CHAPTER 2

The Logic of the Budget Process

The budget process provides the medium for determining what government services will be provided and how they will be financed. It may also help establish how the services will be provided. The basic budgeting problem, simply stated, is the following: "On what basis shall it be decided to allocate *X* dollars to activity *A* instead of activity *B*?"[1] That is a pretty simple-sounding question, but, like many things in life, its application is where the problems lurk. How many dollars should be moved from private businesses and individuals to government, and, once moved to government, how much should go to each government activity? Indeed, the answer is remarkably clear: move money from private to public use and among alternative public uses until it is not possible to move one dollar from one use to another without losing as much from where you took it as you gain from where you put it. It's not a big deal conceptually. There is no lack of theoretical guidance as to how things should work. Markets for private goods do the allocation invisibly, as prices and profits provide the resource allocation signals and private businesses and individuals take it from there. But markets don't work for public goods, the home turf of governments, so here come the lawmakers to do the allocation job that markets can't. They may bungle the job (in a democracy, we elected them, so it is our collective fault), but the budget process is where those choices get made for government operations, not so quietly and we hope not so invisibly, but definitely politically. When governments tax and spend, making decisions within the framework of the budget process, they are doing for the public sector what the private market does for the provision of private goods and services. They are deciding how big government will be relative to the private sector and, within government, the relative sizes of the various-programs and agencies that the government provides. They even make decisions about how programs and agencies will operate. Each government has some method for making these fiscal choices, although the degree of formality varies widely. But we do know

[1]V. O. Key, Jr., "The Lack of a Budgetary Theory," *American Political Science Review* 34 (December 1940): 1137. The sentences after this quotation in this text do outline a precise budgetary theory. As it turns out, the title of the article is wrong because there has been no absence of a budget theory for many years. Indeed, there is a cornucopia of theories both of how governments ought to behave (prescriptive) and of how governments actually behave (descriptive).

what the budget process ought to be doing—moving resources to the best advantage of the population.

Except for the limited number of town-meeting processes, referendum decisions, and participatory budget processes, elected representatives make the primary spending and financing decisions. However, in budget preparation and in the delivery of services supported by the budget, nonelected public employees make many crucial decisions. Although these employees enjoy at least some measure of job security and may be less responsive to voters than elected officials, the logic of representative government presumes that such bureaucrats, and certainly the elected executives and legislators who guide their work, will be responsive to the citizenry.[2] And if they aren't, those elected officials deserve to be voted out of office.

Public organizations can operate with a haphazard budget process. Many local governments manage with casual or ad hoc processes, most nonprofit organizations are informal and unstructured with budget documents of limited utility, and a number of observers note that the federal government recently has barely been following its own processes even though they are rather rigidly laid out.[3] However, a system designed with incentives to induce officials to respond to public demands is more likely to produce decisions in the public interest, and thereby provide citizens with the quality and quantity of desired public services at the desired times and locations and at the least cost to society. At a minimum, the process must recognize competing claims on resources and should focus directly on alternatives and options. A major portion of the process involves presentation of accurate and relevant information to individuals making budget decisions on behalf of the citizenry. At its best, the budget process articulates the choices of the citizenry for government services (and how those services will be paid for) and manages efficient delivery and finance of those services. Before considering the logic of the budget, however, it is good to understand some basic facts about government expenditure.

Size and Growth of Government Expenditure[4]

Government spending can be divided into two primary categories: purchases and transfers. Both purchases and transfers need to be financed (as must interest payments on outstanding government debt, another spending category), and both entail a government payment, but their impacts on the economy differ, so the categories

[2]This is an example of the "principal/agent problem": bureaucrats and elected officials (the agents) are inclined to pursue their own self-interests, which may well differ from the interests of the citizenry (the principals). "Participatory budgeting," discussed in a later chapter, provides an alternate and direct channel for getting citizen priorities into the deliberations.

[3]Irene Rubin, "The Great Unraveling: Federal Budgeting, 1998–2006," *Public Administration Review* 67 (July/August 2007): 608–17.

[4]One might also measure the size of government by the public-sector share of total employment in the nation. According to recent International Labor Organization data, this is around 16.2 percent in the United States (or 14.5 percent in Germany). However, the governments in the United States (and other nations) do lots of spending without hiring government workers. For example, when the Department of Defense purchases a new aircraft, it buys from a private company and the aircraft was built by employees of that private firm. Looking up government employment data will not give much information about the size of government.

are differentiated in the national economic accounts. Furthermore, transfers and purchases are commonly treated differently by government budget processes, as is discussed in considerable detail in later chapters.[5]

1. **Government purchases** divert productive resources (land, labor, capital, natural resources) from private use by businesses and individuals to government use in the provision of education, national defense, public safety, parks, and all the other services that governments provide. Some of this spending pays wages and benefits to government employees, some pays suppliers of items used by these employees in the production of government services, and some pays private entities who have agreed to produce government services under contract. Most of this spending is for the provision of current services, but part of this spending is government investment—the purchase of long-life capital assets like roads, buildings, and durable equipment.[6] In the national income accounting system, the system that is used to keep track of national economic activity, this direct provision represents the government contribution to gross domestic product (GDP). In other words, when a city outfits its fire department to provide services during the year, pays its firefighters, or purchases a new fire truck, it will be purchasing from *private* suppliers. (In contrast with a socialist system, productive resources in the United States are mostly privately owned.) Some purchases will provide services within the year of purchase (consumption), and others will yield services over the longer useful life of the asset purchased (gross investment). These purchases represent direct acquisition of resources by the government, and these resources purchased will provide public services as they are used by the government. They represent the direct contribution of government to aggregate demand in the national economy.
2. **Transfer payments** constitute the other major element of government spending. These payments provide income to recipients without service being required in return. Such direct payment transfers to individuals include Social Security benefits, unemployment insurance payments, and other cash payments by governments to low-income individuals. These payments amount to almost 40 percent of all current government expenditure in the United States, so they represent an important contributor to the financing requirements of government and an important concern for government operations. While the government is not directly spending the money, it will need to find the money to pay for the transfers, using the revenue resources available to it (taxes most of the time). In contrast to government purchases, the direct impact on GDP is through spending by the transfer recipients, not through spending by the government. The transfers certainly will make things better for the individual who receives them, but they do not involve direct purchases of anything by the government, nor do they represent direct provision of services by the government.

[5]Two easily available explanations of economic statistics as they relate to analysis of government finances are Congressional Budget Office, *The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts* (Washington, D.C.: Congressional Budget Office, 2007); and Enrico Giovannini, *Understanding Economic Statistics: An OECD Perspective* (Paris: Organization for Economic Cooperation and Development, 2008).

[6]This gross investment—meaning spending to purchase new assets without taking account of the depreciation (wearing out) of the existing capital stock—amounts to a bit more than 10 percent of total U.S. investment.

Table 2–1 shows the path of federal, state, and local government spending in the United States from 1960 to 2010. These data focus on the movement of resources between private and public sectors, that is, the way in which sectors of the economy claim production of the economy. They do not exactly coincide with the fiscal year, cash-outlay data that later chapters use, but they do make important points needed for the understanding of U.S. government finances.[7]

Total spending by all government in the United States—federal, state, and local combined—was 38.1 percent of total economic activity (measured by GDP) in 2010. That is considerably higher than the 26.2 percent fifty years earlier, and even higher than the 30.4 percent in 2000. State and local government spending as a share of the economy increased by about 60 percent over the fifty years, compared with about a 50 percent increase for the federal government. However, the increased total share in the last decade—from 30.4 percent in 2000 to 38.1 percent in 2010—was mostly from the federal government, and that federal increase was primarily driven by the cost of wars in Iraq and Afghanistan and economic stimulation efforts to combat the Great Recession.

Data in the table also highlight two other significant patterns in government expenditure: the importance of transfer payments (spending without making purchases) and of payments to government employees. These transfer payments are payments made to persons without a current work requirement made of them. At the federal level, these are predominantly Social Security payments to the elderly, persons with disabilities, and the surviving dependents of covered individuals; at the state and local levels, the payments are predominantly retirement benefits for former employees and unemployment compensation. These payments have increased substantially as a share of total spending. At the federal level, the increase has been from 21.2 percent of the total in 1960 to 43.7 percent of the total in 2010 and, at the state and local levels, from 9.1 percent to 23.9 percent over the same years. This expansion of share raises considerable concern for fiscal sustainability and is a topic discussed at length in later chapters.

Compensation of current employees, as the table shows, represents an important component of the cost of government services—many services are labor intensive. The share of total spending for state and local governments was

[7]The 1995 revision of the national income and product accounts brought significant change in how the accounts treat government expenditure, especially for capital asset purchases. The components in the new structure include the following: gross government investment includes total government expenditures for fixed assets; "government consumption expenditures" replaces "government purchases" and includes the estimated value of the services of general government fixed assets, as measured by consumption of fixed capital (as well as the purchases for use in the year); and government consumption and investment expenditures show the total current-year government contribution to GDP. See Robert P. Parker and Jack E. Triplett, "Preview of the Comprehensive Revision of the National Income and Product Accounts: Recognition of Government Investment and Incorporation of a New Methodology for Calculation Depreciation," *Survey of Current Business* 75 (September 1995): 33–41.

