

**BUDGET THEORY  
IN THE PUBLIC  
SECTOR**

*Aman Khan  
W. Bartley Hildreth  
Editors*

**QUORUM BOOKS**

# Budget Theory in the Public Sector



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Edited by  
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and  
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*Dedicated to  
Marcia Lynn Whicker*



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# Preface

Public budgeting, as a field of study, has grown tremendously in recent years both in form and substance. With such growth comes a need to have a coherent theory or body of theories that allows one to understand the field, its essential core that guides its development, and its scope for dealing with real world problems. V.O. Key recognized this need in 1940 when he wrote his now famous piece, "The Lack of a Budgetary Theory." Key tried to address the issue of public budgeting not having a theory of its own by offering a microeconomic solution to the problem, one that would increase allocative efficiency of government. He based his theory on the same rationale that guided the economists to search endlessly for a function that would improve the welfare of society within the broader schemes of Paretian principle.

In a similar vein, Verne Lewis (1952) tried to explain how the traditional microeconomic theory, in particular the concept of marginal utility, could be used to determine the relative value of a good or service to justify resource allocation that in the aggregate would improve social welfare. Attempts by other economists, such as Arthur Smithies (1955), were not much different from those offered by the mainstream welfare economists. But, as Wildavsky (1961) reminds us, budgeting is more than allocating the scarce resources between X and Y activities; it is about meeting the conflicting needs of a society by bringing about compromises in the political marketplace through incremental adjustment(s) in budget allocation. Not only that, as Mosher (1954) would point out, it is a measure of bureaucratic behavior and administrative competence. Others would argue that it is not necessary to have a single theory of budgeting but

rather a set of theories, each unique to the problem budgeting is trying to address (Schick, 1988).

Ironically, some sixty years since Key's work, theorists still continue to model behavior in search for explanations of budgeting in city halls, county court houses, school district headquarters, state capitols, and in the halls of power in the capitals of sovereign governments. Perhaps the explanation for this lack of coherence lies in the field itself. Public budgeting is eclectic; it is multidimensional. As Albert Hyde puts it: "In their voluminous and complex formats, budgets simultaneously record policy outcomes, cite policy priorities and program goals and objectives, delineate a government's total service effort; and measure its performance, impact, and overall effectiveness" (Hyde, 1992:1). Budgeting, according to Hyde, is partly political, partly economic, partly accounting, and partly administrative. As a political document, it allocates the scarce resources of a society among multiple, conflicting and competing interests. As an economic and fiscal document, it serves as the primary instrument for evaluating a jurisdiction's redistribution of income, stimulating its economic growth and development, promoting full employment, combating inflation, and maintaining economic stability. As an accounting document, it provides a ceiling on government spending and makes it legally binding for it to live within the allocated funds. Finally, as a managerial and administrative document, it specifies the ways and means by which public services are provided, and it establishes criteria by which they are monitored, measured, and evaluated. These seemingly divergent roles that public budgeting plays further reinforce the general perception as to why it is so difficult to have a single theory that can tie all these elements into a coherent theme.

From a practical point of view, however, this lack of inner cohesion may serve both as a weakness and a strength. Not having a single framework always has the danger of the field being overwhelmed by quantity as well as diversity of perspectives that one may find baffling. While the sheer number may overwhelm some, it may also serve as its strength. For it is this competition between quantity, on one hand, and the diversity of inquiries, on the other, that will shape and eventually help develop a comprehensive theory of budgeting, sufficient enough to highlight the eclectic nature of the field and competent enough to provide a common ground from which to study it. But until such a point comes, public budgeting will remain an eclectic field, dominated by multiple, at times, competing theories. This book is a reflection of that diversity.

In the first of these perspectives, Lance T. LeLoup's "Budget Theory for a New Century" introduces the field, particularly as it pertains to national budgeting. He traces the history of budget theory from incrementalism (the 1950s and 1960s characterized by agency and presidential power) through a transition phase (1970s to early 1990s marked by the conflict between legislative and executive branches during tough economic times) and into the current period. This later period, from the mid-1990s forward, is termed the "emerging new paradigm" and is characterized by coequal branches making tactical, dynamic

decisions in a fiscally surplus environment. LeLoup examines each era in terms of several dimensions of budgeting, including: the political and economic environment of budgeting; the policy focus; the nature and scope of budgeting; budgetary process characteristics; key actors; budget reforms; and legislative-executive relations. As the remaining chapters confirm, these dimensions of budgeting are central to public budget theories.

In the next chapter, Julia Beckett returns to V.O. Key's classic 1940 paper on the lack of a budgetary theory and finds a long-overlooked reference. In the "Early Budget Theory: The Progressive Theory of Expenditures," she investigates Key's citation of Mabel Walker's 1930 book, *Municipal Expenditures*. This is important since Walker's work predates key budget writers, including Herbert Simon's performance measurement research in Chicago. Walker's work contains a search for the norm of distribution, or proportion. This approach for a positive budget theory based on marginal utility leads to comparative output measures, an issue that continues to bedevil us. As such, Walker foreshadows current issues. Moreover, Walker's work is an early marker for organizational learning via the study of expenditures.

Public budgets must traverse the complex nature of executive-legislative relationships. Thomas P. Lauth's "The Separation of Powers Principle and Budget Decision Making" uses six court cases—two from the U.S. Supreme Court and four from state courts—to examine judicial interpretation of executive versus legislative disputes over budgets. Specifically, he cites as examples the essential budget principles of separation of powers.

In "Nonconventional Budgets: Interpreting Budgets and Budgeting Interpretations," Gerald J. Miller returns to the core principles of *comprehensiveness*. He focuses on proposals for a "super budget" as a way to coordinate the increasing tendency for policy actors to carve out and define new packages of activity as budgets in order to assert control over that particular arena. Calls for a regulatory budget fit this pattern. He examines budget control criteria, including not just economic or political factors but also human interpretation.

Individuals involved in the budgetary process have *roles and orientations* that can influence decisions. Katherine G. Willoughby's "A Multiple Rationality Model of Budgeting: Budget Office Orientations and Analysts' Roles" focuses on the policy, management, and control perspectives of the role of the executive budget analyst in five southern states. Her research also highlights differences in executive budget office relationships with the governor and spending departments.

John Forrester studies budget participant behavior in "The Principal-Agent Model and Budget Theory." This chapter explores "the seasoned theoretical framework for assessing relationships," namely principal-agency economic theory, with its focus on *information* (exchange). Information is critical in an effective contract between the principal and agent, so this paper examines the budgetary implication of who controls that information—the legislative body,

the agency, or the “iron triangle.” It closes with a call for an organizational perspective on the control and management of the exchange of information.

The information-rich environment of public organizations allows L.R. Jones and Fred Thompson, in “Responsibility Budgeting and Accounting Reform,” to make a case for *decentralization* (or remote control) management. This chapter melds organizational economics (contract theory of principal and agent) with managerial accounting principles.

Although Gerasimos A. Gianakis and Clifford P. McCue, in “Budget Theory for Public Administration . . . and Public Administrators,” do not posit a theory, they offer an organization-based approach to budgeting, especially for local governments. Specifically, they center on the “resource allocation process” given the “tightly coupled,” “differentiated” nature of “public organization”—that in their view is what separates public from private management theory. They note that the bottom line of a (local) public organization is to improve the economic base.

Merl Hackbart and James R. Ramsey, in “The Theory of the Public Sector Budget: An Economic Perspective,” return to Musgrave’s three-function classification of *public expenditure theory*. In doing so, they reassert the central questions of why items are included in the budget and which level of government should be responsible.

In “Budgets as Portfolios,” Aman Khan provides a managerial perspective on budget theory by looking at budgets as portfolios. Khan’s argument rests on a simple premise that budget requests in government are very similar to portfolios the finance managers in the private sector deal with on a regular basis. To be considered acceptable, from their perspective, the portfolios must be efficient. Not all portfolios will be efficient, but some will, depending on the amount of risk and return they produce for a decision maker. Likewise, the problem facing a budget manager in government is how to select the best possible or optimal portfolio from the set of efficient portfolios. The theory suggests that in selecting this portfolio, the managers in government behave the same way as the managers in private firms and businesses; that is, they would select the one that will maximize their utility subject to a risk-return combination.

Budgeting occurs in a *policy agenda* environment. Research suggests that an environment of stability shifts into periods of instability, or non-normalcy. Meagan M. Jordan explores this concept in “Punctuated Equilibrium: An Agenda-Based Theory of Budgeting.” Usually, budgets reflect frequent and small incremental changes, but infrequent and large policy shifts occur. Jordan examines the nature of agenda changes on the budget and the research challenges that emerge from this perspective.

Budgets are implemented by subunit agencies. Marcia Lynn Whicker and Changwan Mo, in “The Impact of Agency Mission on Agency Budget Strategy: A Deductive Theory,” employ a well-designed set of classification screens to describe *agency budget strategy* for achieving the agency mission.

Budgeting, for a long time, has been focusing on outputs, economy, and

efficiency, but very little on outcomes and effectiveness. In “Budgeting for Outcomes,” Lawrence L. Martin provides a conceptual frame of reference for thinking about outcome budgeting—not as a new concept, but as an evolutionary step in the rational approaches to budgeting.

In the final chapter, “Philosophy, Public Budgeting, and the Information Age,” Thomas D. Lynch and Cynthia E. Lynch suggest that those who study budgeting ought to look to political philosophy to try to understand what their empirical work is about. Traversing through the rough terrain of political philosophy from Burke to Bentham, Stuart Mill to Lindbloom, and from Naisbett to Reich, the authors segue from the critiques of rational and incremental budgeting to the argument for entrepreneurial budgeting. The crux of their argument is change: how budgeting has changed, the philosophies underlying those changes, and how as professionals we must accept change, respond to it, and exploit its opportunities.

Each of the chapters presented in this book tells us, in its own way, how much we have traveled over the years to where we are. They also tell us, in its own way, how much more we need to travel and of the endless journey we will have to make along the path that will only grow richer.

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# Budget Theory in the Public Sector

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# Budget Theory for a New Century

Lance T. LeLoup

National budgeting in the United States underwent dramatic changes during the last third of the twentieth century. As the costs of health care and social programs expanded and deficits grew, politicians tried to adopt long-term macro-budgetary strategies to control fiscal balances. The environment for budgeting shifted markedly from expectations of growth in the 1960s to one of constraints and cutback management in the 1980s and 1990s. As the environment changed, agency strategies and the norms of budgeting shifted as well. Power in budgeting seemed to shift upward from agency officials and congressional committee members to the president and top advisers, and a small cadre of party leaders in the House and Senate. However, with greater interbranch conflict, the president's budget became more of an opening bid in negotiations than a definitive policy statement. With severe constraints because of deficits, budgeting became the central governing process. Budgeting became less closed and insider-oriented and, instead, more public and plebescitary, with political parties battling for advantage and support in opinion polls. What would happen to the dynamics of national budgeting in the new millenium when the deficits disappeared and record budget surpluses were recorded?

Microbudgeting—low to intermediate level decisions on agencies, programs and line items, usually made from the bottom up—characterized the stable and predictable budget processes after World War II described by Fenno (1965) and Wildavsky (1964). Macrobudgeting—high level decisions on spending, revenue, and deficit totals and relative budget shares, often made from the top down—became increasingly prevalent because of the historically large, chronic deficits. These budgetary developments also took place around the world with evidence

of macrobudgetary adaptation among many industrialized nations (Schick, 1986). In the last decade, the same trend has been identified among democratizing countries. The fall of the Berlin wall in 1989 and the collapse of communism forced a heavy emphasis on macrobudgeting among the former eastern bloc nations (LeLoup et al., 1998). Monetary union among European Union members and the accession criteria for prospective members required strict deficit control. This emphasis on macrobudgeting transformed budgeting in the United States and around the world in the last century. But what is likely to take place in the new century?

Today, in the early 2000s, the deficit situation around the world is vastly improved compared with the 1980s and 1990s. Following an unprecedented U.S. economic expansion, the outlook has brightened. Today, despite the catastrophe of the terrorist bombings of September 2001 and its economic fallout, the United States faces the prospects of surplus budgets for the foreseeable future. What are the implications for national budgeting? After the dramatic transformations of the past three decades, will there be an emerging new paradigm in budgeting? To try to answer this question, three eras of budgeting are reviewed, two that we have experienced, and one that is just taking shape.

The first era, the post–World War II period through the early 1970s, was characterized by the dominance of “incrementalism.” It emphasized stability, growth, and focused on bottom-up microbudgeting as a broad explanation of how the government makes public policy. The second era, beginning in the 1970s and running through the 1990s, was characterized by the shift toward macrobudgeting in response to chronic deficits, but it did not witness the emergence of a single theory to replace incrementalism. Major institutional changes in the United States that marked this era include the Congressional Budget and Impoundment Control Act (1974), the Gramm-Rudman-Hollings Balanced Budget and Emergency Deficit Reduction Act (1985), the Budget Enforcement Act (1990), encompassing pay-as-you-go requirements and discretionary spending caps, and the Balanced Budget Act (1997). The third era is just emerging. This analysis attempts to describe and explain the most recent trends in budgeting to suggest what a new budgeting paradigm for the twenty-first century might look like.

To do this, the following dimensions of budgeting are examined:

- key actors in the executive and legislative branches
- the balance of legislative-executive power in budgeting, rules procedures, and budgetary processes
- changing budgetary norms and values
- the scope of policymaking in budgeting and main policy emphases
- the nature and consequences of budget reforms

In addition, the analysis is guided by several key questions in order to help define what an emerging new paradigm of budgeting might look like.

*If surpluses continue, how will budgetary behavior and norms adjust? Will policymakers be able to strike a better balance between microbudgeting and macrobudgeting than occurred during the period of high deficits? Will agencies and appropriators regain some of the prerogatives lost during the deficit wars?*

*What will happen to the balance of power between Congress and the president, and the setting of budgetary priorities for the nation? Will budgeting in this new century be characterized by a powerful Congress able to challenge the president and negotiate as a coequal? Or will presidential power reassert itself and the president's budget regain some of its former status as a definitive policy statement?*

*Will budgeting continue to move away from the closed, routinized, insider-dominated process that it was in the 1950s and 1960s toward the more public, politicized process seen in the 1980s and 1990s? Will the plebiscitary aspects of budgeting characterized by battles for public opinion continue to be a central element of the competition between branches and in defining budget success?*

*In an era of surpluses, will budgeting remain the central governing process that it was during the 1980s and 1990s, or will budgeting go back to being more separable from major national policy debates? To what extent will policy issues continue to come under broad scrutiny for long-term budgetary consequences?*

*Will agencies—having had to orient themselves to management cutbacks, privatization, deregulation, and reinventing government—return to more of a growth and expansionary orientation? How will national budgeting balance new program initiatives with debt reduction, tax cuts, and entitlement control?*

*What kinds of budget reforms are likely to be most relevant to the emerging new paradigm of budgeting? Will reforms shift away from the macrobudgetary, deficit-reduction orientation (such as Gramm-Rudman-Hollings) back toward more “rational” budgeting reforms, such as Planning Programming Budgeting (PPB), Management by Objective (MBO), or Zero-Based Budgeting (ZBB), or further process reforms such as biennial budgeting?*

## **INCREMENTALISM: THE OLD PARADIGM**

“Budgeting is incremental, not comprehensive,” Aaron Wildavsky wrote in 1964. “The beginning of wisdom about an agency budget is that it is almost never actively reviewed as a whole every year. . . . Instead, it is based on last year's budget with special attention given to a narrow range of increases or decreases” (Wildavsky, 1964:15). Wildavsky's work, amplified by Richard Fenno's study of Congress and the appropriations process, became a powerful paradigm not only for budgeting, but for how government makes policy. Charles E. Lindblom's (1959) notions of “muddling though” formed a coherent basis for the theory of budgetary incrementalism. The theory received empirical support from the regression models of Davis, Dempster, and Wildavsky (1966) based on data for federal agencies from 1946 to 1963. The budgetary process

in the United States was portrayed as stable and predictable. Agencies acted as advocates, protecting their budget base and requesting small (“incremental”) increases from the previous year. Appropriations subcommittees acted as guardians, making slight reductions in what the agencies requested. These two simple decision rules summarized the process and results of budgeting, revealing the “striking regularities of the budgetary process.” (Davis, Dempster, and Wildavsky, 1966:509) Annual increases averaging 5 to 10 percent were seen as confirming incrementalism. The regression models claimed to explain as much as 99 percent of the variance.

Incrementalism seemed to meet the test of a paradigm in terms of establishing a broad-based theoretical framework that defined relevant research questions (Kuhn, 1970). Additional variables, such as political and economic factors, were introduced to the empirical models but had little impact on the results (Davis, Dempster, and Wildavsky, 1974). Incrementalism was extended to governments at other levels and overseas. Studies found incrementalism in cities, states, school districts, various other countries, the United Nations, the World Health Organization, and the International Labor Organization (Anton, 1966; Crecine, 1967; Gerwin, 1969; Cowart et al., 1975; Hoole et al., 1976). It had a dominant position in textbooks on public administration, public policy, and American government. Yet by the late 1970s, incrementalism was under attack and deemed inadequate to explain the rapid changes in budgeting.

Incrementalism was a theory that reflected the budgetary environment of the era. In a period of steady economic expansion, government could expand to absorb increasing tax revenues, in other words, “budgeting for growth” (Schick, 1990). This was reflected in agency strategies and their emphasis on gradual expansion. Budgeting was presidency-centered to the extent that the executive budget was a definitive policy statement for the appropriations process, but the emphasis was also on agencies and subcommittees. Budgeting was a closed process dominated by insiders in the bureaucracy and in Congress. The Office of Management and Budget (OMB) was seen as a strict guardian in the process, working primarily at the level of budget examiners and providing a source of “neutral competence” (Hecl, 1975). Many reformers did not like the normative basis of incrementalism, and the kind of reforms that emerged in this era were primarily designed to make budgeting more informed and rational. PPB, MBO, and ZBB were oriented toward improving policymaking in the executive branch. Even so, the scope of budgeting was limited and separate from the larger policymaking processes of government.

Incrementalism had a number of problems as a comprehensive theory of budgeting even given the era and environment (LeLoup, 1978). First, it confused mutual adjustment and bargaining processes with the outcomes of budgeting. Bailey and O’Connor (1975:66) concluded that “when incrementalism is defined as bargaining, we are aware of no empirical case of a budgetary process which is nonincremental.” Review of the agency budget outcomes, even in the incrementalists’ own data, revealed that there was a great deal of variation in budget

results, far more than the 5 to 10 percent range. Research showed that using requests in the president's budget was a poor measure of actual agency behavior in the budget process (LeLoup and Moreland, 1978). Methodological problems were found as well, including evidence that the high R squared values were a result of not controlling for collinearity in the data (Wanat, 1974).

Incrementalism was built on a series of analytical choices that severely limited its applicability as a theory and made it unsuitable for explaining the kinds of changes that were taking place in budgeting in the 1970s and 1980s. It was a theory of microbudgeting concentrating on the parts, not the whole. It defined budgeting as a bottom-up process of making marginal adjustments to estimates on an annual basis, without considering macrobudgetary attempts to shape the budget from the top down. Incrementalism looked at budgets by agency rather than by function or broader aggregates. It looked at change over a year rather than over longer time periods. No distinctions were made between discretionary spending and other types of mandatory categories. Budget totals, revenues, deficit or surplus, and other budget measures outside of appropriated accounts were ignored. Incrementalism was a tautology because it is always true in budgeting that this year's budget looks like last year's budget. More than anything, incrementalism disintegrated as a paradigm because it became irrelevant for explaining what was really happening in the world of budgeting. What emerged after the decline of incrementalism was a period of transition in which new concepts, approaches, and ideas were brought forward to explain the profound changes that were taking place in the practice of budgeting.

## **BUDGET TRANSITIONS AND TRANSFORMATION**

### **Changes in the Environment and Composition of the Budget**

One of the driving forces in the transformation of budgeting in the United States was a change in the political and economic environment and shifts in the composition of the federal budget. Before 1970, the steady economic growth of the postwar period allowed expenditures for domestic and defense to grow along with the economy. Beginning with the economic problems that developed during the Vietnam War, the 1970s would witness stagflation—both high inflation and rising unemployment—defying conventional Keynesian logic. President Nixon imposed wage and price controls to stem inflation, but their overall effect was just to postpone it. The U.S. economy suffered a jolt with the OPEC (Organization of Petroleum Exporting Countries) oil embargo in 1974. This action by Arab oil producers sent a wave of price increases throughout all sectors of the economy. Throughout the rest of the 1970s, economic problems continued, plaguing both Presidents Ford and Carter. This had a significant impact on the political environment as well, with growing public pessimism, doubts about the effectiveness of government, and declining trust. Both Ford and Carter were defeated in their reelection bids.

The changes in the economic and political environment of budgeting were accompanied by important changes in the composition of the federal budget. Entitlement spending mushroomed from \$65 billion in 1970 to \$267 billion in 1980, an increase of over 400 percent (CBO, 1985). As a share of the budget, entitlements increased from 33 percent of the budget to 47 percent by the end of that decade. Part of the growth was due to inflation, but much of the increase was due to the liberalization of benefits and expansion of programs. Several large social security increases were approved, including 15 percent in 1970 and 20 percent in 1972. These election year bonuses were favored both by the president and the Congress. Medicare was expanded to cover the disabled. Food stamps increased 1000 percent during the 1970s. Supplemental security income (SSI) was consolidated, and benefits for persons not eligible for social security were expanded. Medicare and Medicaid also grew rapidly because of rapid increases in health care costs and incentives to health care providers to encourage overutilization of services.

One of the most critical changes was the “indexing” of many entitlement benefits, particularly social security. Indexing—tying benefits to changes in the Consumer Price Index—was actually conceived of as a reform in the wake of the big election-year boosts in social security in the early 1970s. However, as inflation reached the double-digit range in the late 1970s, indexing drove entitlements up at record rates. By 1977, social security faced insolvency, and a major increase in payroll taxes had to be adopted. One of the significant aspects of the growth of entitlements and the change in composition of expenditures was the separation of policymaking in this area from the budget process. Most of the legislation establishing and expanding these programs came from the standing committees in Congress, not the appropriations committees. The long-term consequences on spending were rarely considered. By the end of the 1970s, some three dozen programs were directly or indirectly indexed to inflation.

The composition of the budget changed in other ways as well. The government increasingly offered direct loan programs or loan guarantees that cost the Treasury money. Tax expenditures—the cost in lost revenues of exemptions, exclusions, deductions, and tax credits—were increasingly used as effective means to provide benefits to constituents. More special tax preferences were written into the tax code during this period, costing valuable revenues and increasing budget deficits. All of these factors contributed to a significant change in the environment and composition of the U.S. federal budget. At the same time, significant institutional changes were taking place, particularly in Congress.

### **Institutional Changes**

Conflict between the legislative and executive branches escalated in the late 1960s and early 1970s. President Nixon attacked Congress as profligate and incapable of keeping the budget in balance. Congress tried to adopt a spending

cap through a continuing resolution, a tax bill, and a supplemental appropriation, all to no avail. In response, Nixon increased his use of impoundment—the refusal to expend funds legally appropriated by Congress. Nixon also made changes in the Bureau of the Budget (BOB), changes that would lead it away from its tradition of neutral competence toward becoming a more politicized, partisan arm of the presidency. His initial goal was simply to weaken the agency that he mistrusted and believed was populated with disloyal Democrats. Nixon’s reorganization of the BOB into the OMB was approved by Congress in 1970, ostensibly to increase attention to management but also to reduce its influence on policy.

The most critical institutional change during this period of budgetary transition was the enactment of the Budget and Impoundment Control Act of 1974. The Congressional Budget Act (CBA) was passed in reaction to congressional frustration with its inability to take an overview of the budget as well as Nixon’s impoundments. It was enacted just weeks before Nixon resigned from office because of Watergate. The CBA made a number of important changes (LeLoup, 1980), creating:

- a congressional budget specifying spending, revenues, totals by function, and the size of the deficit or surplus.
- budget committees to draw up a concurrent resolution specifying the congressional budget and as a guide for action by the appropriations and authorizing committees.
- the Congressional Budget Office (CBO) to give Congress an independent source of information rather than relying solely on the OMB.
- a defined timetable for completing action on authorizations, appropriations, and adoption of a congressional budget, and moved the start of the fiscal year to October 1.
- limits on “backdoor” spending outside the appropriations process.
- severe limits on the president’s ability to impound funds, allowing the president to request rescissions or deferrals of funds only with congressional approval (McMurtry, 1997).

One of the goals of the CBA was for Congress to redress the perceived imbalance with the presidency in terms of the power of the purse. However, it would not be until the 1980s that the extent of Congress’s ability to challenge and revise the macrobudgetary priorities of the president would be fully seen. Further institutional changes, in conjunction with the changes in the environment and the composition of the budget, would occur in the early 1980s and leave chronic deficits that would further transform budgeting.

The 1980 elections laid the groundwork for a watershed year in federal budgeting, one that would have repercussions well into the late 1990s. Ronald Reagan won a surprisingly easy victory over President Carter, and the Republicans captured the U.S. Senate for the first time in twenty-four years. Led by Budget Director David Stockman, the Reagan administration focused all its energies in



1981 on its economic and budget plan (LeLoup, 1982). It contained three essential factors: a large across-the-board tax cut, a massive defense buildup, and major cuts in domestic spending. With reduced Democratic majorities in the House of Representatives, Reagan needed only thirty or so Democrats to cross party lines to support his program. The first crucial vote was on the budget resolution in May 1981. The president made an effective televised address, urging citizens to call their congressmen and senators to declare their support. The Capitol switchboard was swamped with calls, and the resolution was passed.

Democrats remained confident that they would be able to block much of the plan when the substantive bills came to a vote. The Reagan administration was procedurally innovative, however. It decided to use the moribund reconciliation process, which was originally designed to come at the end of the process to reconcile the budget resolution to spending bills, at the beginning of the process. This would mandate committees to make the desired cutbacks, canceling appropriations, and deauthorizing certain programs. The tactic succeeded, and the massive reconciliation bill was adopted in June by a narrow margin. One month later, the Economic Recovery Tax Act (ERTA), including a 25 percent across-the-board tax cut and dozens of special interest tax preferences, passed by a larger margin.

The adoption of the 1981 economic and budget plan was an unprecedented exercise in top-down budgeting. The administration changed the old bottom-up budget process by attempting to enforce a fixed agenda on the executive branch (Newland, 1985). For domestic agencies, the change meant that they were assigned cuts and instructed to implement them. Opportunities to appeal were limited or nonexistent. Normal policy analysis, program evaluation, or other data were ignored. The OMB took over the agency's traditional role of defending the budget before Congress. While these changes moderated after several years, the executive budget process was permanently changed. What had formerly been a closed process, where agencies negotiated with the OMB and closed ranks on the president's request, became more public, free-swinging, and politicized. Interest groups and clients were used, leaks to the media became more frequent, and end runs around the OMB and the administration became more common.

The role of the OMB changed from an inward orientation toward agencies, to an outward orientation toward Congress. To institutionalize this orientation to Congress, Stockman instituted a computerized tracking system—the Central Budget Management System (CBMS)—to monitor the president's requests at all stages of the process. As budgeting became more tactical, the budget process became more variable, changing from year to year. These changes reflected the overall shift in emphasis from microbudgeting to macrobudgeting in both Congress and the presidency. That shift was necessitated by the policy results of 1981: chronic deficits that would plague policymakers for nearly two decades.

## **Policy Change: The Impact of Chronic Deficits**

Reagan had prevailed in 1981, but the plan had been built on faulty projections and “cooked” numbers. Only months after the budget package was signed into law, it was clear that a balanced budget would not be achieved, and that annual deficits were on a dangerous upward spiral. The deficit topped \$200 billion in FY 1983, some 6.2 percent of gross domestic product (GDP), a peacetime record. By the time the budget was finally balanced in FY 1998, the national debt had expanded by more than \$4 trillion. Deficits throughout the 1980s and 1990s had several effects: they provided severe policy constraints, exacerbated partisan and interbranch conflict, and led to frequent tinkering with budget institutions and processes.

For the presidency, the faulty forecasts in 1981 reduced the administration’s credibility in ensuing years. When the Republicans suffered midterm election losses in 1982, the Democrats regained the advantage in dealing with the White House. The president’s budgets were labeled “dead on arrival” in most years. The president’s budget had been transformed from an authoritative policy statement to an opening bid in negotiations with Congress (Schick, 1990). With the CBO developing its own budget baseline for Congress to work off, the president’s figures were no longer necessary for congressional action. Interbranch conflict between the Republican president and the Democratic House of Representatives increased, and the term “gridlock” was increasingly used to characterize budgeting. Budgets consistently did not pass in time to start the fiscal year, requiring massive continuing resolutions to keep programs afloat. On occasion, inability to break the budget deadlock resulted in government shutdowns (Meyers, 1997). Extraordinary means outside the normal legislative process were needed to resolve budget disputes. In 1983, a bipartisan commission was used to develop a compromise bailout for social security and provide political cover for members concerned about making unpopular decisions. In five of the nine years after 1982, some form of summit between Congress and the administration was held to break budget deadlocks.

## **Gramm-Rudman-Hollings Mandatory Deficit Reduction**

Congress also made major changes to its own budget process and enacted a radical deficit reduction plan in 1985. The Balanced Budget and Emergency Deficit Reduction Act (commonly known as Gramm-Rudman-Hollings) established a set of fixed deficit targets over five years and required automatic across-the-board cuts (sequestration) if the targets were not met (LeLoup et al., 1987). Mandatory deficit reduction was a new and controversial approach, but Congress had grown weary of deficits and frustrated with deadlock. The law provided that if the deficit targets were not met in a given year, an equal percentage of funds in defense and domestic accounts would be sequestered. There were serious

problems with the law, and even its sponsors called it “a bad idea whose time had come.” Much of the budget was exempted from the cuts, putting a disproportionate burden on discretionary spending. Gramm-Rudman-Hollings (GRH) was supposed to commit Congress to a long-term goal of deficit reduction but instead reinforced tendencies to use budgetary gimmicks and smoke and mirrors to meet the targets. After only two years, the targets had to be revised, and after three years they were scrapped altogether. GRH did accomplish several things, however. It made significant changes in the congressional budget process for the first time in ten years, significantly strengthening enforcement. Procedural restraints such as limiting filibusters in the Senate were among the strongest in history. Despite its failings, it continued the process of increasing Congress’s ability to effectively engage in macrobudgeting and challenge the priorities of the president.

### **The Budget Enforcement Act**

Deficits continued to dominate policymaking through the 1980s into the 1990s. Deficits severely constrained policymaking in the Bush administration, particularly in 1990. In February, President Bush presented Congress with a budget that met the GRH for FY 1991. Only six months later, as a result of the savings and loan disaster, a faltering economy, and errors in technical estimates, deficit projections had quadrupled with doomsday predictions of deficits topping \$300 billion. A budget summit was convened in an attempt to reach the largest deficit reduction package in history. Bush reluctantly had to give up on his top 1988 campaign promise: “Read my lips, no new taxes.” Congress and the president finally agreed on a deficit reduction package of \$500 billion, including approximately equal parts of tax increases, defense cuts, and domestic spending cuts.

Part of the Omnibus Budget Reconciliation Act of 1990 was the Budget Enforcement Act (BEA). It made several important changes in the budget process. Congress abandoned GRH and fixed deficit targets in favor of spending control. The BEA established a set of appropriations caps and a pay-as-you-go (PAYGO) system to ensure that policy changes were deficit-neutral. Budgeting during the Bush administration was marked by several other interesting developments. In his first budget, Bush asked Congress for \$10 billion in unspecified cuts, content for Congress to fill in the details. In 1990, Bush allowed most of the budget message to come from Budget Director Darman, whose analogies to Cookie Monster gobbling up monies and unfunded federal mandates as hidden Pac-Men were unique (OMB, 1990). Bush virtually abdicated responsibility to Congress in 1990 after the original compromise was written. During the Gulf War in 1991, Bush took the unprecedented step of collecting billions from Gulf states to pay for the war. And in 1993 after his defeat for reelection, he simply submitted a budget based on the current baseline, allowing President Clinton to come up with his own numbers.

## **Clinton, the Republican Congress, and the Balanced Budget**

President Bill Clinton may have won the election based on his relentless emphasis on the economy, but during the transition the deficits emerged once again to dominate the policy agenda. He was shocked to find that without another major deficit reduction package, budget deficits would surpass half a trillion dollars annually by the end of the decade (CBO, 1993). The battle over his budget package dominated his first year. In the end, he won by the narrowest of margins—Vice President Gore had to cast the tie-breaking vote in the Senate—without a single Republican vote in either chamber. Despite Clinton’s “near death” experience, the package had a dramatic impact on the deficits, placing them on a declining path over the next eight years. Yet he was hardly rewarded by the voters. Combined with his health care reform fiasco the next year, the 1994 midterm elections proved disastrous for the Democrats. Republicans swept into power into both houses for the first time in forty years, ushering in yet another period of interbranch conflict over the budget.

Led by Speaker Newt Gingrich, the Republican-led 104th Congress was determined to pass a plan to balance the budget in seven years, even while providing additional tax cuts for Americans. Medicare, the fastest growing entitlement, was targeted for major reductions. Clinton started the year on the defensive, holding a press conference to assure the country that he was not “irrelevant.” As the struggle over the budget continued in 1995, Clinton and the Democrats launched a counteroffensive, accusing the Republicans of trying to destroy Medicare. It struck a responsive cord with the public. But Republicans decided to play hardball and threatened to shut down the government if Clinton did not accept their plan. Clinton called their bluff, and on two separate occasions, nonessential government workers were sent home. Public opinion polls revealed that most people blamed the Republicans, and congressional approval plummeted. The Republicans decided to wait until after the 1996 elections, hoping they would have a president of their own party with which to deal.

It was not to be. Clinton won reelection handily, while Republicans held on to the House and Senate. Under this result, both sides realized they would be forced to deal with each other. In May 1997, Clinton and congressional leaders announced an agreement on a plan to balance the budget by 2002. After continued conflict, the agreement was implemented through the Balanced Budget Act of 1997 and the Taxpayer Relief Act of 1997. Clinton was also the first president to use a form of the line-item veto, made possible by the Supreme Court’s ruling that the plaintiffs in the legal challenge to the law lacked standing. Clinton used the veto some eighty times to line out over a billion dollars in spending or tax preferences (LeLoup et al., 1998). This tool was finally struck down by the Supreme Court in 1998.

During the 1980s and 1990s, deficits and budgeting dominated policymaking, what some called the “budgetization” of national politics. Budgeting encompassed an ever-growing number of issues, becoming the centralized governing

process of the nation rather than a separate and distinct process. Budgeting had gone through significant transformation. High deficits left the emphasis on macrobudgeting and controlling budget aggregates. With its orientation to Congress, a more politicized OMB had taken on an entirely new role in addition to budget preparation and monitoring. Although top-down budgeting was not repeated to the degree it was in 1981–82, executive budgeting remained more top-down than it had in the previous forty years. Despite problems and instability in the congressional budget process, Congress emerged with a more centralized process capable of establishing its own priorities. The institutionalization of reconciliation gave Congress a powerful majoritarian tool for overcoming its historic fragmentation in budgeting (Gilmour, 1990). The budget process was more public, open, and interest-group driven than ever before. Many of the budget battles were media campaigns for the hearts and minds of the voters rather than back room deals.

By 2000, the transition period seemed to be coming to an end. FY 1998 ended with the first surplus in thirty years, and the FY 2000 budget had a record surplus. President George W. Bush took office with budget surpluses projected for years to come. His top legislative priority during his first year was a huge tax cut, made possible by the surpluses. He was largely successful, getting most of what he wanted from Congress, with several Democrats crossing over to support his proposal. But by August 2001, new budget projections showed that the tax cut and weakening economy would eliminate the surplus in the federal funds side of the budget. Despite the fact that a \$150 billion surplus remained in the Social Security Trust Fund, both parties had promised not to touch that surplus. Would these developments return to deficit-era patterns, or would a new budget paradigm emerge in the post-deficit era?

## **AN EMERGING NEW BUDGETING PARADIGM**

In the early 1980s, some complained that budget theory was not keeping up with changes in the practices of budgeting (Bozeman and Straussman, 1982). However, considerable progress already had been made in terms of increased emphasis on macrobudgeting, greater focus on presidential-congressional negotiation in budgeting, and developing quantitative models that included revenues and budgetary tradeoffs and other perspectives not included in the old incremental models (Kamlet and Mowrey, 1987). Only the most die-hard incrementalists clung to the old paradigm (Pitsvada and Draper, 1984). That is not to say, however, that all good budget research focused on macrobudgeting. Several excellent studies were published that showed the continued importance of agency strategies and behavior in the post-incremental, deficit-dominated era of budgeting (Meyers, 1995).

Despite all the changes in budgeting during the deficit-dominated transition era, no single paradigm replaced what had gone before. Perhaps no single theory will ever dominate to the extent that incrementalism did. But as the deficit era

**Table 1.1**  
**The Evolution of Budgetary Theory**

	<b>Incrementalism: The Old Paradigm</b>	<b>Transitional Phase: Deficit Era</b>	<b>Emerging New Paradigm</b>
<b>Environment</b>	Economic growth, public support for expansion	Economic stagnation, deficits, public turn against government	Growth, surpluses, conservative but pressures for new programs
<b>Policy Focus</b>	Growth, government expansion	Deficit reduction, entitlement control, constrain discretionary spending	Maintain balanced budget, entitlements, tax cuts, debt reduction
<b>Nature and Scope of Budgeting</b>	Bottom-up, micro-level, limited, separate	Top-down, macro-level, comprehensive governing process	Balance macro-level, micro-level; less comprehensive but broad multiyear
<b>Process</b>	Closed, insider dominated, routinized	Open, public, plebiscitary, improvisational	Public, open tactical, more stable
<b>Key Executive Branch Actors</b>	Agencies, budget examiners	President, WH Staff, OMB Director	President, WH Staff, OMB, agencies
<b>Executive Branch Reforms</b>	PPB, MBO, ZBB	Implementing, top-down budgeting, CBMS	Privatization, deregulation, reinventing government
<b>Key Legislative Branch Actors</b>	Appropriations subcommittees	Budget committees, party leaders	Party leaders-balance authorizing, appropriations and budget committees
<b>Legislative Branch Reforms</b>	Spending controls, strengthen appropriations	BCA 1974, GRH 1985, BEA 1990	Entitlement protection, biennial budget
<b>Legislative-Executive Relations</b>	Presidency-centered	Recurrent interbranch conflict, extraordinary resolution	Coequals in cooperation and combat except in national crisis

ends, it is possible to suggest some of the key components that might carry over or change in a new theory or paradigm of national budgeting. The remainder of this analysis is devoted to this task. Table 1.1 compares a set of components of budget theory across the three eras: incrementalism—the old paradigm; the transitional phase dominated by deficits; and the emerging new paradigm. It is designed to highlight the key changes that occurred and to suggest new elements that will be important for budget theory in the twenty-first century.

### **Environment and Policy Focus**

The era of the incrementalism was characterized by steady economic growth and public support for government expansion. Budgeting could be based on

expectations of increases and expansion of government programs. Incrementalism could describe the steady agency growth but did a poor job explaining the expansion of government programs, such as Medicare and Medicaid, that would come to play a critical role in budgeting in more recent years. Not only was the economic environment conducive to budgetary expansion, but the political environment as well with the legacy of the New Deal. Even Eisenhower's presidency was characterized by new program initiatives with major budgetary consequences, including the interstate highway system, the space program, and federal aid to education.

The environment for budgeting changed significantly during the transition period dominated by slower economic growth, stagflation, and eventually chronic deficits. Although the social liberalism of the 1960s faded, there was not a massive turn against government during transition. Public opinion was mixed and complex during this era. Although the public expressed abstract support for lower taxes and cutting government spending, they continued to strongly support popular middle-class entitlements and other social spending. The deficits became the driving force in changing the emphasis from microbudgeting to macrobudgeting. The policy focus after 1981 changed quickly to deficit reduction and entitlement control, and it largely remained there through the balanced budget agreement in 1997.

What is the environment and policy focus for budgeting likely to be in this century? Much of that depends on the continued performance of the U.S. economy. The rapid deterioration of the surplus projections for FY 2003 from around \$300 billion in March 2001 to only \$150 billion in August 2001 (CBO, 2001) was dramatic proof of how sensitive projections are to economic and policy changes. The surpluses were further reduced after the World Trade Center and Pentagon attacks by the billions needed to fight terrorism, rebuild New York, and bail out U.S. airlines. A continued downturn in the U.S. and world economy throughout the 2000s could destabilize the budget and quickly turn surpluses into deficits. If the projected surpluses continue out ten years, the environment for budgeting will indeed be different than it was during the transition period. Despite the favorable projections, the sentiment in Washington shows no signs of returning to the expansionist, growth orientation of the 1960s. Instead, there will be selective pressures for cutting taxes or expanding programs such as education and anti-terrorism in future years.

Having achieved a balanced budget, there will be strong pressure to maintain it. The balanced budget norm, with a little help from the economy, has good prospects in the early twenty-first century. If there are steady surpluses, the policy debate will focus on competing demands for debt reduction, tax cuts, and new spending programs. Both parties have embraced the concept of balancing the budget and eliminating deficits. If a downturn occurs, the current surpluses should make it possible to take corrective action before large deficits occur. Despite the rosy budget picture in the new century, entitlement control will remain important. Given the demographics of the baby boomers and the failure

of the 1997 budget agreement to deal with long-term entitlement growth, any new budgeting paradigm in the next century must still include entitlement control as a key policy focus.

The distinction made between the trust funds surplus, primarily from social security, and the rest of the budget could continue to be a problem. The promise by both parties not to touch the social security surplus has become for the 2000s what George Bush Sr.'s ill-advised "no new taxes" pledge was a decade earlier. Rather than protect the long-term viability of the program, it simply puts certain revenues off limits and commits them to debt retirement, which might not be the nation's top priority during an economic downturn. Clinton made this pledge during his second term, and out of political necessity George W. Bush and the Republicans joined in lockstep. The terrorist attack on America on September 11, 2001, put a temporary end to the debate over the social security surplus. Congress and the president did not hesitate to use that surplus to fund \$40 billion for anti-terrorism and reconstruction, and another \$15 billion to help the airlines. The success or failure of the war against terrorists and the maintenance of homeland security will have a profound impact on the federal budget during the first decade of the 2000s.

### **Nature, Scope, and Process of Budgeting**

Under the old paradigm, budgeting was dominated by agencies and appropriation subcommittees. With the slowdown in economic growth, the rapid expansion of entitlements, and the emergence of deficits, budgeting became more top-down and oriented to macrolevel control of taxing and spending totals. That is not to say that microbudgeting did not continue to take place or became unimportant, but that it had to operate within the macrobudgetary constraints established by high-level bargaining between the president and Congress. In the new century, if the economy remains positive, one might expect budgeting to return to a greater emphasis on microbudgeting and less on macrobudgeting. That probably will not occur for several reasons. Budgeting will certainly *not* return to what occurred in the incremental era. Continued partisanship in budgeting creates continued pressure for macrolevel negotiations and solutions. The changes in the composition of the budget, its sensitivity to the economy, and the long experience with deficits have changed budgeting forever. But if surpluses continue, the budget process will see renewed emphasis on program and policy issues as well as on how to balance the totals.

The scope of budgeting changed from a more limited and separate process during the incremental era to a more comprehensive governing process during the deficit-dominated transition. Once again, budgeting will not return to the earlier period, but in the absence of deficits, constraints on other elements of policymaking will likely not be as strong as they were during the transition era. It is firmly established that budgeting is a long-term, multiyear process that includes a large share of federal activities including entitlements, revenues and



tax expenditures, credit activities, and other nonconventional expenditures. With a stronger economic environment in the 2000s, however, budgeting may not be as dominant a process as it was during the 1980s and 1990s. The old budget process was closed, dominated by insiders, and routinized. That changed dramatically during the transition period to one that was more open, politicized, and permeable to interest groups. Budgeting was unstable, improvisational, and innovative as both branches struggled with the deficits. The budget process is probably permanently changed in terms of its plebiscitary nature. Major budget issues will be resolved by developing supportive public majorities. Unfortunately, the experience since the budget was balanced suggests that truth and honesty in budgeting may suffer as parties and candidates posture and Congress continues to use gimmicks and tricks.

### **Executive Branch Actors and Reforms**

One's view of budgeting depends on which actors are examined. At the level of budget examiners and agency program managers, budgeting has looked pretty much the same as always, going through good times and lean times. Incrementalism ignored other important actors at higher stages of the budget process such as the president and budget director. During the 1950s and 1960s, we have seen that agencies were generally oriented to steady growth, although there were many examples of rapid growth or decline (LeLoup and Moreland, 1978). It has long been asserted that agencies behave as self-interested actors, and in budgeting that initially meant maintaining the base and getting their fair share of any increases (Downs, 1967). The reforms of the era reflected the importance of agencies as actors. PPB, MBO, and ZBB were all intended for them to pursue their expanding budget more rationally and cost-effectively.

In the 1970s and particularly 1980s, agencies were faced with managing cutbacks. The president, top White House advisers, and the budget director emerged as key actors in the transition era. Deficit reduction became the driving force for nondefense outlays in the 1980s, and agencies faced more pressures from the top down in the executive branch than in Congress. Executive branch "reforms," such as they were, had an orientation toward implementing top-down control, such as the CBMS monitoring system introduced by Budget Director Stockman. The cutbacks of the transition period created a more complex bureaucratic culture that has affected budgeting. The Reagan-Bush Sr.-Clinton era has left an important legacy of privatization, deregulation, and reinventing and downsizing government. Given his conservative, private-sector organization, it is likely that emphasis will continue through the administration of George W. Bush. One of the proudest accomplishments touted in the Clinton budget for FY 1998, for example, was the reduction of the size of the federal government (OMB, 1998). Much has been written about each of these areas, and there are many controversies that cannot be addressed here. But they are changes that must be accounted for in any emerging paradigm of budgeting. In the new

century, depending on the stability of the economic and political environment, agencies will continue to protect their interests and try to grow their budgets but not in the same way as in the earlier era. Even in times of surplus, the language of reinventing and legacy of downsizing will be reflected in agencies' response to the changed political environment.

Presidential budgeting has been changed dramatically during the past decades. Bush Sr. may have abdicated power to Congress more than any recent president, but Clinton faced perhaps the most hostile Congress in modern budget history. Yet in responding skillfully to the congressional challenges, he set effective precedents for using the veto and threat of a veto to blunt congressional initiatives and to extract concessions. Once the weapon of government shutdowns was taken off the table for Congress because of the negative public reaction, the president's negotiating position improved. Throughout his second term, Clinton consistently bested congressional Republicans on important issues ranging from increased education spending to blocking major tax cuts. Perhaps in no area is the emerging new paradigm of budgeting less clear than with respect to the president's role. Clinton's impeachment and hostile relations with Congress will probably be unique. Yet as we discuss below, even under unified government, presidents will confront a more powerful, capable Congress in budgeting.

George W. Bush enjoyed unified Republican control of government—the first time since 1953–54—for less than six months. The party switch of Senator James Jeffords (Vermont) from Republican to Independent (but caucusing with the Democrats) gave the Democrats a narrow 50–49 majority. Before the switch, Bush's tax cut of \$1.3 trillion over ten years was adopted by both houses of Congress. It was passed not because of Republican voting, however, since several Republicans voted against the plan. It was adopted because Bush reduced his initial request for \$1.6 trillion and, as a result, attracted more Democrats to the tax cuts than he lost Republicans. Although losing control of the Senate was not good for the White House, it had little impact on the dynamic between the president and Congress over budgeting. What dramatically changed the dynamic of presidential-congressional budgeting was the devastating terrorist attack. Bush asked Congress for \$20 billion, and Congress doubled that amount, giving the president tremendous discretion in expending the money. While the long-term consequences of the attack are not clear for the United States, it is likely that life will return to normal. As time goes on, Congress will continue to assert its own priorities and demand concessions from presidents of either party.

### **Legislative Branch Actors and Reforms**

During the earlier era, budgeting in Congress was dominated by appropriations subcommittees that reviewed agency budget requests. After the late 1940s, relatively few budget reforms were proposed until the 1970s. Those that were proposed were either oriented to strengthening the appropriations process or enforcing some kind of spending control through resolutions or omnibus spend-

ing bills. The 1974 Congressional Budget Act superimposed a new set of actors and processes over the old system. As we have seen, it was not until the 1980s with the potent tool of reconciliation that real shift in budgetary power took place from the spending committees to the Budget Committees acting as an arm of party leadership. Gramm-Rudman-Hollings in 1985 was ill-fated in terms of its effectiveness in deficit reduction but included many critical reforms that further centralized enforcement of the budget process. The Budget Enforcement Act of 1990, also part of a major deficit reduction package, further strengthened enforcement mechanisms.

Who will be the key actors and what kind of budget reforms are likely to emerge from Congress in this new century? As long as the budget remains generally in balance, the instability of the preceding two decades is less likely to occur. The elimination of the deficits allows a greater balance in power between the appropriators and those responsible for the budget process. The congressional budget process, however, will not return to the way it was in the 1960s. Despite the instability and procedural innovation, the existence of a strong budget process has been institutionalized. It may simply seem less harsh and constraining as the nation enjoys fiscal balances, allowing appropriators to have more spending discretion.

Although there is less need to reform congressional procedures, the reform agenda still includes several process changes or restrictions desired by some members. Many members believe that processes should be reoriented to protecting surpluses, rather than to reducing deficits. Proposals to limit supplemental appropriations have been made as well as to change the concurrent resolution on the budget into a joint resolution, giving it the status of law. These reforms were turned down by the House in 2000, however, because of opposition by appropriators (Parks, 2000). Given the continued demands of budgeting on members, the biennial budget could become more appealing. As the fiscal picture has improved and Republican majorities narrowed, interest in the balanced budget amendment or requiring supermajorities for tax increases seems to have waned. Although the so-called “lockbox” for social security surpluses is more myth than reality, the continued political importance of social security and Medicare may lead to more proposed reforms to protect them.

### **Presidential-Congressional Relations**

Even though the president’s role was largely ignored by the incrementalists, budgeting in that era can be characterized as presidency-centered. The president’s budget was a definitive policy statement that was the basis for congressional decision making. It was the only document that took an overview of government spending and taxing. Executive budgeting was closed and confidential, with agencies respecting the “unity” of the executive budget. All that has changed.

During the transition era, budgeting was characterized for nearly two decades

by seemingly constant executive-legislative conflict. Instead of Fenno's (1965) budgetary lexicon that included words like "cut," "slash," "pare," and "whittle," the operative words were "deadlock," "stalemate," "gridlock," and "government shutdown." There was almost constant interbranch conflict over the budget after 1981. Even in 1993 during unified government, Clinton's narrow partisan victory evoked vehement opposition from Republicans. In the 2000s, with the two houses divided so evenly and the Senate back in Democratic control, partisan interbranch conflict over the budget continues. The other notable characteristic during this period was the use of means of extraordinary resolution of conflicts such as summits, bipartisan commissions, among others. Although these negotiations outside of the regular legislative process made compromise possible in given years, they never resolved the underlying policy differences that caused deadlock in the first place.

The 1997 budget agreement was done through much private negotiation between Republican leaders and the White House but without a "summit" per se. Its success, propelled by the economy, could have marked a significant transition in presidential-congressional relations. However, it appears that it has done little to improve interbranch relations. Budget battles over what to do with the surpluses look remarkably like the deficit reduction struggles of earlier years. In 1999, long after the CBO had concluded that Congress had already dipped into Social Security surpluses, both parties continued the fiction that they were not. Misleading rhetoric and budgetary gimmicks are still in practice, such as moving the date of a pay raise by a day to "lower" spending by billions or classifying the 35-year-old Head Start program as an "emergency" so it would not count (Taylor, 1999).

Despite the deference to the president by Congress after the terrorist attacks, Congress has the capacity to negotiate with and compete with the president as coequals. Congressional majorities have the staff, the process, and the rules to develop and pass their own budget under the right conditions. Relations in this new century will depend on election results and the partisan makeup of Congress and the presidency over the next generation. Interbranch relations are likely to reflect a dynamic pattern that shifts between cooperation and combat, depending on the issues. Certainly, in times of crisis, the government can move swiftly with the executive and legislative branches cooperating fully. In the coming years, a continuation of divided government could mean a continuation of the conflicts of the 1980s and 1990s. That pattern is even more likely if deficits reappear. Budgeting in this century will not return to the more restrained conflict and presidency-centered system of the incremental era.

No one can predict all the changes that will shape budgeting in the United States and around the world in the twenty-first century. The century has already seen one of history's most shocking acts of terrorism that changed U.S. public opinion, public policy, as well as budgetary politics. It is also unlikely that a single theory such as incrementalism will be so dominant among political science and public administration scholars in this century. Whatever new paradigm

or conceptual frameworks for budgeting do appear must account for the factors listed in the final column of Table 1.1: a new environment of balanced or surplus budgets, continued policy concerns with entitlements and mandatory spending, attention to legislative budget reforms that maintain surpluses rather than reduce deficits, the need for greater balance between microbudgeting and macrobudgeting, a tactical and highly public budget process, changed agency norms, and a coequal relationship between Congress and the president except in times of national crisis. If these and other new developments are accounted for, budget theory in the new century should be able to help us understand and explain the dynamics of this critical policymaking process.

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## Early Budget Theory: The Progressive Theory of Public Expenditures

Julia Beckett

The search for budget theory did not begin with V.O. Key, but he certainly focused attention on this problem. In the famous 1940 essay, V.O. Key cited only one work as developing a theory of allocation and expenditures:

The only American writer on public finance who has given extended attention to the problem of the distribution of expenditures is Mabel Walker. In her *Municipal Expenditures*, she reviews the theories of public expenditure and devises a method for ascertaining the tendencies in distribution of expenditures on the assumption that the way would be pointed to “a norm of expenditures consistent with the state of progress at present achieved by society.” While her method would be inapplicable to the federal budget, and would probably be of less relevance in the analysis of state than municipal expenditures, her study deserves reflective perusal by municipal budget officers and by students of the problem. (Key, 1987: 118)

Key’s comments raise two lines of inquiry. The first includes questions of: Who is Walker? What did she have to say? And do the perspectives in *Municipal Expenditures* have any relevance and utility for contemporary budget theory? The second asks whether municipal budgeting theory is distinct from state or federal budget theory, or in other words the normative question of whether there is a general budget theory of expenditures. This chapter focuses on the first line of inquiry.

Both the name Mabel Walker and her ideas are not readily apparent in budget literature. Walker was born in 1898 and had a long career as a specialist in local tax and expenditure. Walker’s *Municipal Expenditures* was her first book, and it was also her Ph.D. thesis from Johns Hopkins University. She became the

editor of *Tax Policy* in 1932, and she wrote more than twenty books on local finance, tax, and expenditure issues between 1930 and 1964. This chapter does not attempt to be a biography of Walker or to trace her body of work. Instead, it looks at the more narrow questions of what is the progressive budget theory, and does it have relevance for contemporary budget theory.

To understand Walker's theory and the research used to test it, it is beneficial to note the context. Predominant wisdom about government, administration, and budgeting was different when Walker's progressive budget theory was published in 1930. Walker's *Municipal Expenditures* was published ten years before Key bemoaned the lack of a budgetary theory. Walker's theory was developed before the Brownlow committee and other New Deal reforms, before Gulick's executive responsibility mnemonic, POSDCORB, of 1937, before Keynes argued that deficits were appropriate for governments in his 1937 book *General Theory*, before Maslow published his theory of motivation in 1943, before Appleby argued government is different in 1945, before Simon criticized the proverbs of administration in 1946, and before the Great Depression, World War II, and the civil rights movement changed the ways state, local, and federal government operated.

Walker's perspective centered on the challenges and opportunities of urban life. She focused her attention on municipal administration, particularly the expenditures of city governments. The problem of city government that drew Walker's attention was not the distribution of expenditures in a single city or the way a city carries out the budget process, but a larger question of whether all cities have similar budget distributions. Walker set about to determine if there was a distributional norm by category of municipal government expenditure.

The ideas that held greatest possibility for Walker were those that considered and applied concepts from market economics to government revenues and expenditures, particularly the ideas based on marginal utility. Walker recognized the difficulty for politicians and budget clerks to decide if one or another public object has greater claims. In addition, Walker recognized that there were texts on procedure of budgets, but the question of allocation had been "so severely let alone." Walker had confidence that practical understanding could result from the ideal of marginal utility as a way to determine the appropriate distribution of government expenditures.

Mabel Walker's progressive theory is one of the earliest attempts to develop a positive budget theory. Walker's purpose was to provide a theory based on economic thought, particularly aspects of marginal utility, to be tested through statistical data analysis sufficient to be descriptive. Walker also intended to provide theory to aid in decisions for allocation of government expenditures.

## **DEVELOPMENTAL NATURE OF SOCIETY AND GOVERNMENT**

The developmental nature of society and government is an important tenet of Progressivism. This tenet and the enunciated progressive values undergird the progressive budget theory. Progressivism sets a normative context. Walker's



theory is progressive in two senses of the term: the first concerns the Progressive Era. Hofstadter identifies the Progressive Era as a national political movement lasting from 1900 to 1914; the Progressive movement can also be considered one political movement during the Age of Reform that spanned from 1890 to 1940 (Hofstadter, 1955). Other historians place the national political Progressive Era as 1900 to 1920, but they do not extend it past 1920.

The Progressive political movement, or Progressivism, was a middle-class reform sentiment characterized by use of informed, moderate, and complex thought with concerns for urban reform, labor and social welfare, and interests of consumers. Progressives felt the responsibility to organize, legislate, and administer to address urban social problems. They were both pragmatic and intellectual in their approach (Hofstadter, 1955). Although Walker's theory was developed during the late 1920s, outside the time line set by historians of the Progressive political movement, it is in the Progressive tradition with an emphasis on informed, rigorous, scientifically based knowledge used to administer municipal government.

The second meaning of progressivism that applies to Walker's theory is the use of progressive ideals as part of social and intellectual thought. Like the idea of social Darwinism, the progressive philosophy also holds a core value of a society that develops and improves with the help of government as the agent to produce this change. Waldo notes:

Progress had, since the Renaissance, been a key concept in Western culture, associated with its dynamism, its expansiveness, its productivity, its proclivity to technological invention and social change; signifying a movement forward and upward in the human experience. As such, progress was a distinctively *modern* idea, a modern *invention*; the ancient and medieval worlds had no concept of progress, at least none beyond movement through a repetitive cycle. (Waldo, 1980:123)

This type of progressive philosophy is a base for Walker's theory.

Progressive criteria included implicit and explicit administrative values that public officials needed to understand and use. The value context, or Walker's preconditions, for a progressive theory needs to be set forth.

First, there is a developmental or evolutionary nature of cities, the assumption that governments actively seek to improve to reach a level of excellence. It was assumed that the services and methods used by public officers were evolving for the better, and that public officers could manage this development to a higher level of existence and quality of life. In addition, it was thought that the most advanced progressive cities managed by rational administrators would not accept the minimum level of service or an ordinary level of service. Instead, they would seek to achieve a level of services in quality and quantity that was as close to excellent as they could achieve.

Second, there are the progressive criteria for government crystalized in the four values of honesty, economy, efficiency, and proportion. These four pro-

gressive values for good administration reflected interests and norms of both scholars and society, in definition and operation. These values developed from approximately 1840 to 1930. As requisites these values were held to be neither independent nor exclusive; instead, they are cumulative in nature.

The fundamental requirement was honesty in government. Honesty was recognized by reformers because it was deemphasized from the 1840s to 1880s. Honesty was needed to address and to prevent looting, plunder, and less flamboyant types of graft.

The second requirement is economy. Economy is a retrenchment and paring down of government, especially to keep the tax rate and government receipts low. Based on low expenditures and low revenue, this value is really crude economy.

The value of efficiency is not the same as economy. “A low tax rate is important but it is more important to see that the taxpayer gets full value received for every dollar expended by the city and that important functions are not neglected” (Walker, 1930:13–14). Efficiency emphasized use of resources. The tools used to gain efficiency and minimize waste were scientific management and production reforms. With the efficiency movement, the expert entered government, and a whole train of innovations resulted. Walker attributes the efficiency emphasis to two motivations: “Penuriousness and the desire to expand civic functions—both powerful motives—fought out their battle in 1900–10, and out of the struggle came the last great phase of American municipal government—efficiency—which meant in financial terms, value received” (Walker, 1930: 22–23).

Proportion is the final progressive value. Walker’s proportion value has two parts. First, proportion means a balance in the city’s affairs that it currently pursues; the activities that the city chooses need to be balanced. The second means slow and seasoned development with an orderly assumption of new duties or services. Achieving the balance and orderly assumption of services is the role of government officers.

The values of honesty, economy, and efficiency are ingrained in American public administration. The ideal of proportion and balance is central to budgets, particularly with regard to the problem of expenditures. For Walker, applying theory in systematic research about government activities, particularly expenditures, was one way to provide guidance to achieve proportion. Like many other budget allocation theories, Walker’s study considered the value of proportion. The theoretic context for the questions of proportion and allocation are discussed in the next section.

## **PREDICATE TO A BUDGET THEORY: MARGINAL UTILITY THEORY**

Walker asserted that systematic, theoretically based knowledge was needed for budget decisions, and she found the ideas in economics, particularly the

marginal utility theory, to have most promise. But Walker also noted that economists either viewed government as a necessary evil or that the subject of government expenditures was not a worthy specialization subject for economists. How then, did Walker build upon the marginal utility theory?

Looking at the history of finance theory, Walker noted that the theories fell into two categories: economic-scientific or judgmental. The judgmental approaches were justification that were appeals to the claims of justice, such as the 1892 work of Bastable. Walker believed these judgmental approaches did not provide systematic assistance to those making the budget plans and decisions because justification was in essence an apology. "The old note of apology for governmental expenditure is becoming somewhat less conspicuous and with its passing, opportunity is being given for the development of a real theory of expenditure" (Walker, 1930:31). Thus, Walker rejected judgmental approaches and instead based her work on the economic-scientific approach.

Economic-scientific approach to budget and finance is what we consider to be rational modern analytic techniques; it used research grounded in economic theory and models with carefully gathered empirical data, and systematic analyses using statistics and other quantitative methods. Walker's preference was for economic and scientific approaches for budgets and allocation but, as she noted, government finance theory had primarily been developed by logical deduction that was normative in nature. A more modern, scientific, empirical approach was appropriate, according to Walker. "But there does seem to be a need for just such research; not, indeed, for any criterion laid down by a theorist, showing in rigid proportions the amounts to be expended on each and every function, but for a sympathetic study of the practices actually prevailing in American cities and some forecasting of impending lines of development" (Walker, 1930:30).

Walker limited her discussion of the history of the development of public finance. She was interested in the problem of proportion and allocation. In Walker's words:

The amount of social income that should be taken over by the government and the purposes to which it should be devoted cover a much broader field than the present discussion. Consideration is being given only to those functions which are now universally accepted in this country as municipal responsibilities. *The problem is the proportion of revenue which each function should receive.* (Walker, 1930:32, emphasis added)

Marginal utility was the economic idea Walker used for foundation of her theory. First, marginal utility of expenditures had been accepted "unquestioning" since 1900 as the theory for public finance. Walker described the history of the influence of marginal utility as follows: "The marginal concept of public expenditure is relatively new. The theory of marginal utility was given to the world about fifty years ago. . . . This theory has revolutionized economic thinking. Not only has it been used in the determination of value, but also of rent, wages,

profits and interest” (Walker, 1930:32). Applying the marginal utility theory to government was originated by Emil Sax in 1887 and that resulted in “giving the theory one of its richest applications” (Walker, 1930:32, quoting Weiser, 1893). Walker continued, “The very important contribution which Sax made to the theory of public finance, however, concerns particularly the determination of the total amount of revenue and the manner in which it should be levied. For the first time taxation was to be justified on purely economic grounds rather than on the abstract claims of justice.”

Walker noted that guidance in allocation decisions needed measurable criteria. This is the second reason economic theories relating to the “utilitarian ideal” were appealing: they could provide a framework. The idea that taxation and public finance could be determined from general economic theories had the greatest appeal because it provided measurable criteria in economic categories of want, goods, economy, and value.

In considering measurable criteria, there needed to be a way to determine proportion and to weigh the choices. It is in this problem that marginal utility theory could inform allocation decisions. Walker explained:

Once it has been demonstrated that the point of demarcation between public and private expenditure should be that at which it is a matter of economic indifference whether an additional outlay shall be made by the state or by individuals, it is necessary to go but a step further to say that a given amount of revenue should be distributed among the various governmental functions so equitably, that it would be a matter of indifference where an additional dollar would be spent. (Walker, 1930: 32–33)

This indifference or demand function was the citizens’ indifference curve as understood by administrators and politicians. A further note is that Walker asserted in the market the indifference point was determined in the large scale, and so an aggregate indifference point for all local governments was an equivalent to the market indifference point concept.

Walker also noted two shortcomings of the marginal utility ideal. One criticism of established marginal utility theory was it failed to address the “social-psychology” side of public finance. “Expenditures of governments then are expressions of the wants, desires, hopes, fears, habits, impulses, customs of human beings and must be studied as such if an understanding of them in all of their various aspects is to be had” (Walker, 1930:44, quoting Guest, 1927). The social psychology side asserts the starting point is the social character of consumption rather than the market economics aspects that begin with asserting that consumption is an individual character. This presented the need to consider other factors in the budget in addition to an “economic ideal.”

The second limitation of application of marginal utility theory concerned public officials. Walker explained,

That, as a rule, they are struggling within the limitations imposed by habit, training, pre-occupation, political pressure and other untoward factors to attain maximum social ad-

vantage is doubtless often true . . . The average government official's conception of social utility is decidedly hazy and couched in the terms of individual success, prosperity, and rights. (Walker, 1930:44, quoting Guest, 1927)

Thus, Walker recognized possible problems with acceptance or application of the budget allocation theory based on marginal utility.

## **WALKER'S PROGRESSIVE THEORY**

Walker was concerned with the standard of living in cities and the ability to pay for it. A city's standard of living included both the number and quality of government services provided. Walker's progressive budget theory centered on the premise that the means to decide how to allocate between options was through the "utilitarian ideal" or indifference point in economic theory as applied to government budgets. The indifference point was a measure of current expenditures as an expression of balance between citizen demand and government service provision. A theory of expenditures based on economic ideas was preferable to reliance on abstract pleas to the claims of justice that were non-economic and external to the government. In other words, despite some limitations, allocation based on economics provided facts to replace judgmental arguments.

Walker intended that the research could inform practice. Walker saw that budget makers had real problems that could be addressed by systematic study, but the public officers and the economists did not talk to each other. Walker asked: "Can the gap ever be bridged between the high sounding theories of the scholar and the rough and ready methods of the public official?" (Walker, 1930: 47). Walker described the context of budget decisions as follows:

The problem of budget distribution is one of mechanics. The final appropriation is the resultant of all the forces in action just as truly as in an analogous case in physics. To understand municipal budget making it is necessary to visualize this tremendous pressure that is being exerted from all sides—the pressure of organized interests, of ambitious department heads, of civic groups, of official prejudices, of the political potency of a low tax rate, even of public opinion where not represented by any of the above. The final budget will be the resultant of the forces and not the outcome of a dispassionate evaluation of the various functions. (Walker, 1930:47–48)

Walker advanced her belief that the ideal of marginal utility was desirable, but it needed to be applied according to the "progressive-values" or "human nature values." The problem was developing a theory that recognized the limits of context and that might be amenable to measurement and application. This indifference point determined by Walker, at least for a start, would be measured from expenditures currently undertaken across U.S. cities. Walker used this based on her assessment of measurement approaches. There were three basic approaches to measure and apply marginal utility theory according to Walker:

1. In the business world, marginal utility was measured through markets, free competition, and standardized products, but this method does not carry over to government services.
2. Using a consensus of opinion regarding the varying degrees of utility of different governmental functions might produce a measure of utility, but a general consensus was lacking. Furthermore, a consensus measure would be based on deduction, and it would be considered tautological.
3. Marginal utility could be approximated by an objective study of existing budgets. This was simpler, cruder, and largely pragmatic.

