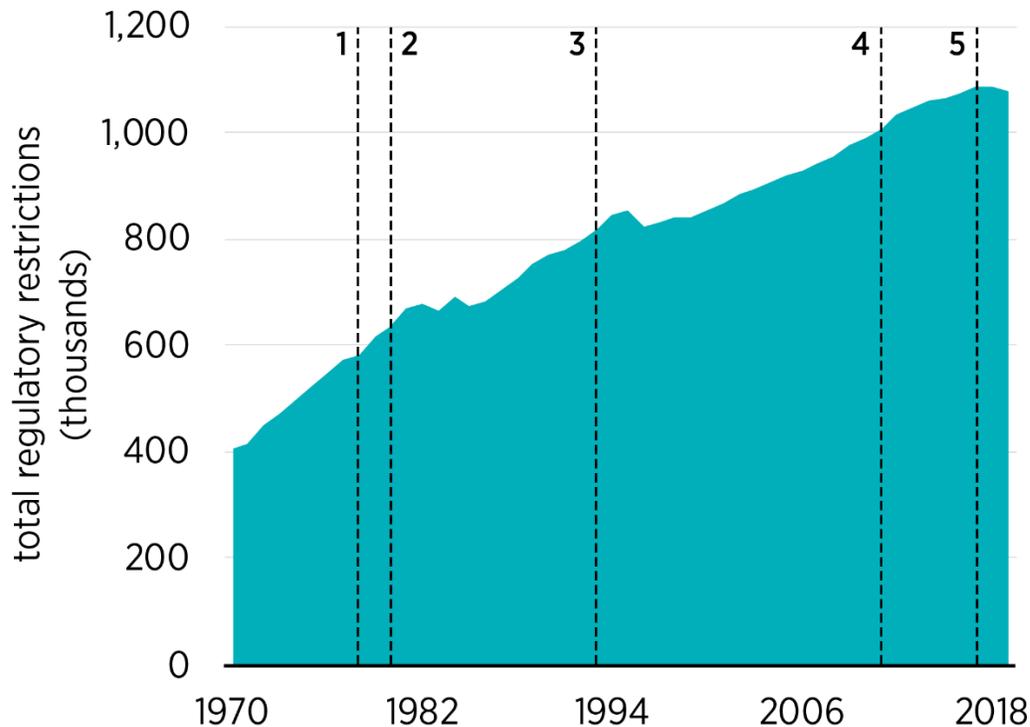
²⁶ Exec. Order No. 12044, 3 C.F.R. § 152 (1978).

²⁷ Exec. Order No. 13563, 76 Fed. Reg. 3821–23 (January 21, 2011).

²⁸ Patrick McLaughlin and Stephen Stosko, “What Can the 1990s Tell Us about Good Regulatory Policy in the 21st Century?,” *The Bridge*, September 4, 2018.

²⁹ Exec. Order No. 13771, 82 Fed. Reg. 9339 (January 30, 2017).

³⁰ RegData U.S. Regulation Tracker. “United States Federal Regulation Tracker.” Available at: <https://www.quantgov.org/federal-us-tracker>. Accessed May 7, 2020.



Source: James Broughel, “COVID-19 Reveals the Need for a Regulatory Reset” *Policy Brief: Special Edition* (Arlington, VA: Mercatus Center at George Mason University, 2020); and RegData US (dataset), Quantgov, Mercatus Center at George Mason University, accessed April 15, 2020, <https://quantgov.org>.

Note: Vertical lines reference the following events:

1. 1978: Jimmy Carter signs Executive Order 12044, “Improving Government Regulations.”
2. 1980: Regulatory Flexibility Act passes.
3. 1993: Bill Clinton creates the National Performance Review.
4. 2011: Barack Obama signs Executive Order 13563, “Improving Regulation and Regulatory Review.”
5. 2017: Donald Trump signs Executive Order 13771, “Reducing Regulation and Controlling Regulatory Costs.”

One reason these efforts have failed to rein in the growth of the regulatory state is that new rules continue to be written even as old ones are repealed, thereby offsetting some or most of the reductions.³¹ The lack of sunset provisions at the federal level may explain why rules are so rarely modified, let alone repealed. Another explanation is that the administrative procedures for creating regulations were, in part, set up to ensure regulations, once in place, would be hard to remove.³² This means there are structural impediments in place obstructing pragmatic periodic review of rules.

