Chapter 4

Public Budgeting

MPA Comprehensive Exam
Study Guide

4.1 Major authors in Public Budgeting and their Theories

Kelly suggests budget theory runs parallel to political theory. Budgeting is an open system capable of changing to reflect public opinion; the budget is primarily an instrument of control, either facilitating or limiting government intervention into public and private affairs.

Willoughby on Budgeting says used as a central controlling feature of system of financial administration. Budget as instrument of: democracy, correlate legislative and executive action, secure administrative efficiency and economy, feature of municipal reform.

Budgeting was a reform introduced during the Progressive Era (1890-1920) in response to corruption, bossism, plutocracy, and declining morality. American labor movement grew and industrialized and scientific management practices emerged (Gulick/Urwick POSDCORB) suggesting best management practices.

President Taft - In 1909, President Taft (1909-1913; Sec. of War, 1904-1908) asked for $100,000 to study the methods of appropriation and expenditure. The commission concluded that one of the problems was "an inadequate provision of the methods of getting before Congress a definite budget." In 1912, President Taft sent the commission's report. He construed the constitutional privileges pertaining to receipts and expenditures and the state of the union as authorizing a definite, well-considered budget.

1913 Amendment to Constitution: Federal income tax. Idea was to create an executive budget where central figure would look at it. Great immigration population moving to larger cities — needed control by executive.

National Municipal League (NML) called for uniform municipal bookkeeping, which facilitated statistical analyses.

New York Bureau of Research (NYB) was a corps of municipal experts with specialized skills and a new ethic of social morality. NYB argued that improvement would be possible with introduction of efficient business and accounting practices. New York was first state to write budget idea into its constitution.

Before 1912, a variety of techniques were recommended for centralizing and locating responsibility for the budget (Congress, executive, comptroller, or board). After 1912, many reform proposals called for budget proposals from the chief executive.

Before 1912, many of the reformers wanted to take money saved by increased efficiency and spend it on social programs and capital projects. After 1912, the focus was on saving money to reduce the scope of government services and tax burden.

In the Taft Administration, emphasis was changed from obtaining public input into the budget plan to requiring detailed reports from responsible administrators on what they had already done.

NYB was founded by William Allen, Henry Bruere, and Frederick Cleveland and was funded by donations from businessmen.

The Ideological Differences

Progressives	Conservatives
Expansionary, activist government	Smaller government
Cost Effectiveness	Efficiency and cost cutting
Trusted the public and its representatives	No trust in the public and its representatives
Proposals had some influence, but have fallen out of favor	Proposals had a major influence on the 1921 Budget and Accounting Act
Egalitarianism; No representative had the right to defeat the will of the people. All men are basically equal.	Government by elites who would ignore popular demand and exercise their own judgment.
Government by the people through the initiative, the referendum, and the recall of judicial decisions.	Suspicion of legislative bodies that would give in to public sentiment.

Three Budget Reform Movements

1. Municipal Reform Movement (1870s): NML (municipalities instituting budget idea).

2. Research Bureau Movement (1906): NYB introduce good business practices.

3. Budget Reforms (1914-1920): Taft Commission on economy and efficiency.

The Budget Reformers

- **Frank Goodnow**
  - An early progressive who became a conservative.
  - In 1913, he wrote about the delegation of budgetary discretion from the legislature to the executive, advocating that the legislature maintain some control in case the executive did not manage efficiently.
  - In 1916, as chairman of the Maryland Economy and Efficiency Commission, he strongly endorsed the executive being responsible for preparing and submitting a budget subject to limited legislative budgetary power.
- **Frederick Cleveland**
  - Also a progressive who became a conservative.
  - Argued that the public should be involved in all decisions concerning an increase or decrease in taxation.
  - In 1912, before the release of the Taft Commission report, was not advocating a strong executive. His solution was to educate the public and provide administrators with the information they need to govern efficiently.
  - In 1913, recognized the need for the chief executive to review agency requests and present budget proposals to the legislature because the executive is the one responsible for implementing policy. The legislature gets a yes-or-no vote on the proposal.

Changes in the Content of Reform Proposals

In 1921, the Budget and Accounting Act established the Bureau of the Budget (BOB) and General Accounting Office (GAO). Rational budget reforms with focus on management was influence by the Brownlow Committee of 1937 with BOB transferred to office of President. Brownlow Report references performance budgeting, included expansion of government action in linking inputs to outputs. It recommended changes to address administrative management.

The Management Movement (1946-1958)

Post WWII economic boom, high confidence to conquer problems scientifically lead to prosperity. Hoover Commission (1949) suggested more data in the budget process which involved performance budgeting.

TYPES OF BUDGET REFORMS

Management by Objectives (MBO) placed less emphasis on long-range planning and program evaluation. It respected the jurisdictional lines. It encouraged a more participative approach with line managers involved in the setting of agency objectives. MBO consisted of three-part cycle:

1. managers and subordinates agree on measureable, results-oriented objectives;
2. milestones to be achieved to reach the objectives were established;
3. results were evaluated via a year-end report to department head. MBO failed to establish itself as an activity essential to budgeting.

Zero-based Budgeting (ZBB): The process was result of experiments at the private, state and local governments. President Carter brought the idea from Georgia when he was governor. Carter felt the federal budget process was inefficient, chaotic, and uncontrollable. ZBB would help to reduce costs and make the federal government more efficient and effective by:

1. improving quality of budgetary information,
2. involving line managers in the decision process, and
3. emphasizing the kind of analysis that would yield better understanding on cost-effectiveness of programs.

ZBB used four-step process:

1. organizational objectives were determined and decision units defined;
2. each decision unit was analyzed within framework of decision package;
3. prioritizing—ranking of decision packages; and

4. organization’s budget was formulated based on funding needs.

Problem with ZBB was the little evidence of its effect on outcomes. It had little impact on budgeting in Georgia. It did not take into consideration past history. Although ZBB went out with Carter, the Reagan administration tried zero-based for several programs (i.e. Amtrack and Appalachian Regional Commission) but Carter restored the funds.

These reforms were unsuccessful due to inconsistencies with political nature of budget process and workload and paperwork requirements that were overwhelming.

Management Reforms

Gramm-Rudman-Hollings (GRH) of 1985 because of large federal deficit, set ceiling for deficit. Cannot create programs without identified revenues to support them. Gov’t is not the solution – it’s the problem. Reduce it and you reduce problem. Reagan supply side economics – lower taxes stimulate economic growth and induce investment, create jobs, deficits would shrink due to increased supply of money. Cut back budgeting, backward budgeting (aka revenue budgeting). Clinton spurred on by Reinventing Government (Osborne and Gaebler) – National Performance Review (NPR) and Government Performance and Results Act (GPRA), GAO – General Accounting Office all focus on performance-based budgeting. Congressional Budget and Impoundment Act of 1974 reasserted congressional influence over the budget.

GPRA emphasis was on outcomes. Federal agencies were to set goals, measure performance against them and report on the progress within framework of long-term and annual performance plans. The Government Performance Results Act (GPRA) of 1993 was a product of the National Performance Review directed by Vice President Al Gore. It called for agency strategic planning, performance measures, focus on customer involvement and measure outcomes of government actions. Its connection to CFO Act is that in the future, budget numbers will accurately relate to audited statements of government assets and liabilities.

The ability to implement performance measurement requirements of GPRA is expensive to perform properly. Agencies that participated in the pilot process demonstrated the effectiveness of GPRA. Strategic and performance planning enabled review and reformulation of agency missions, achieved greater clarity of objectives and resulted in a better understanding of relationships between mission and outcomes.

4.2 Budgeting Theory

Irene Rubin - suggests the idea of budgeting did not begin with private agencies but with public agencies and academia. Innovation in cities spurred by NML and NYB, which were comprised of practitioners and academics, included the adoption of budget systems and accounting practices that were not drawn from business but were invented for the cities (e.g. Chicago and Minneapolis). Rubin's Real-Time Budgeting: requires flexibility in decision-making because of environmental changes, variables and actors. Budgeting is non-linear and non-sequential. Time is a constraint, deadlines, timing.

Budget theory should be able to answer questions about why particular practices should be adopted, the importance of particular tasks, and the location of particular tasks in a larger process.

Budgeting does not currently have a theory in this sense.

Writers on budgeting do not agree on common assumptions or recommendations.

There is no widely accepted set of linked hypotheses concerning cause and effect in budgeting.

Budget theory today is fragmented and incomplete.

Budget theory is in the process of being invented.

Factors Inhibiting Theory Development

In his renowned 1940 article, V.O. Key Jr. lamented about "the lack of budget theory." Twelve years later (1952) Verne B. Lewis attempted to construct a normative budget theory. More recently in one of her numerous writings, Irene Rubin noted that "budget theory today is fragmented and incomplete…It is in the process of being invented." Why is budget theory still viewed as incomplete and fragmented?

- There is no consensus as to what budgeting actually is, whether it is a political, economic or social process.
- There is no agreement on the scope of a budget theory.

- There is no agreement on the dominant methods or techniques of budgeting.
- There is no agreement about the approach a budget theory should take.
- There is no agreement about the status of theory itself.

Wildavsky notes that budgeting must provide continuity for planning, flexibility to respond to crises, rigidity to control spending, and openness for accountability.

Process: There is no agreement on the "type" of process budgeting is. The literature often speaks about a "political process" or an "economic process". However, Schick and Seligman (1926) have noted that budgeting encompasses so much that it has become a "social process".

Scope of Theory: budget debate centers on the scope of theory and the number of actors to be included in the theory.

V.O. Key question: On what basis shall it be decided to allocate X dollars to Activity A instead of Activity B?

Suggestions offered by Key:

A careful and comprehensive analysis of the budgetary process is needed, involving answers to the following questions:

- What forces go into the making of state budgets?
- What factors govern decisions of budgetary officials?
- Precisely what is the role of the legislature?
- Studies should be performed on congressional appropriating processes.
- Personnel in budgetary agencies should not rely solely on persons trained primarily in accounting and fiscal procedure.
- New training schemes are needed for those in budgetary roles.

Traditional Budget Theory

Public budgeting has been viewed from 3 perspectives: economics, management and political science.

Resource allocation processes serve to create and continuously recreate the public organization.

Normative Theory

The problems of developing normative in a political environment are compounded in budgeting where outcomes are direct precipitants of the clash of political values.

The organization-based approach to budget theory allows normative theorists to focus on the organizational role of the finance official and distinctive competencies of the profession.

The formal budget process should be open to political participation and the underrepresented must be represented by the organization.

Descriptive Theory

Research should focus on the determinants of the elements of the budget process, as well as the determinants of budgetary outcomes favored by political science and the normative standards for the mix of outcomes targeted by economics.

Incrementalism Theory: Dominant budgeting method.

Rubin, LeLoup, Bozeman, Straussman and others cast aside incrementalism as a theoretical construct. Rubin and Schick believe that as an explanatory model, it did not describe the process well, noting that a budgetary base is not always defined.

- Argues that budgeting occurs virtually exclusively inside government.
- Based on the theory of bounded rationality.
- Government is not directly controlled or controllable by society.
- Interest groups exist, but do not determine outcomes.
- Little public involvement in budgeting.
- **Weaknesses of incrementalism:**
    - Incrementalists underestimate the relationship between the society and budgeting, and overestimate the autonomy of agencies in determining budgets.

- Did not envision the budget process as responding to societal problems, emerging situations, or environmental changes.
- Assumed that budgets will continue to be allocated the same way from year to year.

Public Choice Theory:

The shared assumption is that human behavior is based on individual economic rationality and the maximization of individual benefits, or what economists call utility.

Public choice theorists emphasize the very important issue of the relationship between what the citizen taxpayers want government to do and spend and what it actually does and spends.

They assume individuals behave in a rational and utilitarian manner, reveal preferences in a marketplace fashion (exchange of votes). The voting mechanism then provides a chance for citizens to choose among candidates that best reflect their own spending priorities.

- Rooted in political economy of old.
- Pareto—if one person better off from a policy and no one is worse off, then community as a whole is better off.
- PCT points to greedy bureaucrats and assume conflict, not cooperation.
- **Weaknesses of public choice theory:**
  - Theory tends to be deterministic and has difficulty explaining change over time.
  - Cannot explain why government has not expanded further.
  - Impossible to arrive at a figure for aggregate individual utilities.

Principal Agent Theory

- Focus on relationships between those who allocate resources (principals) and those who provide agency services (agents).
- Principals contract with agents to provide public services and the primary focus is the contract (or budget).

- The budget or contract is the central element for what connects the principal and agent.
- Issues involved in the exchange of info, unexpected results in the budget may emerge: adverse selection—principal picked the wrong agent or incorrectly identified the agent's role; moral hazard—agent changes his/her behavior to where it could damage the principal.
- Principals often set the policies and goals while agents implement the programs that will address the policies and goals.
- **Problems:**
    - Information asymmetry – agent expert withholds info from principal.

BUDGET SYSTEMS

- Traditional Budgeting is line-item and incremental
- Condemned because:
- Mindless lines do not match programs.
- Irrational, deals with inputs instead outputs.
- Shortsighted, covers one year instead of many.
- Fragmented, only changes are reviewed.
- Conservative, changes tend to be small.
- **Purpose:**
    - Accountability, linking expenditure activities to responsible officials.
    - Control, makes sure funds are being spent for designated activities.
    - Efficiency, doing things for the least cost.
    - Effectiveness, achieving results.
    - Economic, managing and planning.
    - Political, mobilizing support to implement decisions.

Positives of traditional budgets:

- Calculations are easy, not comprehensive.
- Present is appropriated to the past and not the future.
- Choices that might cause conflict are fragmented.
- Change in objectives without challenging organization survival.

- Simpler, easier, more controllable and more flexible and adaptable.
- Incremental approach permits funding levels for agencies be set based on either or both houses adjustment to prior year totals or budget requests (usually at lower figure of either house).
- **Problems:**
    - Budget involves history but may not look back far enough.
    - Quick calculations maybe worse than none at all if grossly in error.
    - Simplicity may become simplemindedness.
    - Policy neutrality may end up with disinterest in programs.

Unit of measurement—Cash/Volume:

- Cash okay when purchasing power remains constant.
- Volume is better when value of money fluctuates (inflation) in order to provide designated volume of activity.
- Volume budgeting may be counter-productive in fighting inflation by accommodating price increases rather than struggling against them.

Appropriations or Treasury Budgeting:

- Treasury budgeting involves tax expenditures and mandatory entitlements.
- Tax expenditures are forms of tax reductions (home ownerships, college tuition, medical expenses, child tax credits) taken at source.
- Mandatory entitlements provide anyone eligible for certain benefits must be paid regardless of total amount—no cap.
- Economic management can have problems—tax expenditures may rise independent of economic conditions.
- Treasury budgeting is popular because of its value in coping with conflict, calculation, and economic management. Ultimately, pre-programming will be such a large amount of available funds, there will be less flexibility.

Planning, Programming, Budgeting System (PPBS)

Robert McNamara, Secretary of Defense used planning, programming and budgeting (PPB) and part of that was a 5-year defense plan (FYDP). The plan involved multiyear budgetary decisions and integrated different appropriations into a single programmatic effort.

PPB, horizontal comprehensive. Planning is the focus and important part of PPB. Policy analysis is used to increase effectiveness. Change in one element effects change in every element in the system. It is difficult to effect change since objectives are linked to programs. Programs are at risk.

PPBS is rational budgeting, more in the interest of policy analysts. It uses multiple years for budgeting. Must assess alternatives. Congress did not like this method. It did not last.

Zero-based Budgeting (ZBB)

- ZBB, no yesterday. Nothing is taken for granted.
- Agencies were to determine the place or base at which any further drop in funding would render the agency's operations unviable.
- ZBB was implemented as a cost savings measure by allowing both decrements and increments above a baseline.
- It provided for more ground-up budget building and therefore greater participatory management.
- **Problems**
    - ZBB was a process and processes don't trim or expand budgets.
    - Defining performance was a problem.
    - A-historical increases sources of error while decreasing chances to correct mistakes.
    - Both have reason equivalent to ranking objectives. But ranking objectives without considering resources is irrational.
    - But that also yielded greater amounts of paperwork.

Performance-Based Budgeting (Outcomes Budgeting is similar)

- Government performance measurement involves a complex web of relationships from inputs to outputs to outcomes, and contexts resources to results (Joyce).

- Any form that attempts to incorporate performance measures in the budget process (Kong).
- A means of focusing attention on the ends to be served by the government rather than on the dollars to be spent (Seckler-Hudson).
- PBB does not exclude Congress—agencies must consult with Congress.
- Focuses on effectiveness with outcomes.
- Early starts of PBB was part of scientific management. It was used in the military. The Budget and Accounting Procedures Act 1950 expanded PBB to civilian govt agencies.
- Osborne and Gaebler published info that states were pressured into "reinventing" themselves. Al Gore continued the process with "Reinventing Government" after GPRA was passed.
- Allen Schick – stated that efforts to budget on the basis of performance almost always fails.
- Government Performance and Reforming Act (GPRA) 1993 passed to assure govt accountability, efficiency and effectiveness. Established a performance management framework for fed depts. Requires agency strategic plans, annual performance plans, and annual performance reports. It emphasized formal strategic planning with stakeholder consultation.
- Program Assessment Rating Tool (PART) was initiated to provide score for effective agencies. There was a need to use performance info for budgeting. PART addresses or subjects all programs to establishing purpose, strategic planning, managerial performance and establishing outcomes.
- **Problems**
    - Need to get decision makers to use the information.
    - Info advises but does not direct decision-making.
    - Public budgeting is intrinsically political; may apply only to management and non-political decisions.
    - Mixed result at state level—no penalties for failures.
    - Unlikely that single approach to relating performance and financial reporting fits every organization context, mission, perform planning, etc.
    - Out of sync with president cycle (every 3 yrs update plans).

- Failed to approve any managerial pilots.
- Govt wide perform plans got little attention from Congress so OMB stopped developing.

BUDGETING THEORY:

- RUBIN - THEORETICAL SCHOOLS - Each theoretical school makes its own assumptions:
- NEO-MARXISTS: – argue that class interests dominate budgeting and allocation choices.
- Argue that govt is controlled by capitalists, or those who own the means of production, and that they determine spending priorities to serve their own needs.
- Military spending enriches arms manufacturers and tax breaks routinely go to the well-off instead of the poor.

PUBLIC CHOICE THEORY:

- Assumes that human behavior is based on individual economic rationality and the maximization of individual benefits (utility).
- Public choice theorists emphasize the relationship between what the citizen taxpayers want govt to do and spend and what it actually does and spends. The voting mechanism then provides a chance for citizens to choose among candidates that best reflect their own spending priorities.
- PROBLEM WITH PUBLIC CHOICE THEORY – Impossible to calculate a figure for aggregate individual utilities.

INCREMENTALISM: Based on theory of BOUNDED RATIONALITY

- Argues that budgeting occurs virtually exclusively inside govt
- Govt is not directly controlled or controllable by society
- Interest groups exist, but do not determine outcomes
- Little public involvement in budgeting
- SCHICK – “Congress institutionalized incrementalism in the form of the current services budget (president must submit to Congress a current services budget

that displays budget authority and outlays for new fiscal year as if all programs and activities were carried on at the same level in the new fiscal year).

- Weakness of Incrementalism – did not envision the budget process as responding to societal problems, emergencies or environmental changes.

HIERARCHY THEORY:

Argues that top-levels of the executive branch make decisions about broad policy issues, judge the environment, and pass that info down through the budget office to the agencies before they make their requests.

KEY – (1940) The Lack of a Budgetary Theory. Posed the key question in budgeting:

"On what basis shall we allocate X dollars to activity A instead of activity B?"

LEWIS (1952) – He is a RATIONALIST. Response to KEY reflected the administrative environment at the time:

- We can use science to determine how to allocate resources. The problem, Lewis argued, is not that we lack theory, but that we lack facts.
- It can be shown that the problem in government arises out of a lack of firm numbers rather than out of the lack of a method.
- "For X level of funding, Y level of service can be provided." The cost of a thing is the amount of other things we must give up for its sake.
- LEWIS concludes in the end that Key's question is unanswerable.
- It was in this era of optimism undergirded by confidence in rationality and science to bring about optimal decisions that Lindblom's 1959 essay appeared.

LINDBLOM (1959) – INCREMENTALISM, MUDDLING THROUGH, MUTUAL ADJUSTMENT OR BARGAINING.

- Argued that what KEY sought (a theory) and what LEWIS found (better facts) were prescriptive, not descriptive.

- "POLICY is made at the margins, but not through the application of marginal utility theory. It is a system of successive limited comparisons among a finite number of alternatives.

LINDBLOM - STRATEGY FORMULATION IN THE PRIVATE SECTOR:

ADAPTIVE MODE:

- Many decision makers with conflicting goals bargain amongst themselves to produce a stream of incremental, disjointed decisions. Some of the literature describes this as "entrepreneurial mode".
- KEY & WILDAVSKY believe that budgeting equals a full-blown theory of government, and is a supremely POLITICAL PROCESS.

WILDAVSKY – (1961) - In response to Key's lament on our lack of a budget theory:

- Wildavsky advanced Lindblom's argument by pointing out that BARGAINING AND NEGOTIATION, not the application of science, determines public policy. The former is associated with democracy while the latter is not.
- Incrementalism promotes stability and is permeable to the political system, which translates public preferences into policy outcomes.
- "To have such a theory would amount to a POLITICAL THEORY, some way to reconcile the inherent tension between the public's desire for government action and their resistance to revenue extractions that will make it possible." In other words, budgetary theory would tell us the proper role of government in society.
- Wildavsky warned against the zeal of reform: "Surely it is not asking too much to suggest that a lot of reform be preceded by a little knowledge." (Best way to summarize this cycle of American politics).