Walker reasoned:

Since a norm of budget distribution cannot be arrived at by deduction, will it not be wise to obtain such help as we can from objective methods? How are cities actually dividing up their appropriations? What is the average budget distribution for the entire country? What is the average for cities grouped according to various classifications? Can any conclusions be drawn from a survey of actual conditions? (Walker, 1930:49–50)

Walker chose the third approach as best to test her assertion that by using marginal utility theory a mean or an indifference point is discernable in the distribution of government budgets. It is here in the “pragmatic” approach that Walker attempted to discern the indifference for city residents and from established measures of services provided. The use of actual conditions and actual data was held to be preferable to measure marginal utility for local governments. Some of the considerations for the approach were detailed:

It seems reasonable to suppose that just as markets measure the value of commodities, so we may roughly approximate the marginal utility of a governmental service by the average proportion of the budget that is devoted to it in a number of different cities. If the budgets of a sufficiently large number of the most progressive cities could be analyzed and compared, after variations due to peculiar political or geographical exigencies had been eliminated, certain tendencies would be apparent which would point the way to a norm of expenditures consistent with the state of progress at present achieved by society.

This would never be mathematically exact and would probably never be capable of exactly the same application to any two cities. It would simply show limits, more or less imperfectly defined, within which, after proper allowance for the particular situation, certain expenditures should fall. (Walker, 1930:50–51)

Walker acknowledged that marginal utility theory was an ideal that could not fully be attained. She asserted that the best approximation of marginal utility for cities was first obtained as general measure, or an aggregate, that was not distinctive to the locale or region, and then an indifference point could be made more certain for that region based on local preferences. She argued that even though “at best it represents an approach toward rather than an approximation of the goal,” the effort was worthwhile. The alternative would be to “relinquish

the quest for equitable budget distribution” and resign it to the “limbo of insoluble problems” (Walker, 1930:47). She refused to concede that budget distribution and the question of proportion was not amenable to study.

## **WALKER’S RESEARCH APPROACH AND RESULTS**

The standard of living or expected services Walker listed were “clean streets, pleasing architecture, wide thoroughfares, low fire and death rates, ultra modern schools, efficient libraries and abundant parks, to name only a few of the more obvious rewards” (Walker, 1930:31). These are the categories and services to be considered in a budget distribution. Walker’s research to test her theory of municipal expenditures was extensive. She sought to demonstrate a common budget distribution for all American cities, and to demonstrate the state of budget process in regard to excellent levels of services provided. The underlying assumptions in this research were: that cities compared and strived to be excellent; the types and quality of services provided was a matter of administrative policy; and that policy was reflected in the number and quality of services in budgets and expenditures. Walker included statistical data analysis, interviews, site visits, and evaluation of budget procedures and documents. The most important aspect was how it extended and tested aspects of the economic theory of marginal utility to all cities in the country. Walker measured service provision, rather than citizen satisfaction or other measures of service quality.

Walker asserted that, in general, communities had a standard of living, but they were continually trying to raise the standard of living to that of the best cities. The exemplary or best cities were the ones with the highest standard of living. Walker’s research to test her theory was premised on the desire to show accomplishments and exemplary cities. First, Walker wanted to compare the actual achieved services of cities before comparing budget distributions. The importance of ranking according to services provided was seen to lie in the fact that a city government exists to give service, and the citizens have a right to demand it in terms of ultimate results. The next, and extremely vital, consideration is the cost involved in rendering this service. How can a city be criticized on its cost of service until we know what type of service it is rendering?

Finding no previous attempts at a comprehensive ranking of cities by quality of major services, Walker set about this task. She included services in three categories: protective, welfare, and public works. General administration was deliberately excluded because it merely supported, rather than supplied, direct services to the citizens. The ranking of quality of city government was based in twelve services measures: one measure each for garbage collection, sewers, fire, libraries and parks; two measures for schools; two measures for health; and three measures for street conditions (see Table 2.1).

The rankings for service delivery were based on existing data, as well as expert measures from previous studies. The data were less than ideal. For example, there were no uniform definitions or measures of normal police activity

**Table 2.1**  
**Municipal Services Walker Evaluated**

Categories	Service	Service Measure
Public Works		
	Street cleaning	Number of times per week
	Garbage collection	Number of times per week
	Sewerage	Percent of total population sewered
	Highways	Percent of total street area paved
	Highways	Percent of total paving that is durable
Protective		
	Fire	Percent of total real property annually destroyed by fire
	Health	Adjusted death rate per 1,000 population
	Health	Infant mortality rate per 1,000 births
Welfare		
	School	Length of term
	School	Percent of total enrollment in high school
	Libraries	Annual book circulation per capita
	Parks	Number of people per acre of parks and playgrounds

such as arrests. Using Census classification, the sample began with 250 cities of over 30,000 in population; 160 were included in the final ranking. Most of 90 ineligible were excluded because there were insufficient data in the minimum five service measures required for inclusion in the study. A few were ineligible because suburban bedroom communities are of a “parasitic nature” rather than being bona fide cities.

Rather than finding a few excellent cities, most of the evaluations clustered in the middle, or closer to a normal distribution. Out of a possible service delivery ranking between 50 to 100, not one of the cities had a ranking over 90. “The average for the entire country was 78.49, and the range for the country



was from 66.39 to 86.68” (Walker, 1930:113). “Perhaps the most that can be said of the results is that they are roughly indicative of the type of services the city government is rendering” (Walker, 1930:109). Thus, Walker did complete a survey of average actual conditions and an aggregate norm for those cities.

The important results from Walker’s empirical study were that services could be compared and that there was an ascertainable budget norm. The usefulness of this norm would be determined by public officials in preparation or analysis of their budgets, as Walker states:

It would certainly be very superficial action on the part of any city government to try to conform exactly to this norm of expenditures, but every budget making office should be able to “show cause why” the budget deviates from it in any respect. The public officials should be on the defensive in the matter of making appropriations and should be able to justify every local aberration in terms of social expediency. The idea is not so much that they should conform to a set standard as that they should be able to explain satisfactorily to the citizens why they do not conform.

An attempt to hold rigidly to this standard of expenditure would impede progress toward more desirable budget distribution. After taking into full account the average expenditure of progressive cities in its class, an enlightened community may feel so keenly the social desirability of emphasizing some particular function that it may heavily increase the appropriations for it. This, however, should be done as a conscious social policy and not as the result of political machinations. (Walker, 1930:157–158)

Walker also went on to describe local factors and circumstances that acted as restraints on budget distribution. The three major types of restraints are: external government restrictions, overlapping authority, and popular pressure. She visited seven cities to learn about budget-making procedures: Chicago, Milwaukee, Detroit, Cleveland, Buffalo, Philadelphia, and Baltimore. Thus, Walker’s study included qualitative and quantitative measures.

Walker was able to demonstrate that there was a norm of distribution of budgets according to functional categories. She stopped short of saying this was the ideal of marginal distribution of expenditures for local government allocations, but she was firm in her belief that this research effort and similar approaches could inform and aid in budget distribution.

## **WALKER’S CONTRIBUTIONS**

How do Walker’s contributions fit within contemporary budget theory? What are the implications for future study? This section considers these questions after summarizing the main points and noting two weaknesses of the progressive theory. Walker’s theory provides complementary ideas, in part because it is descriptive theory and in part because her ideas foreshadow contemporary topics and concerns.

Before proceeding to look at contemporary implications of Walker’s ideas, here is a review of the main points from Walker: (1) governments are progres-

sive in that they seek to provide a higher level of quality and quantity of services rather than the bare minimum; (2) budget allocations include four values: honesty, economy, efficiency, and proportion; (3) extending the marginal utility concept from economics to budgets postulates that for a given amount of revenue there is an ideal equitable distribution for expenditures that results in a matter of indifference where an additional dollar would be spent; (4) the type and level of services are determined through comparison with other governments; (5) there is a core of similar services that all cities provide, although differing factors between cities such as geographic location, state laws, and local decisions affect individual governments' budget allocations; (6) there is a budgetary distributional norm for the basic government services that can be empirically established; (7) the empirical study of budget allocation should be based on cohorts of similar governments (cities of certain sizes); (8) the distribution of services should be compared based on quality of services actually provided; and (9) there may not be any government that mirrors the aggregate norm, but governments should be able to explain how and why they differ from the norm.

Some of the weaknesses of Walker's theory relate to her representation of economic "indifference point," and her lack of measuring citizen satisfaction or other approaches to quality of services provided. First, Walker's idea of economic indifference was seen as a general measure for citizens, rather than a specific measure for each community. Local differences were seen by Walker to be from influences by noneconomic preferences or social-psychological factors. The idea that there was one general indifference point for urban services, rather than a distinctive difference by locale or region, seems to be too large an aggregation. It does not fit within current understandings of markets and localized demands. Second, it was implied that administrators and politicians would respond to that this general indifference point. The determination of this indifference point by actual services provided does not indicate how the transmission of this indifference measure was made or received by administrators and managers. Thus the transmission and context of this budget indifference point idea is vague. It also appears that this was an area for further study, or that once a general measure was established then local variation could be studied.

The other criticism is in Walker's measure of quality. What Walker used for quality of services was the frequency of service; this is an output measure. She then followed with a few site visits and direct observations. Citizens were not surveyed. Today research expectations would include either more systematic objective measures of services provided through performance measures (e.g., Hatry, Winnie, and Fisk, 1981) or citizen satisfaction surveys.

There are a number of analytical budget themes in Walker's work. First, Walker used marginal utility theory to advance a budget theory. Second, she tested the theory by using multiple methods, quantitative and qualitative, for explanation and understanding. Thus, Walker did meet her goal of descriptive empirical theory. The third theme is a comparative approach. The nature of comparing governments to demonstrate a rough approximation of a point of

marginal utility certainly is a useful concept. The measure of rough approximation, or a norm in budget distribution is now accepted, and, although limited, this approach provides descriptive relevance and acts as a building block for further theories.

The fourth theme is the local focus. Walker chose as her reference and subjects city governments, and this was one reason Key was dismissive about the application to other governments. However, extrapolating or generalizing from one level of government to another can provide perspectives on budget theory, rather than limiting the focus to a single level: national budget theory, state budget theory, or local budget theory. A fifth theme is that research can inform practice. Governments, despite variations, can be compared both by practitioners and by theorists. In effect, Walker was both a pragmatist and an early advocate of praxis.

The sixth and final theme is Walker's insistence on considering quality and accomplishments. The idea of quality has two uses: first as an underlying assumption about the nature of the city and its goals, and second in measuring the quality of services provided, rather than inputs of taxes raised or expenditure categories. Questions of quality and accomplishment have currency now.

The question becomes: what is Walker's influence on and contribution to budget theory? Walker's *Municipal Expenditures* is not widely cited after Key, and when cited, it is for the history of the development of fiscal theory. However, Walker has had a significant effect on budget theory particularly with regard to the question of allocation. Walker said of allocation that "the problem is the proportion of revenue which each function should receive" (Walker, 1930: 32). After reading Walker, Key said the basic budget problem was "On what basis shall it be decided to allocate  $x$  dollars to activity A instead of activity B?" (Key, 1987:117). This question of proportion has been a central issue in budget theory in this century. Walker's other important contribution is on the historical level. Walker provides a cogent summary of the origin and development of the theory of marginal utility from economics as an influence on budget theory during the elementary fifty-year period (circa 1880 to 1930).

Walker was not widely cited, and so many of her ideas were considered or discovered independently by others. It is difficult to explain an absence or lack of citations, just as it is difficult to disprove a negative. However, there are some general observations that can be made about why Walker's ideas are not widely recognized. First, Walker's scholarly interest was local government, and for much of the past sixty years the field has focused on the budget of the national government in theory, practice, and importance. Texts focused on federal practice, and incrementalist theory developed to explain the idiosyncratic federal budget and longitudinal nature of its study (Wildavsky, 1964). At this level, neither statistically suggestive nor statistically significant comparisons between subject governments were possible. Walker, instead, looked for external comparisons that are possible with the larger cohort or classification of municipal governments. However, current normative budgeting, such as performance budg-

ets or outcome-based budgets, has looked to state and local practice for suggestions and ideas to improve federal practice; an example is *Reinventing Government* (Osborne and Gaebler, 1992).

Even in areas where comparison is possible in state and municipal budgets, the type of empirical norm demonstrated by Walker is seen as basic information. A calculated norm for distribution between required functions seems self-evident, and it is standard practice to present Census data in this manner. This now accepted methodological orthodoxy is limited in application (Rubin, 1988). There is also a limitation on the longevity and recognition of authorities. The experts Walker cited—Emil Sax (1887), C.F. Bastable (1887), Friedrich von Weiser (1893), Harold Guest (1927), and Arthur Bentley (1908)—are unfamiliar today. Attributing ideas to the individual that originated them is relegated to histories of the field or to footnotes. The names and works become superseded. The academic knowledge base, in effect, progressed and developed beyond Walker.

An alternative reason for Walker's lack of recognition relates to the disciplinary approach. Caiden noted budget theory developed in three general disciplinary categories: management, economics, and political science (Caiden, 1990). Further, these perspectives were compartmentalized in asking different questions and using separate models. Budget studies are contained within individual disciplines, and interdisciplinary and multidisciplinary approaches are rare (Rubin, 1988). Walker's book was part of a political science series, it relied on economic theory, and it was intended to aid administrative practice. Walker's dominant theory base was market economics, but her approach was multidisciplinary.

A final possible reason for lack of recognition of the progressive theory is based on the timing and dominance of theoretical outlooks. External events can dramatically change conventional wisdom, or, in Kuhn's terms, influence paradigm shifts. A theory that reflects an era may not survive the shift or more pressing questions may change the focus. The Depression changed accepted wisdom about social and economic conditions. Walker herself explained:

Out of the depression has come an awareness of some of our underlying social and economic maladjustments. In the days of prosperity when things appeared to be quite all right to the more dominant groups and when too little attention was paid to the economic threat of the submerged, it was patriotic to be a ballyhoo artist and any Jeremiahs who pointed out defects were decidedly outside the spirit of the times.

But something happened to the morale of America in the bitter years following 1929 and much of the old cocksureness and vaingloriousness disappeared—it is to be hoped forever. A more soul-searching attitude became apparent. The jaunty economic setup which had seemed so depression-proof in the latter twenties gave way at numerous points in the period of strain and many serious-minded individuals became aware for the first time that instead of leading in everything worth while, America had lagged behind other great nations in many respects. (Walker, 1938:vi)

Budget and public finance questions changed with the Depression, and the focus shifted from urban growth to national recovery. In local finance, rather than

considering progress and improvement, the ability to pay obligations and the crisis mode of budget considerations were paramount. Walker moved on to other interests. In 1932, after developing her budget theory, Walker went to work for the Tax Policy League as executive secretary and editor of *Tax Policy*.

## IMPLICATIONS FOR CONTEMPORARY BUDGET THEORY

Walker had a number of themes and ideas that may contribute to contemporary budget theory. Although the lack of historic references may lead others to develop principles and theories independently (reinvent the wheel) there are areas of overlap and relevance for consideration in further efforts on budget theory. These include: comparisons between governments, what proportion of services, problems in data collection, application of economic marginal utility theories, allocation, values, and progressive ideals.

Many budget theories address inputs of taxes and allocation decisions. Walker, however, went beyond these to look at outputs in ways that have currency in the contemporary context. Walker proposed comparison between governments and quality of service. This foreshadows the current interest in that Cope outlined concerning performance measures, quality improvement, and, to a lesser degree, being entrepreneurial (Cope, 1996).

Walker posited rational comparison as a cause for the adoption of new service activity and as a way to determine accomplishments or quality. These comparisons among governments for activities or accomplishments have contemporary applications. A recent emphasis in normative budget theory and practice has focused on practical aspects of comparing and contrasting between governments. Within the best practices movement, organizations have actively sought out and distributed information on budget and service practices. For example, awards and innovation grants are sponsored by Rutgers, Harvard, the Ford Foundation, the National Civic League, and others (Holzer and Callahan, 1998). Budget appraisal, which links budget to performance, has been a goal and an instrumental approach of the Government Financial Officers Association in its budget awards program (Lehan, 1996). Another effort on relating budgets to outcomes is the Governmental Accounting Standards Board program establishing uniform service efforts and accomplishments measures (GASB, 1990). Walker used one framework to begin systematic comparison of budgets, but it is probably Walker's descriptive theory that the budget allocation decisions are based on external comparisons and competition that serves better to foreshadow contemporary approaches and challenges.

Walker's theory that community has a standard of living, and aspires to improve that standard, has some contemporary implications. For Walker the balance between current services provided and services desired was a question of proportion and responsiveness. It was central in her idea of a community standard of living, but competition also affected this. The idea of government affecting quality of living and providing services is reflected in some current

concerns. Proportion also had to do with who provides services, whether private, public, or some collaboration. Comparison of service providers, particularly in privatization discussions, deals with some of the issues of competition (Holzer and Halamachi, 1996). The questions of proportion and balance of a level of government services are now even more difficult to ascertain. The ideals of being a first-class city and the desire to have a high quality of living are concepts worth evaluating.

What seems very contemporary in Walker's effort are the difficulties in collecting data and in testing budget theory. The catalog of data collection problems includes: vague definitions, inadequate constructs, very broad categories of activity, self-reporting errors, and downplaying reputational negatives (e.g., high crime rates). The discussion of fundamental problems of comparisons between governments was given a chapter of its own in Walker's text (ch. 5). Indeed, the problems included notable differences in service provision, internal and external organizational structures, and governmental powers. These limitations go to validity, reliability, and generalizability. Despite advancements in research technology, one interesting consideration is how much or how little these research problems have changed.

Market economics has been used to describe budget allocation, production, and provision decisions. Walker used the marginal utility concept from economic theory as the foundation for allocation. Walker considered how local governments, as suppliers, made decisions about supply. There are two other distinct approaches to applying the market metaphor and economic concepts of marginal utility and equilibrium theories in budget theory: public choice theory and the Niskanen tradition of the budget process.

Public choice theory evaluates and frames issues of local allocation, production, and provision of services. The proponents of this paradigm began from an economic standpoint that emphasized public demand and how the market responded to this demand. Tiebout's pure theory postulates that local governments compete to lure residents (Tiebout, 1956). Tullock and Buchanan followed this by considering how individuals' rational self-interest affects how they vote on government services and taxes (Buchanan and Tullock, 1962). Public choice theories are built on models of individuals as consumers demanding services, thus affecting what is provided because governments respond to this demand (Kraan, 1996). This reasoning continues.

A similar but seemingly anomalous approach of the market-based approach grounded in equilibrium and marginal utility comes from Niskanen, and is extended by others (Niskanen, 1971; Bendor, 1990). These models, based on the federal level, consider the legislature to be the buyer and the agencies to be the suppliers (Bendor, 1990). The discussion and emphasis are on organizational decision making in regard to budget allocation. But the Niskanen model continues with the focus of the public choice theorist of how the demands of the government budget decision makers affects supply.

The public choice and Niskanen approach to marginal utility have the view-

points that emphasize demand and responses to demand. They leave open issues of whether governments act proactively in gathering information, developing, and marketing their product. In contrast, Walker's theories are related to economic exchanges, but she asserts the providers of the services made decisions by comparing themselves to other governments. Walker's findings of the distribution of services and quality provided weak support for these hypothesis. An area for future consideration may lie in comparing, evaluating, and conforming Walker's, Niskanen's, and public choice variations of market exchange models.

In her discussion of budget allocation, Walker considered politics as only part of the public official's concerns. Walker placed greater faith in rational and extensive data analysis to make the decisions. Politics was the context of decisions. Asserting budget decisions informed both by empirical research and through cohort comparisons, Walker had an organizational learning component in her theory. The desire to improve and the systematic comparison to other government for ideas have the base of a judgmental analogy approach rather than Walker's hoped for empirical demonstrable norm. The incremental approach is important regarding budget decisions, and the question of whether the increments may be adjustments to both internal and external comparisons is suggested by Walker's ideas. This area of budget allocation as an incident of organizational learning is ripe for further thought.

Another area for further consideration includes the values, explicit and implicit, promulgated by Walker. In contemporary times the four values—honesty, economy, efficiency and proportion—would be augmented by other values such as effectiveness and equity. However, there are questions of whether the progressive ideal has any currency now. Some assert the progressive outlook is part of the core values of American public administration and society (Dahl and Lindblom, 1953; Waldo, 1980; Wamsley, 1996). The progressive role of government is linked to the American dream (Rivlin, 1992). There is some resonance about progressive assumptions in expectations of higher and better services from governments. The progressive ideal seems to echo in the recent search for excellence and improvement.

The progressive ideal presents questions about knowing and actions. The "developmental" assumptions from the Progressive Era, at first glance, seem naive and incomplete. That is precisely why they should be evaluated. The ideas of a reduction in standards of living and retrenchment government services are absent from the progressive vocabulary. The accomplishment of continually better and higher level of community living is belied by a number of events: the Depression, the urban crises in the 1960s, and the fiscal plateau for big cities. What are the explanations? Walker suggested boosterism. Others' explanations include groupthink, positive thinking, and cyclical nature of finance. Others suggest avoidance of tough choices and procrastination. But perhaps optimism hinders the recognition that tough choices need to be made. The fundamental optimism of the progressive ideal may explain elements of fiscal crises such as over-

optimistic budget projections or slow responses to economic downturns. This is worth further inquiry.

Walker asserted that comparing and contrasting budgets and services are parts of the process for public officers. The decision process of budgets is often compartmentalized as a political concern, an economic construct or jurisdictionally unique (Koven, 1988; Kraan, 1996; Rubin, 1998). Comparisons of spending norms for categories such as education, prisons, or roads are done at the state levels. This type of comparison is seen as usable information to base the policy decisions and justifications. What Walker attempted to show was that the budget was a larger social issue not just a local one, not just political and not just economic. The multidisciplinary approach has some implications for further theory based on complementary ideas. Budgets are related to ideology and to society, and being able to enunciate theories and ideas that accept alternatives and differences is appropriate for further effort.

## CONCLUSION

Walker's progressive budget theory is worth considering. Initially, it may be the historical perspective of Walker's theory that provides interesting questions to ponder. Both the reporting of the development of budget thought and presenting the progressive budget theory provide context. As Thucydides, the Greek historian, said, those who do not know their history are doomed to repeat it.

In addition, there are many themes from the progressive budget theory that still resonate with relevancy and utility, particularly the comparative nature of budget planning, the determination of service accomplishments, and the improvement or developmental assumptions in budgets. Areas of incompleteness or indeterminacy also remain for further theory development, and perhaps the most important, inferred from Key, is whether local budget theory is distinct and not useful for federal budgets.

Walker's ideas predicate or foreshadow contemporary concerns in budget theory. Factors in Walker's theory still have descriptive and explanatory power. The limited ability to describe and generalize based on an empirical study continues. With the inescapable limits of empirical proofs, theory has an essential role in framing the knowledge and practice of budgets. The pragmatic, positive aspect of the progressive budget theory is reflected in Walker's own evaluation: "Perhaps the most outstanding result of the survey is the suggestion of tremendous possibilities for the future" (Walker, 1930:83).

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# The Separation of Powers Principle and Budget Decision Making

Thomas P. Lauth

Public budgeting in the United States is about accounting and financial management; it also is about accountability and governance. A fundamental principle of the American system of governance is separation of powers. The U.S. Constitution, state constitutions, and some local government charters<sup>1</sup> divide government powers among legislative, executive, and judicial branches. Each branch for the most part is independent of the others and has the power to check or balance the other two. For example, the legislature's power to appropriate money serves as a check on the executive branch. Similarly, the chief executive's power to veto bills enacted by the legislature serves as a check on that branch. This chapter is about the importance of separation of powers for restraining the branches and achieving accountability in public budgeting.

## THE SEPARATION OF POWERS PRINCIPLE AND ITS APPLICATION TO BUDGET DECISION MAKING: THEORY AND PRACTICE

### The Theory of Separation of Powers

In *The Federalist*, No. 48, James Madison wrote:

It is agreed on all sides, that the powers properly belonging to one of the departments ought not be directly and completely administered by either of the other departments. It is equally evident, that none of them ought to possess, directly or indirectly, an overruling influence over the others in the administration of their respective powers. It will not be

denied, that power is of an encroaching nature, and that it ought to be effectually restrained from passing the limits assigned to it.<sup>2</sup>

In *The Federalist*, No. 47, Madison quoted Montesquieu who wrote, “There can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates.”<sup>3</sup> In *The Federalist*, No. 51 Madison wrote about “so contriving the interior structure of the government, as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places.”<sup>4</sup>

### **Legislative Power of the Purse**

Separation of powers is the most important governing principle in the American political system for protecting citizens against the budgetary abuses of excessive taxation and imprudent spending.<sup>5</sup> According to the separation of powers principle, the power to levy taxes and appropriate tax proceeds for various government functions and policies is vested in the legislative branch.<sup>6</sup> The power to claim some portion of an individual’s wealth for collective or public purposes is one of the most imposing powers governments possess. For this reason, taxing and spending powers are assigned to the most representative branch of government, the legislature. For example, Article I, Section 9 of the U.S. Constitution states: “No money can be drawn from the Treasury but in consequence of appropriations made by law.” The president can spend money only through executive branch agencies if Congress, acting as representatives of the people, permits him to do so. Further, either by law or common practice, taxing and appropriating legislation usually originate in the lower or most populous chamber of the legislature. That chamber with smaller districts and in some instances more frequent elections is thought to be closer to the people. The power of the purse, James Madison believed, would be an effective weapon for representatives of the people to defend against an executive becoming too powerful. In *The Federalist*, No. 58, he wrote:

The House of Representatives cannot only refuse, but they alone can propose, the supplies requisite for the support of government. They, in a word, hold the purse—that powerful instrument by which we behold, in the history of the British Constitution, an infant and humble representation of the people gradually enlarging the sphere of its activity and importance, and finally reducing, as far as it seems to have wished, all the overgrown prerogatives of the other branches of the government. This power over the purse may, in fact, be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure.<sup>7</sup>

### **Executive Power of Budget Development and Execution**

In the twentieth century, legislatures have chosen to exercise fiscal control over the executive branch by concentrating responsibility for budget develop-

ment and execution in the office of the chief executive, reserving to themselves the power to approve spending plans developed in the executive branch and to appropriate public funds.<sup>8</sup> The Taft Commission on Economy and Efficiency stated in 1912 that the chief executive should have the powers of “initiation and leadership” in budget making, and the legislature should have the powers of “final determination and control.” The president, as representative of the people as a whole, was believed to be in the best position to present a comprehensive spending plan, while the Congress, composed of diverse local interests and constituencies, was thought to be best suited to have the power to accept or reject the budget, but not to formulate it.<sup>9</sup> The Budget and Accounting Act of 1921, which established the Bureau of the Budget (BOB) to aid the president in budget development, epitomizes the executive budget.<sup>10</sup> Similar developments have taken place in the states.<sup>11</sup>

Prior to the executive budget movement, it was common practice for executive branch agencies to submit their spending estimates directly to the legislature. Neither the chief executive, nor any other executive branch agency, had authority to coordinate or revise those estimates, consider them in relationship to each other, or balance them against an estimate of available revenue. As a result of the executive budget movement, agency requests are submitted to the legislature only after being coordinated and reviewed by the chief executive. The chief executive’s budget recommendation to the legislature is a comprehensive document that not only verifies the accuracy of agency estimates and the soundness of agency requests, but also weighs their importance in relationship to each other, and assesses their compatibility with the policy goals and program objectives of the chief executive. As the executive’s budget preparation responsibilities increased, his/her ability to direct and control executive branch agencies was enhanced.<sup>12</sup>

Why did legislatures give chief executives such power? In their essay on the executive budget in the states, Glen Abney and Thomas Lauth have written:

Even though a governor with strong budgetary powers may be a formidable adversary, state legislatures have benefitted from the executive budget in important ways. By relying upon the governor to take a comprehensive view in defining and presenting agency budget needs, legislatures have relieved themselves of the burden of dealing directly with the completing claims of numerous executive branch agencies. The concentration of budgetary responsibility in the office of the governor also enables the legislature to focus and assign responsibility for the resource and expenditure decisions made in the executive branch. Executive leadership is accepted by legislatures because it facilitates legislative budget control.<sup>13</sup>

In most countries of the world, the executive is not separate from the legislature; it emanates from the majority party or the majority coalition of the legislature. In parliamentary systems the budget is prepared and presented by the leader of the majority party, and it is presumed that it will pass pretty much in

the form presented. However, in the United States the president, governors, and local chief executives develop the budget and present it to the legislature in the form of a recommendation. Budget enactment is the prerogative of the legislature. The constituency differences of legislatures and chief executives (district-oriented for the former and government-wide for the latter) tend to make budgetary agreements difficult to achieve. As Joseph White and Aaron Wildavsky have noted, the separation of powers system is designed not to produce efficiency in government, but to prevent the abuse of power.<sup>14</sup> In this connection, Chief Justice Warren Burger wrote, “That this system of division and separation of powers produces conflicts, confusion, and discordance at times is inherent, but it was deliberately so structured to assure full, vigorous, and open debate on the great issues affecting the people and to provide avenues for the operation of checks on the exercise of governmental power.”<sup>15</sup>

### **Separation of Powers in Practice**

Separation of powers is not a static concept. It is a relationship among the branches of government that varies over time and across units of government. Allen Schick has described the evolution of federal budgeting as consisting of three periods: legislative dominance (1789–1921), presidential budgeting (1921–1974), and Congress’ quest for its own budget process to deal with the deficit (1974–present). During the legislative dominance period, “revenue and spending legislation, as well as other financial matters, were concentrated in the House Ways and Means and the Senate Finance Committees.” Fragmentation in legislative action, characterized by the separation of revenue and spending jurisdictions with spending assigned to appropriations committees, and later the assignment of some appropriations activity to other legislative committees, led “Congress to turn to the president to coordinate financial decisions.”<sup>16</sup>

The Budgeting and Accounting Act of 1921 required the president to submit a budget to Congress each year and established the Bureau of the Budget<sup>17</sup> as a staff agency to assist the president in preparing and executing the budget. Following an extensive process of reviewing agency requests for accuracy and credibility, evaluating them for compatibility with the policy priorities of the president, and coordinating proposed spending with available revenue, the president recommends to Congress a spending plan for the coming fiscal year. In effect, Schick writes, “The 1921 act made the president an agent of congressional budget control.”<sup>18</sup> Near the end of this period in the early 1970s, the proportion of the budget devoted to direct expenditures (e.g., social security, medicare and medicaid, and other entitlements), and the size and growth trend of the federal deficit, led to a decline in confidence in the president’s capacity to direct federal revenue and spending decisions. In response to this perceived difficulty, Congress sought to improve its own capacity to make revenue and spending decisions.

Congressional resurgence in the budget process led to the Congressional

Budget and Impoundment Control Act of 1974. The central feature of this act, relating to the roles of Congress and the president in the budget process, is the requirement that Congress adopt a budget resolution specifying the budget totals, deficit/surplus, and functional allocations within the specified total. If the president's budget recommendation represents his revenue and spending plans, the budget resolution represents Congress' revenue and spending plans.<sup>19</sup> The 1974 act also established the Congressional Budget Office (CBO) as an alternative source of staff expertise for Congress, enabling Congress to decrease its reliance on the presidential Office of Management and Budget (OMB). The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings Act), and the Budget Enforcement Act of 1990 were additional congressional efforts to cope with the federal deficit.

Edward Clynych and Thomas Lauth have classified 13 states according to the relative influence of governors and legislatures over the budget.<sup>20</sup> Three states, California, Illinois, and Ohio, are classified as executive-dominant states. In those states governors develop budget instructions, receive and review agency budget requests, and prepare and submit a unified budget recommendation to the legislature. Legislatures do not have access to original agency requests and use the governor's recommendation as the basis for their deliberations during the approval phase of the budget process. In these states the veto gives the governor leverage over budget decisions. However, the executive does not enjoy total domination. In two of the three states, the legislature maintains a role in projecting revenue.

Five states, Connecticut, Georgia,<sup>21</sup> Idaho, Kentucky, and Minnesota, are classified as states where the governor holds a central position in the budgetary process, but legislatures have the ability to make independent judgments and challenge executive budget assumptions and initiatives. In four of those states the legislature and its staff receive original agency requests, but the governor's executive budget still serves as the legislative working document. In Georgia and Idaho, legislative budget offices provide analysis of executive spending recommendations that enhance legislators' ability to challenge executive assumptions and initiatives. In Kentucky, the legislature asserted its authority to write budget instructions.

Four states, Florida, Mississippi, Texas, and Utah, are classified as legislative-dominant states, because the legislature maintains substantial influence over budget formulation. In Mississippi and Texas, the legislature receives budget recommendations from both the governor and the legislative leadership. In Utah and Florida, legislative fiscal staff receive copies of agency requests early in the process, review those requests, and make budget recommendations to the legislature. Although the appropriations committees in Utah and Florida do not receive a separate legislative budget, the committees review agency requests independently of the governor's recommendations. In Florida, the governor and legislature jointly develop budget instructions, and the legislature works with the governor to develop consensus revenue estimates.

In South Carolina, the executive and legislative branches jointly participate in budget formulation through the State Budget and Control Board, which legislative leadership tends to dominate. However, beginning with Governor Carroll Campbell in 1988, governors now submit an executive budget which gives the legislature an alternative to the Budget and Control Board recommendation.<sup>22</sup>

Clynch and Lauth concluded by writing:

The patterns in the states discussed suggest that changes in the power equation often enhance the influence of the least engaged budget actor. Americans hold ambivalent views about concentrating political power. This indecision surfaces in regard to state budget decisions, which determine whose social values prevail. The desire for strong leadership responsive to the majority pushes legislatively dominated systems in the direction of more gubernatorial leverage. At the same time, the desire for pluralistic access opens up executive-dominated systems, which leads to more legislative influence over spending choices. As long as the American states operate with a governor and legislature independent of each other, power over budget decisions will ebb and flow between them.<sup>23</sup>

### **Better Understanding an Important Topic**

Separation of powers in budget decision making is a timely and important topic. In recent years we have witnessed budgetary deadlock between President Clinton and the Republican-controlled Congress—resolved largely through budget summitry between representatives of the president and congressional leaders. Separation of powers, with its potential for interbranch conflict and necessity of interbranch cooperation, is clearly evident in the contemporary federal budget process.

In an effort to better understand the separation of powers principle and budget decision making, six court cases are examined. Two cases deal with the separation of powers principle in the U.S. Constitution, two are about separation of powers in the Mississippi Constitution and the Kentucky Constitution, one emanates from Oneida County, New York, and challenges the constitutionality of State of New York budget practices, and one case involves the separation of powers principle in the Organization Act of DeKalb County, Georgia. The cases have been decided by the U.S. Supreme Court and the highest court of four states. These cases were selected because they serve to illustrate important facets of the separation of powers principle in budget decision making. They are not, of course, the total body of appropriations and budgeting cases in which *separation of powers* has been at issue. For example, there have been numerous state-level cases delineating the line-item veto power. Those cases, which have implications for the separation of powers principle, have been examined by others in two excellent articles.<sup>24</sup>



## CONSTITUTIONAL CHALLENGE TO GRAMM-RUDMAN-HOLLINGS

### Introduction

Congress passed the Balanced Budget and Emergency Deficit Control Act of 1985 (PL 99-177, 99 Stat. 1038, 2 U.S.C. 901 et seq.)<sup>25</sup> with the aim of eliminating the federal budget deficit by restricting spending during the fiscal years 1986 through 1991 and progressively reducing the deficit amount to zero in 1991. If the maximum allowable deficit amounts were exceeded, the president was required to issue a sequestration order implementing a report on this matter issued by the comptroller general of the United States.

The law required the directors of the OMB and the CBO to estimate the fiscal year deficit and to determine whether the projected deficit would exceed the maximum allowable deficit for that year under Gramm-Rudman-Hollings. The directors were required to jointly report their findings to the comptroller general. The comptroller general was required to issue his own report based upon his assessment of the information received from the directors. The president was not permitted to modify or recalculate any of the estimates or amounts set forth in the report.

The comptroller general, while appointed by the president with the advice and consent of the Senate, is removable not only by impeachment but also by joint resolution of Congress for specific causes, including inefficiency and neglect of duty.

### The Constitutional Question

The constitutional question at issue was; did the functions assigned by Congress to the comptroller general under the act violate the separation of powers principle because the act confers upon the comptroller powers that are executive in nature?

### District and Supreme Court Decisions

On February 7, 1986, a three-judge district court<sup>26</sup> ruled that the comptroller general's role in the process was unconstitutional because it violated the separation of powers principle:

We hold, therefore, that since the powers conferred upon the Comptroller General as part of the automatic deficit reduction process are executive powers, which cannot constitutionally be exercised by an officer removable by Congress, those powers cannot be exercised and therefore the automatic deficit reduction process to which they are central cannot be implemented.

The effect of the district court decision was to place the burden of achieving deficit reduction on a fallback provision of the act that provided that the prescriptions of the OMB and CBO directors would take effect only if they were adopted by joint resolution, that is, legislation. Musing over the effect of its decision the court wrote:

It may seem odd that this curtailment of such an important and hard-fought legislative program should hinge upon the relative technicality of authority over the Comptroller General's removal . . . But the balance of separated powers established by the Constitution consists precisely of a series of technical provisions that are more important to liberty than superficially appears, and whose observance cannot be approved or rejected by the courts as the times seem to require.

On July 7, 1986, the U.S. Supreme Court (7–2) held that the duties that the Congress delegated to the comptroller general violated the separation of powers principle and were unconstitutional. Chief Justice Berger, writing for the court, (1) affirmed that the comptroller was subservient to the legislative branch, and (2) concluded that the functions assigned to the comptroller under the deficit control act amounted to execution of the law which was an intrusion on the prerogatives of the executive branch.<sup>27</sup> The court noted: “Congress does not have power to execute the laws and therefore cannot grant to an officer under its control what it does not possess.”

## THE PRESIDENTIAL LINE-ITEM VETO

### Introduction

The Line-Item Veto Act (PL 104–130) went into effect January 1, 1997. Its enactment was a victory for President Clinton as well as congressional Republicans. Since Ulysses S. Grant, presidents have favored adding the line-item veto to the chief executive's legislative powers, and the presidential item veto was an important element of the House Republicans' Contract With America.<sup>28</sup> In effect, the new authority ended the requirement that the president must approve or reject a spending bill in its entirety. The typical reasons cited in favor of the presidential item veto were: controlling pork barrel spending and contributing to deficit reduction.

Several members of Congress challenged the constitutionality of the Line-Item Veto Act. Their contention initially was upheld by a U.S. district court. When the U.S. Supreme Court vacated the district court judgment on grounds that the members of Congress lacked standing to bring the suit, the path was cleared for President Clinton to exercise this new presidential power.<sup>29</sup> He became the first U.S. chief executive to use the line-item veto when he rescinded one spending and two tax provisions in the FY 1998 twin budget reconciliation

acts (PL 105–33 and PL 105–34). He subsequently vetoed seventy-nine items in nine of the thirteen FY 1998 appropriations acts.

Proponents of the presidential item veto frequently cited state experiences with the line-item veto among the reasons for granting this device to the president. The line-item veto in the states, possessed by forty-three governors, developed in part because the executive veto was ineffective when dealing with wasteful and pork barrel spending in appropriations bills. It was intended to restore the governor's ability to protect the executive budget by being able to veto objectionable items added by the legislature to appropriations bills.

During congressional consideration of the presidential item veto, the states' success with it was frequently cited. However, in reality many differences exist between the presidential line-item veto and the various forms of the line-item veto possessed by state governors. For example the new line-item veto act gave the president authority to make substantive changes in a law after it has been enacted and signed, whereas governors typically are required to veto items as part of the process of signing appropriations bills into law. The president could not reduce items,<sup>30</sup> whereas governors in twelve states have the authority to reduce as well as eliminate items of expenditure. The president could not veto policy provisions attached to appropriations bills or limitations on how funds are to be spent; governors frequently veto such narratives. Further, as others<sup>31</sup> have pointed out, the new presidential item veto authority was not the constitutional line-item veto authority possessed by governors but rather an enhancement of the power the president already possesses to rescind appropriated funds. Also, presidents could veto tax benefits and new direct spending provisions; governors cannot, unless courts view spending measures as appropriations.

On June 25, 1998, the U.S. Supreme Court declared unconstitutional the Line-Item Veto Act (2 U.S.C., Sec. 691 et seq.).<sup>32</sup>

### **The Line-Item Veto Act**

The Line-Item Veto Act permitted the president to rescind: (1) any dollar amount of discretionary spending, such as might be found in an appropriations act; (2) any item of new direct spending, for example, legislation dealing with entitlements such as Medicare or Medicaid; and (3) any limited tax benefit, defined as a provision benefiting 100 or fewer beneficiaries.<sup>33</sup>

Within five days of signing a spending or tax bill, the president could transmit to Congress a message listing items to be rescinded. Item veto authority could not be used on spending or tax bills that became law without the president's signature or on acts that became law over a presidential veto.<sup>34</sup> Rescissions could be of items included in lump-sum categories, even if not specified as a dollar amount in the appropriations act as long as they were identifiable in accompanying committee reports or earmarked in authorizing legislation.<sup>35</sup> Rescissions took effect unless Congress passed a disapproval bill within a period of thirty

days in which both houses were in session. *Enhanced rescission* was a variation of the rescission authority found in the Congressional Budget and Impoundment Control Act of 1974. However, in contrast to that act the new line-item veto law shifted the burden to Congress to disapprove rescissions in order to prevent them from taking effect. The president could veto a disapproval bill, and Congress could override a presidential veto by a two-thirds vote.<sup>36</sup> Savings from the line-item veto were directed to deficit reduction and were not to be used for spending elsewhere.

### **Members of Congress Go to Court**

On January 2, 1997, six members of Congress<sup>37</sup> filed suit in federal court contending that the president's new power to veto specific items in spending and tax bills, instead of having to veto entire bills containing such items, was unconstitutional. They contended that the Line-Item Veto Act violated the presentment clause of the U.S. Constitution, Article I, Section 7, Clause 2, which provides that after a bill is passed by a majority of both houses of Congress it may be (a) signed in its entirety by the president, (b) vetoed in its entirety, or (c) allowed to become law without presidential signature. But, it may not be partially or item vetoed.

On April 10, 1997, U.S. District Court Judge Thomas Penfield Jackson found for the plaintiffs and held that Congress may not grant the president authority to cancel specific spending items from appropriations bills, or to rescind a tax benefit that he already had signed into law.<sup>38</sup> Judge Jackson wrote in his opinion that "where the President signs a bill but then purports to cancel parts of it, he exceeds his constitutional authority and prevents both houses of Congress from participating in the exercise of lawmaking authority." He also held that "Congress has turned the constitutional division of responsibilities for legislating on its head."

The Line-Item Veto Act provided for an expedited appeal to the U.S. Supreme Court rather than to a federal appellate court. In arguing the case before the Supreme Court on May 27, 1997, the government contended that members of Congress lacked standing to sue because at the time of the suit there had been no presidential item vetoes resulting in injury to the plaintiffs, that is, no case or controversy. On June 26, 1997, the Supreme Court agreed (7–2) that the members of Congress lacked standing to sue and vacated the district court judgment. Chief Justice William H. Rehnquist wrote that the members of Congress "alleged no injury to themselves as individuals," and that the alleged "institutional injury" is insufficient to establish standing to sue. His opinion also noted that the decision does not foreclose the act from challenge by someone who suffers "judicially cognizable injury resulting from it."<sup>39</sup> Although the Supreme Court did not address the issue of constitutionality, the effect of vacating the district court decision was that the Line-Item Veto Act remained in force.

### **Clinton Vetoes Three Items**

The conventional perception of the line-item veto is a mechanism for canceling selected items from appropriations bills.<sup>40</sup> However, the first use of the presidential line-item veto occurred on August 11, 1997, not with respect to discretionary spending (as in an appropriations bill), but with respect to one item of new direct spending and two limited tax benefits.<sup>41</sup> The direct spending item was a Medicaid item that would have allowed New York to continue to levy certain kinds of taxes on health care providers to raise money in lieu of state money for the state's share of Medicaid matching funds, and the limited tax benefits were an item that would have allowed capital gains tax deferrals on the sale of certain food processing plants to farmers' cooperatives, and an item that would have allowed financial service companies to defer their payment of taxes on the income from overseas operations.<sup>42</sup> These three items were not part of appropriations bills but were in the twin reconciliation bills<sup>43</sup> enacted August 5, 1997, to adjust existing spending and taxing laws to meet the five-year deficit reduction targets agreed to on June 5, 1997, in the FY 1998 budget resolution (H.Con.Res. 84). That resolution embodied the "budget deal" between President Clinton and Republican congressional leaders (May 2, 1997).<sup>44</sup> The budget resolution sets deficit reduction targets; reconciliation identifies the programs to be cut and revenue sources to be changed to achieve those targets.<sup>45</sup>

President Clinton's use of the line-item veto was heralded as a message to "special interests" that wasteful spending and tax loopholes no longer would be permitted, even though his three vetoes would have a negligible impact on the deficit. The perceived political benefit of using the new veto power at the first opportunity apparently was so great that the president decided not to wait for an appropriations bill to come to his desk. The rescissions resulted in injured parties withstanding to sue, and the issue of constitutionality was back in the courts.

### **Injured Parties Go to Court**

On February 12, 1998, a U.S. district court again declared the 1996 Line-Item Veto Act unconstitutional because it violated the method prescribed by the constitution by which a bill becomes a law and transferred legislative authority to the executive. The petitioners were New York City and Snake River Potato Growers, Inc., who claimed that President Clinton's vetoes caused them economic harm. The U.S. Department of Health and Human Services (HHS) had ruled that New York City unfairly taxed health care providers to make money for its share of Medicaid payments. The FY 1998 Reconciliation Act (PL 105-33) granted New York permission to do what the HHS ruling had prohibited. President Clinton rescinded the provision of the reconciliation act that would have helped New York finance its Medicaid program through taxes on health care providers, and the city sued.<sup>46</sup> The president also vetoed a provision of the

FY 1998 Reconciliation Act (PL 105–34) that would have allowed the owner of the stock of a qualified agricultural refiner or processor to defer capital gains on the sale of that stock to eligible farmer cooperatives as long as the gains are reinvested in stocks. The farmers cooperative sued after President Clinton vetoed their tax breaks.<sup>47</sup> District Court Judge Thomas Hogan ruled that the president injured New York City and the Snake River plaintiffs when he canceled legislation that provided a benefit to them.

### **Supreme Court Rules Line-Item Veto Unconstitutional**

The U.S. Supreme Court heard oral arguments on April 27, 1998.<sup>48</sup> The two issues that received the most attention during oral argument were the standing of New York City and Snake River Potato Growers to sue, and whether or not the requirement that the president sign a bill into law up to five days before exercising his rescission authority satisfied the Article I, Section 7, Clause 2 requirement that a bill presented to the president be signed or vetoed in its entirety. On the latter point, the government contended that the Article I requirement is satisfied, and rescission is merely an exercise of Article II authority the president has been granted by Congress within the meaning of his Article II powers to faithfully execute the laws.

On June 25, 1998, the Supreme Court ruled that the Line-Item Veto Act of 1996 was unconstitutional; that the Constitution prohibited the president from amending legislation passed by Congress by vetoing single items of spending. Justice John Paul Stevens, for the Court (6–3), wrote,

The presidential actions at issue have amended two Acts of Congress by repealing a portion of each . . . there is no constitutional authorization for the president to amend or repeal. Under the Presentment Clause, after a bill has passed both Houses, but “before it become[s] a Law,” it must be presented to the President, who “shall sign it” if he approves it, but “return it,” i.e., “veto” it, if he does not. There are important differences between such a “return” and cancellation under the Act: The constitutional return is of the entire bill and takes place *before* it becomes law, whereas statutory cancellation occurs *after* the bill becomes law and affects it only in part.

The court expressed no opinion about the wisdom of the act.

## **THE MISSISSIPPI COMMISSION OF BUDGETING AND ACCOUNTING: BUDGET DEVELOPMENT PERMITTED BUT BUDGET EXECUTION PROHIBITED**

### **Introduction**

On November 23, 1983, the Supreme Court of Mississippi declared unconstitutional the state practice of legislators serving on boards and commissions

with executive responsibilities.<sup>49</sup> The court decision permitted legislative leadership to develop a budget for submission to the legislature but prohibited legislative involvement in budget execution. The case was initiated by Attorney General Bill Allain. At issue were the separation of powers sections of the Mississippi Constitution.

Article I, Sections 1 and 2, of the Mississippi Constitution provide:

Section 1. The powers of the government of the state of Mississippi shall be divided into three distinct departments, and each of them confided to a separate magistracy, to-wit: those which are legislative to one, those which are judicial to another, and those which are executive to another.

Section 2. No person or collection of persons, being one or belonging to one of these departments, shall exercise any power properly belonging to either of the others. The acceptance of an office in either of said departments shall, of itself, and at once, vacate any and all offices held by the person so accepting in either of the other departments.

### **Commission of Budgeting and Accounting**

From 1955 to 1983, the Commission of Budgeting and Accounting was the principle institution in Mississippi for budget development and execution. It was composed of the governor as chairman and five leaders from each legislative chamber (the lieutenant governor, president pro-tempore of the Senate, chairman of the Senate Finance Committee, chairman of the Senate Appropriations Committee, and a member of the Senate named by the lieutenant governor; the speaker of the House of Representatives, chairman of the House Ways and Means Committee, chairman of the House Appropriations Committee, and two members of the House of Representatives named by the speaker). The commission, acting through a director and other support personnel to conduct its affairs, prepared a proposed state budget for submission to the legislature, "the budget-making process," and administered appropriations after enactment of appropriations bills, "the budget-control process."

### **Legislators Versus the Attorney General**

The case originated on April 7, 1982, when state legislators filed suit in the state circuit court against Bill Allain, the attorney general of the state of Mississippi in response to an opinion letter he had written. The legislators sought a declaratory judgment that their concurrent service on named state boards and commissions (including the Commission of Budgeting and Accounting) did not violate Article I, Sections 1 and 2 of the Mississippi Constitution of 1890, and that statutes providing for such service were constitutional. Later the same day the attorney general brought an action against the legislators seeking a declaratory judgment that (1) the named boards (including the Commission of Budgeting and Accounting) were in the executive department of government, (2) that

the named statutes were unconstitutional insofar as they authorized legislators to serve or to appoint members to the boards, and (3) that the legislators were in violation of Article I, Sections 1 and 2 of the Mississippi Constitution of 1890. The attorney general also sought to oust defendant-legislators from the legislature, or, alternatively, from the boards. In summary, the issue was whether in performing budget functions “the members of the legislature have overstepped the restrictions imposed on them by the constitution and thereby encroached upon the powers constitutionally vested in the executive department.”

The trial court found that the contested statutes were unconstitutional to the extent that they authorized legislators to sit on the boards, and declared that the legislators were removed from the boards and ousted from the legislature.

### **Supreme Court Affirms in Part and Reverses in Part**

On appeal the Supreme Court of Mississippi defined several issues for adjudication. However, only one of the issues is of direct interest for our purposes, namely, whether the Mississippi Constitution forbids legislators to serve on boards (including the Commission of Budgeting and Accounting).

The court began its analysis of legislative encroachment on the executive department by defining executive power as “the power to administer and enforce laws as enacted by the legislature and as interpreted by the courts.” Citing the U.S. Supreme Court, it found pertinent the following distinction: “Legislative power, as distinguished from executive power, is the authority to make laws, but not to enforce them or appoint the agents charged with the duty of such enforcement. The latter are executive functions.”<sup>50</sup>

The attorney general had contended that the preparation of a proposed state budget, “the budget-making process,” and the administration of appropriations after the enactment of appropriations bills, “the budget-control process,” are executive functions belonging solely to the executive department of government by virtue of Article I, Section 2, and legislators are constitutionally forbidden to perform such functions, either directly or indirectly.

Legislators contended otherwise, arguing that the separation of powers article should be given a flexible construction to permit overlap in the exercise of powers. They also argued that the existing system in which legislators had substantial influence upon boards and commissions that exercise powers regarded as executive in nature worked well and for that reason should not be disturbed. The court did not find either argument persuasive.

The Supreme Court held “that the whole of the legislative power has been vested in the legislature of this state. We further hold that the whole of the executive power has been vested in a separate and distinct department of our government, and that no person a member of the legislative branch may consistent with the constitution exercise powers essentially executive in nature.” Having enunciated this guiding principle, the court then turned to the two budgeting processes, “budget making,” and “budget control.”



### The Budget-Making Power

The court enunciated three sets of principles regarding budgeting making. First, budget making is a legislative prerogative. Second, the governor has a constitutional right to submit budget recommendations to the legislature, including the submission of an entire executive budget for the legislature's consideration. Third, any commission or agency involved in budget making on which both legislators and members of the executive branch serve as voting members is unconstitutional.<sup>51</sup>

Speaking to the first principle, the court wrote, "Constitutionally, budget-making is a legislative prerogative and responsibility in Mississippi. The legislature has the power and prerogative to provide for the collection of revenues through taxation and other means and to appropriate or direct the expenditure of monies so raised. Though subject to gubernatorial veto, the primary budget-making responsibility vests in the legislature."

Addressing the second principle, the court wrote,

The legislature has acknowledged the right of the Governor to submit to it his recommendations upon the budget prepared by the Commission of Budget and Accounting, not excluding a recommendation for changes thought desirable by the executive . . . Although the statutory language seems to contemplate the governor will merely comment upon the recommendations of the Commission of Budgeting and Accounting, it does not preclude the governor from making an entire executive budget for the legislature's consideration . . . In sum, we are of the opinion the governor is constitutionally empowered each year to submit to the legislature an executive budget for its consideration in making appropriations for the government of this state . . . Ultimately, of course, the legislature has the power and prerogative to accept or reject the budget recommendation of the governor, in whole or in part.

Writing on the third principle, the court said, "The constitutional imperative that the powers of government be divided into separate and distinct departments, however, renders unconstitutional the organization of any commission or agency on which both legislators and members of the executive branch serve as voting members. . . . We hold that the Commission of Budget and Accounting as presently structured violates the article on separation of powers in this state." The existing statute which "creates a Commission of Budget and Accounting composed simultaneously of members of both the legislative and executive departments as voting members is hereby declared unconstitutional."

The court also noted that both the legislature and the governor have the prerogative to create such committees as seem appropriate to assist with budget-making responsibilities.

### The Budget-Control Process

The court ruled that the budget-control process is exclusively an executive function:

The budget control process presents a different issue in that it is an executive function. Once taxes have been levied and appropriations made, the legislative prerogative ends, and executive responsibility begins to administer the appropriation and to accomplish its purpose, subject, of course, to any limitations constitutionally imposed by the legislature . . . We have held above that the constitution does not permit the legislature to directly or indirectly invade the powers and prerogatives of the executive branch of government. The legislature thus may not administer an appropriation once it has been lawfully made and is prohibited from imposing new limitations, restrictions or conditions on the expenditure of such funds, short of full legislative approval.

Existing statutes that vest “budgetary control powers and responsibilities in a commission on which persons who are members of the legislative department serve is hereby unconstitutional.”

The Supreme Court vacated the judgment of the circuit court that would have ousted legislators from their offices in the legislature, arguing that as duly elected members of a coordinate branch of government they should be given respect commensurate with their standing within the government. It seemed sufficient to hold that they have been unconstitutionally exercising powers that are properly reserved to the executive branch. No good purpose would be served by requiring their removal from office.

### **Postscript**

Following the Supreme Court decision, the legislature in 1984 created the Joint Legislative Budget Committee (JLBC), consisting of the same ten legislative leaders who served on the Commission of Budget and Control, to exercise the legislature’s budget-making prerogatives. A Legislative Budget Office was established as a staff arm of the JLBC. For the executive branch, the legislature in 1984 established the Fiscal Management Board (FMB), consisting of the governor and two gubernatorial appointees, to exercise the governor’s budget-making and budget-control prerogatives. In 1989, the legislature abolished the FMB and created the Department of Finance and Administration, which includes a budget division.<sup>52</sup>

The issue of separation of powers in the Mississippi budget process re-emerged at the end of the decade when a suit alleged that participation of the lieutenant governor on the JLBC was a violation of the provision for separation of executive and legislative powers of the Mississippi Constitution.

The Mississippi Code Annotated, Sec. 27–103–101(1) in part states: There is hereby created the Joint Legislative Budget Committee and the Legislative Budget Office which shall be governed by such committee. The joint committee shall be composed of the Chairman of the Senate Finance Committee, the President Pro Tempore of the Mississippi State Senate, the Lieutenant Governor of the State of Mississippi, the Chairman of the Appropriations Committee of the Senate and one (1) member of the Senate to be named by the Lieutenant Gov-

ernor, and the Chairman of Ways and Means Committee of the House of Representatives, the Chairman of the Appropriations Committee of the House of Representatives, the Speaker of the House of Representatives and two (2) members of the House of Representatives to be named by the Speaker of the House.

Plaintiffs relying upon *Alexander et al. v. The State of Mississippi By and Through Allain*, 441 So. 2d 1329 (1983), contended that (1) no officer of one department may perform a function “at the core” of the power properly belonging to either of the other two departments, (2) that budget making is “at the core” of the legislative department, and (3) the lieutenant governor is an executive officer.

The Supreme Court distinguished this case from its *Alexander* ruling by holding that the lieutenant governor is not simply an officer of the executive branch, but constitutionally an officer of both legislative and executive branches, and as president of the Senate constitutionally eligible to receive the legislative powers conferred upon him by the legislation creating the Joint Legislative Budget Committee.<sup>53</sup>

## THE MOVE TO LEGISLATIVE INDEPENDENCE IN KENTUCKY

### Introduction

Kentucky is a state in which the governor is relatively strong in budgetary matters, even though Kentucky governors may serve only one four-year term.<sup>54</sup> Since 1972 the Office for Policy and Management (OPM) has been the budget and planning arm of the governor. OPM assists the governor in budget preparation and review, and following legislative appropriations, OPM makes allotments to programs. Kentucky has a sixty-day limitation on its biennial legislative session. Snyder and Ireland report that governors often withheld the budget until the end of the session and used the budget as a bargaining tool with legislators who wanted projects included in the executive budget.<sup>55</sup> However, in the late 1970s and early 1980s the legislature began to assert its independence. In 1978 the legislature established a Legislative Budget Review Office that provides staff support to the Appropriations and Revenue Committees.<sup>56</sup> Merl Hackbart reports, “The move toward legislative independence gained momentum in the 1982 legislative session with the passage of House Bill 649,” a bill containing “a series of changes designed to strengthen the legislature’s role in the budget process.”<sup>57</sup>

Included in House Bill 649 were requirements that (1) the governor submit his or her budget by the fifteenth day of legislative session (his or her first budget) or by the tenth legislative day (his or her second budget); (2) the budget include a budget reduction plan, thereby restricting the governor’s ability to redirect resources in the event of a shortfall; (3) the Legislative Research Commission (L.R.C.) be authorized to write the

state budget instructions; (4) the legislative branch draft a budget memorandum to clarify legislative intent; and (5) the budget be in the form of a resolution rather than a bill.<sup>58</sup>

Some provisions of HB 649 were not challenged by Governor John Y. Brown, such as the provision requiring that the budget be presented early in the legislative session. However, several other provisions were challenged, and the Kentucky Supreme Court was required to sort through issues of executive and legislative branch prerogatives and the separation of powers principle as it related to budgeting in the Commonwealth.

In January 1984 the Supreme Court of Kentucky held that the legislature, acting through its staff arm the Legislative Research Commission,<sup>59</sup> has the power to formulate budget instructions for the biennial general fund budget. The court also upheld the budget submission date and budget reduction provisions. However, it held unconstitutional the provision that the budget be in the form of a resolution rather than a bill.<sup>60</sup>

### **Legislature Prevails on Most of the Constitutional Issues**

At issue in *Legislative Research Commission et al. v. John Y. Brown et al.* were several statutes relating to the budgetary enactment process and oversight following the passage of the budget. In each instance, the statutes<sup>61</sup> presented a potential violation of the separation of powers principle in budget decision making. In laying out the state's separation of powers doctrine the Supreme Court wrote,

Our present constitution contains explicit provisions which, on the one hand, mandate separation among the three branches of government, and on the other hand, specifically prohibit incursion of one branch of government into the powers and functions of the others. Thus our constitution has a double-barreled, positive-negative approach:

Section 27 The powers of the Commonwealth of Kentucky shall be divided into three distinct departments, and each of them be confined to a separate body of magistracy, to wit: Those which are legislative to one; those which are executive, to another; and those which are judicial, to another.

Section 28 No person or collection of persons, being of one of those departments, shall exercise any power properly belonging to either of the others, except in the instances hereinafter expressly directed or permitted.

One statute (KRS 48.130) required each branch of government, when submitting a budget request to the General Assembly, to develop and submit a plan for a reduction of that budget in the event the Commonwealth suffered a revenue shortfall. If a revenue shortfall developed during the period between sessions of the legislature, the reduction plan approved by the General Assembly would be implemented. During the first biennium of Governor John Y. Brown's administration revenue shortfalls had necessitated cuts in the budget enacted by the legislature. The legislature had objected to some of his choices, which led to

the statute prescribing how future budget reductions would be handled.<sup>62</sup> The trial court declared this statute unconstitutional because it permitted the Legislative Research Commission (LRC) to veto executive decisions administering the budget, and because execution of the budget is the prerogative of the executive branch. The Supreme Court reversed, holding that the statute does not delegate control to the LRC, but simply directs each branch of government to carry out the reduction plan that was enacted by the General Assembly. Related statutes (KRS 48.400; KRS 48.600) required the executive branch to monitor the Commonwealth's financial position and give periodic reports to the other branches, and in the event of a severe revenue shortfall (one in excess of any reduction plan prescribed by the General Assembly) to act according to its best judgment but to report its action to the appropriate legislative committee. The Supreme Court held that these statutes were not an intrusion into the domain of the executive branch and did not harm the separation of powers doctrine.

Another statute (KRS 48.500) required each branch of government to interpret provisions of the appropriations act in conformity with the budget memorandum adopted by the General Assembly. When the General Assembly is not in session, such interpretations are to be reviewed by the Interim Joint Legislative Committee on Appropriations and Revenue. If the executive branch and the Interim Committee disagree on the interpretation, the statute provides two options: (1) the interpretation is not implemented until it is determined to be in compliance with legislative intent, or (2) the executive branch informs the Interim Committee of its intention not to comply and offers an explanation for noncompliance. The trial court held this statute unconstitutional because it permitted a veto of executive action in administering the budget by a legislative committee. The Supreme Court reversed, holding that if the executive branch complies with either of the provisions of the statute, that is, (1) amends its interpretation to conform to that of the Interim Committee, or (2) notifies the committee of its intention not to agree with the committee, it may proceed with its own interpretation. While the Interim Committee may disagree or object to a contested interpretation it may not veto the decision of the executive branch. Therefore, there is no legislative veto and no prevention of the executive branch executing its budget. By narrowly construing the statute as only requiring the executive branch to report noncompliance to the Interim Committee but not comply with the interpretation of the Interim Committee, the court was able to avoid the constitutional issue that seemed to be inherent in the statute.<sup>63</sup>

Another statute (KRS 48.310) required that the budget be introduced as a *resolution*, rather than as a *bill*. It further provided that the budget should be subordinate to the Kentucky Revised Statutes and that the budget should not contain any language that would exempt it from existing statutes. The rationale for this action was to preclude the possibility that provisions of a budget bill would repeal existing statutes. However, the trial court declared this act unconstitutional because the Kentucky Constitution requires the budget to be enacted by a bill that the Governor may veto on a line-item basis. The Supreme Court

upheld the lower court ruling, in effect, preserving the line-item veto prerogative of the chief executive.

### **The Bottom Line**

Snyder and Ireland concluded, “In *L.R.C. v. Brown*, the court acknowledged the legislature’s preeminence in budgetary matters, while invalidating some of the statutes as an infringement upon the governor’s constitutional obligation to ‘faithfully execute’ the budget.”<sup>64</sup> The legislature’s role in writing state budget instructions is unique among the states. The legislature prevailed in its desire to receive the budget earlier in the legislative session. The legislature gained ground in its desire for greater influence over budget reductions in times of revenue shortfall. The legal standing of required executive branch compliance with “legislative intent” remains uncertain. The governor’s line-item veto prerogative was preserved by the holding that the legislature must enact the budget by a bill rather than a resolution.

## **NEW YORK EXECUTIVE BRANCH LACKS AUTHORITY TO IMPOUND APPROPRIATED FUNDS**

### **Introduction**

New York has a constitutional executive budget system. However, the legislature exerts considerable influence in the budget process as illustrated by the requirement that when agencies submit their budget requests to the governor they simultaneously must send their requests to the Assembly Ways and Means Committee and the Senate Finance Committee. These two committees hold a joint budget hearing with the governor’s Division of the Budget.

In the executive budget for FY 1976–77 New York Governor Hugh L. Carey recommended a \$12 million appropriation for the sewage works reimbursement program. During legislative consideration of the budget, the legislature added \$14 million to the recommendation and passed a total appropriation of \$26 million. The governor signed the appropriation into law. In October 1976, approximately half way through the fiscal year,<sup>65</sup> the director of the budget reduced by \$7 million the allocation to the Department of Environmental Conservation for the maintenance and operation of local sewage treatment systems. The announced reason for the impoundment was to maintain a balanced budget throughout the fiscal year. The county of Oneida asserted that it had been improperly denied state reimbursement for the operation and maintenance of sewage treatment works, and petitioned for dispersal of the impounded funds.<sup>66</sup>

### **The Constitutional Question**

At issue was whether the state director of the budget, acting as an agent of the governor, may refuse to spend \$7 million appropriated by the legislature.

The executive branch argued that the governor had a constitutional obligation to maintain a balanced budget throughout the fiscal year and that impoundment was necessary to achieve that objective, and that the appropriation act granted discretionary authority to the budget director to reduce appropriations. The Supreme Court, the Appellate Division, and the Court of Appeals<sup>67</sup> all held that “no authority inheres in the Governor under the State Constitution to impound funds appropriated by law and that the . . . appropriation statute conferred no discretionary authority upon the Director of the Budget to disapprove otherwise proper expenditures.” The impoundment of \$7 million of the appropriations was unconstitutional.

### **Court of Appeals Decision: No Inherent Power to Impound**

The Court of Appeals ruled that although the governor has a constitutional obligation to propose a balanced budget, he is not obligated to maintain a balanced budget throughout the fiscal year, nor does he possess implied constitutional power to reduce enacted appropriations in order to achieve a balanced budget. In the case before it, the court held that the state director of the budget, acting as an agent of the governor, may not in an effort to reduce state spending refuse to spend \$7 million appropriated by the legislature to aid municipalities in operating and maintaining sewage treatment works. The court quoting itself from an earlier opinion stated that a duly enacted statute, “once passed, cannot be changed or varied according to the whim or caprice of any officer, board or individual. It remains fixed until repealed or amended by the Legislature.”<sup>68</sup>

The court also noted that although the governor possesses the item veto over appropriations, he chose not to exercise it, and approved the appropriations bill presented to him by the legislature. Referring to the legislative addition to the governor’s budget recommendation, the court wrote, “As a legislative addition, the \$14 million was subject to executive veto. The Governor elected to approve the measure, however, and it became law . . . Once the appropriation was approved, the governor and his subordinates were duty bound ‘to take care that [it was] faithfully executed.’ ”<sup>69</sup> The court in effect held that appropriations must be treated by the executive branch as mandatory not discretionary: “However laudable its goals, the executive branch may not override enactments which have emerged from the lawmaking process. It is required to implement policy declarations of the Legislature, unless vetoed or judicially invalidated.”

With regard to the separation of powers principle, the Supreme Court held that the executive impoundment constituted an “invasion of the legislative domain.” The Court of Appeals noted that executive power to impound funds would be inconsistent with the state’s constitutional form of government: “Our State Constitution establishes a system in which government powers are distributed among three co-ordinate and coequal branches. . . . Extended analysis is not needed to detail the dangers of upsetting the delicate balance of power existing among the three, for history teaches that a foundation of free government is

imperiled when any one of the co-ordinate branches absorbs or interferes with another.” Further on the same subject, the court wrote, “True, there are areas in which the responsibilities of the three great branches of government overlap or intersect, and in which powers cannot be immutably fixed. But it cannot be denied that a principal function of the executive is to carry out the laws of the State, whether embodied in statutory or other form.”