³¹ See, for example, the recent experience of Kentucky, which faced similar challenges. James Broughel, “Tracking the Progress of Kentucky’s Red Tape Reduction Initiative.” *Mercatus Policy Brief* (Arlington, VA: Mercatus Center at George Mason University, 2020).

³² McNollgast, *The Political Origins of the Administrative Procedure Act*, 15 J.L. ECON. & ORG. 180 (1999).

It need not be this way, however. Many states have sunset provisions, which, while far from perfect, help to constrain the overall level of regulation. Academic research has found that sunset provisions are associated with lower levels of regulation.³³ The average state has about 131,000 regulatory restrictions,³⁴ compared to more than a million in the federal rulebook. New Jersey has a sunset review process for regulations whereby seven years after rules are adopted they expire automatically unless re-adopted by the regulating agency.³⁵ Roughly 35 percent of regulations filed each year are re-adoptions, the vast majority of which are amended in some way from their original versions,³⁶ meaning they are likely being updated. North Carolina is a state that requires rules be reviewed every ten years.³⁷ Rules that aren't reviewed or that are deemed unnecessary expire according to a schedule set by a state Rules Review Commission, an executive branch agency that reviews and approves regulations adopted by state agencies.³⁸ Regulations deemed necessary as part of this review process are re-adopted as if they are new rules.

These anecdotes suggest that sunset provisions may be a reasonable way to force periodic reevaluation of rules. They may have an added benefit of holding regulatory creep at bay, at least relative to the alternative of having no sunset provisions. As of 2017, for example, North Carolina had approximately 109,000 regulatory restrictions in its administrative code,³⁹ almost exactly one tenth the volume of regulation as exists at the federal level.

III. Zero-Based Regulation in Practice: The Case of Idaho

Idaho's experiment with zero-based regulation began in an unlikely place, at the State Board of Pharmacy. The BoP, as it is known, oversees pharmacy regulations in the state of Idaho and is charged with protecting public health, safety and welfare.⁴⁰ Beginning in 2017, some rather aggressive reforms went on at the BoP, reforms that would eventually spread to other agencies across state government. The national media even began to take notice when, in 2019, the state allowed its entire regulatory code to expire for the first time in state history.⁴¹

³³ Russ Sobel and John Dove.2016. "Analyzing the Effectiveness of State Regulatory Review". *Public Finance Review* (44)4: 446-477.

³⁴ James Broughel and Patrick McLaughlin, "Ranking the States by Regulation," *National Review*, October 17, 2019.

³⁵ New Jersey Rev. Stat. § 52.14B.5.1.

³⁶ James Broughel, "Cutting Red Tape in the Garden State: New Jersey's Regulatory Reform Program under Governor Chris Christie" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2018).

³⁷ North Carolina Gen. Stat. § 150B-21.3A.

³⁸ North Carolina Office of Administrative Hearings, "Rules Review Commission," <https://www.oah.nc.gov/rules-division/rules-review-commission>.

³⁹ James Broughel and Daniel Francis. "A Snapshot of North Carolina Regulation in 2017." Mercatus Center at George Mason University, 2017.

⁴⁰ Idaho State Board of Pharmacy, "About Us", available at: <https://bop.idaho.gov/about-us/>. Accessed May 14, 2020.

⁴¹ See Kevin Williamson, "Idaho's Deregulatory Revolution," *National Review*, May 19, 2019; Wall Street Journal, "Idaho Quits Worrying About Snails," June 28, 2019; Keith Ridler, "Idaho governor has unfettered chance to cut state rules" Associated Press, April 17, 2019; James Broughel and Krista Chavez, "Idaho is the Least Regulated State and a Model for the Rest of the Country," *The Bridge*, January 2, 2020.