Table 2–1
United States Government Spending in Relation to Gross Domestic Product, 1960–2010

	1960 $ Billion	1960 % Gross Domestic Product	1960 % Total	1970 $ Billion	1970 % Gross Domestic Product	1970 % Total	1980 $ Billion	1980 % Gross Domestic Product	1980 % Total	1990 $ Billion	1990 % Gross Domestic Product	1990 % Total	2000 $ Billion	2000 % Gross Domestic Product	2000 % Total	2010 $ Billion	2010 % Gross Domestic Product	2010 % Total
Federal Government																		
Employee compensation	22.6		24.1%	48.3		23.5%	102.5		16.8%	193.9		14.8%	233		12.3%	466.3		11.9%
Current transfer payments to persons	19.9	3.8%	21.2%	55.6	5.4%	27.1%	219.6	7.9%	36.1%	445.1	7.7%	34.0%	769.1	7.7%	40.5%	1708.3	11.8%	43.7%
Total expenditures	93.7	17.8%	100.0%	205.3	19.8%	100.0%	608.4	21.8%	100.0%	1307.4	22.5%	100.0%	1900.6	19.1%	100.0%	3906.9	26.9%	100.0%
State and Local Governments																		
Employee compensation	25.5		50.5%	71.1		53.7%	193		53.1%	415.9		51.9%	679		48.3%	1064.2		47.6%
Government social benefit payments to persons	4.6	0.9%	9.1%	16.1	1.6%	12.2%	51.2	1.8%	14.1%	127.7	2.2%	15.9%	271.4	2.7%	19.3%	534.6	3.7%	23.9%
Total expenditures	50.5	9.6%	100.0%	132.3	12.7%	100.0%	363.3	13.0%	100.0%	801.7	13.8%	100.0%	1404.5	14.1%	100.0%	2237	15.4%	100.0%
All Governments																		
Employee compensation	48.1		34.9%	119.4		38.1%	295.5		33.5%	609.7		30.8%	912		30.2%	1530.5		27.6%
Government transfer payments to persons	24.4	4.6%	17.7%	71.7	6.9%	22.9%	270.8	9.7%	30.7%	572.7	9.9%	29.0%	1040.6	10.5%	34.4%	2242.9	15.4%	40.5%
Total expenditures	137.7	26.2%	100.0%	313.2	30.2%	100.0%	883.1	31.7%	100.0%	1976.9	34.1%	100.0%	3021.5	30.4%	100.0%	5538.8	38.1%	100.0%

SOURCE: U.S. Department of Commerce, National Income and Product Accounts

NOTE: No adjustment has been made for intergovernmental transfers.

47.6 percent in 2010, about half the total, but not quite as high as in earlier years. This high share reflects the importance of teachers, firefighters, and police officers in the service delivery of these governments. Employee compensation is a much smaller component of federal spending—11.9 percent in 2010, down from 24.1 percent in 1960. The federal government more heavily contracts out work to private firms and also spends more on materials made by private firms (like military equipment and supplies).

Special attention should be given to the difference between price and physical effects on purchases. Government spending increased from $137.7 billion in 1960 to $5,538.8 billion in 2010. That increase resulted from two forces: (1) purchases of more "stuff" (trucks, computers, workers' time, etc.) and (2) payment of higher prices for the items purchased. The total increase encompasses both change in prices and change in physical (real) purchases. Because only the latter represents greater capacity to deliver service, it is important to divide the components of change. Sidebar 2–1 describes the basic mechanics of making price adjustments. The division of total spending into the portion that represents paying higher prices and the

Sidebar 2–1
Deflating: Dividing between Real and Price Change

The amount of money spent depends on how many items are purchased and what the price of each item is: 400 gallons of motor fuel at $2.10 per gallon means $840 spent on fuel. More money spent in 2014 than in 2013 does not mean that more things have been purchased if the prices of those things have changed between the two years. It is useful to know whether higher spending is the product of higher prices or more things purchased, since more spending because prices are higher gives no reason to believe that more government services are being provided. So how can analysts compare real purchasing power of money spent across periods when prices are different? The answer lies in the use of price indexes.

Suppose a set of purchases (commodities and services) cost $100 at 2014 prices, but only $75 at 2000 prices. That means that between 2000 and 2014, prices have risen on average by 33 percent ([100 − 75]/75, converted to percentage form), or the ratio of 2014 prices to 2000 prices is 1.33, (i.e., 100/75). This ratio of the value of a group of commodities and services in current dollars (or "then-year" dollars) to the value of that same group in base-year dollars (or constant dollars) is a price index. If 2000 is the base year, its index would be 100 and the index for 2014 would be 133 (or 33 percent higher than the base year). (The index could also be stated in ratio form. In this case, 2000 would be 1.00 and 2014 would be 1.33.) A price index provides a method for identifying to what extent higher expenditure reflects real change (more items purchased) and price changes (higher prices); the index shows how prices, on average, differ from those in a base year.

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SIDEBAR 2–1
(continued)

Here is an example from the budget of the U.S. government. Federal spending for natural resources and the environment increased from $17,055 million in 1990 to $43,662 million in 2010. The deflator for nondefense spending, using 2005 as base year, went from 0.6958 to 1.1256 between those years. That implies a 61.8 percent increase in prices between the years [(1.1256 − 0.6958)/0.6958]. Total spending for natural resources and the environment increased by 156.0 percent, but how much was due to more "stuff" to be used to provide services? In other words, how much of the increase was real? In constant (base year 2005) dollars, natural resource and environment spending in 1990 was $24,511 million [17,058/0.6958], and in 2010, it equaled $38,790 million [43,662/1.1256]. That means that the real increase was 58.3 percent—a big increase, but not as much as the 156 percent for spending without price adjustment.

Analysts use many different price indexes, depending on the expenditure category being analyzed; the *Survey of Current Business* from the U.S. Department of Commerce reports many of these, as do other publications. The data used here came from the federal budget. Prices of all items do not change by the same amount. Some go up a lot, some go up a little, some don't change, and some even decrease. All those changes are captured in a single index by computing a weighted average in which the price change for big purchase items counts for more than the price change for small purchase items. Traditional indices have used fixed weight measures: the base-year spending patterns establish fixed weight values for computing the averages. This practice creates a problem when there is considerable difference in the amount of price change among items: purchasers substitute those items whose price has risen less for those items whose price has risen more. The fixed weights become wrong. Analysts now remedy the problem by using a rolling average, or chain weights, instead of fixed base-year weights. The system sets the weights by taking the average growth of the current year and the preceding year. Price weights are thus constantly updated for changes in relative prices.

Spending calibrated in prices from one year can be easily converted into prices for another. In the previous example, if 1990 were to be the reference year, then the price index for 1990 is 100.0 [= (0.6958/0.6958) × 100], and the price index for 2010 is 161.8 [= (1.1256/0.6958) × 100]. The absolute level of the index and the absolute difference between years in the index differ according to the base year used, but the percentage change remains the same across base years. Price indexes and deflated (constant or real) values have meaning only in a relative sense.

Whenever an analyst is examining spending data over a time span of several years, it is important to make adjustments for changes in prices. In most eras, annual rates of price change in the United States have been relatively modest, but even a small annual rate maintained for a decade will make for a large difference between beginning and end. And price changes in some other countries have been much more dramatic than in the United States. When data from different years are being compared, it is always a good practice to make adjustment for changes in prices. It is never completely wrong to do so, and it can sometimes be catastrophic to fail to do so.

portion that represents purchasing more resources is one of the most basic tools of fiscal analysis because purchasing more resources creates the possibility of providing more services, while paying higher prices creates no such expectation.[8] When adjusted to reflect constant prices (2005 = 100.), the increase was from $939.3 billion to $4,914.6 billion, a big increase, but certainly less than the current dollar comparison would have suggested.

How does the size of the American public sector compare with that of other countries? Table 2–2 reports data for several countries of the Organization for Economic Cooperation and Development (sort of a club for industrialized, market-oriented democracies). Although the conventions used in these measures do not exactly match those of the national income and product accounts just discussed, the basic logic is comparable and can be interpreted in the same way. Measured by final consumption expenditure, the countries ranged from 30.0 percent of GDP in Denmark to 10.7 percent in Mexico; the U.S. value, 17.6, is below the mean of 20.9 percent. As noted previously, purchases do not measure the full extent of public-sector involvement in the economy. Total general government expenditure percentages range from 24.2 percent of GDP in Mexico to 58.5 percent in Denmark. The U.S. percentage, 42.2 percent, is below the mean of 42.7 percent.[9]

The nature of these government expenditures—in other words, the kinds of services governments provide—are examined in the next chapter. But it is now important to learn the general elements of the budget process and the language that applies in fiscal systems.

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[8] The real and price changes do not add to the total change, but they are mathematically related. If X_{10} = total expenditure in 2010, X_{80} = total expenditure in 1980, and t = the percentage increase in total expenditure between the years; if D_{10}, D_{80}, and g are the similar variables for deflated (real or constant dollar) expenditure; and if F_{10}, F_{80}, and p are similar variables for price levels, then

$$X_{10} = X_{80} + (X_{80} \times t) = X_{80}(1 + 1)$$
$$D_{10} = D_{80} + (D_{80} \times g) = D_{80}(1 + g) \text{ and}$$
$$P_{10} = P_{80} + (P_{80} \times p) = P_{80}(1 + p)$$

In other words, start with the value in 1980 and add to it the increase to 2010 and you will have the value for 2010.

Total expenditure in 2010 equals real expenditure in 2010 times the 2010 price level:

$$X_{10} = D_{10} \times P_{10}$$

Thus, substituting into this equation yields the following:

$$X_{80}(1 + t) = D_{80}(1 + g) \times P_{80}(1 + p)$$

Rearranging terms, we obtain

$$X_{80}(1 + t) = D_{80} \times P_{80}(1 + g)(1 + p)$$

Because $X_{80} = D_{80} \times P_{80}$, then $(1 + t) = (1 + g)(1 + p)$. One plus the rate of price increase times 1 plus the rate of increase of deflated expenditure equals 1 plus the rate of total expenditure increase.

[9] Governments also interact with the private sector through regulations, legal requirements, and mandates. These effects are difficult to measure, but many would place the United States considerably higher in the league table than its ranking according to government-spending share.