WILDAVSKY – Wildavsky's STRATEGY FOR BUDGETERS:

- OPPORTUNISM – Beyond the apparently linear logic of the public sector and the nonlinear logic of the private sector, ONE OTHER way of thinking exists in Wildavsky's strategy for budgeters – Opportunism.

- His budgetary person is OPPORTUNISTIC and follows neither a linear or nonlinear logic.
- The budgeter builds confidence, finds allies and shows results.
- This is similar to MINTZBERG'S "EMERGING STRATEGY", which many have found appropriate for public sector managers.
- Public organizations can be seen as low on deliberate strategy and high on emergent and unrealized strategy.

KELLY (2005) – We have an answer to V.O. Key's question about a theory of budgeting. History provides it:

- A theory of budgeting is a theory of political cycles driven by changing public opinion about the proper role of government.
- Two enduring features of budgeting practice that emerged in the past century: Incremental budgeting reflects Americans' preference for incremental policy change. The traditional line-item format provides financial accountability.
- When Americans trusted the private sector more than the public sector, budget reform was centered on cost control and improved efficiency. When Americans turned to government to solve problems the private sector could not, budget reform was centered on programmatic effectiveness.
- Budgeting is an OPEN SYSTEM capable of changing to reflect public opinion.
- The Budget is primarily an instrument of control, either facilitating or limiting government intervention into public and private affairs.
- Budgeting theory has shifted with political cycles like a pendulum: On one end is concern for the public interest and social justice, on the other end is concern for private interest and economic prosperity.
- "We have a theory of budgeting, or at least of budget reforms, and it is a theory of public opinion cycles".
- Changes in our orientation toward govt (either obstacle to the public good or agent of the public good) fuels the desire for change in the budget process. The starting point for budget reform is ALWAYS a constant – THE TRADITIONAL, LINE-ITEM, COST-CONTROL BUDGET. We may dress it up in different ways

(performance measures, program evaluations, cba), but THE TRADITIONAL BUDGET IS OUR TOUCHSTONE OVER TIME.

- Nothing that followed the New York Bureau of Municipal Research's LINE-ITEM BUDGET was as important to the profession as IDENTIFICATION OF COST, and nothing remains as useful in what we think of as accountability, either in the financial or political sense.

Neuby (1997) – On A Lack of a Budget Theory.

- There is no consensus as to what budgeting actually is, whether it is a political, economic or social process.
- No agreement on scope, dominant methods or techniques of a budget theory.
- No agreement about the status of theory itself.
- The general focus of budgeting is on the allocation of resources, but there is no agreement on whether that is primarily a political or economic function.

Schick & Seligman (1926) – "Budgeting encompasses so much that it has become a SOCIAL PROCESS."

KEY & WILDAVSKY believe that budgeting equals a full-blown theory of government, and is a supremely POLITICAL PROCESS.

SCHICK – "Congress institutionalized incrementalism in the form of the current services budget

PRINCIPAL-AGENT THEORY: Principals and Agents manage information and both may act in their own self-interest.

- When there are issues involved in the exchange of information, unexpected results in the budget may emerge:
    - Adverse Selection – Principal chose the wrong Agent or has incorrectly identified the Agent's role, responsibility or agenda.
    - Moral Hazard – Agent that works for Principal may change behavior to such an extent that it damages Principal.
    - Goal Conflict is assumed to exist between agents and principals.

- Information Advantage – Agency domination (agent controls information), Legislative or Executive Dominance.
- Issue Network – Neither principal or agent has informational advantage and goals are not necessarily in conflict.

PUBLIC CHOICE THEORY:

Rooted in the political economy of old – study of govt. behavior and classical economics of Smith, Mill & Marx.

Assumptions of PCT:

- Self-Interest – bureaucrats will strive to maximize their budgets (NISKANEN, 1971) or their slack (diff. between revenue and minimum cost of production.
- Science of exchange of public goods by self-interested bureaucrats and politicians, interest groups and voters.
- Analysis should take perspective of the representative individual (OSTROM).
- Pareto-Optimal Solutions – If one person is better off and no one worse off, then community is better off.
- Power of competitive marketplace to optimally allocate resources (Coase's Theorem)

FORRESTER (2001) – Public Choice Theory and Public Budgeting: Implications for the Greedy Bureaucrat.

Public Choice Theory says self interest and the free market explain why people (and bureaucrats) make the decisions they do. Public Budgeting is different but can learn from Public Choice Theory.

OSTROM- Supported Public Choice Theory. Normative theorist Public Choice Theory reflects principles of self-governance and self-interest as seen in the Federalist Papers. If these principles are reflected in units of govt. then centralization and hierarchy are held to a minimum.

BUDGETING SYSTEMS/METHODS:

TRADITIONAL LINE-ITEM - remains the dominant budgeting method to date.

Control-based – Executive has line-item control over expenditures.

INPUTS are the single scope of analysis

Decision units are simply objects of expenditure

INCREMENTAL policy making style

PERFORMANCE BUDGETING:

- MANAGEMENT IS KEY
- Focus on INPUTS and OUTPUTS
- Decision units – ACTIVITIES of agency
- INCREMENTAL policy making style

PLANNING PROGRAMMING BUDGETING (PPBS):

- PLANNING is KEY
- Focus is on INPUTS, OUTPUTS, PLANNING and ALTERNATIVES (Managers must submit alternative budgets)
- Decision units – PURPOSE OF AGENCY/MISSION
- CENTRALIZED policy making style – CUTS CONGRESS OUT OF BUDGETING PROCESS.

TBB – RUBIN – TARGET BASED BUDGETING

Must have accurate revenue projections to be useful.

PBB – PERFORMANCE-BASED BUDGETING – GPRA (1993) is the legislation that led to adoption of PBB at fed level.

RESULTS-ORIENTED. Focus on OUTCOMES and ACCOUNTABILITY.

STRATEGIC PLANNING, MANAGEMENT and GOAL ATTAINMENT (established by top admin.)

Focus – INPUTS, OUTPUTS and OUTCOMES.

Agencies must create: STRATEGIC PLANS, GOALS, PERFORMANCE REPORTS

UNLIKE PPBS, CONGRESS IS INCLUDED IN THE PROCESS.

WILDAVSKY, LEWIS AND LINDBLOM form the main camp in support of incrementalism as theory. They feel that it should be the basis of theory because the process dominates reality.

LEWIS notes that recent budgetary reforms such as ZBB and PPBS have NOT altered the use of a base figure and increments.

RUBIN, BOZEMAN STRAUSSMAN and others cast aside incrementalism as a theoretical construct.

RUBIN & SCHICK – believe that as an explanatory model, INCREMENTALISM does not describe the process well, noting that a budgetary base is not always defined.

BUDGET REFORM MOVEMENTS:

HALACHMI (1997) – Reform is not a process that is based on reasoning or objective rational analysis. In democratic and open societies, govt reform is principally about forging a new popular consensus on national or governmental objectives.

JACKSONIAN ERA (1829-1872): PRIVATE REGARDING

Laissez-faire economics were still orthodoxy – It had been the founding principle of a commercial republic.

Budgeting was simply accounting for revenues and expenditures.

States took the lead in financing the railroad boom early on. However the economic panic of 1837 caused several states to default on their bonds.

PROGRESSIVE ERA (1873-1921): PUBLIC REGARDING

Depression struck in 1873 and lingered through the 80s – only to hit harder in 1893.

Citizens hurting – and very aware that great wealth was accruing to the titans of industry. Populists called for restrictions on corporations, especially the railroad industry.

New role of govt. redefined from an environment where private interests could flourish to protecting the public from “big business”.

Municipal Reform Movement (1870s)

Response to over-expansion after the Civil War and a recession in 1873.

Focused on limiting costs by examining departmental estimates and buffering government from demands by using comptrollers and/or boards, by requiring agreement among several officials and in some cases by requiring taxpayer approval.

The single executive model fit the activist progressive era better. The NML’s model charter (budget template) advocated the mayor proposing a budget to the council, which could reduce it but not increase it.

ACT TO REGULATE COMMERCE – 1887 – Created the ICC – INTERSTATE COMMERCE COMMISSION

Congress gave ICC authority to investigate complaints against the railroads.

Research Bureau Movement (1906) Bureaus of Municipal Research, National Municipal League & the New York Bureau (1907)

Dahlberg (1966) – “Bureau founders believed that wasteful, ineffective government could not serve democracy well.”

Bureaus were non-partisan and independent, committed to a scientific method of administration patterned after the private sector and focused on efficiency and economy (Dahlberg).

Bureaus researched and documented conditions that needed government action and they surveyed cities to find the most effective form of government.

They devised and spread budget reforms that emphasized goals, costs and public involvement.

Schick (1966) notes that the NYB tried to walk the line between the reform agenda and the more management-oriented efficiency goal and ultimately chose control.

Budget Reforms (1914-1920)

Supported a strong chief executive who could control departmental and agency requests, cut spending, gave tax relief to business, and provided accountability after the fact rather than through prior restraint.

TAFT COMMISSION on Economy and Efficiency created in 1910.

TAFT COMM produced a 1912 report: "The Need for a National Budget". In included:

President reviews estimates of the agencies and consolidates estimates into a unified budget to Congress.

Budget would include summary financial stmt for the past year.

Summary of all proposed expenditures was to be included

Summary of proposed legislation to enable Admin to conduct public business with greater economy & efficiency

Treasury Dept. should submit financial report to Congress showing revenues and expenditures

A uniform system of accounts be established under the president's authority

President should be responsible for recommending the content of appropriation bills.

FEDERAL TRADE COMMISSION ACT (1914) – Regulated working hours, working conditions and protected consumers from unfair business practices.

ROARING TWENTIES(1921-1932): PRIVATE REGARDING

WWI redirected public attention from the Progressive agenda, for obvious reasons.

Enthusiasm for a science of administration developed during this period.

Post WWI prosperity restored American confidence in Business.

BUDGET AND ACCOUNTING ACT – 1921

Created a centralized executive budget, requiring the President to submit unified budget annually to Congress.

Contained most of the recommendations of the TAFT COMMISSION

Established BOB and GAO.

Followed similar reforms at state and local levels (not sudden change)

Lasting effect – increased Presidential power over the budget

Lasting legacy – Institutional – both BOB & GAO influence debates over budget policy

CRASH OF 1929

Confidence in a self-regulating economy was high, which makes the stock market crash of 1929 easier to understand.

Political response to crash of 1929 and the depression that followed was slow. Even as unemployment climbed toward one fourth of the workforce in 1931, Herbert Hoover still maintained that government had business interfering in private economic matters. However, public opinion had already started shifting toward the public interest.

DEPRESSION AND THE NEW DEAL (1933-1945): PUBLIC REGARDING

RATIONAL BUDGETING REFORMS

BROWNLOW COMMITTEE (1937) Roosevelt appointed committee to study the management of the executive branch. Recommended REORGANIZATION to address admin mgmt. BOB transferred from Treasury to Office of the President.

The old role of budgeting was cost control and prevention of malfeasance. The new role would be management in pursuit of public good.

GULICK & URWICK (1937) – POSDCORB- Included BUDGETING as one of the elements.

Gulick forcefully argued that budget professionals should share the pursuit of the public interest through the exercise of best management practices.

THE MANAGEMENT MOVEMENT (1946-1958): PRIVATE REGARDING

The Truman admin attempted to build on the New Deal, but found itself thwarted by a conservative Congress and another shift in the American political cycle. The Allied victory and postwar economic boom reinvigorated confidence in the ability of science to conquer problems and confidence in the private sector to accomplish economic prosperity. Scientific Management movement growing and scientific principles of administration promised public sector improvement and productivity.

HOOVER COMMISSION (1949): Commission found glaring weaknesses in departmental budget processes.

PERFORMANCE BUDGETING - More data in budget process, EFFICIENCY ORIENTED.

Idea for performance budgeting started in local cities.

Basic idea was to adopt a budget based on functions, activities and projects. It would enable mangers, agency heads, elected officials and citizens to have some insight into the costs associated with govt activities.

Gave detailed breakdowns of unit costs and agency outputs. Emphasis on integration of program information and budgeting.

PLANNING-PROGRAMMING BUDGETING (PPBS) – (1961) Instituted by DOD.

Focus on EFFECTIVENESS, results and on multi-year planning.

Competing expenditures are evaluated on their marginal benefit to the program objective.

Started in the Defense Department.

Hailed as a way to integrate planning and budgeting by using systems theory and cost-benefit analysis.

Superior to Performance Budgeting because in PPB, substitutable alternatives are evaluated for their contribution to the program objective, yielding higher-quality budget decisions.

Basic idea: Budgeting should be based on OUTPUT categories rather than INPUTS.

PPBS combined two management techniques: Program forecasting (goal-oriented) and Systems Analysis (studies outputs by means of quantitative methods).

PROBLEMS WITH PPBS – SCHICK: “Created enormous information and analytical burdens”.

MANAGEMENT BY OBJECTIVES (MBO) – Offered NIXON a way to align budget activities with objectives.

Emphasis on long-range planning and program evaluation.

Encouraged a more participative approach with line managers involved in setting agency objectives.

MBO Three-Part-Cycle: Managers & subordinates agree on measurable, results-oriented objectives. Milestones established. Results evaluated yearly via report to department head.

MBO failed to establish itself as a viable budgeting activity.

CONGRESSIONAL BUDGET AND IMPOUNDMENT ACT (1974)

Prior to this Act, Congress never examined or voted on overall spending, revenues or fiscal policy.

Culmination of 30 yr effort to give Congress more influence on budget.

Provided Congress with House & Senate Budget Committees and the CBO.

Spurred by Nixon impoundment actions

Lasting effect – pendulum swinging back in direction of legislative control.

ZERO-BASED BUDGETING (ZBB) – (1977) Focused on the base rather than annual review. President Carter brought the idea from Georgia. ZBB killed by Reagan in 1981.

These reforms were UNSUCCESSFUL due to inconsistencies with political nature of budget process and because the workload and paperwork requirements were overwhelming.

THE GRACE COMMISSION (1982) – Reagan's private sector survey of government operations FINDS WIDESPREAD INEFFICIENCIES IN THE FEDERAL GOVERNMENT.

DEFICIT-BASED BUDGET REFORMS:

GRAMM-RUDMAN-HOLLINGS (GRH) 1985- Focused on reducing the deficit and balancing the budget.

SEEKS TO BALANCE THE FEDERAL BUDGET BY MANDATING ACROSS-THE-BOARD CUTS OVER A PERIOD OF YEARS.

Spurred by large federal deficit – ceiling raised for first time to $2 trillion

Focused on guarantee of specific outcome and SINGLE YEAR budget projections.

BUDGET ENFORCEMENT ACT (BEA) 1990- Amended the GRH Act to require that new spending be balanced by new taxes or spending cuts.

3 Changes – 1) Annual budget target eliminated. 2) Limits on discretionary spending thru 1995, and 3) PAYGO – new enforcement process.

RESULTS – GRH unsuccessful. BEA was able to constrain some actions of Congress but did not reduce deficits due to unforeseen large increases in mandatory spending (Medicaid & Medicare)

The CHIEF FINANCIAL OFFICERS ACT (1990) – Requires federal agencies to create a CFO position to oversee agency finances.

GOVERNMENT PERFORMANCE RESULTS ACT – GPRA (1993) – Requires agencies to justify their budget requests on the basis of the results or outcomes to be achieved.

The aim of GPRA is to INTEGRATE PLANNING, BUDGETING, MANAGEMENT AND PERFORMANCE ASSESSMENT. It is intended to provide for the establishment of strategic planning and performance measurement in the federal government (Halachmi, 2002)

Nature of Budget Reform:

- Reforms resulted in MARGINAL, not wholesale changes
- Large scale changes (i.e. PPBS) only progress as political system allows.
- Budgeting highly conservative and decreasing in flexibility

For the rest of the BUDGETING REFORM TMELINE – see article: Kelly, Janet (2005) A century of public budgeting reform: The key question

Remnants of Reforms:

- President has more managerial control due to moving BOB/OMB
- Budgets are now more focused on the FUTURE than before PPBS
- Modified forms of Zero-Based Budgeting common (agency budget <=90% of prior yr.)
- Program budgeting emphasis on analysis of outcomes led to increased capacity for policy analysis used in budget process.

Appleby (1957) – Classic Article – The Role of the Budget Division – modified the "control" idea.

Control in this context did not mean guarding against misappropriation of public funds (as it did in the Progressive movement); however as a check on spending.

Appleby argues that some sort of equilibrium is reached when no director is able to get everything he wants.

It was in this era of optimism undergirded by confidence in rationality and science to bring about optimal decisions that Lindblom's 1959 essay appeared.

LINDBLOM (1959)

Argued that what KEY sought (a theory) and what LEWIS found (better facts) were prescriptive, not descriptive.

"POLICY is made at the margins, but not through the application of marginal utility theory. It is a system of successive limited comparisons among a finite number of alternatives.

WILLOUGHBY (1918) – The Movement for Budgetary Reform in the States.

Member of TAFT Commission 1912 which called for a national executive budgeting system. (Origin of movement for adopting a federal budget).

Influenced the BUDGETING AND ACCOUNTING ACT of 1921.

Budget Reform involves:

- How budgets affect popular control
- How budgets enhance legislative and executive cooperation
- How budgets ensure administrative and management efficiency
- Budget first demanded as a feature of MUNICIPAL REFORM.
- Permanent reform not accomplished by continually throwing out officials who use public goods for private gain.
- Problem needs to be attacked from a TECHNICAL as well as MORAL standpoint.
- NML and Bureaus of Muni Research contribute improved methods of municipal admin.
- Budgetary system based on assumption that municipalities have same characteristics as BUSINESS Corps and should operate as such.
- In as early as 1899, NML had a draft municipal budget plan – Mayor submits budget to Council.

KEY – (1940) The Lack of a Budgetary Theory.

Posed the key question in budgeting:

"On what basis shall we allocate X dollars to activity A instead of activity B?"

KEY & WILDAVSKY believe that budgeting equals a full-blown theory of government, and is a supremely POLITICAL PROCESS.

Schick & Seligman (1926) – "Budgeting encompasses so much that it has become a SOCIAL PROCESS."

SCHICK – (1966) The Road to PPB: The Stages of Budget Reform.

Chronicled the development of budgetary theory from the era of accountability and control (line-item budget) to performance budgeting with its emphasis on managerial efficiency, to PPBS, which stressed objectives, planning, and program effectiveness.

SCHICK stated: "Efforts to budget on the basis of performance almost always fails".

SCHICK – (1969) System Politics and Systems Budgeting

PROCESS AND SYSTEMS POLITICS:

Process Politics - The activity by which BARGAINS ARE STRUCK AND ALLOCATIONS NEGOTIATED or rules of the game for the decision of budgetary matters.

Process Politics centered on pluralistic decision making, viewed to maximize a Pareto model.

System Politics – Unlike Process politics, is concerned with the OUTCOME or RESULTS, not the activity of deciding.

Systems Budgeting manifests itself in the form of PPBS budgeting systems which are concerned with results and outcomes more than anything else.

Schick argues that Process Politics dominated the literature through the mid 1960s because resources were plentiful. He argues that in an environment of scarce resources, Process Politics will not work.

SYSTEMS BUDGETING – Schick believes that better outcomes can be achieved through a systems approach.

RUBIN & SCHICK – Cast aside Incrementalism as a theoretical construct.

RUBIN & SCHICK believe that as an explanatory model, Incrementalism did not describe the process well, noting that a budgetary base is not always defined.

Irene RUBIN – (1992) – Budgeting: Theory, Concepts, Methods and Issues.

- Budgeting does not currently have a theory
- Writers on budgeting do not agree on common assumptions and recommendations
- Budget Theory today is fragmented and incomplete
- Budget theory is in the process of being invented
- In the U.S., state and local budgeting differs significantly from federal budgeting (size, scope, variety of functions performed by the public sector, openness of the budget process, etc.

THEORETICAL SCHOOLS - Each theoretical school makes its own assumptions:

NEO-MARXISTS:

- Argue that class interests dominate budgeting and allocation choices.
- Argue that govt is controlled by capitalists, or those who own the means of production, and that they determine spending priorities to serve their own needs.
- Military spending enriches arms manufacturers and tax breaks routinely go to the well-off instead of the poor.

PUBLIC CHOICE THEORY:

- Assumes that human behavior is based on individual economic rationality and the maximization of individual benefits (utility).
- Public choice theorists emphasize the relationship between what the citizen taxpayers want govt to do and spend and what it actually does and spends. The voting mechanism then provides a chance for citizens to choose among candidates that best reflect their own spending priorities.

PROBLEM WITH PUBLIC CHOICE THEORY – Impossible to calculate a figure for aggregate individual utilities.

INCREMENTALISM:

- Argues that budgeting occurs virtually exclusively inside govt
- Based on theory of BOUNDED RATIONALITY
- Govt is not directly controlled or controllable by society
- Interest groups exist, but do not determine outcomes
- Little public involvement in budgeting
- Weakness of Incrementalism – did not envision the budget process as responding to societal problems, emergencies or environmental changes.

HIERARCHY THEORY:

Argues that top-levels of the executive branch make decisions about broad policy issues, judge the environment, and pass that info down through the budget office to the agencies before they make their requests.

RUBIN "First, budgeting theory strongly emphasized rationality and getting the most from each dollar; then a second school grew up to refute the maximizers, arguing that very little rational decision making went on; and the current literature argues for a variety of positions in between."