The state Board of Pharmacy began its experimental regulatory reform by measuring the amount of pharmacy regulations the state had. On July 1 of 2017, Idaho statutes and regulations relevant to the practice of pharmacy in the state were collected. They were then analyzed using text analysis technology, and the results of the analysis were eventually published in an academic journal article by the then-executive director of the Board of Pharmacy, Alex Adams.⁴² The analysis found that, in 2017, there were 37,882 words in regulations relating to the practice of pharmacy in Idaho. This was up from 26,698 in 1996, constituting an increase of 42 percent. Like so many other jurisdictions, regulatory creep was occurring at the BoP as well. In fact, by this measure the practice of pharmacy was more regulated in Idaho than either nursing or medicine at that time. About 16 percent of Idaho's pharmacy regulations related to occupational licensing, 44 percent related to professional practice standards, 19 percent to facility standards, and the remaining portion to board governance and general provisions.⁴³ Moreover, Idaho had another 20,003 words dedicated to the practice of pharmacy in statute.⁴⁴

Using these numbers as a baseline, Adams and his team at the Board of Pharmacy implemented a "repeal and replace" strategy. In early 2018, the board of pharmacy received approval from the legislature for a full repeal of all Board of Pharmacy rules.⁴⁵ The old code was subsequently replaced with a new and more streamlined set of rules. Not all regulations were repealed, of course. Many stayed in place in largely the same form. However, by repealing the agency's code in its entirety the agency was able to start from scratch, picking and choosing those rules that made sense to maintain, while also respecting statutory obligations, and at times rewriting rules to improve readability and clarity.

The end result was a much more streamlined, and easy-to-follow set of guidelines and requirements for state pharmacies. All told, the board oversaw a 55% reduction in word count and a 62% decrease in regulatory restrictions; additionally six categories of licensure were eliminated.⁴⁶ The significant reduction in the number of words in Idaho's pharmacy rules is illustrated in figure 2.

Figure 2: Word Count of Idaho Board of Pharmacy Regulations

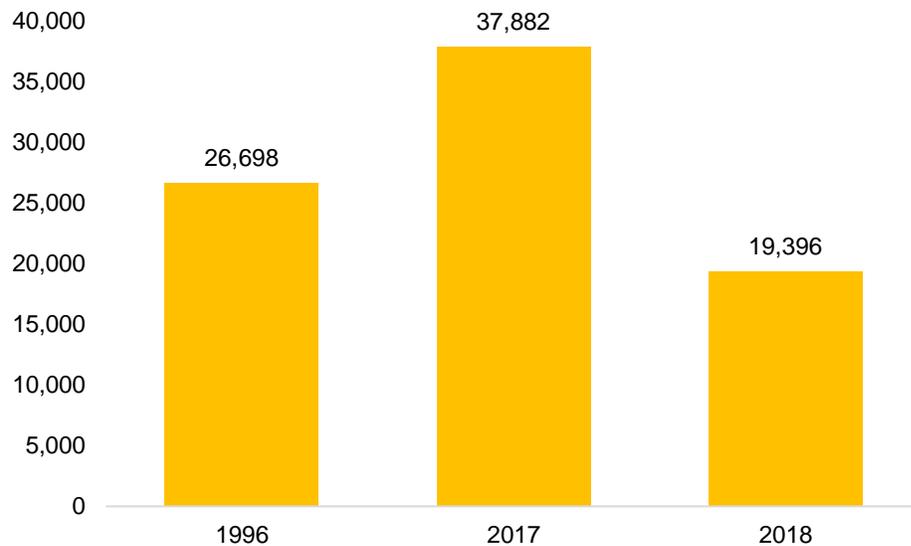
⁴² Alex Adams. 2019. "Transitioning pharmacy to "standard of care" regulation: Analyzing how pharmacy regulates relative to medicine and nursing." *Research in Social and Administrative Pharmacy*.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Idaho State Board of Pharmacy, News, March 2018.

⁴⁶ Idaho State Board of Pharmacy, News, March 2018.



Source: Author's calculations. Based on Adams (2019); Idaho State Board of Pharmacy (2018); and personal communication with DFM Administrator Alex Adams on May 31, 2020.

The reforms at Idaho's Board of Pharmacy would have been impressive in their own right, but the approach taken at the BoP would soon be emulated across the entire state and, tellingly, the reforms would again take place under the leadership of Alex Adams. By 2019, Adams had moved on from his role as executive director of the Board of Pharmacy to become administrator of the state Division of Financial Management (DFM), tapped for the position by a new governor, Brad Little.