Table 2–2
Government Expenditures in Selected Industrialized Countries, 2009

	Total General Government Expenditure (% GDP)	General Government Consumption Expenditure (% GDP) Final
Australia (2008)	35.3	17.6
Austria	52.3	19.9
Belgium	54.2	24.7
Canada	44.1	22.1
Czech Republic	45.9	22.0
Denmark	58.5	30.0
Finland	56.0	25.0
France	56.0	24.7
Germany	47.5	20.0
Greece	53.6	21.2
Hungary	50.5	22.2
Iceland	50.9	26.5
Ireland	48.9	19.5
Italy	51.9	21.5
Japan (2008)	37.1	18.5
Korea (2008)	30.4	15.3
Luxembourg	42.2	16.7
Mexico (2008)	24.2	10.7
Netherlands	51.4	28.4
New Zealand (2008)	41.9	20.1
Norway	46.3	22.9
Poland	44.4	18.4
Portugal	48.3	21.8
Slovak Republic	41.3	20.0
Spain	45.8	21.1
Sweden	54.9	27.8
Switzerland	33.7	11.6
Turkey	n.a.	14.7
United Kingdom	51.6	23.4
United States	42.2	17.6
Mean	46.2	20.9

SOURCE: Organization for Economic Cooperation and Development (OECD).

What Is a Budget?

A budget is a critical document in the operation of any modern public organization. It has an explicit meaning and it has several expected components. In simplest terms, a budget is a financial plan that carries forward the financial implications of carrying out a particular planned response to the anticipated operating conditions in a future period, normally a year. It has been prepared to fit expenditure programs within

the constraint of revenues available in that future period. The budget takes a policy plan for provision of physical services and translates it into the cost of providing that plan. It is not a forecast of future spending by the organization, but it represents the intended response of that organization to the conditions that the organization expects to face in the future. It isn't a projection of government spending and revenue collections, and it isn't a target. It isn't a wish list of what the organization would like to do if it had no limits on its resources. And it isn't a shopping list of the things that the organization intends to purchase in a future year. A good budget says, in essence, these are what we believe are likely to be the operating conditions in the budget period (sorts of problems that will emerge, level of prices that the organization will have to pay for what it purchases, resources that we expect to have available within the period, etc.), and here is what we intend to do about the problems and opportunities. The expected operating conditions may not materialize as we have expected, but if they do, here is our operating response. If they don't, we will make adjustments on the fly.

Here are the blunt facts: If a program manager knows what she is doing and intends to do, she will be able to produce a budget. If she doesn't and is just filling a chair, she won't be able to do it. If she believes that producing a budget is keeping her away from the important tasks of running the operation, she should be relieved of duties before she creates any more damage. If you know what you are doing, you can do a budget and can and should use it as an important tool for management and evaluation.

The complete budget will include at least three distinct segments: a financial plan that reflects expenditures intended to carry out the planned response to the operating conditions expected in the budget year, a revenue forecast that reflects how much revenue the government expects to collect in the budget year based on the anticipated state of the economy and the revenue structure that the government intends to have in place, and a plan for managing any difference between the expenditure plan and the revenue forecast. The budget begins with a narrative discussion of what the government expects and how it plans to deal with those expectations; it then moves to a financial section that provides budget numbers. Later chapters of this text will go into considerable detail about the meaning of the sections of the budget, the methods used to prepare each section, and the tools used to analyze the sections. Later chapters will also discuss the revenue side of the budget process, including the development of revenue forecasts. However, budget managers are seldom directly involved in the revenue forecast, and they will be operating within revenue constraints prescribed for them, so our first emphasis will be on the expenditure portion of the budget.

Budget Process and Logic

The market allocates private resources without a need for outside intervention; price movements serve as a signaling device for resource flows. In the public sector, decisions about resource use cannot be made automatically from price and profit signals because of four special features of government decisions. First, public goods, the primary service focus of governments, are difficult, if not impossible, to sell, and, even where sales may be feasible, nonrevenue concerns may be as important as the cash collected. Consequently, profit can neither measure success, nor guide resource allocations, nor serve as an incentive to efficient operations. When markets have failed, it is a mistake to try to use simple market information as a first guide for decisions. Second, public and private resource constraints differ dramatically. Whereas earnings and earnings potential constrain spending of private entities, governments are limited only by the total resources of the society.[10] Resources are privately owned, but governments have the power to tax. There are obviously political limits to tax extractions, but those limits differ dramatically from resource limits on a family or a private firm. Third, governments characteristically operate as perfect monopolies. Consumers of government services cannot purchase from an alternate supplier, and, more important, the consumer must pay whether the good provided is used or not. Again, this makes market-proxy data based on traditional government operations suspect as a guide for resource allocation. Finally, governments operate with mixed motives. They are trying to achieve more goals than the single objective of maximizing value of the firm that characterizes private business decisions. In many instances, not only the service provided, but also the recipients of the service (redistribution) or the mere fact of provision (stabilization) is important. For example, the federal Supplemental Nutrition Assistance Program (SNAP, formerly the food stamp program) seeks to make healthy food available to low-income families by supplementing the money these families have to buy food. But the program is administered by the U.S. Department of Agriculture. In other words, it seeks to help low-income families, but it also aims to increase the income of American food producers (farmers), even though there may be more economical means of achieving either of these objectives by itself. Accordingly, more may hinge on the provision of a public service than simply the direct return from the service compared with its cost. Because these multiple and mixed objectives cannot be weighed scientifically and because achievement of objectives cannot be easily measured across programs, the budget process is political, involving both pure bargaining or political strategies and scientific analysis.

The Parts of the Public Expenditure/Public Revenue Process

Government spending must be financed, but, whereas receiving the benefits of a good or service is linked in the private sector to paying for it (you have to buy it before you can use it), in the public sector what the government provides does not determine how its operations will be financed. When a business makes shirts, it knows exactly from whom the financing will be received: the people to whom it sells those shirts. If people don't buy the shirts, the business is in trouble. But when the federal government decides to increase its provision of national defense, it must make another decision: Who will pay? It isn't going to sell the service; there is no link between who receives the service and how it will be financed. In other words, public expenditure and public revenue involve two separate planning processes. Payment for a government service is not a precondition for benefiting from that service; if the mosquito abatement district has seen to its job, both those who pay taxes to the district and those who don't will be free of mosquito bites.

There are two distinct components of public finance. The *expenditure* side of budgeting should set the size of the public sector, establishing what is provided, how it is provided, and who gets it. The *revenue planning* side, on the other hand, determines whose real income will be reduced to finance the provision of the budgeted services. Although the total resources used must equal the total resources raised (including current revenues, borrowing, and, for national governments, the creation of new money to spend), the profile of government expenditure does not ordinarily indicate how the cost of government should be distributed. In some instances—for example, the Holland Tunnel that connects New York and New Jersey under the Hudson River—it is feasible to identify the direct beneficiaries of the public service and to finance its provision through user charges, thus causing the operators of the facility to be more like a private business than a government, but the range of public services for which such financing would be practical is limited. (Charge financing will be discussed in a later chapter.) More often than not, government services are more like mosquito abatement than the Holland Tunnel, and revenue planning will be distinct from decisions about spending.

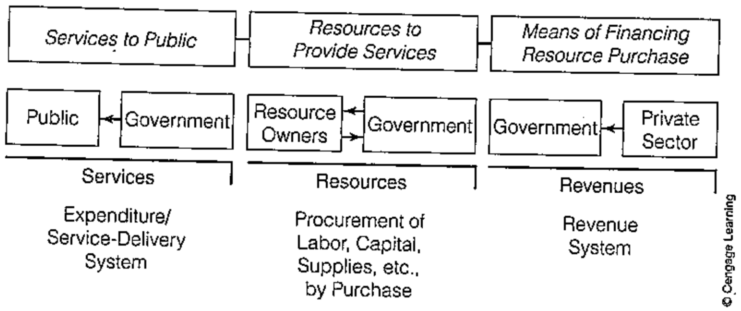
Figure 2–1 shows how dollars, resources, and public services logically flow from the revenue system to the procurement process to service delivery. The public procurement process involves exchange transactions (purchase on the open market) and, with few exceptions (eminent domain purchase of property and military draft being two), is economically (but possibly not politically) comparable to procurement by private firms. The unique public-sector features of the flow involve revenue-generation and service-delivery decisions, the concerns of the following chapters. Governments devote much of their attention to the part of the budget process that deals with expenditure and service-delivery processes; the next several chapters examine this part of the budget. Revenue planning is examined in later chapters.

The basic communication device of the process is the budget, a government's plan for operation translated into its financial implications. Governments prepare budgets as a means for (1) elaborating executive-branch intentions, (2) providing legislative-branch review and approval of those plans, (3) providing a control-and-review structure for implementation of approved plans, and (4) providing a template for external review of the legality of what the government has done with funds entrusted to it.[11] As will be discussed in a later chapter, the budget—by explicitly spelling

[10] Few have dared suggest natural limits to the ability of governments to extract resources from society since Colin Clark's proposition many years ago: "25 percent of the national income is about the limit for taxation in any nontotalitarian community in times of peace" ("Public Finance and Changes in the Value of Money," *Economic Journal* 55 [December 1945]: 380). That limit was based on zero inflation—so it may not have been truly tested. However, many successful modern democracies exceed that level with minimal general price increases (recall the OECD data in Table 2–2.).

[11] Only appropriation and historical reports of spending and revenue are mentioned in the U.S. Constitution, Article I, Section 9[7]: "No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published from time to time."

Figure 2–1
Service Delivery and Revenue Systems as Separate Planning Processes



out provisions for spending and identifying responsibility for all money to be spent—provides the first and most critical defense against public corruption. Governments can also use the budget to communicate their program intentions for the future to the public, although not enough governments think of the budget in such terms and the public is not accustomed to looking at budgets at all.[12] At the minimum, the budget includes the expenditure plan, the plan for raising revenue to cover that spending, and the plan for managing any difference between revenue and expenditure. But public budgets are almost always considerably more than that minimum.