RUBIN's Budgeting Concepts:

- Public budgeting is both political and technical, influenced by interest groups and agency heads.
- Public budgeting is open to the environment, and is influenced by the economy, public opinion, other levels of govt., interest groups, the press, and by politicians.
- Budgeting is a decision making process.
- Budget processes vary, both between jurisdictions and over time.
- There is a relationship between the allocation of decision making power and budgetary outcomes.
- Shifting locus of power in budgeting processes – Executive vs. Legislative, Top-Down vs. Bottom-Up.
- The kind of information used in budgeting decisions is highly variable.

- Line-item budgets often provide no other information than a dollar figure.
- Program budgets – allow officials to clearly choose between priorities, but does not provide a way of evaluating the relative efficiency or effectiveness of a program.
- Accountability – Is government doing what tax payers want it to do?
- Fund Accounting – Provides budgetary accountability by creating specific pots of money for specific purposes (not one big budgetary piggy bank).
- Balance – One of the most fundamental concepts in budgeting. Total revenues must match total outlays.
- We have rejected the extremes of decision making models that postulate either economic rationality or bounded rationality, but we have barely begun to map out the real territory that lies between the extremes.
- Each of the major efforts at budget reform has given us new ideas and new techniques, and we have incorporated them into our budget processes.

Irene RUBIN – (2000)

"Our confidence that changing the budget process will positively affect policy outcomes is remarkable, especially because history shows that it often does not work or does not work in the expected way. Elected officials seem compelled to reexamine the budget process, especially in periods of distrust of government, rather than deal with the factors that contribute to distrust or the consequences of it for public policy."

KELLY (2005) – "We have a theory of budgeting, or at least of budget reforms, and it is a theory of public opinion cycles".

"When Americans feared that govt was corrupt, the budget process was reformed to control costs and isolate executive responsibility. When Americans believed management and science could advance the general welfare, budget process was reformed to be more rational and scientific. When Americans thought that there was much more important work for govt to do, the budget was reformed to be more programmatic. When Americans lost faith that govt action could solve difficult social problems, the budget process was reformed to incorporate elaborate justifications for program expenditures. When Americans believed that govt had become an obstacle to prosperity, the budget process was reformed to hold bureaucracy accountable for outcomes."

Changes in our orientation toward govt (either obstacle to the public good or agent of the public good) fuels the desire for change in the budget process. The starting point for budget reform is ALWAYS a constant – THE TRADITIONAL, LINE-ITEM, COST-CONTROL BUDGET. We may dress it up in different ways (performance measures, program evaluations, cba), but THE TRADITIONAL BUDGET IS OUR TOUCHSTONE OVER TIME.

Nothing that followed the New York Bureau of Municipal Research's LINE-ITEM BUDGET was as important to the profession as IDENTIFICATION OF COST, and nothing remains as useful in what we think of as accountability, either in the financial or political sense.

WILDAVSKY (1964/84) – The Politics of the Budgeting Process

Was the best expression of INCREMENTALISM. A DESCRIPTIVE THEORY OF BUDGETING.

BUDGETING IS POLITICAL – CONGRESSIONAL INFLUENCE IS VERY IMPORTANT.

BUDGETING REFORM IS POLITICAL SYSTEM REFORM.

A NORMATIVE THEORY OF BUDGETING IS POSSIBLE, BUT VERY DIFFICULT.

WILDAVSKY (1969) – Rescuing Policy Analysis from PPBS.

"NO ONE KNOWS HOW TO DO PPBS!"

PPBS' planning and analytical functions are not compatible with budgeting's basic aims.

WILDAVSKY - Budgeting must provide continuity for planning, flexibility to respond to crises, rigidity to control spending, and openness for accountability.

KEY & WILDAVSKY believe that budgeting equals a full-blown theory of government, and is a supremely POLITICAL PROCESS.

LEVINE (1978) – Organizational Decline and Cutback Management.

Old era of "Positive Budgeting" is over. New era of "Negative Budgeting" and Cutback Management will depend on degree of political uncertainty and the magnitude of budget shortfalls.

CAIDEN (1981) – Public Budgeting amidst Uncertainty and Instability.

The budget environment is changing and is more dominated by fiscal stress and political uncertainty.

WILDAVSKY & CAIDEN (2001) The New Politics of the Budgetary Process

Federal budgets today are unbalanced, uncertain, and dependent on circumstances beyond their control.

A normative theory of budgeting would a comprehensive political theory detailing what government activities ought to be at a particular time. It would eliminate the political struggle which helps to develop the budget, thus ending politics.

LINDBLOM, CYERT & MARCH - BUDGET FORMULATION IN THE PRIVATE SECTOR:

ADAPTIVE MODE:

Many decision makers with conflicting goals bargain amongst themselves to produce a stream of incremental, disjointed decisions. Some of the literature describes this as "entrepreneurial mode".

4.3 The Big Names in Budgeting

Brownlow, Louis 1937	**Committee Report to FDR** **The president needs help**
Caiden, Naomi 1981	Public Budgeting Amidst Uncertainty and Instability Uncertainty and stress must be taken into account in budgeting.
Cleveland, Frederick A. 1918	Evolution of the Budget Idea in the United States (pp. 7-23 in Government Budgeting by Hyde) This article was the justification of the Taft Commission which led to executive budgeting.
Forrester, John P. 2001	Public Choice Theory and Public Budgeting: Implications for the Greedy Bureaucrat (pp. 101-116 in Evolving Theories of Budgeting, John R. Bartle, ed.) Public choice theory says self interest and the free market, explain why people (including bureaucrats) make the decisions they do. Public budgeting is different but public budgeting can learn from public choice theory.
Gulick, Luther 1937	POSDCORB Planning, organizing, staffing, directing, reporting, budgeting
Harding, Warren G. 1921	Signed The Budget and Accounting Act Created the Bureau of the Budget, GAO, and executive budgeting

	Focused on accountability and control Line item budgeting
Key, V.O. 1940	The Lack of a Budgetary Theory "On what basis shall it be decided to allocate x dollars to activity A instead of Activity B?" Budgeting is "applied economics"---allocating scarce resources The budget must reflect the public's interest
Keynes, John Maynard 1936	The General Theory of Employment, Interest and Money
Keynesian Theory	Fiscal policy (government spending & taxing policies) can, and should be used to influence the economy
Lewis,Verne 1952	Towards a Theory of Budgeting (see p. 29, Hyde) He is a rationalist---but in the end concludes that Key's questions is unanswerable He said "for x level of funding, y level of service can be provided" Doctrine of Public Utility --- marginal utility ; diminishing return (i.e., battleships of poor relief) The cost of a thing is the amount of other things we must give up for its sake. We must make choices---i.e., 4 or 5 tires for a car, but not 6.
Lindblom, Charles 1959	The Science of Muddling Through
Osborne, David and Gaebler, Ted 1992	Reinventing Government, How the Entrepreneurial Spirit is Transforming

		the Public Sector Led to Government Performance and Results Act and National Performance Review---1993
Ostrum, Vincent	**1974**	The Intellectual Crisis in American Public Administration He supported public choice theories
Rubin, Irene	**1990**	Budget Theory and Budget Practice: How Good the Fit? (see p. 77, Hyde) No single theory explains budgeting---they are fragmented and incomplete Budgeting is complex Neo-Marxist, public choice, incrementalism Rational (to maximize return), non-rational, now combination
Schick, Allen	**1966**	The Road to PPB: The Stages of Budget Reform (see p. 52, Hyde) A classic---it traced the evolutionary cycle of budgeting reform from line item/strict expenditure control to performance budget/management – work efficiency
Taft, William Howard	**1912**	Taft Commission presented The Need for a National Budget Led to Budget and Accounting Act of 1921
Wildavsky, Aaron	**1964/84**	The Politics of the Budgeting Process The best expression of Incrementalism---a descriptive theory of budgeting Budgeting is political --- Congressional influence

	is very important Budget reform is political system reform A normative theory of budgeting is possible but very difficult Redistribution is behind all budget decisions His later writings were less incrementalism-oriented
1969	Rescuing Policy Analysis form PPBS No one knows how to do PPBS
Willoughby, William F. 1918	The Movement for Budgetary Reform in the States (see p. 20 in Hyde) The public should be involved in the budget process Part of the Progressive movement in the early 1900's

Theories/Reforms of Budgeting

Line Item (incremental)---1921

Performance---1940's-50's Hyde:

- Management oriented system heavily focused on efficiency by relating costs to measured outputs
- This has seldom worked

Program Budgeting---1960's

- focus on planning and goal setting
- Little evaluation

PPBS (Planning, Programming, Budgeting System)---1960's

- Used in public sector budgeting
- Combined planning and budgeting
- Focus was on multi - year approach
- Robert McNamara brought it from Rand Corp to Dept of Defense under LBJ
- Used systems theory and cost benefit analysis
- Rational approach
- Best linkage of goals and budgeting --- MBO

ZBB---1977

- Zero based budgeting introduced at federal level by Jimmy Carter
- Abandoned in 1981 when Reagan was elected
- Continual program justification
- Budget requests are rank ordered

Outcomes budgeting ---1993

- Results matter---GPRA---MBO
- Outcomes/effectiveness is most important
- Performance based budgeting
- Treasury budgeting (tax expenditures and entitlements= 60% of federal budget
- Target based --- set limits
- This is not necessarily rational
- Planning and budgeting are merging
- Entrepreneurial budgeting---2000
- The Evolution of Public Budgeting
- See Irene Rubin's articles

4.4 Budgeting Terms

Accrual Method of Measuring Cost (Accrual Accounting)

Records cost when the liability is incurred. As applied to retirement benefits, cost is recorded when the benefits are earned rather than when they are paid or at some other time.

Authorization

An authorization is an act of Congress that establishes or continues a federal program or agency, and sets forth the guidelines to which it must adhere.

Balanced Budget

A balanced budget occurs when total receipts equal total outlays for a fiscal year.

Budget Authority (BA)

Budget authority is the authority provided by law to incur financial obligations that will result in outlays.

Budget Enforcement Act (BEA) of 1990

The BEA is the law that was designed to limit discretionary spending while ensuring that any new entitlement program or tax cuts did not increase deficits. It set annual limits on total discretionary spending and created pay-as-you-go rules for changes in entitlements and taxes.

Budget Resolution

The budget resolution is the annual framework that Congress uses to set targets for total spending, total revenues, and the deficit, as well as allocations, within the spending target, for discretionary and mandatory spending. A budget resolution does not become law and is not binding on the Executive Branch.

Cap

A “cap” is a legal limit on annual discretionary spending. See Discretionary Spending.

Capital Planning and Investment Control

A decision-making process for ensuring that information technology (IT) investments integrate strategic planning, budgeting, procurement, and the management of IT in support of agency missions and business needs.

Clinger-Cohen Act

The Clinger-Cohen Act is also known as the Information Technology Management Reform Act of 1996. The act supplements the Paperwork Reduction Act of 1980 by establishing a comprehensive approach for executive agencies to improve the acquisition and management of their information resources.

Competitive Sourcing

Competitive sourcing is a management initiative to make government more market-based, allowing the public sector to embrace the principles of competition, innovation, and choice. It determines the most effective method of obtaining services available in the commercial marketplace. One commonly used process is found in OMB Circular A–76 and may result in a public-private competition or the conversion of in-house work to the private sector.

Deficit

A deficit is the amount by which outlays exceed receipts in a fiscal year.

Discretionary Spending

Discretionary spending is what the President and Congress decide to spend through the 13 annual appropriations bills. Examples include money for such activities as the FBI and the Coast Guard, housing and education, space exploration and highway construction, and defense and foreign aid. See Mandatory Spending.

E-Government

E-Government refers to the federal government's use of information technologies (such as Wide Area Networks, the Internet, and mobile computing) to exchange information and services with citizens, businesses, and other arms of government.

Enterprise Architecture

Enterprise architecture is an agency-wide framework for incorporating business processes, information flows, applications, and infrastructure to support agency goals.

Entitlement

An entitlement program is one in which the federal government is legally obligated to make payments or provide aid to any person who meets the legal criteria for eligibility. Examples include Social Security, Medicare, Medicaid, and Food Stamps.

FAIR Act

The Federal Activities Inventory Reform (FAIR) Act of 1998 requires federal agencies to submit annually to OMB an inventory of all activities performed by federal employees that are not inherently governmental in nature (i.e., that can be performed by the private sector). After OMB review, the agency must send a copy of the inventory to Congress and also make it available to the public.

Federal Debt

Debt Held by the Public —The cumulative amount of money the federal government has borrowed from the public and not repaid.

Debt Held by Government Accounts —The debt Treasury owes to other accounts within the federal government. Most of it results from the surpluses of the Social Security and other trust funds, which are required by law to be invested in federal securities.

Debt Limit —The maximum amount of federal securities debt that may legally be outstanding at any time. It includes both the debt held by the public and the debt held by government accounts. When the debt limit is reached, the government cannot borrow more money until the Congress has enacted a law to increase the limit.

Fiscal Year

The fiscal year is the federal government's accounting period. It begins on October 1 and ends on September 30. For example, fiscal year 2003 begins on October 1, 2002 and ends on September 30, 2003.

Full-time Equivalents (FTEs)

Civilian employment in the Executive Branch is measured on the basis of full-time equivalents. One FTE is equal to one work year or 2,080 non-overtime hours. For example, one full-time employee counts as one FTE, and two half-time employees also count as one FTE.

Gross Domestic Product (GDP)

GDP is the standard measure of the size of the economy. It is the total production of goods and services within the United States.

Human Capital

Human capital refers to the education, knowledge, skills, and competencies of the personnel of an agency.

Mandatory Spending

Mandatory spending is authorized by permanent law rather than annual appropriations. An example is Social Security. The President and the Congress can change the law to change the eligibility criteria and thus the level of spending on mandatory programs, but they don't have to take annual action to ensure the continuation of spending. See Discretionary Spending .

Offsetting Collections and Offsetting Receipts

Offsetting collections and offsetting receipts are monies that are deducted from outlays, rather than counted on the receipts side of the budget. They are often paid in return for providing goods or services. For example, payments the Postal Service receives for stamps are offsetting collections.

Off-Budget

By law certain programs, such as Social Security and the Postal Services, are accounted for separately from all other programs in government and are accorded this separate treatment.

On-Budget

Those programs not legally designated as off-budget.

Outlays

Outlays are the amount of money the government actually spends in a given fiscal year.

Pay-As-You-Go

Created by the Budget Enforcement Act (BEA), pay-as-you-go refers to requirements that new mandatory spending proposals or tax reductions must be offset by cuts in other mandatory spending or by tax increases, to ensure that the deficit does not rise or the surplus does not fall. See Budget Enforcement Act.

Performance-based Budgeting

Performance-based budgeting separates programs that work from those that do not. It allocates budgetary and human capital resources by comparing historical and expected future performance levels with the full cost of producing desired program outcomes as defined in the agency's strategic goals and objectives.

Receipts

Receipts are the collections of money that result from taxes and other government activity. Examples of receipts include income taxes, excise taxes, and customs duties. They do not include collections from the federal government's business-like activities, such as the entrance fees at national parks. Business-like collections are subtracted from total spending to calculate outlays for the year.

Surplus

A surplus is the amount by which receipts exceed outlays in a fiscal year.

Trust Funds

Trust funds are federal government accounts set up by law to record receipts and spend them for specified purposes.

Unified Budget

The unified budget includes receipts from all sources and outlays for all programs of the federal government. It is the most comprehensive display of the government's finances.

Fiscal policy- Collectively, all federal government policies on taxes, spending, and debt management: intended to promote the nation's macroeconomic goals, particularly with respect to employment, gross national product, price level stability, and equilibrium in balance of payments. The budget process is a major vehicle for determining and implementing federal fiscal policy. The other major vehicle for determining and implementing federal fiscal policy. The other major component of federal macroeconomic policy is monetary policy.

Capital Budget- A budget that deals with large expenditures for capital items normally financed by borrowing. Usually, capital items have long-range returns and useful life spans, are relatively expensive, and have physical presence (for example, buildings, roads, and sewage systems).

Current Services Budget- An executive budget projection that alerts the Congress- especially the Congressional Budget Office, the budget committees, and the appropriation committees- to anticipate specific revenue, expenditure, and debt levels, assuming that current policy is unchanged. It also provides a baseline of comparison to the presidential budget.

Authorizing Legislation- Substantive legislation that sets up or continues the legal operation of a program or a program or agency, either indefinitely or for a specific period of time, or that sanctions a particular type of obligation or expenditure within a program. Authorizing legislation is normally a prerequisite for an appropriation. It may place a limit on the amount of budget authority to be included in appropriations acts or it may authorize the appropriation of "such sums as may be necessary." In some instances, authorizing legislation may provide authority to incur debts or to mandate payment to particular persons or political subdivisions of the country.

Zero-Based Budgeting- An approach to public budgeting in which each year's activities are judged anew, with no reference to the policy precedents or dollar amounts of past years.

Rescission- The consequence of executive and legislative action that cancels budget authority previously provided by Congress before the time when the authority would have otherwise have lapsed (that is, when appropriated funds would have ceased to be available for obligation). The Congressional Budget and Impoundment Control Act of 1974 specifies that whenever the president determines that all or part of any budget authority will not be needed to carry out the full objectives or scope of programs for which the authority was provided, the president will propose to Congress that the funds be rescinded. Likewise, if all or part of any budget authority limited to a fiscal year- that is, annual appropriations, or budget authority of a multiyear appropriation in the last year of availability- is to be reserved from obligation for the entire fiscal year, a rescission will be proposed. Budget authority mat also be proposed for rescission for reasons of fiscal policy or other reasons. Generally, an amount proposed for rescission is withheld for up to 45 legislative days while the proposal is considered by Congress. All funds for rescission, including those withheld, must be reported to Congress in a special message. If both houses have not completed action on the rescission proposed by the president within 45 calendar days of continuous session, any funds withheld must be made available for obligation.

Crosswalk- any procedure for expressing the relationship between different classification of budgetary data, such as between appropriation accounts and government policy.

Cash Accounting System - (**Cash basis of accounting**)-The basis of accounting whereby revenues are recorded when received and expenditures (outlays) are recorded when paid, without regard to the accounting period in which the transactions occurred.

Accrual Accounting System (Accrual Basis of Accounting)- The basis of accounting under which revenues are recorded when goods are received and services performed, even though receipt of the of the revenue or payment of the expenditure may take place, in whole or part, in another accounting period.

Employment Act of 1946-federal legislation that called for economic planning and for a budget policy directed toward achieving maximum national employment and production.

Congressional Budget Office (CBO)- Federal office responsible for presenting the Congress with reasonable and viable forecasts of aggregate levels of spending and revenue. The office also makes cost estimates for proposed legislation reported to the floor and provides cost projections for all existing legislation.

Impoundment- any action or inaction by an officer or employee of the U.S. government that precludes the obligation or expenditure of budget authority provided by Congress. It is also the power of the president to withhold (refuse to spend) funds that have been appropriated by Congress.

Assets-Any item of economic value owned by a government unit. The item may be tangible (that is, physical and actual) or intangible (that is, a right to ownership, expressed in terms of cost or some other value).

Balance Sheet- an accounting statement designed to balance total assets, total liabilities, and fund balance.

Appropriation- A legislative authorization that permits government agencies to incur obligations and to make payments out of the treasury for specified purposes. An appropriation usually follows enactment of authorizing legislation. An appropriation act is the most common means of providing budget authority, but in some cases the authorizing legislation itself provides the budget authority. Appropriations do not represent cash actually set aside in the treasury for purposes specified in the appropriations act; they represent limitations of amounts that agencies may obligate during the period of time specified in the relevant appropriations act. Several types of appropriations are not counted as budget authority, since they do not provide authority to incur additional obligations. Examples of these include: (a) appropriations to liquidate contract authority; Congressional action to provide funds to pay obligations incurred against contract authority; (b) appropriations to reduce outstanding debt- Congressional action to provide funds for debt retirement; and (c) appropriations for refunds of receipts. There are 13 major appropriation bills passed by Congress that make up much of the federal budget. These appropriation bills correspond to the subcommittees of the appropriation committees in the House and Senate.

Continuing Resolution- If a decision has not been reached on appropriations prior to the beginning of the current year, then Congress can pass a resolution that says that the government can continue to obligate and spend at last year's budget levels or the lowest level passed by a chamber of Congress. The wording is usually framed to permit spending at the lowest amount the legislature is likely to pass.

Expenditures- Payment of an obligation.

Planning-**Program**-**Based Budgeting**- An attempt in the federal government and some state and local governments to bring more analysis into the budgeting process. It is not itself an analytical technique, but it stresses the use of analytical tools in deciding budget issues related to specific government programs.

Budget and Accounting Act of 1921- Federal legislation that provided for an executive budget for the national government and for an independent audit of government accounts.

Contract Authority- Statutory authority that permits obligations to be incurred in advance of appropriations or in anticipation of receipts to be credited to a revolving fund or other account. Contract authority is unfunded and most subsequently be funded by an appropriation to liquidate obligations incurred under the contract authority, or by the collection and use of receipts.

Line-Item Budget- A budget format that presents the exact amount planned to be spent for every separate good or service to be purchased.

Transfer Payments- Money moved from one government to another or to private persons. They often serve as automatic stabilizers built into the economy. These payments normally rise substantially during periods of recession and fall during periods of prosperity. For example, the unemployed receives unemployment compensation; in recessionary times they may eventually receive welfare and food stamps as well.