The DFM in Idaho is the equivalent of the state budget office, akin to the Office of Management and Budget in the federal government, including in its oversight role of the regulatory process. Idaho kicked off another round of reforms in early 2019 soon after Governor Little took office, with the signing of an executive order dubbed the "Red Tape Reduction Act."⁴⁷ The executive order required that two regulations be identified for elimination each time a new regulations was added. The order also designated new Rules Review Officers to lead red tape reduction efforts within agencies and to work in coordination with the director of the DFM.

Idaho's reforms began simply enough and were not so different from other red tape reduction efforts that were going on at the federal level or in other states around that time.⁴⁸ However this all changed in April of 2019. Idaho is a unique state in that each year all of its regulations on the books sunset, unless reauthorized for an additional year by an act of the legislature.⁴⁹ Usually reauthorization occurs without a hitch—after all, who wants to let the entire state regulatory

⁴⁷ Governor Brad Little, Exec. Order 2019-02 "Red Tape Reduction Act," (Jan. 21, 2019).

⁴⁸ For more on contemporary regulatory reform efforts, see James Broughel, "The Mighty Waves of Regulatory Reform: Regulatory Budgets and the Future of Cost-Benefit Analysis," *The Business, Entrepreneurship & Tax Law Review* (3)2: 1-18.

⁴⁹ Idaho isn't totally unique in this regard. Utah has a similar law. See UTAH CODE ANN. § 63G-3-502(2).

code expires?—but in 2019, due to infighting going between the different legislative chambers, the legislature left town, ending its session without having passed a reauthorization bill.⁵⁰

This unexpected turn of events created an unprecedented opportunity to institute reforms similar to those that went on at the state board of pharmacy, except in this case on a much larger scale. By failing to reauthorize the code, the state legislature had, in essence, started regulations in Idaho from a zero-base. Like when the Board of Pharmacy repealed its entire rulebook earlier, this did not mean that all regulations went away. Rather, it meant there was an opportunity to remove unnecessary clutter that had accumulated over past decades, and to rewrite those rules that needed to be maintained in simpler, clearer language, all while removing unnecessary burdens wherever they could be identified.

And this is precisely what Governor Little, and his staff led by Adams, did. All told, 19 percent of rule chapters, 10 percent of pages, and 19,000 regulatory restrictions were allowed to expire on July 1 of 2019.⁵¹ Remaining rules were extended through the issuance of emergency regulations promulgated by the executive branch. The governor's office later claimed that in 2019 it cut or simplified 75 percent of all rules and eliminated 250 rule chapters, 1,804 pages of regulations, and close to 31,000 regulatory restrictions.⁵² As a result of these reforms, Idaho claimed to be the least regulated state in the nation.⁵³

In fact, the process was viewed as so successful that Governor Little quickly moved to institutionalize the 2019 reforms to make them a part of regular governance in Idaho. In early 2020, Little signed another regulatory reform executive order, this one aptly named “Zero-based Regulation,”⁵⁴ which set up a process whereby on a five-year revolving basis agencies would have to review their rules. The review process would begin by agencies formally issuing a rulemaking repealing their existing chapter from the administrative code. The repeal rule would then be followed by issuance of another rulemaking, a replacement rule, which, if necessary, re-implemented the relevant chapter, hopefully with improvements. Moreover, new economic analysis requirements were put in place to ensure a retrospective analysis would be undertaken when regulations were re-proposed.⁵⁵

While some of Idaho's rule changes could perhaps be classified as cutting low hanging fruit,⁵⁶ the experience was nonetheless a dramatic contrast to the federal experience. Whereas year

⁵⁰ James Broughel, “Idaho Repeals its Regulatory Code,” *The Bridge*, May 9, 2019.

⁵¹ Cynthia Sewell (@CynthiaSewell), “Idaho @GovernorLittle announces more regulatory cuts on the horizon in Idaho. Goal: 55%-60% may be cut by end of year. #IDpol #IDleg,” Twitter, July 19, 2019, 1:35 p.m., <https://twitter.com/CynthiaSewell/status/1152270706714894336>.