Budget Classification, Structure, and Presentation Years

The expenditure side of government budgets deals with plans in terms of spending money to deliver services to the public. Logically, the agency develops plans to provide services and estimates the cost of purchasing the resources necessary to execute those plans. In that respect, government operations are similar to those of private business: resources are acquired and used to deliver a valued output. The public agency's budget is its business plan for the next year, subject to the approval of certain representatives of the people.

The information in that plan can be organized in various ways to facilitate policy formulation, resource allocation, fiscal discipline, and compliance with the law. Three fundamental categorizations are:

1. **Administrative.** An identification of the entity that is responsible for management of the public funds and for provision of public services with those funds. In other words, the budget would be classified according to funds to the police department, the fire department, and so on in the city government. This classification is critical for identification of responsibility and for ongoing execution of the budget.
2. **Economic.** An identification of the type of expenditure—compensation of employees, utilities to be purchased, supplies, and so on. This classification is also called line item (the items in a purchase list) or object of expenditure. This represents something like a shopping list for the government.
3. **Functional.** An identification of spending according to the intended purposes and objectives of the government. This classification organizes government operations into their broad purposes (like education or national defense) without regard for the entity responsible for the resources. It is a classification particularly suitable for fundamental resource allocation choices.

The three classifications are independent of each other, and many governments maintain all three in an effort to provide for full transparency of finances.

The most basic (and most traditional) classification is economic or line item, with its focus on inputs to the flow of service provision, that is, on the resources—labor, equipment, supplies, and the like—purchased by the government in the course of responding to the demand for service with organization according to administrative unit for control and responsibility. The budget approved for the fire department of the city of Tempe, Arizona, for 2011–2012 illustrates that classification (Figure 2–2; only a portion of the department budget is shown in the figure) and provides an excellent starting point for understanding how budgets are presented.[13] The 2009/2010 column reports the most recent budget execution, the 2010/2011 budget column represents the budget planned to be executed when the budget for that year was adopted, the 2010/2011 revised column reports how budget execution is proceeding (some categories have had to be increased, either by internal transfers or by more money being approved by the legislative body), and the 2011/2012 column represents the program plan for the upcoming fiscal year. The budget items are for expenditures to be made (purchases) by the department. This format is the basic structure for budget development in that it is the template an agency would use for estimating the cost of carrying out its plan for service.

The budget in Figure 2–2 demonstrates some important features. First, governments develop complete object-classification structures for use across all agencies, but not all agencies will make purchases in all object classes each year. (For instance, this department intends no purchase of landscaping supplies in some years.) The classification systems will not be the same in different governments, but it is important that consistent classification be used within a single government for tests across agencies and for meaningful aggregation of objects. Second, this display is for the fire department. There will be a similar budget component for each administrative agency of the city. Budgets to agencies provide a mechanism for control and responsibility in the process. Administrators of the fire department are responsible

[12] Recent budgets of the U.S. government have been reformulated so that the main volume is intended as a communication device, with colors, pictures, and charts. It is not clear that the public has paid much attention, however, and not many budget analysts are particularly impressed. Perhaps governments should embed YouTube videos in their presentations to draw more attention. Because budgets of many governments are now posted on websites, such videos would be entirely possible. Mayors could introduce their budgets with a nice song-and-dance routine.

[13] Tempe also prepares its budget using other budget classification systems, to facilitate presentation of what the administration intends to do and to make analysis and deliberation about the budget more productive. Presentation of multiple classifications is typical for well-run budget processes.

Figure 2–2
A Portion of the City of Tempe, Arizona, Line-Item Budget for the Fire Department, 2011–2012

	Fire	9/10 Actual	10/11 Budget	10/11 Revised	11/12 Budget
6010	Salaries	12,482,574	13,054,689	12,213,343	13,729,779
6011	Wages	38,789	44,410	76,288	44,581
6012	Overtime	1,511,084	1,520,733	1,544,456	1,621,930
6013	Vacation Pay	759,257	0	808,771	0
6014	Sick Pay	530,400	0	341,157	0
6015	Holiday Pay	686,005	677,351	774,297	815,548
6017	Bilingual Pay	16,911	16,802	15,600	21,812
6020	Event/Reimbursement-Labor	-163,217	0	0	0
	Salary & Wages	15,861,804	15,313,985	15,773,912	16,233,650
6120	Fica Taxes	311,937	404,624	295,803	354,219
6121	Arizona State Retirement	165,487	183,071	162,972	191,420
6123	Employee Health Insurance	2,801,802	2,094,547	2,068,373	2,185,274
6124	Pub. Safety Retirement-Fire	2,460,181	2,585,188	2,413,021	2,900,986
6126	Long-Term Disability	7,529	0	0	0
6127	Mediflex Reimbursed Expense	22,684	37,744	30,812	36,731
6133	Public Safety Cancer Insurance	15,300	15,359	11,300	11,343
6136	IRA Expense- DROP Participants	422,258	420,737	497,646	574,610
6137	Deferred Comp Employer Match	0	2,715	2,600	0
6138	Retiree HRA Contribution	200,445	0	0	0
6141	Vehicle Allowance Pmts	5,000	0	0	0
	Fringe Benefits	6,412,622	5,743,985	5,482,527	6,254,583
6201	General Office Supplies	5,190	8,000	6,000	8,000
6305	Uniform Allowance	205,267	251,422	146,422	146,422
6309	Batteries	11,457	6,000	7,000	7,000
6310	Chemical Supplies	9,353	5,500	5,500	5,500
6315	Landscaping Supplies	-20	0	0	0
6339	Hazardous Material Supplies	19,643	15,000	15,000	15,000
6340	Gasoline + Diesel Fuels	598	500	500	500
6342	Oil + Lubricants	8,948	6,500	7,500	7,900
6344	Propane Gas	232	0	0	0
6350	Hand Tools	3,002	4,038	4,038	4,038
6351	Minor Equipment	8,417	6,000	6,000	5,500
6352	Mechanic Tool Allowance	1,000	1,000	1,000	1,000
6356	Shop Supplies	4,097	3,500	4,500	4,500
6360	Traffic Control Materials	0	750	750	750
6366	Paint, Thinner, Etc.	38	0	101	0
6370	Printing + Copier Supplies	5,202	6,500	6,000	6,000
6401	Building Materials	59	500	500	500
6410	Motor Vehicle Parts	65,404	75,000	65,000	70,000
6415	Communication Equip Part	122	700	700	700
6416	Comm. Parts - Telephone	0	700	700	700
6420	Operating + Maint. Supplies	37,035	42,500	41,000	41,500
6421	SCBA Parts + Supplies	9,555	15,490	17,000	15,490
6422	Fire Hose + Nozzle	15,699	21,755	0	21,755

(continues)

Figure 2–2 (continued)

6423	Emergency Preparedness	-611	1,300	0	1,300
6424	Technical Rescue Team Supplies	10,028	9,000	10,000	9,000
6505	Books + Publications	1,293	6,500	6,500	6,000
6513	First Aid Supplies	97,026	75,000	67,000	75,000
6514	Awards + Recognition	6,433	1,000	1,000	1,000
6552	Other Equipment + Supplies	0	10,500	10,500	9,500
6556	Unrealized Discounts	1	0	0	0
6599	Miscellaneous Supplies	23,003	16,776	16,776	16,776
	Materials & Supplies	547,472	591,431	446,987	481,331
	(other object classes follow)				

SOURCE: City of Tempe, Arizona, 2001–2012 Budget for the Fire Department.

for this appropriated money. Third, the budget display includes information for the upcoming budget year (the plan). But it also includes comparable information for the current year—in this instance, both the initially budgeted amounts and the amounts revised to reflect likely actual execution—and for the most recently completed budget year. This presentation of these years provides a basis for the analyst (or for an inquisitive member of the general public) to get an idea of what changes might be in store for the city in the next year. Multiyear presentations are standard for government budgets. Unfortunately, nonprofit organizations frequently submit only single-year budgets to their boards to get approval of plans. It is not clear what these boards are supposed to do with only a single year. Possibly check the math?

The years appearing in a budget logically are these:

1. **The budget year.** The document focuses on the budget year, 2011/2012 in this example. These numbers reflect what the agency plans for operations, what it has requested for approval by various stages of review, and what resources will be required for the execution of these plans. These columns are the action items for consideration and legislative approval and, once enacted into law, become the template against which the agency will be held responsible. Some executive budgets will report what the agency requested initially, along with the amount recommended by the executive; this one does not.
2. **The progress-report year.** The budget for 2011/2012 will have been considered during the 2010/2011 budget year. The 2010/2011 columns in this budget report what was budgeted for that year and what the actual result is likely to be for the current year. (Frequently, only the likely result for the current year is reported; the figures initially adopted are not reported.) Some budgets, particularly those developed in executive and legislative reviews, also report the amount and percentage of any difference between progress-year and budget-year amounts. This one does not, but you can be certain that those changes were checked by those reviewing the budget.
3. **The final-report year.** This column reports the fiscal figures for the most recently completed fiscal year, 2009/2010 in this illustration. These figures provide a standard for comparison.

4. **Out years.** Some budgets (but not the one in Figure 2–2) also carry figures for out years, or years beyond the budget year in the request cycle. Some governments prepare a multiyear financial framework with budget estimates for from three to five years into the future so that a longer perspective on finances is possible. However, these out years are not part of the basic budget appropriations.

The federal government has recently used a budget year plus four years in executive budget summary presentations.[14] However, the Obama administration's first budget framework, *A New Era of Responsibility, Renewing America's Promise,* returned to a ten-year horizon in its budget summaries, a horizon that was used in presidential budgets from 1997 through 2002. The longer horizon reflects a concern with future implications of fiscal decisions, even though specific actions on those future figures seldom will be taken in that particular cycle. Nor should those fiscal choices be locked in early; priorities, needs, and fiscal circumstances may well change. The earliest multiyear presidential budget presentations date from the Reagan administration. Skeptics suggest that these were developed in order that control over the federal deficit could be shown eventually, although the deficit reductions were only in years at considerable distance from anything actually proposed in the budget. Later Obama budgets provide a five-year horizon.