### **Postscript**

Joseph Zimmerman has reported that the immediate result of the *County of Oneida v. Berle* decision was “resurrection of the item veto as an important tool in the arsenal of weapons employed by the governor to defend his fiscal program against legislative extravagance in form of items added or increased.”<sup>70</sup> New York governors have had the item veto since 1874, but following the establishment of the state’s executive budget system in 1929 had come to prefer impoundment over the item veto as defense against spendthrift legislatures.<sup>71</sup>

This development illustrates the relationship between impoundment and the item veto. If a chief executive is permitted to impound funds appropriated by the legislature, use of the item veto may be deemed unnecessary. If impoundment is used in moderation within a zone of acceptability that has been worked out between the chief executive and legislative leaders, the more formal power of the item veto may not be necessary to protect the integrity of the executive’s budget. However, as was seen in the impoundment controversies between President Richard M. Nixon and Congress, violations of the norms of acceptability are likely to lead to formal constraints such as the Congressional Budget and Impoundment Control Act of 1974, or as in the New York case judicial invalidation (*County of Oneida v. Berle*, 1980).

In a somewhat similar federal case, the U.S. Supreme Court held that the administrator of the Environmental Protection Agency (EPA) was obligated “to allot the funds authorized to be appropriated” by the Federal Water Pollution Control Act Amendments of 1972.<sup>72</sup> In that case, the court held that despite direction from the president not to allot the maximum amounts,<sup>73</sup> the EPA administrator was not permitted to allot less than the amounts authorized to be appropriated for grants to New York City and similarly situated municipalities. However, the court did not address the constitutionality of presidential impoundment, choosing instead to decide the case by interpreting the specific provisions of the 1972 act.

## **ATTEMPTED “COUP D’ ETAT” AGAINST THE DEKALB COUNTY CHIEF EXECUTIVE OFFICER**

### **Introduction**

In 1998, the DeKalb County (Georgia)<sup>74</sup> Board of Commissioners and the county’s chief executive officer (CEO) engaged in conflict over the CEO’s



budget powers. The proximate issue was the standing of ordinances passed by the Board of Commissioners governing the administration of capital outlay projects. The principle at stake was the delineation of powers between the legislative and executive branches of county government.<sup>75</sup>

On May 19, 1998, the Board of Commissioners enacted two ordinances (Nos. 98-06 and 98-07) requiring the county to retain a program manager to oversee and provide construction management for all projects funded pursuant to the Annual HOST<sup>76</sup> Projects List, and to establish requirements for budgeting, approving, and monitoring HOST-funded projects. The former became known as the “Program Manager Ordinance,” and the latter was known as the “HOST Budgeting Ordinance.” The CEO vetoed the ordinances (May 26, 1998) calling them “illegal power grabs that usurp the power of her office,”<sup>77</sup> and the board overrode the veto (May 28, 1998). The CEO filed a complaint in the superior court<sup>78</sup> of DeKalb County seeking a declaratory judgment that the ordinances violate the Organizational Act of DeKalb County.

The events took place against the backdrop of a long-running controversy between the CEO and several members of the Board of Commissioners. In the controversy that led to litigation, the CEO, asserting her power to implement county ordinances, policies, rules and regulations, proposed a pool of engineering firms to draw up a list of public works projects to be undertaken with sales tax funds approved by county voters in 1997. However, the Board of Commissioners asserted its power to spell out which projects would be funded, insisting that such projects be distributed equally among the county’s five districts.

### **Homestead Option Sales and Use Tax**

In March 1997, DeKalb County voters approved a plan to add beginning July 1, 1997 a 1 percent sales tax (on top of the state’s 4 percent sales tax), and to cut property taxes starting in 1999. This action is authorized under the state’s Homestead Option Sales and Use Tax provision.<sup>79</sup> The plan presented to voters included a provision that the first eighteen months of revenue from the new sales tax increase would be used for much needed public works projects, including a courthouse addition and road and sidewalk projects. Thereafter, 80 percent of the revenue from the new 1 percent sales tax would be used in lieu of homeowner property tax payments,<sup>80</sup> and 20 percent of the revenue would be dedicated to capital outlay items. Capital outlay projects would be funded and implemented from a priority list.

The measure was designed to create a new revenue source, provide property tax relief, and dedicate funds for capital maintenance and improvements. It was expected that a substantial portion of new revenue would be collected from nonresidents, and that the tax reduction provision would attract new homeowners to the county.

## **Organization Act of DeKalb County**

Interpretation of the county charter, the 1982 Organization Act of DeKalb County, was at the center of the dispute between the CEO and the Board of Commissioners. Seven commissioners, elected from five districts, set policy including approval of the county budget. The CEO, elected by voters of the entire county, supervises agencies of the executive branch, is responsible for day-to-day county operations, introduces the county budget to the Board of Commissioners, and has veto power.<sup>81</sup> The county does not have a county manager, but the CEO functions as a county manager. The CEO also presides at board meetings,<sup>82</sup> but is not a member of the board. The CEO asserted that she had authority under the Organization Act to oversee how sales tax proceeds are spent on public works projects. The Board of Commissioners' ordinance called for the hiring of a project manager to oversee the projects, and for a series of public meetings and commission retreats to select projects that would be funded. The project manager would report to the board. The board wanted influence in each stage of the process from project selection, through bidding, to project completion. The CEO characterized the board's ordinances as "micro-management" and "ward politics."<sup>83</sup> Her view of the process was that the board picked the projects and assigned funding, but then relied on the CEO and the executive branch to implement the projects.

In her suit, the CEO cited a provision of the Organization Act stating that the commissioners "shall deal solely through the chief executive in all matters concerning the operation, supervision and administration of the various departments, offices, and agencies of the county government. No member of the commission shall directly or indirectly order, instruct or otherwise attempt to control the actions of county personnel subject to the administrative and supervisory authority of the chief executive." The project manager provision of the board's ordinance was argued to be a violation of that provision.

## **CEO Wins Round One in Superior Court**

On August 6, 1998, a DeKalb Superior Court judge ruled that the two disputed Board of Commissioners' ordinances were void. The HOST Program Manager Ordinance and the HOST Budgeting Ordinance were held to be in direct violation of the county's Organization Act. In a statement attached to the opinion the court characterized the ordinances as an attempted "coup d'etat" by the commissioners.<sup>84</sup>

The ruling noted: "There is a natural tension between executive and legislative branches in just about every level . . . government. . . . However, it is the duty of elected public officials to work within those limitations." The court concluded: "The Organizational Act delineates the separation of powers between the executive and legislative branches of county government. The legislative

body, the Commission, has the power to make policy decisions about how much funding should be made available for projects and which projects should be funded. . . . The Commissioners do not have the authority to administer the spending of appropriated funds; the supervision, administration and control of this executive function is vested exclusively in the CEO.” Similarly, the court’s opinion noted, “The Commission is empowered under the Act to decide only whether a particular project is in the best interest of the citizens of DeKalb County and therefore should be funded. After that legislative policymaking decision has been made, contract administration . . . becomes the sole responsibility of the CEO, not the Commissioners.”

The court further stated that any changes to the powers of the CEO must be made not by ordinances of the commission, but by procedures delineated in the Organization Act first requiring an act of the Georgia General Assembly and then approval by the voters of DeKalb County. Specifically, the court said, “. . . the Commissioners have attempted to take over the administrative and budgetary control of the monies to be accrued under the HOST statute, virtually removing any administrative control from the Chief Executive Officer. This they cannot do by merely passing an ordinance.”

With specific regard to the Program Manager Ordinance, the court ruled that it was in violation of the county Organizational Act because it would have placed the commission in a direct supervisory position over personnel within the executive branch, a function reserved exclusively to the CEO. With specific regard to the Budgeting Ordinance, the court ruled that it violated the Organizational Act because it created a separate and independent process for HOST projects, placed additional duties upon the CEO with respect to budgeting for those projects, and departed from the process and procedures established for the annual county budget. The Budgeting Ordinance also violated the Organizational Act because it would have involved commissioners in the administrative details of county procurement and contracting, a prerogative reserved exclusively to the CEO.

### **Round Two in the Georgia Supreme Court Is Closer to a Draw**

On February 22, 1999, the Georgia Supreme Court unanimously held that under provisions of the Organization Act of DeKalb County, the Board of Commissioners sets policy and passes budgets, and the CEO is responsible for day-to-day operations of government.<sup>85</sup> Both sides in the dispute claimed victory. The CEO stated that the decision vindicated her position “that a majority of the commissioners had overstepped their authority.” One of the commissioners stated, “The court reaffirmed that we are the watchdogs.”<sup>86</sup>

The Supreme Court held that the Board of Commissioners could not force the CEO to hire a project manager, and did not need board approval before sending out requests for project bids or before applying for federal matching

funds. However, the court ruled that the board did have authority to vote on project bids after they are received. Further, the board could appoint an auditor to investigate county spending patterns.

Elaborating the separation of powers matter, the court held that a reading of the county's Organizational Act reveals that the Board of Commissioners and the CEO are not equals; the act conveys a limited grant of power to the board, while bestowing on the CEO broad executive and administrative powers. In this connection the court wrote, "The act expressly gives the commission the power to make appropriations and to determine the priority of capital improvements. However, once the commission approves appropriations, the act provides that it is the task of the CEO to enforce the requirement that county funds be spent only in accordance with the approved budget. Citing the county's Organizational Act, the court noted the CEO "shall have exclusive power to supervise, direct and control the administration of the county government." And, the commission shall "deal solely through the chief executive . . . in all matters concerning the operation, supervision, and administration of the various departments, offices, and agencies of the county government."

More specifically, the court held that the Program Manager Ordinance requiring the county to retain a program manager to oversee and provide construction management for projects funded by the HOST supplanted the CEO's day-to-day responsibilities in supervising county personnel, in violation of the county's Organizational Act. Also, provisions of the Budgeting Ordinance requiring the CEO to seek board approval before requesting additional funding and services, such as matching federal funds, and before releasing requests for proposals or invitations to bid for HOST projects conflicted with provisions of the county's Organizational Act giving the CEO power to establish rules to regulate purchasing for the county. However, provisions of the Budgeting Ordinance detailing the process by which the Board of Commissioners would appropriate HOST funds and determine the priority of capital projects funded by HOST did not impermissibly alter the budget process set out in the county's Organizational Act. Provisions of the Budgeting Ordinance requiring the CEO to attend public meetings and board retreats were held invalid.<sup>87</sup>

## CONCLUSION

In a separation of powers system, the legislature's role is to protect against a tyrannical executive, and the executive's role, as representative of all the people, is to check the particularistic interests of the legislature. The legislature enacts public policies; the executive initiates and recommends policies and implements those enacted by the legislature. Yet, legislative and executive roles are not mutually exclusive; the success of each branch depends upon the cooperation of other branches. However, from time to time the branches intrude upon each other's prerogatives—something Madison warned against. When this happens, courts have been called upon to define the limits of each role. Each of the six

cases discussed in this chapter illustrates a different kind of threat to the constitutional principle of separation of powers in government budgeting.

In the Gramm-Rudman-Hollings deficit reduction case, Congress attempted to assign to the comptroller general, an official subject to congressional removal, a function which was executive in nature. The U.S. Supreme Court held that because Congress does not have the constitutional power to execute the laws, it cannot assign to a governmental official power that itself does not possess. No matter how important the legislative objective of deficit reduction might be, the process through which it is implemented must meet the constitutional test of separation of legislative and executive powers.

In the presidential line-item veto case, Congress attempted to expand the ordinary executive veto power by adding to it the functional equivalent of the line-item veto, that is, *enhanced rescission* power. The U.S. Supreme Court held that action to be a violation of the separation of powers principle because the power to enact or change legislation is a power that only Congress may exercise; it may not be transferred even in part to the executive branch. The other side of the separation of powers coin is checks and balances. The traditional line-item veto (the kind possessed by most governors) is a check by the executive on legislative action. It is a negation of legislative action, not a positive performance of the law-making function that is assigned to the legislative branch. The constitutional flaw in the *enhanced rescission* approach to giving the president the functional equivalent of the line-item veto was that it granted to the chief executive a positive power to change legislation after it had been passed by Congress. This was an impermissible transgression of the separation of legislative and executive powers.

In the Mississippi case, the legislature for nearly thirty years had been exercising power through the Commission of Budgeting and Accounting that encroached on the budgeting execution prerogatives of the executive branch. The Mississippi Supreme Court ruled that "the budget-making" process was the prerogative of the legislature, although it was proper for the governor to make spending recommendations to the legislature. The "budget-control," or execution, process was the sole prerogative of the executive branch. Neither the budget-making process nor the budget-control process could be performed by a state agency comprised of both legislative and executive branch members. However, the court also ruled in a subsequent case that the separation of powers principle is not violated when the lieutenant governor serves as a member of the Joint Legislative Budget Committee; the lieutenant governor is an official of both the legislative and executive branches.

In the Kentucky case, a series of statutes aimed at strengthening the legislature's role in the budget process were largely sustained. The court affirmed the legislature's preeminence in enacting the state's budget and the governor's duty to implement the budget that is passed by the legislature. The court noted that while the governor may recommend a budget to the legislature, he or she is not

constitutionally required to do so. It also noted that the executive budget recommendation is not binding on the legislature.

In the New York case, the longstanding practice of gubernatorial impoundment of appropriated funds was held to be unconstitutional. Legislative appropriation enactments were held to be mandatory, not discretionary for the executive branch. Following the invalidation of gubernatorial impoundment, use of the line-item veto is reported to have dramatically increased.

In the DeKalb County case, the Board of Commissioners had attempted to usurp the fiscal management prerogatives of the chief executive officer (CEO) by appointing a program manager responsible to the legislative branch who would perform duties largely within the executive branch. The Georgia Supreme Court enunciated the principle that under the county's Organizational Act the legislative branch had the power to approve capital outlay projects, but the day-to-day financial management of those projects was the prerogative of the CEO and the executive branch.

Placement of the power of the purse in the hands of the legislature was historically intended to protect against tyranny of the monarch. Today, it is intended to control public spending by focusing responsibility for budget development and execution on the chief executive. Conversely, the chief executive's power to control and direct agency budget development, to veto in whole or in part legislative appropriations, and to execute appropriations are intended to protect against inefficiency and pork barrel politics in public spending. In short, the principle of separation of powers in public budgeting is intended to protect against the abuse of power. For this reason it is an essential principle of budget decision making.

## NOTES

Edward J. Clynych, Phillip J. Cooper, Merl Hackbart, Philip G. Joyce, and Joseph F. Zimmerman read an earlier version of this chapter and provided helpful suggestions for its improvement. Their contributions are gratefully acknowledged.

1. In the mayor-council and council-manager forms of local government, there is separation of powers among the branches. Mayors are in a somewhat stronger position than are managers vis-à-vis the council, because they usually have the power to veto council budget enactments. In the commission form of local government, there is not a separation of powers among the branches. Each commissioner is simultaneously an agency head and a commission member. In this connection Irene S. Rubin writes: "separation of powers between the branches is much less rigid than at the national and state levels and hence competition between the branches is less noticeable." Irene S. Rubin, *Class, Tax, and Power: Municipal Budgeting in the United States* (Chatham, NJ: Chatham House, 1998), 3. (See also James J. Gosling, *Budgetary Politics in American Governments*, 2nd ed. (New York: Garland Publishing, 1997), 197–201.

2. Alexander Hamilton, John Jay and James Madison, *The Federalist: A Commentary on the Constitution of the United States* (New York: The Modern Library, 1937), 321.

3. *Ibid.*, 314.

4. *Ibid.*, 336.

5. In the 1970s and 1980s, the Tax and Expenditure Limitations (TELS) movement relied upon referenda to achieve the somewhat more limited objectives of restricting government's ability to increase budgets or taxes.

6. This principle was established in the *Magna Carta* (1215), which asserted that when a king wanted to raise a tax he would have to obtain the consent of the common council of the realm.

7. Hamilton, Jay, and Madison, *The Federalist*, 380.

8. Allen Schick, *Budget Innovations in the States* (Washington, DC: The Brookings Institution, 1971).

9. President's Commission on Economy and Efficiency, *The Need for a National Budget* (Washington, DC: U.S. Government Printing Office, 1912), 143–145.

10. Larry Berman, *The Office of Management and Budget and the Presidency, 1921–1979* (Princeton, NJ: Princeton University Press, 1979).

11. Glenn Abney and Thomas P. Lauth, "The Executive Budget in the States: Normative Idea and Empirical Observation," *Policy Studies Journal*, 17 (summer 1989): 829–840.

12. *Ibid.*, 831.

13. *Ibid.*, 829.

14. Joseph White and Aaron Wildavsky, *The Deficit and the Public Interest: The Search for Responsible Budgeting in the 1980s* (Berkeley: University of California Press, 1989), 1.

15. *Bowsher v. Synar et al.*, 478 U.S. 714, 92 L. Ed.2d 583, 106 S.Ct. 3181 (1986).

16. Allen Schick, *The Federal Budget: Politics, Process and Policy* (Washington, DC: The Brookings Institution, 1995), 34–35.

17. In 1970, renamed the Office of Management and Budget.

18. Schick, *The Federal Budget*, 35.

19. *Ibid.*, 37–38.

20. Edward J. Clynch and Thomas P. Lauth, eds., *Governors, Legislatures, and Budgets: Diversity across the American States* (Westport, CT: Greenwood Press, 1991), 149–155. See also: Glenn Abney and Thomas P. Lauth, "Perception of the Impact of Governors and Legislatures in the State Appropriations Process," *Western Political Quarterly*, 40 (June 1987): 335–342.

21. A study of Georgia concluded: "The history of Georgia budgeting in this century has been characterized by extreme periods of legislative domination (prior to 1931) and executive domination (1931–1961). Since 1962 gubernatorial power has been checked . . . by restrictions on the manner in which revenue surplus can be distributed, while on the other hand it has been strengthened by an enhancement of formal budgetary powers. During the same period the legislature has sought to maintain parity with the executive branch by exercising greater independence in selecting its officers, acquiring its own staff expertise, and increasing line-item control in the appropriations act." Thomas P. Lauth, "The Executive Budget in Georgia," *State and Local Government Review*, 18 (spring 1986): 58.

22. The 1993 South Carolina General Assembly enacted a statute devolving upon the governor the State Budget and Control Board's function of submitting the annual state budget recommendations to the legislature (Act 132 of 1993).

23. Clynch and Lauth, *Governors, Legislatures and Budgets*, 155.

24. Richard Briffault, "The Item Veto in State Courts," *Temple Law Review*, 66

(1993):1171–1204; and Louis J. Fisher, “The Line Item Veto Act of 1996: Heads-up from the States,” *Public Budgeting and Finance*, 17 (summer 1997): 3–17.

25. The act is popularly known as Gramm-Rudman-Hollings, the names of its sponsors: Senators Phil Gramm (R-Texas), Warren Rudman (R-NH), and Ernest Hollings (D-SC).

26. U.S. District Court for the District of Columbia (85–1377).

27. *Bowsher v. Synar et al.*, 478 U.S. 714, 92 L. Ed.2d 583, 106 S.Ct. 3181 (1986)

28. Ed Gillespie and Bob Schellhas, eds., *Contract With America* (New York: Times Books/Random House, 1994).

29. *Franklin D. Raines et al. v. Robert C. Byrd et al.*, 117 S. Ct. 2312 (1997).

30. This provision of the act was somewhat ambiguous. The act clearly stated that the president could not reduce items. However, if the president could propose a portion of an appropriated item for cancellation while leaving intact the remainder of the appropriated item, that would seem in effect to be a reduction. Had the Line-Item Veto Act of 1996 survived, the meaning of this provision is likely to have been the subject of litigation.

31. Thomas P. Lauth, “The Line Item Veto in Government Budgeting,” *Public Budgeting and Finance*, 16 (summer 1996): 97–111; and Philip G. Joyce and Robert D. Reischauer, “The Federal Line-Item Veto: What Is It and What Will It Do?” *Public Administration Review*, 57 (March/April 1997): 95–104.

32. *William J. Clinton, President of the United States et al. v. City of New York et al.*, No. 97–1374. Argued April 27, 1998; decided June 25, 1998.

33. Committee on the Budget, U.S. Senate, *The Congressional Budget Process: An Explanation* (Washington, DC: U.S. Government Printing Office, December 1996), 23–26.

34. House Committee on Rules, *The Uses and Application of the Line Item Veto* (Washington, DC: U.S. Government Printing Office, January 2, 1997), 4.

35. Joyce and Reischauer, “The Federal Line Item Veto,” 98; and House Committee on Rules, *The Use and Application of the Line Item Veto*, 2–3.

36. For example, President Clinton on October 6, 1997, canceled 38 items in the Military Construction Appropriations Act (PL 105–45); the Senate voted (69–30) on October 30 and the House voted (352–64) on November 8 to restore the canceled items; the president on November 13 vetoed the bill restoring the canceled items; the House voted (347–69) on February 5, 1998, and the Senate voted (78–20) on February 25 to override the presidential veto.

37. Senators Robert C. Byrd (WV), Carl Levin (MI), Daniel P. Moynihan (NY), and former Senator Mark Hatfield (OR), and Representatives David E. Skaggs (CO) and Henry A. Waxman (CA).

38. *Robert C. Byrd et al. v. Franklin D. Raines et al.*, 956 F. Supp. 25 (1997).

39. *Franklin D. Raines, Director, Office of Management and Budget et al. v. Robert C. Byrd et al.*, No. 96–1671 (1997), 18.

40. Appropriations bills emanating from the thirteen subcommittees of the House and Senate Appropriations Committees provide funding for: Agriculture; Commerce, State and Justice; Defense; District of Columbia; Energy and Water Development; Foreign Operations; Interior; Labor, HHS and Education; Legislative Branch; Military Construction; Transportation; Treasury and Postal Service; VA, HUD, and independent agencies.

41. The Joint Committee on Taxation had identified 79 items in the tax bill as meeting the definition of a *limited tax benefit*.



42. *The Atlanta Constitution*, August 12, 1997, p.1, and the *New York Times*, August 12, 1997, p. A12.

43. The Balanced Budget Act (PL 105–33) and the Taxpayer Relief Act (PL 105–34).

44. For a thorough analysis of the 1997 budget deal, see Daniel J. Palazzolo, *Done Deal?: The Politics of the 1997 Budget Agreement* (Chappaqua, NY: Chatham House Publishers, 1999).

45. Schick, *The Federal Budget*, 82–86.

46. *City of New York v. William J. Clinton*, 985 F. Supp. 168 (1998).

47. *Snake River Potato Growers, Inc. v. Robert E. Rubin*, 985 F. Supp. 168 (1998).

48. *Clinton, President, et al. v. New York City et al.*, No. 97–1374 (1998).

49. *Alexander et al. v. The State of Mississippi, By and Through Allain*, 441 So. 2d 1329 (1983).

50. *Springer v. Phillipine Island*, 277 U.S. 189, 202, 72 L. Ed. 845, 849, 48 S. Ct. 480 (1927).

51. However, in a somewhat similar set of circumstances the Supreme Court of South Carolina upheld the constitutionality of its State Budget and Control Board. *State of South Carolina ex rel. McLeod v. Edwards, et al.*, 269 S.C. 75, 236 S.E.2d 406 (1977). The State Budget and Control Board is an executive body dealing with the fiscal affairs of state government. The board is comprised of the governor, the state treasurer, the comptroller general, the chairman of the Senate Finance Committee, and the chairman of the House Ways and Means Committee. The constitutional attack was two-fold. First, that the inclusion of the chairman of the Senate Finance Committee and the chairman of the House Ways and Means Committee violated Article I, Section 8 of the South Carolina Constitution which provides that: “In the government of this State, legislative, executive, and judicial powers of the government shall be forever separate and distinct from each other, and no person or persons exercising the functions of one of said departments shall assume or discharge the duties of any other.” Second, that membership of the two legislators on the board usurps the executive powers of the government in violation of Article IV, Section 1, which states that “the supreme executive authority of this State shall be vested in . . . ‘The Governor of the State of South Carolina.’ ” In deciding the case, the Supreme Court cited established precedent in other state cases as permitting membership of legislative members on the board. However, the court also offered an interpretation of the underlying principle:

Important in this case is the fact that the General Assembly has been careful to put the legislative members in a minority position on The Board. The statutory composition of The Board does not represent an attempt to usurp the functions of the executive department, but apparently represent a cooperative effort by making available to the executive department the special knowledge and expertise of the chairman of the two finance committees in the fiscal affairs of the State and the legislative process in general. We view the ex officio membership of the legislators on The Board as cooperation with the executive in matters which are related to their function as legislators and not usurpation of the functions of the executive department.

52. For a discussion of the resulting institutional changes in Mississippi state government, see: Edward J. Clynych, “Budgeting in Mississippi: Are Two Budgets Better Than One?” *State and Local Government Review*, 18 (spring 1986): 49–55; and Edward J. Clynych, “Mississippi: Does the Governor Really Count?” In Edward J. Clynych and Thomas P. Lauth (eds.), *Governors, Legislatures, and Budgets: Diversity across the American States* (Westport, CT: Greenwood Press, 1991).

53. *Kirksey et al. v. Dye et al.*, 564 So. 2d 1333 (1990).
54. Clynych and Lauth, *Governors, Legislatures, and Budgets*, 153.
55. Sheryl G. Snyder and Robert M. Ireland, "The Separation of Governmental Powers under the Constitution of Kentucky: A Legal and Historical Analysis of L.R.C. v. Brown," *Kentucky Law Journal* (1984–85): 226.
56. Merl Hackbart, "Kentucky: Transitions, Adjustments, and Innovations," in Clynych and Lauth, *Governors, Legislatures, and Budgets*, 83–91.
57. *Ibid.*, 88.
58. *Ibid.*
59. The Legislative Research Commission is an "arm" of the General Assembly comprised of the following members: president pro tem of the Senate, speaker of the House, and the majority and minority floor leaders of the Senate and House.
60. *The Legislative Research Commission et al. v. John Y. Brown, et al.*, 664 S.W.2d 907 (1984).
61. Kentucky Revised Statutes, Chapter 48 (1983).
62. Snyder and Ireland, "The Separation of Governmental Powers," 226.
63. *Ibid.*
64. *Ibid.*, 228.
65. New York's fiscal year begins April 1.
66. *In the Matter of County of Oneida et al. v. Peter A. Berle, Commissioner of the Department of Environmental Conservation of the State of New York et al.*, 49 N.Y. 2d 515, 404 N.E. 2d 133 (1980).
67. In New York, the Supreme Court is a state court of original jurisdiction, and the Court of Appeals is the highest state court.
68. *Schumer v. Caplin*, 241 NY 346 (1925), at 351.
69. New York Constitution, Article IV, Section 3.
70. Joseph F. Zimmerman, "Rebirth of the Item Veto in the Empire State," *State Government*, 54 (1980): 51–52, at 51.
71. *Ibid.*
72. *Train, Administrator, Environmental Protection Agency v. New York City et al.*, 420 U.S. 35; 95 S. Ct. 839; 43 L. Ed. 2d 1 (1975).
73. Letter from President Richard M. Nixon to William D. Ruckelshaus, November 22, 1972.
74. DeKalb County is part of the Atlanta metropolitan area.
75. Urban counties have two basic forms in the executive branch: the elected executive, and the county administrator or manager appointed by the board or commission. In both instances, the executive branch has responsibility for budget development, recommendation, and execution, while the board of commissioners or supervisors has responsibility for budget approval. In rural counties, these budget functions typically are performed by the board of commissioners or supervisors that also performs the function of budget approval.
76. Homestead Option Sales and Use Tax (HOST).
77. *Atlanta Constitution* (May 27, 1998), B1.
78. *Liane Levetan v. Board of Commissioners of DeKalb County et al.* (No. 98–5945–3). The superior court is a state court of general jurisdiction hearing a broad range of serious cases, including felonies and serious civil suits.
79. Official Code of Georgia Annotated, Sections 48–7-149, 48–8-3, 48–8–6.
80. The property tax relief applies only to general-purpose county government oper-

ations. Property owners still pay property taxes for county bonds, school operations, city of Atlanta operations (for those county residents simultaneously living in the city of Atlanta), and state operations (.25 percent). HOST almost totally removes general-purpose county operations from the property tax bill of residents.

81. Except over zoning decisions.

82. This practice clouds the separation of powers feature of the county charter.

83. *Atlanta Constitution* (May 29, 1998), D1.

84. *Liane Levetan*, in her official and representative capacity as chief executive officer of DeKalb County, Georgia v. *Board of Commissioners of DeKalb County et al.* (No. 98–5945–3).

85. *Board of Commissioners et al. v. Levetan, et al.*, 270 Ga. 544, 512 S.E. 2d 627 (1999).

86. *Atlanta Constitution* (February 22, 1999), E1.

87. *Board of Commissioners et al. v. Levetan et al.*, 270 Ga. 544, 512 S.E.2d 627 (1999).

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# Nonconventional Budgets: Interpreting Budgets and Budgeting Interpretations

Gerald J. Miller

The call for budgets never ceases! In governments across the world, we find not only the traditional call for a separate capital budget but also calls for a tax expenditure budget, a mandate budget, a regulatory budget, a credit budget, and an insurance budget. We assume calls for other budgets will emerge as observers reveal additional areas of “hidden spending.” These calls have occurred at all levels of government and in many different countries, but, perhaps, most loudly at the federal level in the United States.

This chapter inquires into the various approaches to budget for nonconventional spending. We start with a survey of the problem of nonconventional spending control and the way that problem is interpreted. We then analyze the current proposal for control—a superbudget—from several perspectives in trying to hypothesize the way this fiscal institution would operate given the various points of view concerning the proposal.

We define budget control as budget formulation control. Control suggests that we give extra strength to the guardians in the budget formulation process or to those budget actors who have played a “conserving” role in budget formulation (Schick, 1988:64–67), opposing that of the “claiming function” or advocates who always want more and will go to unanticipated lengths to get it.

The calls for tax expenditure budgets, mandate budgets, regulatory budgets, credit budgets, and insurance budgets, among others, go on unabated to this very moment. The reason why we have these calls for budgets in areas of growth, however measured, is probably because we traditionally interpret budgets primarily as a means of control. Having a budget means asserting control in an area some think is growing beyond restraint. The reaction to growth without

restraint emerges with both conservative and progressive interpretations. The conservative view of growth in nonconventional spending is one of unimpeded expression of government power. The progressive view is one of appropriate government intervention in society.

## **INTERPRETING CONTROL: CONTROLLING GOVERNMENT INSTEAD OF CONTROLLING THE GOVERNED**

Conservatives view with distaste expansion in the exercise of government power. Government, through the group of nonconventional spending tools as a whole, acts to control the governed. The use of different techniques, at first glance only a means of evading traditional budget controls, is growing faster, some say, than government can control their use, faster than efforts can be made to control government.

What we have, again, is simply the idea that government budgets are first and foremost efforts to control the governed. This control, whether through taxes, conventional spending, regulation, credit or insurance, whether control of the governed for their own good or not, or whether control of the governed on behalf of any one group against all others or not, still constitutes control.

Through this interpretation of budget control, we find calls to limit the use of power. Budgets serve as a brake on the ability of the government to control the governed, in a sense to serve the second great responsibility of government—to control itself.

The distinction comes from James Madison himself in the “Federalist Papers, No. 51.” He wrote: “In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself” (1978:264).

This presents the first interpretive dimension to conceptualize budgets. The “Federalist” perspective echoes in more modern times. The distinction between government efforts through the budget to control itself and government efforts through nonconventional means to control the governed has provoked wide comment, and two students of budgeting deserve mention. First, Wildavsky has observed that “the more government tries to affect citizen behavior, it appears, the less able it is to keep its own house in order. This new relationship between government and citizen may have many advantages, but control over spending is not one of them” (1986: 350).

Schick is more forceful about the problem than Wildavsky. He detects in the growth of off-budget expenditure a “paradox of control.” That is:

Off-budget expenditures have resulted from the transformation of the public sector from one in which spending was done within the government to one in which spending largely occurs outside government. Not the least of the reasons for this transformation has been the striving of government to strengthen its control of the economy, the distribution of

income, investment policy, and the supply of goods and services. The paradox is that in its effort to extend its control over the private sector, the government has surrendered a good deal of its control over the public sector. (1981: 349–350)

The control of the governed presents a problem of liberty. Government control represents the naked meddling by those in power in the affairs and decisions of those they represent, ultimately allowing those in power to control for control's sake.

## **INTERPRETING CONTROL: INTERVENTION IN SOCIETY**

Finding an appropriate role for government and restraining government power through analysis, the progressives view nonconventional spending as just another form of intervention in society. Therefore, tax incentives, credit and insurance incentives, regulatory sanctions, and state and local government mandates are different values on the same dimension. These policy tools generally either induce or sanction. At bottom, there is no difference between inducement and sanction: both are means of the government's intervening in society.

Nonconventional spending, therefore, is a variation of intervention. Let us conceive of government intervention as the following development of the policy tools approach (Vedung, 1998:22–25; Anderson, 1977). This school asks the question: When we face a public problem, what do we do about it? The answer: often we leave it to the individual, the family, or household to decide. Sometimes “the community,” we think, should decide issues of import. Finally, some problems are matters “the market” should decide without government interference.

When we do believe in government intervention, it tends to be a matter of creating inducements and specifying sanctions or something in between. Sometimes an indirect approach is taken, with education, moral suasion, the bully pulpit, propaganda, or other sermon-like approaches.

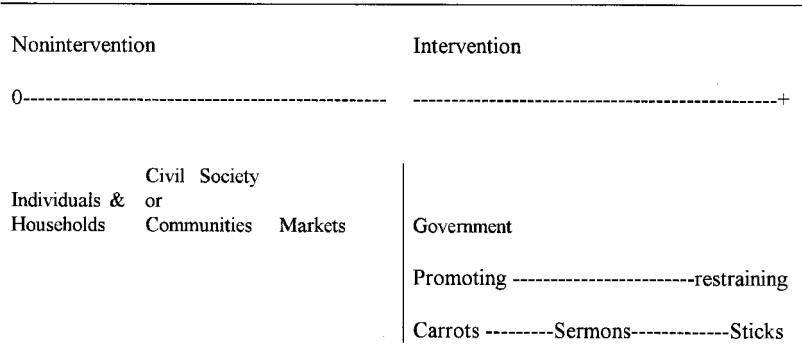
## **INTERPRETING CONTROL: A MATTER OF SUBSTITUTABLE POLICY TOOLS**

The conventional and nonconventional expenditure of effort—policy tools—represents the government end of the spectrum in Figure 4.1. What is more important than the distinction between government's direct and indirect efforts is that the budget can prioritize, allocate, economize, or control and otherwise “fit” the appropriate policy tool to the problem at hand. Control is exerted by forcing choices to be made among competing means for achieving some identifiable and sought-after end, maximizing the impact of government intervention.

Adding the element of scarcity can also exert control. Intervention as a whole must be allowed to cost no more than  $x$ , in other words. To maximize interven-



**Figure 4.1**  
**Government Intervention and Policy Tools**



tion, we either limit cost or set a goal on the amount of intervention it will take to achieve a just and productive society.

The progressive view of nonconventional spending tends toward a rational view of the uses of technology. These various nonconventional, off-budget items are really different ways of doing the same thing. They are policy tools, it is often asserted. Efforts to control them should focus not only on their cost but also on their substitutability.

Therefore, budget control is not primarily a matter of cost control but of the analysis of alternative policy tools and the choice of the appropriate one based on its fitness in the context in which it is examined. According to Surrey and McDaniel:

Whenever government decides to grant monetary assistance to an activity or group, it may choose from a wide range of methods, such as a direct government grant or subsidy; a government loan, perhaps at a below-market interest rate; or a private loan guaranteed by the government. Or the government may use the tax system and reduce the tax liability otherwise applicable by adopting a special exclusion, deduction, or the like for the favored activity or group. (1985:3)

A tax credit may work similarly to a government grant, the tax credit having some administrative advantages perhaps, the government grant distributional advantages. Nevertheless, analysis, many argue, should focus on the tradeoff over many dimensions, among policy tools, selecting the one that suits the purpose the best. Perhaps, control should then be asserted over all these conventional and nonconventional expenditures together.

In summary, the budget serves as a means by which government intervenes in society, inducing, educating, or sanctioning conduct and effort. Budget control is a means of selecting the most appropriate tool for maximizing the achievement of intervention.

In the calls for analysis of policy tools in choosing the most effective means

of government intervention in society, we find a generally positivist effort to comprehend a budget. In the control-of-government discussion, we find a much different comprehension of a budget, a different political theory of government's role in society.

Both, though, lead to a clear mandate to budget and thereby control. This traditional view in budgeting is also a matter of belief: Budget control usually means that someone somewhere knows what is being done, that he or she knows how much is being done with what effect. Budget control also means that this someone should limit and direct what is being done, at least to the extent that a larger consensus exists about the amount of this activity we should pursue through government or government sponsorship.

The issue of budget control is also a matter of research. What fiscal institutions—structures, procedures, laws, organizations—do what with what result? Work by Poterba and von Hagen (1999), still in its infancy, has provided many possible avenues for defining and measuring both institutions and results.

## **INTERPRETING CONTROL TODAY: COST CONTROL OF NONCONVENTIONAL SPENDING**

Where do we stand now between the conservative and progressive view of nonconventional spending? So far, each of the areas of nonconventional or otherwise seemingly uncontrolled expenditure has yielded somewhat to control through budget devices as we presently know and use them. Consider the U.S. federal government experience. Budget rules in several pieces of legislation starting most forcefully with the Budget Enforcement Act of 1990 have constrained direct spending, tax expenditures, and entitlements. Administrative and legislative efforts have focused on tradeoffs among direct government operations, contracts, and grants in the name of privatization. Credit reform has forced into the traditional budget process the direct costs of interest subsidies and the discounted future costs of loan defaults. Insurance reform, particularly that related to bank deposits, has led to considerable legislative scrutiny and new proposals for budget treatment of losses—the difference between discounted future outlays and expected insurance premium receipts. Gradually, many different nonconventional financial techniques are being forced to take on the characteristics of cash transactions that must submit to the limits placed by cash budgets.<sup>1</sup>

Missing here are the areas of mandates and regulation. So far only mild efforts have been made. Statutes have provided for legislative review of mandates directed toward state and local governments and administrative review of regulation aimed at the private sector. A mandate applying to state and local governments must observe a point of order rule during legislative deliberation if the mandate is estimated to cost more than \$50 million (net of state and local savings and direct federal funding contained in the bill). The point of order rule simply ensures that a vote preceded by debate will allow scrutiny of the mandate.

Legislation amending this point of order rule to extend it to mandates for the

private sector when they exceed \$100 million has been proposed at this time (H.R. 350, Mandates Information Act of 1999). Proposals (Thompson, 1997; Litan and Nordhaus, 1983) have appeared to cost out “the financial burden that a regulatory agency could impose on individuals and organizations in the private sector, state governments, and subordinate jurisdictions” (Thompson, 1997:91), authorize it through normal legislative mechanisms, appropriate it, and then enforce it through administrative and legislative budget channels.

Proposals have also been made to monetize mandates and regulation. For mandates, some have proposed reimbursement with cost sharing (Posner, 1998: 169–171). For regulation of business, some have proposed regulatory taxes on those regulated, the money from which would then be used for grants to those who would remedy the effects of whatever problem is the focus of regulation or for reimbursement to those who have suffered (Bardach and Kagan, 1982: 291–292).

Appropriate or not, these proposals do illustrate the ability to control government nonconventional budgets through the element of cost. The list of actions taken to deal with nonconventional expenditures goes on and on, and the efforts to control hidden or heretofore uncontrolled spending have taken place piecemeal, one area at a time.

## **BUDGETS ONE OR MANY: WHAT WE WANT OR WHAT THE SYSTEM ALLOWS**

What do we do to limit government control of the governed or to prioritize intervention? Piecemeal efforts have taken place first. We now subject each tool of government action to control or at least, at this stage, special scrutiny. This comes in the form of either relatively sophisticated or primitive budgets for each area of activity that we perceive as “hidden spending.” As a result, we now have or soon will have elementary tax expenditure budgets, credit budgets, insurance budgets, and regulatory budgets.

Yet, to many, this would still not maximize the impact of government intervention in society or control government as Madison, Wildavsky, and Schick point out. As a result, in policy argument, in budget theory and in discussion of practical affairs, we have had calls for unified budgets or “superbudgets.”

### **Policy Argument**

In policy argument, especially devoted to regulatory reform, we move from an interpretation of the budget as a means of control of the governed to an interpretation of the budget as a full-fledged control of government. This superbudget idea comes from Litan and Nordhaus in the context of regulatory budgets. They point out, not frivolously, that

If there were a superabundance of unemployed accountants, it might be desirable to integrate all federal activities—expenditures, tax expenditures, credit allocation programs, and regulatory programs—into a single “superbudget.” Such a budget would enable Congress and the Executive not only to keep track of the cumulative economic impact of federal programs but to compare and trade off totally different types of government efforts. (1983:4–5)

Litan and Nordhaus go on to point out the difficulties, but, optimistically, others have argued the technological possibility and promise, at least if regulatory budgets are any indication (Thompson, 1997).

### **Budget Theory**

The idea of superbudgets also lies embedded in the budget theory literature in public administration, there called the norm of comprehensiveness in budgeting or the unified budget idea.

First, Stourm defines the idea of comprehensiveness and unity as universality. He states that “universality means budgetary entries of all expenditures on the one hand and of all revenues on the other, each in a distinct list” (1917:146). He then argues the political and legal basis for universality: “All public revenues and all public expenditures, without exception, must be sanctioned by the representatives of the country”; thus it is necessary to produce one comprehensive statement so that it receives “this necessary sanction.”

There are other reasons than legal. Quoting Say (1917:166), Stourm indicates that unity is a matter of promoting simplicity and promoting clarity:

The principle of unity is the principle of clearness. Nobody can know his financial situation unless he considers it in its totality. . . . There is not unity of the budget, if it is not possible to make all the revenues enter into one treasury and to make the money for all the expenditures come out of the same one big common fund. There is no unity of the budget, if it is not possible to handle all the appropriations allotted by the Chambers under the same conditions with regard to justification, annulment and carrying forward.

The basic values of representative government and human needs in decision making underlie Stourm and Say’s advocacy of unity.

Many years later, the quest for unity led to the most influential effort yet to create a sense of the whole in the U.S. federal budget. The controlling document on unity at this level of government was the President’s Commission on Budget Concepts Report (1967). In it (pp. 24–25), the commission members held that “to work well, the governmental budget process should encompass the full scope of programs and transactions that are within the Federal sector and not subject to the economic disciplines of the marketplace. . . . The budget should, as a general rule, be comprehensive of the full range of Federal activities” (1967: 24–25). The members did not go to great lengths to define what they meant by

“work well,” but we assume they meant maximizing the effect of government intervention in society while minimizing the power of government to control the governed.

The report went on to point out that focusing the attention of budget decision makers on what belonged in the budget came with knotty problems:

[Achieving unity], however, poses practical questions as to precisely what outlays and receipts should be in the budget of the Federal Government. The answer to this question is not always as obvious as it may seem: the boundaries of the Federal establishment are sometimes difficult to draw. . . . Providing for national security or collecting census data are obviously activities of the Federal Government which should clearly be in “the budget.” It is equally clear that the housewife’s purchase of groceries or a private corporation’s borrowing from a commercial bank represent transactions outside the Federal sector. Between these obvious extremes, however, are a wide variety of activities ranging from clearly within the Federal domain to those clearly outside the Federal establishment (1967:24).

What is in and what is out of the federal budget, therefore, requires a concept that the commission specified as “the flow of cash between the public and government as a whole” rejecting the concept of “the Federal Government’s impact on the flow of income and production in the economy” concept (Sweeney, 1967: 20, 22).

Despite the problems, Wildavsky describes the ideal and reality of present-day circumstances some three decades after the Commission on Budget Concepts work:

The norm of comprehensiveness stipulated the ideal that all revenues go to the central Treasury and that all expenditures be made within a comprehensive set of accounts. . . . Today no one needs to be told that direct loans, loan guarantees, tax preferences, off-budget corporations, regulations that increase costs in the private sector, open-ended entitlements, and other such devices have made a hash out of comprehensiveness. . . .

Comprehensive accounting once meant accounting by departments; governmental expenditure, except for a special fund here and there, meant department expenditure. If you controlled departments, the understanding was, you controlled expenditure. Today, when spending by departments on goods and services in industrial democracies accounts for only a third of spending, the inescapable conclusion is that traditional norms do not cover the bulk of expenditure. Most money is spent to affect citizen behavior rather than to support direct government actions. Since most spending is done by individuals who receive payments or loads and by subnational governments, the irrelevance of department control is clear.

Control of spending has declined along with the norm of comprehensiveness because one cannot simultaneously maximize in opposing directions. . . . The more interest a government has in influencing citizen behavior, say by encouraging use of medical facilities, the less such a government is able to control its own spending (1997:260).

Thus, public administration theorists attending to budgeting problems see the legal and sometimes human needs for unity. They even point out authoritatively the idea. Yet, they also see the reality for underachieving that ideal.

### Practical Affairs

In practical affairs, we also get some notion of the need for some comprehensive mechanism to force choice among policy tools. Lawmakers and other budget controllers should be able to trade off policy tools against each other to determine the best way to achieve a purpose, thus gaining the ability to assert control.

This need for analysis of tradeoffs probably appears regularly in legislative and administrative bodies as in the following testimony in Congress. In this instance one member asked:

*Chairman Blanchard:* Have you made any conclusions as to where governmental loans are an effective policy instrument and where they are not? Where loan guarantees are an effective policy instrument and where they are not? How they work, in what instances they work well and where they don't, and where they can be effective and where they aren't? Because we are looking at these in relation to other tools that the government has to operate. . . . Have there been any studies on . . . federal use of direct spending versus loans versus loan guarantees versus the tax code, and then the various types of tax preferences and their effectiveness in different instances?

*Dr. Rivlin:* Let me see if my colleagues know of any such study. . . .

*Mr. Shillingburg:* We are unaware of any such literature, Mr. Chairman. (Salamon and Lund, 1989:23)

Chairman Blanchard's frustration may be understandable, as the policy tools approach seems so practical, so rational. The unified budget, far from an ivory tower construction, fulfills a felt need of decision makers.

In policy argument, budget theory, and practical affairs, many call for placing all government action in one or *the* budget. With unified budgets given some credence for managing, even maximizing, government intervention or minimizing government control, we might ask what such a budget might entail. Some see the superbudget's scope as merely nonconventional and conventional dollar spending. Others include mandates and regulation. Beyond, but in this same spirit, others would include all social regulation and its coercive effects (Schattschneider, 1975:106).

This unification permits scrutiny, analysis, and wise choice. On the basis of great purposes that are served, budgeteers can search for various, alternative policy tools; calculate each's costs and benefits; and determine the appropriate tool given limited resources imposed to achieve these purposes.

The control of the budget at the formulation stage might be the major ques-

tion, however. The answer might lie in conventional notions of budgeting and budget formulation control.

## **NORMS OR PROVERBS**

Since Simon's article on proverbs of administration (1946), we have constantly looked at norms as empirical questions. The same is so with the norm of comprehensiveness in budgeting. Is comprehensiveness an end in itself, or is it a tool in which some desired outcome is achieved?

The research problem with comprehensiveness involves measurement, especially in the context of conventional and nonconventional spending. Do we have adequate measures of comprehensiveness, in other words? Would we know a comprehensive from a noncomprehensive budget? The problem in the nonconventional area in which we are setting this paper is the notion of mandates and regulation as spending. These are by no means clearly cash transfers in the conventional sense. They are "drains" on the economy in the effort to achieve something other than economic growth, at least in many arguments made for and against mandates and regulation. Thus the difficulty in achieving some measure of comprehensiveness is difficult. On what dimension do we test this notion?

Beyond the definition and measurement of comprehensiveness, there is always the outcome for which we test the value of comprehensiveness. Is budget control the uppermost goal of budgeting? What other goals does budgeting serve? Conflict resolution or wide political participation might be other goals in which a noncomprehensive budget—or multiple noncomprehensive budgets—might provide more value in achieving.

Empirical research is needed on the notion of comprehensiveness. Theoretical work, from which empirical research might proceed, is needed, connecting a measure of comprehensiveness to a measurable and preferable set of outcomes of the budgetary process, as has been done with other fiscal institutions (Poterba and von Hagen, 1999). The necessity for such research emerges vividly when we review the nature and concepts of budget control as applied to the super-budget idea.

## **WHAT DOES CONTROL MEAN?**

Distilling the wisdom of the budget theorists (Stourm, 1917; McKinsey, 1922; Stedry, 1960; Hofstede, 1968; Wildavsky and Jones, 1994; Schick, 1997; Campos and Pradhan, 1999), we can conceive a hypothetical government budget control system as having five major components—focus, estimation, scarcity, criteria, and choice. These components refer to the parts of the role played by guardians as they view the proposals of advocates in the formulation of the budget; control in the budget execution process is another matter. These components, too, are budget decision-making steps and are therefore components of

a larger decision-making system in which policymaking at times dominates budgeting and at other times is dominated by budgeting.

### **Focusing Scrutiny**

The scrutiny of controllers must focus on certain elements in the budget that can be controlled; therefore budgets isolate activities in separate elements, sometimes in some places called envelopes (McCaffery, 1984) and in others, arenas (Meyers, 1994:108), such as the separation of mandatory from discretionary spending or the separation of discretionary spending into functional elements or spending accounts. Budget process designers separate, essentially, the controllers or measurers of each part of the budget, establish authority for scrutiny to decide what can be controlled and how, and unite scrutinizers, political and administrative, in each envelope. The definition of what is in what element or envelope varies—functions, programs, departments, activities or strategic initiatives—but considered so, the expenditures within the envelope—direct and equivalent (tax expenditures, insurance, credit, regulation and mandates)—compete among themselves. Therefore, theoretically, scarce resources may require that as some expenditures within the envelope increase, others decrease by the same amount. The number of envelopes varies, but the emphasis is on manageability and discipline: “If you have too many . . . you will fail. If you only have one you will fail; it is between these two that you need to go” (Wildavsky and Jones, 1994:13).

### **Estimating Costs**

As projects or programs are proposed or are reviewed periodically, the budget controller asks what the project or program costs. This is a difficult conceptual problem because the cost basis may vary. For example, the cost of a program may be based on dollars spent as on salaries for employees or dollars obligated (accrued) as on employee pensions. Cost may follow another basis akin to shadow pricing, such as in the loss of revenue due to a tax incentive. Or cost may represent a more ambiguous effort at loss compensation—the dollar equivalent of environmental regulation based on a tax on the polluter sufficient to compensate the sufferer for the pollution’s effects. The cost may also be measured in the dynamic terms of economic growth, such as a percentage of gross domestic product. In tax expenditure terms, this dynamic measure might be the gain to be realized from the economic growth that takes place considering the changes in behavior the incentive provokes. That is, tax rate reductions prompt less ingenuity and maneuver on the part of taxpayers; reductions might also prompt greater constructive investment in a particular area than before.

The timing of the costs will also be a factor for consideration. The costs may occur in the period proposed for review, say annually, or the timing may be



over multiple periods or even generations (Auerbach, Kotlikoff and Leibfritz, 1999).

Finally, the cost may be calculated in terms of baselines—generally, the cost of carrying on the program as it is without changing policies, allowing for changes in the economy (inflation) and the population only.

### **Establishing Scarcity**

At some point more or less concurrent with estimating costs, budget controllers also establish the ceiling or total costs that the budget will finance and allocate this total cost among envelopes. This total may be influenced by the orthodox budget norm of balance. However, it may be influenced by other norms such as full employment, the business cycle, or some other norm that finds agreement. The question remains: what is the maximum or minimum allowed? The limit or aspiration, whichever it may be, traditionally instills competition among projects to fit within these parameters.

The limit that is established has been a dominant part of budget debate. Among budgeteers, there seems to be some consensus that the limit be loose enough to avoid rigidifying the budget and thereby favoring old programs over new. There must be an increment or a net increment guaranteed.

Wildavsky and Jones (1994) argue that modern industrialized countries peg the limit to a percentage increase in total budget resources no greater than the rate of change in gross domestic product. Others have included net worth, ratio of spending to the level of gross domestic product, rate of change in spending (as in zero real growth), as well as a nominal level of spending or deficit (Shand, 1998:70).

### **Applying Criteria**

To decide among competing expenditures and expenditure equivalents within envelopes, the budget controller requires justification of these proposals. Justification is made in terms of some set of criteria that relates to the measures used in establishing costs and total costs. Therefore, the decision about criteria is the fundamental decision in budget control because it is the crucial frame of reference in deciding among competing projects and programs and trading off various budgetary approaches to solving problems, such as government operations, grants, contracts, loans, tax expenditures, and insurance.

### **Choice**

The remaining component of budget control merely brings the previous components to a satisfactory conclusion. The budget controller selects those projects or programs best fitting the criteria, selecting those in some priority order up to the limit established by scarcity. The decision requires no judgment where the

**Figure 4.2**  
**Budget Control Variables and Measures**

Focus of scrutiny	informal ↔ formal
Measurement	primitive ↔ sophisticated, well-developed
Scarcity	obvious norms ↔ vague norms
	well-enforced ↔ poorly enforced
Criteria for allocation or reallocation	single criteria ↔ multiple criteria
	single venue ↔ multiple venues

criteria are clear enough, the costs accurate enough, and the limits definite enough; action becomes automatic.

A good budget formulation control system seeks to accomplish many things. First and especially in the nonconventional spending area, budget control sheds light on what has not appeared before—matters that seem hidden. Thus budget control encourages transparency. Second, budget control tends to force political aims—reward the faithful, punish one’s enemies—to conform to the more general demands of rational political debate over the achievement of broad goals the public supports. Third, budget control can offset the tendency of government spending to thwart economic growth, especially through heavy demands on capital markets. Fourth, budget control can compensate for poor resource allocation in ensuring that budget justifications are linked to competent resource allocation, making scarce resources flow to their highest and best uses. Fifth, budget control can force equity principles to the fore in debate, attempting to even the distribution of benefits and burdens. Finally, budget control can lessen fiscal illusion—the tendency for concentrated benefits and dispersed costs to mask the true costs of government. Many of the problems budget control seeks to solve or allay lead to a more general disillusionment with government by the public, either through the general wariness and cynicism with gimmickry or the true rebellion that comes with higher taxes to pay for uncontrolled spending. We can say that budget control breeds confidence in government leaders’ abilities to translate demands into action, efficiently, effectively, and expeditiously.

### Empirical Research Strategies

These dimensions of a budget control system allow investigation, as fiscal institutions, into the varying impact they have on budget outcomes (Poterba and von Hagen, 1999) as in Figure 4.2. For example, budget *scrutiny*, whether called envelopes or elements, might vary from the informal to the formal and may vary among budget controllers, say executive and legislative bodies. *Measurement* might be primitive, giving attention mainly to cash in a conventional annual review process, or a more sophisticated and well-developed focus of measurement on accrual concepts over a multiyear, even generational time frame. *Scarcity* might be investigated in terms of obvious norms or vaguer

norms, such as balance over an economic cycle or zero net economic loss or maximum economic contribution or gain. The scarcity portion of the system might be investigated in terms of the level of enforcement, strict or lenient. The *criteria for allocation and reallocation* might be based on single or multiple criteria and applied at single or multiple venues (executive only, legislative and executive, multiple executives, and multiple legislative bodies).

### **Rational Budget Control**

The generalized model of budget control readily translates into a set of rules governing the interplay of advocates and guardians under a truly comprehensive or superbudget. The model sets the rules of the budget game. This control system dictates that there will be competition due to the imposition of scarcity. The system locates arenas of competition by saying what programs will be compared with what programs and what budget tools—tax incentives, spending, loans, insurance—will be used instead of what. The system establishes the cost basis for comparison of these programs and tools. Most importantly, the system prescribes a basis for making choices—the criterion—that ultimately makes the program and tools decision obvious.

Despite the use of envelopes or arenas and the multiplicity of criteria envelopes imply in the model of budget control, scarcity—setting a budget limit or overall ceiling—forces allocation and reallocation among envelopes on the basis of one criterion or at least multiple criteria that have a conceptual unity.

The budget control system, then, resembles a rational, comprehensive decision-making system. With that resemblance, the system draws all the objections traditionally raised in opposition or disbelief (Wildavsky, 1966; Downs and Larkey, 1986: ch. 5). For our purposes, we concentrate on only one: criteria.

While all matters of control have their difficulties, the matter of criteria is central. Estimation and the establishment of budget totals rely on the criteria used to decide projects. For example, a criterion related to expenditure control might place strict limits on cost measures and especially totals. The criterion this would suggest—absolute necessity or emergency—would lead controllers to choose those programs that minimized government growth or influence through any means. Another criterion might be economic efficiency—for the given level of expenditure, decision makers would choose those programs using those tools that minimized cost or minimized the use of economic resources or maximized economic growth. However, economic growth, such as the achievement of full employment, might yield different measures of cost and totals and might yield a criterion suggesting cost-effectiveness that we define as the expenditure needed to achieve a given level of, say, employment. Still another criterion might be the distribution of costs and benefits or even the distribution of income. Therefore, a worthwhile project, high on the priority list within the limits of scarcity, would be one in which all income strata of society received the same proportional or appropriate benefit. The possible criteria are many,

and, in short, they serve as the fundamental purpose of the government and its budget, as has been so often pointed out. For a superbudget, could there be an overriding criterion?

The surprising fact is that an overriding criterion has probably always existed; it has merely changed over time. Few have missed the move from attention to full employment to one of economic growth in which the destructive effects of borrowing to cover deficits has attained center stage. In fact, observers have detected long periods in American history when one criterion dominated (Phillips, 1990), only to fall to a successor despite fragmented decision-making structures at all levels of government and divided political institutions being more the case than the exception. What provokes interest widely is how this criterion changes (Kingdon, 1995; Berkman, 1993; Conlan, Wrightson, and Beam, 1990; Witte, 1985). Significant interest also follows commentary and research on who can and who has specified the criterion (Wildavsky and Caiden, 1997; Fischer, 1990; Fischer and Forester, 1987). The study underlying a superbudget might profitably move to find where this criterion comes from.

Criteria are sometimes relatively easy to establish, as where there is a consensus, gained for a variety of reasons, on the basis for comparison of alternative means. According to Schneider and Ingram, research by analysts and advisers implicitly seeks to reveal or suggest the appropriateness of various budgetary and policy tools under different conditions. They argue that “the extent to which a policy making environment, for example, is dominated by scientific thinking [in which there is a consensus] instead of by political strategies is influenced by the ability of the scientific community to link policy design ideas to accepted scientific theories” (1997:78).

Where consensus does not exist, either broadly in society or narrowly as with deference to expertise, the criterion becomes the flashpoint for contending forces. According to Fainstein:

In the grossest terms, the conflict over criteria often boils down to a dispute over efficiency versus equity, or aggregate output versus distributional effects. Whether the subject be tax policy (should it provide incentives to investors or relief to low-income people?), transportation (efficient vehicular movement against access for low income people), or housing (trickle down from private sector profitable investment or direct subsidy of low-income people), similar lines are drawn. (1987: 233)

The contention over a single criterion is also rooted among institutional values. One institution's preferred portfolio of spending tools that is geared toward helping the homeless, for example, is not easily compared with an institution the aim of which is to control them (perhaps a mental health agency or a public housing agency), or with an institution that wants homeless people to make up their own minds (an authority that guarantees housing developers' loans) (Schon and Rein, 1994:129–161; March and Olsen, 1989).

The politics of budgeting argues for criteria based on political power. As Fainstein argues:

In order to protect their positions, groups seek to generalize their concerns by supporting the use of evaluative criteria that will favor their desired outcomes. . . . [G]rowth with equity solutions are difficult to achieve because those favoring equity measures are usually relatively powerless. Nowhere are the relations among evaluative criteria, group power, and political outcomes more evident. (1987:233)

Group power, then, says it all.

Yet, modern analysis of the various forms of nonconventional spending (Salamon, 1989) argues that the development of these various government service delivery mechanisms has created a context around the policy tool, not around a problem or area of scientific theory and expertise. That is, each tool—from tax expenditures to loan guarantees—has grown out of a different environment of executive departments, legislative committees, and beneficiaries. Salamon observes that “each instrument has its own distinctive procedures, its own network of organizational relationships, its own skill requirements—in short, its own ‘political economy’ ” (1989:8).

A contextual school of thought involved with microbudgeting seems to unify these observations. These researchers argue that an imperative—sometimes political, sometimes a major problem, sometimes the experience gained from living with an existing program as it develops through implementation—provides a frame of reference or context within which to view the economic or technical imperatives demanded by budgets (Thurmaier, 1995; Forester, 1984; McCaffery and Baker, 1990). One observes, “Administrators . . . [otherwise] capable of conducting the technical analysis . . . searched for the context in which to make their decision . . . a noneconomic context” (Thurmaier, 1995:455).

Therefore, there are some possible alternatives for the place where a criterion for a superbudget would come from, if existing experience is any guide. Perhaps context is some guide. Each scientific community and its particular interests provide a context within which such experts draw deference; their assertion of the appropriate criterion dominates. Powerful groups dictate or force attention on problems, and the criterion emerges. Institutions control the criterion when given responsibility for dealing with a public problem. For nonconventional spending, the political economy in which a tool exists forces the dominant criterion.

Which of these will succeed in defining the context? Perhaps Kingdon’s concept of policy windows opening helps explain (1995: ch. 8). Moments—years long actually—may provide an opening for a given scientific community, institution, group, or spending tool political economy to press its definition of the context, its definition of the problem or necessity for resort at the moment to its preferred course of action. “Public perception” moves to focus on what the revealed context demands. The criterion emerges. Kingdon’s windows may sug-

gest a moment that passes quickly, but the line of research that has issued from critical or realigning elections indicates that these windows, their contexts, and their emerging criteria may be longer term (Key, 1955). The states roots model of change suggests similar long-term opening and defining (Berkman, 1993).

So far, the dominant criterion seems to emerge from a context. The context, it would seem, is the area within which a given set of public problems, budget tools, group power, and institutions exist. Within these contexts, budget controllers enforce the criterion; they intend that advocates justify their proposals on meaningful grounds and intend that advocates' proposals stand judgment by objective and systematic means. Even if final decisions in the budget process seem to take on the image of horsetrading, there is a need to ensure that the horsetrading is within the bounds of acceptability to the horsetraders' constituents, other participants in the process, and the larger public. As Schneider and Ingram point out:

Public officials must pay some attention to producing public policies that are addressed to major public problems and that are effective. . . . Public officials are expected to explain and justify their policy positions to the electorate by articulating a vision of the public interest and then showing how a proposed policy is logically connected to these widely shared public values. To maintain credible arguments about policy effectiveness, they need to have a believable causal logic connecting the various aspects of the policy design to desired outcomes. . . . They also must take into account the tendency of the American public to believe in fairness and justice. Government should not give anyone more than they deserve, nor should government contribute to unfairness or injustice. (1997: 111)

Budget control serves a necessary "conserving" function. However, the question exists as to whether budget controllers enforce criteria already decided for them or whether there is some criterion that controllers devise out of their own reading of the context. Does the profession of budget control or public financial management have its own criterion? Does the budget controller act independently or as an accessory to others? Is budget control only necessary to the perception of a democratic process; does it work only to make budgeting look as though the process is working as expected, as a rational decision-making system?

The present reality of budget control dictates the importance of research into criteria. We are fast approaching a fairly inclusive, if not super, budget at the federal level in the United States. Especially since the Budget Enforcement Act of 1990, limits over tax expenditures, loans, and loan guarantees have come into being with increasing efforts toward scrutiny of mandates, insurance, and regulation. Slowly but, some would say, surely, comprehensiveness is returning to this budget.

Yet, even with this context and budget control discussion, there seems to be

indecision about the source of the ultimate criterion in a superbudget. We suggest that another line of inquiry can provide insight.

## **BUDGETING INTERPRETATIONS: THE SOCIAL CONSTRUCTION APPROACH**

Another view of the criterion problem comes from those who take the social construction/interpretive approach in public policy. That is, criteria affecting tradeoffs is not based solely on an economic variable such as how much the particular tool will stimulate or dampen economic growth, or remedy market failures, or restore balance in the distribution of income, or some other variation on the theme of making domestic progress. Criteria are not based solely on political variables either: Does the spending tool maximize what some constituents get or some others do not get?

Criteria are also, and mostly, they argue, based on human nature. In this view, as humans, we classify groups targeted for government intervention through our social constructions of them. Groups are targeted as deserving or undeserving or even groups to be punished. We tend to think that the context within which claiming and conserving functions meet develops out of a social construction of people and their problems or the problems they cause. From context emerges a criterion that makes a particular tool appropriate. Therefore, any analysis of the tradeoffs among tools will be affected by this fit between our social constructions and the tool. Said in another way, the tool chosen will be based on its relationship to the construction of the target population, not its cost effectiveness, cost efficiency, or political constituency reward potential.

### **The Human Nature Factor**

The human nature approach to budget control criteria comes from two basic sources, ambiguity theory and social construction theory, both of which I have explored previously (Miller, 1991). The first, ambiguity theory, centers on the disconnectedness of ends and means and assumes inherent ambiguity in the effort to make any choice. As March and Olsen explain, much of life in organizations involves unknown or contradictory goals and technologies as well as individuals who may differ in their levels of participation over time. That is, "intention does not control behavior precisely. Participation is not a stable consequence of properties of the choice situation or individual preferences. Outcomes are not a direct consequence of process. Environmental response is not always attributable to organizational action. Belief is not always a result of experience" (1976:21).

In such pervasive situations, choice, according to March and Olsen, comes with difficulty. The actors may seldom realize their preferences until they have made choices. Or, as Weick has put it, "How can I know what I think until I see what I say" (1980:19).

A second source for the human nature approach to budget control criteria comes from a field of thought that emphasizes the relativity of meaning, a field that focuses on the social construction of reality (Berger and Luckmann, 1966; Goffman, 1961, 1974; Schon and Rein, 1994). This field argues that every organization, being in essence a social assemblage somewhere between transience and permanence, embodies a set of shared views of the world that gives meaning to what they do. These views or “interpretations of reality” build and gain legitimacy through an interaction among individuals. Moreover, the existence of interpretations belies the notion that there exists an objective reality shared by all organizations or people.

Our discussion of context can be related to the social construction of reality. Given the fact that context is necessary to enable a criterion to emerge, context becomes a function of a given social construction’s ability to gain salience. The social constructions of a scientific community, an institution, a powerful group, or a spending tool political economy, this line of thinking would say, becomes dominant through windows.

Simply stated, the alternative approach to budget control criteria discussed here holds that interpretation drives out ambiguity; that is, the greater the number of different, constructed realities, the greater the ambiguity that exists within and among people, organizations or governments. For practical problems of management, the greater the ambiguity, the less likely prescriptions, such as economic criteria for budget control decisions in superbudgets, have any real applicability. Not agreeing about what a criterion “means,” to what set of values it relates, if at all, decision makers employ procedures that are “loosely coupled” to any one view of reality (Weick, 1976). As a result, the greater the compounding of differences among views in a group of individuals having some collective interest, such as an organization or a government, the greater the influence of randomness—in terms of events and specific people shaping meaning—and the larger the amount of interpretation needed by members to make sense and to act in a concerted way (Weick, 1979).

### **Policy Design and Social Construction**

The application of the social construction approach has proceeded quickly over the last decade, most notably in the work in policy design by Schneider and Ingram (1994, 1993, 1990). However, adaptations could serve to make a case for this research here in budget control criteria and the basis for trading off policy tools in a superbudget.

Fundamental to policy design is the nature of those who will receive the benefit or bear the burden of the policy, or as they say, become the targets for policies. What is a target population? Schneider and Ingram define it as “persons and groups whose behavior and well-being [affect] and are affected by public policy” and in the case here, the budget (1993:334).

They go on to characterize their view of the social construction of target



**Table 4.1**  
**Social Constructions and Political Power: Types of Target Populations**

	Positive Construction	Negative Construction
Strong Power	Advantaged The elderly Business Veterans Scientists	Contenders The rich Big unions Minorities Cultural elites Moral majority
Weak Power	Dependents Children Mothers Disabled	Deviants Criminals Drug addicts Communists Flag burners Gangs

Source: Schneider and Ingram (1993: 336).

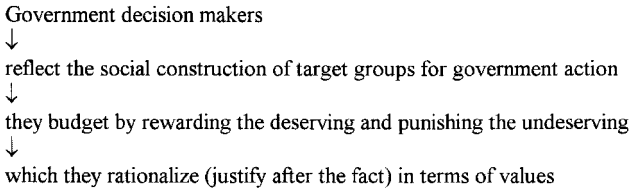
populations as referring to “1) the recognition of the shared characteristics that distinguish a target population as socially meaningful, and 2) the attribution of specific, valence-oriented values, symbols, and images to the characteristics. Social constructions are stereotypes about particular groups of people that have been created by politics, culture, socialization, history, the media, literature, religion, and the like” (Schneider and Ingram, 1993: 335). The characterization or social construction of the various target populations tends to be negative or positive, given the conditions under which it occurs—rewarding or punishing through public policy. These tendencies toward negative or positive social constructions “depends partly on the power of the target population itself (construed as votes, wealth, and propensity of the group to mobilize for action) but also on the extent to which others will approve or disapprove of the policy’s being directed toward a particular target” (1993:335).