⁵² Idaho Exec. Order 2020-01 “Zero-based Regulation” (2020).

⁵³ James Broughel and Krista Chavez, “Idaho Is the Least Regulated State and a Model for the Rest of the Country,” *The Bridge*, January 2, 2020.

⁵⁴ Idaho Exec. Order 2020-01 (2020).

⁵⁵ *Ibid.*

⁵⁶ For example, regulations governing a lottery game show that came to exist in the state or related to restrictions on out of state plant-eating snails that could be considered an invasive species, were lifted. See Wall Street Journal, “Idaho Quits Worrying About Snails,” June 28, 2019.

after year the federal code seems to only grow more complex and unwieldy, Idaho appears to have cut about a third of its regulatory restrictions. The Idaho experience also demonstrates how small pilot programs, like that at the state Board of Pharmacy, can inform much more ambitious reforms later on, moving the state towards a simpler, more concise code and by extension a more business friendly regulatory environment.

IV. Responding to Concerns about Zero-Based Regulation

There are several reasons why a system of zero-based regulation might not work in practice as well as its proponents hope, and many of these concerns mirror concerns sometimes raised about zero-based budgeting. One concern relates to cost, that is, ZBR is likely to require significant time and effort from regulators, as well financial resources; it may simply not be worth it to implement it. This may be especially likely if most of the cost savings have already been squeezed out of the system. The somewhat mixed track record of ZBB in the states may also support this conclusion. A few states have abandoned using the tool over the years, in part because of the amount of work needed to produce detailed reports about project initiatives.

There are several reason why this concern may be overstated, however. First, the costs of regulation are almost certainly significant. One recent study estimated that the costs of federal regulations could be about \$4 trillion annually.⁵⁷ Another estimated as high as \$39 trillion.⁵⁸ These estimates suggests that we are nowhere near an efficient level of regulation; there are plenty of savings to be found.

Also, as stated earlier, different regulatory programs almost certainly deserve different levels of scrutiny depending on their size and scope. In the federal government, only “significant” executive branch regulations are required to have a cost-benefit analysis and undergo review by the Office of Information and Regulatory Affairs.⁵⁹ Significant regulations only constitute about 8 percent of federal regulations,⁶⁰ meaning the vast majority of regulations issued by federal agencies do not receive this level of scrutiny. This is not to say that 8 percent is the right number. That numbers seems quite low, but a tiered system where smaller, less-costly projects or programs have a lower bar to pass to be maintained than larger ones makes a lot of sense. Indeed, the federal regulatory system is set up just this way.

For similar reasons, it probably does not make sense to sunset the entire regulatory code each year. Idaho’s annual sunset clause acts more like a form of legislative review than a sunset clause. Indeed, the sunset clause has only been exercised once. States that impose sunset

⁵⁷ Bentley Coffey, Patrick A. McLaughlin and Pietro Peretto. “The Cumulative Cost of Regulations,” *Review of Economic Dynamics*, forthcoming 2020.

⁵⁸ John W. Dawson and John J. Seater, “Federal Regulation and Aggregate Economic Growth,” *Journal of Economic Growth* 18, no. 2 (2013): 137–77.

⁵⁹ See Section 3(f) of Exec. Order No. 12866, Regulatory Planning and Review, 58 Fed. Reg. 51735 (October 4, 1993).

⁶⁰ James Broughel and Laura Jones. “Effective Regulatory Reform: What the United States Can Learn from British Columbia.” *Mercatus Research* (Arlington, VA: Mercatus Center at George Mason University, 2018).

clauses for individual regulations usually have longer sunset periods, in the range of seven to ten years, and they operate on a staggered basis with some regulations expiring in some years, and others expiring in other years. Even Idaho's review policy under its 2020 Zero-Based Regulation executive order is about five years, implying roughly 20 percent of the code is reviewed in a year. Setting up a staggered time schedule for rule expirations can help avoid the problem of overwhelming the system by having to refile all regulations at once.⁶¹

It's possible that zero-based budgets have not endured at the state level due to their primarily being executive led efforts, meaning they were instituted by the governor or a secretary of state through an executive action, rather than through legislation. Legislation is likely to prove more enduring than executive action, since it cannot be undone as easily by a subsequent administration. However, legislation is also harder to build widespread support for. This suggests ZBB may still be somewhat controversial, but doesn't necessarily imply unworkability.