Budget classification in functional form provides the same budget proposal as an administrative presentation, but it organizes the information to highlight resource allocation choices as opposed to highlighting the entities that are to be responsible for the funds. Table 2–3 illustrates the point with information from the federal budget. Federal outlays are organized according to function in the left side of the table and according to administrative department in the right. Total spending for both sides of the table is the same, just organized differently. The functional classification identifies spending for provision of a particular service or purpose category, without regard for the responsible entity. So spending to provide service for support of natural resources and the environment is considerably different from spending by the Environmental Protection Agency because a number of agencies are involved in supporting services for natural resources and the environment. And so it is with each function and for most agencies—several agencies contribute to the functions and single agencies are contributing toward multiple functions. The functional classification gives a view of fundamental resource allocations to deal with the array of public problems.[15]

Alternative classifications of budgets, including the strengths and weaknesses of each classification, will be discussed in greater detail in later chapters. However, behind any budget classification lurks some "grocery list" of inputs that will be needed for the service plan regardless of the vision or strategy for providing services that has produced that plan. Just as a cook has to decide whether to bake cherry pies or angel food cakes before preparing a grocery list (the inputs), a government executive needs to have a service plan before creating the list of inputs to be purchased. And both the cook and the government executive will eventually need a grocery list to carry out the plan. Hence, the input classification is the most basic and durable format of all. In many small governments and nonprofit organizations, it is the only classification structure for the budget.[16]

[14] In the middle of 1996, the Congressional Budget Office started doing ten-year budget estimates. Nobody but politicians and the media took these seriously, particularly the more distant years of the estimating horizon. It is hard enough to get reasonable estimates for the five years required in laws establishing budget procedures. Rudolph G. Penner, "Dealing with Uncertain Budget Forecasts," *Public Budgeting & Finance* 22 (Spring 2002): 1–18.

[15] The federal budget provides the standard multiple years for both administrative and functional classifications. They are not included in the table because of space limitations.

Functions of the Budget Process

Governments exist to provide services. The budget process provides a time for decisions about the services desired by the public and the options available to the government for providing these services. A traditional expectation is that properly working budget processes act to constrain government and to prevent public officials from stealing. Indeed, public budgeting in the United States developed first at the municipal level to prevent thievery, pure and simple. Budgets should do that, but they should also do more, particularly in regard to seeing that governments fulfill their appropriate role in delivering the services demanded of them by businesses and individuals through choices made in the democratic process and that resources available to government are reasonably used. The process allocates resources among government activities and between government and private use. The great struggle that the budget process contains is between "needs" and "availability." On the one hand, the resources available to the government are limited by economic conditions and the extent to which the government is willing to apply its fiscal authority to draw revenue from the private economy. On the other hand, agencies and departments of government have commitments and opportunities to deliver services to the citizenry. Long-term fiscal sustainability—the ability of the government to maintain its operations on behalf of the public without deterioration of services or dramatic increases in taxation—requires that actual spending be within resource availability. That means continuing tension because opportunities for service always exceed resource availability. The budget process has to work that out as part of the agenda for sustainability.[17] Budget presentations that extend several years into the future, well beyond the term of current budget proposals, are primarily documents for fiscal sustainability and are usually designed to present the fiscal profile that is shown in the presentation.

[16] The Tempe budget elsewhere categorizes spending by cost centers within each department, so that it can identify the cost of providing each of its primary services to the public, and it provides substantial performance information. Its classification extends well beyond the traditional budget presented here for an illustration.

[17] Many nations have instituted what are called *medium term expenditure frameworks (MTEFs)* in an effort to provide this balancing of needs and availability over a three- to five-year horizon. The MTEF involves development of a top-down (from the central budget office or Ministry of Finance) resource constraint from a macroeconomic model, a bottom-up (from the agencies) estimation of the medium-term cost of delivering services according to current policies, and a reconciliation against government priorities. The framework feeds into the annual budget process to give better responsiveness to national priorities and some greater predictability of funding to agencies.

Table 2–3
Federal Outlays by Function and by Administrative Organization, Fiscal 2010

Superfunction and Function	$ million	Department or Other Unit	$ million
National Defense	**693,586**	Legislative Branch	5,839
Human Resources	**2,385,731**	Judicial Branch	7,181
Education, Training, Employment, and Social Services	127,710	Department of Agriculture	129, 460
		Department of Commerce	13,236
Health	369,054	Department of Defense– Military Programs	
Medicare	451,636	Department of Education	666, 715
Income Security	622,210	Department of Energy	92,858
Social Security	706,737	Department of Health	30,778
Veterans Benefits and Services	108,384	and Human Services	854,059
		Department of Home	
Physical Resources	**88,753**	and Security	44,457
Energy	11,613	Department of Housing	
Natural Resources		and Urban Development	60,141
and Environment	43,662	Department of the Interior	13,164
Commerce and Housing Credit	−82,298	Department of Justice	29,556
Transportation	91,972	Department of Labor	173,053
Community and Regional Development	23,804	Department of State	23,802
		Department of Transportation	77,750
Net Interest	**196,194**	Department of the Treasury	444,338
Other Functions	**174,065**	Department of Veterans	108,274
International Affairs	45,195	Affairs	
General Science, Space, and Technology	31,047	Corps of Engineers-Civil Works	9,876
		Other Defense Civil Programs	54,032
Agriculture	21,356	Environmental Protection Agency	11,007
Administration of Justice	53,436	Executive Office of the President	582
General Government	23,031	General Services Administration	861
Allowances	....	International Assistance Programs	20,041
Undistributed Offsetting Receipts	−82,116.0	National Aeronautics and Space Administration	18,906
Total Federal Outlays	3, 456,213.0	National Science Foundation	6,719
		Office of Personnel Management	69,915
		Small Business Administration	6,128

(continues)

Table 2–3
(continued)

Superfunction and Function	$ million	Department or Other Unit	$ million
		Social Security Administration (On-Budget)	70,758
		Social Security Administration (Off-Budget)	683,420
		Other Independent Agencies (On-Budget)	−7,507
		Other Independent Agencies (Off-Budget)	4,700
		Allowances	....
		Undistributed Offsetting Receipts	267,886
		Total outlays	3,456,213

SOURCE: Office of Management and Budget, Budget of the Government of the United States, Fiscal 2012 (Washington, D.C.: OMB 2011)

Public financial managers expect budget procedures to (1) provide a framework for fiscal discipline and control, (2) facilitate allocation of government resources toward uses of highest strategic priority, and (3) encourage efficient and effective use of resources by public agencies as they implement public programs.[18] They also expect budget procedures to be the primary mechanisms for creating transparency in the fiscal operations of the government. The procedures work through budget planning and development, budget deliberations, budget execution, and audit. The processes of analysis and management apply equally to government and nonprofit organizations, although they are usually more highly developed and more routine in governments.

1. **Fiscal discipline and control.** The expenditure-control function in budgeting involves restraining expenditures to the limits of available finance, ensuring that enacted budgets are executed and that financial reports are accurate, and preserving the legality of agency expenditures. The control function—making sure that expenditures agree with the legal intent of the legislature—helps develop information for cost estimates used in

[18]*Public Expenditure Management Handbook* (Washington, D.C.: The World Bank, 1998), 17.

preparation of future budgets and preserve audit trails after budget years are over.[19] Much of the control comes from within the spending unit, to ensure that funds are being spent within legal intentions because it is better to prevent misuse than to try to punish it after it has occurred. A post-expenditure audit is external to unit administration. Budgeting and appropriating given dollar amounts to purchase given quantities of goods or services simplifies the fundamental external audit question: Do financial statements of the agency tell the truth, is the agency sufficiently protective of public resources, and did the agency use the resources provided it in the intended way? If the appropriation was for the purchase of 10 tons of gravel, was that gravel actually purchased and delivered in a responsible manner, was the gravel adequately protected while it was in the agency's hands, and do the agency's financial reports accurately reflect the gravel transaction?

One of the great challenges of creating a more responsive government may involve restructuring the notion of control away from inputs purchased toward services provided. Unfortunately, the definition of accountability in government has remained relatively constant over the past fifty years: "limit bureaucratic discretion through compliance with tightly drawn rules and regulations."[20] If government is to be flexible, responsive, and innovative, narrow control and accountability to the legislature and within the operating agencies almost certainly must change from internal operations to external results.

2. **Response to strategic priorities.** The budget process should work to deliver financing to the programs and projects that are of greatest current importance to the citizenry. Governments face many fruitful opportunities for providing useful services. Their resources are limited, so they must choose among useful options, recognizing that their choices both influence and must be influenced by community, state, and national environments. They should not have to work around legal or administrative constraints that protect certain activities without regard for their relative importance. All resources controlled by the government should be available to respond to the legitimate demands of the country; the competition for those scarce resources ought to be balanced among the alternatives, with the final decision about how the funds are used driven by the return from the competing uses, not barriers that hinder allocation of those funds. This is difficult for politicians and interest groups—both have an innate tendency to want to tie the hands of future generations with what they believe to be timelessly good ideas. Making sure that fire department horses had access to hay and water was critical in the nineteenth century; it isn't an issue today. Permanent dedication of certain shares of a tax source to provision of particular services, called tax earmarking, is popular with lawmakers, but represents an effort to tie the hands of future governments, thus inhibiting the prospects of response to strategic priorities.