Balanced Budget Act of 1985-the Gramm-Rudman-Hollings Act, one of three major laws passed between 1974-1992to cure the budget crisis. The provisions of each law were complex and ineffective. It was established deficit reduction targets for specific fiscal year. The law left major loopholes such as funding the bail-out of the 1980s federal budget failures has meant the collapse of budget regularity, the encouragement of deceitful accounting practices, a premium on gimmicks that produce short-term improvement but do not ease the structural problem, strained relationships between the president and Congress, lessening the effective leadership of the president, Congressional congestion and frustration, overloading the ability of the political leaders to reach an effective solution, crowding out other important national concerns, and insufficient resources to respond to emerging issues and priorities.

Budget and Accounting Act of 1921- provided for a national budget and an independent audit of government accounts. The law specifically required the president to submit a budget, including estimates of expenditures, appropriations, and receipts for the ensuing fiscal year. The new legislation created the Bureau of the Budget (BOB) in the treasury department. This strengthened the role of the president. The Bureau of the Budget was later moved to the Executive Office of the President and ultimately became the Office of Management and Budget in 1970.

Bureau of the Budget- The Bureau, when directed by the president, shall make a detailed study of the departments and establishments for the purpose of enabling the president to determine what changes (with a view of securing greater economy and efficiency in the conduct of the public service) should be made in (1) the existing organization, activities, and methods of business of such departments or establishments, (2) the appropriations, (3) the assignment of certain activities to particular services, or (4) the regrouping of services. The results of such study shall be embodied in a report or reports to the president, who may transmit to Congress such report or reports or any part thereof with his recommendation on the matter covered thereby. The bureau creates the president's budget. Agencies were required to submit their estimates and supporting information to BOB and were allowed no contact with Congress. Thus ensuring the presidents power.

Office of Management and Budget- (OMB) the major implementer of fiscal policy once decisions are made by Congress and the president. An office of the president set up in 1970 in succession to the bureau of the budget (founded in 1921) which is responsible for preparing the executive's budget for presentation to Congress in January each year. After examination by the House and Senate committees, a concurrent resolution on the budget is announced by April 15 to be followed by legislation by May 15. Once the budget is passed, the OMB supervises and controls its administration and provides data on program performance.

Budget Enforcement Act of 1990- part of three major laws between 1974-1992 to cure the public budget crisis. This law sets targets within categories.

Progressive Tax-A tax whose rate rises as income or expenditures rises. The principle examples of these taxes are on personal and corporate incomes. Progressive taxes aim to achieve a more equal distribution of income post-tax than pre-tax.

Flat Rate Tax- An income tax which is at the same rate for every level of income. The justification for a tax of this kind is its simplicity and lack of disincentive effects inherent in some forms of tax progression. However, a flat rate tax is likely to be unfair burden on low-income groups if the rate at which it is levied is high.

Monetarism- A modern revival of the quantity theory of money, making use of modern neoclassical economics. It regards the money supply as the most important determinant of aggregate money income and reasserts the relevance of price theory of economics. In practice, most monetarists use the gradualist approach of aiming for a rate of monetary expansion, which will achieve long-term price stability. This school is associated with economist, Milton Friedman.

Sequestration- 1. Spending cuts in the federal budget imposed under Gramm-Rudman-Hollings Law. 2. Temporary seizure of assets under a court order, e.g. of union funds under British employment legislation.

John Maynard Keynes- (1883-1946) In three books, he groped towards a theory which was to dominate western macroeconomics for over thirty years. A member of the Liberal party, he connected together the theories of the consumption function, aggregate demand, the multiplier, the marginal efficiency of capital, liquidity preference and expectations.

Keynesian Economics- Keynesian policy is most popularly regarded as the use of national budget deficits to maintain full employment. An emphasis on the importance of the investment multiplier, an assertion that the liquidity preference schedule is stable in the long run and unaffected by the actions of central banks and the insistence on the major importance of fiscal policy so that money and the rate of interest are of little importance to the management of the economy.

Laffer Curve- A graphical representation of the relationship between average tax rates and total tax revenues which asserts that above certain average tax rate of tax revenue will decline. The curve implies that, as there is a ceiling to the amount a government can raise, there is a limit to the public goods, which can be provided. The theory assumes that if the tax rate were zero, no taxes would be collected. Likewise, the theory assumes that if the tax rate were 100 percent, no tax revenues would be generated.

Federal Reserve System- Established in 1913, it is the system that carries out the functions of a central bank for the United States. The original aims of the system were to give the country an elastic currency, to provide facilities for discounting commercial paper and to improve the supervision of banking.

Prime Rate of Interest- The rate of interest that us commercial banks charge medium and small sized firms for borrowing. Historically, this was the interest rate the most creditworthy customers of banks were charged but with the development of the commercial paper market, the largest customers borrow below the prime rate.

Regressive Tax- One, which falls disproportionately on lower income, groups. As income decreases, the average rate of tax increases. Many indirect taxes, e.g. excise duties and sales taxes, are regarded as regressive but the extent to which they are depends on the consumption patterns of different income groups. Poll taxes are the simplest case of regression.

Backdoor spending- Backdoor authority as well as mandatory spending legislation. That is, legislation that mandates the payment of benefits or entitlements, such as increases in veteran's compensation or pensions. Such mandatory legislation requires the subsequent enactment of appropriations.

Reconciliation Bill- (**appropriation bill**)- A legislation bill which authorizes expenditure for a particular purpose, e.g. defense. It has to be passed by both the House of Representative and the Senate. Annually all bills are expected to be reconciled by a Reconciliation Bill by the end of June; if reconciliation is impossible, then a continuing resolution is passed which permits Departments to continue at their current expenditure levels.

Concurrent Resolution- A resolution introduced in both houses of a legislature.

Supply-Side Economics- A major U.S. school of economics which inspired the economic policies of the U.S. under President Reagan and of the UK under Prime Minister Thatcher. Opposing the Keynesian view that aggregated demand is central to determining the level of economic activity, supply-siders place emphasis on aggregate supply. Thus there has been a revival in the respectability of Say's Law and a concern for the disincentive effects of taxation. The Laffer curve has been a major innovation of the school. The adherents of supply-side economics and monetarism often coincide. The New Classical Economists have formalized many of their insights.

Demand-Side Economics - The opposite of supply-side economics. This theoretical framework holds that "demand" creates its own supply and views consumers to be (rather than producers) the central actors in an economy. Demand-side economics includes the work of John M. Keynes and the monetarist theorists.

Phillips Curve- The relationship between unemployment and inflation so named by Samuelson and Solow after Phillips attempted to identify it in 1958 by plotting data on changes in money wage rates for the period 1861-1957 against the national unemployment rates. Later work on Phillips Curve sought to take into account incomes policies and inflationary expectations. The long run Phillips Curve is vertical at the natural rate of unemployment. In contemporary economics, the validity of the Phillips Curve has been questioned.

Performance versus Program Budgeting- Budget formats vary in their focus. Program Budgeting stresses management and planning to help budget officials move beyond the constraints of line-item and incrementalism toward a more rational and flexible decision-making that focuses on program results. Performance Budgeting is now required in most states. The major emphasis is on activities or programs. The idea is to focus attention on how efficiently and effectively work is being done rather than on what things are being required. Whereas line-item focuses on inputs, performance budgeting focuses on outputs. In short, Performance Budgeting measures work performance and how well agencies are achieving stated objectives.

4.5 Accrual Based Accounting vs. Cost Based

Accrual based accounting refers to the method used to report earnings and income over the fiscal accounting reporting period. For many legal entities, such as C corporations and governments, that year ends on September 30th of each year. For the rest of us, those years ends as the physical year ends, on December 31st each year.

What do we mean when we use the term "accrual" basis for accounting? Accrual-based accounting means that sales are recorded when the sale occurs; it doesn't matter when the money is actually received. For many government agencies, the accrual based accounting system has never been used, but thanks to fact that governments and other public sector entities are using private sector type financial statements, there may be a shift in accounting methods, even for the government.

There are basically two forms of accounting methods: cash and accrual. Cash based systems are great if your income is below one million, and you don't have problems collecting for your products or services. Well, by that definition alone, many of today's businesses should not even consider the cash based accounting methods.

What benefit does accrual based accounting provide? Actually, quite a few if you happen to be a mid-sized business and you need to keep an accurate picture of your company's profitability on a regular basis. A few of the additional benefits are: greater focus on the business output, not the input; more cost-effective and efficient use of resources; the full cost of providing your product or service can be compared across industry standards; improved accountability and better financial management, just to name the most common.

What benefit does the government hope to gain, since profitability isn't an issue? This method of accounting also provides the business with a better perspective of management performance and results. What does that mean for government? It's a new viewpoint in comparing how our government measures up against private sector businesses, and produce better management and efficiency from the public sector of the business world.

The greatest advantage to accrual based accounting is that it allows an information manager, or if you're a small business, the business owner to accurately assess whether or not the business is generating a profit. You can better assess profit levels because you match income to expenses, accurately when you use the accrual based method of accounting.

Compare this to the use of your credit card. Suppose you use your credit card to purchase an item. You don't actually have a deduction of your personal checking account until you pay for the credit card debt; this is cash accounting methods. If you use your credit card, and then right a check immediately to satisfy that debt on your credit card, regardless of the due date of the bill, you're using accrual based accounting. Can you see how accrual forces accountability, and also makes you aware of your spending limits?

For some businesses, there is a need to be able to view finances from both pictures. Access to both methods provides information managers with a better view of actual cash flows, and keeps CEOs and CFOs more aware of the actual state of the business.

4.6 Federal Defense Budgeting

Definitions

BCP - Budget change proposal

BEA - Budget Enforcement Act

BEA - The Bureau of Economic Analysis

CBO - Congressional Budget Office

DHHS - The Department of Health and Human Services

DHS - The Department of Homeland Security

DOD - The Department of Defense

EPA - The Environmental Protection Agency

GDP - Gross Domestic Product

NIPA - National Income and Product Accounts

OMB -The Office of Management and Budget

OSD - Office of the Secretary of Defense

PPBES - Planning, programming budgeting execution systems

PPBS - Planning, programming budgeting systems

USDA - The Department of Agriculture

Executive Summary

The Department of Defense is responsible for "coordinating national security threat assessment, long- and intermediate-range planning and programming with annual budget formulation and execution" (Jones and McCaffery, 2005). Defense budgeting has been highly studied and remains controversial. The most effective and efficient way to allocate funds and distribute them in a timely manor in an environment that changes daily is challenging at best. To that end, this paper will address the following question: Is it realistic to assign a theory to defense budgeting?

The method used to explore theories applied to defense budgeting and proposed defense models is a literature review and comparison of the effectiveness of each proposal. An effort was made to obtain literature both pre and post 9/11/01 to reflect more recent changes in national defense structure. A similar attempt sought literature from both domestic and international sources in an effort to approach the analysis of this topic from an unbiased perspective.

V. O. Key challenged the world for a theory of budgeting in 1940. Has anyone or any one theory risen to the challenge? Incrementalism has correctly, yet retrospectively described defense budgeting for specific time periods. However; incrementalism itself has been discredited as a legitimate theory. PPBS and PPBES are still running strong in defense budgeting according to Jones and McCaffery in their 2005 publication. Multi-year budgeting would greatly enhance the functionality of PPBES; however this has yet to be realized. Budgetary trade-offs are a realistic sign of limited resources. If resources were unlimited, then trading one service for another would not be necessary. Although budgetary trade-offs in the defense department are realistic and necessary, the idea of a trade-off does not constitute a budgetary theory.

September 11, 2001 did not impose any earth shattering changes on defense budgeting theory, since it can be argued that there was not a theory in place to start with. Joyce (2005) sums up this topic nicely by stating that since 2001 the budget outlook has worsened, the process of defense budgeting has not changed, and Congress still fails to approve a budgets in a timely manor. This almost unrestricted access to funding in the defense department in the form of supplemental appropriations has made a mockery of any attempt to create a valid theory of budgeting that could accurately provide control yet accessibility to funds when needed. Budgeting exists simply because resources are limited. Public preference does hold a strong influence over with defense spending, however public preference is reactionary and does not constitute a theory of defense budgeting. Nonlinear dynamics is the closest to being able to explain defense budgeting; however it is presented as a qualitative method of retrospectively analyzing defense budgets, not as a predictor of future events or theory. Nonlinear dynamics is a paradigm, a way of thinking or viewing a system, not a theory that can guide decision making. Heuristics are valuable as a strategic guide in an unpredictable environment, but is not useful in determining future funding allocations.

Theory building involves prediction, which is not always possible in the world of defense. Theory development is solidified by validation and replication (Kiel and Elliott, 1992). Proposed defense budgeting theories are weak at best, and do not stand the test of time (replication). It is this authors' conclusion that a functional budgeting theory for the federal defense department has not been applied up to this point. Further, with the current structure of the federal budgeting system, a defense budgeting theory is not realistic.

Abstract

Is it realistic to assign a theory to defense budgeting? This question may surprise many, who 'assume' formal structured budgeting is necessary for any agency or department to function. While the author is not disagreeing with the necessity for accountability, the question is whether the current accountability formats are functional. This paper will explore past and current defense budgeting methods as well as options, such as supplemental appropriations, that were designed to be a safety-net in times of dire need and have more recently become routine as a way to appropriate funds more quickly. Accurately forecasting defense budgeting is not proving to be a realistic option. Heuristics may serve as an option for strategic decision making.

Introduction

The Department of Defense is responsible for "coordinating national security threat assessment, long- and intermediate-range planning and programming with annual budget formulation and execution" (Jones and McCaffery, 2005). Defense budgeting has been highly studied and remains controversial. The most effective and efficient way to allocate funds and distribute them in a timely manor in an environment that changes daily is challenging at best. To that end, this paper will address the following question: Is it realistic to assign a theory to defense budgeting?

One of the major difficulties in studying governmental budgeting is deciding and defining what is to be studied. For example, appropriations and outlays can be studied on the same topic and the results may be entirely different. Appropriations indicate budgeting authority and outlays describe what funds are actually spent. Prior to the 1974 Congressional Budget and Impoundment Reform Act, appropriations and outlay data was not reliably or consistently available (Wlezien and Soroka, 2003). The office of Management and Budget has retained data on defense appropriations and outlays since 1976. Brauer (2004) calls into question the appropriateness of using national defense outlay data, claiming that it does not accurately reflect defense expenditures. Brauer (2004) claims that the U.S. National Income and Product Accounts is a better reflection of defense spending, but lacks full disclosure by not including the defense departments portion of interest payments on the accumulated federal debt. The delays and discrepancies between appropriations and outlays in the defense budget calls into question the utility of the budgeting process to respond to defense needs.

Method

The method used to explore theories applied to defense budgeting and proposed defense models is a literature review and comparison of the effectiveness of each proposal. Most of the literature is from the mid 1970's to present, with the exception of the 1964 and 1966 works of Wildavsky and Davis et al. An effort was made to obtain literature both pre and post 9/11/01 to reflect more recent changes in national defense structure. A similar attempt sought literature from both domestic and international sources in an effort to approach the analysis of this topic from an unbiased perspective. The major topics to be reviewed include incrementalism, PPBS, PPBES, trade-offs, effects of 9/11/01, supplemental appropriations, public preference, non-linear dynamics, heuristics and the need for a defense budgeting theory. Each topic will draw from relevant literature to provide an account of defense budgeting theories that have been utilized, remain in effect, and defense budgeting proposals as well as an argument against defense budgeting theory as a whole. The conclusion of this paper will offer a summary analysis of each major topic and include the authors opinion as to what path defense budgeting should follow to render it functional and effective.

Results

Theoretic and Historic Literature

The first challenge for a general budgeting theory was proposed in 1940 by V. O. Key. Wildavsky and Davis et al. (1966, 1974) answered this dare with incrementalism as the budgeting theory. Incrementalism itself has been discredited as being applicable to budgeting by Rubin (1988) and Berry (1990). Jones and McCaffery (2005) also support the claims of Rubin (1988) proclaiming incrementalism as an observation, not a theory. Yet, Kanter (1972) reports that Congress rarely changed the President's defense requests by more than 2% during FY1960 – FY1970 and supports the idea that incrementalism was at hand. Incrementalism has been documented as recently as FY2006 in Schuler's 2005 publication on Biodefense budgeting. Kiel and Elliott (1992) reviewed defense outlays from FY1963 to FY 1990 and illustrated a lack of coherence to the incremental budget theory, even up to the 10% level. This study calls into question the timing of Kanter's study, since it covered only ten fiscal years, compared to the twenty-eight fiscal year records studied by Kiel and Elliott.

The Department of Health and Human Services (DHHS) and the Department of Homeland Security (DHS) are the primary recipients of defense funds, but they are also distributed to the Environmental Protection Agency (EPA) and the Department of Agriculture (USDA). The incremental cost doctrine (part of the Budget Enforcement Act of 1990) required the Department of Defense (DOD) to report "only the incremental costs of carrying out contingency or emergency operations." (McCaffery and Godek, 2003) This resulted in a lowering of supplemental appropriations requests, as small requests were incorporated into other programs. If only incremental costs were reported, then depending on the data source reviewed, it could very well appear that incrementalism was at hand.

Overall defense efforts in the form of policy choices led to citizen dissatisfaction of the defense plans during the 1960s. According to Kanter (1972), Congressional influence over defense policy manifested in two ways:

“(1) Congress simply could make nontrivial dollar changes in the President’s budget request, and (2) these budget changes might be attributable to Congressional policy concerns and program preferences rather than to other motives, especially a desire simply to reduce the level of defense spending.”

These methods address both the fiscal impact and Congressional motives for defense budgeting. Congressional power can implement or prevent defense policies, directly affecting budgetary needs. Congress’s actions on defense budgeting in the 1960’s indicate a concern for fiscal responsibility as well as programmatic budgeting (Kanter, 1972).

Carter (1989) identifies local economic effects as being a significant indicator for defense budgeting during the Reagan administration. While Kanter argues that defense policy shapes defense budgeting, Carter argues that defense budgeting shapes defense policy, and Domke et al., (1983) take yet another approach that the budgetary process does not facilitate priority setting.

The political impacts on defense budgeting are especially apparent in the 1980’s through the 1990’s. After the Vietnam War, defense spending fell substantially. The Regan administration increased defense spending with the help of a newly Republican-controlled Senate. Defense spending increased from just over $50 billion in 1980 to over $100 billion in 1987 (in constant 1995 dollars) (Goyal et al., 2002). Federal budget reforms in the late 1980’s held defense spending to around $100 billion. By 1996, the figure had dropped to under $50 billion, with the fall of the Berlin wall in 1989 and changing presidential party control to the Democrats.

PPBS and PPBES

The Department of Defense was responsible for allocating almost half of the discretionary portion of the U.S. federal budget in FY 2005 (Jones and McCaffery, 2005). That totals is expected to be just over $2.5 trillion for the 5 year period of FY 2004 – 2009. Planning, programming, budgeting systems (PPBS) has not been studied specifically how it relates in the defense department, according to Jones and McCaffery (2005), because it is too complex and it is not comparable or relevant to the systems already established in other departments. Schick (1988), states that all budgeting processes involve planning, management and control processes, but in different ratios according to department-specific needs.

In 1961, Robert McNamara was appointed Secretary of Defense by President John F. Kennedy. McNamara applied PPBS tactics to this empire of 4.5 million employees for the first time and was successful in increasing civilian control in the budgeting and management process. Changing control from the military to the civilian side involved equal parts control, politics and PPBS. By 1964, PPBS was the theory running the Department of Defense. Decisions were divided into assessment, actions and finance. Secretary of Defense Donald Rumsfeld regained some of the power and control back to the Office of the Secretary of Defense (OSD), while maintaining support for PPBS. During the Cold War, it could be argued that the defense budget directed the program, when PPBS was intended to do the opposite. The Office of Management and Budget held influence over the Presidents recommendations and the congressional approval, proving once again that budgeting can easily turn into politics. Jones and McCaffery (2005), best describe the political conflicts involving the Department of Defense (DOD) as follows:

“In DOD, this competition takes place between civilian and military assessments of resource requirements, between planners and budgeters, between OSD and the military departments / services, between joint war-fighter combatant commanders and the military departments and service responsible for the hiring, training and provisioning forces, and between other agents in a variety of contexts.”

PPBS forced the DOD to build its budget first by performing a strategic assessment of threat. The planning stage focused on how to provide services / commodities / manpower to address and deter perceived threats. Programming required “building a force structure that will provide the capabilities to do so” Jones and McCaffery (2005). Jones and McCaffery (2005) go on to say that “the key budgeting tasks in PPBS in DOD are quite limited, seeking only to develop correct pricing and timing decisions about force structure requirements established in the strategic planning process.” One item to note is that strategic planning for the Department of Defense is on a multi-year timeline. This has implications when conforming to the annual budgeting cycle of the federal government.

The DOD had chosen to minimize management control (the process where managers assure the efficient and effective use of resources) in lieu of planning. DOD management never wanted to be as unprepared as it was on December 7, 1941. They were successful until September 11, 2001. It is no surprise then that in both 2001 and 2004 the federal Comptroller issued the DOD grades of 'A' for planning but failing grades for management control and fiscal management. Without management control, a structured budgetary system beyond line-item appropriation was impossible. This situation sets the stage for out of control supplemental appropriations, which will be discussed in a later section.

While the Department of Defense was not happy with the results of PPBS as it relates to budgeting, no other system appeared to offer solutions to its shortcomings. Jones and McCaffery (2005) offer some criticisms of PPBS as it relates to the DOD including, "PPBS in DOD failed to move the focus away form budget justification and toward management, control and better analysis…", "…it continued to subsist as a disjointed long-range resource planning mechanism.", "This has resulted in huge wastes of taxpayers' money and civilian and military time and energy, …", "…inability to supply war-fighter needs on time, and not having enough money to afford implementation of a badly needed weapons platform…". The Department Of Defense can best be described as a huge, overly bureaucratic organization lacking coordination, management, control, and worst of all, a management control system that could address these challenges.