Table 4.1 is a replica of Schneider and Ingram’s basic illustration of target populations and their social constructions. Policy design, they say, follows these social constructions. Target populations’ problems (or the problems with certain target populations) are the country’s (state’s, locality’s) problems: what is good (bad) for them is good (bad) for the country. Solutions designed to benefit them or punish them are designed. The justification is then found to convince the public. Such a process is illustrated in Figure 4.3.

First, socially construct target populations. Then, design policy tools to act on these social constructions. Finally, rationalize these tools as appropriate to a given problem.

Such a construct, budget, and rationalize sequence is consistent with March’s view. He says that “most information in organizations is collected and recorded not primarily to aid decision making directly but as a basis for interpretations that allow coherent histories to be told. As a structure of meaning evolves for

**Figure 4.3**  
**Process of Interpretation and Budgeting**



the information and from the process of decision making, specific decisions are fitted into it” (1987:38).

If budgets contain the major policy tools we want to use, we can readily choose the appropriate mechanisms for dealing with different, constructed, target populations. Thus, we have budgets for taxes, budgets for spending, budgets for regulation, budgets for insurance, budgets for credit, and budgets for mandates, all of which follow on the already constructed context of target populations. We select the policy tool that best fits the deserving or undeserving target population’s needs or threats.

If we succeeded in establishing a superbudget, what would the criteria be for inclusion of high-priority projects and exclusion of lower-priority projects? If this line of research suggests an answer it is whatever in retrospect we could shape to fit our view of the balance among inducements and sanctions among deserving and undeserving target populations.

We tend to think that the tool ought to fit the context appropriately, and the context derives from the social construction of the target group. Therefore, any analysis of the tradeoffs among the policy tools—the choice of what criterion to use—should be affected by this fit between our social constructions and what we want to do for or against target groups we have defined. Said in another way, the tool chosen will be based on its appropriateness to the construction of the target population as well as, if not instead of, its cost-effectiveness, cost efficiency, or reward potential for a political constituency.

The problem then is budget arguments over who is deserving and who is undeserving. The budget, therefore, could be thought of as two budgets, one for the deserving and one for the undeserving/punishable. In each, the incentive budget and the sanctions budget, the total of action is capped, then allocated among strategic initiatives, and the particular tools proposed to achieve these initiatives are traded off against each other. The tool chosen is the one that provides the appropriate measure of cost benefit, cost-effectiveness, and/or incidence in achieving the strategic initiative.

The basic question this raises:

Let’s assume that Schneider and Ingram are correct. That is, the social construction of the target population as basically deserving or undeserving will dictate the fundamental criterion in any superbudget. Consider also the libertar-

ian notion that greater growth in budgets, however translated through financial tools, only results in greater government control of the governed and less control of government. Budget control does seem contradictory. The greater the control, the more we tend to allow favored status for some and force punishment on the others. The less budget control, the greater the government control of the governed, although through multiple budget tools representing multiple perspectives, decentralization, and diverse, sometimes contradictory even countervailing approaches.

Political leaders often reflect constituents and supporters whose social constructions are firm; thus the construction is followed by the choice of tool and then a rationalization of the suitability of tool to the context. These leaders, however, may also reflect views that are not firm, in which case oftentimes an objective criterion, stipulated by scientific observers knowledgeable in the particular field or professionals in budget control, leads to the choice of the policy tool.

### **The Context That We Force to Emerge, That We Enact, That We Socially Construct**

While many view the program objectives in a budget arena as important in analysis, the interpretive approach, based on well-accepted notions of fact and value, might be easier to use in finding a solution to the budget control problem in a comprehensive budget. Advocating that objectives determine tools perspective, Salomon observes:

While research work on the tools framework goes forward, improvements can be made in government's capacity to manage alternative tools and make choices among them. A first step in this direction must be to sensitize policymakers to the tool-related choices they are making, to the fact that particular programs embody particular types of tools that may have distinctive consequences for the performance of the program. Too often these issues . . . never surface for explicit attention. Alternative means for carrying out a particular governmental objective are therefore not explicitly assessed. To the contrary, tool choices are often dictated by factors wholly unrelated to a program's purposes—such as a desire to avoid budgetary impact or escape governmental personnel ceilings. A more explicit review of the benefits and drawbacks of alternative approaches would help remedy this and thus gear program operations more closely to program objectives. (1989: 261–262)

The counter to this line of thinking digs deeper. What is an objective and how is it established, an alternative approach asks. If there is a problem, there is a mindset (enactment, social construct) that defines the problem in a particular way that is not different from, fundamentally, the deserving/undeserving mindset.

Thus, the problem definition is a problem of values in the Simon sense (1976). Values establish the problem, the context that is enacted or socially constructed.

From these values, people are able to perform rationally in relating means to these ends.

So, how do we regenerate, rather than degenerate to deserving/undeserving, the establishment of values, ends, problems? How do we establish the context in other than a primitive and perhaps unhealthy way? Consider the approach Schattschneider's work (1975) suggests. The establishment of greater scarcity—with a comprehensive budget—will stimulate more conflict and more competition and more debate. In fact, he has faith that the greater the conflict and competition, the greater the participation in the process (1975: 126–139).

The basis of this debate would then be the budget. The budget, as it monetizes everything, becomes the substance of the whole governmental system.

How can this debate be held so that it does not end in stalemate? This might yield from the establishment in the public's debate of the possibility of government shutdown and its negative consequences, and more importantly, the absolute political downfall and removal of those leaders who would let it happen.

Results are the common sense criterion used in a system of popular sovereignty. Results are guaranteed when there is enough discussion of what problems there are (ends) and what means there are to solve them. Discussion, says Schattschneider (1975), comes from conflict, and that comes from competition. Conflict comes from the tension between government's role in coercion (sticks) and its role in promotion (carrots). Conflict comes from the tension between government intervention, and control of the governed, and government control of itself. According to Madison, competing decision arenas ("Federalist No. 51") and competing interests or factions ("Federalist No. 10") work to increase the number of different views that compete and prevents the dominance of any one view over all issues.

How can we guarantee competition and also prevent stalemate? Constraint breeds the effort to outwit it, as all lessons in budget control, and control generally, concede. Despite the problems this holds for most budget controllers, the wisdom of the constraint actually can show through. The effort to outwit the control is really a contribution to innovation. In the instances pointed out by Salamon (1989), new policy and budget tools have actually not expanded government control of the governed but have bred more public-private partnerships. These partnerships have blurred the line between what is government and what is private and have actually gained the consent of the governed in going beyond privatization of government action. Therefore, in a comprehensive budget, scarcity breeds the solution to problems with which all can live.

## NOTE

1. At the U.S. state and local government level, government accounting standards now prescribe the reporting of all financial and capital assets, liabilities, revenues, expenses, gains, and losses as one net total using an accrual basis of accounting (GASB, 1999).

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# A Multiple Rationality Model of Budgeting: Budget Office Orientations and Analysts' Roles

Katherine G. Willoughby

Budgeting in these United States is more complicated than ever. Year after year, we witness delays by Congress in passing appropriations bills at the federal level. All too often, state legislators grapple with their budget into the wee hours of the morning of the final day of the legislative session, only to be called back into special session later to address some sort of budget crisis. Local government officials, especially those in large urban areas, increasingly approach budget deliberations apprehensively, having to determine what tax and expenditure changes will be necessary to avoid a budget shortfall. We know that public budgeting is full of complexities. From an academic viewpoint, the theory of incrementalism remains a fairly adequate explanation of the public budgeting process; final budgets being a function of past and present political bargaining and agreement, a “satisficing” endeavor with heavier discourse swirling around issues over and above budget base. However, we cannot deny the infiltration of “rational” methods into budget processes as governments at all levels establish guidelines and boundaries for departments and agencies to follow to promote efficiency and effectiveness in programs, activities and services (Melkers and Willoughby, 1998).

Yet, we still lack clear understanding of why specific initiatives seem to “bubble to the top” during budget development—some of these initiatives lead to new spending and new or substantially changed policy; some of these initiatives die down to a slow boil, only to resurface later at a more “feasible” time. Incrementalism, with all its inadequacies in terms of explaining modern budget process, remains viable because we are unable to determine conclusively what influences the budget decisions that then affect budget outcomes, that is, final

appropriations (Jordan and Hackbart, 1999). Specifically, how do budget actors approach budget decisions? What budget cues are most important to them when making spending decisions? Why are certain aspects of the budget decision context more important to the budget actor when deliberating about budgeting problems?

This chapter attempts to find some middle ground between understanding budgeting as politics and budgeting as management (Alexander, 1999). The present study outlines a multiple rationalities model of budgeting that recognizes the complexities of modern spending decisions. This research assesses budget process with particular focus on microlevel decision making. The model acknowledges the temporal nature of budgeting, illustrating budgeting as an evolutionary process in which budget outcomes are influenced by the decision contexts, roles, and information processing of individual budget actors at given stages in the budget cycle (Thurmaier and Willoughby, 2001). The chapter begins with consideration of individual cognitive thought process and organizational behavior. A brief consideration of John Kingdon's (1995) model of agenda setting related to policy development is provided to lay the foundation for its applicability to a multiple rationalities model of budgeting. Current research that investigates the role and decision behavior of the central budget office (CBO) analyst in state government is then presented. Finally, some suggestions about future research paths are offered.

## **THEORETICAL FOUNDATIONS**

Underlying an effort to understand the decision-making practices of public officials is the desire to influence public policy. Essentially, human judgments about spending determine budgets that feed public policy. The following section presents traditional and modern considerations of the human judgment process. Subsequent sections then relate such concepts to the decision-making context of a specific budget actor in government, the CBO analyst.

Our understanding of human judgment and choice has evolved from a structured to amorphous interpretation of such behavior. In the field of psychology, early considerations of individual decision making relied on normative models of behavior requiring "indirect comparisons" of individual judgments with analytically derived theorems or equations (Hammond et al., 1987:753). The economic assumptions that underlie rational choice theory offer concise rules of behavior and provide some explanation for its initial appeal (Wright, 1984).

For instance, the Bayesian approach is a mathematical model of utility theory that illustrates human decision making as a process of choice based on explicit probabilities and payoffs. Human decision making is portrayed as a rational process of choice, a maximizing endeavor. Individuals maximize expected value or utility. Feedback and learning from feedback are inherent aspects of this model—feedback supplies the individual with information as to whether she or he has reached or surpassed "equilibrium" (technically, where marginal cost

equals marginal benefit) (Cyert et al., 1956; Simon, 1957, 1986). Accordingly, decision making is deliberative behavior toward optimality—either maximizing benefits or minimizing costs (Einhorn and Hogarth, 1986:55).

Dissatisfaction with the unrealistic nature of such normative models has led to numerous descriptive studies of human cognitive process that address issues of uncertainty, intuition, and the environment. Termed “process-oriented approaches to decision-making,” this body of research employs more sophisticated techniques that are representative of a behavioral approach (Wright, 1984:101). Such theory illuminates the contextual influences on and covert nature of human judgment and decision making that normative paradigms ignore. Decision making is characterized as a complex and integrative (and not necessarily sequential) process that occurs in an environment of conflict and ambiguity (Einhorn and Hogarth, 1986). Decisions are rarely predictable, even to those making them (Rohrbaugh and Wehr, 1978:522). Intuitive thinking is often considered “less structured” or less rational than analytical thought process (Von Winterfeldt and Edwards, 1986). And, while individuals possess the capacity for both emotive and cognitive decision making, they may be predisposed to one type over the other (McCue, 1999).

That is not to say that one type of decision making is superior to the other. Both intuitive and analytical cognition have cheerleaders as well as detractors. “Good intuition is often said to be the mark of a true expert, yet intuition is often despised as mere guesswork hiding behind analytical laziness. Good analytical ability is often praised as high competence, yet often dismissed as nothing more than slavish ‘going by the book’ ” (Hammond et al., 1987:754). In fact, in his study of executive uses of intuition when making important management decisions, Agor (1985) found that it is not the misuse of analysis, but the nonuse of intuition that led to “faulty decisions.” He suggests that although analytical thought process is a more lucid concept, such thinking does not necessarily lead to better results.

Theory about human judgment in an organizational setting grapples with the tradeoffs between man and machine in a given decision context. Mechanistic models are consistent, but only as reliable as the information contained therein (which is humanly developed and subsequently input). While man is better able to interpret the qualitative aspects of the “dynamic decision environment,” he is only human, and thus subject to physical, emotional, and mental shortcomings (Whitecotton et al., 1998). Forrester and Adams (1997:467) find this characteristic of government administration and the implementation of procedures (which are technically rational) that “once people become involved, they bring with them their capacity for skilled incompetence and the organizational defenses, fancy footwork, and malaise that follow.”

According to Whitecotton et al. (1998: 332), the goal should be to combine “human intuition and mechanical prediction to exploit the strengths of one while compensating for the weaknesses of the other.” In other words, “successful” judgments will incorporate some of each. Results from their experiment involv-

ing subjects' assessments of financial data and analysts' perspectives regarding bond ratings for several dozen governments illustrate that, "in the rich context condition, where there were extremely diagnostic cues for subjects to draw upon, human judgment was vastly superior to the base-rate model" (information available regarding the environment in general) (Whitcotton et al., 1998: 327).

The above suggests that individuals have analytical and intuitive cognitive capacities that often are weighted differentially and react differently to changing circumstances. Also, analytical thought is not necessarily superior to intuitive thinking. That is, there is much to be said for experience and "going with your gut" in certain decision situations. Finally, a "global" judgment that uses both types of cognition, perhaps to varying degrees, can afford the decision maker the greatest decision-making "success."

The following section assesses theory about decision making from a macro-perspective as understood by Kingdon and others that is applicable to the government setting in the United States. Then, important components of human judgment, organizational decision making, and agenda setting are highlighted that serve as the foundation for a multiple rationalities model of public budgeting.

### **Agenda Setting in the United States**

Kingdon (1995) lays out a model of policy making in which he describes multiple decision streams, clusters of decision actors (both visible and invisible), governmental and decision agendas, and predictable and unpredictable decision opportunities. He describes the process of decision making as complex and non-linear. Decisions about problems, policy alternatives, and politics are separate streams in the policy process. Dramatic policy change is possible as streams converge and policy "entrepreneurs" take advantage of a window of opportunity to push an issue forward that changes existing policy into something else.

Kingdon explains policy development as a "policy primeval soup" in which certain problems and solutions bubble to the top at any given time. Public officials grab those at the surface and with the help of staff (the hidden cluster) move a policy initiative forward. If the problem or solution does not meet political, technical (economic), and budgetary feasibility, however, the issue may be left on a slow boil to be ladled from the soup at some later period when feasibility can be met (Thurmaier and Willoughby, 2001).

Majone (1989) and Baumgartner and Jones (1993) enhance this model, emphasizing that policy development depends on the discourse about ideas and theories as much as anything else. Baumgartner and Jones (1993) concentrate on how issue redefinition occurs in policy monopolies—redefinition can lead to a change in policy image that fosters mobilization and potentially new policy. Like Kingdon, they recognize the role of policy entrepreneurs who are vested in policy redevelopment that can pay off in the future with new or changed policy.

Loomis (1994) reflects Kingdon's model by recognizing links between the budget cycle, political agendas, and politicians' time lines. "Presidents and governors must operate within the intertwined cycles of electoral and budgetary politics" (Loomis, 1994: 13). He then describes the "linking" role of the CBO to and from the governor and agencies. The budget office works on behalf of the governor "in multiple policy arenas. The webs of issue networks are almost always connected in some way to the [budget office] staff" (Loomis, 1994: 21). The work of Sharkansky (1968) and later Thompson (1987) brought to light important associations between agencies, their spending requests, the governor's recommendation, and legislative appropriation. It is only more recently that research has focused specifically on the role of the CBO analyst, potentially the strongest connection between agencies and their appropriations (Lynch, 1995; Gosling, 1985, 1987; McCue, 1999; Thurmaier, 1992, 1995, 1997; Willoughby, 1993a, 1993b).

### **The Evolving Roles of Budgeters**

David (1998) discusses the evolving roles of public administrators and budget officers. He recognizes a tug between the two traditionally distinct orientations—policy makers are interested in the activities and operations of government (service to the public) whereas finance officers are oriented toward accountability and control (number crunching). He suggests that effective governing today involves meshing these two roles. That is, advanced technologies have freed finance officers from a conventional accounting focus, while new performance-based budget and reporting requirements have added to their "interpretive" focus. Similarly, policy makers and program managers must have a more sophisticated understanding of financial accounting systems and creative financing options to support the business of government.

Alexander applies this broader, more integrating role to the decision environment of today's local government administrator. She refers to O'Toole's (1997) call for more focused attention on the networked contexts of modern public managers by stating:

In an environment of multiple organizations and diffuse political power, administrators are called on to exercise facilitative and interpretive skills; they must coordinate multiple streams of information and often divergent agendas. . . . In the current environment, where administrators are called on to reconcile competing claims, neither the neutral technical competence nor the agency advocacy role is comprehensive enough to inform public budgeting decisions. (Alexander 1999:553)

Similarly, David calls for greater activism of finance officers in program design and development. "They must move away from transaction processing to analysis, design, forecasting, evaluation and guidance" (1998: 58–59). Miller agrees that the real power of the finance officer lies with responsibility for the revenue

forecast upon which all budget deliberations are based. Finance officers “set the stage” for budget deliberations by “informing the governor of available revenue” (Miller, 1991: 205).

We see similar evolution and integration of roles of the analysts employed in state government CBOs. Thurmaier (1997) emphasizes that governors are dependent on their budget analysts to interpret the merit of agency spending plans during budget development. Lee adds that budget development is “critical to the policy-making process” (1992: 19). Analysts in CBOs process information about agency spending requests for the governor, providing traditional baseline analysis, along with other (often new) information about program and resource needs and wishes. They work in support of the governor’s agenda while helping to prepare his or her recommendation for presentation to the legislature. Once the recommendation reaches the legislature, they can then become “intimately allied with the agency in ‘selling’ approved budget recommendations to the legislature” (Yunker, 1995: 155).

Thus, while predominantly “cued” to gubernatorial prerogatives, analysts provide a vital link to agency perspectives (Forsythe, 1991; Lynch, 1995). In such a unique and contextually rich environment, and with so many opportunities to provide input, there is little doubt that the CBO analyst can influence appropriations and greatly contribute to policy development (LeLoup and Moreland, 1978; Gosling, 1987, 1985; Willoughby, 1993a; Thurmaier, 1992).

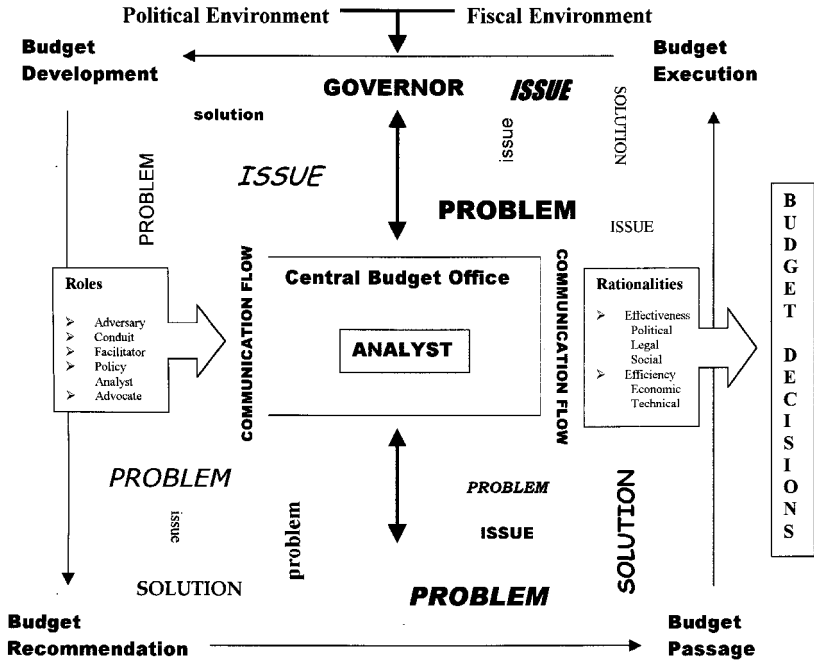
## A MULTIPLE RATIONALITIES MODEL OF BUDGETING

From the above research about individual judgment, organizational behavior, agenda setting, and the role of budgeters, we cull components of a multiple rationalities model of budgeting discussed at length by Thurmaier and Willoughby (2001). That is, individual decision making is comprised of analytical/objective and intuitive/emotive processes. While complex, these processes have structure and can be modeled. Applied to budgeting in CBOs, the decisions of analysts are made in a multifaceted environment. This context influences budgeters’ use of different decision frames, and attachment to role(s), when involved in budgeting decisions during various points in the budget cycle.

In fact, analysts weigh political and economic factors differentially when making decisions about spending. Also, these decisions are influenced by the fiscal condition at hand (Thurmaier, 1995; Willoughby, 1993b). Essentially, these budgeters are characterized by multiple roles they can play in the budget process—roles that have expanded well beyond number crunching. This allows greater room for intuitive as well as strict analytical thinking on their part. That is, analysts, as experts, can use their experience and understanding of the decision environment and then frame “superior” decisions to realize success with spending initiatives (success defined as acceptance by the governor).

An important variable affecting budget role and decision framing is time. Budgeting decisions are a function of time and timing. Time is how long the

Figure 5.1  
Model of Decision Environment of the CBO Analyst



Source: Adapted from Thurmaier and Willoughby (2001: 302).

individual has to gather and analyze information before coming up with a decision. The budget process prescribes when decisions must be made. Analysts filter information, apply differential weights to specific decision cues, and ascribe to particular decision strategies, in part, based on when a decision must be made, and where in the process their decision input falls. They must employ specific strategies to be successful in the budget process. They must understand how to effectively navigate a decision through a “window of opportunity” with the goal being acceptance of their decision by those higher up—the final decision being an appropriation. Figure 5.1 illustrates a model of the CBO analyst’s decision environment that accounts for the rich context within which this budget-eter must work.

According to this model, analysts’ budget decisions reflect their role(s) and decision rationalities. Political, fiscal and organizational factors will characterize the analyst’s environment as constrained or slack. Organizational factors illustrated here include the chain of command and communication flow involving agencies, the CBO, and the governor. Issues, problems, and solutions swirl around the analyst at any given time in the budget cycle; some of these are big issues or big problems, and some are not. The lack of boundaries in the model

illustrates the fluidity of budget decision making at any point during a typical cycle, reminiscent of Rubin's (1997) model of "real-time" budgeting. For the analyst, understanding issues, problems, and solutions involves framing them in terms of effectiveness and efficiency.

Effectiveness rationalities involve political focus that implies understanding what is important to whom in the process and when. Legal rationality considers the law related to a problem (for the analyst, the legal history of an agency's budget). Social framing considers the cultural reasons behind a problem or issue (for the analyst, the reason that the agency has evolved to produce the services that it does). Essentially, what is the public value behind a particular program that seeks funding?

"Whereas the goal of effectiveness decisions is characterized as social integration, the goal of efficiency decisions is characterized as maximizing utility or satisfaction" (Thurmaier and Willoughby, 2001:98–99). In a discussion of the different possible means of framing problems, these authors note that the efficiency focus is of two types, economic and technical. Economic efficiency involves ranking issues, problems, and solutions from most important to least important. The goal of the analyst is to allocate scarce resources as efficiently as possible across and within programs. Technical efficiency is more specific involving choice of the most efficient means of production.

The CBO analyst will frame decisions differently, depending upon the political and fiscal environments of the state, budget office orientation (more strongly control or policy), communication flow between the governor, the CBO and agencies, and period in the budget cycle. The different roles illustrated in Figure 5.1 are evolutionary regarding level of integration of decision rationalities. Possible roles of the modern analyst can include, for example, *adversary* of the agency by remaining suspicious of agency requests and serving in a traditional guardian function; *conduit* of information between the governor and agency and back again; and, *facilitator* (extension of the conduit role) by enlightening agencies of gubernatorial priorities and funding strategies, while alerting the governor of legal and other requirements that must be met. The *policy analyst* role is exhibited when the analyst tries to "sell" the governor on an initiative—the analyst takes advantage of a window of opportunity to push a policy initiative. Finally, the *advocate* supports the development of requests that reflect agency desires. Such analysts would be willing to "go to bat" for the agency vis-à-vis the governor regarding spending initiatives. These rationalities are weighted differently, according to role. For example, the policy analyst role, in particular, requires heavy weighting of the political rationality—clear understanding of the governor's agenda and how to mold agency requests into spending options that fit this agenda and are accepted by the governor. An advocacy role necessitates that analysts understand the legal and social "reasons" behind agency programs to be able to make a case for agency needs that again fit with the governor's agenda (political rationality). The adversary and conduit roles will apply greater weighting to the economics of the budget problem; guardianship implies an



accounting approach and political rationality is not necessary for transmitting information.

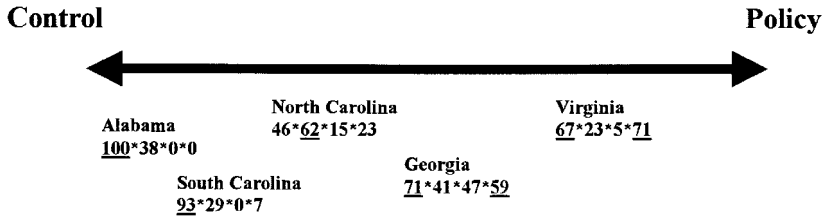
Based on this model, it is expected that analysts in budget offices of a strong control orientation (that focus predominantly on transaction processing or control functions), with relatively constrained communication flow between the governor, the CBO, and agencies, and a poor fiscal environment will exhibit traditional decision strategies when involved in budget decisions (in this case, reviewing agency spending plans)—strategies expected involve checking numbers and accounting activities. The number of roles they play in such a CBO is expected to be limited as well. However, analysts in strong policy CBOs (that focus on budget and policy development over budget execution activities and generation of budget options versus budget checking during budget development), with freer flowing communication among the governor, the CBO, and agencies, and with slack resources should exhibit decision strategies illustrative of the more evolved role of policy analyst over strict information conduit and/or agency adversary. Further, it is expected that these analysts will exhibit a broader range of roles in the budget process than their counterparts in control oriented budget offices.

## EMPIRICAL SUPPORT

Face-to-face interviews were conducted in 1994 with 73 CBO analysts from the five states, Alabama, Georgia, North Carolina, South Carolina, and Virginia, yielding a response rate of 90 percent. Respondents included analysts responsible for budget review in each CBO, the section managers, deputy directors and, when possible, the budget director. Subjects were asked about their role in the budget process, the types of activities that they are involved in during a typical budget cycle, the factors they consider most important when reviewing agency programs and services to determine spending plans for the upcoming fiscal year, whom they work for, and what are the most important characteristics of analysts to be effective in their job. Interviews concentrated on analysts' strategies for collecting information about agencies under their purview, their perception of agency and gubernatorial agendas, and their role in relaying information to both entities during budget development as well as throughout the budget year. See Thurmaier and Willoughby (2001) for a complete description of research protocol and interview questions.

A content analysis of transcribed interviews was conducted. The orientation of the budget office is based on analysts' answers to questions posed. Offices are compared relative to one another on a continuum from strict control to strict policy in orientation according to proportion of analysts indicating said orientation. Comments indicative of a *control orientation* focus on base budget assessment and emphasize analysts' heavier role in budget execution over development. In these offices and during budget development, it is not the role of the analyst to provide spending options or scenarios to the governor but to

**Figure 5.2**  
**State CBO Placement Along Control-Policy Orientation Continuum**



check agency requests for changes at the margin. Analysts focus on accounting transactions related to budget checking predominantly. There is little discussion of the governor’s agenda, which in all likelihood is not directly conveyed to analysts.

However, comments indicative of a *policy orientation* focus on budget development activities over execution ones. Analysts in these offices prepare spending options to suggest to the governor. In these CBOs, analysts consider gubernatorial agenda by continually checking it against agency spending plans. Comments from analysts in these offices indicate a greater interpretive approach to the preparation of budget requests than those from analysts in offices of a control orientation. Using Gosling’s (1987) and Gosling and Thurmaier’s (1998) consideration of policy, analysts were coded as indicating a policy orientation if they “exercised discriminating policy choice” in their development of spending options for the governor.

Using Schick’s (1966) model of budget reform on a continuum from control to planning, management and planning orientations are recognized here as well. Comments indicative of a *management orientation* focus on budget execution and analysts’ day-to-day interaction with agencies about their program operations, personnel, and management. Comments indicative of a *planning orientation* focus on activities related to planning, multiyear analysis, and strategic thinking about agency programs and operations.

Figure 5.2 presents the CBOs aligned on a continuum from a control to policy orientation. The numbers beneath each state correspond to the proportion of analysts coded as indicating a control/management/planning/policy orientation as defined above. Predominant orientation(s) have been underlined when indicated by 50 percent or more of the analysts in the office. For example, 100 percent of analysts in Alabama’s State Budget Office indicated a control orientation, as their responses lean heavily toward checking and accountability activities and a focus on budget execution over budget development. A little over one-third (38 percent) of these analysts indicated a management orientation. No analyst in this CBO indicated a planning orientation or any kind of policy discernment illustrative of a policy orientation. In general, Figure 5.2 indicates that control remains a strong, often predominant orientation of these CBOs. The

following section provides a brief accounting of each budget office orientation, assessing analysts' comments and the environment evidenced.

### **Traditional Control Orientation**

A budget office exhibits a traditional control orientation if analysts concentrate their time on budget execution over budget development. During the development phase, analysts review budget requests by checking the base for agency acquisitiveness, comparing line items with last year's appropriation, and checking that the components of the request are in place to package with all others. It is expected that these analysts have little contact if any with the governor concerning issues or agenda items important to the chief executive. An environment that would hold analysts to a control orientation include a line-item budget format, tight revenues, a budget heavy on earmarked revenues, and fairly substantial "distance" from the governor (perhaps organizationally as well as in terms of the governor's communication with the budget office).

Alabama's State Budget Office in the Department of Finance, and South Carolina's Office of State Budget in the Budget and Analysis Division of the Budget and Control Board both illustrate strong control orientations. Alabama's CBO analysts are certainly constrained from evolving to a policy orientation by a budget format that divides the budget pie into an education (earmarked) fund and general fund. Many of the analysts noted that such separation dramatically constricts their input into spending decisions. A majority of Alabama's analysts mentioned their predominant activities involved budget checking during execution with little to no involvement in "making recommendations." One mentioned an accountability focus, "We have a lot of control lists. We have a lot of database files on agencies for due dates on budgets and which have come in and which ones haven't." The budget director agreed that the office orientation emphasized budget compliance over analysis.

At the time of this study, analysts in the Alabama CBO did not have direct contact with the governor, and in fact, many expressed difficulty understanding what the governor's priorities were. The state budget officer communicated the governor's agenda to analysts, having received it by way of the finance director. Communication flow was difficult because both the budget director and the head of the Department of Finance were new hires at the time and just beginning to figure out how they would relate to others up and down the organization. The director and analysts together talked of moving to a stronger policy orientation, yet all concurred that budget format, a poor fiscal environment, lack of adequate communication, and perhaps, most especially, some clerical vacancies within the office at the time precluded any advancement in that direction.

Communication with the governor's office was as murky for analysts in South Carolina's CBO. That is, these analysts did not receive indications of agenda leanings directly from the governor but through their section managers who received such information from the governor's staff. Nonetheless, South Caro-

lina's CBO analysts did have greater berth than Alabama's to conduct budget development and analysis over and above budget checking activities. By virtue of their historical location within the jointly executive-legislative Budget and Control Board, these analysts held close ties to staff aligned with the money committees in the legislature. This explains, in part, the 7 percent of analysts from this office expressing a policy orientation for their office. While one analyst did recognize that the newly legislated executive budget system required that the office "serve at the pleasure of the governor," none was clear about how such change would effect the analysts' relationship with either the chief executive or the legislature in the future.

### **Strong Management Orientation**

A budget office exhibits a strong management focus if analysts concentrate their time on the management issues related to funding, personnel, and programs within agencies. Not strictly concerned with budget control to the exclusion of policy development, these analysts are interested in developing budgets for agencies that work with the governor's agenda, as well as making the budget work for the agency during the fiscal year. An environment conducive to a management orientation includes one less fiscally stressed than the environments noted, funding sources that are not predominantly earmarked, and close alignment with the governor, organizationally and via communication flow. North Carolina's Office of State Budget and Management (within the governor's office) is the only CBO in this study in which most of the analysts (62 percent) indicate as primarily management oriented.

Analysts in this CBO held clear understanding of the governor's agenda that they received indirectly from the senior deputy state budget office, a thirty-year veteran of the budget office. Longevity of all the players in the CBO contributed positively to communication flow up and down the organization. Popular Governor Jim Hunt was serving in his third term as the chief executive in 1994. As well, analysts in this office held the highest average years of service (nineteen) of the analysts in this study.

These analysts differentiated between making accounting decisions (the continuation budget) and making policy decisions (the expansion budget). Generally, they felt that their decisions about continuation budget items were acceptable to the governor, while those regarding expansion items might need more purposeful argument on their part via analysis. Their recommendations on expansion were very much dependent upon leanings of the governor and funding availability. Analysts in this CBO viewed their job as objective analytical support to the governor for budget development and execution.

Interestingly, the senior deputy state budget officer did talk of an evolving orientation of the office by personnel changes among analysts. With several retirements impending at the time of the study, a team approach was underway in which analysts would be required to work across sections, gaining budget

development experience in more than one policy area. The deputy noted that such dual coverage of policy areas would enhance the efficiency of office activity as well as analysts' knowledge of budget processes across different state programs and departments.

### **Strong Policy Orientation**

A budget office exhibits a strong policy orientation if analysts concentrate their time on budget development over budget execution. It is expected that analysts in such an office conduct analysis of agency requests for the purposes of preparing and presenting spending options to the governor. They are cognizant of the governor's agenda, perhaps receiving communication in person from the governor or his office regarding agenda items. As stated earlier, these analysts are interested in developing budgets for agencies that work with the governor's agenda, as well as making the budget work for the agency during the fiscal year. An environment that is conducive to a policy orientation includes one that is fiscally strong, funding sources that are not predominantly earmarked, and a CBO with close alignment to the governor, both organizationally and regarding communication flow.

The most policy-oriented offices in the study are Georgia and Virginia. Budgeters in Georgia's Office of Planning and Budget (located in the governor's office) enjoy a very direct relationship to the governor that fosters their proactive approach to generating spending options. Aside from traditional means of learning about gubernatorial priorities (in speeches, via the media, press releases, and through those higher within the CBO), one analyst claimed to pick up agenda tidbits "when I meet with the governor." And later on in the budget development phase, it was the norm for these analysts to brief the governor directly about major budget items related to their agencies. In such meetings, analysts felt comfortable taking on a policy analyst and even advocacy role. As one analyst noted, "You find an angle and try to make the governor see it."

Like North Carolina's analysts, Georgia's OPB analysts distinguish between budget and policy decisions, to a degree. Said one, "For continuation, I provide recommendations. For improvements, I present options and show benefits and cons of all options." These analysts believe they influence policy and spending through their development and presentation of options, even though the rate of acceptance of improvement options by the governor may run anywhere from 25 to 80 percent (versus 90 percent for continuation recommendations). One analyst determined that success with improvement options is dependent on "how well you sell."

These analysts recognized the importance of "making the case" to the governor regarding agency spending. One analyst cautioned, "You must make a good case for new spending or know that the governor likes it." They portray budgeting as an art, "the job is not only crunching numbers. It involves looking at policy and the organizational and financial consequences of policy. It is grat-

ifying to know that you were there at the start and pushed it forward to program start.”

Virginia’s analysts in the Department of Planning and Budget (DPB) (in the finance secretariat), although organizationally removed from the governor, indicated a clear sense of their chief executive’s priorities, too. These analysts “learn how to budget within the governor’s agenda and limited funds, accounting for mandates and compliance items.” They receive information about gubernatorial priorities from “guidance memorandum” and/or from the director of DPB via section managers. While all seemed clear about the concerns of the governor, none claimed to receive information directly from him. Nor did these analysts brief the governor personally, although such briefings have occurred in past administrations.

Analysts in Virginia’s DPB believe that they influence the state budget and policies by shaping “decisions, alternatives, and choices.” They listed numerous tasks that legitimize their office as a “one-stop shop” for the governor—tasks including assessments of legislative impact, executive legislation, fiscal legislation, review of regulations, budget execution and control activities, as well as budget development. And like Georgia’s analysts, Virginia’s portray budgeting as an art. According to one, “I like the creativity and innovative aspects of the job, the politics. To see how something is going to play. Getting something through the legislature is an art.”

### **Multiple Roles and Rationalities of CBO Analysts**

Role characterization of analysts was determined similarly to office orientation, through content analysis of analysts’ answers to questions posed. Analysts’ responses were coded according to whether they exhibited the roles defined earlier as adversary, conduit, facilitator, policy analyst, or advocate. Analysts’ responses indicate both type and number of roles exhibited. The Average number of roles that analysts exhibit is calculated for each CBO.

Findings indicate that analysts from the five CBOs collectively exhibit the role of conduit predominantly (85 percent of analysts exhibit this role behavior), seconded by advocacy (75 percent), then facilitator (50 percent), policy analyst (45 percent), and finally adversary (41 percent). Conduit and adversary roles are consistent with a control orientation in which analysts’ rationalities are predominantly efficiency oriented—attuned to baseline checking and general oversight of flow of funds to and from agencies. It is interesting, however, that while most of these CBOs hold on to a control orientation, either strictly or in conjunction with another orientation, the role of adversary is not a predominant one for analysts in any of these offices. In fact, only 11 percent of North Carolina’s analysts exhibit this role, illustrating the least propensity of the analysts studied here to take on the adversary role. This may be explained by the strong management orientation of the office that fosters close working relationships of analysts with agencies throughout the year.

In any event, it seems that regardless of evolution (or lack thereof) of an office to even a partial policy orientation, the *roles* of analysts have expanded beyond strict guardianship. Such findings support the work mentioned earlier regarding the evolving roles of fiscal officers and managers. Similarly, these findings attest to the model of budgeting presented here that illustrates the numerous rationalities (of both the efficiency and effectiveness type) and roles possible of CBO analysts.

Another noteworthy finding is the distinction across CBOs in average number of roles exhibited by analysts. These numbers range from a low of 1.5 roles in Alabama to a high of 3.7 in Virginia. The average number of roles exhibited in North Carolina's CBO is 2.3, in South Carolina's 2.9, and in Georgia's 3.1. Such results coincide with expectations that as CBOs "evolve" to other orientations, analysts will exhibit a broader range of roles. South Carolina analysts are somewhat of an aberration to the model, as explained below.

CBOs with the greatest proportion of analysts indicating the policy analyst role include South Carolina, Georgia, and Virginia. As noted earlier, South Carolina's analysts consider that they are able to serve in this role vis-à-vis their association with legislative staff. This may explain the higher number of roles (on average) exhibited by these analysts compared with those in the other strong control CBO, Alabama. In Georgia, 50 percent of the analysts indicated the policy analyst role; greater percentages of these analysts claimed the advocate role (82 percent), conduit role (82 percent) and facilitator role (76 percent). The largest proportion of analysts exhibiting the policy analyst role is in Virginia's CBO (60 percent). Slightly different from Georgia's analysts, this role falls fourth behind conduit (95 percent), advocate (90 percent), and adversary (75 percent). No analyst in either the Alabama or the North Carolina CBOs indicated the policy analyst role.

Unfortunately, it is difficult to tease out any distinguishing features of the CBO orientations or analyst roles based on political and fiscal status. Politically, the states were mixed. In 1994, South Carolina and Virginia had Republican governors and Democratic legislatures. The rest of the states were Democratic in both branches. And, North Carolina and Georgia both had very popular governors, Jim Hunt and Zell Miller, respectively. The powers of the chief executive were varied as well. For example, North Carolina and Virginia had very strong budget systems, yet the office of the governor was compromised a bit—in North Carolina by the lack of veto authority; in Virginia by the inability to serve more than one four-year term. The fiscal/economic environments of these states in 1994 were fairly similar, although Alabama and South Carolina ranked near the bottom relative to the other states on several indicators (Thurmaier and Willoughby, 2001: 16–17, 21). Analysts in all of the CBOs studied here expressed concern about their tight fiscal environments. Certainly such conditions constrained analysts in the Alabama and South Carolina CBOs from evolving into stronger policy shops. Alternatively, the policy orientation and role evolution

evidenced in the Georgia and Virginia CBOs were sustained in spite of such condition.

Nonetheless, these findings provide good support for the model presented in Figure 5.1 that illustrates analysts as fulfilling a number of possible roles regarding their relationships to the chief executive and agencies throughout the budget cycle, and clearly so during budget development. And, role ascription reflects budget office orientation. Analysts in Alabama's CBO exhibit two roles predominantly, advocate and conduit. However, the highest average number of roles exhibited is found in the CBOs of other orientations, particularly in strong policy shops in Georgia and Virginia. Analysts in these CBOs reveal the stronger policy analyst role, which is nonexistent in both Alabama and North Carolina, and, as noted earlier, attenuated in South Carolina.

## CONCLUSION

This research shows that analysts recognize the orientation of their office as either predominantly control (Alabama and South Carolina), or mixed with another orientation (strong management in North Carolina, and strong policy in Georgia and Virginia). And the roles of analysts in these offices reflect such orientations. Alabama's CBO is the prototypical strong control office in which analysts' predominant roles are to communicate information back and forth between agencies and the budget office and to work with agencies to execute their budgets during the year. The strong control oriented CBO harbors analysts who fulfill fewer roles than those in offices more evolved to a stronger policy orientation. That the South Carolina analysts exhibit the policy analyst role is aberrant to this model but can be explained in part by the unique organizational setting of this office and the historical relationship in that state of analysts to legislative staff. Evidence here supports that as budget offices evolve to orientations other than control, the analysts who staff them exhibit a broader range of roles and the decision rationalities that reflect such roles.

The environment of the strong policy CBOs is telling. These offices afford their analysts much greater communication about the governor's agenda, either directly or indirectly, but nonetheless frequently and clearly. This free-flowing communication and the flexibility to work on spending options afford analysts the opportunity to take on a broader range of roles and to better utilize both efficiency and effectiveness rationalities when making budget decisions. This could imply the possibility of "superior" decisions—if we define superior as generating spending plans acceptable to the governor and then recommended to the legislature with a greater possibility for success in terms of final passage as an appropriation.

Forrester and Adams (1997) and Alexander (1999) call for budget theory that is more interdisciplinary, that draws from more than politics and economics. This chapter has attempted to present such a model that more fully accounts for the complexity of human decision making, organizational behavior, and the flu-



idity evident in budgetary process. The budgeters studied here understand the orientations of their offices and respond accordingly by virtue of the role or roles that they take on to fulfill their duties as analysts. This is a model about microlevel budgeting that nonetheless has applicability to other levels of government as well as other budget actors and circumstances. While the analyst position is distinctive, given its nexus between the governor and agencies, it is expected that the decision context is no less complex for other important budget actors involved in public budgeting.

Future research should extend this study's findings by examining the decision environments, orientations, and roles of other budget offices and actors, including the governor's staff, executive agencies and their budget officers, and legislative budget offices and their analysts, as well as staff aligned with important money committees in state legislatures. Research of this type about budget actors and their decision strategies on the federal and local levels of government is also needed.

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# The Principal-Agent Model and Budget Theory

John Forrester

Relationships within the executive and the legislative branches, between members of these branches, and between actors at different levels of government are profoundly affected by the budgeting process. Through the Budget Reform Act of 1974, Congress created entirely new committees and support staff, and imposed new checks on the president; the Omnibus Budget Reconciliation Act of 1981 provided the means for the federal government to consolidate numerous categorical grants into fewer and less well-funded block grants for state and local governments to administer; and federal National Performance Review reforms appear to be the force behind some federal agencies becoming more rigorously involved in strategic planning and performance measurement development. Even the very “routine” events of budget hearings and the presentation of the executive budget before the legislative body may affect how budgetary actors think about each other and interact. The objective of this chapter is to offer to students of public budgeting a seasoned theoretical framework for assessing relationships between budget participants and the consequent budgetary effects of those relationships. The framework is that of principal-agent theory. Clearly, prior research has delved into relations between budget participants (e.g., cutback management—Rubin, 1985; congressional budgeting—Fenno, 1966; roles of actors under incremental budgeting—Wildavsky, 1988), but all too often the theoretical relationships are addressed unconsciously, and, consequently, without consistent rigor.

Reflecting on the potential for principal-agent theory in explaining budgetary relationships will begin by defining and explaining the theory. This is followed by a description of the basic theoretical relationships and their conceptual biases.

Drawing on findings in the current budgeting literature the usefulness of the relationships will be assessed. In conclusion, we will reflect on the value of basing future budgetary studies on principal-agent theory.

## PRINCIPAL-AGENT THEORY

At the heart of public budgeting are relationships among those who provide agency services and those who allocate resources to service providers. Schick (1988) has referred to these individuals as claimants and conservers, respectively. Others have entitled them more generally as agents and principals, respectively (Demski, 1998; Baiman, 1982; Holstrom, 1979). In other words, those who make claims on governmental resources are *agents* and those who allocate and ration the resources are *principals*. In this relationship, the principals contract with agents to provide services to the public, and the main focus for all those involved is the contract (i.e., the budget) itself. Two key questions for both participants are “What can be done to draw up the most effective contract possible?” and “How can the contract be upheld?” While no one has come up with The Answer, current research suggests that we should look at the elements that are common to the contract and its enforcement, namely (1) the distribution and management of information, and (2) the hierarchical relationships among budget participants.

### Information

Governments at all levels use information, especially input and process information, to decide upon revenues and expenditures, and to assess performance. From the principal-agent perspective, the information is managed by principals and agents to advance their own self-interest or to maximize their own utilities. The information is exchanged so that both sets of participants might adapt and learn in a dynamic, yet resource constrained environment (Forrester and Adams, 1987). Managing the exchange of information is likely to be a challenge, however, because principals and agents often have conflicting interests, have “different types and amounts of information, and have different incentives to reveal that information” (Stevens, 1993:263). Where there is such an asymmetry of information, there is every reason to expect that the consequent budgetary solution will be suboptimal and wrought with unexpected results. The suboptimal conclusion is well-grounded in economic theory. Concluding that unexpected results will arise is based in statistical theory—insufficient or biased information will not give decision makers the ability to estimate with a high degree of certainty the effects of their decisions. Two such unexpected results highlighted by the public choice literature are “adverse selection” and the risk of “moral hazard.” Under adverse selection, the principal has either selected the wrong agent to provide the service or it has incorrectly defined the agent’s responsibility or agenda. Moral hazard is said to occur if the agent hired by the principal

changes his or her behavior in a manner detrimental to the principal. The forms that adverse selection and moral hazard (Stevens, 1993: 281–282) assume depend upon how principals and agents relate.

### **Hierarchical Relationships**

Principal-agent relations also are likely to be affected by the hierarchical relationships between budgetary participants and the resulting asymmetry of information that occurs among the participants. Nearly all government programs and policies are determined and implemented in a hierarchical manner. Agencies report to departments, departments to the chief executive officer (CEO), and the executive generally to the legislature. Even within a single organization, such as an agency, subordinate positions are designed to be accountable to supervisor positions. In budgetary relationships, agents are most often government agencies, since they are responsible for actually implementing policies and programs. Principals, however, tend to vary according to the nature of the government's budget decision making process. Where the legislature determines the structure of budget authority and the public policy agenda, then the legislature may be defined as the budget principal. Where the executive exercises more power in determining such issues, then the executive may be defined as the budget principal. In both cases, principals are assumed to set the policies and overall goals, and agents then implement programs intended to address the principal's policies and goals.

To implement the programs, the agents need money or budget authority. Following principal-agent theory, the amount of budget authority granted an agency should be determined by the relative dominance of one party over the other during budget negotiations. Unfortunately, the negotiation process may yield inefficient results. In the private marketplace, an efficient allocation of resources is likely to result if there are several suppliers and several consumers, all armed with sufficient information to make rational decisions. In the public sector, however, traditionally there have been relatively few suppliers (agencies) for any one good or service, and either relatively few purchasers of a service (e.g., the legislature, who makes payment in the form of an appropriation) or purchasers who have little choice in who provides the service (e.g., consumers of a utility who have little choice but to purchase from that utility). In turn, because of the complexity of both the resource allocation process and the service provision process, and because of the channeling of information that occurs in organizations dependent upon hierarchical relationships, not all parties will likely have equally good budgetary information.

### **BUDGETING AS PRINCIPAL-AGENT RELATIONSHIPS**

Traditionally, principal-agent models assume a hierarchical relationship between actors, goal conflict between principals and agents, and an informational

advantage on the part of agents (Bendor, 1988). Where each is true, agents control the information, and the resulting behavior is modeled as “Agency Dominance.” By relaxing the third assumption, where either the legislature or the executive control the distribution of information, the resulting behavior is modeled as “Legislative Dominance” or “Executive Dominance,” respectively. Further relaxing the third assumption so there is not necessarily an informational advantage by either the principal or the agent, and relaxing the second assumption such that goals are not necessarily in conflict, then the resulting behavior can be modeled as an “Issue Network.” Each model is reviewed below.

### **Agency Dominance—Hierarchy, Conflict, Agent Controls Information**

There may be conditions where agencies control the flow of budgetary information and thus dominate the decision-making process. This is the point of view most commonly associated with the public choice literature (Ostrom & Ostrom, 1971), where government bureaus are characterized from a conservative economic perspective, and bureaucrats, because of their control over information, can leverage the budget negotiation process. Under these conditions, agencies have been characterized as budget maximizers (Niskanen, 1971; Bendor, 1988: 354–362).

This view assumes that agents control the flow of information about the service they provide and, consequently, will use that control to maximize the resources given them by the principal. Bureaucrats behave as economically rational men, put their personal preferences ahead of legislative preferences, and act to maximize their personal gain. Such preferences aim to increase the salary of the agency head and his or her subordinates; to increase the bureaucrat’s desire for power and prestige; and to enhance the reputation of both the agency and the agency head (Niskanen, 1971). Traditionally, supporters of this view have contended that agency dominance results in the self-maximizing bureaucrats trying to maximize their agency’s budgets. More recently, this conclusion has been challenged as being too narrow. As Wyckoff (1990) argues, budget maximization presents the legislative body with an all-or-nothing choice (i.e., an elastic demand curve). To maximize the size of the budget, “a bureaucrat would have to reduce the price charged to the sponsor to the level of his costs, eliminating productive inefficiency.” In so doing, little if any money would be available for increasing staff size or increasing salaries over what is needed to maintain productivity. An alternative conclusion is that bureaucrats will try to maximize their budgetary slack. For a slack maximizing bureaucrat, more resources would have to be available for the bureaucrat to “purchase whatever nonproductive expenditures” he or she desires (Wyckoff, 1990: 35). With numerous mechanisms (rules, regulations) in place to constrain bureaucratic discretion, agencies probably function as part budget maximizing and part slack maximizing.

The herald of this perspective has been William Niskanen, a prominent and staunch public choice advocate and an active member of recent Republic administrations. In 1971 he published a treatise entitled *Bureaucracy and Representative Government*, where he eloquently drew on the theory of the profit-seeking firm to explain what from his perspective were the functions and limitations of government bureaucracies. He characterized bureaucrats as rational, self-interested, and monopolistic controllers of marginal cost and performance information; bureaus as monopolistic suppliers of services and inefficient budget maximizers; and legislatures as the sole buyers of the services.

Niskanen's agency dominance perspective has been developed and respected by many advocates of public choice. For instance, Vincent Ostrom (1974) supported the ideas of Niskanen and of public choice generally in his classical work *The Intellectual Crisis in American Public Administration*, where he put forth a public choice paradigm for public administration (Ostrom, 1977; Golembiewski, 1977a, 1977b). Most recently, advocates of New Public Management have drawn quite heavily on the theory of public choice, especially the perspective of agency dominance to support policies of contracting out services and privatization, and requiring government agencies to compete (e.g., through a bidding process) for the opportunity to provide services (Thompson, 1994; Antonsen and Jørgensen, 1997; for more debate see recent articles in the journal *Canadian Public Administration*—e.g., Borins, 1995; Savoie, 1995; and see a recent symposium in the *Journal of Policy Analysis and Management*, vol. 16, no. 3, 1997).

The agency dominance perspective is very appealing, especially from a conservative economic point of view, but it is not without criticism. It has a deep and rich theoretical basis that, like the legislative dominance perspective, is based upon a conflict that its supporters say characterize the decision-making process, but its impact on actual policy making may be overstated (Frey, 1993). For instance, agencies define budgetary success in numerous ways, only one of which is by the size of the budget increase in good times, or by the ability of an agency to avoid a large budget decrease in bad fiscal times. Also, there is no reason to presume that agencies reasonably understand their marginal costs or the values of their services, especially since very few government agencies calculate their marginal costs or even have raw data on the fiscal worthiness of their services. Both sets of information are expensive to gather and compute. Nevertheless, there is good reason to believe that agencies know more than their legislative principals about the services they provide, giving them at least some control over information flow.

For agency dominance to work, bureaucrats must operate in their own self-interest, with well-ordered goals and objectives, as well as good measures of performance and good data to analyze their performance. While some government bureaucracies recently are making significant strides in setting clear goals and in measuring performance, most have not, and perhaps cannot. (Even Niskanen acknowledges that bureaus are chosen to supply public goods because of the difficulty in defining the character of the services.) In effect, the information



they control often is partially valid and partially reliable. The more agencies have to rely on low-quality information to defend their arguments for budgetary growth, the more difficult it will be for them to defend their proposal. This is more likely where the proposal is very information dependent (i.e., budget is intended to generate future cost-savings or to offer new levels of services), but is less likely where quantities of information add minimally to the debate (i.e., budget simply adjusts to price changes or workload changes). Without such data, bureaucrats cannot engage in effective monopolistic behavior.

The more information-dependent the budget proposal, the more likely an agency is to pass biased or filtered information through to the legislature. In such situations there is an increased likelihood that either the legislature will select the wrong agency to implement a policy, or that the consequent programmatic agenda for the agency will not match legislative intentions. And because the agency will in many cases get the first look at information about a program's performance, or because there may be unforeseen needs, urgencies and opportunities, an agency may change its behavior after it has been assigned responsibility for implementing a program (or policy).

### **Legislative Dominance—Hierarchy, Conflict, Legislature Controls Information**

Given that agencies cannot spend money unless given the authority to do so, the legislative dominance model might reasonably depict the relations between budgeting principals and agents. Under this view, the legislative body is the principal, or at least it embodies the principals (e.g., committees, committee chairs, majority leaders, minority leaders), and the principal controls the executive, who is the agent, or at least embodies the agents. Congress, for instance, "can choose to organize the budgetary process in different ways" and it can gain the upper hand during budget negotiations by variously clarifying or concealing its preferences for goods and services (Bendor 1988: 357; Miller and Moe, 1983; Bendor et al., 1985; Bendor et al., 1987). According to Rubin (1999: 34) during colonial times, governments were limited, and Americans favored the legislature over a strong executive. Reflecting the needs of the government, legislatures favored a simple budgeting process, with agencies taking their budget requests directly to the legislature who in turn approved the requests. Today, legislative control arises from the legislature's ability to limit the informational advantage of the executive agency (for example, the Congress draws on resources of the GAO, CBO, and other legislative agencies to give it informational leverage) and to manipulate the relationship between itself and the agency so as to elicit better and more complete information from the agency and to mitigate adverse selection problems. The legislature also draws on its committee system, requirements for majority rule, and the desires of its members to pursue their personal interests to assert control over agencies (Stevens, 1993: 289). In short, the legislature structures and controls the flow of information

throughout the entire budgeting cycle, especially during the legislative budgeting phase.

For instance, at the time Congress decides to consider deliberating a public issue, the issue is “assigned” to a specific committee and subcommittee. Just the culture of either committee is likely to determine how the ensuing deliberations over the problem will evolve. As the time comes for testimony to be presented to the committee, the chair in particular will significantly influence the list of experts allowed to testify, as well as the duration of the questioning and cross-examinations. In the end, committee members will determine if their resolution requires funding, and, if so, the structure of that budget authority—appropriation or back door. Throughout this phase, the legislative principal, not the agent, determines the budgetary decision. Legislative dominance has reared its head over the years, and it continues in part today, and, as Stevens (1993) indicates, it generally has led to outcomes that have been stable and predictable (p. 289).

At the federal level, Congress dominated the budgetary negotiations with federal agencies, at least until the early part of the twentieth century. In the early years, agencies negotiated their budgets directly with Congress. Unfortunately, Congress became inundated with so much information from the agencies that it found it could not effectively address the fiscal matters of the executive branch. To redress this apparent lack of direction, Congress passed the Budget and Accounting Act (BAA) of 1921. Subsequently, the president was required to submit, for the first time, a budget for the executive branch (municipal executive budgeting dated about fifteen years earlier in New York and Boston). By passing the BAA, the president’s budgetary power clearly increased, but Congress benefited as well: it sacrificed a quantity of information in exchange for better information and a more coordinated executive.

More recently, the Budget Reform Act of 1974, in part, may be seen as an effort by Congress to reassert its dominance in the budget process. To better coordinate the expenditure and revenue sides of the budget, Congress could now rely on a new budget structure that included newly created Budget Committees; to offer an independent set of fiscal projections, it could now draw on its new Congressional Budget Office; to give committees time to understand and assess the implications of the executive budget, Congress gave itself a new budget timetable; and to hold check on the president’s authority to withhold budget authority, Congress implemented tougher guidelines on presidential impoundments. Given the frequency that Congress passed continuing resolutions and deficit-laden budgets in the years following the 1974 reform, the real gains that Congress made in reasserting its dominance over the budgeting process should not be exaggerated. Starting slowly with the Gramm-Rudman-Hollings Act and the Reaffirmation Act, and with more determination through the Budget Enforcement Act of 1990, Congress may now have the means in place to reestablish some control over the federal budget, and in turn the executive.

While Congress may in part control budgetary decision making, the institution’s control may be effectively limited to the degree members of Congress

misunderstand, and have limited programmatic control over, the bureaucracy. For instance, Congress may assign a policy or program to the “wrong” agency, or statutory language may be too tightly (or too loosely) structured for a program to be administered effectively (Stevens, 1993:290). Either may occur because Congress misreads the skills and abilities of the agency designated to implement the program. Or perhaps conditions in the environment are so uncertain or dynamic that, especially at the state level where several legislative bodies are part-time and frequently out of session, the legislature’s window of opportunity may be too narrow for it to effectively determine which agency is appropriate for a given policy/program. The other major problem is that instead of pursuing the principal’s goals, the agency may, over time, pursue its own goals. Being closest to the clientele, the bureaucracy may come to believe, for right or wrong, that it better understands the real problem and the best solution. Feeling strongly about this solution, the bureaucratic agents may take matters into their own hands, as may have been the case recently with the Internal Revenue Service and the measures it has used to encourage taxpayer compliance. From Congress’ perspective, the solution may be to more intensely monitor agency activities and pursue in-course corrections (Stevens, 1993:290). The solution, however, may require more substantial efforts, such as requiring agencies to strategically determine, on a recurring basis, their missions and objectives, and to tie both to the budget requests. Or a combination of stepped-up monitoring activities (e.g., performance measures) and strategic planning and budgeting might give to Congress the information it needs to control the budgeting process.

The legislative dominance perspective may partly explain the recurrence of congressional budgetary reforms, but it does not necessarily explain the reasoning behind all such reforms, nor does it explain budget reforms that are not centered about the legislature. For help here we turn to executive dominance and issue networks.

### **Executive Dominance—Hierarchy, Conflict, Executive Controls Information**

The counterpart to legislative dominance is executive dominance. The rise in power of the chief executive is tied most closely with the good government or reform movements of the early twentieth century. With executive dominance, agencies are required to first submit their budget requests to the chief executive or his or her budget office, who, following negotiation and modifications, compiles and organizes the requests into an executive budget. This budget is then submitted to the legislative body for review and approval. At the national level, the executive budgeting process was first mandated by the Budget and Accounting Act of 1921. It is also found in states with part-time legislatures, and in local governments who have strong mayors, city managers, and even in commissions with strong presiding commissioners.

With executive-dominated systems, the chief executive or his or her budget

team controls the flow of information. The budget office, for instance, initially is able to control the information through the budget instructions it presents to the agencies and by the budget timetable the office gives to the agencies. The budget office also disburses appropriations through an apportionment process because of its fiduciary and management responsibilities. It also reviews agency budget proposals, and it may present agencies with guidelines or requirements for program efficiency and effectiveness. In addition, the executive and his or her budget office is likely to require that agencies follow a certain budget format. And in the event the legislature approves agency appropriations in excess of the executive's preferences, under an executive-dominated system the governor, for instance, may be able to further dominate agency powers using the item veto. However, as current research illustrates, this power is likely to be used more for partisan purposes rather than for fiduciary or management purposes (Abney and Lauth, 1985; Gosling, 1986).

The durability of executive-dominated budgeting over the twentieth century is exemplified by several factors, but two of the more notable ones are efforts to strengthen the president's budget office, and the evolving legacy of budget formats. The BAA of 1921 gave the president, for the first time, a budget office. Initially, this office, the Bureau of the Budget, was located in an executive agency, the Treasury Department (Berman, 1979), and was empowered "to assemble, correlate, revise, reduce, or increase the estimates of the several departments or establishments" and "secure greater economy and efficiency in the conduct of the public service" (42 Stat. 20 1921). In effect, the BAA, through the Bureau of the Budget, "denied federal agencies independent influence in the budget decisions of Congress" (Berman 1979:4). Unfortunately, the bureau failed to develop as an administrative staff agency, as the Brownlow Committee on Administrative Management acknowledged in 1937. By 1939, Reorganization Plan 1 was enacted into law, establishing the new Executive Office of the President and "transferred to it the Bureau of the Budget (from Treasury)." (Berman, 1979:13). Berman adds, the bureau's new and expanded authority was spelled out in Executive Order 8248 (1979:13, 14). Over the next half century, the bureau came to take on more tasks, but at the same time came to be viewed by Congress as problematic and irresponsible. In 1970, the bureau was replaced with the Office of Management and Budget (OMB) (Berman, ch. 5, p. 112). OMB got off to a politicized and rocky start, but since its inception twenty-nine years ago, it has continued to facilitate executive dominance over the budget process.

Executive dominance also has been exemplified by a see-saw of attempts over the years to reform the budget format. President Taft, the 1912 Taft Commission on Economy and Efficiency, and the 1949 and the 1955 commission on Organization of the Executive Branch of the Government (First Hoover Commission and the Second Hoover Commission) were all early proponents of requiring agency budget requests to be based on agency performance. The National Security Act Amendments of 1949 and the Budget and Accounting Procedures

Act of 1950 were passed to put the idea of performance budgeting into practice at the federal level. These early reforms, unfortunately, fell far short of expectations (Lee & Johnson, 1994:92–93). In the years that followed, several attempts were made by Democratic presidents to centralize the management and planning dimensions of the budget process, only to be unraveled immediately by their Republican successors, who seemed to value centralizing the more traditional dimension of expenditure control. From 1965 through 1969 President Johnson gave a go at implementing the Program Planning Budgeting System (PPBS), only to be removed by President Nixon in 1969. In 1977, the Carter administration went ahead with zero based budgeting (ZBB), followed by its removal in 1981 by President Reagan. Most recently, the Clinton administration has implemented the National Performance Review, which includes a performance or outcome based budget process. Just how long this reform will last is not clear. Chief executives have used the budget format to achieve budgetary dominance, but clearly the administrations do not always prefer to dominate the same thing.

While executive-dominant reforms have been tried over and over again throughout this century, at least two factors—adverse selection and moral hazard—have limited their effectiveness. Drawing on the above scenarios, first, it took several years to realize that the president’s budget office would operate more effectively if it was held accountable to the president rather than to the Treasury. But even today there is debate about the appropriate scope of their responsibility; just how many responsibilities should the budget office take on? Moral hazard in this case is likely to be found after the fact. Once a budget office has been reformed to take on a broader set of responsibilities, time and budgetary resource constraints may force budget examiners to pick and choose among the rules they will truly enforce. Whether their choices reflect the values of the chief executive are not clear.

Second, the failure of budget reforms almost seems to be the budgetary legacy of the twentieth century, but this failure may have less to do with the reforms themselves and more to do with how the reforms are implemented. All too often the reforms simply have been administered to an organization rather than worked into the organization’s goals and culture, where budget offices and CEOs simply define the agencies’ new budgetary responsibilities and process. Unless agencies are prepared to accept the reform, we can only be surprised if the reform works (Forrester and Adams, 1997). In this case, moral hazard will be visible, for instance, where performance measures are defined by an agency to protect it against executive, or perhaps where budgetary goals are defined less according to a mission and more according to what the agency currently is doing. Because reforms are implemented most often to help executives determine where to cut and by how much, agents can be expected to behave in a manner that resists such cuts, even if the behavior is counter to the executive’s wishes. Consequently, packaged budget reforms often die very quickly.

### **Issue Networks—Hierarchy, Cooperation, Sharing of Information**

A fourth view of the relationship between principals and agents is that of an issue network (Kenis and Schneider, 1991:41; Hecló, 1978; Stevens, 1993, ch. 9). In an issue network relationship, a legislative committee, an agency and a third group(s), often a beneficiary of the agency's services, are assumed to act in concert to support or fight a policy or program. For example, in response to an unforeseen natural disaster, such as the recent floods in the midwest, all parties (e.g., Congress, FEMA, state agencies/governor) generally agree that an area of a state should be declared a disaster area and that federal assistance is needed immediately, even though there may be disagreement over the amount of resources needed. Or, in support of new defense weaponry members of the defense committees within Congress, the Army, Navy, and Air Force, and large, powerful defense contractors historically join forces to advance the weaponry. Each party of the network's web works with the other parties to achieve success. This view seems to be discussed and supported most frequently in public administration textbooks; in research the support often is less obvious.

In issue networks, information tends to flow freely between the budget participants, and individual participants come out ahead by working with other participants in a mutually supportive manner. From an economic perspective, bureaucrats and legislative members of a network may be acting to maximize their self-interest as they perceive it, but contrary to what would be expected under the agency dominant perspective, they are likely to work cooperatively with their legislative principals and service beneficiaries to ensure their growth. Such behavior is rational from an inter- or transorganizational point of view rather than from a more myopic intraorganizational view that is suited to both the legislative dominance and the bureaucratic dominance perspectives. On this point, a remark by Bruno Frey (in his critique of public choice's unwillingness to draw on advances made in the social sciences) is appropriate:

The economic model of human behaviour properly understood perfectly lends itself to the integration of so far neglected aspects of people's actions. What is needed, however, is an effort to overcome the model of "homunculus economicus" who is at all times in full control of his or her emotions, who does not know any cognitive limitations, who is not embedded in a personal network, who is extrinsically motivated and whose preferences are not influenced by processes of discussion. (1992:97)

One strength of issue networks is that they characterize human decisions in a more socially realistic manner—as dependent on interpersonal communication and the sharing of information, traits missing from the dominance models. Perhaps the model goes too far, however, by unrealistically assuming that participants interact in such a cooperative manner; the dominance perspectives argue

that principals and agents variously control a decision-making process that is rooted in conflict.

So what type of budget decision making is likely to result from an issue network? With all participants seeing value in the proposed program, sharing programmatic goals and objectives, and willing to share information vital to the success of the proposed program and its budget, issue network budgets should be very growth oriented (unless, of course, all parties agree to eliminating a program, in which case they would be very cut-back oriented). If quality information is shared between participants within the network, then the program or policy that is being budgeted probably will have a relatively clear focus and mission, and the resultant budget proposal will be larger and more strongly supported compared to proposals based on information of lesser quality. Where the information shared is of lesser quality, then the success of the budget proposal is more likely to depend upon political tradeoffs. Generally, though, the success of budget proposals will be constrained by several factors, the more prominent of which include the extent to which other parties or networks are vying for the same budgetary dollars, the CEO's priorities, and the political culture and values within the legislature.