3. **Efficient implementation of the budget.** Budgets also serve as a tool to increase managerial control of operating units and to improve efficiency in agency operations. This function focuses on government performance and utilization of resources the unit has acquired with funds made available to it. The important concern is the relationship between the resources used and the public services performed by the unit. The public budget—as in a private business plan—serves as the control device for the government and identifies operational efficiency. For this purpose, the agency must consider what measurable activities it performs, an often difficult, but seldom impossible, task. The process should induce agencies to economize in their operations, identify the services of greatest importance to the populations they serve, choose best available technologies and strategies for delivering those services, and respond quickly when service demands or operating conditions change. Simple husbandry of inputs or resources purchased by the agency is important, but is not enough. Not spending funds made available to the agency in its approved budget is not praiseworthy if the agency has also failed to provide desired public services. And it certainly is not praiseworthy if other agencies have pressing service demands that budget limitations have prevented them from meeting.

Delivering Those Budget Process Functions

The budget process should enforce aggregate fiscal discipline, facilitate allocation of government resources to areas of greatest current public priority, and encourage efficient agency operations. Some process features that help to realize those promises are (1) realistic forecasts of receipts and other data useful for development of budgets; (2) comprehensive and complete application of the budget system to all parts of the government; (3) transparency and accountability as the budget is developed, approved, and executed; (4) hard and enforced constraints on resources provided to agencies, but with considerable flexibility in how agencies may use these resources in service delivery; (5) use of objective performance criteria for agency and government accountability; (6) reconciliation between planned and executed budgets; and (7) capable and fairly compensated government officials to prevent susceptibility to corruption.[21] It is expected that the budget will be authoritative, in the sense that spending will occur only according to the budget law, and that records will be accurate with recording of actual transactions and flows.

The budget should also be forward looking, in the sense that, while being prepared and adopted for the short fiscal period of only a single year or two, it sets

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[19] An audit trail is a sequence of documents—invoices, receipts, canceled checks, and so forth—that allows an outside observer to trace transactions involving appropriated money: when the money was spent and who received it, when purchases were delivered and what price was paid, and how the purchases were cared for and used.

[20] Paul C. Light, *Monitoring Government: Inspectors General and the Search for Accountability* (Washington, D.C.: Brookings Institution, 1993), 12.

[21] Ed Campos and Sanjay Pradhan, *The Impact of Budgetary Institutions on Expenditure Outcomes: Binding Governments to Fiscal Performance*, Working Papers Series (Washington, D.C.: The World Bank, Policy Research Department, 1996).

the stage for years in the future. Therefore, the public is best served if the budget is formulated within a medium-term economic framework of four or five years, so that the chances of fiscal sustainability will be improved. That doesn't mean that the budget should be adopted for four or five years at a time.[22] Indeed, the expectations of the budget process are better served if the budget is adopted on an annual basis for better fiscal discipline and responsiveness to changed conditions. It does mean that an effort should be made to track the implications of fiscal decisions made in the current budget process into the medium term as a way to provide better guidance for decisions being made now.

Overarching all the budget process, all budget procedures, and all budget documents is a concern with *fiscal transparency*. This interest is inherent in democratic governance: If the public cannot see what the government has done, is doing, and intends to do, how can it give its informed consent to that government? Fiscal transparency requires that the general public, analysts, and the media have easy access to information about service delivery, financing arrangements, debt management, and the other elements that explain what is going on. Transparency does not mean pictures and pie charts in the budget document, but it does mean provision of accessible information about operations, achievements, and intentions. And it does not mean a data storm of discrete operating details, provided en masse in an arcane data format when inquiries are made by analysts, researchers, or the media. Closing the information door, responding to legitimate information requests in an unhelpful way, and presenting heroic pictures rather than operational information are inconsistent with public transparency and with democratic governance. It is, indeed, appropriate for government officials to believe that someone is watching them closely. After all, it isn't their money that they are spending, and they aren't operating programs according to their own tastes and preferences. It is the public's business, not theirs.

The Budget Cycle

Recurring (and overlapping) events in the budgeting and spending process constitute the budget cycle. Although specific activities differ among governments, any government that separates powers between the executive and legislative branches shows many of the elements outlined here.[23] The four major stages of the cycle—executive preparation, legislative consideration, execution, and audit and evaluation—are considered in turn. The cycles are in fact linked across the years because the audit and evaluation findings provide important data for preparation of future budgets. The four phases recur, so at any time an operating agency is in different executive and

[22]In 2008, the Duma of the Russian Federation passed an actual three-year budget covering 2009–2011, an exception to the multiyear budgets that offer only an advisory framework. Apparently, the budget had to be abandoned in 2009 because of political and economic developments.

[23]A parliamentary government would not neatly fit this cycle because there is no separation between executive and legislative branches. The city manager approach to local government does not easily fit the separation either.

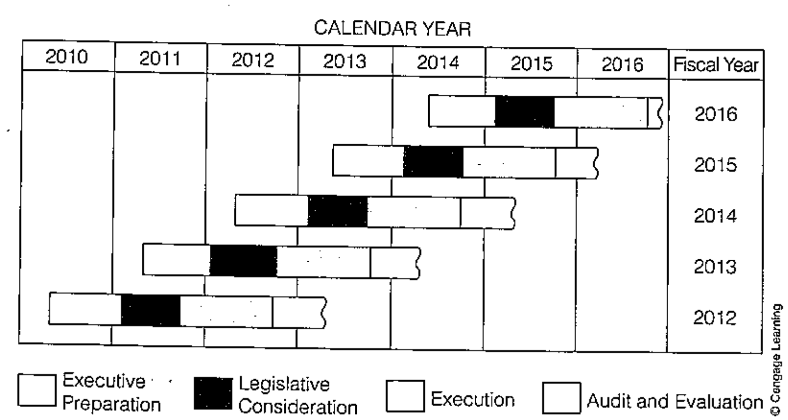
legislative roles. But the budget still must be prepared and adopted in phases of different budget years. Suppose an agency is on an October 1 to September 31 fiscal year and it is March 2013. That agency would be in the execution phase of fiscal year 2013 (fiscal years are normally named after their end year). It would likely be in the legislative consideration phase of fiscal year 2014, just at the beginning of the executive preparation phase of fiscal year 2015, and in the audit and evaluation phase of fiscal 2012 and prior years. Thus, the budget cycle is both continuous and overlapping, as Figure 2–3 illustrates.

The federal fiscal year begins in October; many local governments have fiscal years beginning in January; all state governments except Alabama, Michigan, New York, and Texas start fiscal years in July. The fiscal year in Alabama and Michigan starts in October, New York has an April start, and Texas's is in September.

Executive Preparation

Several separate and distinct steps constitute the executive preparation phase. At the start of the preparation phase, the chief executive instructs all departments and units of government to prepare their agency requests. These instructions (sometimes labeled the "call for estimates") include (1) a timetable for budget submissions, (2) instructions for developing requests, (3) indication of what funds are likely to be available (either in the form of an agency ceiling or in terms of a percentage increase), and (4) overall priority directions from the executive. The federal instructions, Circular A-11 revised annually, appear on the Office of Management and Budget website for all to see. Many states also place their instructions on their budget agency's website. The instructions may also, but not necessarily, provide forecasts of certain operating conditions for the fiscal year, including things like input price increases, service

Figure 2–3
Phases of a Budget Cycle



population trends, and so on, with an eye toward making sure that all agencies work with the same basic data. An important element in developing the instructions is a forecast of the economic climate and what it means in terms of revenue and expenditure claims on the government. A forecast of difficult economic conditions and limited revenue growth usually means instructions with limited prospects for the expansion of existing programs or the development of new programs, and possibly instructions to reduce spending.

The agency request builds on an agency plan for service in an upcoming year (the agency response to public demands for service) and an agency forecast of conditions in the upcoming year (the group of conditions influencing the agency, but not subject to agency control). These forecasts ought to be best estimates of conditions in the future. They are not necessarily projections, or simple extensions, of current conditions into the future. And the request is definitely not a forecast or projection of agency spending. For example, a state highway department request for snow-removal funds would involve a forecast of the number of snowy days and a planned response for handling that snow. For any snow forecast, the agency budget request will vary depending on how promptly the agency responds to snowfall (after trace snowfall, after 1 inch, after 3 inches, etc.), which roadways will be cleared (arterial, secondary, residential, etc.), and so on. The forecast does not dictate the request. Some agencies build their plans on inputs (the highway department bought 120 tons of road salt last year, so it will request about that amount for the budget year); this approach makes changes in service-delivery methods and practices difficult and is a pretty good indicator that the agency isn't doing the taxpayers any favors. In sum, the public-service demands and operating conditions will be forecasts, but the amount requested by the agency will reflect its planned response to those forecast conditions. Different response plans will mean different budget requests.

An agency develops not only a cost estimate for providing the services it plans to deliver, but also a narrative justification for the requests. The estimate and its justification reflect the large number of program decisions the agency has made. The chief executive's budget office gathers the requests made by many operating agencies and consolidates these requests. The budget office reviews budget requests for consistency with the policies of the chief executive, for reasonable cost and logical content, and for total consistency with spending directions. Often there are administrative hearings for reconciliation of an agency request and budget office adjustments. Finally, the executive budget document is transmitted to the legislature for its consideration. Law usually establishes the date of transmission to the legislature.

The budget document, or executive budget, incorporates all agency requests into a governmentwide request or plan. The requests by the agencies have been accumulated and aggregated according to the policy plan of the chief executive. Some legislative bodies, including the U.S. Congress, propose their own alternative budgets. Agency requests will almost always be reduced by the chief executive to produce an overall executive plan. And, of course, the expectation is that the vision or priorities of the chief executive will dominate the direction of the final plan. As is discussed later, the substantial changes made in agency requests before proposals are seen by the legislature reflect differences in attitudes and service clienteles of the agencies and the chief executive.