The Planning, Programming, Budgeting System (PPBS) was renamed in 2003 to PPBES, or Planning, Programming, Budgeting Execution System. The purpose of PPBES was to stress execution and replace an annual budget cycle, two-year programming cycle, and six-year planning cycle with a singular four-year resource planning and decision cycle. The 'off-cycle years' allowed time for evaluation and execution analysis of he budget. One of the issues with PPBS was the lack of adequate time for analysis of existing budgeting levels. Although PPBES did incorporate time for evaluation, the effects of program based budgeting may sometimes not be seen for many years. The main intent for PPBES was to transfer power, allowing the program to drive the budget, instead of the other way around, which is what resulted from PPBS. Unless a budget change proposal (BCP) was received and approved, budgets remain the same as the previous year for the four year cycle. Jones and McCaffery (2005) contend that the DOD would be better able to respond than most if not all other departments of the federal government, if Congress were to recognize, accept and implement multiple year budgeting.

Defense Budgeting and Trade-offs

Domke et al. (1983) identify the following three categories of trade-offs as they relate to defense budgeting:

Long-term trade-offs: trends in the defense share of national resources (or budgets) that are negatively related to trends in welfare spending;

Short term trade-offs: yearly changes in which defense expenditures are negatively related to changes in welfare spending;

Discrete decision-point trade-offs: explicit choice of central decision makers to spend more for defense at the expense of social programs, or vice versa.

Domke et al. (1983) and Mintz and Stevenson (1996) addressed the guns versus butter trade-off debate, exploring the theory that increasing spending in one area requires a decrease in spending in another. Domke et al. (1983) did not find any indication of welfare spending acting as a trade off for defense spending in four countries with the exception of "wartime and postwar reconstruction." This would indicate that long-term trade-offs affecting welfare spending only exist in special circumstances. The act of a direct budgetary trade off of one program against another was found to be "rare or nonexistent in democratic governments", according to Domke et al. (1983).

This does not discount Mintz and Stevenson's (1996) suggestion of an indirect relationship between defense spending and the economic resources of civil society as follows; "Budgetary decisions have economic consequences; economic performance has an effect on government allocation decisions, therefore an "indirect link" may exist between guns and butter." The idea of an indirect link is difficult to disprove, since resources are limited, any diversion to a defense focus will limit the availability of those resources to society as a whole in the long run.

Budgetary trade-offs do exist, whether direct or indirect, and the defense of our nation is held in the eyes of the public as a priority responsibility of the government. There are situations where the needs of national defense can create bottlenecks in the production of public goods, since any resource in short supply that is diverted to defense will be temporarily unavailable for the private sector or lower priority public programs. Mintz and Stevenson (1996) contend that dollars are more effective when spent on civilians in this modern welfare state.

The relationship between defense expenditure and economic growth is even less clear. According to Goldsmith (2003), other states spend proportionately more on defense than democracies do. Military expenditure is used to measure the defense effort, or military effort of a nation. Goldsmith (2003) found the average defense burden to be 2.75% of the Gross Domestic Product (GDP) of all studied states. North and South America were found to spend significantly less of their nations GDP on defense when compared to European states. Not surprisingly, the defense burden was found to be an integral part of both the domestic political economy and the international environment. Reports have been published supporting both a direct and indirect relationship between defense spending and GDP spending. Gerace (2002) did not find any evidence showing GDP spending running counter-cyclic to U.S. military defense spending; however non-military expenditures did show this counter-cyclic relationship to GDP growth rate. Of course, the Keynesian argument states that "military expenditures are used as a fiscal policy tool and have a positive impact on economic growth" (Gerace, 2002). The counter argument to the Keynesian position is that military expenditures take human resources and capital away from emerging industry, placing domestic advancement on hold during times of conflict.

Defense Budgeting post September 11, 2001

Prior to the terrorist attacks in 2001, large surpluses existed in the federal budget as a result of the Clinton administration. No model or theory of defense budgeting existed then or exists now to predict the financial outcome of such an attack. Large deficits now exist where surpluses were expected to be. This illustrates the inability of any budgeting theory to accurately forecast for defense budgeting. As reported by Joyce,

(2005) competition for funding between national defense and domestic government, in the form of trade-offs, has existed since World War II.

Joyce defends three points in the 2005 analysis of post-9/11 defense budgeting. First, since 2001 the budget outlook has worsened. Second, the process of defense budgeting has not changed. Third, in light of the failure of Congress to approve a budget in a timely manor has placed the process at a critical juncture and may result in budgeting at the federal level being rendered irrelevant. Since 2001, Congress is more likely not to challenge Presidential defense budgeting proposals. Financial forecasts have been made by the Office of Management and Budget (OMB) and Congressional Budget Office (CBO) indicating a deficit of close to two trillion dollars by 2007, four trillion less than their prediction made in January of 2001 (Joyce, 2005). Even in January of 2001, 9 months prior to the terrorist attacks, the deficit prediction was off by four trillion dollars. This is another illustration of the lack of accurate prediction abilities with budgeting in general, and specifically defense budgeting. This is a worst-case scenario example of how the environment can affect the best laid plans.

Joyce (2005) explains the difference in defense budgeting pre and post 9/11 in the following way:

"After 1998 (and continuing until approximately 9 AM eastern time on September 11, 2001), this target was replaced by a consensus that the budget should be balanced excluding the surpluses in the Social Security funds. Now, however, there is no consensus, and the lack of agreement means that the budget process is operating without a notional budget constraint."

Joyce's statement reflects both the governments and societies priorities when it comes to defense spending in an era of global terrorism. This statement also brings up the point of budget constraints. If limits on overall spending are enforced, then trade-offs will increase as unpredictable or unforeseen events continue to occur and require funding. The other option available for unplanned funding needs is supplemental appropriations, which will be discussed next.

Getting by on Supplementals

The purpose of a supplemental appropriation is to provide financial relief in unforeseen emergency circumstances. These situations can be a natural or human-caused disaster. Defense budgeting has survived on supplemental appropriations, limping by when needs present themselves. Funds may be transferred or reprogrammed, but some circumstances can require such large financial support, the only an additional appropriation can meet this need. Supplemental appropriations helped to finance some of the 50 major disaster missions of the U.S. navy from 1990 to 1997 (McCaffery and Godek, 2003). This is not the way supplementals were originally intended to be utilized.

The 1974 Congressional Budget and Impoundment Reform Act curbed the use of supplemental appropriations as a way to fund routine expenses. The Congressional Budget and Impoundment Reform Act required that foreseen spending must be requested in the president's budget, not simply requested as a supplemental appropriation after the fact. Of course, the critical flaw with that statement is 'foreseen spending'. The fact that terrorism and national defense spending is unable to be accurately predicted during a fiscal budgeting cycle is an easy argument to make.

The 1990 Budget Enforcement Act went a step further by setting spending caps. With this new rule, supplemental appropriations could only be approved with a matching / offsetting spending reduction or revenue increase (McCaffery and Godek, 2003). The exception was for 'dire emergencies' when appropriations would be made and applied to the deficit. The 'dire emergency' clause was instituted every year from 1990 to 1999, when the overall defense supplemental expenditures netted $86 billion dollars over recessions (McCaffery and Godek, 2003). Supplemental appropriations tend to be approved more quickly (average 4 months) than normal appropriations bills (average 10 + months). That makes supplemental appropriations a much more attractive route to take when funding is needed.

The 1990 Budget Enforcement Act affected defense budgeting by requiring pay-as-you-go budgeting techniques. This theory of take-from-one to pay-for-another also allowed the use of supplemental appropriations with the 'dire emergency' clause, so nothing really changed for the defense department. During this time, efforts were made to cut spending in other areas, but if funds were needed for defense, supplemental appropriations remained available. This is not to be construed as an open wallet for the Department of Defense. Congress can, and has employed techniques such as funding half of the requested amount, asking DOD to assist with their own financing.

Not all actions in budgeting are ethical. McCaffery and Godek (2003) report that in 1992 $314 million up to $2.1 billion in 1997 of regular appropriations was classified as a 'dire emergency' for the purpose of evading spending cap restrictions. In the 1970's, prior to spending caps, Congress and the President utilized supplemental appropriations to fund mandated programs. The change to 'dire emergency' spending only was an effort to gain more control over federal budgeting. Due to the nature of supplemental appropriations, Congress and the President usually are relying on rough estimates of what will be required to help or fix a specific issue. This figure may be enough, but often fails to incorporate long-term effects of disaster and defense problems.

Public Preference

Eichenberg and Stoll (2003) argue that citizen desires or public preference has a strong influence over defense spending decisions. They claim that public opinion is the "most consistently significant influence" on changes in defense spending. This can be seen in election cycles such as the current Presidential campaigns. Defense efforts and funding are a top rated topic for determining political candidate preference. The candidates' positions on defense funding have been used both as a positive for that candidate and a negative for their rivals.

Eichenberg and Stoll (2003) found that in the United States and Europe, public opinion did not favor defense spending that increased more rapidly than non-defense program spending. Public opinion reacts to governmental policies and the environment in a rational and systematic way, unlike the erratic reactions speculated by early scholars (Eichenberg and Stoll, 2003). The problem with the generalized statement of the public reacting in "rational and systematic" ways is that the root cause of the reaction is not predictable. After the terrorist attacks of 9/11/01, the public was in favor of increasing defense spending. This is a rational response to achieve the goal of being proactively involved in attempting to prevent future attacks. The attack itself was not planned for and funding was not readily available to deal with that situation, although the public was willing to forgo deficit control and immediately respond to this threat.

Wlezien (1995) offered the thermostat metaphor, stating that if the public's threshold was crossed (high or low), citizen demands will reflect the opposite for several years. The thermostat analogy was supported by the findings of Eichenberg and Stoll (2003), who note that public opinion reacted in a significantly negative manor to unpopular changes in defense spending, with the exception of France. Goldsmith (2003) agrees with the impact of public preference, but only in peacetime. According to Goldsmith (2003), international factors as well as public preference have a large influence on the defense budget in times of war. As mentioned earlier, Carter (1989) identified local economic effects as being a significant indicator for defense budgeting during the Reagan administration, supporting the public preference viewpoint.

Nonlinear Dynamics

Kiel and Elliott (1992) akin budgeting to nonlinear dynamics in the natural sciences. This is an opportunity to view a social process (defense budgeting) as an open system, strongly affected by the environment, public preference and politics. The application of nonlinear dynamics is not new to the social sciences. Studies have successfully applied its principles to evaluate economic equilibrium cycles, business cycles, competitive behavior among firms, the arms race, patterns of urban growth and noncompliant social behavior (Kiel and Elliott, 1992).

Nonlinear systems are identified by a constantly changing relationship between the variables, such as the constant changes seen in the politics of defense. There are four temporal classifications of nonlinear systems. Stable systems are grounded to a fixed point and can be temporarily predicted by a mathematical equilibrium. Oscillating systems exhibit a smooth patterned cycle, although the amplitude is unpredictable and will vary. Unstable systems are characterized by un-patterned behavior. Finally, random systems are completely devoid of patterns and can only be described as chaotic. Changes in nonlinear systems produce exponential effects on the structural configuration of the system. An example of an exponential effect in defense budgeting would be the effect of a single terrorist attack (9/11/01) on future defense budgeting. Based on the definition and properties that comprise nonlinear systems, long-term predictions of nonlinear systems are highly suspect (Kiel and Elliott, 1992).

Kiel and Elliott (1992) mention Wildavsky's 1988 recant of his earlier incrementalist position where he claims that modern budgeting appears virtually random in nature. The fact that budgeting is an open system (Rubin, 1990), and susceptible to external disturbances immediately rules out the option for budgeting to be a linear system. National defense and natural disaster preparedness are perhaps the two situations face by the federal government subject to the most "external disturbances". Kiel and Elliott's (1992) analysis of defense budgeting, total mandatory and total discretionary domestic outlays illustrates considerable instability in the defense budget, compared to mandatory and discretionary outlays.

Heuristics

A rule of thumb or heuristics approach to the defense budget would serve as a guide in times of a changing environment. Kiel and Elliott (1992) analyze defense budgeting using non-linear dynamics, and use this concept to defend budgeting as a dynamic, ever changing system that does not fit within a neat theory framework. Defense budgeting does not occur by inserting numbers into a formula and approving whatever an equation spits out. The reality is closer to Carter's 1989 statement that "Presidents shape their defense requests with an eye to what they think Congress will approve. Members of the authorizations or appropriations committees adjust presidential requests to reflect congressional concerns as much as possible bearing in mind the possibility of a veto". This statement sums up the politics of defense budgeting, but could be extended to budgeting in general. This rule of thumb approach exhibits the true reality of defense budgeting and policy.

How can a true defense budgeting theory exist in an environment of uncertainty and politics? Carter (1989) also found that U.S. senators "more consciously calculate the economic consequences of their votes on non-procurement decisions than they do on procurement matters." The implication is that non-procurement matters are more open to the public and will reflect back on the senator more than procurement decisions. This also supports Ripley (1969), who proposed the "salience" hypothesis, which states that party leaders are more successful on issues that are not in the public spotlight.

Dolan (2002) assessed how accurately top level bureaucrats represent the viewpoints of the public. This was analyzed using a survey given to both groups asking their opinion on funding levels of various federal departments and programs, including defense. The assumption is that non-elected public administrators are cut from the general population; therefore an unbiased viewpoint should reflect that of the citizenry. The concern is whether or not public administrators are more supportive of funding programs for which they are employed in an effort to preserve their own self-interests. In fact, the overall findings were that public administrators favored a 6.9% increase in defense spending, compared to a 17.5% increase requested by the general population. When looking only at defense department public administrators, a 15.1% increase was favored, compared to the 17.5% of the general public. This shows that employees of the defense department favor funding their own interests more so than other public administrators, but still less than the general population. Dolan (2002) found that bureaucrats overall were more likely to advocate decreased government spending than the general public. This may be attributed to the bureaucrats heightened awareness of budgeting constraints, decreasing discretionary spending and the publics concern over the budget deficit, realizing that the only way to control the deficit (without increasing taxes) is to control spending. The generation of heuristics or multiple rules of thumb may be more successful than efforts have been to develop a budgeting theory.

The Argument against a Budgeting Theory

Schick (1988) suggests and Kiel and Elliott (1992) agree that a theory of budgeting is not realistic since most budgets, such as the defense budget, are dynamic and changing systems. Environmental influence is unpredictable in the defense world and can only be studied retrospectively, providing models to fit a specified time period, but unsuitable for forecasting future needs. As stated by Kiel and Elliott (1992), "The dynamics in the relationships between variables over time in nonlinear systems can generate complexities that defy generalization, which underscores the challenge of building theories relevant to complex social phenomena, such as government budgeting."

The relationship between appropriations and outlays holds a lot of variability (Wlezien and Soroka, 2003). Specifically, between 1976 and 2002 the defense department lagged as much as 40 billion dollars, taking up to two years for outlays to catch-up to appropriations. Fluctuations in appropriations were found to mimic public preference (Wlezien and Soroka, 2003), however the delayed outlays may not be sufficient to address immediate needs.

Brauer (2004) disagrees with the notion that defense budgeting has a viable theory. Brauer (2004) argues that all defense budgets and studies are being conducted with flawed data. Wlezien and Soroka (2003) identified the problems with differences between appropriations and outlays. Brauer (2004) acknowledges that fact, and goes a step further proclaiming that all sources of 'reliable' data are incomplete and misleading. Line item budgeting comparisons exclude many relevant categories, such as $571 million allocated to biodefense in FY2004, categorized under 'Health'. Brauer (2004) found that comparing federal budget-based national defense outlay data with the U.S. National Income and Product Accounts resulted in a difference of nearly $100 billion dollars for 2003. Even the U.S National Income and Product Accounts data lacks full disclosure by not including the defense departments' portion of interest payments on the accumulated federal debt.

Palmore and Melese (2001) view national defense through game theory. This is an accurate viewpoint in many circumstances, such as the Cold War, the Iraq War and even terrorism in general to a certain extent. The problem with game theory, as it relates to defense budgeting, is its conditional response to situations. Given a goal of minimizing risk to the nation (possibly by maximizing deterrence) with the lowest cost to taxpayers, how does one project a budget for such a theory? The U.S. position will depend on the actions of others (which, in game theory, will depend on U.S. action).

Palmore and Melese (2001) provide an example of the potential for a missile attack during the Cold War. Even with the limited choices of "Hi" and "Low" for both the U.S.

and USSR, which provides a matrix of four budgeting alternatives on that one topic alone. The current U.S. budgeting cycle begins over a year prior to actual funding allocation and outlays, rendering the system inflexible to rapidly changing needs, which would be needed in game theory. Game theory may be a realistic and viable defense strategy in a more flexible system, but it is not conducive to accountability and forecasting in defense budgeting.

Conclusion

V. O. Key challenged the world for a theory of budgeting in 1940. Has anyone or any one theory risen to the challenge? Incrementalism has correctly, yet retrospectively described defense budgeting for specific time periods. However; incrementalism itself has been discredited as a legitimate theory.

PPBS and PPBES are still running strong in defense budgeting according to Jones and McCaffery in their 2005 publication. Multi-year budgeting would greatly enhance the functionality of PPBES; however this has yet to be realized. It is interesting to note that PPBS was declared "ended" (Pilegge, 1992), yet according to Jones and McCaffery (2005), the highly related PPBES remains the current operating theory for defense budgeting. PPBES is not proving to be a very effective option, given the quantity of literature devoted to defense budgeting trade-offs and supplemental appropriations.

Budgetary trade-offs are a realistic sign of limited resources. If resources were unlimited, then trading one service for another would not be necessary. Although budgetary trade-offs in the defense department are realistic and necessary, the idea of a trade-off does not constitute a budgetary theory.

September 11, 2001 did not impose any earth shattering changes on defense budgeting theory, since it can be argued that there was not a theory in place to start with. Even if PPBS can be considered the leading theory at the time, it did not change to PPBES until 2003. The leading change with PPBES was to stress multi-year budgets, which is not in effect today. Joyce (2005) sums up this topic nicely by stating that since 2001 the budget outlook has worsened, the process of defense budgeting has not changed, and Congress still fails to approve a budgets in a timely manor

The original purpose of budgeting supplementals was to provide financial support during times of unforeseen financial circumstances. The process of acquiring funding by labeling it a "dire emergency" proved to be easier and faster than acquiring the same funding through routine channels. This almost unrestricted access to funding in the defense department has made a mockery of any attempt to create a valid theory of budgeting that could accurately provide control yet accessibility to funds when needed.

Budgeting exists simply because resources are limited. Society's priorities determine (to a certain extent) where financial support is assigned. While funding limits may drive defense spending, budgetary processes do not facilitate priority setting (Domke et al., 1983). There are multiple issues with this plan. First, who defines "society"? In our representative democracy, elected officials are expected to speak for the majority in their jurisdiction. The reality is that political pressures and personal beliefs tend to taint that perfect view of decision making. The second issue is that there does not yet exist a theory that can determine what the priorities of a society are as a collective whole. Public preference does hold a strong influence over with defense spending, however public preference is reactionary and does not constitute a theory of defense budgeting.

Nonlinear dynamics is the closest to being able to explain defense budgeting; however it is presented as a qualitative method of retrospectively analyzing defense budgets, not as a predictor of future events or theory. Nonlinear dynamics is a paradigm, a way of thinking or viewing a system, not a theory that can guide decision making. A key element argued by Kiel and Elliott (1992), is that the fundamental element of traditional theory building involves prediction, an unobtainable goal when one is dealing with a nonlinear system involving changing relationships of the players involved.

A rule of thumb or heuristics approach to defense budgeting is a practical viewpoint that fits most situations. The problem with heuristics is that it is more of an action decision-making guide rather than a budgeting theory. Heuristics are valuable as a strategic guide in an unpredictable environment, but is not useful in determining future funding allocations.

Theory building involves prediction, which is not always possible in the world of defense. Theory development is solidified by validation and replication (Kiel and Elliott, 1992). Proposed defense budgeting theories are weak at best, and do not stand the test of time (replication). Each individual study of defense budgeting theory is restricted to a specific time period and set of conditions. Overall, the limitations of such a group of studies outweigh any practical significance. It is this authors' conclusion that a functional budgeting theory for the federal defense department has not been applied up to this point. Further, with the current structure of the federal budgeting system, a defense budgeting theory is not realistic

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4.7 Summary of Budgeting: Theories, Concepts, Methods, and Issues

Budget – A political and managerial instrument allocating scarce public resources among social and economic needs.

Budget theory in particular should be able to answer questions about why particular practices should be adopted, the importance of particular tasks, and the location of particular tasks in a larger process. Budgeting does not currently have a theory in this sense as it is fragmented and incomplete. The purpose of this article is to organize and reduce the confusion by outlining some of the key assumptions, concepts, methodologies, and current issues.

When the relationship of budgeting to society is examined for the United States, there has been little agreement as to what budging reveals about the society. A theory that utilizes differentiated interest groups would probably be more effective at capturing and describing business impact and would undoubtedly be better at outlining the impacts of other interests on the budget. (Neo-Marxist – class interests dominate budgeting and allocation choices).

A second theoretical approach to linking budgeting and society is the public choice school. Individual theorists have taken widely varied positions, but what they share is the assumption that human behavior is based on individual economic rationality and the maximization of individual benefits, or what economists call utility. Their model of the ideal government is an extension of the marketplace where citizens can buy exactly the amount of services they want in the combinations they prefer.

Public choice theorists emphasize the very important issue of the relationship between what the citizen taxpayers want government to do and spend and what it actually does and spends.