As with the other models, issue networks too are subject to adverse selection and moral hazard. Entrenched interests may have either much to gain if a particular agency is given the authority to implement a program or much to lose if the service is provided by another agency. In either case, the agency selected to provide the service may not be the best one for the job, or the agenda that the agency is to follow in delivering the service may be incorrectly specified, especially if the interested parties rush to get the program's budget approved.

Whether or not the problem of "moral hazard" occurs may be a function of the observer's station—inside or outside the network. A participant of the network may interpret any changes in agency behavior that occur after the agency has been assigned responsibility for implementing a policy or program as a responsible reaction to a dynamic and unpredictable environment. An individual outside the network, however, may see such change as irresponsible and threatening to legislative intent. To help manage the perception of moral hazard, participants could try to enlarge the group so that more people have more to gain by the success of the program. In this case, unlike the previous three scenarios, we will draw on a case study of the Missouri Department of Revenue (MDOR). The case study demonstrates how a well-prepared reform may be used to correct an existing problem with adverse selection and moral hazard.

Soon after her appointment, the director of MDOR found that she was unable to shift employees from one division to another or from one program to another to address seasonal peaks and valleys in workloads. As a consequence, for instance, during the busy tax season, not enough employees were available to process all the tax records. The solution was to ship a large portion of the forms to Illinois for processing. Unfortunately, this solution was costly and yielded results that were laden with errors. The only way to effectively change this

policy was to get the legislature to change the appropriation language from line-item to lump-sum. This might not be too easy, however, since over the years MDOR had demonstrated that it was not entirely fiscally responsible. Before the appointment of the new director, the department had a dismal reputation with the legislature, rarely “playing it straight” or openly with them in budget hearings. Even the governor’s office expressed concern with MDOR because of budgetary figures that did not add up. Clearly, then, if the director wanted increased budgetary flexibility then somehow she had to assure the legislature and the governor’s office that the department, in turn, would be accountable. The process of finding a solution to the budgetary problem began by enlarging the network and giving all the persons of this network the opportunity to affect the solution. The director worked with the directors of MDOR’s division, their staff, members of the House and Senate, and the governor’s office. Within months after the process began, the legislature both approved a lump-sum appropriation for the department and a policy (called the Detailed Base Budget) that required the department to become more directly accountable to the legislature and the governor.

To date, the two-tracked solution is working well. One reason may be that with the reform, the governor and the legislature gave the director the opportunity to use her personnel more effectively, such as using MDOR employees, not state of Illinois personnel, to process tax forms—a change that was more economical and more effective. Perhaps the more important reason is that the problem of moral hazard that had existed—the director had a very detailed appropriation that impeded MDOR’s effectiveness—was virtually eliminated. With the lump-sum budget the director acquired an important budgetary and management tool that worked to the benefit of all parties. By broadening the field of participants to include various principals (legislature and governor) and agents (director, division heads and other employees) in the reform, more people came to have a stake in the reform’s success.

## CONCLUSION

The objective of this chapter has been to argue that public budgeting can be studied by drawing on theories of principal-agent relationships. More specifically, the discussion has reiterated the argument of current literature in postulating that the relations between participants in the budgeting process can be patterned into at least four clusters: agency dominance, legislative dominance, executive dominance, and issue networks. The clusters are based on differing assumptions regarding the exchange of information and the hierarchical relationships between budget participants, giving students of budgeting several perspectives for rigorously hypothesizing how individuals and institutions strategically exchange information in the budgeting process. In the preceding pages, a few examples were cited to show how several budget reforms and



strategies of the last seventy-five years can be partly understood from one, if not several of these perspectives.

While principal-agent models may help explain budget participant behavior, they will explain only part of that behavior. Some of the behavior also can be explained by organizational and political factors (among numerous others). Organizational culture and personally defensive routines, for instance, regulate an agency's ability to adapt and learn in a dynamic and resource constrained environment, and, in turn, affect the successful prospects of budget reforms (Forrester and Adams, 1997). A challenge for future research is to not only continue exploring these different perspectives on budgeting, but to merge or integrate them into grander theories about budgeting. Drawing on the research presented here, that integration might be addressed in an inter- and intraorganizational context that focuses on the control and distribution of the budget information, the thread that ties the budgetary contract with the accountable and responsible enforcement of that contract. Whatever integrated frameworks researchers use to conduct their analyses, the frameworks should be strong enough to allow them to present theoretically grounded and specific hypotheses about relationships between budget participants and about the prospects for reform. While we may disagree on how to interpret the results from such research, the increased rigor of the research will be appreciated. From this, all can benefit.

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# Responsibility Budgeting and Accounting Reform

L.R. Jones and Fred Thompson

Management control is a process for motivating and inspiring people, especially subordinate managers, to serve the policies and purposes of the organizations to which they belong. It is also secondarily a process for detecting and correcting unintentional performance errors and intentional irregularities, such as theft or misuse of resources.

The discipline of management control is based on the presumption that controllable behavior is largely self-interested. Its goal is the minimization of agency costs. Agency costs (principal-agent problems) arise where employees (*agents*) opportunistically pursue their own interests instead of their employers' (*principals*). Agency costs also arise where the principal finds it unpleasant to discipline or dismiss agents. Finally, they include any resources expended to reduce the divergence of interest. Hence minimization of agency costs means minimizing the sum of costs that results from opportunistic behavior on the part of agents and of controlling that behavior (Zimmerman, 1995). Economic theory tells us that this optimum is to be found where the marginal costs of control equal their marginal benefits (Breton and Wintrobe, 1975).

Control costs range from the employment of security guards to the design and implementation of new or reconfigured accounting and reporting systems. This essay focuses primarily on accounting and reporting systems. Of course, the existence of a labor market and competition tends to reduce agency costs—at least where the potential for agent replacement is present. Moreover, agency costs can be reduced by attempting to make agent goals more congruent with those of their principals through the use of incentive schemes, although not by changing principal or agent preferences.

Assets are subject to rules governing their use or decision rights. Decision rights over assets can be assigned to legal persons—individuals or organizations, who can then be held accountable for outcomes resulting from the employment of those assets. Organizations partition decision rights by creating and allocating hierarchical decision making power. Three systems aid this process:

- systems that measure performance (internal accounting systems)
- systems that reward and punish performance
- systems that partition rights

All three approaches are interconnected. Hence, when a organization changes one, it must change them all.

Traditional Weberian-type organizations resolve the decision-making problem by separating decision management from decision control in the creation of hierarchical structure. Where a manager either initiates or implements decisions he or she exercises discretion. Decision control is the means by which managers either ratify or monitor decisions. A second device that organizations have created to control employee behavior is the use of periodic performance evaluation systems. Accounting safeguards the organization's physical assets from agency costs; employee embezzlement, theft, and more. Usually the accounting function is performed independently of the assets or people it is monitoring.

## RESPONSIBILITY BUDGETING

In many organizations the primary instrument of management control is *responsibility budgeting*, which embraces both the formulation of budgets and their execution. In responsibility budget formulation, an organization's policies, the results of all past policy (*capital budgeting*, see Thompson, forthcoming) decisions, are converted into financial targets that correspond to the domains of administrative units and their managers (Anthony and Young, 1995: 19). In responsibility budget execution, operations are monitored and subordinate managers evaluated and rewarded.

Responsibility budgeting is as much organizational engineering as it is cost accounting. Like large organizations themselves, it is a product of the bureaucratic revolution. Large organizations are justified by *economies of scale and scope*. Economies of scale are produced by spreading fixed expenses over higher volumes of output, thereby reducing unit costs. Economies of scope are produced by exploiting the division of labor—sequentially combining highly specialized functional units in multifarious ways to produce a variety of products. Large organizations are made possible by hierarchy and bureaucracy. Bureaucracy breaks tasks down into their simplest component parts and recombines them to produce complex goods and services, allocates scarce resources to adminis-

trative units, and formulates organizational strategies (Chandler, 1962; Rosenberg and Birdsall, 1986).

Under responsibility budgeting, work is arranged into administrative units according to *mission, function, and/or region*. An organization's administrative units and their relationships to each other—the structure depicted in organization charts—constitute its administrative structure. Responsibility budgeting requires authority and responsibility to be allocated to individuals within the organization. This constitutes an organization's *responsibility structure*. Finally, responsibility budgeting requires a system of measuring and evaluating performance—information on inputs, costs, activities, and outputs. This is the organization's *account or control structure*. Under a fully developed responsibility budgeting and accounting system, administrative units and responsibility centers are coterminous and fully aligned with the organization's account structure, since the information it provides can be used to coordinate unit activities as well as to influence the decisions of responsibility center managers.

Under responsibility budgeting, two basic rules govern organizational design. First, organizational *strategy* should determine structure. Strategy means the pattern of purposes and policies that defines the organization and its missions and that positions it relative to its environment. Single mission organizations are supposed to be organized along functional lines; multimission organizations are supposed to be organized along mission lines; multimission, multifunction organizations are supposed to be organized along matrix lines. Where a matrix organization is large enough to justify an extensive division of labor, responsibility centers are supposed to be designated as either mission or support centers, with the latter linked to the former by a system of internal markets and prices (*transfer pricing*).

The second basic rule is that the organization should be as decentralized as possible. Most students of management believe that the effectiveness of large, complex organizations improves when authority and responsibility are delegated down into the organization. Of course, authority should not be delegated arbitrarily or capriciously. Decentralization requires prior clarification of the purpose or function of each administrative unit and responsibility center, procedures for setting objectives and for monitoring and rewarding performance, and an account structure that links each responsibility center to the goals of the organization as a whole.

As we noted elsewhere (Thompson and Jones, 1986),<sup>1</sup> the biggest difference between government budgets and responsibility budgets is that government budgets tend to be highly detailed spending or resource acquisition plans, which must be scrupulously executed just as they were approved; in contrast, operating budgets in the private sector are usually sparing of detail, often consisting of no more than a handful of financial targets. Indeed, the originator of what we now call responsibility budgeting, General Motors' Alfred P. Sloan, believed that it was *inappropriate*, as well as unnecessary, for top managers at the corporate level to know much about the details of responsibility center operations

(Womack, Jones, and Roos, 1990: 40–41). If the numbers on sales, market share, inventories, and profit showed that performance was poor, that meant it was time to change the responsibility center manager. Responsibility center managers showing consistently good numbers got promoted, ultimately to headquarters.

This notion that responsibility centers should be managed objectively by the numbers from a small corporate headquarters reflects the effort to delegate authority and responsibility down into the organization. As the OECD report, *Budgeting for Results: Perspectives on Public Expenditure Management* (1995), explains, delegation of authority means giving agency managers the maximum feasible authority needed to make their units productive—or, in the alternative, subjecting them to a minimum of constraints. Hence, delegation of authority requires operating budgets to be stripped to the minimum needed to motivate and inspire subordinates. Under responsibility budgeting the ideal operating budget would contain a single number or performance target (e.g., a production quota, a unit cost standard, or a profit or return on investment target) for each administrative unit/responsibility center.<sup>2</sup>

### Types of Responsibility Centers

Responsibility centers are usually classified according to two dimensions:

- The integration dimension—that is, the relationship between the responsibility center’s objectives and the overall purposes and policies of the organization;
- The decentralization dimension—that is, the amount of authority delegated to responsibility managers, measured in terms of their discretion to acquire and use assets.

On the first dimension, a responsibility center can be either a *mission center* or a *support center*. The output of a mission center contributes directly to an organization’s objectives or purpose. The output of a support center is an input to another responsibility center in the organization, either another support center or a mission center.

On the decentralization dimension, accountants distinguish among four types of responsibility centers based on the authority delegated to responsibility managers to acquire and use assets.<sup>3</sup> *Discretionary expense centers*, the governmental norm, are found at one extreme and *profit and investment centers* at the other. A support center may be either an expense center or a profit center. If the latter, its profit is the differences between its costs and its “revenue” from “selling” its services to other responsibility centers.<sup>4</sup> Both profit and investment centers are usually free to borrow, and investment centers are also free to make decisions about plant and equipment, new products, and other issues that are significant to the long-run performance of the organization.

Discretionary expense centers incur costs. The difference between them and other kinds of responsibility centers is that their managers have no independent authority to acquire assets. Each acquisition must be authorized by the manager’s

superiors. In the U.S. system, under detailed line-item budgets, acquisitions must be authorized by Congress and signed into law by the president. But all discretionary expense center managers are accountable for compliance with an asset acquisition plan (expense budget), whether written into law or not. Once acquisitions have been authorized, discretionary expense center managers are usually given considerable latitude in their deployment and use. In some cases, expense center managers are evaluated in terms of the number and type of activities performed by their center. Where each of the activities performed by the center earns revenue or is assigned notational revenue (*transfer price*) by the organization's controller, these centers are referred to as *revenue centers*. University development offices are frequently revenue centers. Managerial accountants generally believe that unit should be set up as a discretionary expense center only where there is no satisfactory way to match its expenses to final cost objects, as in an accounting department.

In a *cost center*, the manager is held responsible for producing a stated quantity and/or quality of output at the lowest feasible cost. Someone else within the organization determines the output of a cost center—usually including various quality attributes, especially delivery schedules. Cost center managers are usually free to acquire short-term assets (those that are wholly consumed within a performance measurement cycle), to hire temporary or contract personnel, and to manage inventories. In a *standard cost center*, output levels are determined by requests from other responsibility centers, and the manager's budget for each performance measurement cycle is determined by multiplying actual output by standard cost per unit (see above). Performance is measured against this figure—the difference between actual costs and the standard. In a *quasiprofit center*, performance is measured by the difference between the notational revenue earned by the center and its costs. For example, let's say a hospital's department of radiology performed 500 chest X-rays and 200 skull X-rays for the department of pediatrics. The notational revenue earned was \$25 per chest X-ray ( $500 = \$12,500$ ) and \$50 per skull X-ray ( $200 = \$10,000$ ), or \$22,500 total. If the radiology department's costs were \$18,000, it would earn a quasiprofit of \$4,500 ( $\$22,500 - \$18,000$ ).

In large complex organizations in the private sector, most individual production units are standard cost centers; most staff units are discretionary expense centers.

In *profit centers*, managers are responsible for both revenues and costs. Profit is the difference between revenue and cost. Thus, profit center managers are evaluated in terms of both the revenues their centers earn and the costs they incur. In addition to the authority to acquire short-term assets, to hire temporary or contract personnel, and to manage inventories, profit center managers are usually given the authority to make long-term hires, set salary and promotion schedules (subject to organization wide standards), organize their units, and acquire long lived assets costing less than some specified amount.

In *investment centers*, managers are responsible for both profit and the assets



used in generating the profit. Thus, an investment center adds more to a manager's scope of responsibility than does a profit center, just as a profit center involves more than a cost center. Investment center managers are typically evaluated in terms of return on assets (ROA), which is the ratio of profit to assets employed, where the former is expressed as a percentage of the latter. In recent years many have turned to economic value added (EVA), net operating "profit" less an appropriate capital charge, which is a dollar amount rather than a ratio.

### Transfer Pricing

Under responsibility budgeting, support centers provide services or intermediate goods to other responsibility centers in return for a notational transfer price. Reasons for transfer pricing within organizations include determining the costs of services provided by one unit to another, establishing and manipulating incentives, and measuring the performance of responsibility centers. Transfer pricing also reveals the internal costs of service decentralization where costs are born to transfer decision rights to others within an organization. When one subunit transfers goods, knowledge, skills, and more to another, both units calculate the cost as a means of revealing their liquid and tangible asset use internally and in external provision of service.

Several transfer-pricing methods may be used. First, market price reflects the external market price. Second, if no external market exists marginal or variable costs may be used. A third method is based upon full cost of the service or product. A fourth method commonly used involves the buyers and sellers negotiating a price. In summary, transfer pricing involves decentralization and formation of means for measurement and reporting of the costs of services provided between centers where organizations are structured to take advantage of specialized knowledge and other factors including locational conditions. Center managers must be allowed to make decisions and to be held responsible not for the optimality of each decision but, for overall division performance.

The circumstances that justify large complex organizations—economies of scale and scope—also render transfer pricing problematical, however.<sup>5</sup> Scale economies are usually the result of large, lumpy investments in specialized resources—technological knowledge, product specific research and development, or equipment. These investments tend to give rise to bilateral monopoly, a circumstance that provides an ideal environment for opportunistic behavior on the part of suppliers and customers. For example, once an intermediate product producer has acquired a specialized asset, customers may be able to extract discounts by threatening to switch suppliers. In that case, the supplier may find it necessary to write off a large part of the specialized investment. Or, if demand for the final good increases greatly, the intermediate product supplier may be able to extort exorbitant prices from customers. Hence, where the relationship between intermediate product supplier and customer is at arm's length, opportunistic behavior may eliminate the payoff to what would otherwise be cost-effective investments.

The new economics of organization tells us that vertical integration occurs because it can mitigate this problem, in part through the substitution of direct supervision for indirect influence (Williamson, 1985). For example, in a study of the U.S. aerospace industry, Scott Masten (1984) demonstrated that specialized investments are critical to vertical integration. Where intermediate products were both complex and highly specialized (used only by the buyer), there was a 92 percent probability that they would be produced internally; even 31 percent of all simple, specialized components were produced internally. The probability dropped to less than 2 percent if the component was unspecialized, regardless of its complexity.

Unfortunately, the problems that arise in arm's length transactions where there are few alternative suppliers/customers also arise where one attempts to replicate free market forces within the organization, allowing buying and selling responsibility centers complete freedom to negotiate prices (*laissez-faire transfer pricing*). Traditionally economists have argued that services should be transferred at *marginal* or *incremental cost* to the buying responsibility center. But this can seriously distort the evaluation of support center performance and tend to eliminate incentives to improvement. As a result, organizations face a serious dilemma. They can maximize short-run performance by using marginal cost in internal transactions, thereby seriously distorting divisional performance measurement and incentives, and, consequently, suffer shortfalls in long-run performance. Alternatively, they can sacrifice short-term performance by relying on *laissez-faire transfer pricing*, thereby obtaining superior measures of divisional contributions to organizational performance, and improve the chances of maximizing performance in the long term.

Nowadays, many economists allege that bilateral monopoly can be governed satisfactorily by *unbalanced transfer prices*,<sup>6</sup> *multipart transfer prices*, or *quasivertical integration*, in which the buyer invests in specialized resources and loans, leases, or rents them to their suppliers. Quasivertical integration is common in both the automobile and the aerospace industries, and, of course, it is standard procedure for the Department of Defense to provide and own the equipment, dies, and designs that defense firms use to supply it with weapons systems and the like (Monteverde and Teece, 1982). Other organizations that rely on a small number of suppliers or a small number of distributors write contracts that constrain the opportunistic behavior of those with whom they deal.

In still other cases, desired outcomes can be realized through alliances based on the exchange of hostages (e.g., surety bonds, exchange of debt or equity positions) or just plain old-fashioned trust based on long-term mutual dependence. Toyota, for example, relies on a few suppliers that it nurtures and supports (Womack, Jones, and Roos, 1990; *The Economist*, Oct. 18, 1986: 71). They have substantial cross-holdings in each other, and Toyota often acts as its suppliers' banker. Toyota maintains tight working links between its manufacturing and engineering departments and its suppliers, intimately involved them in all aspects of product design and manufacture. Indeed, it often lends them personnel

to deal with production surges, and its suppliers accept Toyota people into their personnel systems.

Toyota's suppliers are not completely independent companies, having only a marketplace relationship to each other. In a very real sense, they all share a common purpose and destiny. Yet, Toyota has not integrated its suppliers into a single, large bureaucracy. Its suppliers remain independent companies with completely separate books—real profit/investment centers, rather than merely notational ones—selling to others whenever possible. Toyota's solution to the bilateral monopoly problem appears to work just fine, however (Womack, Jones, and Roos, 1990). In fact, with the exception of unbalanced transfer prices, none of the solutions to the bilateral monopoly problem noted here presumes vertical integration. All that is required full access to cost and production information (Milgrom and Roberts, 1992).

## RESPONSIBILITY BUDGETING IN GOVERNMENT

The origins of responsibility budgeting and accounting in government can be traced to the Planning Programming Budgeting System (PPBS) era in the U.S. Department of Defense (1961–1967). Responsibility budgeting and accounting was the centerpiece of Project Prime, perhaps the most promising of the organizational design and development efforts initiated under Secretary of Defense Robert McNamara. Project Prime was the brainchild by Robert N. Anthony (Juola, 1993: 43–44), who succeeded Charles Hitch as defense controller in September 1965. Anthony saw the need for clarification of the purpose of each of the administrative units that comprised the Department of Defense, their boundaries, and their relationships to each other, and for an account structure that would tie the entire organization together. Anthony (1962) proposed that the Department of Defense:

- classify all administrative units as either mission or support centers.
- charge all costs accrued by support centers—including charges for the use of capital assets and inventory depletion—to the mission centers they serve.
- fund mission centers to cover their expected expenses—including support center charges.
- establish a working capital fund to provide short-term financing for support units.
- establish a capital asset fund to provide long-term financing of capital assets and to encourage efficient management of their acquisition, use, and disposition.

The principal formal device by which a measure of intraorganizational decentralization was and is accomplished within the U.S. Department of Defense is the revolving fund. These funds involve buyer-seller arrangements internal to the Department of Defense. They have actually been in use for some time. The Navy had a revolving fund as early as 1878. Modern-day revolving funds date

to the 1947 National Security Act, which authorized the defense secretary to use them to manage support activities within the Department of Defense. Two kinds of funds have been established under this authority: stock and industrial funds. Stock funds are used to purchase supplies in bulk from commercial sources and hold them in inventory until they are supplied to the customer—usually a military unit or facility. Industrial funds are used to purchase industrial or commercial services (e.g., depot maintenance, transportation, etc.) from production units within the Department of Defense. Both kinds of funds are supposed to be financed by reimbursements from customers' appropriations (Juola, 1993: 43).

Anthony's proposal would have expanded the scope of this device and enhanced its effectiveness by establishing rules for setting transfer prices prospectively rather than retrospectively and by making support center managers responsible for meeting explicit financial targets. Internal buyer-seller arrangements encourage efficient choice on the part of support centers, as well as the units that use their services, only if prices are set ahead of time and support centers charge all of their costs against revenues earned delivering services. Furthermore, their managers must be fully authorized to incur expenses to deliver services, and held responsible for meeting the stated financial goals of their centers (Bailey, 1967: 343).

Project Prime failed. One reason for its failure is that the federal government of the United States accounts for purchases, outlays, and obligations, but it still does not account for consumption.<sup>7</sup> Full value from the application of responsibility budgeting can be obtained only where government adopts a meaningful form of consumption or *accrual* accounting (measuring the cost of the assets actually consumed producing goods or services). Because the U.S. government does not account for resource consumption, its cost figures are necessarily statistical in nature (i.e., they are not tied to its basic debit and credit bookkeeping/accounting records). Without the discipline that debit and credit provides, these figures are likely to be satisfactory only for illustrative purposes or where a decision maker must make a specific decision and a cost model has been tailored to the decision maker's needs. Another reason for the failure of Project Prime is that U.S. appropriations process does not perform the capital budgeting function satisfactorily, a problem that PPBS did not really address and certainly didn't fix. Besides which, the existing process procrusteanizes every operating cycle to fit the fiscal year.

Responsibility budgeting next surfaced in the United Kingdom, as part of the Thatcher government's *Financial Management Initiative*, which was announced May 17, 1982 (Pollitt, 1993; Lapsley, 1994). The Financial Management Initiative called for a radical change in the internal structure and operations of government agencies. Objectives were to be assigned to responsibility centers, within which costs would be systematically identified to enable those responsible for meeting particular objectives to be held responsible for the cost of the resources they were consuming. Costs were to be measured on an accrual basis

(i.e., matching resources consumed to services delivered) and include not only the direct costs of service delivery but overheads as well.

The scope of responsibility accounting and budgeting in the U.K. was further extended in 1988 by the Thatcher government's *Next Steps Initiative*. In the last eight years, much of the British civil service has been reorganized into a set of *executive agencies* that have been given considerable administrative and fiscal flexibility and expected to meet annual financial performance targets. The heads of these executive agencies are no longer career civil servants. They are recruited from either the private sector (about 25 percent) or public sector, hired on short-term contracts, with pay and tenure contingent on their success in meeting annual performance targets. By April 1996, there were 125 executive agencies in the U.K., with thirty-seven more candidates under consideration, covering about 75 percent of the British civil service (Roberts, 1997).

Following the launch of the Financial Management Initiative in Great Britain, other governments—Australia, Canada, Denmark, Finland, and Sweden—have adopted responsibility budgeting and accounting. None, however, has moved as far or as fast as New Zealand. Moreover, New Zealand's reformers explicitly recognized their debt to agency theory (Boston et al., 1996).

## New Zealand

Most of the external attention given to New Zealand's public management reforms has focused on its efforts to improve the quality of external financial reporting practices: the adoption of accrual accounting and reporting on performance. New Zealand was the first country to publish a full set of government accounts, including a balance sheet of assets and liabilities and an accrual-based operating statement of income and expenses. However, the changes made in the structure of the government of New Zealand designed to promote effective resource use and investment are even more significant than are its changes in financial reporting practices.<sup>8</sup> First of all, New Zealand's Parliament privatized everything that was not part of the *core public sector*. The residual core public sector now includes a mix of policy and regulatory and operational functions and the military services, policing and justice services, social services such as health, education, and the administration of benefit payments, research and development, property assessment, and some other financial services.

Second, Parliament redefined the relationship between it and the heads of government agencies. Agency heads lost their permanent tenure and are now known generically as "chief executives." They are appointed for fixed terms of up to five years, with the possibility of reappointment. Each works to a specific contract, the conditions of which are negotiated with the State Services Commission and approved by the prime minister. The State Services Commission also monitors and assesses executive performance. Remuneration levels are directly tied to performance assessment.

Third, Parliament changed the way it appropriates funds for use by the re-

maining government agencies to link appropriations to performance, allowing Parliament fiscal control, but, at the same time, providing greater fiscal flexibility for agency heads. The basis of appropriation depends on the agency's ability to supply adequate information about its performance. Three modes of appropriation are possible, recognizing that some agencies provide goods and services that are more commercial or contestable than others.

All agencies started out in Mode A, but most have now progressed either to Mode B or C. Under Mode A, agencies are still treated as discretionary expense centers. Parliament appropriates funds for the purchase of resources. Indeed, the only change from the budget process in effect before 1989 (or, for that matter, the budgets used by most governments throughout the world) is that separate appropriations were provided for expenditures for plant and equipment. This mode remained in force until the agency developed a satisfactory accrual accounting system and identified its outputs, both of which are needed for performance assessment.

Under Mode B, agencies are treated like cost or quasiprofit centers. This mode is designed for agencies that supply traditional, noncontestable, governmental services: the central control agencies, including the State Services Commission, most regulatory and police functions, and some justice services, i.e., policy agencies and activities that include an element of compulsion for the buyer. Under this mode, Parliament appropriates funds retrospectively to reimburse agencies for expenses incurred in producing outputs during the period covered by the contract, whether for the government or third parties. Costs are measured on an accrual basis; they include depreciation but exclude taxes and the return on funds employed. Changes in an agency's net asset holdings are also explicitly appropriated.

Under Mode C, agencies are treated like investment centers. Appropriations pay for the outputs produced by the agency and for any changes in the agency's net assets. Agencies in Mode C are required to pay interest, taxes, and dividends and must establish a capital structure. Mode C agencies are set up in a competitively neutral manner so that their performance can be assessed by comparison with firms in the private sector. The prices paid for the outputs supplied by Mode C agencies are supposed to approximate fair market prices. In general, this means that agencies must show that they are receiving no more than the next best alternative supplier would receive for providing the outputs. Mode C agencies are not permitted to borrow on their own behalf nor to invest outside their own areas of operation. Each month, each agency reports on its financial position and cash flow and resource usage and revenue by output. Variances are calculated and explanations provided. Under both Modes B and C, managers are free to make some decisions (under C most) about investments in plant and equipment. The fact that their financial performance is one of the main bases upon which managerial performance is assessed helps to ensure that those decisions will be sound.

The government's key decisions remain firmly in the hands of Parliament.

The decisions that have the most significant future consequences for the government of New Zealand's stakeholders are clearly those that have to do with the kind, quantity, and quality of service provided by the citizenry. Under the existing system of appropriations and financial reporting, those issues must be explicitly confronted when the cabinet enters into long-term contracts with agencies, state-owned enterprises, and firms to deliver service outputs, and its consequent liabilities must be stated in present value terms.

### **The United States**

Responsibility budgeting and accounting has held little or no practical effect in this country, although it was adumbrated in the United States and influenced the now defunct Defense Management Report Initiatives of the Bush/Cheney era in the Department of Defense, and arguably the content of both the Chief Financial Officers Act and the National Performance Review's call for *performance-based organizations* and mission driven, results-oriented budgets (OECD, 1995: 230).

There are two explanations for this fact. The first is that many students of the expenditure process reject the notion that responsibility budgeting and accounting can be reconciled with the American legislative budgetary process. Some people even assert that it can be practiced only by responsible unitary governments on the Westminster model, although that claim seems to be belied by the Swiss and Swedish examples (Schedler, 1995; Arwidi and Samuelson, 1993). Of course, it would not be easy to reconcile responsibility budgeting and the American legislative process, but we do not believe that they are necessarily incompatible either (see Thompson, 1994; Harr, 1989; Harr and Godfrey, 1991, 1992). The second explanation for its failure to influence significantly government accounting and budget practices in the United States is that, unlike most other countries, America has large, well-organized associations of government accountants, auditors, budgeters, program analysts, and teachers of government accounting and budgeting. All of these groups have a vested interest in differentiating public from private practice, because that difference gives value to their expertise. Anyone inclined to doubt the significance of this explanation should look carefully at the politics of FASB.

### **CONCLUSION: WHAT GOES AROUND, COMES AROUND**

It is somewhat ironical that governments are beginning to embrace responsibility budgeting at the same time many well-managed businesses are abandoning it (Bruggeman, 1995; Otley, 1994; Bunce, Fraser, and Woodcock, 1995). Businesses have abandoned responsibility budgeting because it no longer reflects the way they are organized. These organizational changes are, we believe, primarily due to the information revolution, which is eliminating economies of scale and giant organizations built upon functional specialization and minute

divisions of labor. Indeed, Michael Hammer, argues in an article in the *Harvard Business Review* that the use of modern databases, expert systems, and telecommunications networks now provides many, if not all, of the benefits that once made administrative centralization and specialization of administrative functions such as reporting, accounting, personnel, purchasing, or quality assurance attractive, without sacrificing any of the benefits of decentralization. He asserts that jobs should be designed around an objective or outcome instead of a single function—that functional specialization and sequential execution are inherently inimical to expeditious processing; that those who use the output of activity should perform the activity and the people who produce information should process it, since they have the greatest need for information and the greatest interest in its accuracy; that information should be captured once and at the source; that parallel activities should be coordinated during their performance, not after they are completed; and last, that the people who do the work should be responsible for decision making and control built into job designs (Hammer, 1990: 108–112).

This has led to smaller, flatter organizations. Some single-mission organizations are now organized as *virtual networks*; some multimission organizations as *alliances of networks*. Philip Evans and Thomas Wurster refer to both of these kinds of organizational arrangements as *hyperarchies*, after the hyperlinks of the World Wide Web (Evans and Wurster, 1977). Evans and Wurster assert that these kinds of organizations, like the Internet itself, the architectures of object-oriented software programming, and packet switching in telecommunications, have eliminated the need to channel information, thereby eliminating the tradeoff between information bandwidth (richness) and connectivity (reach). They describe virtual networks (structures designed around fluid, team-based collaboration within the organization) as deconstructed value chains and alliances of networks (the pattern of “amorphous and permeable corporate boundaries characteristic of companies in the Silicon Valley”) as deconstructed supply chains, in which “everyone communicates richly with everyone else on the basis of shared standards.”

The system used by IBM at its plant in Dallas, Texas, is an example of an existing virtual network. It has been designed to mimic a market-like, self-organizing system. Everyone in the organization plays the part of customer or provider, depending on the transaction, and the entire plant has been transformed into a network of dyads and exchanges. Each exchange is a closed loop involving four distinct steps: request from a customer and offer from a provider, negotiation of the task to be performed and the definition of success, performance, and customer acceptance. Until this last step is completed, the task remains unfinished. Each closed loop of workflow is further broken down into subloops. Under this system, even simple tasks give rise to dozens of loops and interconnecting lines; more complex tasks, such as modifying a major product, to hundreds; and managing the entire Austin plant to thousands. IBM uses powerful computers to keep track of all of these loops and lines, to chart all activities



**Table 7.1**  
**Nonfinancial Performance Indicators**

PERCENTAGE OF ON-TIME SERVICE  
 SERVICE COMPLETENESS  
 MEETING PRODUCTION SCHEDULES  
 INVENTORY MEASURES  
 EMPLOYEE TURNOVER  
 SERVICE QUALITY  
 PERCENTAGE OF ERRORS  
 CUSTOMER SATISFACTION

and operational flows within the plant, to keep track of progress being made at each stage of each transaction, and to prod tardy participants into action.

The effect of this system has been to break down departmental boundaries, eliminate bottlenecks, and to empower employees to take initiatives and coordinate themselves. As a by-product, the computer systems that keep track of all these loops and lines also identify the resources going into a particular job, almost entirely eliminating the need for cost allocation. Moreover, this information is available both prospectively and retrospectively to anyone in the organization.

Some well-managed multimission organizations such as Johnson & Johnson, 3M, and Rubbermaid have already organized themselves into loose alliances of networks, sharing only their top management, a set of core competencies, and a common culture (Quinn, 1992). The control systems used by these organizations are like those of centralized bureaucracies in that they collect a lot of real-time information on every aspect of operations, including nonfinancial information (see Table 7.1), but unlike the control systems of centralized bureaucracies, which were erected on the premise that the exercise of judgment should be passed up the managerial ranks, this information is used to push the exercise of judgment down into the organization, to wherever it is needed, at the point of sale, at delivery, or in production (Simons, 1995). From top management's perspective, the primary purpose of this information is to provide them with insight into the integrity, competence, and morale of their network managers and employees so that they can allocate their best people to the most important jobs.

How far hyperarchy will go is an open question. Evans and Wuster (1997) claim that it challenges all hierarchies, whether of logic or of power, "with the possibility (or the threat) of random access and information symmetry." But they don't stop there. They further claim that hyperarchy will also turn markets on their heads owing to the possibility that far richer information can be ex-

changed than is currently the case when exchanging goods, services, or certificates of ownership. So far, however, the effect of the information revolution has been somewhat asymmetrical. Given that the choice of governance structure resolves primarily to a question of hierarchy or market, the information revolution has clearly favored the latter (Reschenthaler and Thompson, 1996).

On a more mundane plane, recent changes in the way work is organized have already affected cost measurement. Everyone knows that the information revolution has greatly reduced information costs, including the cost of measuring costs. But its implications for management control are now only beginning to be understood. Control once focused on flows per period—on products produced, functions performed, expenses incurred, profits, or earnings. Capital budgeting has always been project-oriented, with each project having an identifiable beginning and an end. Nevertheless, controllers viewed projects (megaprojects aside) primarily in terms of their consequences for period flows. In turn, this perspective reflected the fact that organizations used sequential processes, repetitive activities, and standardized components to produce like products.

In contrast, under flexible production, jobs are tailored to the preferences of specific market segments and treated as discrete projects. Consequently, control necessarily focuses on projects. This means that cost analysts have had to shift their attentions to projects and job cycles—product life, product development, manufacturing, treatment, and more (Thompson, 1995). Consequently, in networked, flexible production organizations, the distinction between capital and operating budgets has blurred, as has the distinction between cost estimation and cost measurement (Tani, 1995; Otley, Broadbent, and Berry, 1995).

These changes have also given us a new perspective on responsibility budgeting. It is now apparent, as it really was not before, that responsibility budgeting and accounting systems restrict the upward flow of operating information within the organization—making decentralization a necessity as well as an ideal. Responsibility budgeting is essentially a form of internal and external contracting wherein costs of services to meet mission requirements are negotiated. Decision units are then held accountable for execution of their budgets to fulfill the commitments agreed to in the negotiation process. Responsibility budgeting employs explicit contracting between units for the provision of specific services or goods in exchange for financial resources for operation and capital acquisition necessary for production. The distinguishing elements of responsibility budgeting are (a) the evaluation of units and managers relative to the contract obligations they accept, (b) the exclusive use of financial measures to intended to reward accomplishment and punish failure, and (c) identification and attribution of financial success or failure entirely to managerial decisions and/or employee performance.

In networks and alliances, people work in information-rich environments. For the most part, access to information is symmetrical (equally available to all). Decentralization can work in such an environment only where top management attends to top management functions—strategic planning, organizing, staffing,

the intellectual and cultural development of the organization—and refrains from meddling in the conduct of operations. This takes practice and self-restraint.

For that reason, it may make sense for governments to experiment with responsibility budgeting rather than going directly to the new modes of organization and control. Few have had much experience with decentralization, and almost none with self-restraint. As is often the case, it may be necessary to walk before learning to run (Johansen, Jones, and Thompson, 1997).

## NOTES

1. This article also distinguished between *ex ante* and *ex post* controls, a notion that is central to the exposition in *Budgeting for Results*.

2. It is very important that targets be stated in monetary terms, both to compare the performance of unlike responsibility centers and to keep higher levels of administration ignorant of operating details, thereby discouraging them from meddling in the affairs of their responsibility center managers.

3. This section is based on the discussion in Anthony and Young, 1995.

4. Selling is in quotation marks here because the organization as a whole has not sold anything to an outside party. Rather, the responsibility center providing the service records revenue in its accounts, and the center receiving the service records an expense. Both revenue and expense cancel out when the organization consolidates its books. Money rarely changes hands in interdivisional transfer pricing, and responsibility centers don't get to keep "their" profits. Only the organization as a whole earns a profit, and selling to and buying from outsiders are the only activities that can generate real profits or losses for the organization.

5. When factors enter into joint production, they typically develop a degree of specificity with respect to each other. Specificity gives rise to a Williamsonian "Fundamental Transformation" from an *ex ante* competitive relationship to an *ex post* bilateral monopoly (see Joskow, 1988; Milgrom and Roberts, 1992).

6. Under unbalanced transfer prices, the selling responsibility center is credited with the full cost of the transacted item (often standard cost), plus an agreed upon markup, the buying center is charged its marginal cost, and the controller adjusts the organization's accounts to reflect the difference between the two. Unbalanced transfer prices should almost never be used where market prices are available.

7. Justine Rodriguez (1996) would fix this problem by creating a new set of accounts along the lines of the fund accounting systems used by nonprofit schools and hospitals. For example, each department could have one or more *capital asset acquisition accounts*. Outlays to acquire capital assets would be charged to these accounts, which would hold assets but perform no operations. These accounts would also be permitted to borrow from Treasury to acquire assets. The assets they held would be rented/leased to programs, so each program account would show the cost of using assets, but this rent would net out of department totals because of offsetting collections to capital acquisition accounts. In cases where large inventories were acquired, they could be held by intragovernmental support revolving funds (e.g., franchise or working capital accounts) and sold just in time to programs. There are already employee pension funds that receive accrual payments from departments, although not always from programs and not always for the full accrual amount. These lacunae could be remedied and retiree health benefits treated the

same way. Similarly, Rodriquez argues that we could require clean-up liabilities be paid to an account that would finance future environmental restoration. To connect resources with results, program budget accounts would be aligned with programs providing goods, services, and transfers to the public. Support budget accounts (e.g., for personnel, legal, and computer services) would be financed by intragovernmental support revolving funds. Under this system, nearly all resources, except perhaps those to the agency head for policy coordination, would go to the programs, which would buy their support competitively from their own department, from other departments, or from the private sector. Program outlays would then approximate program costs and could then be fairly related to program outputs.

8. The following is based on Scott, Bushnell, and Sallee, 1990.

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# Budget Theory for Public Administration . . . and Public Administrators

Gerasimos A. Gianakis and Clifford P. McCue

This chapter outlines an approach to the development of budget theory in public administration that characterizes its subject matter as the internal resource allocation process of the public organization—an organization that operates in a highly political environment and whose boundaries are quite permeable, particularly during the formal budgetary process. This approach reflects the assumption that as an applied field public administration should seek to develop theories that have utility for public managers. Such theories should identify possibilities for, and constraints on, action, or illuminate the nature of the action environment of public management. The development of practical budget theory in public administration is facilitated if the field views the budget process from the perspective of the public management practitioner. Practitioners practice in public organizations; the structure, culture, processes and procedures of the public organization, and its network of environmental relationships define the action environment of the managers that it houses.

The second assumption reflected in this approach is that as a “borrowing field” public administration should seek to develop a focus to synthesize its borrowings and define itself as a unique discipline. Without a unique focus the field simply duplicates the theories and concepts developed in other disciplines. Public administration is defined here as the study of the organizational arrangements to deliver societal knowledge as public services, given the polity’s preferences for macrosocietal governance structures and political processes. The responsibility for optimizing the “goodness-of-fit” between operational technologies and organizational arrangements for delivering them as public services, and for managing the day-to-day operations of complex organizations point to the need to

borrow from various substantive policy areas, as well as from the range of fields necessary to illuminate organizational functioning. The focus on the operation of public organizations justifies these borrowings, and the development of budget theory will be examined in this context.

The public organization is defined here as the totality of public service delivery systems and administrative support systems in a given political jurisdiction. The variety of service delivery systems that comprise them and the necessary deference that must be paid to substantive expertise in the policy making process mean that public organizations are highly differentiated and very complex systems—so much so that the concept of a single integrated organization can be an evanescent one, particularly at the federal level, where it breaks down completely. The salient characteristics of the public organization are described in more detail in the next section, and the extent to which state and local budgeting may differ from federal budget and, hence, may require different approaches to theory development is also explored. This is followed by an examination of traditional budget theory, which has tended to focus on the federal level and, hence, has ignored the organization-based approach and has not produced theory that has utility for practitioners. The chapter closes with an exploration of the implications that the organization-based approach holds for the development of descriptive/explanatory theory, assumptive theory, normative theory, and instrumental theory in public administration (Bailey, 1968).

## THE PUBLIC ORGANIZATION

The federal government is a huge enterprise comprised of a variety of organizations, each of which enjoys a degree of autonomy from the authority of the chief executive due to enabling legislation, structural arrangements, or practical considerations. For research purposes, these agencies can be approached as independent political actors rather than as elements of a single organization. Local government agencies may also be more tightly coupled with their individual operating environments and political constituencies than with one another, but they are more often than not members of a single organization under the authority of a single executive. States manifest structural characteristics of both the federal and the typical local government. The executive authority of the governor usually weakens as the number of elected state officials increases. The local government organization is also strengthened by the fact that legislators are typically part-time politicians, and the legislative body does not usually have access to an independent analytical capacity—such as the Congressional Budget Office or the General Accounting Office. The requirement that local budgets must balance also calls for a stronger managerial hand.

Although the local government public organization is an identifiable organization, it is a highly differentiated one. Individual agencies respond to particular constituencies and employ specific perspectives in what is a highly decentralized policy making process due to the necessary deference to substantive expertise



in decision making. The weakly integrated organization is highly permeable to the political environment, and it is subject to enormous centrifugal forces. These forces inevitably constrain the allocative efficiency of the resource allocation process. The allocation scheme can become purely a function of political power and in-fighting rather than the product of a consensus view regarding the actual needs of the jurisdiction; in short it comes to resemble the federal process.

However, the local government organization is coupled on one dimension that is substantially under the control of the executive: the resource allocation process. The formal budget process is the only time that the individual agencies that comprise the local government organization must acknowledge that they are members of the same organization. Other centralized staff functions such as personnel, finance, or data processing can be approached as staff functions of the individual agency. The centrality of the Congress in the federal budget process, coupled with the absence of the requirement to balance, makes this acknowledgment less likely, or even relevant, at the federal level. The chief executive of the local government organization can control the format of the formal budget process and the presentation to the legislative body, as well as the timing of public hearings. The chief executive also exerts strong influence on other facets of the resource allocation system: the revenue forecasting process, the fund structure of the jurisdiction and the operation of internal service funds, fund balance targets, debt policies, economic development programs, the capital budget process, supplemental appropriations, level of budgetary control, as well as the initial determination of the balancing point.

The emphasis on an integrated organization under a single executive does not mean that the authors call for simply moving the focus of budget research from the politics of the formal budget process to the techniques involved in the preparation of the executive budget document, which some have contended may be fertile ground for budget theory building (Cope, 1989). The executive budget merely summarizes the outcomes of the public organization's resource allocation processes for presentation to the formal budget process. Neither the formal budget process nor the executive budget process captures the continuous nature of the resource allocation process—a characteristic that is only just beginning to be recognized by budget theorists (Rubin, 1993; Forrester and Mullins, 1992). The resource allocation process of the public organization is characterized by a continuous series of disaggregated, overlapping, and fragmented, but nevertheless interdependent, parallel decision sequences (Rubin, 1993).

The formal budget process and the executive budget provides no more than a summary snapshot of the dynamic interrelationships of these dimensions of the resource allocation process. The structure and environmental relationships of the public organization, however, provide a locus for viewing their interactions. This view also allows one to determine whether these interactions yield allowances, that are directed to the actual needs of the community. This will help realize the promise of professional public management for efficiency and effectiveness in the delivery of public services.

## TRADITIONAL BUDGET THEORY

Public budgeting has been studied from three, usually divergent perspectives: economics, management, and political science (Caiden, 1990). Studies rooted in economics tend to focus on the nature of public goods and the allocative efficiency of the mix of goods and services provided by government. Various decision rules and allocation processes are examined for their relative utilities in this regard. Recent efforts have sought to construct models of public sector decision making using concepts from micro economics. The specter of the public administrator as the self-interested budget maximizer is a central character in these scenarios. Economics offers logic, mathematical elegance, and simple forms that avoid issues regarding political values, but, economists have “offered remarkably little guidance to the budgeteer of the practical world” (Caiden, 1990: 233).

Political scientists naturally highlight the political dimensions of the resource allocation process, and the budget’s role in the policy making process. The political perspective has been dominated by the theory of incrementalism, which began as a descriptive theory but achieved normative status in some circles. In brief summary, incrementalism holds that budgets change only marginally from year to year, and major reallocations can be costly and should be avoided in light of the state of knowledge regarding public sector policy issues; the resource allocation process is a fragmented, bottom-up process characterized by deference to substantive expertise and previous allocations. The organization-based approach to the development of budget theory focuses on how the nature of the public organization affects the resource allocation process and how the nature of the resource allocation process affects the operations of the public organization.

The public organization is as inescapable on the local level as it is problematic at the federal level, even if it is only weakly coupled on the resource allocation process. This is why practitioners in public organizations experience the budgetary process as the internal resource allocation system of their organizations, rather than as a purely political process. A potentially productive area for research is the prospect for enhancing the capacity of the resource allocation process to serve an integrative role in the public organization. If the salient decision makers in the various service delivery areas are more tightly coupled and share operational perspectives and decision premises, the resource allocation schemes they produce will be more responsive to community needs. Political scientists typically approach public agencies as atomistic political actors in the policy making process, and the organizational dimensions of agency functioning are usually ignored. The less ambitious management school focuses on the relative utility of alternative budget formats, and on the place of analytical techniques and formal policy planning in the budget process.

The prescriptions written from the management orientation are only occasionally based on descriptive or explanatory studies associated with any of the

three perspectives. The management perspective is the one most clearly associated with public administration. Budgeting is approached as a technical process, and public administrators are cast as technicians apart from the organizations in which they work. Theoreticians are able to avoid value issues through this separation, but the development of theory is constrained by the question that has dogged the field from its beginnings: technical efficiency for what end?

One of the reasons that budget theory prescriptions have been divorced from budget theory descriptions is that most of the latter have been based on studies of the federal budget process, and adoption of the former has been more widespread at the state and local level. The substance of the dominant incrementalist description of the national budget process obviously limits the relevancy of management tools, but any descriptive theory of budgeting derived from analysis of the federal process will be of limited relevance to the state and local level. However, state and local budget processes differ widely (Hackbart and Carson, 1993) and, hence, those areas appear to be less promising ones for the development of a single theory of public budgeting than the national budget process. The “grandness” of the theory derived from a focus on the federal government, however, is ultimately dimmed by its limited generalizability to other levels of government.

The conceptual fragmentation that characterizes budget theory reflects the multidimensional nature of the subject (Caiden, 1990), the variety of approaches brought to bear on it (Schick, 1988), and the fragmented structure of the field of public administration in general. Indeed, some theorists view budgeting, itself, as a distinct discipline (Caiden, 1990; Cope, 1989), from which public administration borrows and in which it tinkers. The perspectives and findings of a range of related disciplines regarding a variety of relevant phenomena are imported by public administration but never synthesized to form a unique theoretical perspective. The management perspective on budget theory that public administration calls its own fails to address the allocative efficiency concerns of the economists, the related political issue of distributional equity, or the challenge to the relevancy of analysis posed by the incrementalist model.

Practitioners are left with an impressive array of tools for action but no realistic guides to action. Bailey (1968) contends that instrumental theory—that is, guides to action in specific situations such as those that the management perspective on public budgeting seeks to develop—should be based on normative and descriptive/explanatory studies of the particular phenomena under consideration. However, in the absence of the latter, the management school theorists, including those focusing on the executive budget, tend to ascribe normative status to instrumental theories (Rubin, 1990; Cope, 1989). According to Bailey (1968), normative theory should seek to prescribe future states by identifying the values that should undergird administrative action. These value issues are those that public administration avoids by focusing on techniques rather than on the demands of the environments and the nature of the organizations in which they are employed—that is, on the context of public management. The fact that

budget reforms have been widely adopted by state and local governments (Rubin, 1990) may be quite beside the crucial point: do they help, and what do they help one do?

From the perspective of the practicing public administrator, resource allocation processes serve to create and continuously recreate the public organization. The appropriateness of the goals and technologies is always in question, due to differences in political values and the general lack of cause and effect knowledge regarding many public issues. These goals and technologies are manifested in resource allocation schemes; the budget process can potentially change organizational goals, enable new technologies that have resource allocation implications, and legitimize alternative organizational arrangements. The nature of this process and the basis on which these decisions are made constitute the basic stuff of public management, describe the environment of the practicing administrator, and delineate the theoretical turf of public administration.

Few studies have approached budgeting from this perspective. The most fully developed model is provided by Miller (1991) in his theory of government financial management. Miller builds an interpretive theory of financial management, in which the financial manager must deal with the ambiguity and uncertainty precipitated by the social construction of an organizational reality by a variety of actors manifesting a range of perspectives on, and interpretations of, organizational mechanisms, processes, and other phenomena, such as the budget process. For Miller, traditional financial management theory is based on the assumption that there is considerable consensus about organization goals and technologies in public organizations, and this may not hold for governmental organizations. In this scenario, budget managers manipulate symbols and produce rituals centered on the common element of resource constraints. These serve to bridge the range of alternative visions of the organization's enterprise made possible by the absence of "the widespread notion of 'making a profit'" (Miller, 1991: 101). The budget office becomes a salient organizational actor and a unifying metaphor in an environment characterized by resource scarcity.

Rubin (1979) examined the responses of five state universities to budget cut-backs in an effort to determine the relationship between resource reductions and the organizational concept of "loose coupling." This study was weakened by conceptual confusion regarding the nature of "loose coupling" (Orton and Weick, 1990). Lynch develops an approach to public budgeting that focuses on explaining those aspects of public budgeting involving policy making, management, and the interrelationship of policy and management. With a better theoretical knowledge of that phenomenon, one can use that understanding to argue for change in the way that activities are conducted in a bureaucracy (Lynch, 1989: 325).

However, his model rests at an abstracted "systems" level, which he recognizes may not be intuitively accessible to practitioners. Many theories of organizations tend to reify their subject, and conceptual abstraction may become an issue with any organization-based approach to budget theory. Other studies have

examined organizational dimensions of specific budgeting processes, such as forecasting (Klay, 1985), decision sequencing (Whicker and Sigelman, 1991), the adoption of budget reforms (Rubin, 1990), the supplemental budget process (Forrester and Mullins, 1992), and budget analyst behavior (McCue, 2000; Thurmaier, 1995; Willoughby, 1993). These studies indicate that an important link exists between the structure of the public organization and the nature of the jurisdiction's budget process, and they highlight some of the areas in which organization theory may be able to illuminate that relationship.

## **ORGANIZATION-BASED BUDGET THEORY**

One of the organizational purposes of the budget process is to enhance the capacity of the organization's management to make optimal resource allocation decisions. In pursuit of this end, the resource allocation process should function as a counterweight to the centrifugal forces generated by the highly differentiated nature of multiservice public organizations. Budget formats and processes should be examined for their relative utility in that regard, in light of the existing capacity of the management staff. In addition to the prescription that the resource allocation process should enhance the capacity of the management staff to make optimal resource allocation decisions, it is posited here that the ultimate criterion for determining optimality is the preservation and development of the organization's economic base. The local government organization derives its resources from the economic base of its jurisdiction, and a basic function of professional public management is to maintain the organization's flow of resources.

In this scenario, the resource allocation process of the public organization serves a developmental function for both the internal structure of the organization and its relationship with its external environment. The need to maintain the economic base of the jurisdiction functions as a centripetal force in the public organization, in much the same way as the need to make a profit does in the private sector. This is not to say that the determination of the optimal course of action is not ultimately a function of societal values and political power. The approach outlined herein provides a framework for the development of theory to inform and to guide the actions of the participants, particularly the professional public administrators. Thus, the organization-based approach to budget theory also holds promise for the development of a normative theory of budgeting rooted in the profession of public management.

These issues are examined in this section using Bailey's framework for the objectives of theory in public administration. For Bailey, "four overlapping and interlocking categories of theory are required if improvement in the processes of government are, in fact, to take place: descriptive-explanatory theories, normative theories, assumptive theories, and instrumental theories" (Bailey, 1968: 129). The implications that the organization-based approach to budget theory holds in each of these areas are explored below. "Improvement in the processes of government" is defined here as the maximization of the number of "politically

legitimated goals” that can be achieved within “constitutionally mandated means” (Bailey, 1968: 129); this definition ties professional public administration to enhanced efficiency in the use of public resources; as developed below, the responsibility is not limited to technological efficiency, nor is it only a function of the finance professional.

### **Assumptive Theory**

Bailey defined assumptive theory as “propositions which articulate root-assumptions about the nature of man and about the tractability of institutions” (Bailey, 1968: 133). He decried public administration’s tendency to articulate administrative models and management techniques without due regard for the contexts in which they would be implemented. Although the field has made some progress in describing institutional inertia and in prescribing organizational change processes (or, at least the field of organization theory has made such progress), less progress has been made in understanding and characterizing public organizational man.

Political science and economics tend to de-contextualize public managers. In studies of the public resource allocation process, the public manager is cast as another political or economic actor seeking to maximize his or her own self-interest, and this characterization is reinforced by the tendency to focus on the national resource allocation process, where it is feasible to approach the agencies in which these managers function as individual political actors. Thus, the “budget maximizing bureaucrat” has become a mainstay of budget theory, despite evidence that public managers will often refuse funds tied to the assumption of duties that may compromise their capacity to pursue their organizations’ primary missions (Wilson, 1989), and findings that public managers seek to expand only the discretionary portion of their budgets (Blais and Dion, 1991) or simply seek to maximize the autonomy they require to function as professional managers.

These two caveats indicate the issues on which assumptive theories of public administration should be focused. The budget maximizing bureaucrat is, in part, a default characterization of the public manager in the public resource allocation process, because the field of public administration has developed no alternative. This has left the world of practice open to attack from reformers advocating private sector management techniques or market-based alternatives to public sector provision of core services. The failures of the field to describe public management and managers has meant that they have been described in the negative—as “broken” private management and as venal or incompetent private managers.

The development of assumptive theories in public administration requires that researchers study public managers in the context in which they function—namely the public organization. The authors have taken some care not to tie this polemic on budget theory to any particular paradigmatic approach to social

science research, in part to encourage a dialogue with practitioners, but assumptive theories require researchers to understand practice from the perspective of practitioners. Positivistic research tends to standardize or randomize contexts, and much of the “theory-practice gap” in public administration is due to the dominance and limitations of the positivist paradigm (Harmon, 1981; Miller and King, 1998). Furthermore, studies of “man’s personal and institutional capacity” (Bailey, 1968: 135) in regard to public administration forces the field to face its elemental question: the role of the expert in a democratic society—an issue it has largely sought to escape. Both of these factors have led to an emphasis on the development of de-contextual techniques, rather than the illumination of context. Assumptive theories here call for the definition of a profession and the organizational context in which it is practiced; in this way, personal and institutional capacities are delineated, and the prospects for increasing these capacities are enhanced.

### **Descriptive Explanatory Theories**

Bailey held that “we cannot improve what we cannot describe and explain” (Bailey, 1968: 131). Here he focused squarely on the nature of the organizations in which public administrators practice. What must a budget theory for public administration explain? Research should focus on the determinants of the elements of the budget process broadly defined, as well as the determinants of budgetary outcomes favored by political science and the normative standards for the mix of outcomes targeted by economics. Budget theory for public administration should be able to explain national budget processes in light of society preferences for macropolitical and economic structures, differences in state and local budget processes, as well as differences among national, state, and local processes. Factors influencing the evolution and development of budget systems should also be explored.

A potentially fruitful focus for these efforts is the public organization. The concepts, elements, and issues outlined above can be explored by other disciplines, but the field of public administration should operationalize them in terms of the public organization because that is definitive disciplinary focus of the field. The focus on the public organization will allow the field to develop a contingency theory of resource allocation processes in terms and contexts that are familiar to practitioners. Possible contingent factors include the degree of organizational differentiation and integration, managerial capacity, available technology, and form of government, as well as environmental factors such as political divisiveness, political culture, economic base, and demographic variables.

Public administration is also the field that should target what occurs within the public organization and how organizational process and structures influence budgetary outcomes and processes. The public organization is where the societal history, political and economic structures, political culture, needs for collective

action, and resource capacity, which are the proper study of other disciplines, meet the organizational structure, development, culture, and decision-making capacity that is the proper study of public administration. In the framework described here, the former are operationalized as the environment of the public organization, and public budgeting issues can be approached as the study of the “goodness of fit” between these environmental factors and the public organization’s managerial, operational, and strategic planning subsystems. Organizational factors include the source and substance of the values and predispositions that budget analysts use to evaluate resource requests, the role of the budget process as an organizational communication mechanism through which agency missions and their interrelationships are expressed, the symbolic and latent functions of the formal budget process, and the degree to which the parallel decision processes that comprise the resource allocation process described by Rubin (1993) are integrated and rationalized in the organization.

The thing to be “improved” through this effort to develop descriptive/explanatory theories of the resource allocation process from an organizational perspective is the capacity of the organization’s managers to produce “good” decisions. The nature of this “good” is outlined in the section on normative theory that follows. The development of instruments to pursue this end should be rooted in the descriptive/explanatory theories of the resource allocation functions of public managers operating in public organizations described here. Otherwise, instrumental theories of managerial action are rooted in theories of private management, and they reflect the normative stance the public sector management should simply be made to resemble private sector management.

### **Normative Theory**

Although he acknowledged the problems associated with the articulation of desirable “future states,” values or outcomes, Bailey contended that “if the supreme objective of public administration is the improvement of practice, normative postulates are essential. How do we know that improvement has occurred unless values are established as a measure of approximation?” (Bailey, 1968: 133)? The problems of developing normative theory in a political environment are compounded in budgeting, where outcomes are direct precipitates of the clash of political values. As pointed out by Key (1940), judgments regarding the normative status of budgetary outcomes are ultimately a function of political philosophy.

The organization-based approach to budget theory allows normative theorists to focus on the organizational role of the finance official and the distinctive competencies of the profession. Distinctive competencies do not simply refer to the application of rational analyses to determine the optimal mix of outputs. The role of the finance professional in private sector firms is to ensure the long-term financial viability of the firm; public sector finance professionals, particularly at the local level, where viability can become problematic, share the same respon-



sibility. Thus, one proposition of a normative theory for local government budgeting is that the finance professional should seek to protect the long-term financial viability of the local government organization.

This proposition does not mean that the finance professional can determine the resource allocation mix that can optimize this end through structured analysis or implement a solution through fiat based on professional expertise. However, the finance officer's professional responsibility mandates that he or she bring this issue to the resource allocation process, because there is virtually no political constituency for this end. Thus, his or her professional responsibility lies in ensuring a better budget process—that is, one that considers the long-term financial viability of the organization, and one that is informed by structured analyses of alternative courses of action. However, these professional values must ultimately be manifested in terms of outcomes, because no political values will be viable if the financial viability of the jurisdiction is long ignored.

One way of providing for the long-term financial viability of the jurisdiction is to provide a mix of goods and services that meet the short-term needs of its constituents. Thus, the allocative efficiency of the budget process is also a responsibility of the finance professional. The emphasis here is, once again, on process; the finance professional should provide a resource allocation process that maximizes the probability that it will yield a responsive mix of goods and services. This entails minimizing the centrifugal forces that characterize multi-service public organizations, because the resource allocation process must inevitably defer to the substantive expertise housed in the many agencies that comprise the organization. The decision perspectives of these agency managers are crucial to the responsiveness of the allocative mix, and this implies that the financial professional also has an organizational development responsibility. As above, the budget process is the only organizational dimension that can serve this managerial capacity building effort.

The finance professional should seek to build knowledge of the local jurisdiction into the public organization and see that this knowledge base informs the organization's resource allocation processes. The protection of the long-term financial viability of the organization and the production of a responsive mix of budget outputs will not come from the application of professional standards or accepted theories. In order to meet these ends, it is necessary to know the jurisdiction in terms of service preferences, political history, and social culture. This implies that the formal budget process should be open to political participation, and the underrepresented must be represented by the organization. This requirement may further politicize the process and conflict with the need to develop a management team manifesting a common decision-making perspective.

### **Instrumental Theory**

By identifying a basis for normative theories of the budget process, it becomes possible to use descriptive/explanatory theories to develop instrumental theories

regarding pursuit of those normative ends. The normative stance outlined above focuses on the nature of the resource allocation system of the public organization and how that system could be positioned to produce optimal outcomes. Instrumental efforts would target the capacity of the management staff to make “good” resource allocation decisions, given the need to maintain the long-term financial viability of the organizations and to be responsive to the short-term needs of the jurisdiction.

Instrumental theories would focus on the extent to which alternative budget systems facilitate these ends, as well as the extent to which the public organization is capable of employing alternative budget systems. It is posited here that the resource allocation process can be used to develop and enhance the managerial capacity to overcome the centrifugal forces of the public organization, and that limited managerial capacity may render some budget systems unfeasible. Pettijohn and Grizzle (1997) have demonstrated that alternative budget formats and resource allocation processes, largely under the control of the local government public organization, are not neutral to the policy process; the organization-based approach to budget theory provides a platform for examining how resource allocation processes influence budgetary outcomes.

The contention here is that they may work through their effects on managerial capacity and organizational communication. The focus on the organization also allows researchers to reach into other areas of public administration study for instrumental theories regarding managerial capacity building through the resource allocation process. These include theories of motivation, relationships to incentive systems, organizational communication, and strategic planning and other administrative systems. Rubin contends that “budget theory has been too restrictive about what is important for far too long” (Rubin, 1990: 187). The field must be broadened, and the public organization provides a common locus for these additional considerations.

## CONCLUSION

Irene Rubin has described budgeting as “a special corner of politics, with many of its own characteristics” (Rubin, 1993: 237). Aaron Wildavsky contended that “most practical budgeting may take place in a twilight zone between politics and efficiency” (Wildavsky, 1961: 186). We contend that Rubin’s corner of politics centers on the public organization, an institution that often manifests the uncertainty and contradictions suggested by Wildavsky’s imagery. This does not mean, however, that public administration should simply carve out the executive budget process as its own area of focus. The public organization and its environmental relationships constitute the context for the formal budget process, as well as the executive budget process, as part of what we have called the resource allocation system of the public organization. It is the focus on the public organization that distinguishes public administration as a discipline, and which will permit the field to develop theories that are accessible to practitioners.

We have indicated how the organization-based approach to budgeting can

yield theoretical insights into the four areas for public administration theory identified by Bailey (1968). Most importantly, these four areas can be inter-related through the organizational focus. Descriptive/explanatory theories of the budget process need not be restricted to macropolitical/economic issues in which public administration practitioners can take no more than a layman's interest, and instrumental approaches need not be limited to the atheoretical cataloguing of tools that casts public administration as deficient private management.

The nominative base described here encourages the public organization, as manifested through public managers, to engage the community as an integrated organization. Public institutions are inevitably political ones; the crucial issue for the field is the relationship of substantive expertise and this political role. The resource allocation process should be studied as a means to illuminate this relationship and as a tool for developing the appropriate decision-making perspectives, which we regard as the community as a whole. Professional public administration exists in order to maximize the managerial capacity of public administrators; we have attempted to define an approach to normative theory, based on the professional responsibility of the finance professional to the organization that he or she serves, that reflects that end. We envision an integrated organizational community of experts engaging the community as a whole.

The field of organizational theory, to which we would turn for theory building in budgeting, is not without its own theoretical issues regarding appropriate level of analysis, conceptual confusion, and inevitable methodological debates. However one is looking for something, it is ultimately more fruitful to search for it where it is most likely to be found than where the light is better. The organization-based approach also allows the field to bring knowledge from its other areas to bear on the resource allocation process; it provides a forum for examining how incentive systems, motivation theory, communications processes, organizational culture, and other concepts are related to budgeting. The field of public administration tends to compartmentalize the various subjects that are related to its area of study, and this tends to de-contextualize each. It may be easier to shine a light on each of these stand-alone tools, but the field is searching for public management.

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# The Theory of the Public Sector Budget: An Economic Perspective

Merl Hackbart and James R. Ramsey

While federal, state, and local government budgets are driven by policy priorities and make “policy statements,” public budgeting theories have tended to focus on the rationale for incremental budget changes (Key, 1940; Simon, 1957; Lindbloom, 1959; Wildavsky, 1964; Rubin, 1990; Davis, 1974; Ippolito, 1993; Berry, 1990). As a consequence, budget theory development, particularly incrementalism, has focused on explaining budget decisions rather than focusing on how budget policy and budget content is determined. An inherent assumption of incremental budget theory is that marginal budget decisions are the “necessary tools for policy change negotiation” as marginal changes are more politically feasible. Therefore, incrementalism has greater value for explaining marginal budget or policy tradeoffs than as a theory that explains what is in public budgets or what goods and services should be provided by the public v. the private sector.

Also, by emphasizing small budget changes, incrementalism has been criticized for its inability to explain large, nonincremental, budget adjustments. Authors such as Caiden raised concerns regarding “time-bombs” (Caiden, 1989), and others have found evidence of large budget changes that pose problems for incremental budget theory (Davis, 1974). Still others determined that while incremental budget changes may predominate, breaks in incremental funding must be accounted for and analyzed (Baumgartner and Jones, 1993).

So while a descriptive budget theory such as incrementalism provides insights into marginal budget and policy adjustments, it is lacking in its ability to explain why nonincremental budget reallocations might occur. Moreover, incrementalism lacks the ability to explain why programs or policies are being executed

through the public expenditure budget. Assuming that the budget is an articulation of policy and policy change, a theory that explains why programs may or may not be in the budget under different circumstances is a valuable addition to budget theory. A corollary to that conceptual question is: In a federalist system which level of government should budget for various expenditures, or how should the costs of the public programs be shared across government levels? This issue is becoming an increasingly important public policy concern.

Decisions as to whether program X or program Y should be in the public budget are often derivatives of broader policy decisions regarding the appropriate role of government in the economy. In any case, policies and policy changes drive the content and adjustments to public budgets. A policy driven theory of public budgeting should provide the basis for developing and interpreting non-incremental budget adjustments.

Researchers regarding nonincremental budget change have postulated that large budget changes are the result of policy adjustments. Researchers have confirmed and analyzed nonincremental budget change. At the forefront of such research are writers who have analyzed punctuated equilibrium (True, 1995; Jones et al., 1996). True found that domestic policy issues drove expenditures and that budgets were driven by policy. He attributed nonincremental budget changes to policy adjustments such as “the Great Society,” and the “cold-war build up.” Jones et al. found similar effects in policy epochs such as Truman-Eisenhower, Kennedy-Johnson, Nixon-Ford-Carter, and Reagan-Bush-Clinton. Jones et al. focused their work on budget authority, following the suggestion of True (1995) that it most effectively reflects the policy desires and decisions of policy makers. Meanwhile, Jordan determined that nonincremental change is common for local governments in selected functional program areas (Jordan, 1999).