The executive budget is a message of policy; the financial numbers on spending, revenues, and deficits or surpluses are driven by those policies. Dall Forsythe, who once served as New York State budget director, emphasizes the point for governors (and all chief executives): "If you cannot use the budget to state your goals and move state government in the direction you advocate, you are not likely to make much progress towards those goals."[24] For the budget process to meet its expectations, the executive presentation for legislative deliberation should (1) be comprehensive (i.e., cover all government revenues and expenditures), (2) be transparent (i.e., present a clear trail from details to aggregate summaries of revenue and expenditure so that the implications of policy proposals and operating assumptions are clear), (3) establish accountability (i.e., clarify who will be responsible for funds, in what amount, and for what purpose), (4) avoid revenue dedications (earmarks) or other long-term commitments that could hinder response to new priorities or problems, and (5) establish as clearly as possible for what public purpose (i.e., desired result, not administrative input) the funds will be spent.

Legislative Consideration

In a government with distinct legislative and executive branches, the budget document is transmitted to the legislature for debate and consideration. The legislature typically splits that budget into as many parts as appropriation bills will ultimately be passed and submits those parts to legislative subcommittees. This consideration usually begins with the lower house of a bicameral legislature. In subcommittee hearings, agencies defend their budget requests, often calling attention to differences between their initial request and what appears in the executive budget. After the lower house has approved the appropriation, the upper house goes through a similar hearing process. When both houses have approved appropriations, a conference committee from the two houses prepares unified appropriation bills for final passage by both houses. The bills are then submitted to the chief executive. Appropriation acts are the outcome of the legislative process. These laws provide funds for operating agencies to spend in a specified fashion in the budget year. The initial requests by the agency reflect the plans of that agency; appropriation converts these plans (or portions of them) into law.

The chief executive normally must sign the appropriation bill before it becomes law, and thus gives operating agencies financial resources to provide services, but not all executives have the same options. Some executives may sign parts of the bill, while rejecting others (called *item veto power*); others must approve it all or reject it all, thus returning the bill to the legislature. Most state governors have item veto power, but the president does not. Some observers feel the item veto provides a useful screening of projects that political clout, rather than merit, has inserted in the appropriation bill. Others are skeptical about such power because of its possible use for executive vendettas against selected groups, legislators, or agencies.

[24] Dall W. Forsythe, *Memos to the Governor, An Introduction to State Budgeting* (Washington, D.C.: Georgetown University Press, 1997), 84–85.

Execution

During execution, agencies carry out their approved budgets. Appropriations are spent, and services are delivered. The approved budget becomes an important device to monitor spending and service delivery. Although there are other important managerial concerns during execution, spending must proceed in a manner consistent with appropriation laws. Law typically forbids (often with criminal sanctions) agencies from spending more money than has been appropriated. The Anti-Deficiency Act of 1906 is the governing federal law; similar laws apply at state and local levels and in other countries with well-developed fiscal systems. Spending less than the appropriation, while a possible sign of efficient operation, may well mean that anticipated services have not been delivered or that agency budget requests were needlessly high. Thus, finance officers must constantly monitor the relationship between actual expenditures and planned/approved expenditures (the appropriation) during the fiscal year. Failure to spend the full appropriation is not necessarily a good achievement. Central budget offices (the Office of Management and Budget for the federal government) normally handle the monitoring and release of funds during execution of the budget. Most governments have some pre-expenditure audit system to determine the validity of expenditures within the appropriation and some controls to keep expenditures within actual resources available. It is normal that funds will be maintained in a single treasury account rather than being distributed among separate agency accounts.

Spending is the direct result of appropriations made to carry out the service envisioned in the agency's initial budget plan.[25] However, because expenditures can involve the purchase of resources for use both in the present and in the future, it would generally be incorrect to expect the expenditure to equal the current cost of providing government services. Some of the current expenditure will provide services in later periods. (In simplest terms, part of the road salt purchased this year may be used next year, but much of the difference between expenditure and service cost will be caused by purchase of capital assets, such as buildings, trucks, computers, etc.) The cost of government would equal the amount of resources used, or consumed, during the current period—some resources coming from expenditure in that period and some from previous expenditures. Focus on expenditure thus renders an inaccurate view of the cost of government. Figure 2–4 outlines the flow of transactions and accompanying management information requirements between budget authority and service cost: (1) *budget authority* provides funding (the appropriation law approves agency Z's plan to publish an information bulletin), (2) *obligation* occurs when an order is placed (agency Z orders paper from business A), (3) *inventory* is recorded when material is delivered (business A delivers the paper to agency Z), (4) *outlay* occurs when the bill is paid (agency Z pays for the paper), and (5) *cost* occurs when the materials are used (agency Z prints an information bulletin on the paper).

Some reference to the federal structure may help clarify. Budget authority—provided through appropriation, borrowing authority, or contract authority—allows agencies to enter into commitments that will result in immediate or future

[25]Not all expenditure, however, results from appropriation. This complication is explained later.

Figure 2–4
Financial Information for Management

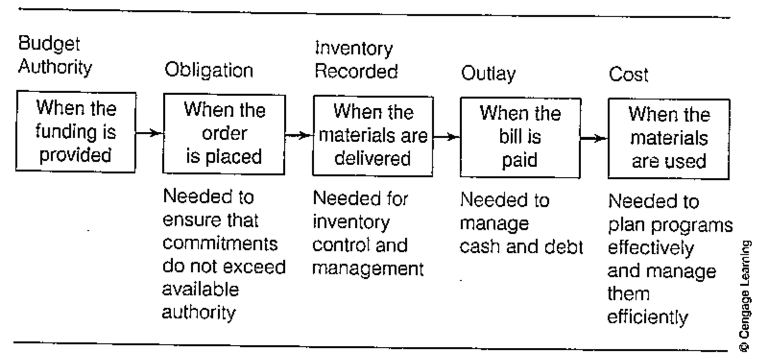
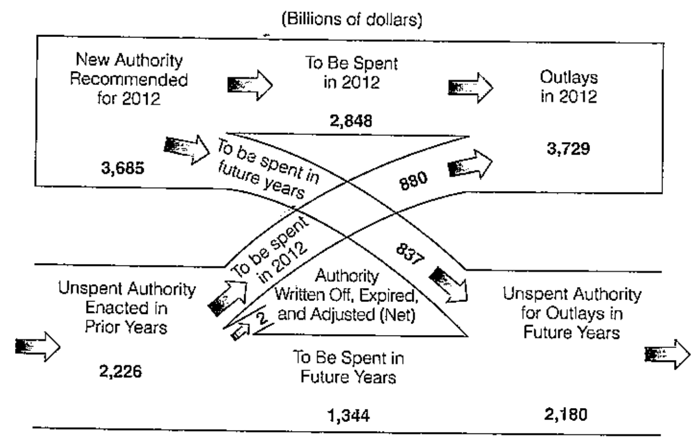


Figure 2–5
Relationship of Budget Authority to Outlays for 2012



SOURCE: Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012. Budget Concepts and Budget Process 2012*, p 127 (Washington, D.C.: U.S. Government Printing Office, 2011), 127.

spending.[26] Budget authority defines the upper limit for agency spending without obtaining additional authority. Figure 2–5 illustrates the relationship between budget authority and outlays envisioned in the 2012 federal budget. The budget plans outlays of \$3,729 billion. Most of the outlays are based on proposals in this budget (\$2,848 billion), but \$880 billion (30.9 percent of the total) is based on unspent authority enacted in prior years. Therefore, budget authority in a particular year differs from outlays for the year; outlays may result from either present or previous budget authority.

[26]Borrowing authority permits an agency to borrow funds and to spend the proceeds for qualified purposes. Contract authority allows an agency to make obligations before appropriations have been passed.

Operating agencies should have managerial flexibility in the use of funds, allowing them to change the particular mix of inputs they purchase, so long as they can provide the level of service to the public that was envisioned in the adopted budget. Agencies almost certainly know more about new technologies, changes in prices of inputs that could allow cost savings, and emerging problems than does the legislature or the budget agency. Hence, locking agencies to the line-item details of the proposed and adopted budget usually inhibits efficiency and innovation. Ideally, the operating agency should be responsible for budget totals and agency results, not the details of exactly how money was spent (within laws of theft and corruption).

Audit and Evaluation

An audit is an "examination of records, facilities, systems, and other evidence to discover or verify desired information."[27] The audit seeks to discover deviations from accepted standards and instances of illegality, inefficiency, irregularity, and ineffectiveness early enough to take corrective action, to hold violators accountable, and to take steps to prevent further losses. The audit may be internal (in other words, the auditors are subordinate to the heads of the departments being audited) or external (the auditors are outside the structure being audited and, for governments, are ultimately responsible to the citizenry). In general, the auditors verify the assertions made by the audited entity. Information is documented on the basis of a sample of transactions and other activities of the entity—a judgment about purchasing practices, for instance, is made from a review of a sample of transactions, not from an examination of all invoices.

Post-expenditure audits determine compliance with appropriations and report findings to the legislature (or to a judicial body if laws have been violated).[28] At the federal level, the Government Accountability Office (GAO), an agency of Congress, supervises audits of agencies, although the actual auditing is typically done by agency personnel.[29] States frequently have elected auditors or independent agencies that audit state agencies and local governments. Local governments sometimes have audits done by independent accounting firms as well as by government bodies, although some such governments have not frequently had independent audits.[30]

Government audits may be classified according to their objectives into two types: financial and performance. Financial audits include financial statement audits, which "determine (1) whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows or changes in financial position in accordance with generally accepted accounting principles, and (2) whether the entity has complied with laws and regulations for those transactions and events that may have a material effect on the financial statements,"[31] and financial-related audits, which "include determining (1) whether financial reports and related items, such as elements, accounts, or funds are fairly presented, (2) whether financial information is presented in accordance with established or stated criteria, and (3) whether the entity has adhered to specific financial compliance requirements."[32] These audits test financial records to determine whether the funds were spent legally, receipts were properly recorded and controlled, and financial records and statements are complete and reliable. They concentrate on establishing compliance with appropriation law and on determining whether financial reports prepared by the operating agency are accurate and reliable. The financial audit still must determine, however, whether there has been theft by government employees or their confederates, although this part of the task should be minor because of protections created by controls within the agency (internal controls).