Another potential issue that may arise under a ZBR system may be that managers may feel threatened when their activities are closely scrutinized. This is probably unavoidable to some extent, but also may be desirable. When managers are held accountable for their actions, both for successes as well as for failures, there is likely to be a beneficial feedback loop that produces better results and better performance.

ZBR may also require specialized personnel to implement it. For example, it may be necessary to hire economists or other experts since without high quality analysis, ZBR may not work. This isn't necessarily a criticism as much as an acknowledgement of reality, akin to the saying in business that "it takes money to make money." Unless ZBR is adequately funded, it is unlikely to work.

Importantly, there are also costs to not having a ZBR system in place. A system where no regulations are ever periodically reviewed may not cost the government much money on its books, but it could cost society a considerable amount. Furthermore, experience suggests that implementation costs could be modest. At the federal level, OIRA's budget is quite small. It employed approximately fifty-two employees in 2020 and had a budget of around \$11 million.⁶² This is a drop in the bucket compared to regulatory agencies more generally, whose annual budgets are closer to \$75 billion.⁶³ States are likely to require even fewer resources than OIRA, since the scope of their activities tends to be narrower than that of the federal government.

A final concern about ZBR is it might run into conflicts with the law. If, for example, regulatory agencies' guiding statutes prohibit cost-benefit balancing in setting regulatory standards or

⁶¹ It is worth noting, however, that Rhode Island was able to sunset its entire code in 2018, and did not seem to overload its regulatory system. This may also have been due to responsible coordination across agencies by the state's budget, which oversaw the sunset.

⁶² Mark Febrizio, Melinda Warren, and Susan Dudley. "Regulators' Budget: Homeland Security Remains Key Administration Priority: An Analysis of the U.S. Budget for Fiscal Years 1960 to 2020." George Washington University Regulatory Studies Center and the Weidenbaum Center on the Economy, Government, and Public Policy at Washington University in St. Louis. October 2019.

⁶³ Ibid.

prohibit sunseting a regulation, then ZBR might be illegal. However, even this concern is overstated. A regulation that is required by law can still be sunset, so long as it is replaced with another rule that maintains compliance with the law. Agencies simply need to be careful to ensure there are no time lapses between when old rules expire and new ones take their place. Even when rules are required by law, there is value in periodically revisiting them, and just because regulators can't allow cost-benefit balancing to inform their decisions in some instances, this does not mean they can't produce a regulatory impact analysis. RIAs are broader than just a cost-benefit analysis; the process of putting one together forces regulators to bring together all the relevant information that could be useful in a decision. That's just good governance, even in cases when some information in a cost-benefit analysis is left out of the final decision making calculus.

Although most of the concerns about ZBR are likely to be overstated, nonetheless ZBR may work best in environments where substantial savings are likely to be found in the regulatory system, and legal frameworks are flexible enough to allow for cost-benefit analysis and other analytical tools to guide policy priorities. Fortunately, this is likely to be the true in the vast majority of cases.

Conclusion

Despite a fairly rigorous system of checks and balances being established for new federal regulations, including requirements for cost-benefit analysis and review by the Office of Information and Regulatory Affairs, a comparable system of review for existing regulations is sorely lacking. This need not be the case, however, as states like Idaho have systems that, while far from perfect, at least demonstrate that a better way is possible. By combining sunset provisions, budgeting systems for regulations, and economic analysis requirements, Idaho has shown what zero-based regulation looks like in practice. Such a system has the potential to be evidence-based and responsive to evolving circumstances on the ground.

Any governments interested in advancing efficient, low cost, regulations should consider implementing ZBR. ZBR does not assume that regulations, once on the books, should exist forever. Rather, it forces a periodic reset and reevaluation of priorities. This may create discomfort for those who benefit from the inertia of the current system and it may create some additional costs to the government. However, the costs of implementing a ZBR program are likely to be relatively modest compared to the costs of the regulatory system as a whole. Those who care about fiscal accountability and results therefore think favorably upon zero-based regulation, just as many already think favorably of its close cousin, zero-based budgeting.