## CHAPTER FOCUS

This chapter provides an alternative view of public budgeting by focusing on the what and by whom questions. More specifically, the “what should be in the budget” and a related question of “which public budget should it be in” are considered from an economic public expenditure policy perspective. Historically, the appropriate roles or functions of government in a market economy or, the what question, has been debated by leading economists (Bator, 1960, 1958; Coase, 1960; Thurow, 1971; Samuelson, 1954). While broad agreement regarding the role of government has emerged, active policy debate continues among economists regarding the level of government involvement in these “appropriate government functions.” As a consequence, the appropriate level of public expenditures tends to be resolved by marginal reallocations during the budget process (Mikesell, 1999; Bator, 1958).

We consider public expenditure theory as a policy-based theory of public budgeting. In contrast to incrementalism, public expenditure theory considers

which goods and services or programs should or may be provided by government and included in a public budget. Also, public expenditure theory provides insights regarding which budget, federal, state or local, various programs should be in rather than explaining how final budget allocations are resolved. In addition, public expenditure theory-based policies may produce nonincremental budgetary changes as well. Such policy driven budget adjustments may contribute to the nonincremental changes observed by Davis, Baumgartner, Jones, Jordan, and others.

## ECONOMIC POLICY FUNCTIONS AND THE PUBLIC BUDGET

It is generally agreed among economists that there are basic responsibilities and functions of government in a free market economy. These functions are:

- The allocation function
- The distribution function
- The stabilization function

We begin with a brief discussion of market failure and its implications for determining which allocation functions are appropriate for the public sector through the budget process. The budget process of the federal, state, and local governments is, of course, the vehicle by which allocation policy decisions are established. While market failure analysis may provide guidance regarding which goods and services or “programs” should be provided by the public sector, decisions regarding which goods and services will be provided by government involves policy decisions. The distribution function of government has grown both as an absolute and as a relative percentage of the federal budget (Mikesell, 1999). Policy makers use the expenditure budget, the “tax expenditure” budget, and revenue policy to achieve redistribution policy goals (Rosen, 1985: 353–355). Again, policy decisions will dictate the nature and level of redistribution expenditures in public budgets. The final function of government, in a free market economy, is the stabilization function or the achievement of defined macroeconomic goals through budget policy including both expenditure and revenue initiatives.

After considering the functions of government, discussion in this chapter considers theoretical policy issues surrounding the determination of the appropriate level of government for the allocation of resources, the redistribution of income, and economic stabilization policy. The simultaneous pursuit of multiple policy goals in an intergovernmental administrative environment is a complex policy challenge. However, budget theory guidance for the rationalization of these decisions can be adapted from public finance expenditure theory.

## Allocation Function

The marketplace, through the interaction of supply and demand, determines the “optimal” provision and allocation of most goods—those produced in a perfectly competitive market. In addition, the marketplace automatically answers the three basic economic questions that must be answered in every economic system: (1) what is produced; (2) how are goods produced; and (3) how are the goods produced distributed? However, if the assumptions of the competitive model are not satisfied “Pareto optimality,” or maximum social welfare, may not be obtained through the marketplace and a case may exist for the public sector to “allocate” resources through the political process.

Four situations that can occur may cause the marketplace to fail to optimally provide for a good or service:

1. the existence of public or collective consumption goods or services,
2. the existence of externalities,
3. the existence of natural monopolies or imperfect competition, and
4. the existence of consumer ignorance.

Each of these situations and their relevance to determining what will be in a public budget is briefly discussed in sections which follow.

### The Case of Public Goods

Public goods are defined by two basic characteristics: nonexcludability and nonrivalry of consumption. Nonexcludability exists when a good is equally available to all consumers; e.g., a fireworks display. One person’s consumption of a fireworks display does not preclude someone else consuming the fireworks. It is impossible, or at least extremely expensive, to exclude anyone from the consumption of a public good, since these goods cannot be packaged and distributed separately to individuals. Hence, the characteristic of nonexcludability. Nonrivalry of consumption means that individuals are not rivals over the consumption of the same good. Nonrivalry exists when the marginal cost of each additional consumer is zero. For example, take the case of a lighthouse—the marginal example cost of one additional boat using the light from a lighthouse is zero. Boats are not rivals for the consumption of the light of the lighthouse.

Goods that have these two characteristics are defined to be pure public goods. (It is possible to have a situation where the characteristic of nonexcludability is present but nonrivalry is not, or vice versa—such a good is an impure or quasipublic good.) It is recognized that in many cases, public goods, or quasipublic goods can, and will, be provided by the private marketplace. However, generally, public goods will *not* be provided through the marketplace, since no one can be excluded from the consumption of a public good. Individuals can consume a public good without having to pay for the good. Each consumer will



have a tendency to “mask” or understate his preference for the good, thereby avoiding having to pay for the good. Consumers attempt to become “free riders”—consume the good without paying for it. If all consumers of public goods act in this manner, there will appear to be no demand for the good, hence, it will not be provided via the market.

Let’s take a simple example to illustrate. Suppose that Mr. Smith and nine of his friends buy ten acres of land in the country and plan to build houses on one-acre lots. Now assume further that this land is really in an isolated area and does not have roads or highways. Furthermore, the state has no plans to build a road leading to the property. It may be that the only access to Mr. Smith’s property from the closest highway is a dirt path made by the construction company that built his home and those of his friends. What happens when winter sets in the first year Mr. Smith is living in his new home? In all likelihood, the rain and snow will turn the dirt path, which is used by Mr. Smith and his neighbors to get to the highway, into mud and, in fact, the path may become impassible.

Given that this is the case, one of his neighbors may investigate and find out that it would cost only \$1,000 to pave the path; a cost of \$100 per family living in the area. Suppose further that this neighbor begins collecting this \$100 from everyone living in the area, and he has been successful until he reaches Mr. Smith. Really, Mr. Smith would like the path paved, but suppose that Mr. Smith decided to “mask” his preferences to become, in every sense of the word, a free rider. He tells his neighbor who is collecting the \$100 that he has a four-wheel-drive jeep, or that he doesn’t really mind getting stuck in the mud occasionally. He reasons that if the path is paved, he will be able to use it since it would be impossible to exclude him from it. Mr. Smith might be able to save money and drive on the newly paved road only if all of his neighbors do not decide to mask their preferences; if they do, no road would be built.

Therefore, when we have public goods, individual preferences for public goods can only be revealed through a political process or by a voting system whereby each individual realizes that they must live with the choices that are collectively made, and collective preferences will be revealed through the budget process. In other words, when public support is sufficient, public goods will be provided through the budget process to deal with the special characteristics of public goods. Moreover, when the political process determines that new goods and/or services should be provided, new programs will be established and non-incremental budget changes may occur. In like manner, when the policy decision process fosters major increases for programs such as education or national defense, budget adjustments may be anticipated.

### The Case of Externalities

When externalities exist, goods will be provided through the market process (unlike the case with public goods), but these goods will either be under- or overprovided by the market. Therefore, governmental intervention is required to

guarantee that the output of these goods is “optimal.” It should be noted again that this intervention need not require actual government provision.

Externalities are activities the production and/or consumption of which gives rise to benefits or costs to persons other than those individuals producing and/or consuming the goods. Goods that give rise to externalities are separable and divisible and can be exchanged via the market process, yet the market still is not optimal. To better understand this, we will think of both consumption and production externalities.

Suppose that we have two individuals, Mr. X and Mr. Y, and that their utility functions are represented as:

$$\begin{aligned}U^X &= U(X^A, X^B) \\U^Y &= U(Y^A, Y^B, X^A)\end{aligned}$$

We see, on the one hand, that Mr. X receives utility or satisfaction from his own personal consumption of goods A and B. Mr. Y, on the other hand, receives utility or satisfaction from his own personal consumption of goods A and B, but he also receives utility (or perhaps disutility) from Mr. X’s consumption of good A. That is, Mr. X’s consumption of good A enters into his utility function as well as that of Mr. Y. This is a consumption externality. Furthermore, we can say that if, in fact, Mr. X’s consumption of good A increased Mr. Y’s utility, or

$$\frac{\Delta U^Y}{\Delta A^X} > 0$$

we have a positive externality or an external economy. If Mr. X’s consumption of good A decreases, Mr. Y’s utility, or

$$\frac{\Delta U^Y}{\Delta A^X} < 0$$

then we have a negative externality, or external diseconomy.

Let’s take an example. Suppose Mr. X and Mr. Y have homes located next to each other and Mr. X likes to party: loud music and the works. If Mr. Y happens to like parties and loud music, Mr. X’s partying may increase his utility and thus a positive externality exists. If, instead, Mr. Y is not a partier, Mr. X’s consumption of parties decreases Mr. Y’s utility and, thus, a negative externality exists.

Other more meaningful examples of consumption externalities exist such as the case of education. When one person consumes education, it enhances their utility (it increases their productivity and, hence, lifetime earning potential). But at the same time, consumption of education by one individual increases the utility of the rest of society since they will earn more income, pay more taxes,

be better citizens, and so on. In fact, it is because the rest of society also benefits from one individual's consumption of education that, collectively, we are willing to subsidize a person's consumption of education and absorb part of the cost.

The case of a negative consumption externality is the converse of this. In this case, an individual consumer considers only his or her costs and benefits, but additional costs may be imposed on society. Since an individual does not consider the total costs to society, only his or her own costs as an individual, the private marketplace results in an overconsumption of the good. Thus, government intervention, for example, in the form of taxes, is required to increase the cost to the individual and, thus, cause his or her consumption to decrease. (It is noted that with small groups, bargaining may take place. For example, depending upon the establishment of property rights, one person may pay another person for the opportunity to party.) We also note that the external diseconomy may not be completely eliminated, rather, it is reduced in an efficiency level, or the level where marginal social benefits are equal to marginal social costs.

As indicated, the existence of externalities, such as positive externalities associated with education, may establish the case for public provision of goods and services by the public sector through the budget process. In other cases, such as when negative externalities are produced, the case may be made for the creation of public regulatory agencies which, in turn, are funded through the budget process. In such case, the budget allocation issues involve decisions regarding the size and capacity of the regulatory activity compared to other budget choices. The creation of new agencies and/or programs can generate nonincremental budgetary changes as well.

### The Case of Natural Monopolies and Imperfect Competition

The marketplace may also fail to allocate economic activities efficiently because the conditions of perfect competition are not met: a producer may have a sufficient share of the market such that he is able to affect the price of the product by changing his output level (i.e., he is not a price-taker.) As a result, his profit-maximizing price will not be equal to marginal cost, as is the case with perfect competition.

This situation can actually occur for several reasons: (1) The efficient size of the firm may be so large relative to the size of the market that it forms a natural monopoly; (2) the market (for a variety of reasons) may be characterized by oligopoly (e.g., the automotive industry), in which just a few firms dominate the market; or, (3) there may be a large number of firms, but each has sufficient market power that it faces a sloping, rather than a horizontal demand curve.

Economics of scale occur in production when, as the inputs into the production process increase, the output of that production process increases by proportionally greater amounts. For example, if the inputs into the production process are doubled, output will increase by more than twofold, and as a result, the average cost of production will continually decline with expansions in output. In such a situation, only one or maybe just a few firms can survive in the

market, given the limited demand that exists for the product. That's why we say that such markets will be natural monopolies—one firm will generally be able to continually expand output at lower average costs and, by so doing, drive his competitor out of the market.

As already stated, when monopoly power is present, price exceeds marginal cost, and it can be shown that Pareto-optimality will not be attained. Output is lower and price is higher than would be the case in a perfectly competitive situation. Accordingly, when monopoly power exists, governmental intervention is desirable to increase efficiency in the utilization of resources. There are various forms this intervention has taken over time: (1) antitrust legislation (for example, as the Sherman and Clayton Antitrust Acts); (2) governmental regulation of the prices charged by the firm; or, (3) since the product is excludible and rival, government may actually provide the good and charge a price for the good, as would be the case with the private market.

With the case of imperfect competition, firms set prices above marginal costs, resulting in suboptimal resource allocation. However, government intervention may not result in improved resource allocation. In fact, if government intervention results in setting prices equal to marginal costs, a decrease in welfare may result. For example, the Organization of Petroleum Exporting Countries may set a policy resulting in increased oil prices. At the same time, if it is believed that electricity provided in a noncompetitive market is "overpriced" and the government attempts to set electricity prices equal to marginal costs (MC), an excessive use of electricity may result, *vis-à-vis* oil products. Thus, the theory of "second best" applies to industries and sectors of the economy that are interdependent. This often places policy makers in an unfortunate position of often being forced to accept some point of inefficiency.

Relative to the budget, this form of market failure also suggests reasons for funding of public sector action. Goods and services from an industry with natural monopoly characteristics could be provided by the public sector. Alternatively, like the case of externalities, industries with monopoly tendencies can be subjected to public regulation with funding provided by the budget process.

### The Existence of Consumer Ignorance

The final case that results in the failure of the marketplace occurs when consumers are ignorant, or do not have complete and perfect information. In such a case, consumers are not aware of all of the benefits and costs associated with the consumption of a particular good. Therefore, the consumer is not in a position to make a "rational" decision with regard to how much or how little of the good to consume. Consider the case of education. Education gives rise to externalities or benefits to individuals other than the direct consumer of the education. In addition, it is often likely that the individual consumer of education is not aware of all the benefits that accrue to him because of his consuming education. That is, many of the benefits of education are of a consumption nature—they accrue at the time of consumption. But many of the benefits of

education are of an investment nature in that they do not accrue except at some period in the future. A student attending school may consider only the present cost and benefits in deciding whether or not to consider additional education. Since so many of the costs are incurred today (out of pocket expenses, forgoing income, unpleasantness of study, boring teachers) and so many of the benefits accrue in the future, it may appear that costs exceed benefits and, therefore, a rational economic decision is to not consume more education. In this case, since the consumer is ignorant of the future benefits of education, the government requires the individual to attend school through age sixteen, or the government subsidizes one's education to reduce the cost part of the cost-benefit calculation.

As another example, take the case of drug consumption. Many of us are unaware of the full range of costs of consuming certain drugs. Thus, the federal government has established the Food and Drug Administration to regulate drug production and distribution. In fact, certain drugs are illegal and cannot be distributed at all. Again, we might note that while there exists a need for government intervention, this intervention does not imply actual government provision. Intervention again could involve the creation of a policy or program activated by the budget process.

Thus, to sum up, the interaction of supply and demand determines the optimal provision and allocation of a good produced in a perfectly competitive market. However, the perfectly competitive market fails to properly provide and allocate goods when there exists goods with public good characteristics or which give rise to externalities, when we have industries characterized by increasing returns to scale, or imperfect competition and consumer ignorance. Thus, an economic rationale for government provision exists, and the public sector budget becomes the policy tool for government involvement in the marketplace.

### **Distributive Function**

As noted above, given the absence of externalities, public goods, and consumer ignorance, perfectly competitive markets ensure that society reaches this mystical point known as Pareto-optimality, or the point whereby the welfare on no one individual can be increased without causing a reduction in the utility of at least one other individual. But it is unlikely that existing factor endowments (the distribution of land, labor, and capital), society's tastes and preferences, and technologies, will be such that the resulting distribution of income is acceptable to society. It is generally agreed then that government redistributes resources through both revenue and expenditure measures to ensure that society achieves an ethically acceptable income distribution.

What is it that determines the existing patterns of income distribution; i.e., why are some people better off than others in terms of income? The answer to this question can be partially found in the economist's marginal productivity theories that tell us that an individual's wages are equal to his marginal product. If some people have less income than others, the policy prescription is quite

simple—increase the productivity of those with lower incomes (by means of education, better health care, job training, and more). In addition, due to market imperfections, public employment programs, wage subsidy programs, and effective enforcement of antidiscrimination laws have been implemented to enhance the effectiveness of programs designed to improve worker productivity.

At the same time, it is also recognized that productivity levels of individuals are a function of many variables in addition to education and investment in human capital. For example, some individuals are born into families with wealth or perhaps a family business that guarantees the individual a high income level. Some individuals are born with extremely high IQ levels; some people are born seven feet tall and with the ability to play basketball; and some people are born with attractive appearances and pretty voices. In all of these cases, individuals were lucky enough to be born with some special characteristic that will allow them to earn a high income. Thus, the point is that the present distribution of income is in part determined by one's productivity, but it is also determined in part by one's luck.

While poverty in the United States is both an absolute and a relative concept, we all readily admit that poverty does exist in this country. The question now becomes what can the government do about the existing pattern of income distribution? Government can, through the budget process, affect the income distribution, both absolute and relative, in various ways: through its tax structure, through specific expenditure programs, and through its macroeconomic policies to promote growth and full employment. Policies initiated to affect income distribution patterns may influence the traditional, incremental adjustments to program budgets, much like the adjustments resulting from policy changes relative to public goods, externalities and natural monopolies.

### **Stabilization Function**

The allocative and distributive functions of government are concerned primarily with the basic microeconomic questions of what is produced, how it is produced, and to whom goods are distributed. The stabilization function, however, is concerned with the macroeconomic problems of unemployment, inflation, and economic growth. The Full Employment Act of 1946 made official a government policy of promoting an economy with full employment, price stability and a desirable rate of economic growth. This was the first statement of such a policy in our economic history. Prior to this time, we did not worry much about the macroeconomic problems. In fact, much of our economic theory assumed unemployment could not exist, at least for long periods, because workers who were laid off would begin to bid the wage rate down by offering to work for less, in the hopes of resecuring employment. This bidding-down process would continue until the labor market could be restored to equilibrium. Thus, wage flexibility ensures that the economy will always be restored to equilibrium full employment.

During the Great Depression of 1929–1939, it became obvious that the labor market would not always automatically adjust to a level of full employment, and we began to look to government to help stabilize our economy through a combination of the use of monetary and fiscal policies. The fiscal policy impacts of stabilization policy initiatives have, periodically, resulted in large or nonincremental budget adjustments. Such adjustments realized as large increases in jobs programs, highway construction, and other jobs creating infrastructure programs and projects may produce punctuations in historical budgetary patterns.

### **Economic Policy Functions and the Budget: A Summary**

The budget is a reflection of and the means by which the basic goals of government and society are achieved. The budgetary process is complicated by the fact that we often try to achieve separate policy goals through the use of one policy instrument: the budget. The functions of government may be in conflict with each other. Ideally, it would be nice if we could have three separate budgets or sub-budgets, each of which could be targeted to a specific function of government. For example, we might like to have a distribution budget, for which its manager would design a tax-transfer program reflective of society's social welfare function. In turn, we would like to be able to have an allocative budget with its manager responsible for determining when the marketplace fails to optimally provide certain goods and then developing a budget that would include these goods. Finally, we would like to be able to have a stabilization budget, the manager of which would be responsible for developing the proper fiscal policies and monetary policies to guarantee a fully employed economy.

In reality, we do not have three separate and distinct budgets, and budget planning does not permit evaluation of each objective of government on its own merits. Rather, most often the achievement of one objective can be accomplished only at the cost of another. Thus, conflicts between the three functions of government may exist.

### **THE BUDGET AND FISCAL FEDERALISM**

Thus far we have spoken of government as if there were only one government unit in our economy. In fact, we know our system is federalistic, which involves the interaction of the federal government with state governments and local governments. Government has three goals to accomplish through the budget process, so a next question is, what level of government should do what?

It is normally believed that the stabilization function of government must be performed centrally by the federal government. The reasons are twofold. First, there must exist a central agency to control the size of the money supply; if each level of government was able to create and destroy money, there would exist an irresistible incentive to rapidly expand the money supply. The second problem with decentralized stabilization would be that the effectiveness of state

and local fiscal policies would also be rather limited. Spending leakages from a decentralized economy and the inability of state and local governments to use fiscal deficits would restrict the effectiveness of fiscal policy. So it is normally accepted that stabilization is a function best performed by the federal government.

While a conceptual argument can be made that the stabilization of the government is best performed centrally, for many years state and local governments have been actively involved, from a public policy perspective, in efforts to create jobs and capital formation. Some southern states have begun to use tools such as industrial revenue bonds, tax credits, tax abatements, among others, approximately seventy-five years ago, in an effort to bring economic development to a region of the country that was not prospering to the degree that other regions were. Today, economic development is a major public policy objective of nearly all state and local governments. Both budget expenditures and revenue tax expenditures are utilized to attract business and industry to grow the local economy. This is in part due to the fact that central monetary and fiscal policy have not always been successful in achieving our macroeconomic goals: the existence of recessions of varying degrees of magnitude.

In addition, the tools of central stabilization policy are, by their nature, macro in their application. Various regions of the economy experience differing levels of economic prosperity, even when the national economy is at full employment with price stability. Over the last twenty years, state and local policy makers have realized the concept of "rolling recessions." That is, while the national economy in total is growing, various regions of the economy may be experiencing economic slowdowns and high levels of unemployment. This was particularly true in the early 1990s when the finance, insurance, and real estate sections of the economy were going through a significant shakeout, which impacted the economies of many of the states along the East Coast and the West Coast. While the national economy and regions within the national economy did well, there was a bicoastal recession that was often masked in the national economic statistics and, therefore, was not a focus of central stabilization policy.

In many cases, state and local governments are attempting to bring new capital investment into the U.S. economy as they recruit direct foreign investment. In other cases, the economic development policies of state and local governments are a zero sum game, in that state and local governments are competing with each other for the same business and industry expansion. There is a great deal of economic literature on economic incentives and their role in the corporate decision-making process. This prior economic research tends to suggest that specific incentives offered by state and local governments for economic growth are important only at the margin: when all other decision variables are equal. Yet competition among state and local governments for new jobs and equipment has been so intense in recent years, due to unevenness of economic growth throughout the country, that today, state and local economic development policies are a routine part of public policy decision making.



A conceptual argument can be made that the distributive function can best be achieved centrally. Within a highly decentralized fiscal system, state and local governments working independently to achieve differing redistribution objectives are likely to run into trouble because of migration and the “free-rider” problem. Consider the two communities depicted below. Suppose Community X places a greater importance on income equality; its residents take an equalitarian point of view. In Community Y the attitude may be more one of *laissez-faire*. Now what could we expect to happen in this case? The low-income people living in Community Y will tend to migrate to Community X because of its highly developed welfare system. As this welfare system becomes more expensive to the wealthy living in Community X, they will have a tendency to move to Community Y, since they will not be required to make payments to a welfare system there. If carried to an extreme, we could end up with all the low-income families living in Community X (with nothing to redistribute) and all the high-income families living in Community Y. Thus, uniformity and equity dictate that a policy of income redistribution has a much greater probability of success if carried out by the national government.

It should also be recognized that, while the distribution function of government is ideally best performed centrally, state and local government, again, have been active, primarily through budget expenditures, in attempting to achieve this function of government. State and local involvement is, in fact, a function in large measure, of federal policy that is delegated to management and administration of many of our income maintenance programs to state and local governments. While many of these programs are primarily funded from the federal government, these programs are often of a matching nature, requiring states to co-fund public assistance programs such as Medicaid, temporary assistance for needy families, and others. While federal matching requirements and program guidelines diminish interstate differences in public assistance programs, differences do exist, and the potential for the Tiebout effect, “voting with one’s feet,” exists as well (Tiebout, 1956).

The concept of externalities (now in the form of community spillovers) would suggest that the allocative function be performed centrally. Consider the good education. We know that education gives rise to externalities, that is, individuals other than the individual consumer benefit from the consumption of good. Now it may be that some of these individuals live in communities other than the one providing the education. For example, primary and secondary education are goods that historically have been provided locally, say, by a county. However, not everyone who receives his education in one county will live and work in that county. Thus, when these individuals move, this represents a spillover to the county to which they move, since this county will be receiving a good it did not pay for. Now communities and counties act just as individuals do when making consumption decisions—they consider only the costs and benefits that accrue to other communities. This thinking on the part of communities, just as in the case of individuals, can lead to over- and underprovision of the goods in

question. The only way to guarantee the optimal provision of these goods is to expand the decision-making horizon, which in this case, would suggest the goods be provided, or allocated, by the federal government, vis-à-vis state and local governments.

However, there are several arguments that suggest the allocative function be performed at the state and local level. First, it is often argued that a basic shortcoming of a unitary form of government is its insensitivity to varying preferences among the residents of the different communities. If all public goods are supplied by a central government, one may expect uniformity across all communities. This may well be inefficient, because the people of New Orleans do not need snowplows (or hope that they don't), and the people of Buffalo do not need hurricane protection systems.

Second, it may be that possibilities for welfare gains through decentralization are enhanced by consumer mobility. As noted by Charles Tiebout, in a system of decentralized government, a consumer can select as his place of residence a community that provides a fiscal package (taxes and public services) well suited to his preferences. This is known as "voting with one's feet" or the Tiebout effect, as stated earlier and such individual preferences cannot be expressed when all goods are all uniformly provided by the central government.

It is often also argued that decentralization of the allocative function may result in greater experimentation and innovation in the production of public goods. And finally, there is reason to believe that decentralization may lead to efficiency, because expenditure decisions are tied more closely to resource costs; that is, the taxpayer has a better opportunity to see what he is getting with his or her money.

The optimal government organization for achieving the allocative function would be one whereby goods are allocated by that level of government that best represents the beneficiaries of the consumption of the good. National defense clearly benefits everyone nationwide, therefore, it should be provided centrally. Street lights in a local neighborhood benefit primarily only the people of that neighborhood. Thus, it should be provided locally. Certainly, many gray areas arise, but basically, the allocative function is being performed by a multiplicity of government levels, each responsible for providing the efficient level of output of the good consumed collectively by the residents of its jurisdiction. Thus, the allocative function is to be performed at all levels of government: federal, state, and local.

## **PUTTING IT ALL TOGETHER**

The adaptation of economic expenditure theory as a "policy-based" theory of public budgeting has been the focus of this chapter as a means of explaining: (1) why programs or activities are included in the public sector budget; and (2) which level of government should be responsible for or budget for certain public programs. The theory of public expenditures provides a useful framework for

understanding why governments select certain products and services for public provision and inclusion in public budgets. As such, it adds to the incremental theory that focuses on budget changes, once the set of publicly provided goods and services is determined. The reallocations, incremental or nonincremental, involved in budget processes, from a public expenditure theory perspective presumes a change in preferences among public goods, attitudes regarding how best to manage the problem of externalities, policy-wise, and public attitudes regarding income redistribution. Therefore, economic theories of public expenditures expand the understanding of the budgetary choices among “X” and “Y.”

Likewise, extensions of the theory of public expenditures into the intergovernmental arena provides guidance for the management of intergovernmental budgetary issues. While funding for public programs are often shared across levels of government, the rationale for divisions of responsibility benefit from theoretical constructs of responsibility and administrative appropriateness. Such contributions have been summarized in this discussion.

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## Budgets as Portfolios

Aman Khan

Budget theory in the public sector has a long and enduring tradition, although at times it has been rather inconsistent. Led, in part, by Aaron Wildavsky in his classic work *The Politics of the Budgetary Process* (1964), much of this tradition has been grounded in traditional descriptive theories of budget behavior (Fenno, 1966; Schick, 1975; Ippolito, 1978; Shuman, 1984; LeLoup, 1988; Rubin, 1990). While descriptive theories provide a post hoc explanation of budget behavior, they lack a normative content that underlies most decision processes in government (Key, 1940; Lewis, 1952; Smithies, 1955). From a normative point of view, every activity that involves a budgetary decision, whether it is to provide for a new service or for expanding an existing one, must have a goal, explicit or implicit, that should provide a basis for undertaking that activity. Budgeting can be construed as the means that gives viability to the activities a government undertakes to achieve a defined goal or objective.

An important aspect of this decision process is that when a government undertakes an activity or allocates funds for it, it is often considered not in isolation but together in combination with other activities. Both descriptive and normative theories fail to recognize this simple yet critical difference between when a decision involves a single as opposed to a combination of activities. The rationale behind this argument is that an activity that may not have an appeal when considered in isolation may appear attractive when considered in combination, as a package, with other activities. This chapter looks at budgeting as a process involving amalgams or combinations of activities—existing as well as new—and attempts to demonstrate how these combinations shape budget decision making in government.

## BUDGETS AS PORTFOLIOS

Anyone familiar with public budgeting knows that each year budget managers in government receive funding requests for scores of activities from various operating agencies that far exceed the available resources. This puts a restriction on the number of activities that can be realistically funded with a given budget. Given that the number of activities for which funding is requested generally exceed the available resources, it is possible to organize these activities into different combinations or packages, defined here as *portfolios*. Theoretically, one can have  $n$  number of such portfolios, each with its own budget, that would constitute the choice set from which a budget manager must make his or her decision.

This notion of budgeting as a decision-making exercise involving multiple packages or combinations is consistent with *portfolio theory* used for a long time in financial decision making in the private sector. Developed by Harry Markowitz in the 1950s to deal with the problem of asset management under conditions of risk and uncertainty, the theory states that activities (assets in this case) that may not be acceptable when considered individually might merit acceptance when an optimum combination of new and existing activities is taken into consideration. This may result from favorable interaction, called *portfolio effects*, among these activities.

### The Concept of Expected Return

Our discussion starts with a simple assumption that for every activity in government for which funding is requested there is an expected return, which may be monetary or nonmonetary. The notion of expected return is critical in budget decision making because without this there would be no rational basis for allocating funds. For instance, when funds are allocated for education, the expected return may be the greatest number of children that can receive education. Similarly, when funds are allocated for library or public safety or transportation, the expected return may be an increase in the number of readership, a reduction in the number of vehicle accidents, and a lowering of traffic congestion by certain percentage, in that order. In each instance, the expected return is a target value (i.e., an objective) that may or may not be fully achieved. In the latter case, this may be due to factors unknown to the decision makers at the time of decision making, or, even if they are known subsequently, the decision makers may not have enough control over them to affect their final outcome.

Since the decision makers can never know for sure whether a target value will be fully realized, we can formally define the expected return of a portfolio as the weighted average of the expected rates of return of the activities it contains. The weights, in most instances, represent the probability assigned to the realization of a target value for the proportion of total funds (budget) allocated to an activity. Obviously, the more an activity realizes its target value,

the greater the weight assigned to that activity. In general, for a portfolio containing two activities, 1 and 2, the expected return can be written as

$$E(R_p) = E(X_1R_1 + X_2R_2) \quad (1)$$

$$\text{or } E(R_p) = X_1E(R_1) + X_2E(R_2) \quad (2)$$

where  $R_p$  is the portfolio return,  $X_1$  is the proportion of the total budget allocated to activity 1,  $X_2 = (1 - X_1)$  is the proportion of the budget allocated to activity 2, and  $R_1$  and  $R_2$  are the returns on activities 1 and 2, respectively.

To give an example, suppose that a budget consisting of \$100 is to be split between two activities, 60 percent to activity 1 and 40 percent to activity 2 with a 90 percent probability that activity 1 will achieve its target value (i.e., its objective) and 85 percent probability that activity 2 will achieve its target value (i.e., its objective). The expected return for the two-activity portfolio will thus be:  $E(R_p) = X_1E(R_1) + X_2E(R_2) = (0.6)(0.90) + (0.4)(0.85) = 0.54 + 0.32 = 0.86$ . This means that, on average, the portfolio comprising the two activities will achieve 86 percent of its target value. In reality, the actual return at the end of the year may be higher or lower than 86 percent.

For a portfolio containing n-activities, it can be expressed as<sup>1</sup>

$$E(R_p) = \sum_{i=1}^n X_iE(R_i) \quad (3)$$

where  $\sum X_i = 1$ . That is,  $X_1 + X_2 + \dots + X_n = 1$ , which ensures that all available funds are fully allocated.

### The Concept of Variance/Covariance

When an activity fails to achieve its target value, it indicates a departure from expectation. The departure, commonly known as *variance*, is a statistical expression for dispersion from an expected return. Because of its stochastic, that is, unpredictable nature, the variance of a portfolio is frequently defined in terms of *risks* associated with it. We can define risk as the chance one takes when making a decision, such as betting on a horse or skydiving. The term is often used interchangeably with uncertainty. The difference between the two is that with risks the decision makers can assign a probability on the occurrence of the outcomes of those decisions, while with uncertainty it may be difficult to do so. However, it may be possible to reduce problems with uncertainty to those of risks with more information, although there may be a cost associated with it. Theoretically, then, for every expected return, there is a corresponding variance or risk that measures the departure from that expected value.

As a general rule, to evaluate a portfolio or budget, one needs to have both

its expected return,  $E(R_p)$ , and the variance,  $\sigma_p^2$ , based on expected returns and variances for individual activities in the portfolio. In portfolio literature, the variance of a portfolio indicates not only a departure from an expected value but also a covariance among all its activities. A *covariance* is a measure of the degree to which a pair of activities move together or covary. In other words, it measures the effect the interaction between a pair of activities produces in a portfolio.

For a two-activity portfolio, the variance can be written as<sup>2</sup>

$$\sigma_p^2 = X_1^2\sigma_1^2 + X_2^2\sigma_2^2 + 2X_1X_2\sigma_{12} \quad (4)$$

where  $\sigma_p^2$  is the portfolio variance,  $X_1$  and  $X_2$  are the proportions of the total budget allocated respectively to activity 1 and 2, and  $\sigma_{12}$  is the covariance or interaction between activities 1 and 2. Note that all three terms in Equation 3 represent risks: risk associated with activity 1, risk associated with activity 2, and the interaction risk between activities 1 and 2. Since all three terms represent risks, the variance represents the total risk in a portfolio.

To illustrate the point, let us return to our two-activity portfolio example. Let us say that for activity 1, we have a variance ( $\sigma_1^2$ ) of 0.020 and for activity 2, it is ( $\sigma_2^2$ ) 0.015, with a covariance ( $\sigma_{12}$ ) of 0.005. The latter indicates the interaction effect, i.e., the contribution the interaction between the two activities makes to the risk of the portfolio containing the activities. Thus, using the terms in Equation 3, we can calculate the variance of the portfolio as:  $\sigma_{12}^2 = X_1^2\sigma_1^2 + X_2^2\sigma_2^2 + 2X_1X_2\sigma_{12} = 0.6^2(0.90) + 0.4^2(0.85) + 2(0.6)(0.4)(0.005) = 0.324 + 0.136 + 0.00 = 0.4624$ . If we take the standard deviation of the this coefficient (since a variance is always expressed in terms of squared units), the risk associated with the portfolio will be 0.68 or 68 percent. This may seem rather high, but much depends on how the decision makers view this in light of risk-return combination.

Since the covariance of a random variable with itself ( $\sigma_{ii}$  or  $\sigma_{jj}$ ) is simply its variance, the variance of an n-activity portfolio can be written as

$$\sigma_p^2 = \sum_{i=1}^n \sum_{j=1}^n X_iX_j\sigma_{ij} \quad (5)$$

where  $i$  and  $j$  represent all activities in the portfolio. Note that the activities have been paired off for purposes of computing covariance.

A covariance can be positive, negative, or zero. A positive covariance occurs when the expected returns of two activities move in the same direction. For instance, for a pair of activities, 1 and 2, if activity 2 tends to be above its expected value  $E(X_2)$  when activity 1 is above its expected value  $E(X_1)$ , the activities are said to covary positively with each other ( $\sigma_{ij} > 0$ ). By the same token, if activity 1 is below its expected value  $E(X_1)$  when activity 2 is above its expected value  $E(X_2)$ , or vice versa, the activities covary negatively or in-



versely ( $\sigma_{ij} < 0$ ). However, for a zero covariance, the movement of the activities in terms of their expected values is independent of each other. That is, one has nothing to do with the other ( $\sigma_{ij} = 0$ ).

In constructing a portfolio, most decision makers would prefer a negative covariance as opposed to a positive covariance because a positive covariance, other things remaining equal, makes  $\sigma_p^2$  larger, while a negative covariance makes it smaller. To put it another way, since the expected returns from two activities move in opposite directions in a negative covariance, it tends to reduce risk (i.e., variance) in a portfolio, thus making it attractive to a decision maker. The point to note here, however, is that the signs and magnitude of the covariance term in  $\sigma_p^2$  largely determine the benefits derived from a portfolio.

### The Concept of Dominance

Our discussion of expected return and variance brings us to another important concept in portfolio theory, called *dominance*. Dominance is a situation where one or more activities in a portfolio dominate others, meaning that when faced with a situation involving multiple activities a decision maker will most likely prefer some activities more than others in a portfolio. The activities that are preferred dominate those that are not.

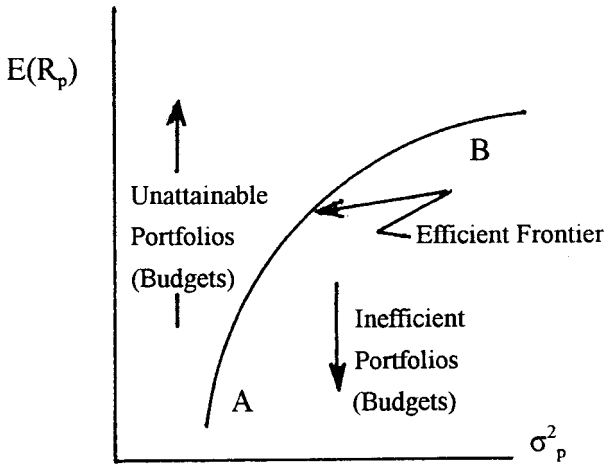
The underlying notion behind dominance in portfolio theory is the desire to make the best possible decision based on expected returns and risks of the activities in a portfolio. For instance, when we pay less for a commodity, whatever that may be, it increases our return for that commodity. Thus, the cost of an activity is measured by the amount one pays and the risk one assumes when purchasing that commodity. For government, the funds allocated for different activities in a portfolio must reflect the expected return and, given the allocation, it must also reflect the assumption of as little risk (i.e., variance) as possible for those activities.

Based on this simple knowledge of portfolio theory, we can now extend our discussion to multiple portfolios and try to explain the role these concepts play in determining the best from a set of efficient portfolios or budgets.

### EFFICIENT PORTFOLIOS (BUDGETS)

When an individual makes a decision, it is difficult to know for certain whether he or she has made the right decision. While there is no way to ensure that an expected return will eventually become a realized return, the decision maker must make some trade-offs between risk (i.e., variance) and return (i.e., its target value). This also applies to budget managers in government. Faced with the option to choose from several different portfolios or budgets, the budget manager is expected to select the portfolio that would maximize the expected return and minimize the variance. In other words, select the portfolio that for

**Figure 10.1**  
**Efficient Frontier**



any given expected return will have minimum variance, or select a portfolio that for any given variance will have the maximum expected return, that is, it will be efficient.

Suppose that our manager has a fixed amount of resources, i.e., funds that he or she can allocate on any of a number of possible portfolios, out of which only some will be efficient. We can define a portfolio to be efficient if there does not exist another portfolio with a higher expected return and a lower (or same) variance. Ideally, a prudent manager will try to eliminate as many of the inefficient portfolios (budgets) as possible from the set of all possible portfolios and retain the ones that are efficient. This is shown in Figure 10.1, where the line AB represents the set of efficient portfolios. As the figure shows, portfolios lying below the line, called *efficient frontier*,<sup>3</sup> are inefficient, while the portfolios lying above the line are unattainable given the funds available.

This creates an interesting dilemma for the budget manager as to which portfolio he or she must select that would produce the best or optimal portfolio. To a large measure, the solution to the problem can be found in *utility theory* (Schlaifer, 1969). In its bare essence, utility theory attempts to formalize rational decision making, where a decision maker specifies his or her preference among alternatives.<sup>4</sup> The value the decision maker attaches to the alternatives (which may be monetary or nonmonetary) represents an integration of all conditions relevant to the decision. These conditions, generally known as *axioms of coherence or choice*, allow one to construct an index of utility for use such that one is able to predict individual choices under conditions of risk or uncertainty (Winkler, 1972). The following constitute the essence of these axioms:

1. *Indifference.* For any two alternatives (X and Y), a decision maker can specify the preference for one over the other (i.e., X is preferred to Y; Y is preferred to X), or remain indifferent between the two.
2. *Substitution.* For any two alternatives (X and Y), if a decision maker is indifferent between them, then one can be substituted for the other.
3. *Transitivity.* For any three alternatives (X, Y, and Z), if X is preferred to Y, and Y is preferred to Z, then X must be preferred to Z.
4. *Combination.* [A] For any three alternatives (X, Y, and Z), if a decision maker prefers X to Y, and Y to Z, then there is a probability combination of X and Z that is preferred to Y, a probability combination of X and Z that is inferior to Y, and a combination of X and Z that will leave the decision maker indifferent relative to Y; [B] For more than three alternatives, if a decision maker prefers X to Y, and Z to some other alternative, a probabilistic combination of X and Z will be preferred to a probabilistic combination of Y and Z; and so on.

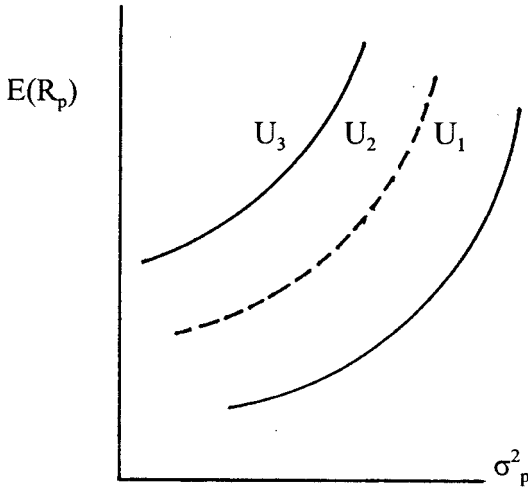
If a decision maker conforms to these axioms, it is reasonable to assume that he or she will maximize utility. This means that a rational decision maker will always select those alternatives that will maximize his or her utility, that is, will produce the greatest amount of satisfaction (Shoemaker, 1982). It is important to note that one does not actually have to work out these axioms or calculate the utility of alternatives. They are posited only to ensure that if an individual's behavior is consistent with these axioms, his or her decision will be consistent with utility maximization. However, there do exist some likely choice behaviors that these axioms rule out (not discussed here). They are treated as paradoxes. Although a prominent theory<sup>5</sup> related to these paradoxes has been in existence for some time (Arrow, 1950, 1971), no generally accepted method for removing these paradoxes has been found.

Interestingly, however, the choices individuals make are often subjective, which makes it difficult to specify their utility functions in precise operational terms. To avoid the problem, a rational decision maker will always try to select the alternatives with minimum risk (i.e., variance). This type of decision makers is known as *risk avoiders* (Raiffa, 1970).

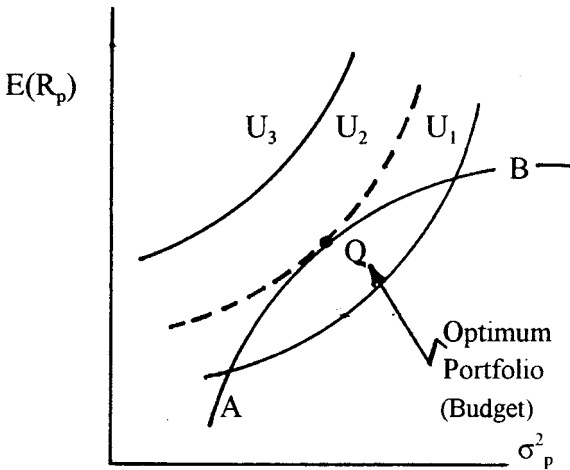
Figure 10.2 presents a set of utility curves, called *utility isoquants*, for a risk-avoiding decision maker. An isoquant is a combination of expected returns and variances with the same utility. That is, utility remains the same for any combination of expected returns and variances along the curve. The figure also shows that utility increases as one moves from a lower to a higher utility curve. What this means is that the combinations of expected returns and variances on curve  $U_3$  have the same total utility, but this utility is much higher than the total utility of the combinations on  $U_2$ , which, in turn, is higher than the combinations on  $U_1$ . In other words,  $U_3 > U_2 > U_1$ .

Now to determine the optimal portfolio, one simply needs to superimpose Figure 10.1 onto Figure 10.2 to find a point that is common to both, as shown in Figure 10.3. As the figure shows, for a portfolio to be optimal, it must lie on

**Figure 10.2**  
**Utility Curves (Isoquants)**



**Figure 10.3**  
**Optimal Portfolio (Budget)**



the tangency point between the efficient frontier and the highest attainable utility isoquant. This is the point Q in the figure. At this point, the decision maker attains the highest level of satisfaction, given the funds available to him or her. If more than one decision maker is involved, other than the budget manager, each decision maker with his or her utility function would attain the maximum satisfaction at other points of tangency.

It is important to note that our optimal portfolio (budget) is also the dominant portfolio, since, for the same degree of risk (i.e., variance), no other portfolio has a higher expected return, or, for the same expected return, no other portfolio has less risk (i.e., variance), given the funds available to the budget manager.

## LIMITATIONS OF THE THEORY

Although it may seem uncomplicated, the application of portfolio theory to public budgeting is not without difficulty. The difficulty arises from at least three different directions: two theoretical, and one empirical. The first, which may not be a limitation in a real sense, is the relevance of utility maximizing principle in determining the optimal portfolio. The second, which is a real issue for a budget manager, is the application of the theory to all activities, including those that are not divisible. And the third, which is more of an empirical problem, is how to deal with a situation when the number of activities facing a budget manager becomes large. Let us briefly look at these issues and examine the concerns that underlie them.

### The Relevance of Utility Maximizing Principle

The use of utility maximizing principle to explain the behavior of decision makers in an organization is nothing new. For instance, Oliver Williamson in 1964 used this principle to predict the behavior of managers in private organizations, in particular corporations. In Williamson's model, managers are assumed to maximize their own utility subject to a minimum profit constraint. What the model predicts about managerial behavior depends in large measure on the assumption about what produces utility for managers. According to Williamson, managers derive their utility from increases in personnel size and profit given to shareholders. The former is considered necessary because a larger personnel is often associated with higher salaries for managers. The latter produces satisfaction to the managers in the form of pride or a sense of accomplishment.

Building on the work of Williamson, Niskanen (1971) produced the first formal model focusing on the decision makers in government, mostly bureaucrats. Niskanen assumes that bureaucrats will maximize utility by maximizing the total budget of their bureaus. Like Williamson, Niskanen argues that all things that are likely to increase a bureaucrat's utility level (such as higher salaries, more power, more authority, and others) are positively related to the bureau budget. The bureau's size will be limited, however, by the fact that it must supply that amount of output expected of it, and a bureau that promises more than it can deliver will suffer in future appropriations (Warren, 1975).

Later on, Migue and Belanger (1974) criticized Niskanen by arguing that if Niskanen was right in assuming that the bureau budget was maximized, then no expenses other than those contributing to productivity could be incurred since these would directly compete with output. According to the authors, the model

of bureaucratic behavior must allow for the possibility that bureaucrats would expend part of their budget on utility enhancing prerequisites (such as higher salaries, leisure, and others), although this may increase the bureau's marginal costs of production and affect the amount of output the bureau would decide to produce.

Others, such as Rogowski (1978), argued that bureaucrats do not always maximize utility by maximizing bureau budgets. There are other factors besides budget maximization that could equally guide a bureaucrat's utility maximizing behavior. For instance, a bureaucrat may be deeply committed to the missions of an organization he or she serves (Downs, 1967), or he or she may be simply driven by a sense of professionalism that is much deeper than budget growth for self-promotion within an organization (Margolis, 1975). In either case, the point remains that bureaucrats do maximize their utility, although not necessarily by maximizing the size of the bureaus.

The utility maximizing behavior of the budget manager, as suggested here, is not far removed from those suggested by Williamson, Niskanen, and others. In our model of budget behavior, managers derive their utility from two principal sources: expected return and risk. Increases in expected return (target value) with lower risk (variance) will increase the benefit a particular portfolio produces for those the managers serve (similar to the minimum level of profit that benefits the shareholders), which, in turn, will increase returns for budget managers. It is this return that is more than likely to enhance a budget manager's utility level (through higher salaries, more authority, more satisfaction from job accomplishments, and so on) if we are to believe the conventional wisdom, but, again, it may not matter at all to a dedicated budget manager.

### **Application to Nondivisible Goods**

On the second question of general applicability of the theory to all public goods, one has to be extremely careful how it is applied. The theory holds good only for those activities that are divisible such that it is possible to acquire units of these activities, each with the same level of expected return and variance. In fact, there are plenty of examples in government (such as the number of school luncheons served, number of patients treated, number of books circulated, number of accidents prevented, number of permits issued, gallons of water supplied, tons of garbage collected, and so on) that would fit this scenario. For these activities, the efficient frontier is the continuous line, and the weighting system reflects the percentage of the budget allocated for each activity.

But there is a wide array of activities (such as roads, bridges, highways, buildings, equipment, and the like) that are difficult to break down into divisible units with the same expected return and variance, because these activities are lumpy or indivisible. As such, they must be accepted or rejected as a whole, i.e., the whole return and whole variance, and no fractions. In other words, a manager cannot acquire 62 percent of return and 38 percent of variance for

these activities. The continuity of the line as presented in Figure 10.1 thus makes sense for divisible activities. It would be unrealistic to apply the same logic to activities that are indivisible (Baum et al., 1978).

One way to avoid the problem would be to use a weighting system comprising of a value of 0 or 1, that is, nothing or all, as in integer programming. This is where methods such as integer programming become useful. By requiring that activities be either completely accepted or rejected, integer programming can correct the problem imposed by partial or fractional acceptance for indivisible activities. In a well-recognized work in 1963, Weingartner was first to suggest that Markowitz's approach could be applied to nondivisible goods by imposing a restriction that the decision variables be binary. According to Weingartner, a "frontier" of efficient solutions can be generated by finding the decision vectors that satisfy the constraints and maximize

$$\mu - \lambda\sigma^2 = \sum_i \mu_i X_i - \lambda \sum_{ij} \sigma_{ij} X_i X_j \quad \text{for all } \lambda \geq 0 \quad (6)$$

subject to

$$x_i = 0, 1$$

where  $\mu$  = expected total return;  $\sigma^2$  = variance of total return;  $\mu_i$  = expected return from activity (asset)  $i$ ;  $\sigma_{ij}$  = covariance of return from activities (assets)  $i$  and  $j$ ; and  $x_i = 1$  if an activity (asset)  $i$  is selected and 0 if it is not. The variance,  $\sigma^2$ , in the above formulation, represents the measure of risk. Therefore,  $\lambda$  may be considered a measure of risk aversion or trade-off between expected return and risk, the latter given by  $\sigma^2$ .

There have been other formulations of the problem, and the literature on integer programming itself has grown enormously vast since Weingartner's initial work on the subject lending further support to his model.

### Dealing with a Large Number of Activities

On the third and final question of how to apply the theory when the number of activities becomes large in a portfolio is least problematic of the three. It is quite possible that the number of activities a budget manager will have to deal with will be rather large, in which case the efficient set would include a significant number of portfolios from which to decide. In this type of situation, the manager can state his or her preference in terms of a minimum number of acceptable returns, defined as the *lower limit of confidence level*, as in interval estimation. This limit can be expressed in the following way:

$$CL_i = E(R_p) - W\sigma_p \quad (7)$$

where  $CL_1$  is the lower limit of confidence,  $W$  is a constant selected a priori by the manager to denote the number of standard deviations in a probability distribution, and  $E(R_p)$  and  $\sigma_p$  are the expected return and standard deviation of a portfolio, respectively.

The manager can set up a threshold below which the return on a budget should not fall. Depending on where the minimum return is set,  $W$  represents standard deviation(s) below the expected return. In other words, by putting a value on  $W$  the manager can set a minimum acceptable return on the budget for the risk he or she is willing to accept. For instance, if  $W$  is set at 1.58 standard deviation, it means the manager is willing to accept only a 2.805 percent probability of the return falling below the minimum acceptable level (assuming a standard normal distribution). The probability can be obtained from a  $Z$ -table in any standard statistics textbook. It may be worth noting that as the minimum acceptable return ( $CL_1$ ) increases for a given budget, the number of efficient combinations to choose from will decrease. With fewer efficient portfolios to consider, the efficient frontier will also become small.

## CONCLUSION

This chapter has briefly explored the potential of portfolio theory in public budgeting, especially as it relates to budget decision making. Since its development in the 1950s, portfolio theory has been used extensively in business literature. When applied to budgeting, the theory seems to make good sense, although one has to be careful how it is used. The argument made here is that budget requests in government are very similar to portfolios the finance managers use in deciding how best to allocate a given sum of money. To be considered acceptable, the portfolios must be efficient. Not all portfolios will be efficient, but some will, depending on the amount of risk and return they produce for a decision maker. The problem facing a budget manager in government is how to select the best possible or optimal portfolio from a set of efficient portfolios. The theory suggests that in selecting this portfolio, the managers in government would behave the same way as the managers in the private sector; that is, they would select the one that will maximize their utility subject to a risk-return combination.

## NOTES

1. Equation 3 is really an extension of Equation 2 for an  $n$ -activity portfolio. Both of these equations are based on two basic conditions: [1] the expected value of the product of a constant,  $k$ , and a random variable,  $X$ , equals the product of the constant times the expected value of the random variable:  $E(kX) = kE(X)$ ; and [2] the expected value of two random variables, ( $X$  and  $Y$ ), equals the sum of their expected values:  $E(X + Y) = E(X) + E(Y)$ .

2. The expression is based on general acceptance of the following conditions: (1) the variance of the product of a constant,  $k$ , and a random variable,  $X$ , equals the constant



squared times the variance of the random variable; that is,  $\sigma^2(kX) = k^2\sigma^2(X)$ ; (2) the variance of the sum of two or more random variables, say, (X, Y, and Z), equals the sum of their respective variances plus 2 times the covariance between different pairs of the random variables; that is:  $\sigma^2(X+Y+Z) = \sigma^2_X + \sigma^2_Y + \sigma^2_Z + 2\sigma_{XY} + 2\sigma_{YZ} + 2\sigma_{XZ}$ ; and (3) the covariance between a pair of activities of a constant and a random variable equals the product of the two constants multiplied by the covariance between the two random variables; that is:  $\text{Cov}(kX, lY) = kl\text{Cov}(X, Y)$ . Note that condition (2) means that for a portfolio consisting, say, of 8 random variables (activities, in our case), there will be 8 variances and 28 interaction components or covariances; that is,  $[n(n - 1)]/2 = [8(8 - 1)]/2 = 28$ . As the number of activities increases in a portfolio, it also increases the number of covariances geometrically, creating a computational problem. The problem can be corrected with a method, called *indexing*, which uses some pre-determined characteristics to evaluate a portfolio under consideration.

3. The efficient frontier represents a plot of desirable portfolios in a risk-return combination space. The shape of the frontier and its location in this space with respect to risk-return axes depend on the activities under consideration and the amount of correlation that exists between them in a portfolio.

4. The term "utility" has different meanings to different users. In sports, it means a player who can play in more than one position, as in utility fielder. In microeconomics, it means the satisfaction (i.e., subjective benefit) one derives from consuming varying proportions of different commodities. In decision analysis, the term is bent somewhat to indicate the preference a decision maker has for given outcomes. To avoid this problem of multiple interpretations, decision theorists use the term "preference" as a substitute for "utility."

5. It is the well-known "impossibility" theorem of Arrow.

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# Punctuated Equilibrium: An Agenda-Based Theory of Budgeting

Meagan M. Jordan

V.O. Key (1940) described budgeting as the process of deciding whether to allocate more resources to activity X over activity Y. As such, he considered budgets as a process for deciding who gets what and how much. In other words, public budgeting is a reflection of priorities and constraints—what gets put on the agenda and what does not. Punctuated equilibrium is a relatively new theory that reflects efforts to control and shift the priorities addressed on the agenda.

Due largely to the work of Wildavsky (1964) and Davis, Dempster, and Wildavsky (1966, 1974), incrementalism is the most prevalent budget theory. Although incrementalists acknowledge the occasional occurrence of large budget changes, budgeting is characterized by the fact that most budget change activity is small. However, another theory is needed to explain both the frequent small changes and infrequent large changes. This chapter explores the concept of punctuated equilibrium theory, which encompasses all of those changes.

Baumgartner and Jones (1993) established their concept of “punctuated equilibria” that addresses both incremental and large budget changes. It asserts that there is a state of equilibrium followed by a punctuated change followed again by equilibrium. The state of equilibrium is during quiet periods of incremental change. Punctuations are breaks from the equilibrium norm. During a time of instability on the official agenda there is a window of opportunity to create large change.

This chapter introduces the punctuated equilibrium theory of budgeting as a more comprehensive alternative to incrementalism. The foundation of punctuated equilibrium as an agenda-based theory is discussed, as well as applications of the theory to public budgeting.

## INCREMENTS VERSUS PUNCTUATIONS

Punctuated equilibrium recognizes the significance of stability on the agenda. That stability does not indicate a lack of movement but rather small adjustments from the status quo. These small adjustments or increments describe the most common movement on the agenda. Due to this tendency toward small changes, incrementalism is often used to describe policy making.

Simon's (1957) and Lindblom's (1959) foundation of incrementalism is based on the limitations of the human mind's ability to rationally and comprehensively resolve a problem. There is no stringent consensus requirement or one established criterion for identifying problems, objectives, goals, and priorities. These concepts may very well depend on the circumstances, experiences, and values of the decision makers. If two people do not agree that there is a problem, then it follows that consensus on resolving the problem is not likely.

This tendency toward conflict is an important aspect of incrementalism. Policy makers reduce conflict by limiting themselves to alternatives that are only marginally different from the previous conditions. This reduces opposition toward alternatives. Furthermore, incremental adjustments are easier to reverse.

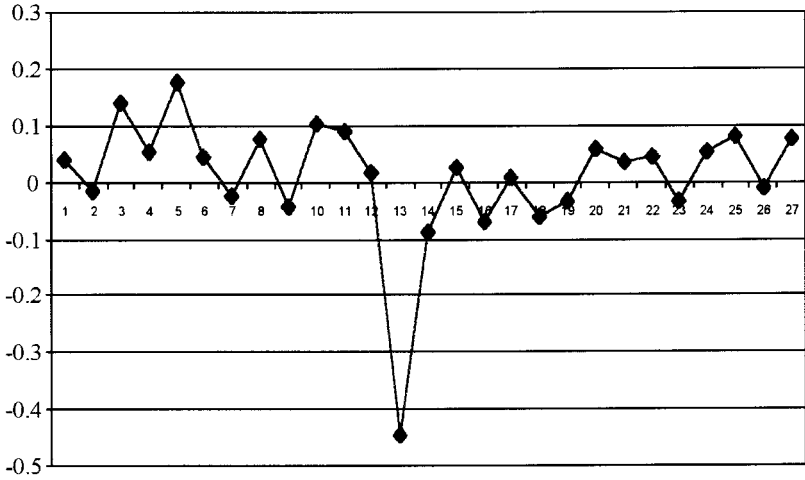
### Incrementalism in Budgeting

"Incrementalism has been the dominant descriptive theory of public budgeting for nearly three decades" (Gordon, 1990:152). Wildavsky (1964) saw incrementalism as the outcome of politics and concentrated his focus on budget policy making. There are winners and losers in politics; therefore, there are conflicts. Incremental policy changes are the necessary tools for negotiation because they are more politically feasible. With incremental policy making, one does not start over and decide whether expenditures should exist. Instead, small changes to previous spending decisions are the norm.

Since budget incrementalism represents small changes from the budgetary base, budgets are usually driven by historical data. Inherent in incremental budgeting is the avoidance of a comprehensive examination of budget requests. Sharkansky states, "To inquire into the justifications of an agency's expenditure base . . . would reopen an infinite number of complex issues and settlements that had been negotiated in the past" (1969: 201). Therefore, incrementalism is not just a method of negotiation but also a method of avoidance. Sharkansky argues that controversies may still exist around the budget policy makers; however, incrementalism allows budget outcomes to separate themselves from the controversy.

Although much of the empirical research on incrementalism has focused on the federal or state level (Davis et al., 1966, 1974; Lowery, Konda, and Garand, 1984; Thompson, 1987), it has been quite pervasive as a descriptive theory at the local level as well. Brown and Halaby (1984), McDonald (1984), and McDowall and Loftin (1984) suggest that city government finance is influenced neither by economic forces nor changes in ideology and political regime but

**Figure 11.1a**  
**Cincinnati: Change in Total Expenditures, 1966–1993**



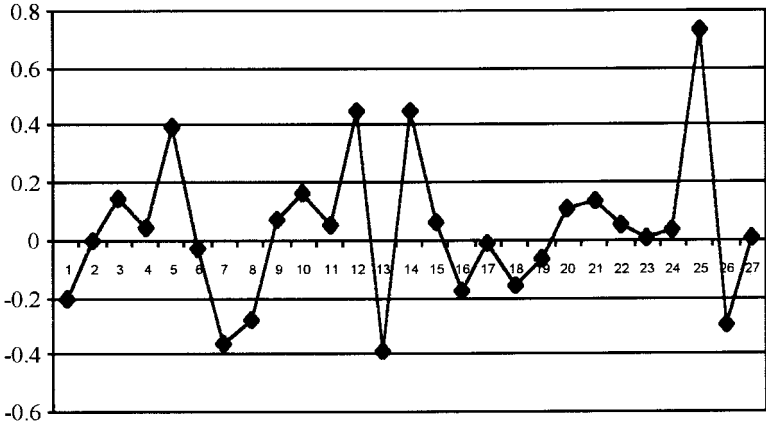
rather by incrementalism. The dominating force influencing city expenditures is spending for the previous year.

Looking at local authorities, Kleinman, Eastall, and Roberts (1990) conclude that incrementalism is relevant but more so for the overall budget than for individual functions. Jordan (1999) further demonstrates this point by looking at the city of Cincinnati’s total expenditures and highway expenditures over a twenty-seven-year period. As depicted in Figure 11.1a, the city’s expenditures do not show much fluctuation. Almost half of the percentage changes in expenditures are within 5 percent, only four beyond 10 percent. However, Figure 11.1b demonstrates more volatility at the individual function level. More than half of the percentage change in highways expenditures are greater than 10 percent. This suggests that, within the total budget for the city of Cincinnati, there are shifts in spending priorities.

While budget policy making has been widely accepted as incremental, there are instances where incrementalism is not an appropriate description of budget activity. Caiden (1989) specifically addresses the appropriateness of incrementalism when she asks the question of how to budget for “time-bombs.” She defines time-bombs as a current or potential disaster that requires enormous sums of funds to arrest. Time-bombs occur because incrementalism is institutionalized. The methods of problem solving can be characterized by avoidance or disregard for dealing with long-term fundamental issues, stalemate, and indecision.

Caiden (1989) specifically refers to nuclear weapons storage and the savings and loan debacle; however, entitlement programs can be ticking time-bombs, as well. Incrementalism does not take entitlement programs into consideration

**Figure 11.1b**  
**Cincinnati: Change in Highway Expenditures, 1966–1993**



(Rubin, 1990). However, these are areas that may require large adjustments in spending owing to changing demographics that construct the spending formulas. As Ippolito (1993) and Doyle and McCaffery (1991) point out, budget reform legislation often does not include entitlement programs such as Medicare and social security. So, the problem continues to fester. Incrementalism is less important and impractical with the increase in entitlement programs (Gist, 1974).

Using the U.S. manned space program as a case, Schulman (1975) argues for a framework to account for nonincremental policies. There is a demand for comprehensive decisions that require nonincremental policy action. Unfortunately, incremental budget theory does not properly prepare organizations for potentially large funding decisions. However, convincing decision makers to venture beyond the incremental view of budgeting is not simply a question of cost but is also a question of policy. Policy decisions are a reflection of priorities and are intertwined with budget decisions. Therefore, breaking away from incrementalism to deal with potential non-incremental expenditures is a matter of priorities. Caiden states, “The absence (of regular processes) has in no small measure contributed to the problems (of time bombs) in the first place” (1989: 92).

Interestingly, Davis et al. (1966) find large-scale changes in spending in their seminal work. However at that time, the authors focused on incremental changes. The authors later (Davis et al., 1974) take a second look at those large changes. They conclude that incremental changes are still the most prevalent changes, but after sufficient pressure is applied, large changes will occur to respond to societal needs. However, incremental changes remained the focus because they describe the most common budget change activity. Baumgartner and Jones (1993) also find that incremental changes are predominant, but there are breaks in that incremental flow of budgeting that must be accounted for and discussed

because they reflect significant changes to the agenda. Punctuated equilibrium encompasses both incremental and punctuated changes.

## THEORY OF PUNCTUATED EQUILIBRIUM

Punctuated equilibrium theory involves environments of stability shifting into environments of instability. Baumgartner and Jones (1993) conclude instability is created when organized efforts (or mobilizations) have successfully shaken the status quo. Short-run incremental decision making is not sufficient in this case. A force powerful enough to break through the status quo contains a momentum that necessitates a nonincremental reaction.

### Agenda-Based Theory

Punctuated equilibrium is an agenda-based theory. The official agenda is where decisions are made and policies are chosen for implementation. The process of deciding which issues are placed on the agenda is competitive. This competition is due to the cognitive limitation of the decision makers. Like incrementalism, punctuated equilibrium recognizes the individual's limited ability to process information. The decision maker cannot address all problems simultaneously. Therefore, successful participants in this agenda-setting process will see their problems addressed, while others will not. Within a political and often crowded environment, it is understandable that some issues do not make it to the agenda for consideration. Therefore, it is important to attract attention so that the issue is distinguishable in the crowd.

Kingdon (1984) discusses three mechanisms used for bringing problems to the attention of decision makers. One mechanism is *indicators*, such as infant mortality rates or patterns of expenditures on a program. Indicators are used to assess the magnitude of a problem and to recognize changes in a problem. A change in an indicator could mean a change in the state or condition of a system. For example, an increase in infant mortality rates may indicate the need to provide more funding for prenatal care.

Another category is the *focusing* mechanism, which includes events, crises, and symbols. The focusing mechanism either reinforces preexisting perceptions, serves as an early warning, or combines with other events to draw attention. An example of this mechanism is the New York City Trade Center and Oklahoma City bombings. Both of these focusing events or crises led to concern over domestic terrorism and the funding of federal law enforcement agencies.

The third mechanism is the *feedback* mechanism. This mechanism provides information by responding to a condition. Formal feedback may include systematic monitoring and evaluation studies, and informal feedback includes citizen complaints. Because feedback may be positive or negative, bureaucrats may try to highlight or limit the flow of feedback to policy makers.

A critical part of attracting attention to an issue is problem definition. The

definition of a problem influences how decision makers view the problem and subsequently impact how or whether they address the problem. Problem definitions seek to place the problem within a certain context or a frame of reference. The image of the problem becomes more defined. Schneider and Ingram (1993) argue that the image determines whether the issue is perceived in a negative or positive context. Rochefort and Cobb (1993) argue that certain portrayals such as urgency or novelty can increase attention.

Portz (1996) examines the importance of problem definition as it applies to education policy and concludes that not all problem definitions are created equal. A problem definition that has a powerful advocate is more likely to reach the top of the agenda. Kingdon (1984) refers to these advocates as policy entrepreneurs. Like business entrepreneurs, policy entrepreneurs are willing to invest time, energy, money, and reputation on promoting ideological beliefs and pushing a policy onto the official agenda. Their reasons for doing this may be for personal interests such as expanding or saving one's agency or position, but the entrepreneur's participation is vital to the issue's rise onto the agenda. Natchez and Bupp (1973) give an early example of the concept of policy entrepreneurs. They argue that agenda setting in the federal bureaucracy is capitalistic in nature, with aggressive entrepreneurial division directors successfully building political support. These entrepreneurs protect their resources from competing interests.

Entrepreneurs work not only to have their issues placed onto the agenda but also to maintain a position on the agenda. Because decision makers cannot address all issues simultaneously, some issues are removed from the agenda or fade away. Kingdon (1984) gave several reasons for the fading of an issue. One explanation is that once legislation is passed or administrative decisions are made, officials move on to the next item on the agenda. Another issue has become more salient. A second reason is that attention to a problem will continue to grow until there is negative feedback. Not only are their advocates working to maintain position on the agenda, there usually are participants that are actively opposing that issue's position on the agenda as well. This opposition, especially when well organized, can create negative feedback that puts the issue's position into question. Third, the novelty of the issue has ended. The problem may no longer pose a threat, or the fad has ended. Fourth, the failure to effectively address or solve a problem could lead to its lower prominence on the agenda. Timeliness is important. Kingdon's final explanation, borrowed from Downs (1972), is that the spotlight on a problem fades when there is realization that the financial and social cost of the solution is enormous. Portz (1996) argues that having a viable solution is critical. The problem cannot be addressed if the solution is outside of the scope of the decision makers.