The voting mechanism posits that citizens can choose among candidates that best reflect their own spending priorities.

The mechanism of suburbanization suggest that citizens choose their residences based on their preference for public service packages – they move to communities whose residents are people like themselves who want the same things from government and who are willing to pay similar amounts of taxes to get them.

Openness of taxation implies that the scope of government and the expense would be controlled if people clearly saw how much they were paying in taxes.

Despite some obvious strengths, public choice theory also has some weaknesses. This theory tends to be deterministic, and has difficulty explaining change over time. The theory ignores the importance and existence of altruism and the existence of group goals that are different from individual goals. The third major theory that relates budgeting to society is Incrementalism, and its related theory of interest-group pluralism. Incrementalism argues that budgeting occurs virtually exclusively inside government (Taft ?). Incrementalists see budgeting as a formal process based on bargaining and technical needs, but fairly devoid of policy concerns.

The incrementalists do not envision the budget process as responding to perceived societal problems, emerging situations, or environmental changes.

Thus, incrementalism is unable to theorize about changing budgets or budget process.

More recent theories of budgeting have not coalesced into a single school, but they have moved toward a common understanding of how budgeting relates to the society more broadly.

Hierarchy theory says that the top levels of the executive branch make decisions about broad policy issues, and judge the environment, and pass that information down through the budget office to the agencies before they make their requests.

The macro-micro budgeting theory argues that bargaining still goes on over budget strategies, but broader policy issues are also explicitly dealt with and frame the choices and outcomes of the bargaining.

The current consensus is that budgeting is linked to the society and to the environment by both technical constraints and policy, and that interest groups are sometimes important in determining outcomes. Budget theory has developed in a dual fashion. First, theory strongly emphasized rationality and getting the most from each dollar; then a second school grew up to refute the maximizers, arguing that very little rational decision making went on. The current literature argues for a variety of positions in between.

Budget - A detailed plan, based on estimates of needs and resources, for financing an enterprise or government during a definite period, which is prepared and submitted by an executive to a representative body.

Evolution of Public Budgeting

The U.S. Constitution did not include mention of a budget, but it required the president to provide “a regular statement of receipts and expenditures”.

Budgeting first introduced in the Progressive Era (1890-1920) in response to corruption and declining morality.

Municipal reformers turned to scientific methods and professionalism to eliminate corruption.

The National Municipal League (NML) and the New York Bureau of Municipal Research (NYB) called for uniform bookkeeping

NYB was formed by Frederick Cleveland and others, and was funded by businessmen.

Municipal reformers were the first to introduce budgeting in the U.S.

Budgeting practices in municipalities eliminated the worst forms of corruption.

STATES – Wisconsin 1912 adopted a budget measure as a joint venture between Governor & Legislature.

New York was the first state to write the budget idea into its constitution.

Reform Proposals:

Before 1912, various techniques were recommended for centralizing responsibility for the budget. After 1912, most reform proposals called for budget authority to rest with the chief executive.

TAFT COMMISSION – (1910) – Suggested that the President should prepare and present a budget to Congress, became foundation of Budget and Accounting Act of 1921. The commission reasoned that the constitutional privileges pertaining to the receipts and expenditures and the state of the union authorizes a definite, well-considered budget.

1913 – Taft submits a budget to Congress. It was not acted upon.

1921 – Budget and Accounting Act –

Established BOB and GAO. Each dept. to have a budget officer.

Created a centralized executive budget.

1932 – Economy Act – Pushed for installation of accounting forms, systems & procedures.

1939 – Reorganization Act –

Moved Bureau of Budget (BOB) from Treasury dept. to the Executive Office of the President.

BOB changed to OMB.

1974 – Budget and Impoundment Act –

Restricted impoundment authority.

Created CBO – Congressional Budget Office to counterbalance OMB.

Failed to stop budget deficits.

1985 - Gramm-Rudman-Hollings (Balanced Budget and Emergency Deficit Control Act)

Focused on reducing the deficit and balancing the budget.

1990 – Chief Financial Officer's Act – established CFOs in agencies.

1993 – GRPA – Govt. Performance and Results Act.

Was a product of Al Gore's National Performance Review

Called for agency strategic planning, performance measures, outcomes

Complex and expensive to implement.

Allen Schick – Emphasis of budgeting changed over time

from Control to Management to Planning to Accountability/Results.

CONTROL – Early 1900s – Line Item Executive control, Incremental.

MANAGEMENT – 30s-50s – From recommendations of Brownlow Committee and Hoover Commissions.

PLANNING – 60s – PPBS – efforts to rationalize budget process continued.

MBO and ZBB – 1970s.

Nothing reform-wise happened in 80s – general antipathy toward gov't.

SEA initiative – from GASB - Service Efforts & Accomplishments.

Encouraged State & Local govts to include statements of service results in annual financials (needed more performance info for financial reporting).

ACCOUNTABILITY - GPRA – 1993 – A Congress-initiated reform – emphasis on planning & accountability for results. Long time horizons.

Budget Theory (See Handout Session 4 – Enzo & Amy)

Each theoretical school makes its own assumptions. (See Tyler & Willand article)

Neo- Marxists Theory:

Argue that class interests dominate budgeting and allocation choices

Argue that govt is controlled by capitalists, and they determine spending priorities.

Public Choice Theory:

Assumes

Various authors agree that there is no consensus as to an acceptable, operational concept of budgeting.

INCREMENTALISM :

Dominant budgeting method used to date.

Wildavsky, Lewis & Lindblom support incrementalism as a theory.

HIERARCHY THEORY:

Argues that top-levels of executive branch make decisions about broad policy issues, then pass that info down through the budget office to agencies before they make their requests.

MACRO-MICRO BUDGETING THEORY:

Argues that bargaining still goes on over budget strategies, but broader policy issues frame the choices and outcomes of bargaining.

Economic policies, priorities, spending ceilings and assumptions about the growth of the economy are made by the budget committees and guide the decisions of other committees.

Budget Systems:

Line Item

Control-based – Executive has line-item control over expenditures.

Inputs are the single scope of analysis.

Decision-units are simply objects of expenditure.

Incremental policy-making style

Performance Budgeting

Management is KEY.

Focus on Inputs and Outputs

Decision units – Activities of agency

Incremental policy-making style

PPB

PLANNING is KEY

Scope is on Inputs, outputs, effects and alternatives (managers submit alternative budgets)

Decision units – purposes of agency/mission

Centralized – cuts Congress out of process.

ZBB

TBB – Target based budgeting (Rubin). Revenue projections need to be accurate.

PBB - Performance-Based Budgeting (See Session 7 handout from Agatha & Amy)

Results-oriented. Focus on outcomes and accountability

Strategic Planning, Management and Goal Attainment (established by top admin.)

Scope – Inputs, Outputs AND Outcomes

GPRA (1993) is the legislation that led to the adoption of PBB at Fed level.

Agencies must come up with: Strategic plans, goals, performance reports

Unlike PBB, Congress is included in the process.

Clinton told Gore to perform the Nat. Performance Review. Gore looked at other countries that were calling their new budgeting system “New Public Management”. Review resulted in recommendations out of which came GPRA, out of which came PBB.

Reform Movements – See Rubin (1994) in Session 2 Handout from Mark & Jill.

Municipal Reform Movement (1870s):

Response to expansion after Civil War, corruption. NML - Large cities were important for experimenting with different budget systems.

Research Bureau Movement (1906):

Reflected the Progressive spirit – Executives/Professionals running govt. Desire of progressives is to move away from non-qualified people running govt. NY Bureau of Municipal Research.

Budgeting Concepts:

Budgets are an important link between taxpayers and the public officials. Budgets tell citizens what their taxes are being spent on, and in a general way how well their taxes are being spent on, and in a general way how well their money is being spent. Public budgeting is both political and technical, influenced by interest groups and agency heads. Public budgeting is open to the environment, in the sense that it is influenced by the economy, by public opinion, by other levels of government, by interest groups, by interest groups, by the press, and by politicians. Descriptions of budget processes have not been simply a list of decisions, actors, and due dates, but descriptions of the shifting location of power. Two major dichotomies have been used to describe the shifts in location of power: executive versus legislative, and top-down versus bottom-up.

The overall direction of change during this century (20th) has been toward more executive and more top-down budgeting.

Line-item budgets seem almost deterministic. They tell little if anything about the cost or efficiency of programs provided.

These types of budgets are becoming rare

Program budgets allow public officials to clearly choose between priorities and express them in the budget, but they do not provide a way of evaluating the relative efficiency or effectiveness of programs.

Performance budgeting has had many difficulties, and while sometimes implemented has seldom worked as billed, and has often been modified.

Zero-based budgeting in its full-blown form requires the agencies to put all their budget requests into decision packages, and rank order them in importance. Then the rankings of the agencies are gathered and arranged according to criteria that make sense at a government-wide level.

Planning programming budgeting systems were the most integrated and fullest statement of the linkage between planning and budging, but even when the full system is not adopted, budgets may state goals and link spending requests with those goals.

The emphasis on linking budgeting to goals was used with the linkage of Management by Objectives (MBO) to budgets.

Some Budget Terms:

Tradeoffs – money being spent on one program or project can not be spent on another at the same time.

Equity – a broad term that also applies to taxation, but in the context of spending choices it raises the topic of welfare economics. Does government have a role in making the distribution of income more equal than the market alone would create?

Accountability – is government doing what the taxpayers want it to do? Do the priorities of the government, as reflected in the budget, reflect the priorities of the taxpayers?

Balance – means the total income has to match the total outgo, with or without borrowing.

Reform – change in a direction advocated by some groups or individuals. It does not necessarily mean improvement!

Methodology

Studies of budget processes have normally been based on elite interviewing and participant observation (Qualitative). However, studies on decision making have been quantitative. Surveys have also been a continuing part of budget studies, and are particularly useful to define changing practices at the state and local levels, where more qualitative work has difficulty generalizing.

For the future, more qualitative studies are needed, and studies of the variety and history of budgeting are required.

Issues

The relationships among different business interests and their impact on budgets need further exploration.

Public choice theory postulates excessive public demands for government services, but provides no mechanism for the choice among demands.

Hierarchy theory is supposed to tie budget process to changing environments, to be historically rooted, but to date the school has used data only from one period of time, and has assumed the policy input from the president.

Much more work needs to be done to link processes and decision making to outcomes.

4.8 Important Comps Questions and Student Answers

Q – 1: Other than Performance-Based Budgeting, what are the most important recent developments in financial management? Why are they important and what precipitated them? Explain how these recent changes may/can influence the work of public managers and policy makers.

Indeed, performance based budgeting has been a significant development in financial management. The initial performance based budgets were developed in the 1940s as a result of the Brownlow and Hoover Commissions. These budgets were management-oriented systems heavily focused on efficiency by relating costs to measured outputs. In the 1960s Planning-Programming Budget Systems (PPBS) emerged emphasizing multiyear planning, policy analysis, and program objectives focusing on effectiveness. PPBS was discontinued in government in the 1970s during a period in which the executive and legislative branches battled over who controlled the budget. Then in 1977, under the Carter administration, Zero Based Budgeting was implemented in the federal government. ZBB was to replace the traditional incremental (line item) budgeting systems. It was overwhelmed by changing economic events and in 19981 was rescinded by the Reagan administration. Budget deficits were the budget focus of the 80s and the passage of the Balanced Budget and Emergency Deficit Control Act in 1985 (Gramm-Rudman-Hollings Act) began a lengthy era of dealing with deficits. With the passage of the Government Performance Review Act in 1993, we see the emergence of a new performance budgeting system more concentrated on outcomes. This form of budgeting dominates both federal and state budgets and continues to exert influence in budget decisions today. Of significance is that performance budgets, or outcome budgets, connect the budgeting process with policy formulation, strategic planning, program goal formulation, and program evaluation.

Since the early 1990s with the rapid implementation of performance based budget there have been some important new developments affecting public budgets. Growing deficits, the public's demand for accountability, and a clear rivalry between the President and Congress as to who should control the budget has precipitated these developments. Some of these new developments are a result of the passage of new laws related to public budgeting. These would include:

Budget Enforcement Act – 1990 – amended the Gramm-Rudman-Hollings Act and created a number of procedural requirements such as "pay-as-you-go". This meant that after the budget had been passed, any new spending approved by Congress and the President had to be compensated for by new sources of revenues other spending reductions.

Credit Reform Act – 1990 – tightened requirements on federal lending and loan guarantees.

Chief Financial Officers Act – 1990 – added new financial management responsibilities for federal agencies including creating a CFO position to oversee agency financial practices.

Omnibus Budget Reconciliation Act – included major reductions in defense spending and tax increases for upper income groups and no tax cuts for the middle class.

The Line Item Veto (1996 to 1998) – For a two year period, gave the President the power to veto specific appropriations. Found to be unconstitutional by the U.S. Supreme Court in 1998.

Performance based budget reforms have focused attention more that ever on sharing information and decision making in budgeting. Sharing information about what governments do well, through performance measurement and reporting, can go a long way in reducing cynicism. Broader participation in trading off various goals and means to achieve them, as well as in developing performance measures, will yield better decisions and a sharing of risks among citizens, public managers, and elected officials.

The GPRA and state and local results acts and executive orders emphasize program results and holding federal government agencies accountable for them. The GPRA focuses managers' attention on setting goals, and reporting publicly on progress made. One of the foremost purposes of the act is to instill confidence in the public about federal government managers' ability to solve problems and meet citizen-taxpayers' needs. To implement the GRPA, each agency must first develop strategic plans covering a period of at least five years. The strategic plan must include a mission statement, outcome related measurable goals and objectives, and plans that agency managers and professionals intend to follow to achieve these goals through their activities and through their human, capital, information, and other resources. Those in the agency must consult Congress and others interested in or affected by the plans: in other words, they must consult stakeholders. The new reforms incorporate most of the goals of the previous reforms, but they seek to achieve them through decentralized incentives that give program managers greater authority to combine resources as they think best but that hold the managers accountable for the results.

Performance based reforms deal widely with organization change. Keep in mind that no other decision making system has the leverage to pressure departments to improve program management like the budget. Also, the budget has always been the place where everyone raises questions of the efficiency, economy, effectiveness, productivity, impact, and results of government activities. Lastly, budget offices can inspire agencies to strengthen their programs, operating systems, and organizational structures.

These new efforts at performance budgets appear to have a promising future; however, some authors are not so enamored with performance based budgets. Wildavsky warns that results that are "too good" can have adverse effects in that superb results may result in no further funds being appropriated, as the goals will have apparently been achieved. Caiden finds that performance may be irrelevant in making budget decisions as political popularity and the need to balance budgets are the sole reason for budget decisions.

For managers of programs that meet their goals and objectives and otherwise exhibit exception performance, pay-for-performance has emerged as a strategy for responding to increased productivity of staff. Merit pay is one method, including bonuses, commissions and formulas for sharing savings. NOTE: For more information on the use of merit pay, good and bad, refer to: Halachmi, A, Holzer, M. (1987). Merit pay, performance targeting, and productivity. Review of Public Personnel Administration, 7 (Spring), 80-91.

Q – 2 : In her article treating budgeting, included within Naomi Lynn and Aaron Wildavsky's Public Administration: The State of the Discipline, Naomi Caiden concludes that "Public Budgeting is undoubtedly a discipline in the dictionary definition of the term as a 'branch of knowledge or learning'."

What evidence supports this assertion?

Caiden then cautions: "But if the study of public budgeting is to be more than a collection of disparate concerns, it requires stronger themes, and theories that act not only to unify them but also to reveal the philosophical assumptions underlying empirical description and normative proposals."

Q – 3: Assess the state of the "discipline" of public budgeting

Q – 4: In a renowned 1940 article, V.O. Key, Jr. lamented about "the lack of budget theory." Twelve years later (1952), Vernon B. Lewis attempted to construct a normative budget theory. In one of her numerous writings, Irene Rubin noted that "budget theory today is fragmented and incomplete....It is in the process of being invented." Based on the work of scholars who address this issue, discuss the extent to which the literature of public budgeting evidences "theory." Assess the limitations of such a "theory of budgeting."

Q – 5 : Cite the major federal financial and budget reforms of the past decade, identifying the basic characteristics (provisions) of these reforms. Discuss the implications that these budget reforms hold for public management at the federal, state, and local levels. Discuss the implications of the value assumptions implicit in these reforms vis a vis the fundamental values and beliefs which under gird public administration."

Public budgeting in the US is about accounting and financial management; it is also about accountability and governance. A fundamental principle of the American system of governance is separation of powers – an aspect which is important for restraining the branches and achieving accountability in public budgeting. Protects citizens against the budgetary abuses of excessive taxation and imprudent spending.

Budget Reform in the 1990s: The "New" Performance Budgeting

In the 1990s considerable attention has been refocused upon performance budgeting resulting in a "new" notion of performance budgeting to use Mikesell's term, or what others have called "Entrepreneurial Budgeting" (Cothran, 1993; Lynch, Hwany and Lynch, 1996). As is usually the case, however, these concepts did not suddently spring upon the scene, but rather became the object of renewed attention and interest as fiscal constraints persisted in many governmental entities.(9) Several things converged though to refocus attention on performance budgeting.

One influence was the 1992 publication of Reinventing Government, How the Entrepreneurial Spirit Is Transforming the Public Sector by David Osborne and Ted Gaebler. They noted among other things what was widely known--Americans are cynical about their government. (See, for example, Kanter, 1989.) As one remedy they proposed a results-oriented budget system (although the term was not unique to Osborne and Gaebler). The idea was to hold governments accountable for results rather than focus upon inputs as traditional budgets and management did. Cost-savings and entrepreneurial spirit would be rewarded. A long term view would be facilitated in terms of strategy, costs and planning for programs. Gaebler was a former city manager turned consultant and Osborne was a writer and consultant. Thus, they had exposure to a wide variety of governments. From this experience they focused on examples they found of enptrepreneuial management in government. A local government example they cited as a "performance leader" was Sunnyvale, California and its focus on outcomes rather than inputs (1992: 142). Other examples of "innovation" at the federal and state level were also cited.

Interestingly, as is often the case, efforts to improve performance and increase economy in the public sector were underway before Reinventing Government was published.(10) At the federal level, for example, the Chief Financial Officers Act of 1990 (P. L 101-576) required the development and reporting of systematic measures of performance for twenty three of the larger federal agencies. The Governmental Accounting Standards Board had already examined the use of service efforts and accomplishments (SEA) reporting for state and local government entities. Beginning in the early 1980s it had encouraged governments to report not just financial data in budgets and financial reports but also information about service quality and outcomes and in 1992 issued a Preliminary Views report on SEA reporting (Wholey and Hatry, 1992) followed by another statement in 1994 (GASB, 1994).

Federal Reform Efforts in the 1990s

One thing that popular ideas like reinventing government do, however, is get the attention of the media and political leaders. Drawing on this attention, the Government Performance and Results Act (GPRA) of 1993 (P. L. 103-62) was passed by Congress. The GPRA drew upon earlier antecedents, such as a report submitted during the Reagan Administration and a bill introduced in 1991 by Senator William Roth that had not been enacted, but was revised and became the GPRA. (See Groszyk, 1995.) This act specifically focused attention on results and performance budgeting. The act requires federal agencies to prepare strategic plans by 1997, to prepare annual performance plans starting with fiscal year 1999, and submit an annual program performance report to the President and Congress comparing actual performance with their plans beginning in the year 2000. Due to its relatively recent passage and phase-in schedule, the GPRA will obviously need some time for assessment.

As the GPRA was becoming law, the National Performance Review (NPR) was coming to the forefront also as an initiative for Federal government reform led by Vice President Al Gore. The NPR embraced many of the ideas of the GPRA and added more attention to performance and results management, calling also for a move toward budgeting based on results.(11) The ‘New" Performance Budgeting, however, draws from earlier performance budgeting ideas and from program budgeting/PPBS concepts as well. It differs from those ideas in that it does not advocate crossing agency lines like program budgeting and PPBS did, however. And, according to Mikesell (1995: 189), it does not concentrate on tasks, activities or outputs as much as the old performance budgeting did, rather emphasizing an outcome focus.

As a result of the activity and interest at the national level in managing for results and performance budgeting, both the General Accounting Office (GAO) and the Congressional Budget Office (CBO) have studied the reform proposals in recent years. The CBO, in a 1993 study, Using Performance Measures in the Federal Budget

Process, concluded that performance measurement "is limited in its ability to bring about substantial change" (1993: 44; see also Joyce, 1993). It noted, however, that some of these limitations had nothing to do with commitment but rather with the difficulty of measuring government performance itself, and particularly that of the national government. The greatest obstacle it found was the identification of the measures themselves, in large part because at the national level "so many programs [are] influenced by other actors, including state and local governments, private businesses, and individuals" (Congressional Budget Office, 1993: 44). In so far as performance budgeting itself is concerned, the CBO, after studying state and local government experience, concluded that performance measures did not appear to significantly influence the allocation of budgetary resources. Rather, they were used more to carry out budgets than to make decisions. The GAO (1993) came to similar conclusions as well.

State Reform Efforts in the 1990s

State interest in the "New" Performance Budgeting in the 1990s is evident in a number of ways. The National Governors' Association (NGA), for example, published An Action Agenda to Redesign State Government in 1993 which called for creating performance based state government with measurable goals, such as benchmarks and performance measures, in order to move to performance budgeting. A year later, the National Conference of State Legislatures (NCSL) published a study entitled The Performance Budget Revisited: A Report on State Budget Reform (Carter, 1994). Together these two studies found interest in performance budgeting and measurement in a number of states, including Oregon, Minnesota, Montana, Iowa, Texas, Idaho, Ohio, Florida, Mississippi, California and Virginia, to name a few.