### **Policy Punctuations**

The process that an issue must go through to get on that agenda is the foundation of punctuated equilibrium. The very structure of the American political



system contributes to maintaining the current agenda. Multiple political parties and checks and balances of government branches promote incrementalism. One political party will often try to restrain the actions of another political party, or the parties negotiate less controversial policy changes in order to get any changes implemented at all. These usually result in changes that are small and relatively easy to undo, if necessary. Also, one branch of government is granted powers by the Constitution that can also restrain the actions of another branch of government. Furthermore, interest groups can apply pressure through lobbying, lawsuits, voting, and other methods of voicing their view that also limit fast-moving and expansive policy changes. These political characteristics contribute to a stable agenda.

Policy subsystems are needed to maneuver through this inertia-provoking environment. A subsystem is an entity including citizens, politicians, and bureaucrats who advocate a position or issue. An example of a subsystem is the one opposing gun regulations. This subsystem consists of gun manufacturers and their employees, gun owners, and national gun associations. Obviously, subsystems have to compete for attention and resources. Defeating or dividing a subsystem that currently has a policy issue on the agenda will subsequently change the agenda (Baumgartner and Jones, 1991, 1993).

However, the image and venue of a policy can determine the success of a policy subsystem. Baumgartner and Jones (1991) illustrate that the use of various images and venues by environmentalists resulted in the 1970s collapse of the nuclear power subsystem. They define policy image as how an issue is understood and discussed (Baumgartner and Jones, 1993). Those individuals who are the most invested in an issue will try to place their issue in favorable terms. The problem may be explained in simplified and symbolic terms as a means to justify a particular public policy approach. Of course, different groups may have different images of the same policy. The proponent of an issue will focus on one set of images, while an opponent of an issue will focus on another set of images. Gun control is an example. On the one hand, proponents of gun control policies may conjure up the image of fully automatic weapons and mass adolescent violence. On the other hand, opponents of gun control policies may conjure up the image of the traditional hunting lifestyle and the deterioration of the Constitution. Image is a powerful way of positioning an issue on the agenda.

Venue is the location or the institution assigned to make authoritative decisions on a given issue. Often an issue is firmly assigned to one particular jurisdiction; however, this may change over time. For example, the federal government may push an issue onto the states (i.e., Reagan's New Federalism). There may also be jurisdictional shifts among branches of government. Because one jurisdiction may receive an issue differently from another, venue will affect an issue's placement on the agenda.

A change in image may lead to the adoption of other venues, and a change in the venue leads to a focus on an issue's image. The degree to which an issue is linked to an image is related to the monopolistic control a jurisdiction has

over the policy-making decisions surrounding that issue. If an issue has one clear image that is not controversial or varying, then the policies regarding that issue are more securely in place within the current jurisdiction. Similarly, when the venue shifts then the terms of the debate shifts, possibly leading to shifts in the symbols used to construct the issue's image (Baumgartner and Jones, 1991, 1993). For example, if tobacco regulation changed venues from the Food and Drug Administration to the Agricultural Department, tobacco companies may be viewed less as addictive drug manufacturers and more as family farms and farming corporations. If a policy has a change in image or venue, then instability occurs, creating an opportunity for large punctuated change; therefore policies, despite the incremental tendencies of the U.S. democratic system, are still vulnerable to major or serial shifts.

Serial shift is the term used to "denote the episodic change from one set of preferences to a second in decision making" (Jones, 1994: 27). Jones argues that individual decision makers are susceptible to serial shifts. Individuals process information in a serial or sequential manner. Preferences are not easily shifted, but the attentiveness to those preferences can be rapidly altered by the contextual perception of the environment. Therefore, individuals are not only rational, preference maximizing decision makers, but individuals are also problem solvers whose perceptions of issues are placed in context. One preference may dominate a conflicting preference owing to the perceived environment. It is this human condition of contextual sensitivity that makes episodic shift in choices possible. A change in attentiveness to a preference due to contextual sensitivity can lead to an alternative choice or the reversal of a choice.

Jones (1994) applies the concept of serial shift to policy making and subsystems. The policy-making process is subject to similar limitations of individual decision makers because the decision-making body (i.e., Congress) is limited in the number of items under consideration. Issues seeking to be placed on the agenda are competing for time and attention; they are in conflict. Also, subsystems are sensitive to image and venue placement that are also contextual. Therefore, according to Jones (1994), large shifts by decision-making bodies are also possible.

Clearly, attentiveness to the attributes of preferences may alter choices. The attributes are the conditions or characteristics used to define and make choices. The choices must be structured to list alternative solutions. The structure or decision design is needed to assist the decision maker in making difficult and complicated tradeoffs among attributes (Jones, Baumgartner, and True, 1996). That structured organized consideration of alternatives continues until the decision maker is forced to reevaluate the set of attributes. Upon reevaluation, the new attributes cause a major change. Changing the decision design to a new decision design is not trivial because only a major change could disrupt its static nature.

These decisions are made within political institutions. The static nature of the American political institution makes mobilization necessary. These political mo-

bilizations, which include policy subsystems, are attempts to alter how an issue is defined and ultimately will impact whether the issue will be placed on the agenda. The major policy changes, the punctuations, are the result of successful mobilizing efforts. However, mobilizations are also at work to maintain the current agenda; therefore, large, well-organized mobilizing efforts are necessary to create punctuated movements.

## **BUDGET APPLICATIONS OF PUNCTUATED EQUILIBRIUM THEORY**

True (1995) extends the work of Baumgartner and Jones to budgeting. True finds that domestic policy issues drove expenditures, and that budgets were in fact driven by policy. He concludes that large nonincremental shifts occurred because of policy shifts. Policy shifts such as “The Great Society” and the cold-war military buildup were the causes for large budgetary shifts. Priorities were readjusted at those times and reflected in the budget expenditures.

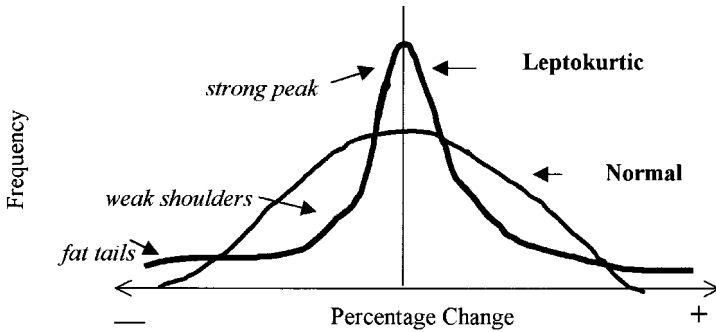
Jones et al. (1996) continued their punctuated equilibrium study of the budgetary process. The authors examine U.S. budget authority for fiscal years 1947 to 1994 and find that changes in budget followed a leptokurtic distribution as opposed to a normal distribution. Incrementalism implies a normal distribution because of the assumption of continuous dynamic adjustments. There are smooth, continuous transitions. However, a leptokurtic distribution indicates the existence of episodic decision making (Padgett, 1980; Jones et al., 1996).

Compared to the normal distribution, a leptokurtic distribution contains a strong central peak about zero. This peak represents the high frequency of marginal changes. The weak shoulders indicate a much lower frequency of moderate decision making. However, there is a higher frequency of large budget changes than compared to the normal distribution. Figure 11.2 visually demonstrates the difference between the leptokurtic distribution and the more familiar normal distribution.

Jones et al. (1996) find that budget changes are drawn from a specific type of leptokurtic distribution, a Paretian probability distribution, which is consistent with the findings of other budget and finance data (Mandelbrot, 1963; Padgett, 1980; Peters, 1991; Ramanathan, 1993; Reiss and Thomas, 1997). The significance of their findings is that the federal budget exhibits more budget changes in the tails of the distribution than had the budget been normally distributed. Furthermore, the vast majority of the changes are in the central peak (about zero), indicating the stability of the budget agenda. They conclude that this leptokurtic distribution exists because neither individuals nor institutions can attend to all policy problems simultaneously; therefore, shifts in attention cause punctuations.

Jones, Baumgartner, and True (1996) again examine policy punctuations using federal budget authority. They test three rival hypotheses as a challenge to the punctuation hypothesis: (1) partisan control, (2) capitalist surplus (robustness of

**Figure 11.2**  
**The Leptokurtic Distribution**



the economy), and (3) populist representation or public opinion. They conclude that policy punctuations do exist and are not fully accounted for by traditional economic and political forces. Therefore, budget policy reflects shifts in the agenda beyond the influences of traditional forces.

True (1999) tests the punctuated equilibrium theory on social security for fiscal years 1940 to 1998. Using budget authority and payments and collections, he concludes that policy-driven budget punctuations have occurred in social security. True characterizes the history of social security spending as having an early period of stability, followed by a hidden punctuation, then a period of slow expansion, and later policy-driven punctuations. Amendments to program law in 1950 and the 1983 bailout of social security are two of the policy-driven punctuations supported. True concludes that social security punctuations are the result of “lurches and lulls” in attention and action, and that the punctuations will continue to occur.

Although most work on punctuated equilibrium has focused on policy making and the federal budget, Jordan (1999) concludes that local government budgeting also reflects shifts on the agenda. Jordan tests the presence of punctuated budgeting at the local level. Fiscal years 1965 to 1992 expenditure changes for six budget functions in thirty-eight large cities are examined. The six functions are police, fire, sanitation, parks and recreation, public buildings, and highways. The findings are consistent with Jones et al. (1996). Each budget function follows a leptokurtic distribution and exhibits more large changes than if the budget changes had followed a normal distribution. Therefore, punctuated agenda shifts exist in local government budgeting.

Punctuated budget activity is the result of instabilities arising in agenda setting. The infrequent but significant unstable moments create a window of opportunity for nonincremental changes to occur. By applying this theory to budgeting, the discussion of budget changes has expanded by encompassing both incremental and nonincremental budget changes in the description of budg-

eting. Therefore, the budget changes that reflect conflict in policy priorities are being incorporated.

## CONCLUSION

By allocating scarce resources, budgeting implies choice between potential objects of expenditure, trade-offs. The essence of trade-offs is the existence of winners and losers. Multiple entities cannot spend the same dollar. In other words, the mutual exclusivity of money is a critical characteristic necessary to the understanding of budgeting. Trade-offs are hardly detectable when budget changes are small. However, large changes in budget allocation force significant trade-offs. Trade-offs force disruptions in the flow of the budget process by designating some agency participants as “winners,” while the “losers” receive reduced or no allocations. Significant trade-offs require budget policy revisions and attract the attention of the agency losers and their constituents. By focusing only on incremental budget changes, these trade-offs are overlooked.

Incrementalism recognizes the limited cognitive abilities of decision makers. Complete knowledge and consensus are impossible. Decision makers do not have the ability to process all issues and solutions simultaneously; therefore, not every issue can appear on the official agenda for resolution. This creates conflict and competition for attention. Incrementalism is a means of resolving or avoiding that conflict by producing marginal changes from the status quo. However, large changes create more conflict by attracting opposition prompting more in depth investigation and justification. These characteristics make increments more useful in negotiations and, therefore, the most common budget activity.

Like incrementalism, punctuated equilibrium recognizes that most budget change activity occurs at the margins. However, punctuated equilibrium goes further by offering an agenda-based perspective to explain budget punctuations.

- Budget agendas are basically stable; therefore the nature of most of the agenda’s activities is incremental. There are usually only small movements from the budgetary base.
- Stability of the agenda does not preclude a flurry of activity surrounding the agenda. Once a condition is set onto a path, there are sponsors or entrepreneurs working actively to prohibit deviations from that path.
- A new path or agenda is created when the momentum of the status quo is broken by the punctuation. Opposing subsystems have successfully weakened the current agenda. This occurs when the decision makers’ attention has been refocused, creating a shift in priorities.
- After the punctuated budget change, the budget agenda returns to an incremental and stable pattern.

Punctuated equilibrium points out that even during budget expenditure stability there are still mobilization efforts to maintain the status quo. Policy en-

preneurs resist losing the trade-offs battles. Therefore, the actual occurrence of a punctuation is an indicator of a shift in priorities from the previous status quo.

### **The Future of Punctuated Equilibrium**

The benefit of the budgeting application of punctuated equilibrium is that it brings the agenda into focus. Budget activity does not take place out of tradition but rather in the context of the official agenda. The agenda-setting process is made up of individuals, groups, and events competing for the attention of decision makers. This perspective of budgeting is more aligned with budgeting as a reflection of priorities. Therefore, examining punctuated budgets of particular policy areas will only clarify that policy's position on the official agenda. True (1999) has taken this initial step by focusing on social security.

The leptokurtic characteristic of budgets is consistent with punctuated equilibrium theory. Therefore, further empirical examination of punctuations cannot rely upon the traditional analyses that assume normality. For instance, regression analysis is biased against values in the tails of the distribution because they are outliers. Outliers are considered "maverick" values that are greatly different from most of the observations. The concern is that their existence could impose a strong influence on the regression estimates, resulting in false conclusions or masking important information. Therefore, they are usually identified and eliminated. Probability and statistical theory based on the normal distribution are mainly concerned with calculating measurements for averages—not extreme observations.

However, with a non-normal distribution, like the leptokurtic distribution, the magnitude and frequency of outliers increase. Because traditional normality-based strategies for prediction are not appropriate, other techniques will have to be used, such as the historical examination of punctuations. Public administration research will also need to explore other analytical techniques that do not assume a normal distribution. Other fields such as business, engineering, and astronomy have examined extreme conditions, and public administration will have to do the same in order to circumvent the limitation of normality-based analyses.

According to punctuated equilibrium theory, the extreme or punctuated part of a sample can be of great importance. In the budgeting application, it reveals a shift in spending priorities. Pinpointing the punctuation and examining the agenda-setting process surrounding its occurrence will explain the shift. This will provide insight into the policy subsystems or focusing mechanisms that lead to the punctuated change.

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# The Impact of Agency Mission on Agency Budget Strategy: A Deductive Theory

Marcia Lynn Whicker and Changhwan Mo

Scholars of public administration as well as politicians and public officials have interest in budget strategies that agencies employ to secure funding. Wildavsky (1992) and Cothran (1993) discuss budgeting as a compromise of conflicting promises where strategies partially determine the degree of agency success. Rubin (1990) notes that because public budgeting involves a wide variety of actors with different spending goals, competition among agencies to garner resources necessarily leads to politically calculated strategies. Axelrod (1995) observes that agency heads rely on various strategies, ploys, and tactics when dealing with those skeptical of the value of agency spending, including critics in the central budget office, the administration, and the legislature.

In examining the U.S. federal budget, Posner (1997) discusses whether strategies can be developed to compensate for bias against capital formation and expenditure while simultaneously retaining the discipline of the current unified budget structure. Budget strategy also has a time frame, according to Barkdoll (1992), who examines the Federal Drug Administration's (FDA) attempt to develop a comprehensive agency vision in the context of the annual budget cycle.

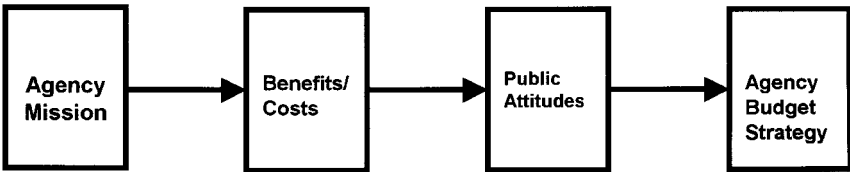
Other scholars have argued that bureaucrats attempt to maximize resources. Tullock (1976) contends that agency officials attempt to maximize the size of their agency, which necessarily involves increasing resources available to the agency. Niskanen (1973) similarly argues that bureaucrats attempt to maximize the size of their agency budgets. Larger agency budgets benefit bureaucrats personally by providing higher salaries and fringe benefits associated with greater responsibilities and scope of control. Additionally, larger agency budgets usually facilitate agency survival. When agencies are growing, operations are

more easily modified to meet changing times, and incompetent officials can more easily be moved laterally out of key positions where they otherwise would impede agency progress. Further, external budget actors expect agencies to request increases, and failure to do so projects an image of stagnation or even decline (Dunleavy, 1991).

Accordingly, bureaucrats develop strategies for budget requests to increase the probability of maximizing their funding. Some have challenged budget maximizing as an empirical description, questioning whether officials really maximize budgetary resources or rather satisfice instead. Examining agency definitions of budgetary success is a key in addressing this issue (Duncombe and Kinney 1987). Other scholars argue normatively that even if bureaucrats do maximize their budgets, they should not. Rather, budget strategies should be used for protecting public interests and efficiently implementing agency missions, not for bureaucrats to self-servingly maximize their agency budgets for personal gain.

Some scholars have questioned whether budget strategies matter in the long-run distribution of resources, citing incrementalism as a model of how budgeting actually occurs (Axelrod 1995). LeLoup and Moreland (1978), however, implement an empirical analysis and conclude that agency strategies affect budget outcomes. If an agency requests budget increases effectively and aggressively, it may obtain a larger budget increase than other agencies that do not. This view is opposite to that of incrementalists, who contend that agency strategies are basically similar. LeLoup (1978) criticizes budgetary incrementalism by asserting that "its self-fulfilling nature renders incrementalism nearly useless for social science theory and the main biases of incrementalism is toward stability and against change." Rubin (1990) also contends that incrementalism is inapplicable to modern budgeting for several reasons. For instance, budget outcomes for various agencies may be invisible or noncomparable, diminish incremental restraints on agency heads in asking for additional resources. Rapid turnover in agency heads also diminishes the relevance of the incremental model for budgeting, since it applies primarily to actors who have to deal with each other year after year. Incrementalism also underestimates the importance of the budget process in regulating competition and does not recognize the conditional nature of agency budget strategies (Rubin, 1990). Further, agency use of budget strategies to gain resources may be but does not necessarily have to be incompatible with incremental budgetary outcomes at the aggregate level. Each agency may employ particular strategies that have worked for it in the past to assure that it gets its "fair share" of resources. When all agencies employ different but similarly effective strategies for their particular clienteles, publics, and legislative committees, the final outcome may be incremental in impact. Further, incrementalism may be a budget strategy in particular situations where an agency views requests for incremental increases as the best ploy to maximize resources gained through the appropriations process. In addition to the incremental strat-

**Figure 12.1**  
**Linkages between Agency Mission and Agency Budget Strategy**



egy, agencies that are facing different circumstances may need different marketing strategies for promoting their budget requests and securing funding.

Finally, incrementalism is undercut as a dominant approach to budgeting in recent years by agencies striving to remove their resource allocation from the budget process to an off-budget status. Off-budget resource allocations include loans, loan guarantees and insurance, tax expenditures, and other benefits that do not require approval through the annual budget process. The primary focus of some agencies then is no longer to grow through incremental discretionary expenditures, but rather to go off budget and out of the scrutiny of controllers of the budget process (Meyers, 1994).

The purpose of this article is to link agency mission to agency budget strategy. Agency mission refers to whether agencies are distributive, redistributive, regulatory, or market emulators. We contend that agency missions establish the benefit and cost structures that agencies confront. Both costs and benefits may be concentrated among a few citizens, or dispersed across a large group. Benefit/cost structures with respect to agency outcomes, in turn, affect public attitudes toward the agency. While the public never eagerly embraces new taxes and revenue mechanisms for funding government services, resistance to funding may be moderate or high. Similarly, support for agency outcomes may be narrow but intense or broad but weak. Each of these three factors—agency mission, benefit/cost structure, and public attitudes—either directly or indirectly impacts agency budget strategy. Agency mission defines benefit/cost structures for the organization, which, in turn, impacts public support for the agency and its programs. Public support then impacts agency budget strategies (Figure 12.1).

Despite attempts by agencies to seek resources off-budget, discretionary budgeting remains an important method of resource acquisition for agencies. This study is particularly important in an era of downsizing, budget cuts, and privatization. If agencies do not successfully strategize in the budget game, they may become the victims of antigovernment sentiment and retrenchment. This chapter will shed light on agency budget strategies, which have been largely ignored as a result of the domination of incrementalism in the field of budgeting. It extends the budget strategy studies of Sharkansky (1965) and LeLoup and

Moreland (1978), which enumerate possible factors that may impact on agency strategy choices and budget success. We argue here that the differences of agency missions mainly influence the agency choices of budget strategies and budgetary outcomes. We also argue that agency budget strategies are restricted not only to inside agency in relation to budget requests but also to outside agency in relation to budget politics. Agency budgeteers often interact with external actors in budgeting, for example legislative committees, the mass media, or interest groups. Thus, we do not assume that agency budget requests to the chief executive officer fully reflect the real intentions of an agency.

## AGENCY MISSION

Due to market failures, people argue that government interventions in the free market are necessary. The traditional market failures occur when a market has public goods, externalities, monopoly, and information asymmetry. The private sector does not adequately provide public goods for society, since public goods have the characteristics of nonrivalry and nonexcludability. Providing public goods is a key distributive function of governments. The free market mechanism also does not reflect external costs and benefits. When a woman drives her car, for example, she may only care about the gas price that she has to pay and the individual comfort that she enjoys. However, since the individual driving activity produces air pollutants, it unintentionally adds a cost to the whole society. Society needs regulatory government interventions to internalize this social environment cost, because this cost is not part of the private cost taken into account by buyers and sellers of gasoline. Owing to negative externalities, governments may implement redistributive functions for the poor and the socially weak groups. If a society does not take care of them, these groups will destroy not only themselves but also the society itself. In other words, redistributive policies are beneficial not only for the poor but also for the rich. To protect consumers from monopoly manipulations, society also needs regulatory government interventions. Finally, the neoclassical economists' assumptions of perfectly competitive markets are not always true. In particular, customers do not have perfect information about products, while producers also do not have perfect information of consumers' demands. Further, there are significant differences in the quantity and quality of information that each consumer and producer possesses. The free market, therefore, has flaws in efficiently allocating scarce resources, and it cannot function properly without the interventions of public agencies. Therefore, the governmental interventions are justified. Accordingly, Downs (1967) proposes nine reasons why public organizations are required: large external benefits or costs, indivisible benefits, redistribution of incomes, regulation of monopolies, protection of consumers from their own ignorance or incompetence, compensation for aggregate instabilities or deficiencies in a market economy, areas of producer disorganization, creation of a framework of law and

**Table 12.1**  
**Agency Mission**

<b>Agency Mission</b>	<b>Mission Description</b>	<b>Examples of Agency Missions</b>
Distributive	Provide government services widely used by different segments of the population that are broadly dispersed across geographic districts.	Defense, transportation, general public education; broad health care oriented toward disease prevention and control.
Redistributive	Engage in transfer payments and service delivery that shift income from one segment of society to another, usually providing income for those considered economically disadvantaged or needy.	Welfare, social services for low-income groups, education programs targeted for needy or disadvantaged groups, health programs targeted for low-income individuals and the elderly, rent subsidies and public housing for the poor.
Regulatory	Use positive incentives including tax exemptions and privileges along with the negative incentives of fines, administrative sanctions, and criminal prosecutions to modify behavior of regulated industries to achieve socially desirable outcomes.	Environmental protection agencies; regulation for food and drug safety; financial regulation of banking, stock markets, savings and loans, and other financial institutions; and civil rights regulation.
Market Emulators	Produce marketable goods with clearly identifiable unit costs that can be sold to individuals in a market exchange; goods produced by market emulators have characteristics that promote public as well as private interests and well-being.	Public utilities, museums, parks, post office, higher education.

order, and maintenance of the government itself. Because of these market failures we can argue that public agencies are indispensable for society.

Lowi (1964) has identified three types of policies: distributive, redistributive, and regulatory. Ripley (1985) divides the regulatory policy by distinguishing between protective and competitive regulatory policies, and he adds foreign defense policy types: structural policy, strategic policy, and crisis policy. Owing to the increase of deregulation and privatization, however, the Ripley's distinction between protective and competitive regulatory policies has no significant usefulness. However, Almond and Powell (1980) subdivide public policy into four policy types: distributive, regulatory, extractive, and symbolic. Their classification, however, does not include the redistributive policy of Lowi's. Therefore, this study applies the policy classification of Lowi to classify public agencies by mission: distributive, redistributive, and regulatory. To these three categories for agency mission, we add the fourth of market emulator (Table 12.1).

We discuss these categories as mutually exclusive and exhaustive, while the

real world is far more complex. In the real world, agencies have multiple missions, or differing missions for different organizational subunits or even programs. The larger the organization, the more likely it is to have multiple missions. Hence, agencies are more likely to have multiple missions than are bureaus, and departments are more likely still to have multiple missions. Nor are the four different agency missions always mutually exclusive in purpose, but in some instances may overlap or coexist. For theoretical interest, however, we discuss the four agency missions as separate and distinct. Further, we argue that agencies tend to be *predominantly* one mission as opposed to another. It is the *predominance* of one mission over other usually competing missions that produces a *tendency* to use one type or set of budget strategies more frequently and consistently than other possible strategies. We argue, then, for statistical linkages between mission and strategy, not for universality and determinancy.

### **Distributive Agencies**

Distributive agencies provide government services widely used by different segments of the population. These services may be broadly dispersed across geographic political districts, and hence, may garner diverse political support. The production of national defense is one example of a distributive agency, where most segments of the population benefit, the good or service is not targeted to one particular segment, and where the good may be produced or delivered in a wide range of geographic districts. Transportation, such as public roads, railroads, and mass transit, is another example of a distributive good or policy that shares the characteristics of widespread access and nontargeted benefits. While some education may be redistributive, when particular populations are designated as primary beneficiaries of program expenditures, general public education may be distributive in nature. Everyone has access to and presumably benefits from its production and delivery. Similarly, health programs may also be targeted, but broadly oriented general health programs whose goal is general disease prevention and control may be distributive in character.

### **Redistributive Agencies**

Redistributive agencies engage in transfer payments and service delivery that effectively shift real and in-kind income from one segment of society to another. Usually but not always, the targeted beneficiaries of redistributive policies are those considered economically disadvantaged or needy. Redistributive agencies are sometimes quite unpopular with nonbeneficiary groups, who may feel that income is being unjustly taken from them to provide services to other groups not particularly deserving of public support. Labeling redistributive programs as welfare may further erode popular support for agency outcomes. Public assistance or welfare in various forms is redistributive in intent and impact. Other redistributive programs include social services for low-income groups, education

programs targeted for needy or disadvantaged groups, health programs targeted for low-income individuals and for the elderly, and rent subsidies and public housing for the poor. Many redistributive programs are based on income as a sole or even major criteria. Programs that assist the disabled, provide expensive medical treatments such as kidney dialysis, or provide services for people suffering from particular diseases may also be redistributive. More typically, however, income-based need is a criterion on which redistributive agencies base decisions.

### **Regulatory Agencies**

Regulatory agencies attempt to modify private sector behavior to achieve socially desirable outcomes. They do so through the use of positive incentives or “carrots,” such as subsidies, tax exemptions, tax credits, credit incentives, and insurance. They may also use negative or disincentives or “sticks,” including consent payments, fines, administrative sanctions, and criminal prosecutions (Whicker, 1993). In the United States, regulatory agencies may assume an “alphabet soup” nomenclature as they are identified by letters that serve as acronyms. The Environmental Protection Agency (EPA) regulates private sector behaviors to protect clean air and water, and otherwise reduce pollutants in the environment. The FDA and the Animal and Plant Health Inspection Service (APHIS) are responsible for food and drug safety. Financial regulation is conducted by the Securities and Exchange Commission (SEC), Federal Deposit Insurance Corporation (FDIC), Federal Savings and Loan Insurance Corporation (FSLIC), and the Comptroller of the Treasury. Civil rights regulation is conducted by the Equal Employment Opportunity Commission (EEOC). Safety regulation of various types is performed by the Federal Aviation Administration (FAA), Nuclear Regulatory Commission (NRC), National Highway Traffic Safety Administration (NHTSA), Occupational Safety and Health Administration (OSHA), Consumer Product Safety Commission (CPSC), and Mine Safety and Health Administration (MSHA). Dangerous substances are controlled by the Bureau of Alcohol, Tobacco, and Firearms (BATF).

### **Market Emulators**

Market emulators are similar to private sector firms. They produce marketable goods with clearly identifiable unit costs, which can be directly sold to individuals in a market exchange. The goods produced by market emulators have characteristics that promote public as well as private interests and well-being. This agency type may be involved in the production of toll goods. When considering the concept of exhaustion or rivalry, toll goods embody joint use. Toll goods also have the characteristics that exclusion from consumption of the good is feasible and include such goods as turnpikes and toll roads (Mikesell, 1995). The marketable public goods have the characteristics of excludability and non-

rivalry. In producing the good or service, the agency sells the good to a citizen-client, who purchases it for a pre-established price. The citizen-client can exclude other people from consuming the good he or she has just purchased, and therefore has an incentive to finance the good, at least partially through purchases or sales. The marketable public goods can cause critical problems if the private sector supplies them in society. First, the private providers will not supply the socially optimum quantity of the marketable public goods for maximizing their profits (Weimer and Vining, 1992). Second, the private providers will abandon unprofitable groups or places. For example, due to lack of customers, a private bus or mail delivery company will not provide services for non-profitable and rural areas. Although some goods, like health care and education, are marketable, more importantly, they have the quality of "social equity." The government may provide those marketable goods for fulfilling the value of social fairness, while the private sector will not. As Musgrave and Musgrave (1973) point out, they are merit goods. Demerit goods are usually controlled by regulatory agencies through taxation and enforcement. However, merit goods are generally provided by market emulators, distributive, or redistributive agencies. The major distinction between market emulators and distributive or redistributive agencies is whether public agencies directly receive the cost of goods production from citizen-clients in providing services. Because there is a public interest dimension to goods produced by public sector market emulators, however, the citizen-client may not pay the full cost of goods production, and the goods may be partially subsidized with other sources of public money. Examples of market emulators include public utilities, public transportation, museums, parks, post office, and higher education.

## **BENEFITS, COSTS, AND PUBLIC SUPPORT**


Agency mission determines whether or not the organization has a client, producer, customer, or public interest focus. Agency missions also are associated with different cost structures. Both agency benefits and costs may be either concentrated or dispersed. Public support for the agency, in turn, is linked to whether benefits and costs are concentrated or dispersed. These linkages are shown in Table 12.2.

Although Table 12.2 does not show the relationship between the status of a beneficiary group and public attitudes, it is critical to recognize that the status of a beneficiary group strongly influences the level of public hostility or acceptance to agencies. If a beneficiary group holds a high status in society, the level of hostility will be lower than a beneficiary group that is of low status in society. In other words, if a beneficiary group is of low status in society, the level of acceptability will be much lower than a beneficiary group that is of high status. The beneficiary group that enjoys a high status in society has both political power and social desirability.

Musgrave and Musgrave (1973), when they discuss merit goods, argue social



**Table 12.2**  
**Agency Missions Linked to Benefit/Cost Structures, Agency Foci, and Public Attitudes**

 <b><u>BENEFITS:</u></b>	<u>CONCENTRATED</u> (Narrow but intense support for agency outcomes)	<u>DISPERSED</u> (Broad but weak support for agency outcomes)
<b><u>COSTS:</u></b>	<u>CONCENTRATED</u> (High public resistance to financing agency outcomes)	MARKET EMULATORS (Customer Focus)
		REGULATORY AGENCIES (Public Interest Focus)
	<u>DISPERSED</u> (Moderate public resistance to financing agency outcomes)	REDISTRIBUTIVE AGENCIES (Client Focus)
		DISTRIBUTIVE AGENCIES (Producer Focus)

desirability impacts on the decision making of government intervention. For example, the government imposes harsh taxes on liquors and tobaccos, which are demerit goods because the public considers them socially undesirable, while the government provides free paratransit services or health care benefits for the disabled or the elderly, which are merit goods because the public considers them socially desirable. While the government actions to give benefits to heavy smokers and heavy drinkers are not considered as desirable, the government efforts to help the disabled and the elderly are considered socially desirable.

Similarly, Schneider and Ingram (1997) point out the social construction processes of potential target populations. They argue that politically powerful and deserving groups, such as the middle class and senior citizens, can get more benefits than other less positively constructed groups. Accordingly, they contend that politically weak and undeserving populations, such as gangs and prisoners, will bear more burdens than other less negatively constructed populations. This means that while funding for an agency that provides concentrated benefits for the politically powerful and deserving groups will be warmly welcomed in society and budgeting processes, funding for an agency that provides concentrated benefits for the politically weak and undeserving groups will be coldly rejected in society and budgeting processes. However, the politically weak and undeserving groups that Schneider and Ingram have identified are very small in terms

of numbers and resources. In a society, members compete for scarce resources; if one group wants to get benefits, other groups have to sacrifice. More importantly, in a highly capitalistic society, the poor are often regarded as “undeserving” losers in competition. Therefore, although we admit that the extent to which a recipient group is perceived as desirable or deserving will have at least some impact on public attitudes, we contend the factor that mainly affects public attitudes is the differences of political and economical power between the beneficiary groups, for example the rich and the poor. Social desirability in this study that narrowly applies to, for example, the disabled, the elderly, and children is different from the concept of Schneider and Ingram. We argue that giving government benefits to low-income able-bodied adults, although they are classified as the poor, is not considered socially desirable or worthy.

### **Concentrated Benefits**

When benefits from agency outcomes are concentrated, most of the advantages and rewards of agency programs are derived by a narrow segment of the population. As the primary beneficiary, this segment of the population intensely supports the agency outcomes from which they benefit. Other nonbeneficiary segments, however, are not particularly supportive. At best these segments are neutral, ignoring programs that do not directly reward them; sometimes nonbeneficiary segments of the population are hostile to agencies with concentrated benefits that are not distributed to them. Whether or not the reaction of nonbeneficiary populations is neutral or hostile depends, in part, on the status of the beneficiary group. If the beneficiary group is of high status, the rest of the population may largely ignore the agency and its programs. Industrial policy subsidies for corporations have typically not elicited negative reactions from other population segments, because corporations, their owners, and managers have considerable prestige and political clout. By contrast, budget subsidies for low-income recipients, including welfare and other transfer programs, frequently elicit hostility from nonbeneficiary segments of the population. Resistance to expanding and modifying Aid to Families with Dependent Children, the classic welfare program, for example, has been considerable. This hostility reflects the low status of the poor and their lack of political power.

### **Dispersed Benefits**

Dispersed benefits are distributed across a broad portion of the population. The benefits accrued by any individual or subgroup, however, do not usually constitute a major income source or large part of any individual’s well-being. Often, the benefits may be intangible, rather than direct monetary and other tangible benefits. Because of this, many people support the program, but the broad support is typically neither intense nor strong. Examples include environmental protection, where the benefit of cleaner air and water is widely dis-

persed but only a fragment of any single individual's well-being. The benefit accruing to any individual may not be large enough to motivate that person to show strong support for the agency. National defense benefits are similarly dispersed and mostly intangible. National defense production is more tangible but also dispersed across various geographic districts. Again, the status of the beneficiary groups impacts the degree of support. When the status is high, as with defense contractors, the support for the agency is stronger than when the status is low. Proponents of "environmental justice" programs who strive to enhance environmental quality especially in poor and minority neighborhoods confront weak and shallow support, stemming in part from the lower status of beneficiaries as well as the dispersed nature of benefits.

### **Concentrated Costs**

Concentrated costs occur when paying for agency outcomes falls disproportionately upon a limited or small segment of the population. This may occur when special taxes or fines are levied on a subgroup of the population, or a subgroup experiences higher production costs and/or a loss in income resulting from agency programs. Those impacted by the high costs resist paying for the program and politically block the growth of that program or agency. Others not impacted are relatively indifferent, so that the net political impact is skewed to those who protest they are bearing the brunt of the program costs. An example is tobacco product regulation, prohibiting the sale of cigarettes to teenagers. Costs for regulation are borne disproportionately by the tobacco companies, who suffer loss of cigarette sales, and more importantly, loss of future adult customers when teenagers do not smoke. The costs of environmental regulation, similarly, are frequently borne by the producers of pollution. In each instance, those sustaining the costs of agency programs strongly protest or subvert in various ways their role in financing agency outcomes. The status of a damaging group also affects the attitudes of nondamaging groups. Whether or not the reaction of nondamaging populations is neutral or hostile depends, in part, on the status of the damaging group. If the damaging group is of low status, the rest of the population may largely ignore the agency and its programs. If the cost-taking group is of high status, the other groups may jump on the bandwagon in the protest against the agency.

### **Dispersed Costs**

Dispersed costs result when agency outcomes are financed by general taxes. The costs of paying for agency programs are spread across general taxpayers, and are not easily or readily identifiable. In such instances, public resistance to financing the agency may be moderate, because no single group is disproportionately hurt or motivated to protest the agency financing structure. Rather, resistance comes in the form of those concerned with keeping government small,

efficient, and responsive—broad and usually moderate resistance, rather than the intense resistance concentrated costs provoke. Examples of dispersed costs include veterans' benefits, public health programs, and other government programs that are financed from general taxes.

## **AGENCY MISSION AND BENEFIT/COST STRUCTURES**

As agency missions vary, so do benefit/cost structures the agency confronts. Each type of agency mission may be linked to a different benefit/cost structure, which, in turn, impacts public support for the agency's outcomes and resistance to agency funding.

### **The Benefit/Cost Structure of Distributive Agencies**

Distributive agencies confront dispersed benefits and costs in their benefit/cost structure. They have a producer focus, as most distributive agencies are concerned about producing benefits for a large segment of the population where costs are similarly dispersed. Distributive agencies face broad but weak public support stemming from the dispersed benefits. The resistance to distributive agency funding moderates as costs are similarly dispersed. Distributive agencies, therefore, are positioned well politically in the budgetary game of garnering resources and political and public support compared with agencies that confront high resistance. Defense agencies, for example, produce dispersed benefits and costs when we see them from the perspective of citizens as customers. However, they create a politically strong industry that supports the defense agency when we see them from the perspective of corporations as producers. Thus, some distributive agencies may confront concentrated benefits and dispersed costs in their benefit/cost structure. In this case, the subcommittees in Congress, public bureaus, and interests groups may form an iron triangle for maximizing their benefits.

### **The Benefit/Cost Structure of Redistributive Agencies**

Redistributive agencies face concentrated benefits and dispersed costs. They have a client focus, with an emphasis on providing programs for beneficiary groups, whom they view as clients. The support for redistributive agencies, as a result of concentrated benefits, is limited but intense, originating mostly from the client group. By contrast, resistance to financing is usually moderate, because costs are dispersed across the general taxpayer population. This contributes to the "wedge" effect of program expenditures that some welfare programs experience, where smaller initial amounts escalate rapidly in subsequent years, due in part to moderate rather than strong resistance to agency financing. These agencies are politically well-positioned in funding, but many beneficiaries of redistributive policies are the poor, the disabled, the elderly, and other socially

weak groups. These groups have considerably less political clout than business and wealthy groups. Thus, the political support for redistributive agencies in the budgetary game depends, in part, on the status of the client group. However, even within politically weak groups when the status of the group is particularly worthy, as in the case of the disabled and elderly, political support may be quite strong. When the status of the group is lower and perceived by the public as less worthy, as in the case of low-income able-bodied adults, support is less strong.

### **The Benefit/Cost Structure of Regulatory Agencies**

Dispersed benefits and concentrated costs form the benefit/cost structure of regulatory agencies. These agencies have a public interest focus, as they articulate the need for programs where benefits are broadly dispersed across the general population, with no single particularly identifiable beneficiary group. As a result of these dispersed benefits, public support for agency outcomes is broad but weak. The concentrated cost structure confronted by regulatory agencies implies that certain industries or subgroups are impacted most heavily in paying for the agency programs. These industries express high resistance to financing agency programs when they disproportionately bear the immediate costs. In budgetary politics, regulatory agencies confront the most unfavorable situation in garnering political support among the four types of agencies. Regulatory agencies must deal with broad but weak public support for outcomes while simultaneously battling intense opposition from industries negatively impacted by concentrated costs.

### **The Benefit/Cost Structure of Market Emulators**

Compared with the other three types of agencies, market emulators plainly have concentrated benefits and costs. As they emulate market exchanges, where the beneficiary group is also the group that disproportionately bears the costs of agency programs, these agencies develop a customer focus. The public shows high resistance to paying for the costs of supplying public services for the primary customer groups and demands that the beneficiary groups take the whole burden of providing the relatively exclusive benefits that they receive from public services. The customer group intensely supports agency programs. Narrow but intense support is partially offset by high public resistance to public outcomes. The outcome of this political situation usually produces some public subsidies for market emulators but with some additional portion of agency costs, sometimes a substantial portion, being borne by agency customers.

## **INTERNAL AGENCY BUDGET STRATEGIES AND PUBLIC SUPPORT**

Agencies have both internal and external budget strategies. Internal strategies are those employed to make funding choices and recommendations across the

various programs administered by the agency, and across the various client groups it serves. Internally, agencies may use at least four internal budget strategies. Like the external budget strategies identified and discussed by Wildavsky, these internal budget strategies are not strictly mutually exclusive. An agency may employ more than one strategy internally, or different strategies at different points in time.

Whether the budgeting environment is favorable or unfavorable impacts agency choice of budget strategy. When the economy is robust and economic growth is high, the public is more likely to focus on the benefits derived from public expenditures. In a booming economy when the budget environment is favorable, agencies are more likely to emphasize budget strategies associated with their benefit structure and the related public support for program outcomes the agency benefit structure generates.

By contrast, when the economy is in recession and economic growth is stagnating, the public is more likely to focus on the costs associated with public expenditures and to resist financing government programs. Resistance to taxation represents an important challenge to democracy as well as agency survival (Glaser and Hildreth 1996). Citizen-voters may employ different rationales in resisting taxation (Whicker and de Lancer 1997). Public resistance to financing government programs poses a challenge for agency officials that attains greater importance when the economy is stagnating or depressed and the agency budget environment is unfavorable. Under harsh budget constraints, if agencies do not implement effective strategies, they may face budget cuts, downsizing, or privatization. Agencies confronting an unfavorable budget environment are more likely to focus on the budget strategies associated with their cost structure and the public resistance to financing agency programs that cost structure generates (Table 12.3.)

### **Incremental Budgeting**

Incrementalism as an approach to policy decisions was identified by Lindblom (1987). Incrementalism has also been widely recognized as a dominant budget strategy (David, Dempster, and Wildavsky, 1987). Agencies may choose incremental funding for programs, either explicitly or intuitively recommending equal or similar budget percentage increases across different programs and client groups. An agency that decides to request proportionate increases in funding for its various transportation programs, for example, is employing incrementalism.

One incremental strategy is the “previous years increment” approach, where agencies ask for about the same percentage increase in across-the-board program funding that was appropriated in previous years. A second incremental approach is “the inflation” strategy. Here, agency officials use the inflation index to determine incremental funding requests. Yet a third incremental approach is the “best guess” strategy. Agency officials use their knowledge of their programs and of budget actors to form a best guess about a reasonable increment to request

**Table 12.3**  
**Public Support for Agency Outcomes and Budget Strategies**

PUBLIC SUPPORT FOR AGENCY OUTCOMES	INTERNAL AGENCY BUDGET STRATEGIES	EXTERNAL AGENCY BUDGET STRATEGIES
<b>BUDGET ENVIRONMENT FAVORABLE</b>		
<b>BROAD BUT WEAK SUPPORT FOR OUTCOMES</b>	<u><b>INCREMENTAL STRATEGIES</b></u> Previous years increment Inflation increment Best guess	<u><b>LEGISLATIVE COMMITTEE HEARINGS STRATEGIES</b></u> Play the game It works: the problem of effectiveness Avoid extreme claims that can be disproved
<b>NARROW BUT INTENSE SUPPORT FOR OUTCOMES</b>	<u><b>EQUITY STRATEGIES</b></u> Equal dollar Cost-of-living Equity of need	<u><b>CLIENTELE STRATEGIES</b></u> Find a clientele Serve your clientele Expand your clientele Concentrate on individual constituencies Secure feedback End-runs
<b>BUDGET ENVIRONMENT UNFAVORABLE</b>		
<b>MODERATE RESISTANCE TO FINANCING</b>	<u><b>TARGETED STRATEGIES</b></u> Centers of excellence Cut the waste It's our mission	<u><b>CONFIDENCE STRATEGIES</b></u> Be what they think they are Play it straight Integrity I'd love to help you but.... What if they ask
<b>HIGH RESISTANCE TO OUTCOMES</b>	<u><b>STRATEGIES TO PROTECT/ EXPAND AGENCY SCOPE</b></u> Benefit/ cost Market failure The sky is falling	<u><b>STRATEGIES DESIGNED TO CAPITALIZE ON THE FRAGMENTATION OF POWER</b></u> Compensation Cross fire Both ends against the middle Cut the popular program Cut less visible items All or nothing Shift the blame They made me The transfer The camel's nose A foot in the door Just for now The commitment It pays itself; it makes a profit The crisis (salesmanship and advertising)

in the agency budget that is forwarded to the central budget office and to the legislature.

Since incremental budget strategies eschew intense scrutiny of any particular programs or budget categories and assume the budget base is protected, they are linked to broad public support for agency outcomes. Agencies that can be reasonably assured that the public is positively (if mildly) inclined toward their

programs are the most likely to use incremental strategies. Incremental budget strategies are most likely to be used when the budget environment is favorable.

### **Equity Budgeting**

Agencies may choose to treat all programs and client groups within its funding scope more or less equally. While at one level a redistributive agency mission is incompatible with equity budgeting, at the operational level at which agency missions and budgets are developed, there is no incompatibility. A redistributive agency may garner resources from segments of society, especially wealthier segments, that it does not serve, thus redistributing resources from the wealthy to the poor. Once receiving the resources for its clients, however, the agency may use equity budgeting to distribute the resources among its needy clientele. Thus, equity budgeting occurs when an agency is concerned about treating clients (for example, welfare recipients) equally in benefits received. At times, equity budgeting strategies may resemble incremental budgeting strategies in outcomes, although the motive and rationale remain different. If agencies have equal funding across programs and client groups initially, equity funding outcomes may appear to be the same as incrementalism. If, however, funding levels differ across client groups, equity budgeting requests diverge from incrementalism.

One equity strategy is the “equal dollar” approach. Agencies using this strategy request equal dollar amounts across different geographic regions, sometimes to remove incentives for clients moving from low-paying districts to high-paying districts. The “cost of living” strategy is to adjust amounts requested by cost of living differentials in different geographic regions. In districts where the cost of living is high, clients receive greater funding than in districts where living costs are lower. A third equity strategy is the “equity of need” approach. This approach considers the relative need of various client groups and recognizes that severely disadvantaged groups may need more support to attain the same level of outcome as less disadvantaged groups. Actual amounts requested for various client groups may differ, but the rationale is to provide equity in outcomes across differentially disadvantaged or needy groups.

Equity budget strategies are linked to limited public support for agency outcomes. Recognizing that the public is not favorably disposed toward the agency’s basic programs, the agency strategy is to appeal to the public’s sense of fairness as a way to maintain and increase agency funding levels. One aspect of equity funding appeals to the public’s sense of fairness about treatment of client groups. If one group is supported at a particular level, other groups should be funded at similar levels if the budget process is to be fair. Hence, the highest funded group becomes the linchpin by which funding requests for other groups are ratched upward. When equity funding diminishes incentives for clients to move and concentrate in particular geographic districts, appeals can be made to



fairness with respect to providers as well. Equity budgeting strategies are most likely to be used when the budget environment is favorable.

### **Targeted Budgeting**

Under targeted budgeting, agencies strongly differentiate funding requests across the various programs administered by the agency and client groups impacted by its services. Some programs and functional areas are treated favorably in funding requests, while others are not. The percentage increase (or decrease) put forth by the agency for programs within its control is not equal, but rather varies significantly (Levine, Rubin, and Wolohojian, 1986). Targeted budgeting has been recommended by budgeting scholars during times of retrenchment as the rational approach to budgeting, even though incrementalism may be the easier approach politically in hard times. This internal budgeting strategy is like the uneven economic growth strategy that South Korea took for fast economic growth. South Korea concentrated its scarce resources on strategic industries and regions that had higher potentiality than other industries and regions.

“Centers of excellence” is one targeted budgeting approach. Agencies focus on those programs that are performing particularly well, or perceived as performing well, to request larger increases for them. When successful, funding for these centers of excellence programs grows much faster than funding for other programs administered by the agency. “Cut the waste” is a second targeted budgeting strategy. With this approach, agencies significantly cut or even eliminate programs that are perceived to be ineffective, in order to maintain support for other agency programs. “It’s our mission” is a third targeted budgeting strategy. Agencies make larger requests for programs that fall within their basic mission than for programs that are more tangential to the agency’s basic mission.

Targeted budgeting strategies are linked to moderate public resistance to agency financing. Agencies with only mild resistance to financing can afford to request larger increases for some programs without jeopardizing public willingness to fund other agency programs. Hence, larger requests for some programs under the “centers of excellence” and “it’s our mission” approaches do not necessarily jeopardize more modest funding requests for other programs administered by the agency. Using the “cut the waste” strategy in hard times, as well as occasionally in good times, further enhances a public image of agency responsibility and efficiency that accompanies moderate (as opposed to high) public resistance to agency financing. Overall, targeted budgeting strategies are most likely to be used when the budget environment is unfavorable.

### **Strategies to Protect/Expand Agency Scope**

Under this strategy, agencies allocate funds internally in a way that maximizes the scope of their control. Funding recommendations are based on a concern about preventing encroachment from other agencies and potential providers into

the agency's service base. Agencies using strategies to protect and expand their scope are concerned about protecting agency programs and budgets from high political resistance to funding, including deep cuts that may threaten agency existence. Public utilities that are competing with private companies in one geographic or functional area and not so in another area may choose to redirect funds to the area where competition exists, away from areas where the service base is not threatened.

One protection/expansion of agency scope approach is the "benefit/cost" strategy. Using various calculations and justifications, agencies show that the benefits for the proposed budget requests exceed the costs, and they make budget requests accordingly. A second approach that protects agency scope is the "market failure" strategy. Agencies argue that they must provide or expand their programs since markets have failed to provide necessary services to citizens. Agencies allocate funds to programs where markets are perceived as failing and being inadequate. The extent of market failure, then, drives the magnitude of agency requests for funding and is used to protect or expand agency scope. Related to the market failure strategy is "the sky is falling" strategy. Agency officials contend that without protection or expansion of agency scope, dire consequences will be experienced: proverbially, the sky will fall. Agency funding requests that protect agency scope are to prevent dire consequences that otherwise will accrue.

Protection or expansion of agency scope strategies are linked to a high public resistance to financing agency programs. When public resistance is high, agencies know that restoring funding once it is cut is very difficult politically, and sometimes not possible. Agencies confronting high public resistance to financing are driven to protect existing programs or, more aggressively, to expand them, because the consequences of failing to do so will likely be significant and long-term. Protection/expansion of agency scope strategies are most likely to be used when the budget environment is unfavorable and the public is more focused on program costs than on program benefits. Protection budget strategies are designed to overcome high public resistance to agency costs.

## **EXTERNAL AGENCY BUDGET STRATEGIES AND PUBLIC SUPPORT**

In the highly charged arena of budgetary politics and program funding, agencies employ various budget strategies to attain political support and agency funding from external budget actors. In his classic book, *The New Politics of the Budgetary Process*, Wildavsky (1992) has identified four categories of agency budget strategies. The strategies Wildavsky discusses are designed primarily for dealing with actors outside the agency who control its funding: those related to legislative committee hearings, clientele strategies, confidence strategies, and those designed to capitalize on fragmentation of power (Wildavsky, 1992). The fifth category of "being a good politician" that Wildavsky also identifies is not mutually exclusive to the other categories but rather overlaps with

and includes several of them. These strategies, in turn, are linked to the scope and degree of public support. Additionally, we do not consider these four external strategies all incremental since they can be incremental, radical, or any others.

In theory, agencies are concerned about the public attitudes surrounding both their benefits and costs in developing budget strategies. In reality, however, economic conditions dictate which is emphasized more. As with internal budget strategies, economic conditions determine whether the budget environment is favorable or unfavorable. The condition of the budget environment, in turn, impacts agency choice of which external budget strategy to use. When the budget environment is favorable, the public is likely to focus on program benefits. Agencies with favorable budget environments are likely to emphasize budget strategies associated with support for agency benefits. When the budget environment is unfavorable, however, the public is likely to focus on program costs. Agencies with unfavorable budget environments are likely to particularly emphasize budget strategies associated with public resistance to financing. Some agencies may use beneficiaries to overcome public resistance to financing in hard economic times.

### **Legislative Committee Hearing Strategies**

Legislative committee hearing strategies involve agency actions to maximize their funding outcomes before key legislative committees. Legislative committee hearings provide very public arenas for agencies to present their cases for continued and increased funding. Legislative hearings may be covered by the media, further alerting the public to the ongoing budgetary politics, whereas central budget office hearings and decisions are not as likely to receive media attention. Further, since positions on budget and appropriations committees are typically prestigious and highly sought after by legislators, the members of key committees are likely to be either more senior or of high status within the legislature or both. The high status of legislative budget and appropriations committee members further increases the likelihood of media attention. Potential sparks of adversarial exchanges between agency officials and legislators, or among legislators on the committee with competing views, also make legislative hearings visible to the public in an era where controversy and adversarial relationships attract attention. Nonetheless, the public attention generated through hearings may be short-lived, and the support, though broad, may be weak, since legislative committee members likely come from diverse, heterogeneous districts with similarly diverse political and economic interests. Committee members may perceive the value of a meritorious program brought before them, but unless the program directly and strongly impacts their own district and constituencies, they may not be passionate in their interest in or support for the agency programs in

question. Legislative committee hearings strategies are most likely to be used when the budget environment is favorable.

One legislative strategy is “to play the game.” Agency budgets are often cut by the central budget office in the executive branch prior to going before the key budget or appropriations committee. Bound by the rules of the game to not officially contradict the figures put forth in the combined executive budget endorsed by the chief executive (president or governor), agency heads in theory are restricted from presenting alternative information about agency needs and higher figures. The rules of the game, however, do not prevent the agency head from responding to questions put forth by legislative committee members and, indeed, require the agency head to do so. The game played by the agency head, then, is to respond to inquiries without overtly contradicting the combined executive budget but in such a manner that legislative committee members are prompted to ask what were the original budget figures the agency developed, and what are the agency’s needs associated with those figures. The agency, then, is able to present its needs and original figures to the committee without overtly challenging or contradicting the central budget office and chief executive (Wildavsky, 1992). This strategy is likely to work when legislative committee members with mild interest in most programs are prompted to probe further but not to attack the program. The motives for legislative questioning favorable to the agency may range from “grandstanding” by committee members to gain media or other political attention, to concern that a program with modest impact on their own district should thrive.

Another legislative committee hearing budget strategy is “it works.” In this strategy, the agency defends current spending needs on the basis of past performance, using the argument that it has performed successfully in previous years. In short, its programs work. Part of this strategy is to define the criteria for judging the program by those involved in the budget process. If the criteria are defined by program opponents, they may be too rigorous and impossible to meet. Agencies successfully employing this strategy are able to find reasonable criteria that allow the program to be judged a success (Wildavsky, 1992). This strategy is best employed when no one on the committee is motivated to attack the program, and a statement that “it works” by reasonable criteria is taken at face value.

“Avoiding the extremes that can be disproved” is another agency budget strategy employed before legislative committees. This strategy assumes that any contradiction of agency claims will undermine the credibility of agency officials presenting agency budget requests. If extreme cases are made publicly, the likelihood is great those claims will be challenged and shown to be untrue or unrealistic or both by skeptical or hostile committee members. Hence, astute agency officials avoid making extreme cases or claims. Again, when support is broad and weak, committee members are not driven to attack the program, so

avoiding attacks on agency head credibility enhances general committee support for the program.

### **Clientele Strategies**

Clientele strategies involve skillful agency use of clientele groups to enhance agency funding (Wildavsky, 1992). Although these strategies can be used with a variety of clientele groups, they are most successful when the clientele group is highly visible and evokes public support as a needy or deserving group. Clientele strategies include “finding a clientele,” “serving the clientele,” “expanding the clientele,” “concentrating on individual constituencies,” “securing feedback,” and “end-runs.” Finding and serving a clientele group implies agencies should identify and provide services to an identifiable group. For some agencies, such as agricultural, welfare, and veterans agencies, the clientele group is readily identifiable. For other agencies, such as those dealing with the environment, transportation, or food and drug safety, particular clientele groups may be more difficult to identify, reducing the likelihood those agencies will rely on these strategies.

In the strategies of expanding the clientele and concentrating on individual constituencies, the agency improves its relations with the clientele group, so members of the clientele group become more aware of the benefits they derive from the agency and stronger advocates for funding its programs. By securing feedback, the agency assures that its programs continue to serve clientele needs.

Agencies may conduct “end-runs” when the clientele group is not present or viewed as particularly needy or deserving by trying to get revenues through indirect funding mechanisms (access to nonappropriated revenues, or some forms of automatic entitlement funding). When the clientele group is particularly needy, the agency may perform a different type of end-run around its opponents in the central budget office and on the committee, by mobilizing the clientele group to appear in rallies, marches, or before the committee at key decision points. Thus, needy crippled children, elderly in dire straits, and other members of deserving groups may be bused or otherwise brought to legislative hearings and other public forums at strategic moments in the budget process.

Clientele strategies are typically linked to intense but limited public support for agency outcomes. While some of the strategies, particularly mobilizing groups perceived to be needy or deserving, work to gain media attention, most citizens do not benefit from increased agency funding. The intense support for agency funding comes from those impacted by agency programs, but it is limited to the clientele group and friends of the clientele group. Clientele strategies, generally, strive to temporarily expand awareness of program funding needs beyond the clientele group to the general public, to briefly gain broad but likely weak public support for a period long enough to secure funding. Agencies tend to use clientele strategies mostly when the budget environment is favorable.

However, agencies are not necessarily restricted in their use of clientele strategies to good times.

### **Confidence Strategies**

Confidence strategies involve the establishment of mutual support and confidence between agency officials on the one hand, and legislators and other key budget actors on the other (Wildavsky, 1992). Confidence strategies are particularly important when budget requests are very large, such as defense, certain entitlement programs, and large public works. Since no legislator or other person can readily comprehend all that is involved in a large request, having confidence about the legitimacy of the request is important. Confidence strategies are also important when spending is for the production of outcomes that are very technical and complicated, as is the case with defense, public works, space programs, and transportation. Again, the inability of any individual overseeing such expenditures to comprehend all or even most of the technical details and principles involved require that mutual trust exist between those requesting the funds and those granting the funds.

Wildavsky identifies several confidence strategies, including “be what they think you are,” “play it straight,” “integrity,” and “I’d love to help you . . . but. . . .” In the first confidence strategy, agency officials accurately perceive the image that legislators hold of them and fulfil that image. Frequently the image of agency officials is that they are masters of detail, hard-working, self-effacing, devoted to their work, and concerned about efficient use of taxpayers’ money. “Playing it straight” involves being above board, not lying, and avoiding cover-ups of misdeeds. “Integrity” includes providing reliable information and protecting the agency official’s good public name. When agency officials are asked by legislators or other budget actors to engage in actions that the official cannot do without jeopardizing the agency position or his own reputation, the official may use the strategy of “I’d love to help you . . . but.” This strategy implies that the official values the relationship of mutual trust and external constraints, rather than conceding that animosity or adversarial relationships are preventing the official from complying. An additional confidence strategy of “what if they ask” is identified by Al Kliman (1990). The agency official using this strategy always has detailed answers available for budget proposals to give credibility to budget requests.

Confidence strategies are particularly effective when public resistance to agency financing is moderate. With moderate public resistance, confidence alone may be sufficient to encourage legislators to approve agency requests. Stronger public resistance would likely require more detailed and stronger proof of the value of agency outcomes and the need for funding increases. Hence, confidence strategies work well for defense and hospitals, but less well for regulatory agencies who confront high public resistance to agency financing. Confidence strategies are more likely to be used when the budget environment is unfavorable,

and a public image of confidence in agency programs is needed to overcome moderate public resistance to financing agency outcomes.

### **Strategies Designed to Capitalize on the Fragmentation of Power**

A fourth category of actions agency officials use to maximize funding are strategies designed to capitalize on fragmentation of power. In these strategies, agency officials exploit the separation of power between the executive and legislative branches as well as the division of power within each branch to play one power center against another (Wildavsky, 1992).

In several strategies, agency officials try to employ conflict between budget actors to the officials' own interests. In the strategy of "compensation," agency officials attempt to get one power center to agree to higher funding, so that other power centers will more likely split the difference in approved funding, resulting in a higher overall allocation. "Cross-fire" occurs when an agency is caught between competing interests in the budget process. In this situation, agencies must "duck" and allow supporting power centers to argue their case, or else get mowed down. "Both ends against the middle" involves agency officials effectively using conflicts between key decision makers in the legislative process, particularly between a substantive committee and an appropriations committee.

The type of budget cut agency officials recommend when forced to do so may also involve strategizing. Agency officials who employ "cutting the popular program" argue that only programs with strong legislative and public support can be cut in an effort to protect less popular programs from scrutiny and on the faith that funding for the popular program will either remain unscathed or be restored. The reverse strategy is to "cut less visible items" such as house-keeping, maintenance, and infrastructure activities in an attempt to protect core program activities. The "all or nothing" strategy is high risk, implying that any cuts vitiate program viability. In "it pays for itself," officials argue that self-financing programs should not be cut. A more positive version of this general strategy of attributing funding requests to others is "the crisis" strategy. "The crisis" strategy involves salesmanship, advertising, and the attribution of funding requests to an external crisis that must be addressed or dire consequences will result.

Some strategies involve relinquishing responsibility for requests. "Shifting the blame" allows budget actors to argue that others are responsible for cuts they are forced to make. A variant of this strategy is "they made me," where agency officials imply they had no choice in making the requests they do. In "the commitment," the agency officials imply funding increases are a function of prior commitments or other uncontrollable factors.

Some strategies involve disguising actual or likely future funding levels. In "the transfer," agency officials transfer items from one category of spending to another to keep the spending levels for the initial category constant and to appear

like no increases are being requested. “The camel’s nose” is used when a potentially large program is begun with an insignificant sum, but escalating requests and funding levels rapidly ensue. A similar strategy to the camel’s nose is “a foot in the door.” In this strategy, agency officials keep certain items in the budget, even when funded modestly, in the hopes that future funding levels will be increased. “Just for now” is a strategy that implies the requested funding will be temporary.

Strategies designed to capitalize on the fragmentation of power are most likely to be used when there is high resistance to financing agency outcomes. These strategies exploit weaknesses and divisions in the system. Frequently using a “divide and conquer” approach, they are divisive and negative in nature. Under the unfavorable condition of high public resistance to financing, more mild and trusting strategies are not likely to work. Strategies exploiting the separation of powers are more likely to be used when the budget environment is unfavorable as well, contributing to the need for strong and at times conflict-based approaches.

## **AGENCY MISSIONS AND DOMINANT BUDGET STRATEGIES**

Because agencies with different missions also differ in degree of public support for outcomes and resistance to financing, and because public support may be linked to various budget strategies, agency missions, in turn, may also be linked to internal and external budget strategies. Agency choices for both internal and external budget strategies are influenced by whether the budget environment is favorable or unfavorable (Table 12.4).

### **Distributive Agencies and Dominant Budget Strategies**

Distributive agencies effectively use the appropriations process. By virtue of producing goods and services that can be dispersed across a wide range of districts, their output is sometimes labeled “pork barrel.” These agencies may build up political chits with external budget actors, especially significant legislators, which they then call in when needed.

When the budget environment is favorable, distributive agency budget strategies are likely to be impacted by the broad, weak support for program outcomes that agencies with a producer focus confront. In good times, distributive agencies are likely to use incremental strategies in formulating budget requests. The broad public support enables agency officials to ask for across-the-board increases in most or all programs. When dealing with external actors, distributive agencies are likely to emphasize legislative committee hearing strategies. Distributive agencies that can tout the political favor their dispersed benefits are likely to generate among legislators from diverse geographic districts to obtain positive funding increases when economic conditions allow a legislative focus on program benefits. Jones (1991) contends that defense agencies, for example, attempt



**Table 12.4**  
**Agency Missions and Budget Strategies**

AGENCY MISSION AND FOCUS	BUDGET ENVIRONMENT	PUBLIC SUPPORT	DOMINANT INTERNAL BUDGET STRATEGIES	DOMINANT EXTERNAL BUDGET STRATEGIES
<b>DISTRIBUTIVE</b> Producer Focus	Favorable	Broad but weak support for outcomes	Incremental strategies	Legislative committee hearing strategies
	Unfavorable	Moderate resistance to financing	Targeted strategies	Confidence strategies
<b>REDISTRIBUTIVE</b> Client Focus	Favorable	Narrow but intense support for outcomes	Equity strategies	Clientele strategies
	Unfavorable	Moderate resistance to financing	Targeted strategies	Confidence strategies
<b>REGULATORY</b> Public Interest Focus	Favorable	Broad but weak support for outcomes	Incremental strategies	Legislative committee hearings strategies
	Unfavorable	High resistance to financing	Strategies to protect/expand agency scope	Strategies designed to capitalize on the fragmentation of power
<b>MARKET EMULATORS</b> Customer Focus	Favorable	Narrow but intense support for outcomes	Equity strategies	Clientele strategies
	Unfavorable	High resistance to financing	Strategies to protect/expand agency scope	Strategies designed to capitalize on the fragmentation of power

to reward members of Congress that provide them budgetary discretion through the allocation of pork barrel expenditures.

When the budget environment is unfavorable, distributive agencies are more likely to be affected by moderate public resistance to funding their programs. The likelihood that distributive agencies will use targeted budgeting strategies internally increases. To overcome moderate resistance to funding, distributive

agencies are likely to stress their centers of excellence, show how funding increases are linked to the basic agency mission, and show that they have cut waste. Externally, distributive agencies are likely to use confidence strategies to overcome concerns and criticisms.

### **Redistributive Agencies and Dominant Budget Strategies**

Redistributive agencies effectively use the “iron triangle,” successfully exploiting the linkages between the agency, its clientele, and key legislative committees. They rely on client groups for lobbying, and on authorizing committees and entitlement legislation for protection.

A favorable budget environment causes redistributive agencies to focus on their limited but intense public support for outcomes when making budget strategy choices. Favorable environmental conditions are likely to cause redistributive agencies to use equity strategies when internally developing budget requests. Equity strategies allow the agency to use the principle of fairness to offset narrow agency support. In dealings with external budget actors when the environment is favorable, redistributive agencies are likely to use clientele strategies. Clientele strategies enable the agency to mobilize those who benefit from and intensely support agency programs to lobby for funding increases. Using clientele strategies enables redistributive agencies to manipulate a key leg of the “iron triangle” in making its budget requests externally, a triangle consisting of the agency itself, its clientele, and key legislative committees (Keigher, 1988).

An unfavorable budget environment results in a focus by redistributive agencies on the moderate public resistance they experience. Resistance to funding redistributive agencies is moderate because costs are dispersed. Redistributive agencies act similarly to distributive agencies in tight times, using targeted budgeting strategies internally and confidence strategies externally. Redistributive agencies may have large portions of their budget funded through entitlement legislation and mechanisms, so that altering funding requires authorizing as well as appropriations actions. Given this protection, redistributive agencies can afford to use targeted budgeting in tight times, showing how waste is being cut and funding increases are linked to program effectiveness, relevance to mission, and excellence. Externally, redistributive agencies are likely to use confidence strategies when conditions are unfavorable, to overcome criticisms and concerns. When budgets are cut, one study of welfare directors has shown a shift away from client strategies and concerns (Mason, Wodarski, Parham, and Lindsey, 1985).

### **Regulatory Agencies and Dominant Budget Strategies**

Regulatory agencies often use crises not only when they are created as an impetus to obtain initial authorizing legislation, but also to propel funding levels

upward at key intervals. They may further use the media to develop public awareness of the benefits of regulation.

Under favorable conditions, regulatory agencies make budget choices based on their broad, weak public support, which stems from dispersed benefits. In good times, regulatory agencies employ similar budget strategies as distributive agencies. When the economy is strong, regulatory agencies use incremental strategies internally to develop funding requests, and legislative committee hearing strategies externally, to utilize the fact that most or all legislative districts are impacted by the outcomes of regulatory agency programs.

Under unfavorable conditions, regulatory agencies make budget choices based on the high resistance to financing that they confront. Regulatory agencies face high resistance to financing because their costs are concentrated, impacting the regulated more heavily than others. Those experiencing high costs resist agency financing in an effort to lower their own personal or corporate costs. Under unfavorable conditions, regulatory agencies budget internally to protect the agency scope of programs and control. Aware that the creation of regulatory agencies and subsequent expansions in authority have been driven by highly visible crises that temporarily overcome the high resistance of the regulated to agency financing, regulatory agencies resist a shrinkage of their control in tight times, and budget accordingly. Thus, state environmental agencies, for example, resist returning some aspects of environmental regulation to the federal government, which would shrink their own control, even though questions have been raised about the capacities of state agencies to provide effective regulation under unfavorable conditions (Malysa, 1996). Externally, regulatory agencies may use combative and conflictual strategies to overcome high public resistance to funding. These strategies are designed to capitalize on the fragmentation of power by exploiting the separation of power between the legislative and executive branches, as well as power divisions within branches.

### **Market Emulators and Dominant Budget Strategies**

Unlike other agencies, market emulators may not be limited to resources garnered through the budget process. By virtue of selling agency services or products, market emulators may gain resources from market activities. For example, mass transportation agencies may develop new or expanded services to generate additional income or increase fares. Nonetheless, many market emulators do depend on government subsidies and develop budgeting strategies to gain resources from appropriations. Cothran (1993) traces a shift in budgeting from an expenditure control emphasis to a decentralized entrepreneurial budgetary emphasis that holds agency officials accountable for spending and outcomes. This budgeting strategy is most likely used by market emulators, who to some degree experience a "bottom line" like their private sector counterparts. Recognizing that the public may view the public sector as less efficient than the private sector, market emulators downplay their public sector linkages whenever possible. In

requesting budget subsidies, they stress their own efficiency, customer focus, and scope of service.

Because they typically have concentrated benefits, market emulators experience limited but intense support for agency outcomes. When economic conditions are favorable, this limited support drives market emulator budget strategy choices. In good times, market emulators are likely to adopt the same budget strategies as redistributive agencies, which are also confronting limited but intense support. Internally, market emulators in good times are likely to employ equity strategies, to show that funding needs to be based on fairness. Externally, market emulators are likely to use clientele strategies to garner budget subsidies, rallying the client or beneficiary groups to lobby for agency funding.

When economic conditions are unfavorable, market emulators are forced to be concerned about the high public resistance to financing they confront, which derives from concentrated costs. In tight times, market emulators are likely to adopt budget strategies similar to those of regulatory agencies, which also confront high public resistance to financing. Thus, market emulators will budget internally to protect their agency scope, recognizing the difficulty of recouping funding once agency scope and market share have been lost. Externally, market emulators in tight times will adopt strategies that capitalize on fragmentation of power.

## **CONCLUSION: THE COMPLEXITY OF AGENCY BUDGET STRATEGY CHOICES**

The linkages presented here between agency mission, benefit/cost structure, public support, and environment-driven internal and external agency budget strategies are not deterministic. After having made many errors and mistakes, in the long term, an agency relies on the budget strategies that have been most effective in achieving budget success. We argue that those strategies, which are proposed in this study, will be most effective when an agency's mission fits to them. In other words, agencies that have different missions need different budget strategies to maximize their possibility of budget success. More importantly, we contend that agency mission, among many other factors, mainly impacts the agency choices of budget strategies. However, any particular setting, for various idiosyncratic reasons, may result in alternative agency choices. Further, agency *perceptions* of whether the budget environment is favorable or unfavorable may be as important in driving agency strategy choices as whether or not conditions *are* actually favorable or unfavorable. Another factor impacting choice of agency budget strategy will be the personal proclivities of agency heads to be cautious or bold, and to be combative or conciliatory. These factors—stochastic variation, agency perceptions, and personal proclivities of agency officials—may confound deterministic predictions about which budget strategies agencies will use at any particular time. Even without these confounding factors, the relationships between mission and budget strategy are complex. This chapter has presented a

theoretical basis for examining this real-world complexity in greater depth. Developing a theory about agency strategies to maximize agency resources does not mitigate the ethical dilemma posed by critics of budget maximization theory. Concerns of the public over whether or not agencies should receive more resources are separate from theorizing and subsequent empirical testing of how agencies develop strategies to achieve their mission. Further study needs to provide empirical evidence for proving this deductive budget theory.

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## Budgeting for Outcomes

Lawrence L. Martin

At times, it seems every book and article on public budget theory begins by paying homage to V.O. Key. Why break with tradition? Key (1940) is largely remembered for his criticism that public budgeting has tended to be atheoretical and his famous question: How should one decide to allocate X dollars to activity A instead of activity B?

Public budgeting practices over the last sixty years have provided a myriad of responses to Key. The allocation question has been answered in terms of: financial control (line-item budgeting); managerial control (performance budgeting); planning and programming (program budgeting) and its various incarnations (e.g., PPB and MBO); attempts to overcome incrementalism (e.g., ZBB); increased managerial discretion (entrepreneurial budgeting), and others. In terms of budget theory, however, it is unclear that any of these public budget systems truly represents a triumph of theory over process.

The comment has been made that public budget systems tend to be reflections of the “time and circumstances” during which they are conceived (Rubin, 1996). In terms of contemporary time and circumstances, one of the more important forces in government today is the performance accountability movement (Hatry and Whosley, 1994). The Government Performance & Results Act (GPRA) (Public Law 103–62), the service efforts and accomplishments (SEA) reporting initiative of the Governmental Accounting Standards Board (GASB, 1994), and the various state and local government performance measurement programs are all concerned with the collection and reporting of data on the *outcomes* (the results, accomplishments, or impacts) of government programs.

In addition to a focus on the outcomes of government programs, performance

accountability also seeks to promote *transparency* in, and improve the external *communications* of, governments. Transparency in its broadest sense is taken to mean that governments should be as open and visible as possible to their stakeholders (e.g., elected officials, citizens, interest groups and others). Communication means that governments should provide information about programs, outcomes, and attendant costs in a language that stakeholders can understand (McTigue, 2001). The argument can be made that transparency and communication are inseparable from the concept of performance accountability (Chan, 2001). Stakeholders armed with readily understandable performance information about the outcomes and attendant costs of government programs will be better positioned to hold government programs accountable. This emphasis on transparency and communication as an aspect of performance accountability can also be found in the new standards for state and local government accounting and reporting mandated by GASB Statement No. 34 (GASB, 1999).

Given the current level of interest in performance accountability and more specifically with outcomes, it is not surprising then that some governments are experimenting with what can be called: "outcome budgeting." Returning to V.O. Key, outcome budgeting takes the traditional systems approach a step further to suggest an answer to the allocation question: on the basis of the outcomes achieved by program A and their attendant costs as compared to the outcomes achieved by program B and their attendant costs.

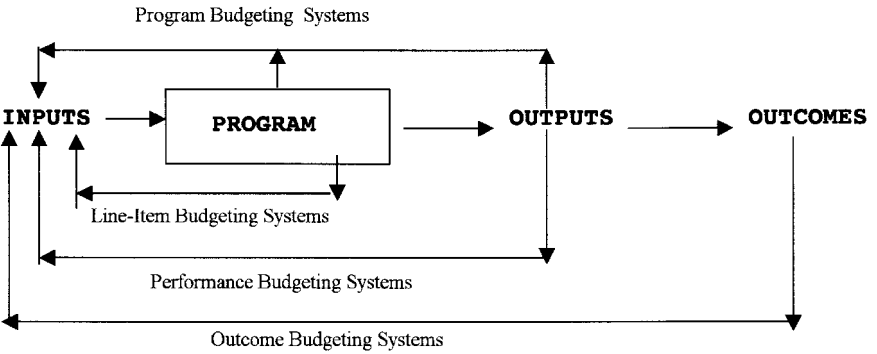
## **OUTCOME BUDGETING: ITS PLACE IN PUBLIC BUDGETING THEORY**

Outcome budgeting is one of those interesting government phenomena that arises from time to time where practice has outpaced theory. With a few notable exceptions (Martin, 2001, 2000, 1997; Gianakis and McCue, 1999), the concept of outcome budgeting has received little attention in the public budgeting literature. As a result, no generally agreed upon definition of outcome budgeting exists.

David Osborne and Ted Gaebler, in their influential book *Reinventing Government*, suggest a working definition. They define outcome budgeting as: "A budget system that focuses on the outcomes of the funded activity" (Osborne and Gaebler, 1992:161). Osborne and Gaebler are not the first to use the term outcome budgeting, but they are generally credited with popularizing the concept (Martin, 2000, 1997; Gianakis and McCue, 1999). The term outcome budgeting does have some history in the literature on human services administration that actually predates Osborne and Gaebler. For example, in a 1990 textbook, *Designing & Managing Programs: An Effectiveness-Based Approach*, the authors make specific reference to outcome budgeting and describe it as an extension of program budgeting (the allocation of organizational costs to major programs) and the linking of outcome goals and objectives to those programs in order to derive unit costs per outcome (Kettner, Moroney, Martin, 1990:162, 177–178).



**Figure 13.1**  
**Comparison of Outcome Budgeting with Other Public Budgeting Systems Using the Expanded Systems Framework**



Budgeting System	Purpose	System Foci	Target Audience
Line-Item	Control	Inputs/Program	Internal
Performance	Management	Outputs/Inputs	Internal
Program	Planning	Inputs/Program/Outputs	Internal/External
Outcome	Outcome Performance, Transparency & Communication	Outcomes/Inputs	External/Internal

Using what can be called an “expanded systems model” (Martin and Kettner, 1996), Figure 13.1 illustrates how outcome budgeting systems differ from other public budgeting systems. The emphasis in Figure 13.1 is on comparisons between outcome budgeting and the three major public budgeting systems (line-item, performance and program).

The primary focus of outcome budgeting systems makes them qualitatively different from other major public budgeting systems. As Figure 13.1 demonstrates, outcome budgeting is the only public budgeting system that makes outcomes its primary focus. Despite this obvious difference, the public budgeting literature has been slow to recognize outcome budgeting as a new species of public budgeting. The failure of the public budgeting literature to recognize the important theoretical aspects of outcomes and outcome budgeting is perhaps due to the tendency to equate outcome budgeting with performance budgeting. Conceptualizing outcome budgeting as a component or subset of performance budgeting fails to recognize the important distinction between a focus on *outputs* and

a focus on *outcomes*. According to most public budgeting scholars, performance budgeting is concerned with “the things that government does” (Tyler and Willand, 1997), rather than the outcomes governments achieve. For example, in his classic text, *Public Budgeting in America*, Thomas Lynch (1995: 373) provides a typical definition of performance budgeting: “a budget format that presents government program input and *output*, thus allowing easy verification of the program’s economy and efficiency” (emphasis added). Outcome budgeting is concerned not with outputs, economy, and efficiency, but rather with outcomes and effectiveness (the ratio of outcomes to inputs). Because performance budgeting does not recognize the importance, or even the existence of outcomes, it is inappropriate by definition to classify outcome budgeting as a subset of performance budgeting.

Figure 13.1 also draws attention to two other dimensions (purpose and target audience) on which outcome budgeting systems differ from other major public budgeting systems. Public budgeting systems have long been held to have three primary purposes: control, management, and planning (Schick, 1966). All public budgeting systems are said to possess these primary purposes but with varying degrees of emphasis. Because outcome budgeting is a manifestation of performance accountability, it has two additional purposes (transparency and communication) not generally found in other public budgeting systems. Outcome budgeting systems are as concerned about making government programs transparent and communicating information about these programs to stakeholders as they are about outcomes.

The target audience for outcome budgeting also differs from those of the other major public budgeting systems. The argument can be made that the target audience for line-item, performance—and to a lesser extent program budgeting systems—is primarily internal, government managers and administrators. Historically, these public budgeting systems have not been what might be called “external stakeholder friendly.” For example, in discussing the budget of the State of Florida prior to its move to outcome budgeting, state Sen. Patricia Grogan commented that “the way we’ve chosen to present budgets doesn’t tell us anything meaningful. I defy anybody to look through the budget act itself and tell us what we are buying” (Hosansky, 1994:26).

The combination of a focus on outcomes, its transparency and communication purposes and its external target audience sets outcome budgeting apart from other public budgeting systems and warrants its recognition as a new species of public budgeting.

## **OUTCOME BUDGETING: A CONCEPTUAL FRAMEWORK**

Implementing outcome budgeting involves two major decisions: (1) the selection of a basic approach, and (2) the selection of a unit of analysis. Both of these approaches are discussed at some length below.

## The Selection of a Basic Approach

David Osborne and Ted Gaebler (1992) identify two basic approaches to outcome budgeting: (a) budgeting systems that *link* specific outcomes to the budget and the budget process, and (b) budgeting systems that *purchase*, or allocate, specific resources for the accomplishment of specific outcomes.

With the linking approach, outcomes are made a part of budget documents and the budget process in much the same way that outputs are made a part of performance budgets. The linking approach enables stakeholders to see what specific resources are being allocated toward the planned accomplishment of what outcomes. The purchase approach involves allocating specific resources for the accomplishment of specific outcomes. The purchase approach goes beyond merely relating resources to outcomes by targeting specific resources for the accomplishment of specific outcomes in a sort of quasic contractual fashion.

Clearly the purchase approach is more sophisticated and consequently more difficult to implement than the linking approach. However, linking outcomes to budget documents and the budget process is a necessary first step regardless of whether outcome budgeting stops here or proceeds on to the purchase approach.

## The Level of Analysis

With the selection of a level of analysis, it is determined at what level outcome budgeting will take place. Theoretically, outcome budgeting can occur at: the program/service level, the agency/organizational level, the state/community level, or any combination thereof (Martin, 1997).

The program/service level takes the form of linking outcomes to program/service level budgets or through the actual purchase of specific levels of program or service outcome. The program/service level may be the easiest level at which to implement outcome budgeting. The program/service level is also compatible with the service efforts and accomplishments reporting initiative of the Governmental Accounting Standards Board (GASB), which has adopted programs as its basic unit of analysis.

The agency/organizational level attempts to transcend individual programs and services by linking or purchasing outcomes that are in keeping with an agency's/organization's overall mission. Outcome budgeting at this level is in keeping with the basic tenets of strategic planning (Bryson, 1995). The idea of combining strategic planning and budgeting to overcome mission fragmentation and program overlap is a major operational premise of *The Government Performance & Results Act* (USGAO, 1997a, 1997b; U.S. DHHS, 1997).

The state/community level attempts to link budgets to geographically determined outcome priorities or by purchasing specific desired increases or decreases in some social indicator. A social indicator is a statistic that "takes the pulse" of a state or community. Frequently used social indicators include: poverty rates, crime rates, employment rates, measures of housing stock, morbidity and mor-

tality rates, and the like. Outcome budgeting at this level is compatible with state and community “benchmarking” efforts. While outcome budgeting at the state/community level is naturally appealing, relating outcomes and resources to the accomplishment of state and community social indicators is difficult at best and raises validity issues that are not encountered at the other levels (Rossi, 1997). The major example of an attempt to implement outcome budgeting at the state/community level is the state of Oregon and its “Oregon Benchmarks” program (Oregon Progress Board, 1997, 1996a, 1996b).

## SOME EXAMPLES OF OUTCOME BUDGETING

The states of Arizona, Texas, and Florida are all currently involved in broad-based efforts to implement outcome budgeting. These efforts are being driven by legislative mandates that reflect, at least in part, the frustration of stakeholders (both internal and external) with the more traditional public budgeting systems. Because Arizona, Texas, and Florida are at different stages of what might be called the evolution of outcome budgeting, they represent interesting and informative mini-cases. Arizona has the least amount of experience of the three states and thus can be seen as a case example of a unit of government that is at the *experimental* stage of outcome budgeting. Texas has considerably more experience than Arizona and can be seen as a case example of a unit of government that is at the *refinement* stage of outcome budgeting. Finally, Florida is the most advanced of the three states and can be seen as a case example of a unit of government that is at the *institutional* stage of outcome budgeting.

### The State of Arizona (The Experimental Stage)

In terms of length of time involved with outcome budgeting, Arizona is the youngest of the three states included in this analysis and consequently has the least well-developed system. Outcome budgeting in Arizona can perhaps best be described as the linking approach operating at the program/service level.

Arizona, like both Texas and Florida, became involved in outcome budgeting as a result of legislative action. By virtue of a series of statutory actions collectively referred to as the *Arizona Budget Reform Legislation* (Chapter 339, Laws 1996; Chapter 283, Laws 1995; and Chapter 252, Laws 1993) all executive agencies and departments of Arizona state government, as well as the university system and the state judiciary, are required to (1) identify every program under their auspices, (2) develop strategic plans and performance measures that encompass all identified programs, and (3) relate the strategic plans and performance measures to the state budget and the budget process. Arizona refers to its current budgeting system as “strategic planning and budgeting” to distinguish it from past budgeting systems.

A major initial task for Arizona was the identification, classification, and categorization of all state programs (i.e., the development of a program struc-

ture). In 1995 Arizona published its first *Master List of State Government Programs*. The Master List was revised most recently in 2000 (Arizona Governor's Office, 2000). The next step for Arizona in moving toward outcome budgeting was the identification of performance measures and their linking to budget documents and the budget process. Table 13.1 presents two representative programs of the Arizona Department of Economic Security together with their related performance measures and budgeted resources.

An examination of Table 13.1 demonstrates that an individual program (e.g., the older workers program) within Arizona's program structure consists of one or more goals (e.g., to increase the number of participants transitioned to unsubsidized employment) with related performance measures, targets, and budgeted resources for three years, fiscal year 2001 and for comparison purposes two previous fiscal years. Although not all types are shown in Table 13.1, Arizona uses five types of performance measures (input, output, outcome, quality, and efficiency). While being far from a perfect communications tool, outcome budgeting in Arizona does make government programs more transparent to stakeholders than do more traditional public budgeting systems.

The question might well be asked: Why does Arizona's budgeting system constitute outcome budgeting? The twofold answer is because of state intent and because of what might be called the natural evolution of outcome budgeting. The *Arizona Budget Reform Legislation* expresses a clear preference for performance measures that emphasize the outcomes of programs. In terms of intent, Arizona clearly desires to move toward outcome budgeting. But not all elements of Arizona's program structure have developed valid and useful outcome performance measures. For example, at least one performance measure identified in Table 13.1 (the number of children receiving services under goal 2) would probably not be considered an outcome by most persons. Because many Arizona programs have yet to develop valid outcomes, alternative performance measures (such as input, process and output) are necessarily included by default, but with the intent that over time outcome measures will predominate. Testifying to Arizona's desire to adopt outcome budgeting are two studies (Martin, 2000; Franklin, 1997), both of which document the state's movement away from the use of input, process, and output measures and movement toward the use of more outcome measures.

The use of a variety of performance measures by a unit of government during the *experimental* stage appears to be a part of the natural evolutionary process of outcome budgeting. This assertion is given added empirical support by the outcome budgeting experiences of Texas and Florida. These two states also demonstrate a progression from the use of multiple types of performance measures to—over time—more of a primary focus on outcomes.

While outcome budgeting in Arizona uses the program/service level, it should be noted that many programs are quite broad in nature and frequently contain one or more subprograms that themselves might well be thought of as individual programs. The grouping of several discrete programs, or subprograms, into

**Table 13.1****Fiscal Year (FY) 2001: Outcome Budgets for the Arizona Department of Economic Security****Older Workers Program****Goal 1** - To improve the quality of life of workers age 55 and over by moving them toward self-sufficiency.

Performance Measure(s)	FY99	FY00	FY01
# of participants transitioned to unsubsidized employment	47	48	50

**Goal 2** - To improve the quality of life of low income persons age 60 and over while providing meaningful intergenerational contact with special needs children.

Performance Measure(s)	FY99	FY00	FY01
% of respondents indicating satisfaction with the program	65	68	71

Budget (000)	FY99	FY00	FY01
General Funds	0.0	935.0	975.4
Other Appropriated Funds	0.0	0.0	0.0
Other Non-Appropriated Funds	399.0	502.1	502.1
Federal Funds	11,539.3	13,016.9	13,543.8
Program Total	<u>11,938.3</u>	<u>14,454.0</u>	<u>15,020.4</u> (Sic)

**Family Support Services****Goal 1** - To prevent child abuse and neglect in families with children under the age of five years.

Performance Measure(s)	FY99	FY00	FY01
# of children receiving services	2,530	2,530	2,530
% of program families not having a validated report of abuse or neglect		96	96

**Goal 2** - To promote child development and wellness in families with children under the age of five years.

Performance Measure(s)	FY99	FY00	FY01
% of program children having developmental screenings to identify delays at appropriate intervals.	80	84	88
Budget (000)	FY95	FY96	FY97
General Funds	2,933.4	4,000.0	5,000.0
Other Appropriated Funds	0.0	0.0	0.0
Other Non-Appropriated Funds	0.0	0.0	0.0
Federal Funds	0.0	0.0	0.0
Program Total	<u>2,933.4</u>	<u>4,000.0</u>	<u>5,000.0</u>

Source: State of Arizona, *Master List of State Government Programs 2000–2001* (Phoenix: Author, 1997), 176–177, 186.

larger program clusters again appears to be part of the natural evolution of outcome budgeting and serves several purposes. The overall number of programs that must be dealt with is reduced. The grouping of several similar programs into program clusters helps reduce mission fragmentation and program overlap. The resulting program clusters may actually provide more useful information to stakeholders. Finally, and somewhat speculatively, agency administrators may be anticipating a future time when more discretion may be associated with the use of resources within specific programs or program clusters. The larger the program, or program cluster, the greater the discretionary authority that administrators will be able to exercise.

### **The State of Texas (The Refinement Stage)**

Outcome budgeting in Texas can perhaps best be described as the linking approach operating at both the program/service level and the agency/organizational level. Texas can be credited with being one of the first states to move toward outcome budgeting. In 1991 the Texas Legislative Budget Board (LBB) mandated through House Bill 2009 (72nd Texas Legislature) that all state agencies, departments, and programs begin operating under a planning and budgeting system that focuses on outcomes rather than efforts and process (Texas State Auditor's Office, 1995). Texas, like Arizona, refers to its current budgeting system as "strategic planning and budgeting." Texas had a history of using program budgeting dating back to the mid-1970s. The decision to adopt a different name suggests that Texas views its current budgeting system as representing a departure, or break, with program budgeting (Texas Governor's Office of Budget & Planning, 1995).

The Texas outcome budgeting legislation requires that state agencies develop performance measures (with a focus on outcomes), establish performance projections or targets, and link the performance targets to state budget documents and the budget process. Once performance measures and targets are established for individual programs, agencies and departments, the legislature designates some as "key measures." Planning and implementation information on key performance measures, as well as other performance measures, is used by the Governor's Office of Budget & Planning and the Legislative Budget Board in making funding recommendations.

Table 13.2 presents the program structure elements with related performance measures, targets, and budgeted resources for a representative program of the Texas Commission on Alcohol & Drug Abuse. As Table 13.2 demonstrates, Texas uses multiple outcome measures. This finding reflects the greater length of time Texas has had to refine its outcome performance measures, as well as the influence of the Texas State Auditor's Office (1997) that evaluates the outcome performance measures used by state agencies, departments and programs.

In the representative biennial outcome budget for the Texas Commission on Alcohol & Drug Abuse shown in Table 13.2, outcome performance measures

**Table 13.2**  
**Fiscal Year (FY) 2002 & 2003: Outcome Budget for the Texas Commission on Alcohol & Drug Abuse**

	FY02	FY03
Goal: Services Distribution		
Provide for the delivery of substance abuse prevention, intervention and treatment based on need throughout the state		
<b>Outcomes (Results/Impact):</b>		
1. Percent of youth who report they are abstinent when contacted during follow-up.	85	85
2. Percent of adults entering treatment who report they are abstinent when contacted following discharge	81	82
3. Percent of unemployed adults completing treatment programs who report they are employed when contacted following discharge	60	60
4. Percent of youth who report a reduction in absenteeism when contacted following discharge	47	47
<b>Output (Volume):</b>		
1. Number of adults served in prevention programs	98,468	98,468
2. Number of youth served in prevention programs	273,207	273,207
<b>Budget</b>	<b>\$30,522,353</b>	<b>\$30,522,353</b>
<b>Efficiencies: (Unit Costs):</b>		
1. Average cost per youth for prevention services	\$91.33	\$91.33
2. Average cost per adult for prevention services	56.57	56.57

Source: Legislative Budget Board, *General Appropriations Act for the 2002–2003 Biennium: Text of Conference Committee Report: Senate Bill 1*, <<http://www.lbb.state.tx.us/WEBDOWN>>, November 19, 2001.

are given prominence over other types of performance measures, although output and efficiency measures are still included. Because Texas does biennial budgeting, fiscal year 2002 and fiscal year 2003 data are presented together. Table 13.2 clearly communicates to elected officials and citizens what results the agency’s goal of “services distribution” is designed to accomplish. The point should be made that multiple smaller programs could be included under the goal of “services distribution.” This finding suggests that the level of analysis of Texas outcome budgeting may be in transition from the program/service level to the agency/organizational level. At some point, the designation of a small number of broad goals, or program structures, begins to be less reflective of the program/service level and more reflective of the agency/organizational level.



## The State of Florida (The Institutional Stage)

Outcome budgeting in Florida is a mixture of the linking approach operating at the program/service level and the purchase approach operating at the agency/organizational level. In 1994 the Florida state legislature passed the *Florida Government Performance & Results Act* (Chapter 94–249, Laws of Florida). Two goals of the Florida legislation are to increase performance accountability and to decrease line-item financial control. Florida refers to its current budgeting system as performance budgeting 2 (PB2). The name PB2 again suggests that Florida views its current budgeting system as not just performance budgeting revisited but something different. The Florida legislation called for phased annual implementation of PB2 over several years with full implementation targeted for fiscal year 2002 (OPPAGA, 1997a).

The overwhelming majority of Florida agencies, departments and programs link outcomes to budget documents and the budget process. After outcome measures are refined and outcome baselines are established, state agencies, departments and programs are allowed, actually encouraged, to move toward the purchase approach to outcome budgeting. Some 55 major state programs had been converted to a “lump sum” appropriation (the purchase approach) by the beginning of fiscal year 1999 (OPPAGA, 2000).

For those programs operating under PB2 lump sum appropriation, noticeable changes have occurred. In exchange for agreeing to be held accountable for outcome performance, agency, department, and program administrators are given increased flexibility. This increased flexibility comes in the form of: additional discretion in budget management, additional discretion in salary rate and position management, and the ability to retain up to 25 percent of unexpended fund balances (OPPAGA, 2001).

Table 13.3 presents the fiscal year 2002 outcome budgets for two programs (child abuse prevention and intervention, and child protection and permanency) operated by the Florida Department of Children and Families. Perhaps the most notable feature of Table 13.3 is the pronounced emphasis on outcomes. Of the twelve performance measures identified for the two programs, ten are outcomes. The fiscal year 2002 data identified in Table 13.3 constitute an itemized list of outcomes the two programs propose to achieve in return for their legislative appropriation. After baselines have been established for each of the outcome performance measures and after the data have been evaluated for reliability, the two programs can move to the purchase approach to outcome budgeting by petitioning the state legislature for a lump sum appropriation. The operation of these two programs under the provisions of Florida’s PB2 lump sum appropriation will represent an example of the desired end stage of outcome budgeting: user friendly budgets that are transparent and communicate with stakeholders and that focus on the outcomes of government programs and their attendant costs.

**Table 13.3**

**Fiscal Year (FY) 2002: Outcome Budgets for the Florida Department of Children and Families**

**Child Abuse Prevention and Intervention**

<b>Performance Measure(s)</b>	<b>Standard</b>
1. The percent of children in families who complete intensive child abuse prevention programs of 3 months or more, who are not abused or neglected within 12 months of program completion (Outcome)	96
2. The per capita child abuse rate (Outcome)	23/1000
3. The number of children in families served (Output)	120,000
4. The number of families served in Health Families (Output)	6,926

**Budget (000)**

Federal Grants Trust Fund	28,378,910
Tobacco Settlement	1,000,000
	<hr/>
Program Total	29,378,910

**Child Protection & Permanency**

<b>Performance Measure(s)</b>	<b>Standard</b>
1. The percent of children who have no findings of child maltreatment within one year of case closure (Outcome)	95
2. The percent of children reunited with their families (Outcome)	3
3. The percent of children not abused or neglected during service (Outcome)	97
4. The percent of children who exited out-of-home care within one year (Outcome)	40
5. The percent of cases reviewed by supervisors in accordance with department time frames for early warning system (Outcome)	100
6. The percent of investigations commenced within 24 hours (Outcome)	100
7. The percent of investigations completed within 60 days (Outcome)	100
8. The percent of foster homes that exceed their licensed capacity (Outcome)	0

**Budget (000)**

General Revenue Funds	162,707,389
Trust Funds	541,656,145
	<hr/>
Program Total	704,363,534

Source: Florida State Senate, *Senate Appropriations Bill 2001*, <<http://www.leg.state.fl.us/Session/index...2001&Chamber>>, November 18, 2001.

## CONCLUSION

This chapter has looked at the topic of outcome budgeting. The argument has been made that because of its primary focus on outcomes, its transparency and communication purposes, and its external target audience, outcome budgeting deserves to be recognized as a new species of public budgeting. The chapter identified two basic approaches (the linking approach and the purchase approach) to outcome budgeting and three levels of analysis (program/service level, agency/organizational level, and community/state level). The three case examples reviewed in this chapter provided examples of: the linking approach operating at the program service level (Arizona), the linking approach operating at both the program/service and the agency/organizational level (Texas), and a mixture of the linking approach operating at the program/service while laying the groundwork for a move to the purchase approach operating at the agency/organizational level (Florida).

The three case examples also demonstrate what can be called the natural evolution of outcome budgeting. At the experimental stage (Arizona), governments use several types of performance measures (inputs, process, outputs, and outcomes). Governments at the refinement stage (Texas), increase their use of outcome performance measures and decrease their use of other types. And at the institutional stage, the use of outcome performance measures dominates and forms the basis for the creation of a quasicontractual relationship in which the accomplishment of agreed upon outcomes is exchanged for increased funding flexibility.

Several concluding comments can be made about outcome budgeting. First, and perhaps most importantly from a budget theory perspective, outcome budgeting clearly represents a new way of thinking about public budgeting. Existing budgeting schemas (line-item, performance, program, and ZBB) are incapable of capturing the focus, purposes, and target audience of outcome budgeting.

Second, outcome budgeting is not some abstract theoretical construct; it actually exists and is alive and well and living in at least three states. In order for outcome budgeting to find its rightful place in public budgeting theory, we must first recognize that it exists and acknowledge it as a legitimate area for research.

Third, outcome budgeting operates under various assumed names, but: a rose . . . is a rose . . . is a rose. The public budgeting literature needs to clearly differentiate outcome budgeting from performance budgeting.

Fourth, outcome budgeting is actually affecting resource allocation decisions between competing agencies, departments, and programs. Any approach to public budgeting that is actually affecting resources allocation decisions is certainly worthy of further exploration.

Finally, to the extent that outcomes and their attendant costs hold promise for determining how  $X$  dollars are to be allocated between activity A instead of activity B, outcome budgeting truly does represent a triumph of theory over

process. If V.O. Key were alive today, he would probably be nodding his head in approval.

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## Philosophy, Public Budgeting, and the Information Age

Thomas D. Lynch and Cynthia E. Lynch

This chapter argues that public budgeting uses philosophy as a lens of understanding, and periodically reformers must change the prescription to accommodate fundamental forces that change society. Perhaps the metaphor of eyeglasses is the best means to explain this argument. When we are young, we may be lucky enough not to need glasses. Eventually, most of us will need glasses as we grow older. From time to time as the aging process occurs we may even need to change the prescription of the lens (Lynch and Dicker, 1998).

In this chapter, we discuss both the great influence philosophy has on determining the lens through which society views itself and how the lens of public budgeting influences public policy. The first section explains the logical flow of human understanding from ideologies to belief systems to philosophy. The convergence of these somewhat esoteric ways of expressing thoughts has a profound and tangible influence on how we order our organizations and make policy. Ultimately, they influence how we present and understand public budgeting, as an expression of our public policy. In this first section, we spend some time discussing democracy to demonstrate how ideology influences the organizational process called public budgeting. Later, we discuss two philosophic streams of thought that tremendously influenced American public budgeting.

The second section of this chapter focuses on specific budget formats to illustrate how budget formats influence public policy and management. This section ties back to the earlier discussions of philosophy, but the primary purpose of this section is to stress the remarkable influence public budgeting has on both policy and management. Thus, students of public budgeting need to view it as a nexus. Culture, including philosophy and decision-making models, influences

public budgeting, but it is also an influencing agent on public policy and management. This theory is more complex than how public budgeting is usually presented, but it is also more dynamic in its explanation of why the budget reform movements occur and how budgets influence decision-making and administrative processes. This theory is a chain of causal influences that a researcher can use to identify dependent and independent variables and even simulate in a complex computer model. Although testing the theory is beyond the scope of this chapter, a researcher can test it.

The third section focuses again on the first part of the cause and effect theory, that is, it looks at the current factors that are driving us to change the budget process. We argue that information technology influences and alters our society significantly. These changes create a situation where our older approaches or eyeglasses simply are no longer appropriate for our new situation, and reform emerges that is consistent with those driving forces. This fundamental paradigm shift in society creates environmental factors that foster organizational reforms including new approaches to public budgeting. In this section, we identify those casual forces that are currently stimulating the calls for budget reform, and we articulate the likely format that these reforms will generate. We also argue that these powerful forces will continue into the twenty-first century, and we are wise to accommodate and channel them.

In the conclusion, we argue that we, in public administration, have an important role to play in society beyond merely framing and testing theories. We argue that we must live within our society, but that we can also take a proactive role in that society by shaping it in appropriate ways. We cannot stop the reforms as they will come with or without us, but we can shape the products of those reforms in a manner that lessens the likely negative impacts of those reforms on human civilization. This section is a call for us to use our knowledge to both understand the world around us but also meaningfully shape it within our capacity or ability to do so.

## PHILOSOPHY AND PUBLIC BUDGETING

### Defining the Logical Paradigm of Public Budgeting

Both ideology, which is a shared set of values and assumptions that influence life's decisions, and the workability of these ideas largely define the logical paradigm we use to select our glasses and lenses. In the United States, one important ideology—democracy—helps define the logical paradigm that decision makers use. Other belief systems and subsystems, such as our approach to morals and spirituality, also influence the manner in which we make our most fundamental decisions, but they are not central to the simplified sketch presented in this chapter (Lynch, 1995).

*Democracy* is a term that has many meanings, as illustrated by the range of its meaning in both western and communist societies. In the United States,

democracy evolved largely from its English roots in the context of a colonial reaction against the economic mercantilist policies of England. The result was a democracy that stressed limited representative government and a high respect for the rights of political minorities. At the beginning of the republic, the agriculture-oriented culture of the colonies considered certain rights, such as freedom of press, so essential they built them into the new nation's Constitution. The founding fathers viewed those rights as means to prevent tyranny and permit the peaceful evolution of a government. In over two hundred years, the society's collective values grew, and the definitions of some key concepts changed. For example, one aspect of democracy is the right to vote. The meaning of the term *voter* evolved from meaning an all white male adult landholder to mean any citizen who was eighteen and older of either sex or any racial background regardless of property ownership (Lynch, 1995).

James Madison's Federalist Paper No. 10 of the 1780s largely explains the American democratic system of government, as created by the nation's founding fathers. Whether individuals and groups acted out their political wishes for altruistic or selfish motivations, they soon learned that acting in groups and directing their political efforts at partisans in the political process maximized their influence on government. Partisans interact and adjust policy based on the relative strength of the lobbying forces and the appeal of the varying influential but shifting ideologies. The success of policy for any given moment may be due to economic interests, but often even those interests rest on the strength of a shared and effectively argued belief system (Lynch, 1995).

In America, the meaning of democracy rests on the notion of partisan bargaining, minority and fundamental human rights, diffusion of power, and the influence of partisans through collective action over time. Public budgeting is the nexus between thinking and doing, and thus it reflects the ideological culture of which it is a part. For example, in the United States, a system of diffused political power makes budget decisions through an often difficult partisan bargaining process. Partisans make decisions, and they then attempt to influence each other by a process called *lobbying*. An illustration is a public agency clientele group (that is, those affected directly by the agency's activities) who can and do lobby the legislature and the executive. Thus, a complex mixture of influences from the executive, legislature, and clientele guide and largely determine an agency's actions. Normally, the most significant means to achieve influence on an agency is the policy document called the *budget*. An idea remains only a good intention until there is a commitment of sufficient resources to manifest it. The people writing the budget have programs and program accomplishments in mind. However, they may have only vague notions about the exact nature of those programs and their goals and objectives. In spite of that vagueness, they believe in those accomplishments enough to request and appropriate funds for a set of activities that they believe will achieve the desired result (Lynch, 1995).

In America, one can easily see many influences of the concept of democracy



in the budget process. Some examples include public hearings, freedom of information, and “sunshine” laws and regulations. They are the manifestations of the political minority and the fundamental human rights acquired from an earlier time. These requirements open the dialogue about the budget details and involve various policy makers, the media, and the interested public. The American system of government, which political scientists call a *presidential system* to contrast it to *parliamentary* democracy, requires some degree of cooperation between executive and legislative leadership in order to achieve the necessary policy mandates as prescribed in fundamental documents, such as the Constitution. The belief system called democracy greatly influences the way Americans and many other peoples go about making their public budget decisions, but some of the more subtle influences are not easily identified due to the influence of philosophy as shall be noted later.

Public budgeting is a government decision-making process. Not surprisingly, several conceptual models, which originated from political philosophy theories, explain how we *should* make public policy decisions. Reformers of the budget process take these theories or conceptual models seriously. Therefore, we must understand these theories and models to comprehend the complexity of contemporary budgeting and budget reforms. A conceptual model is a tool that enables the user to understand and deal with complex phenomena. We judge a tool as “good” or “bad” in terms of the user’s purpose. A hammer, for example, may be a perfectly good tool for building a shed, but it is a terrible tool for chopping wood.

Professionals judge conceptual tools or theories in terms of the model’s usefulness and timely workability in helping them accomplish their tasks. Reformers judge decision-making models in terms of their applicability to their decision-making environment. If the model is not in harmony with their environment, then the model is “bad,” meaning the model is not appropriate to that particular user’s situation or purposes, but that same model might be quite appropriate to another person in their time and circumstances. Thus, what might be good budgeting practice at one time in America might be bad budgeting in another country or be bad budgeting at a different time in America. The timely workability of an idea in an analysis of a policy problem is also a significant factor. Policy makers and managers often find themselves in situations where they must make decisions, because even a so-called nondecision is an authoritative allocation of resources in budgeting. If the data or analyses are not available, then the decision maker must make do with conventional wisdom, personal biased judgment, or contemporary political ideology. Thus the “do-able” or practical even in terms of performing policy analysis is significant in terms of what policy makers select as their decision-making approach (Lynch, 1995).

### **Model: Tool and Lens**

Returning to the lens metaphor described in the introduction of this chapter, Edward Lehan suggests that the budget format and process are not neutral fac-

tors: "People tend to think in terms of what is put in front of them. This axiom of human behavior plays a heavy role in the budgetary process" (Lehan, 1981: 3). Thus, the budget and its related processes are our glasses that help us see clearly in making public policy. Because the budget decisions are the best articulation of the society's values and beliefs, the budget practices and the reforms that policy makers enact become very important as they determine the ultimate policy decisions. Ideologies, which dominate a culture, induce a logical paradigm within which decision makers must accomplish their tasks and thus help define what is "good" and "bad."

Pettigjohn and Grizzle quote R.F. Fennoe, Jr. in their article in the *Journal of Public Budgeting and Financial Management*,

The form of the budget determines what the conversation will be about. And he who determines what executive-legislative appropriations conversation will be about has an enormous intellectual advantage. He fixes the frame of reference, determines the alternatives, sets the agenda for the discussion, reduces his own uncertainty and increases his chances of winning. (1997: 27)

The budget structure or format therefore makes a difference in what will be the budgetary decisions as they directly influence the outcome of the decision-making process. Budget formats define the readers' reality and channel their attention and thought processes. In other words the format creates the lens through which we comprehend our reality. For example, line-item budgeting tends to take decision makers' attention away from policy issues and forces them to consider specific expenditure items. Thus, most people think about the correctness of the size of the various expenditure items rather than the larger issues of the correctness of the programs and policies associated with those items. For exercising control, line-item budgeting is very useful, especially if one wants to tightly control employees in an agency.

The line-item format stresses accountability in terms of what money units are spent but not the larger purposes policy makers wish to accomplish. By assuring the money is spent on only the acceptable expenditures, policy makers achieve a type of accountability, but this approach shows little faith in the managers' ability to direct and ultimately achieve program objectives. The combination of auditing and line-item budgeting direct the policy maker's focus toward expenditure spending, and thus the combination creates a type of accountability that confronts corruption, helps discourage public employees deviating from strict instructions, and enhances tighter control over the employees' behavior (Lynch, 1995).

However, the reality of line-item budgeting is that this form of accountability obscures the purpose for which policy makers created the government activity. Thus, in the progressive/liberal era, there was frustration with the budget process. Reformers created program budgeting. With it, budget officers grouped expenditures not by line items of expenditure but rather by activities that reflected the larger policy purposes. For example, instead of budgeting by salaries one

would budget by activities such as code enforcement and housing inspection. This approach allows decision makers to focus their policy debates among themselves on policy differences and choices among alternative selections of programs and program levels of spending. Program budgeting is therefore a useful tool for strategic planning and decision making as it focuses the human mind on policy issues with analysis of programs used to inform the policy resolution process (Lynch, 1995).

### **Burke and Incrementalism**

Although several decision-making models exist, this chapter cites only the incremental change model and the ideal-rational model because they are the two most commonly used in budgeting. We should associate the incremental model with democratic theory that heavily influenced the creation of the American republic. With firm roots in nineteenth-century conservative thought and Edmund Burke's philosophy of eighteenth-century England, the incremental model accepts that major public policies change should be slow and done in incremental steps. It asserts that no decision maker or set of decision makers can understand the full extent of the implications of major policy changes. According to the incremental model, political forces mutually should adjust their positions and, over time, change public policy. This inherently conservative approach means that the political system bias is against radical, innovative change.

Edmund Burke (1729–1797), born the son of a modest Irish attorney, was extremely well educated in literature and law. He worked for some time as a writer and editor before he began a political career, which lasted nearly three decades. Writing at the peak of the Age of Reason, one of the important characteristics of Burke's philosophical thinking was his consistent rejection of *reason* as it was applied abstractly to understanding politics (Haque, 1998). For Burke there was great danger in using pure reason to guide human action. Leaders, he felt, could easily mislead by applying reason to their actions. He argued that the passions of individuals govern all political action and therefore allow for the arbitrary determination of abstract principles if the subsequent logic appears to be rational.

Instead of reason, Burke relied on experience. He believed "a wise man draws all his ideas from experience rather speculation" (Haque, 1998: 185). Even with a firm belief in the law, Burke felt that the Constitution on paper was one thing as it created and legitimized the activity of government, however, in fact and in experience, it was quite another. Experience can reveal latent forces operating within the course of action that may seem trivial at first but in the larger view are vital. Practice and patience, he thought, would allow us to accept what we first rejected and reject that which is most important to us (Haque, 1998).

Burke's emphasis on knowledge from experience was not unlike his friend's David Hume, who also argued that experience is the foundation for all reason-

ing. According to Haque, Burke's contributions to modern public administration in general are immense although most remain outside the scope of this chapter. However, his extreme distrust in speculative reasoning and his philosophy of patience and practice in political action directly influenced such scholars as David Lindbloom and Aaron Wildavsky who in turn influenced incremental budgeting (Jones, 1995; Haque, 1998).

An example of this approach follows. At the national level, an agency develops a budget, advocates it to its department, the president's Office of Management and Budget, and Congress. In the budget approval process, the agency takes the role of advocate; the reviewer (for example, the Office of Management and Budget) questions the wisdom of the proposal. After the reviewer decides, the process continues with other subsequent actors in the review process, calling sometimes into question the earlier reviewer's decisions. This process is consistent with the incremental change model in that policies usually mutually and slowly adjust over years because someone advocates and someone else accommodates.

The incremental change model helps the professional to understand the political environment of public policy making, but it is not useful in understanding technical and analytical decision-making tools that are commonly and currently employed in more sophisticated budget environments. In the political environment, strategies, and conflicts arise among the participants (clienteles groups, agencies, departments, the central executive budget office, and the legislature). Definable strategies exist that require such ploys as cultivating an active clientele group, the development of confidence in the professional competency of the agency, and skill in tactics that exploit temporary opportunities. Technical policy analyses are not central to the incremental approach except to the extent that they might strengthen a political argument in the partisan accommodation process. Reasoning from the incremental change model, program, and budget analyses must be timely, able to seize political opportunities, and comprehensible to those who must use the analysis in partisan bargaining situations (Lynch, 1995).

Burke's apparent unpopularity is understood in the context of the rationalist movement. His influence is sometimes obscured because he did not follow the mainstream thinking of his time. He went against the wave of the Enlightenment, which regarded *reason* as key to defining politics and government in developing rationalistic order (Haque, 1998).

### **Bentham and Rationality**

Jeremy Bentham (1748–1832) was a child prodigy, who entered Queens College Oxford at age twelve. Following in his father's footsteps, he was called to the bar in 1767 at age seventeen. In spite of his great interest in the law, he never practiced it but rather spent the better part of his life trying to reform it. Among the causes he championed were education, health, prisons, and economic

inequity. The specific reforms that he advocated include annual elections, equal-size electoral districts, and the secret ballot (Martin, 1998).

The contribution, which we most remember about Bentham, is his conceptualization of the “public interest,” referred to as *utilitarianism*. Bentham was a committed empiricist and dedicated to an exhaustive analytical method. He believed that the use of quantitative methods in social observation would result in a more accurate analysis because it would be free of value-laden language and devoid of emotional and ambiguous terms. According to Lawrence Martin, “Bentham wanted to develop a science of human behavior” (Martin, 1998).

Bentham was a prolific writer and a skilled wordsmith. He added such words as minimize, maximize, rational, codify, and demoralize to the popular English vocabulary (Martin, 1998). More importantly he transformed the word “good” from the Aristotelian meaning a descriptor of a positive quality associated with character or behavior, to a new meaning of material ownership. The word “good” became a general noun for items that we could easily add up and quantify. Value came to be attributed to “goods” rather than the “good” quality of human nature.

Utilitarianism is a consequential theory of ethics. Simply put, we determine the moral worth of any action by its consequences. The utilitarian principle simply states “it is the greatest happiness of the greatest number that is the measure of right and wrong” (Martin, 1998). This allows the calculator to arrive at a measure of the utility of the action or the utility of the various alternative actions. This means that we evaluate each individual proposed action by its predicted consequences. The net effect of this tenant on public budgeting is that in order to determine a proper policy or program we must first exhaustively compute both the costs and benefits of each policy alternative, and the benefits must exceed the costs, or the action is wrong. According to Martin, Bentham’s utilitarian influence had a “profound and lasting effect on public policy. . . . Public choice theory, rational choice theory, game theory, and decision sciences in general have their roots in utilitarianism” (Martin, 1998).

## TWENTIETH CENTURY

### Incremental Budgeting

In the incremental model, major public policies evolve through cautious incremental steps; political forces mutually adjust their positions, and over time, public policy changes. This is an inherently conservative approach, and it biases the decision maker against radical, innovative alternatives. Twentieth-century incremental budget reforms focus on making revenue and expenditure policy for the government just prior to the beginning of the fiscal year, and it comes in three versions: line item, program and performance. Table 14.1 presents the line-item budget format.

Table 14.1 presents a simple table for the Code Enforcement Unit that depicts

**Table 14.1**  
**Line-Item Budget Format**

<b>CODE ENFORCEMENT</b>	<b>Past Year</b>	<b>Current Year</b>	<b>Budget Year</b>	<b>BY-CY</b>
Personnel Services	\$49,000	\$52,000	\$60,000	\$8,000
Contractual Services	6,000	5,900	6,590	690
Supplies	<u>576</u>	<u>1,200</u>	<u>1,606</u>	<u>406</u>
Total	55,576	59,100	68,196	9,096

*Source:* Thomas D. Lynch and Cynthia E. Lynch, "Twenty-First Century Budget Reform: Performance, Entrepreneurial, and Competitive Budgeting," *Public Administration Quarterly*, 20 (fall 1996): 255–284; Thomas D. Lynch and Cynthia E. Lynch, "The Road to Entrepreneurial Budgeting," *Journal of Public Budgeting, Accounting and Financial Management*, 9 (spring 1997): 161–180.

**Table 14.2**  
**Program Budget Format**

<b>CODE ENFORCEMENT</b>	<b>Past Year</b>	<b>Current Year</b>	<b>Budget Year</b>	<b>BY-CY</b>
Plan Examination	\$49,000	\$52,000	\$60,000	\$8,000
Inspections	6,000	5,900	6,590	690
Education	<u>576</u>	<u>1,200</u>	<u>406</u>	<u>1,606</u>
Total	55,576	59,100	68,196	9,096

*Source:* Thomas D. Lynch and Cynthia E. Lynch, "Twenty-First Century Budget Reform: Performance, Entrepreneurial, and Competitive Budgeting," *Public Administration Quarterly*, 20 (fall 1996): 255–284; Thomas D. Lynch and Cynthia E. Lynch, "The Road to Entrepreneurial Budgeting," *Journal of Public Budgeting, Accounting and Financial Management*, 9 (spring 1997): 161–180.

three objects over a three-year period of time. This line-item budget format is incremental because of the BY-CY column. This feature draws the reader's attention to the difference between the Budget Year and the Current Year, and most of the reader's thoughts will focus on justifying those differences. Policy makers focus their attention on the critical increment of change from one year to the next.

Tables 14.2 and 14.3 are examples of program and performance budgeting that are incremental in nature. Program budgeting organizes the table and focuses on the activities of the unit. Performance budgeting builds on the program budget by adding output measures as noted in Table 14.3. Analysts could also use program outcome measures if they wished to focus attention on effectiveness instead of efficiency. Alternatively, analysts could use both program output and outcome measures, but they must be careful not to confuse the two sets of data. Notice that the BY-CY column in all three illustrations makes these formats incremental. That is where each format draws the eye, and that is where the lens of understanding remains.

**Table 14.3**  
**Performance Budget Format**

CODE ENFORCEMENT	Past Year		Current Year		Budget Year		BY-CY	
	Amount	Output	Amount	Output	Amount	Output	Amount	Output
Plan Examination	\$49,000	500	\$52,000	550	\$60,000	600	\$8,000	50
Inspections	6,000	100	5,900	110	6,590	130	690	20
Education	576	200	1,200	400	1,606	500	406	100
Total	55,576	800	59,100	1,060	68,196	1,230	9,096	170

Source: Thomas D. Lynch and Cynthia E. Lynch, "Twenty-First Century Budget Reform: Performance, Entrepreneurial, and Competitive Budgeting," *Public Administration Quarterly*, 20 (fall 1996): 255–284; Thomas D. Lynch and Cynthia E. Lynch, "The Road to Entrepreneurial Budgeting," *Journal of Public Budgeting, Accounting and Financial Management*, 9 (spring 1997): 161–180.

**Table 14.4**  
**Current Services Budget Format**

CODE ENFORCEMENT	Past Year	Current Year	CSB	Budget Year	CSB-BY
Personnel Services	\$49,000	\$52,000	\$53,000	\$60,000	\$7,000
Contractual Services	6,000	5,900	6,000	6,590	590
Supplies	576	1,200	1,400	1,606	206
Total	55,576	59,100	60,400	68,196	7,796

The 1974 federal budget legislation in the United States added to the sophistication of the incremental budget concept. The BY-CY column represents a simpler version of incrementalism that some like Aaron Wildvasky argued was a distortion of true incrementalism. The BY amount can grow in spite of the fact that CY budget policies remained the same into the BY. This discrepancy can be due to a number of reasons, including inflation or the continuation of a capital project that may vary in amount from year to year during the life of the project. With the 1974 legislation, analysts accommodate this added refinement by using the Current Service Budget (CSB), which is the BY with CY policies (Jones, 1995). Table 14.4 is a line-item budget using the CSB concept.

The incremental change model is an excellent tool for understanding the political environment of public policy making, but it is not useful for explaining the more technical difficulties associated with budget analysis. With this model, those preparing the budget can better understand the strategies employed by partisans in the process and the conflicts that arise among the participants (clienteles groups, agencies, departments, and the central budget office) who dominate the budget process. Definable strategies exist that require such practices as agency cultivation of an active clientele, the development of confidence among other reviewing officers such as budget examiners, and skill in following tactics that exploit temporary opportunities. Reasoning from the incremental change

**Table 14.5**  
**Program Outcome Budget Format**

CODE ENFORCEMENT	Past Year	Current Year	Budget Year
	Amount Output	Amount Output	Amount Output
Plan Examination	\$49,000	\$52,000	\$60,000
Inspections	6,000	5,900	6,590
Education	576	1,200	1,606
Total (Property fire loss)	55,576 (\$19.8m)	59,100 (\$17.4m)	68,196 (\$13.4m)

*Source:* Thomas D. Lynch and Cynthia E. Lynch, "Twenty-First Century Budget Reform: Performance, Entrepreneurial, and Competitive Budgeting," *Public Administration Quarterly*, 20 (fall 1996): 255–284; Thomas D. Lynch and Cynthia E. Lynch, "The Road to Entrepreneurial Budgeting," *Journal of Public Budgeting, Accounting and Financial Management*, 9 (spring 1997): 161–180.

model, program, and budget analysts see the value in seizing political opportunities and making the budget document comprehensible to those who must use the analysis in partisan bargaining situations (Lynch, 1995).

### Rational Budgeting

In the twentieth century, reformers of the budget process normally predicate their arguments using Bentham's rational model. This philosophically modern model systematically breaks decision making down into six phases. The first step is to establish a complete set of operational goals, with relative weights allocated different degrees to which each may be achieved. The second step is to establish a complete inventory of other values and resources with relative weights. Third, prepare a complete set of alternative policies open to the policy makers. Forth, prepare a complete set of valid predictions of the cost and benefits of each alternative, including the extent to which each alternative will achieve the various operational goals, consume resources, and realize or impair other values. Fifth, calculate the net expectations for each alternative by multiplying the probability of each benefit and cost for each alternative by the utility of each, and calculate the net benefit (or cost) in utility units. Finally, compare the net expectations and identify the alternative (or alternatives, if two or more are equally good) with the highest net expectations. In fewer words, using the rational model calls for decision makers to define their goals, analyzing their alternatives, and select the alternative that best meets their goals (Lynch, 1995).

With the rational model, the format is different. Table 14.5 presents an outcome performance budget, which is ideal for rational analysis. A line-item format is not consistent with the rational model, as it does not permit the consideration of rational alternatives to various policies. A program format can be consistent if the analyst adds outcome measures. In this table, the outcome measure is expressed in terms of property fire loss due to structure and, the measure is for code enforcement rather than any one program within code enforcement. In this case, we are looking for a smaller number. We could add



other outcome measures such as accidents due to building structure or property value due to having more attractive building. Normally, in outcome budgets the challenge is having fewer critical outcome measures rather than many representative ones. The simple addition of an outcome measure creates the performance budget presented in the table. Notice the BY-CY or BY-CSB columns do not exist. Justification, and therefore the format focuses the reader's attention on the BY column.

The rational model helps us to understand the heart of most twentieth-century budget reform and the technical difficulties of analyses. Much of the history of budget reform involves various alphabetical reform efforts such as Planning-Programming-Budgeting (PPB) and Zero Based Budgeting (ZBB). In all cases, the desire was to improve the policy decision-making situation because the reformers assumed key leaders such as the president or city manager could implement the rational model of decision making. They disagreed with the nineteenth-century Burkean conservative belief in incrementalism and thought that rational decision making would achieve better public policy. As a result of this belief, social scientists developed many analytical techniques that are especially important to budgeting, for example, trend charts, scatter diagrams, regression analysis, cost-benefit analysis, and marginal cost analysis (Lynch, 1995).

The various forms of rational budgeting stress different approaches to rationality. PPB is not limited to any one approach, but most would associate it with Bentham's benefit cost utilitarianism. Analysts justify the BY numbers by saying the recommended numbers represent the best ratio of program benefits to program costs. Often analysts translate program benefits into dollar amounts and place them in a ratio with program costs. A less sophisticated approach is merely letting the BY dollar amount represent cost and the BY outcome represent the benefits. ZBB is another rational approach to budgeting that uses the economic concept of marginal utility. This approach focuses on finding the optimal marginal outcome so that we can get the highest return for our tax dollar.

The problems with the ideal-rational model are (1) that it requires you to confront the infinite, (2) it does not use feedback information and evaluation techniques, and (3) often improperly lets you assume that you can always use ratio scales in analysis. The model asks us to think in terms of endless calculations, defining endless alternatives, and performing endless analyses. Thus, those working with the model often advocate using parameters such as adopting the best solution within a given time frame. Another problem is that the model does not recognize the usefulness of feedback and evaluation. Therefore a useful variation to the rational model is to supplant it with an evaluation process.

Although there may not always be analytical solutions to problems, policy makers will find analytical techniques helpful in many situations, and sometimes even a weak analysis can be better than doing nothing analytically. However, in spite of the attempts to improve rational analyses, there are barriers to its usefulness. For example, the technical analytical skill levels in organizations are

often low, and qualified analysts are either not available or the analysts hired are not able to use the analytical techniques or, worse, use those techniques incorrectly, thus lowering the quality of public policy making.

In today's fast-paced technological world neither of these decision-making models is adequate for all situations. The incremental change model is powerful because it helps the professional understand the human and political side of the budget-making process. Although significant, the incremental model often cannot help policy makers when a technical analysis can point the decision makers toward better decisions. The rational model gives the professional a remarkable set of tools that can help policy makers in some situations. However, it can also lead to false and a naïve expectation because the model ignores the political context and even demands the impossible in terms of analysis. This model encourages some individuals in the budget process to neglect timeliness, seek needlessly expensive data, search endlessly for alternatives, and quest for clarity in objectives that will not be forthcoming. The rational model can be useful, and the professional should learn its related analytical techniques. However, the analyst must also gain a full understanding of its limitations (Lynch, 1995).

## TWENTY-FIRST CENTURY

### **Influence of Technology**

Regardless of the era, budget reform takes place when key leaders in society are not pleased with the results of the existing budget process. Normally this occurs when society is undergoing rapid change, and the current practices are neither adequate nor adapting fast enough. Within any era and between eras, budget reforms occur when those key leaders feel that reform is essential. In the 1960s, President Johnson felt that the budget process was inadequate in terms of setting policy objectives in his desired command and control approach to government. In the 1990s, President Clinton and Vice President Gore felt that the budget process was not innovative enough in terms of cutting costs and seeking out new ways of efficiently managing the tasks of government.

According to Max Weber, the German economist, government grows in reaction to complex changes within the society. In the case of the Weberian command and control model, the rapid growth of money-based capitalist economies of the industrial revolution prompted the rapid development of hierarchical organizations (Melchior, 1998). Both the rational and the incremental decision-making approaches operated well within the command and control style of organizational management, but the rational approach was especially suited to it. Utilitarian reforms promoted rationality in all aspects of society. They assumed that individuals could perfect themselves through knowledge. In a society of knowledgeable individuals, factions would dissipate, and policy makers would easily identify public interests (Melchior, 1998).

In contrast, incremental reforms promoted accountability and liability. Being

conservative and cautious in policy making preserved the sacred public trust, which conservatives viewed as noble and minimized their risk and liability by taking such small steps that they could easily rectify any mistakes.

During the twentieth century, bureaucracies were a strange mix of Burkian and utilitarian philosophies. On the one hand, they strived to be scientific and rational in their approach to public policy. Thus, their methods were steeped in facts and numbers, which they believed removed decision making from the impulsive behavior of passionate hearts. On the other hand, both the amount of time such exhaustive inquiry took and the sheer weight of the moral responsibility of protecting the public trust to spend their money drove policy makers to behave incrementally.

As we begin the twenty first century, our societal and organizational needs are changing dramatically again. Although no single philosopher comes to mind with the topic of entrepreneurship, we can see its roots in the writings of J.B. Say, F.A. Hayek, Ludwig von Mises, Adam Smith, and David Ricardo. More contemporary important authors include Joseph Schumpeter, Israel Kirzner, and Nancy Roberts. Authors that brought entrepreneurship into public administration start with Peter Drucker but include David Osborne, Ted Gaebler, W. Edwards Deming, Tom Peters, and Robert Waterman, Jr. (Melchior, 1998).

Futurists like Naisbitt (1994), Drucker (1989a, 1989b), and Reich (1992) tell us that our information technology is transforming our society. They predict that the more successful organizations among us will alter themselves to take advantage of new technology, and we will change in the process. The writing teams of Hammer and Champy (1992) and Osborne and Gaebler (1993) echo the thoughts of the futurist in their calls for the reengineering and reinvention of not only private organizations but also government.

Because of information age technology, society including government is fundamentally different as more and more organizations adapt to the advantages of the new technologies. The old command and control model of doing business of the past century is no longer adequate for our needs. As we move further into the information age, we experience polar opposite conditions from the command and control model created by the progressive/liberal era. As shown in Table 14.6, the speed of technological advance is faster in the information era than in the progressive/liberal era. The major source of new jobs is society shifting from manufacturing to service and knowledge industries. Organizations are changing their structures from top-down hierarchical to networks and webs working in coordinated partnerships. In the past the key to economic success was mass marketing, and now it is specialty niches in the global market. Finally, even social structures are shifting from strong neighborhood and family units to isolated individuals existing in fragmented communities often with dysfunctional family units.

Rapidly evolving information technology combined with competition on a world scale made the shift possible and even forced the shift to occur. We simply must evolve rapidly to information-based organizations with the consequence of

**Table 14.6**  
**Progressive/Liberal Versus Information Age Characteristic**

CHARACTERISTICS	PROGRESSIVE/ LIBERAL ERA	INFORMATION ERA
Speed of Technological Advances	Evolved Slowly	Breathtaking Speed
Source of New Employment	Mainly Manufacturing	Service and Knowledge Industries
Organizational Structure	Top Down Hierarchical	Networks, Webs, Partnerships, Coordinated Teams
Key to Economic Success	Mass Marketing	Global Marketing Targeted at Specific Niches
Social Structure	Strong Associations, Communities, Neighborhoods, and Family Units	Isolated Individuals, Fragmented Communities, Dysfunctional Family Units

*Source:* David Osborne and Ted Gaebler, *Reinventing Government* (New York: Plume, 1993), 15.

not only flatter structures but also fundamental changing in the way we do work in organizations. To be successful, the evolution cannot come about with small changes but rather radical redesigns of all processes including public budgeting. As the complexities of society grow, the need for a flexible, adaptive, and responsible government increases. A quote of Thomas Jefferson on his monument in Washington, DC, says, "As new discoveries are made, new truths discovered, and manner and opinions change, institutions must advance also to keep pace with the times." We must now reengineer our systems, controls, and general mentality, which were the product of the reforms of one hundred years ago.

An entrepreneurial spirit in budgeting means changing the management and policy approach used in the public sector to get those institutions to think in entrepreneurial ways. In other words, public institutions must use their resources in new ways to heighten both their efficiency and their effectiveness (Osborne and Gaebler, 1993). This is not saying the public sector should be run like a business, because there are fundamental differences between the public and the private sectors. Rather, reformers tell us that the focus should be on governing and delivering public services in a significantly more entrepreneurial manner (Osborne and Gaebler, 1993).

The practice of Entrepreneurial Budgeting (EB) is in its early development stage, but its elements can be described. Merrill Stephen King (1995: 1) defines it as, "a method of budgeting whereby policy and chief executives establish the total spending limits and policy priorities, then provide flexibility and private sector-like incentives for program managers to determine how best to specifically spend their budgets and determine the means to accomplish the priorities." In exchange for the increased spending authority, policy makers hold managers

highly accountable for results. The procedure seeks to create an organizational environment that is “lean, decentralized, innovative, flexible, adaptive, quick to learn new ways when conditions change . . . and able to get things done as effectively and creatively as possible” (Osborne and Gaebler, 1993).

In traditional command and control budgeting, policy makers wait for department heads and program managers to submit requests to them. In Entrepreneurial Budgeting, much greater delegation occurs. Expenditure limits and performance measures are often benchmarked against the previous year’s expenditures and measures to provide a point of departure for steering decisions. Analysts express expenditures sometimes in a formula that holds overall spending to a percent increase or decrease determined by the policy makers. The EB budgets are quite brief—sometimes only a few pages long and in sharp contrast to the progressive era control oriented line-item budget that is commonly quite long. This approach focuses the policy maker on the big policy issues instead of the line items where there is a tendency on the part of policy makers to use those items to micro manage agencies’ activities (Cothran, 1993).

The agency heads and program managers are at liberty to allocate and expend their money in the best possible way to achieve the policy mission mandates. In exchange for this liberty, however, each program must have clear mission statements and measurable goals using specific performance measures in order to hold agency heads and program managers accountable to policy makers. One of the most distinguishing features of the EB is the ability of the agency and in some cases even the program to keep a portion of both their unspent money and earned income. The success of the EB is built upon its predecessor—performance budgeting. The latter requires mission statements, measurable goals and objectives, performance measures for both efficiency and effectiveness, and feedback loops for both including the use of citizen satisfaction surveys and focus groups. Performance budgeting assigns responsibility and achieves accountability from agency heads and program managers (Cothran, 1993).

EB is a fundamental, radical departure from the older command and control approach to budgeting (Hammer and Champy, 1992). EB is part of a larger mind-set change that requires focused attention on transforming the bureaucratic behavior of agency heads or program directors into thinking about revenue generation and efficiency oriented management. The information age requires administrators to focus on the program’s bottom line performance rather than just spending the appropriated monies before the end of the fiscal year. EB focuses them to ask how can one insert competitiveness into an essentially monopolistic activity we call government service?

Reformers tell us that policy makers can successfully use market mechanisms and competition within government. In the progressive era, budgeting used monopolistic public agencies to manage public functions. Entrepreneurial government adopts a competitive approach and abandons to the extent possible the monopolistic approach. With few exceptions, there are no service or government functions that policy makers cannot subject to a true competitive process or

arrangement. For example, Phoenix, Arizona, provides an often-cited example of this kind of competitive process (Osborne and Gaebler, 1993). The city decided to privatize their solid waste collection. They divided greater Phoenix into five zones. Over a five-year period, they publicly offered each zone for multiple-year contract. By ensuring that there was a minimum of three contractors providing the service, the city of Phoenix safeguarded a true competitive process. The result was better service at a lower cost to the public.

## CONCLUSION

As Peter Drucker (1985:17) stated, "The time has now come to do for entrepreneurship and innovation what we did first for management in general thirty years ago: to develop the principles, the practice and the discipline." If the futurists are correct, then we are well into a new age, and we must recognize that government including budgeting is undergoing fundamental change. If the previous hundred years indicate anything to us, we can anticipate in the twenty-first century that there will be waves of budget reform that address the three purposes of budgeting but within the context of the information age. Our professional challenge is to recognize the fundamental changes that are upon us, and we must use our abilities to help develop continuing improvements in government activities.

Although these reforms are inevitable, we must also realize that there some very negative aspects to these reforms (O'Toole, 1997; Cope, 1997). They will create serious problems in society, and we, in public administration, are in a position to mitigate those problems with our thoughtful actions. As noted in the budget theory presented in this chapter, budgeting is both a dependent and an independent variable. We must accept the dependent nature of this activity, but this does not mean we are without influence and merely the victims of larger forces. Although we cannot stop the reforms, we can share the budget instrument and its related process with our scholarship. In turn, this will make a difference as public budgeting influences our policy and management (Wolf, 1997).

Thus, we argue here that our role in public administration is first to understand the causal factors that shape public budgeting and also how public budgeting influences policy and management in society. Second, we argue that we must proactively adjust the factors that we can influence by using our insights that we gain from our scholarship. Thus, we can be a key part in shaping a powerful influencing agent on society.

We need to innovate, but we need to innovate with an appreciation of philosophy and the changes in our society created by technology. According to Drucker (1985: 19), "Innovation is the specific tool of entrepreneurs, the means by which they exploit change as an opportunity. . . . It is capable of being presented as a discipline, capable of being learned and capable of being practiced." Our challenge is to build always on the best of the past and improve ourselves for the future. We must innovate and accept change as our friend. Every practice

rests on theory, and we need to improve that theory as conditions such as the information age force us to see the flow of change in society. Our challenge is to recognize we are in an era where we must accept change, respond to it, and exploit its opportunities, rather than fruitlessly resist its inevitability. We need to refine our public organizations so that they are always agents of positive influence on humans and the larger environment of which we are a part. We also should develop theories and models on how we can best do that. We are hopeful that this is one such theory.

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