The NCSL, like the GAO study in 1993, found that performance measures and budgeting had not yet attained the credibility needed to influence budget allocation decisions at the state level, due often to constraints on time, resources and data. Conceptual as well as political issues remain according to these studies regarding performance measurement and budgeting. Still, performance measurement was viewed as useful for internal agency management.

One is reminded when reading accounts of interest in concepts like performance budgeting of Premchand's "fortune cycle" that consists of "great anticipation, quick acceptance, partial implementation, partial dissatisfaction, search for new techniques--and the rediscovery of continuing themes" (Premchard, 1981; see also Lewis, 1988). The "rediscovery" or renewed interest in performance budgeting at the state and national level appears to be drawing on a continuous theme in American budgeting--the need for a way to make resource allocation decisions based on more than the inputs that will be used to carry out public programs. That pressures would build at the state (and local) level in particular for such devices is not surprising given their relatively inelastic revenue sources and requirements for balanced budgets, not to mention their proximity to the citizen and voter.

What we may be missing, however, is the slow, incremental process by which change is occurring in governmental budgeting and management. Periodically one gets a glimmer of evidence of change occurring, such as when changes are studied over extended periods of time. Lee's research, for instance, on developments in state budgeting between 1970 and 1990 found "considerable change" such as more program effectiveness and productivity information being required of state programs, measures being included in budget documents, analysis being conducted by the central budget office and legislature and so on (Lee, 1991). Earlier indications of progress being made in state budgeting outside the glare of periodic reform proposals include changes made in Kansas, particularly involving the introduction of planning into state government and its linkage to state budgeting. (See Bibb, 1984) Thus, managing for results and performance measurement are the focal point in many states as they prepare to enter the 21st century. While they may not have actually initiated formal performance budgeting programs, this should not obscure the direction that many of them appear to be headed in.

The national and state interest in the "New" Performance Budgeting draws upon a common source. That is a cynicism and loss of confidence in government in the United States. The 1970s saw the tax and spending limits movement begin, first in California and then in Massachusetts. Since then it has spread to a number of other states and local governments. In many ways this movement is symptomatic of the loss of public confidence in government. Limitations have often been most severe for local governments, especially when coupled with mandates from higher levels of government and existing restrictions on revenue raising capability. Accordingly, local governments have been forced to find ways to respond to this era of limits and scarcity.

Local Reform Efforts in the 1990s

Some local governments have responded by becoming entrepreneuial. One local government in particular has received a great deal of attention for its entrepreneuial efforts--Sunnyvale, California. Sunnyvale was the inspiration for the Government Performance and Results Act and was cited by Osborne and Gaebler in their book Reinventing Government. A Council-Manager city of about 120,000 people located south of San Francisco, Sunnyvale is unique in its application of performance measurement and budgeting at the local government level. It has a General Plan looking 5 to 20 years into the future. The plan comprises seven elements and 20 subelements that set goals and policies for the city. Its Resource Allocation Plan is a 10-year budget to implement the General Plan. Each year the annual budget is a performance budget that targets specific service objectives and productivity measures linked to the larger plan. Its budget therefore is a service oriented document rather than the traditional line-item, input oriented budget.

In many ways, this city appears to be the embodiment of the contemporary interest in performance budgeting. Yet, observers note that it is atypical of other cities in terms of its demographic characteristics (Lewcock and Rogers, 1988; Mercer, 1994; and "Better Government, A Clockwork City," 1993).

On the other side of the United States is another city which has also received some national attention for its innovative management, Rock Hill, South Carolina (Wheeland, 1993). Rock Hill has been actively involved with strategic planning for a number of years. And, it has also received the Government Finance Officers Distinguished Budget Award, most recently in 1996. This national award was begun in 1984 for outstanding budget presentations by state and local governments. To date over 700 local governments have received the award (including Sunnyvale). Rock Hill is smaller (population 41,600), however, than Sunnyvale and is not located in a high tech growth corridor. Thus it is in many ways more typical of many cities having to struggle with a declining economic base (the demise of the textile industry) and facing competition from nearby growth centers (in this case the Charlotte-Mecklenburg SMA in North Carolina). Like many other cities in its population range, it has the council-manager form of government (as does Sunnyvale, although cities over 100,000 do not commonly use this form). Also, like others, Rock Hill has regularly sought recognition for its financial management and budget practices. In some ways Rock Hill's budget might be what ICMA (1993) calls "Strategic Budgeting." This is a budget process that is built on strategic planning and which uses the budget as a policy guide, a financial plan, an operational guide, and a communications device with citizens and taxpayers. Briefly, the budget includes all funds and addresses all organizational needs through goals and objectives clearly stated and where possible measurable. A longer time horizon than one year is used as well.

When one examines the fiscal year 1996 budget for Rock Hill and compares it with previous years, for example, one notices one clear difference--there are no expenditure line-items in the budget. Departmental expenditures are summarized in terms of program goals, program objectives and performance measures. Thus, like a number of other local governments, Rock Hill is shifting its focus to accountability and results. While cities like Sunnyvale may be described as entrepreneuial, Rock Hill may be more symbolic of what more local governments, particularly cities, are doing to respond to revenue constraints and scarcity, namely engaging in more planning and management improvement using what are viewed as "state of the art" techniques such as strategic planning and strategic budgeting, or the "New" Performance Budgeting. Some evidence exists that productivity and quality improvement efforts at the local level of government are having some impact nationally as well, although more information needs to be collected (Cope, 1995).

CONCLUDING REMARKS: Prospects for Budgeting in the 21st Century

Budgeting in the United States has experienced at least five emphases, starting with control at the turn of the century, moving to management in the New Deal and post-World War II period, to planning in the 1960s, prioritization in the 1970s and 1980s and now to accountability in the 1990s. By all accounts the initial emphasis on control has been successful if one interprets the adoption of line-item budgeting as an indication of that emphasis. It appears that at least eight out of ten cities and counties use line-item budgeting in some form today (Cope, 1995: 43). As Cothran writes: "Although none of these efforts, such as performance, program, or zero-base budgeting, entirely supplanted incremental line-item budgeting, elements of these reforms endure in the budgeting process of many governments" (1993: 445).

Assessing the impact of the remaining reforms becomes somewhat more difficult, in part due to the American federal system and its diversity. In addition, there are methodological challenges to studying large numbers of governments. Survey research is often used and as Schick (1971) notes surveys are not entirely accurate if exclusively relied upon when assessing budget approaches. (The CBO and GAO studies also reflect the need for other research methods, such as case studies and expert panels.)

One thing that most scholars and practitioners agree on is that most reforms are oversold. Consequently, because the expectations are unrealistic, assessments conclude that they have failed. Conclusions of general failure may not be entirely accurate, however. Rubin (1990) makes an excellent point when she notes that budget reforms have been more successful than many people in public administration think. While some reforms may indeed be fads, in other cases some changes have occurred.(12) Partially this is due to overemphasis on the federal level of government by scholars. Innovations often begin and continue at the state and local level of government without much fanfare.

But Rubin and Rose make another point as well that we feel needs to be emphasized. Namely, observers may look too quickly for results. As Rose has written: "The absorptive character of government, gradually adapting and incrementally augumenting its activities, suggests that change may more easily be measured on a time scale congenial to a forester or a geologist than to a Congress or a White House in a hurry" (1977: 64). Many innovations are clumsily introduced and require adaptation (Rubin, 1990) and, ideas are frequently adapted to local circumstances and needs (Walters, 1996). Thus, reforms or innovations have to be evaluated over a period of time using a scale of achievement.

If we take this longer view, it appears that budget reform is alive and well in the United States. The federal government and many states are continuing to experiment with program and performance information as are local governments. Professional organizations, like the Governmental Finance Officers Association, continue to nurture change and advancement in budget presentation and financial reporting.

Cities like Sunnyvale gain attention as they illustrate a willingness to change and experiment resulting in the use of terms like Entrepreneurial Budgeting. Perhaps more often, cities like Rock Hill strive to advance their decision making using more commonly understood notions of performance budgeting and performance measurement in response to taxpayer resistance and revenue scarcity.

Thus, as the twentieth century ends, local governments are a focal point once more for budget innovation and change. Part of the reason for this is that they were at the forefront of the movement in the United States to establish strong executive forms of government. Along with that movement went also the council-manager form of government. Budgeting in the United States is heavily influenced by both the federal system and executive-legislative conflict (Hyde, 1992: 3). Competition between the executive and legislative branches is most evident at the national and state levels of government. It is the local level, and then in the mid-size population range of cities, that we find truly strong executives with weak, part-time legislators in the professionally managed council-manager cities. Whatever the merits of the council-manager form of government, a good case can be made that it has allowed more innovation and reform to occur. Thus, change and continued progress can be expected in the field of American budgeting in the twenty first century building upon both what was begun at the turn of this century and the trends underway in the latter part of this century.

Federal Unfunded Mandate Reform:

A First-Year Retrospective Theresa Gullo and Janet Kelly

This document, written by, describes the progress that The Unfunded Mandates Reform Act of 1995 has made. This act took effect on January 1, 1996, and has made two important changes about the budgetary impact of federal mandates is provided to and used by Congress. First, the act increased the amount of information, and as a result, placed a higher priority on preparing state and even local estimates. Second, this act encouraged Congress to use the information by establishing new points of order procedures.

The Unfunded Mandates Reform Act was enacted as part of the Republicans' Contract with America. However, many governors were reluctant to support such an amendment. They were worried that the pressure for new programs and policies would remain constant while the budget would decrease, and the requirements for balancing the budget would shift the cost of new programs and policies to the states. At the 1995 annual association meeting, the governors declared that the unfunded mandates should be protected first, and the Congressional Republicans agreed.

As stated before, one of the main goals of The Unfunded Mandates Reform Act (UMRA) was to improve the information that Congress received about the effect of federal legislation on state, local, and tribal governments, and the private sector. Another goal was to make it more difficult for Congress to enforce unfunded mandates on state and localities.

The UMRA obtains four titles: Title I, Legislative Accountability and Reform. This Title, in general, makes it harder for the Congress to consider unfunded mandates with cost above specific thresholds. Title II, Regulatory Accountability and Reform, requires federal agencies to review the effect of proposed regulatory actions on the state, local, and tribal governments when the costs of that effect exceeds one hundred million dollars. Title III, on the other hand, forces the U.S. Advisory Commission on Intergovernmental Relations to have three reports. These reports include: a review of the role of mandates in intergovernmental relations; a study of the measurements and estimating issues surrounding the costs of mandates; and finally, a review of federal court rulings to identify requirements placed on state, local, or tribal governments. Lastly, Title IV authorizes federal courts to compel agencies to comply with the duties outlined in Title II.

The UMRA defines an intergovernmental mandate as "any provision in legislation, statute, or regulation that would impose an enforceable duty upon state, local ot tribal governments, except a condition of federal assistance; or a duty arising from participation in a voluntary federal program.” However, this definition is unclear because it excludes legislation that enforces the constitutional rights of individuals. To help with this confusion, a point of order lies against any bill reported from an authorizing committee if a mandate statement from the CBO is not attached to it. A point of order also lies against any bill if it contains an intergovernmental mandate with unfunded act above the threshold. However, this procedural constraint is not self-enforcing. A member of the House or Senate can easily avoid a point of order and pass the bill.

The UMRA has also given the CBO new responsibilities. In fact there have been two important changes. The first change is that the CBO is encouraged to place a higher priority on preparing state and local government estimates. Second, by establishing the provisions on points of order, the new law protects that information. The CBO is also required to prepare state and local government cost estimates since1982. The Congress showed its willingness to take information seriously by using it as the basis for points of order. In addition, the act requires the agency to prepare cost estimates for tribal and private sector mandates and allows for more detailed analysis of both public and private sector mandates when requested.

Of the five intergovernmental mandates that CBO identified as exceeding the fifty million dollar threshold, only the increase in the minimum wage was enacted into law in a form that will impose costs on state and local governments above that threshold.

One of those bills included provisions that would have amended the Fair Labor Standards Act to require an increase in the minimum wage for all workers. The CBO decided that such an increase would constitute an enforceable duty on all employers and thus impose both an intergovernmental and a private-sector mandate as defined by the UMRA.

The Health Insurance Reform, on the other hand, required parity for mental health benefits relative to physical health benefits for group health insurance. A more limited version of the requirement was enacted. The CBO estimated that the direct coasts to the state and local governments of the more limited version were well below fifty million dollars in any year.

The bill, Applying Occupational Health and Safety Standards to State and Local Workplaces, would have changed the Occupational Safety and Health Act to make workplace requirements applicable to the twenty-seven states where they do not currently apply. This bill was never even considered on either the House or Senate floor.

The Fourth bill, Securities Regulatory Reform, would have preempted state laws and regulations regarding certain types of securities and security-related transactions. The estimated costs of the mandates would total about fifteen million dollars annually. This bill was later enacted into law.

The last bill constructed by the UMRA was the Immigration Reform: Driver's License Provisions. This bill would have required state agencies issuing driver's licenses or identification documents either to print Social Security numbers on those items or to collect and verify the number before issuance. Those requirements would have been effective within one year of the bill's enactment. No point of order was raised against the bill, as amended, and it was ultimately enacted into law.

Also, because of the diversity of affected entities, aggregate cost estimates were extremely hard to make. Finally, the agency decided that it was difficult to gather adequate data at the legislative stage of the process, because the available time was often too short and because the likely impacts were too uncertain.

The UMRA did lead to some important changes in the estimating process. By establishing a fifty million dollar threshold for intergovernmental mandate costs, the act tended to simplify the job of the CBO, at least for bills with mandate costs that clearly exceeded that level. The agencies found that one-on-one telephone contacts were still the best tool for collecting data. They have also learned that more interest group has increased the capacity to respond back to the CBO. The state and local interest groups have appeared to increase their capacity to respond to the Congressional Budget Office's inquiries. The Federation of Tax Administrators was an extremely useful resource for the CBO.

Just as the CBO found that the old tools were most effective, the agency also found that the same obstacles were still the hardest to overcome. For example, separating the incremental costs of federal actions continued to be difficult. Consequently, state and local governments analysts have a hard time predicting how they would comply, making it difficult for the CBO to estimate costs reliably. Before the CBO found that state and local estimates generated little interest. If the agency did not provide a state and local estimate for a bill, the Congress rarely asked it to prepare one. And few controversies or questions arose about the estimates either from the Congress or from state and local governments. The CBO operated in an environment where little attention was paid to its state and local estimates.

That environment has changed dramatically since the UMRA has been in effect. Representatives of state and local governments are now much more likely to approach the CBO about mandates proposals and to assist in gathering cost data. Members of Congress and their staff are also much more likely to request analyses of mandates and to question the agency's methods and assumptions. As a result, the estimating process is much more dynamic and has helped improve the quantity and quality of the information being provided to the Congress.

What do we know About Budgeting?

There is virtually nothing of substance about how or why budgetary decisions are actually made. Yet the opportunities for developing and testing important propositions about budgetary decisions are extraordinarily good and I would like to suggest a few of the many possible approaches here.

How do various agencies decide how much to ask for? Most agencies cannot simply ask for everything they would like to have. If they continually ask for much more than they can get, their opinions are automatically discounted and they risk a loss of confidence by the Budget Bureau and Appropriations subcommittees that damages the prospects of their highest priority items. We might also inquire about the participants' perceptions of their roles and the reciprocal expectations they have about the behavior of others. Budgetary items are commonly adjusted on the basis of mutual expectations or on a single participant's notion of the role he is expected to play.

By its very nature the budgetary process presents excellent opportunities for the use of quantitative data although these must be used with great caution and with special attention to their theoretical relevance. It would also be desirable construct a theory of budgetary calculation by specifying the series of related factors that affect the choice of competing alternatives by the decisions makers. This kind of theory would describe how problems arise, how they are broken down, how information is fed into the system, how the participants are related to one another, and how a semblance of coordination is achieved. If changes in procedure lead to different kinds of conclusion, one would like to be able to predict what the impact on decisions was likely to be.

The Goals of Knowledge and Reform

Concentration on developing at least the rudiments of a descriptive theory is not meant to discourage concern with normative theory and reform. On the contrary, it is worthwhile studying budgeting from both standpoints. Surely, it is not asking too much to suggest that a lot of reform be preceded by a little knowledge. The point is that until we develop more adequate descriptive theory about budgeting, until we know something about the "existential situation" in which the participants find themselves under our political system, proposals for major reform must be based on woefully inadequate understanding.

Perhaps the "study of budgeting" is just another expression for the "study of budgeting"; yet one cannot study everything at once, and the vantage point offered by concentration on budgetary decisions offers a useful and much neglected perspective from which to analyse the making of policy. The opportunities for comparison are ample, the outcomes are specific and quantifiable, and a dynamic quality is assured by virtue of the comparative ease with which one can study the development of budgetary items over a period of years.

Q – 6: The budget may be viewed as an instrument of fiscal policy, as a means of determining policy choices, and as a tool for managing the economy. Explain each of these aspects of budgeting. In your answer, emphasize the views of the classical or pre-Keynesian economists, Keynesian economists, neo Keynesians, the monetarists, the public choice school of economy, and leading public budgeting scholars

Classical/pre-Keynesian

- Adam Smith wrote The Wealth of Nations in 1776 --- father of capitalism
- the free market is most important
- government's role in the economy is very limited
- voluntary exchange between buyers and sellers leads to economic efficiency
- prices are set by competition in the free market based on supply and demand

Keynesian

- John Maynard Keynes wrote General Theory of Employment, Interest and Money in 1936
- some government spending is necessary to fine tune the economy
- performance by the economy in the aggregate is more important than individual
- so we need to look at output (GDP) , income and employment rates
- potential GNP means the full use of the factors of production (land, labor, capital)
- compare potential GNP with actual GNP
- aggregate demand $Y = C + I + G + (X-M)$

  C is consumption

  I is investment

  G is government spending

  X-M is exports minus imports

- small deficits are ok---necessary to fine tune the economy
- the multiplier effect is very important---an increase in aggregate demand will result in an even larger increase in actual or equilibrium GNP

Neo Keynesian

- Reagan and Bush One

- they called for big changes in government spending, interest rates and to counter economic cycles
- in a recession they want more government spending and tax cuts to stimulate the economy
- in inflation they want less government spending and tax increases to slow the economy down
- they also use monetary policy (interest rates set by the Federal Reserve Board) to influence the economy

Monetarists

- Milton Friedman and Alan Greenspan
- Professors at Syracuse says monetarists may be right - monetary policy may be more effective in impacting the economy than fiscal policy
- they are also called “counter Keynesians” because they disagree with Keynes
- they say the economy is inherently stable---government fine tuning is not necessary
- to them, the money supply is most important
- and the supply of money is controlled by interest rates which are set by the Fed

Pubic Choice

- this is a modern day theory
- followed by pre Keynsian economists
- individuals are rational---they make choices to best benefit themselves (whether as buyers or as bureaucrats)
- politicians may claim to follow neo Keynesian policies but sooner or later they must balance the budget

see Forrester, John P., Evolving Theories of Budgeting, pp. 101-124

See Stapleford, John E. (1992). “Economic Impact of Budgeting” in J. Rabin (editor), Handbook of Public Budgeting. pp. 401-418. **See hard-copy of summary

Also see Ooms, V.D., Boster, R.S., and Fleegler, R.L. (1999). Handbook of Government Budgeting, pp. 197-226

The Federal Budget and Economic Management, V.D. Ooms, R.S. Boster and R.L. Fleegler

Handbook of Government Budgeting, pp. 197-226 (1999)

The question: Can the budget by used to manage unemployment, inflation and economic growth?

The conclusion: The budget can be used to influence economic growth but NOT unemployment and inflation (this may even be counterproductive).

Definitions:

Fiscal policy---choices regarding a budget's total revenues, expenditures and deficit (government spending)

Budget policy---choices about the broad composition of aggregate revenues and expend.

Stabilization policy---fiscal ("fis") & monetary ("mon") policies to influence unemployment ("unemp"), inflation ("infl") and economic activity in the short term

Growth policy---using fiscal and monetary policies to affect long term changes in productive capacity---

Monetary policy---Federal Reserve actions regarding short-term interest rates to affect the money supply

Economic stabilization---concerned with short term unemployment and inflation---2 years max

Stabilization policy---changes the level of spending and thereby changes the level of output---this affects unemployment and inflation

Real GDP---the total value of goods& services produced in the U.S. per year adjusted for inflation

Potential GDP---the output the economy has the capacity to produce without increasing inflation

Economic growth---an increase in potential GDP over years or decades

Productive factors---labor, skills, machines and their related technology---growth policies Increase future levels of these factors---thereby increasing Potential GDP

Stabilization is concerned with the gap between real GDP and potential GDP and the implications of the gap for inflation and unemployment---see p. 199

The goal of stabilization policy is to manage the gap so that GDP is close to its potential (output and incomes will be high and unemployment will be low)

Growth is concerned with increasing Potential GSP

The goal of growth policy is to raise the slope of the potential GDP curve by increasing productive factors and their technology

Unemployment, Inflation and Growth

Unemployment Rate in Feb. 05 = 5.4% in U.S. and 5.9% in TN

in Jan. 05 = 5.2% in U.S. and 5.9 % in TN

"The number of civilians at least 16 years old who are unemployed and tried to find a job in the last 4 weeks." (Understanding Business, p. 53)

Inflation Rate in Feb = 3.0 % in U.S.

in Jan. = 3.0% in U.S.

Involuntary unemployment has individual costs---low income, anxiety, low self respect and social costs---crime, inequity (it hits low income workers more)

Hysteresis---high unemployment may perpetuate itself (e.g., some European have adapted to it)

The cost of inflation is less obvious

Both the public and the Fed have deep antipathy toward inflation

It produces large redistributions of wealth

Perception of reduced purchasing power

It engenders uncertainty

It leads to high unemployment

The economic growth question:

How much consumption should we sacrifice today to make investments that will help the future? (p. 201)

The authors say we need to be making more future-oriented investments (due to reductions in real incomes and baby boomers retiring)

Stabilization Goals

The federal government promotes maximum employment and stable prices (1946 and 1978 Acts)

There is much disagreement on this but consensus on the fact that unemployment and inflation are independent in the long run. High inflation does not automatically lead to low unemployment and low inflation does not automatically lead to high unemployment---despite the inverse relation shown on p. 203

Remember: Full employment does not mean zero unemployment

Frictional unemployed---people who quit because they didn't like the job

Structural unemployed---restructuring of firms or a mismatch of skills & jobs

Cyclical unemployed---due to business cycles---the most serious

Full employment means the demand and supply for labor are in balance. Therefore, the wage inflation stays at the same rate.

So --- full employment is the lowest unemployed rate attainable without continually rising inflation, also called the non-accelerating inflation rate of unemployment (NAIRU)

Potential GDP means the output that would be produced at the NAIRU

If inflation and unemployment are independent --- why not pursue zero infl? --- p. 204

Probably because it would lead to severe dampening of the economy. (?)

The authors observe that most experts pursue a modest infl rate of 2-3%

Stabilization Policy

We need stabilization policy because (i) aggregate demand does not rise and fall with full employment, and (ii) adjustments of employment and inflation to low demand is slow.

(i) Consumer spending represents 2/3 of aggregate demand. And it shifts to reflect changing sentiment about jobs, wages, etc. Public demand also changes as gov spending changes (e.g., the reduction in military spending after WWII led to a recession despite private growth)

Wages are "sticky downward"---they adjust slowly---so when demand falls, wages remain high leading to involuntary unemployment

Inflation can only be reduced by large reductions in demand---p. 206

This requires higher unemployment and lower output---measured by the sacrifice ratio (the fraction of a year's potential GDP that must be sacrificed to reduce inflation 1 %---about 4%.)

Using Fiscal Policy to Stabilize the Economy

When the economy weakens, the deficit automatically increases and when the economy improves the deficit automatically shrinks.

Discretionary changes in fiscal policy are different. For example, the difference between the structural deficit (which assumes high employment and is caused by the "structure" of tax and spending programs) and the actual deficit is called the cyclical deficit. (p. 207)

If the economy is weak and GDP is below potential the actual deficit will be larger than the structural deficit. If the economy is strong and GDP is above potential, the actual deficit will be smaller than the structural deficit.

Automatic stabilizers dampen the effect of changes in the budget. These include:

- Taxes
- Unemployment compensation
- Food stamps
- Medicaid

So---if military spending is reduced the secondary effects on workers will be moderated because they will have less income on which to pay taxes and they will receive these benefits. The government budget automatically absorbs part of the decline in their income.

Discretionary Stabilization Policy

Rather than merely dampening the effects of changes in aggregate demand through automatic stabilizers, discretionary changes in policy may completely reverse them. For example, a big surge in demand may be offset by restrictive fiscal or monetary policy (such as lower spending or higher interest rates) or a drop in demand may be offset by expansionary policy..

This was the view 30-40 years ago. Today the experts question how effective this approach really is. The idea that the government could (and must) step in and stimulate the economy (refined Keynesian theory) was very popular from the mid '40's to the late '60's.

But this optimism was overtaken by events:

- "Stagflation" in the late '60's---high infl + high unempl (the misery index which hit 21% in 1980)
- Oil crisis in 1973
- Grain shortages

Edward Phelps and Milton Friedman theory:

Unemployment and inflation are independent in the long run. If government policies hold unemployment below its natural (or "equilibrium") point based on supply and demand of labor, inflation will go up continuously. This was the cruel dilemma---by trying to help, the government was making things worse!

We learned that forecasting future economic conditions is very difficult

The doctrine of rational expectations---stabilization policies by the gov won't work because individuals will adjust their behavior in anticipation of them

Time lags between awareness of the problem and ultimate effects of the policy

Inside time lags---within the policy making process

Outside time lags---in the economy, itself

Monetary policy---short inside lags---the Fed meets every 6 weeks long outside lags---the impact of interest rate changes on the economy may take a long time

Fiscal policy---long inside lags because legislation must be passed (the pol change may not take effect until into the next economic cycle!) short outside lags because spending changes quickly affect the economy

Politics play a big role in fiscal policy

Globalization has made fiscal policy less effective (e.g., expansionary fiscal policy raises demand so interest rates go up; this attracts foreign capital causing the value of the dollar to go up making imports less expensive which causes demand to fall)

Discretionary fiscal policy ceased being effective as an expansionary tool in the '80's and early '90's due to large structural budget deficits. Monetary policy---actions by the Fed---became the way to stabilize the economy (p. 213)

Thus, the main role of fiscal policy has now become economic growth rather than stabilization

Growth Policy

Economic growth looks back (to the sharp slowdown in productivity in the ‘70’s) and forward (to the impact of the baby boomers retiring).

Productive capacity is determined by how efficiently and effectively the factor inputs of

Labor hours

Human capital---education and skills

Physical capital---machines and structures

Can be combined to produce finished goods and services. Thus, the technology which is used to bring them together is most important factor.

(Some economists argue knowledge is most important---?)

A big question is why has productivity dropped so much in the last few decades?---p. 215

Growth policy includes strategies to increase physical capital, human capital or technology.

Using Fiscal and Budget Policies to Increase Economic Growth

Fiscal policy---impact private capital formation (it addresses the size of the deficit thereby affecting the amount of national savings available for private investment)

Budget policy---impact public capital formation (it alters the composition of taxes and spending)

National growth policy in recent years has focused on deficit reduction and increasing private capital. Deficit reduction reallocates resources from public use to private investment. But the reallocation is not dollar for dollar.---p. 216

This pol is due to(i) the political appeal of balancing the budget, (ii) a broad consensus that this will work, and (iii) a concern that private savings has fallen so much in recent decades.

See p. 217---public “dissaving” has increased in recent decades due to large deficits

In the last decade (’87-’97) public saving increased

But the outlook for the deficit and improved saving remains unfavorable due to the explosion in retirement and health care as BB’s retire

This proved to be true---9/11!

Budget Policies

National output, federal expenditures, federal tax policy and federal budget policies focus on two things:

Consumption today OR investment to enhance growth in the future.

Budget policies can affect growth in different ways:

1. Redirect public expenditures from consumption to investment (e.g., highways, aviation, water, environmental programs---a concern is that programs of this type are politically motivated)

2. Tax policies (e.g., investment tax credit, capital gains, housing---two problems: excessive demand may result from these policies causing interest rates to go up AND these policies may reduce public saving because money has gone into private saving---the lesson is that the budget policy may requires a coordinated fis pol to be effective)

3. Focus on human capital --- education and training are very important in economic growth

4. Invest public funds in technology---private investment in R& D is not as efficient

Social returns from R & D = 50%

Private returns from R & D = 20-30%

For this reason the private sector under-invests in R & D.

The public sector should increase its investment in R & D---especially in basic research

5. Non budgetary instruments also affect economic growth (e.g., regulatory and trade policy)

Coordination of Fiscal and Monetary Policy

The fiscal policy of the government affects the monetary policy adopted by the Fed much more than the Fed's policy affects the government.

They are theoretically independent but the Fed watches the government very closely and they frequently are coordinated to pursue a single purpose (to expand or restrain the economy).

When more than one goal is pursued at the same time, this coordination is complex.

(The Tinbergen Rule---pursuing multiple policy goals requires an equivalent number of policy instruments)

An expansive fiscal policy (with large deficits) requires a tight monetary policy (with increasing interest rates) to hold down inflation-p. 222

This describes late 2004 and early 2005!

Seven ¼ point increases in short term rates in 6 months

The president, congress and the Fed have different policy goals

The Fed usually worries more about the long term so it is the "inflation fighter"

Politics is always involved

See p. 223---Has the traditional role of Republicans and Democrats been reversed?

Conclusion

1. The budget can be an effective tool to promote long term economic growth.

2. Through automatic stabilizers the budget moderates fluctuations in economic activity.

3. Discretionary fiscal policy is not effective to bring about short term stabilization (it may even be counterproductive) so monetary policy has become our main way to stabilize the economy.

State and Local Budgeting: Coping with the Business Cycle M. Wolkoff

Handbook of Government Budgeting, pp. 178-196 (1999)

State and local officials can do little to influence the economic winds that blow sharply across their bow. P. 179

But these "winds" are very important to them because:

48 state constitutions require a balanced budget

Local and state governments must maintain a good bond rating to incur debt

Local and state governments have less flexibility than fed budget makers (interest rates and fiscal policy are controlled by the fed gov)

Economic Cycles

All economists agree that the US economy goes through cycles of expansion and contraction.

From 1970-1996 there were four such periods---see p. 180

Different regions deal with national economic cycles differently due to different

Industrial composition

Access to markets

Raw materials

Historical happenstance

Technology may make these differences less important

See p. 182--- 1989 to 1995 unemployment rates in the 10 largest metropolitan areas varied greatly---above and below the national average each year

See p. 183---this model shows statistically that local unemployment rates ARE impacted by changes in the national unemployment rate

And that the rates in different SMSAs are impacted differently

For example, a 3 % increase in the national UR will cause a 6% increase in Boston but only a 1% increase in Atlanta.

See p. 185---shows employment shares by industry in the 10 largest metropolitan areas which lead to different experiences as national economic conditions

Linking Economic Cycles to the public Fisc

State and local fiscal fortune is directly linked to the national economy.

When times are good, people are working and the revenue coffers are full.

When times are bad, people need more help from the gov but coffers are empty.

Some jurisdictions are more sensitive to cyclical changes in the national economy

due to differences in their

1. Industrial structure

2. Expenditure responsibilities

3. Composition of their revenue sources (e.g., income taxes are very sensitive to changes in economic conditions while property taxes are less sensitive)---see p. 187 for breakdown

For years the conventional wisdom was that state and local govs had to choose between growth (income taxes) or stability (property taxes) (?) --- p. 186

BUT now experts say that a combination of short term stability and long term growth is possible. Taxes that have higher long-term income elasticities (income taxes) need not vary more over the business cycle than taxes with lower elasticities (property taxes).

Dealing With Budgetary Imbalance

State and local govs have a limited number of options for dealing with budget deficits

1. Pessimistic Budget Estimates

   By assuming the least favorable economic circumstances, deficits due to cyclical changes will be avoided and the budget will always be balanced. But there will never be enough money and services will be far below what the citizenry demands

   Problems with this approach:

   It gives much power to the revenue estimators

   The level of services provided is less than what is sustainable (and needed!)

   Surplus almost guaranteed-giving great power to the executive & incentive to the legislature not to be conservative

   The dashed line represents economic cycle

   SS is a budget in structural surplus---deficits are rare due to pessimistic forecasts

   SD is a budget in structural deficit---surpluses are rare due to optimistic forecasts

   SB is a budget in structural balance---the cyclical deviations are symmetrical

2. Rainy Day Funds

   A percentage of the total budget is set aside and not spent---frequently 5%

   It is saved for future economic hard times

   How do you decide when to add to it or to dip into it?

Executive decision

Legislative decision

Formula---e.g., Michigan (Wolkoff likes this best)

3. Financial Legerdemain

Unsound accounting tricks---"slight-of-hand"

Redefine the fiscal year, or

Show revenue or expenditures in another period

These are temporary fixes ---merely putting off the problem

Move operating expenses to the capital budget

Sell assets

Use money for other purposes

4. Contingency Spending and Taxing Plans

These are tax or spend policies automatically triggered by economic events (e.g., if revenue collections are down, a tax increase kicks in OR spending is reduced, automatically)

Problem with this approach---it can exacerbate local cyclical effects

Remember the impact of mundane, day-to-day decisions on the budget (e.g., leaving a position vacant lowers the level of services)

Endogenous Strategies

State & local govs have three generic strategies to get off the cyclical roller coaster:

1. Revenue structure---chose sources that are less cyclically prone or that offset each other (e.g., combine income and property taxes)

2. Use countercyclical policies---economists now think decentralized stabilization policies may work, after all because local multipliers are larger and borders are less "leaky" than Musgrave thought---p. 194

3. Alter the growth path---this is the flip side of Larkey & Smith's pessimistic budgeting---use optimistic assumptions that the economy will grow its way out of the cycle

Problem---this requires restraint on spending

Conclusion

These strategies for dealing with economic cycles can be applied to other challenges to the budget, such as the need for snow removal or for police overtime.

All of these are difficult to predict and exhibit year-to-year variation in budget requirements.

Flexibility is the key!

The Growing Fiscal and Economic Importance of State and Local Governments by R. Bahl

Government Budgeting: Theory, Process and Politics. 3rd ed. Pp. 363-379 (1984)

State and local gov = 13% of GNP in 1981 and 50% of total gov spending

What is the "proper" balance between fed and state and local gov in the U.S.?

Distribution---are subnational units big enough to influence the interpersonal distribution of income?

Stabilization---can counter-cyclical behavior by state & local gov compromise federal macroeconomic policy?

Allocation---is state & local gov too large (thereby discouraging private investment)? Is it too small (not providing adequate services)?

From 1942-1976 there were four major trends:

1. The state & local sector became more important in the national economy
2. Public spending shifted to health, ed and welfare (big increases in SS)
3. State & local govs became more dependent on federal transfers of money
4. State gov has become very dominant in state & local sector

Since 1976 these trends 1-3 have been reversed.

1. The national sector became more important
2. Spending moved away from health, education and welfare

See p. 366---60% of expenditure increase from1960-76 was for hew

56% of expenditure increase from 1976-81 was for hew

(Is this decrease significant? Is five years long enough?)

3. There was less dependence on federal money

These conclusions are based on measurements of employment and expenditures

From 1954 to 1980 state and local gov employment increased 174% fed gov employment increase only 22%

From 1959 to 1984 the fed share of local spending increased from 40% to 50%

The Economic Role of Subnational Governments

Conventional thought says that of the three functions of public budgets (stabilization, distribution and allocation) only allocation is proper for state & local govs.

National policy is needed to stabilize the economy because of "leakages" from the state economy (i.e., spending on goods produced in other states).

And to distribute income due to mobility (high income individuals may migrate to avoid taxes and low income individuals may migrate to gain benefits).

Thus allocation---deciding which and how much local services will be provided and how they will be paid for---is the proper function of subnational govs. It is also more efficient because the preferences of local voters can be considered.

But Bahl questions this conventional thought and argues that subnational govs can have an important impact on stabilizing the economy and in distributing income.

While subnational govs are ill-equipped to set their own growth and stabilization policies, their reaction to national policies must be considered. Two issues are important:

- Whether state & local budgetary decisions hurt or help federal stabilization programs?

    The studies on this question show mixed results.

    Bahl's conclusion is that "the fiscal actions of state & local govs have to be reckoned with in the formulation of national economic policy. The sector is simply too large a share of GNP to be ignored." (???)

- Whether federal programs which stimulate the state & local sector result in unintended changes in the federal fiscal system?

    Yes -two times in five years.

    Bahl argues that state & local budgets play an important role in distributing income

    He bases this on the size of state & local gov (40% of nondefense gov spending and 13% of GNP)

State &local gov influence distribution of income through taxes, public assistance.

(He notes that low income families have not migrated to high payment areas).

The redistributive effect of taxes is probably less than of expenditures.

What we need from the research is the "net fiscal incidence" that measures the benefits of expenditures and the burdens of taxes on the distribution of income.

Hard research on this question does not offer a clear answer.

But Bahl's hypothesis is that the poor do not fare very well. They are hit by taxes, not always offset by benefits.

Even if the research is not clear that state & local govs actually affect redistribution of income, they express concern about it.

Is the State and Local Government Sector Too Large?

There are no guidelines on the optimal size of gov from political nor economic theory.

Three possible considerations:

1. Gov is too small compared with other industrialized countries. Bahl says this is not a fair comparison because we do not offer the same package of public services, and other countries are so small (the overall tax burden varies greatly among states in the U.S.--- e.g., NY)
2. Gov is too large because it interferes with the market and retards growth. The Laffer Curve theorizes an inverse relationship between tax rates and government revenues---research does not support this but Bahl agrees that high tax rates are a disincentive to capital formation which can be addressed by changing the tax system or reducing the size of government (Is this very likely?)
3. Gov is too small because it has not corrected the unequal distribution of income. It is argued that there is a direct relationship between the size of the public sector and the distribution of income. In Europe there is more redistribution of income than in the U.S. and the larger governments are more involved in social insurance and welfare.

The conclusion---the size of the government in the U.S. should be increased to improve income distribution.

Bahl says increasing the size of government will not likely have this effect

Also the mood in the nation seems to be toward smaller government

Q – 7: Other than Performance-Based Budgeting, what are the most important recent developments in financial management? Why are they important and what precipitated them? Explain how these recent changes may/can influence the work of public managers and policy makers

Indeed, performance based budgeting has been a significant development in financial management. The initial performance based budgets were developed in the 1940s as a result of the Brownlow and Hoover Commissions. These budgets were management-oriented systems heavily focused on efficiency by relating costs to measured outputs. In the 1960s Planning-Programming Budget Systems (PPBS) emerged emphasizing multiyear planning, policy analysis, and program objectives focusing on effectiveness. PPBS was discontinued in government in the 1970s during a period in which the executive and legislative branches battled over who controlled the budget. Then in 1977, under the Carter administration, Zero Based Budgeting was implemented in the federal government. ZBB was to replace the traditional incremental (line item) budgeting systems. It was overwhelmed by changing economic events and in 19981 was rescinded by the Reagan administration. Budget deficits were the budget focus of the 80s and the passage of the Balanced Budget and Emergency Deficit Control Act in 1985 (Gramm-Rudman-Hollings Act) began a lengthy era of dealing with deficits. With the passage of the Government Performance Review Act in 1993, we see the emergence of a new performance budgeting system more concentrated on outcomes. This form of budgeting dominates both federal and state budgets and continues to exert influence in budget decisions today. Of significance is that performance budgets, or outcome budgets, connect the budgeting process with policy formulation, strategic planning, program goal formulation, and program evaluation. NOTE:

Since the early 1990s with the rapid implementation of performance based budget there have been some important new developments affecting public budgets. Growing deficits, the public's demand for accountability, and a clear rivalry between the President and Congress as to who should control the budget has precipitated these developments. Some of these new developments are a result of the passage of new laws related to public budgeting. These would include:

Budget Enforcement Act – 1990 – amended the Gramm-Rudman-Hollings Act and created a number of procedural requirements such as "pay-as-you-go". This meant that after the budget had been passed, any new spending approved by Congress and the President had to be compensated for by new sources of revenues other spending reductions.

Credit Reform Act – 1990 – tightened requirements on federal lending and loan guarantees.

Chief Financial Officers Act – 1990 – added new financial management responsibilities for federal agencies including creating a CFO position to oversee agency financial practices.

Omnibus Budget Reconciliation Act – included major reductions in defense spending and tax increases for upper income groups and no tax cuts for the middle class.

The Line Item Veto (1996 to 1998) – For a two year period, gave the President the power to veto specific appropriations. Found to be unconstitutional by the U.S. Supreme Court in 1998.

Performance based budget reforms have focused attention more that ever on sharing information and decision making in budgeting. Sharing information about what governments do well, through performance measurement and reporting, can go a long way in reducing cynicism. Broader participation in trading off various goals and means to achieve them, as well as in developing performance measures, will yield better decisions and a sharing of risks among citizens, public managers, and elected officials.

The GPRA and state and local results acts and executive orders emphasize program results and holding federal government agencies accountable for them. The GPRA focuses managers' attention on setting goals, and reporting publicly on progress made. One of the foremost purposes of the act is to instill confidence in the public about federal government managers' ability to solve problems and meet citizen-taxpayers' needs. To implement the GRPA, each agency must first develop strategic plans covering a period of at least five years. The strategic plan must include a mission statement, outcome related measurable goals and objectives, and plans that agency managers and professionals intend to follow to achieve these goals through their activities and through their human, capital, information, and other resources. Those in the agency must consult Congress and others interested in or affected by the plans: in other words, they must consult stakeholders. The new reforms incorporate most of the goals of the previous reforms, but they seek to achieve them through decentralized incentives that give program managers greater authority to combine resources as they think best but that hold the managers accountable for the results.

Performance based reforms deal widely with organization change. Keep in mind that no other decision making system has the leverage to pressure departments to improve program management like the budget. Also, the budget has always been the place where everyone raises questions of the efficiency, economy, effectiveness, productivity, impact, and results of government activities. Lastly, budget offices can inspire agencies to strengthen their programs, operating systems, and organizational structures.

These new efforts at performance budgets appear to have a promising future; however, some authors are not so enamored with performance based budgets. Wildavsky warns that results that are "too good" can have adverse effects in that superb results may result in no further funds being appropriated, as the goals will have apparently been achieved. Caiden finds that performance may be irrelevant in making budget decisions as political popularity and the need to balance budgets are the sole reason for budget decisions.

For managers of programs that meet their goals and objectives and otherwise exhibit exception performance, pay-for-performance has emerged as a strategy for responding to increased productivity of staff. Merit pay is one method, including bonuses, commissions and formulas for sharing savings. NOTE: For more information on the use of merit pay, good and bad, refer to: Halachmi, A, Holzer, M. (1987). Merit pay, performance targeting, and productivity. Review of Public Personnel Administration, 7 (Spring), 80-91.