Performance audits similarly encompass two classes of audits: economy and efficiency audits, which seek to determine "(1) whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently, (2) the causes of inefficiencies or uneconomical practices, and (3) whether the entity has complied with laws and regulations concerning matters of economy and efficiency,"[33] and program audits, which examine "(1) the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved, (2) the effectiveness of organizations, programs, activities, or functions, and (3) whether the entity has complied with laws and regulations applicable to the program."[34] Economy and efficiency audits might consider questions of procurement, safeguarding of resources, duplication of effort, use of staff, efficiency of operating procedures, management to minimize cost of delivering appropriate quantity and quality of service, compliance with laws governing use of resources, and systems for measuring and reporting performance. Program audits emphasize the extent to which desired results are being achieved, what factors might inhibit satisfactory performance, whether there might be lower-cost alternatives for obtaining the desired results, and whether there may be conflict or overlap with other programs. Some states link performance audits with sunset reviews: "a set schedule for legislative review of programs and agencies and an automatic termination of those programs and agencies unless affirmative legislative action is taken to reauthorize them. Thus, the 'sun sets' on agencies and programs."[35] States with such legislation typically include a performance audit as part of the preparation for action on agencies or programs eligible for termination.

[27] Peter F. Rousmaniere, *Local Government Auditing—A Manual for Public Officials* (New York: Council on Municipal Performance, 1980), 83.
[28] A pre-expenditure audit ascertains the legality or appropriateness of making payment. Such an analysis often occurs, for instance, prior to the delivery of payroll checks.
[29] The international group of audit bodies is the International Organization of Supreme Audit Institutions (INTOSAI). This group establishes international principles of organization and operation for these supreme audit institutions. The GAO is the U.S. member.
[30] Federal general revenue sharing required an audit at least once in three years for general-purpose governments receiving such money. The aid program is long gone, but the tradition of regular audits fortunately continues.

[31] U.S. General Accounting Office, *Government Auditing Standards*, 1998 rev. (Washington, D.C.: GPO, 1998), 2–1.
[32] *Ibid.*, 2–2.
[33] *Ibid.*, 2–3.
[34] *Ibid.*
[35] Advisory Commission on Intergovernmental Relations, "Sunset Legislation and Zero-Based Budgeting," *Information Bulletin*, no. 76–5 (December 1976): 1.

A simple example may illustrate the focus of each audit. Consider a state highway department appropriation to purchase road salt for snow and ice removal. A *financial audit* would consider whether the agency had an appropriation for salt purchased, whether salt purchased was actually delivered, whether approved practices were followed in selecting a supplier, and whether agency reports showed the correct expenditure on salt. An *efficiency and economy audit* would consider whether the salt inventory is adequately protected from the environment, whether the inventory is adequate or excessive, and whether other methods of selecting a supplier would lower the cost. A *program audit* would consider whether the prevailing level of winter highway clearing is an appropriate use of community resources and whether approaches other than spreading salt would be less costly to the community.

When all audit work is completed, the budget cycle is complete for that fiscal year. In a complementary fashion, the federal inspector-general system in 18 departments or agencies works within units to identify fraud, waste, or abuse under 1976 and 1978 legislation and reports findings to department or agency heads and, eventually, to Congress. The system has potential as an adjunct to the audits conducted for Congress by the GAO.

Government Accounting and Financial Reporting

Proper accounting and reporting practices make government finances more transparent to constituencies, including public officials, the public, and the investment community. They should improve accountability to the public, including allowing the public to see whether current revenues are sufficient to cover current expenditures; they should make it possible to evaluate the operating results of the government for the year, including determining how financial resources are obtained and how they are spent; and they should help with assessment of the level of services that the government can afford to provide, including supplying information about the financial condition of the government. Important topics in accounting for governments include accounting and reporting standards, use of fund accounting, and the basis of accounting.

Standards

Independent authorities or boards establish the standards (or rules) for accounting and financial reporting; in the United States, the Financial Accounting Standards Board (FASB) sets the standards for the private sector, and the Government Accounting Standards Board (GASB) sets them for the public sector. Similar bodies do the work in other countries. These standards establish the appropriate practices that the accounting system will implement and allow any interested party to understand the finances of the government and to make certain comparisons of finances across governments. However, the accounts, even when prepared according to recognized standards, are not statements of scientific validity, as anyone even slightly familiar with the Enron experience of rigged accounts that showed profitability as the company went bankrupt in 2001 will understand. At best, they seek fair representation, not unassailable truth.

The accounting system allows the manager to assemble, analyze, and report data for the essential work expected of the budget process. The data must be complete, accurate, timely, and understandable for all public constituencies. The focus of the system is on revenues and expenditures, on financial balances, and on financial obligations of the government. The financial reporting system is expected to provide understandability (reports should be sensible to the general public as well as to experts), reliability (reports should be comprehensive, verifiable, and without bias), relevance (information provided should meet the needs of users), timeliness (reports should be issued shortly after the close of the fiscal year), consistency (the basis should be the same for all transactions and across fiscal years), and comparability (it should be possible to compare reports across governments). The accounting system is expected to provide the framework for financial control, but it is also expected to be a ripe source of information for government decision makers and the public.

The full accounting system combines several elements:

1. **Source documents:** These are the receipts, invoices, and other original details of transactions.
2. **Journals:** These are chronological summary lists of all transactions.
3. **Ledgers:** These are reports at varying levels of detail that present the balance in any revenue, expenditure, or other account.
4. **Procedures and controls:** These are the forms and instructions for classifying, recording, and reporting financial transactions in the source documents, journals, and ledgers.

Government accounting focuses on cash flows and improved transparency, control, and accountability to constituencies rather than the profit-and-loss emphasis of private-sector accounting. This difference brings several normal practices in government accounting:

1. Governments use fund accounting to permit compliance with legal restrictions on the use of revenue and to facilitate strong financial administration of multiple government operations.
2. Debt is segregated. Bonds to be repaid from general financial resources of the government are reported as obligations of the entire government; bonds to be repaid from specific funds (bonds issued to build a parking garage being repaid through parking garage revenue, for instance) are reported as such.
3. The budget of a government is at the heart of its system of "checks and balances." Demonstrating compliance with the adopted budget is a critical part of the accounting and reporting process. In the private sector, budgets are more in the order of an initial flexible plan, not an adopted appropriation law. Nonprofit organization budgets are somewhere in between.

Governments have historically made little attempt to account for fixed assets in their financial records. They built an infrastructure for the operations of general government, but did not account for its condition in their financial records. That meant that any balance sheet of the government's assets did not accurately portray the true financial situation of the government. It did not reflect depreciation and deferred maintenance of these critical assets. Accordingly, financial reports could portray a misleading sense of the condition of the government: failure to maintain infrastructure eventually adds to the costs of operation, can lead to more borrowing than would be otherwise necessary, can cause previous capital investment to be wasted if not adequately protected, can cause economic development in the community to be impeded because of low-quality government services, and misleads about the total cost of providing services. A GASB standard—GASB 34—now requires larger governments to account for these infrastructure costs in their accounts, and the standard will eventually extend to all governments.[36] The change is driven by the effort to ensure that governments provide information about the full cost of providing government services, something that the omission of a reflection of cost from the existing infrastructure has prevented in the past. How critical this omission might be is open to dispute: there is little reason to know the "going concern" value of a government because nobody is going to buy or sell it.

Funds

In private-sector accounting, a single set of accounts reports all material transactions and details of financial condition. Government accounting, however, segregates funds or accounts because there are legal restrictions on the use of government revenues and on the purposes of government expenditure. Mixing money prevents a clear demonstration of compliance with restrictions. Therefore, distinct funds ("cookie jar accounts") provide the necessary controls.

Governments prepare financial reports in a number of separate funds or accounting entities that are expected to be self-balancing (equal credits and debits across accounts). Generally accepted accounting principles (GAAP) define funds to be interrelated accounts that record assets (revenues) and liabilities (expenditures/obligations) related to a specific purpose. Municipal accounting divides funds into three basic types: governmental funds, proprietary funds, and fiduciary funds, each with subcategories.

1. Governmental Funds
   a. General fund: general revenues to the government, including taxes, fines, licenses, and fees. Most taxes and expenditures are in this fund. There is only one general fund.

[36]A symposium in *Public Budgeting & Finance* analyzes several major implications of the new reporting model produced by Statement 34: Robert S. Kravchuk and William R. Voorhees, "The New Governmental Financial Reporting Model under GSAB Statement No. 34: An Emphasis on Accountability"; Terry K. Patton and David R. Bean, "The Why and How of the New Capital Asset Reporting Requirement"; Earl R. Wilson and Susan C. Kattelus, "The Implications of GASB's New Reporting Model for Municipal Bond Analysts and Managers"; John H. Engstrom and Donald E. Tidrick, "Audit Issues Related to GASB Statement No. 34"; and James L. Chan, "The Implications of GASB Statement No. 34 for Public Budgeting," *Public Budgeting & Finance* 21 (Fall 2001).

   b. Special revenue funds: account for operations of government that are supported by dedicated revenue sources—dedicated taxes, fees, or intergovernmental assistance. Transportation trust funds are one example.
   c. Debt service funds: account for payment of interest and repayment of principal due on long-term debt.
   d. Capital projects funds: include resources used for construction and acquisition of capital facilities or major capital equipment purchases. The fund is dissolved when the project is completed.
   e. Permanent funds: account for resources held in trust, where earnings, but not principal, may be used for public purposes.
2. Proprietary Funds
   a. Enterprise fund: includes the financial records of self-supporting operations, like water or sewer utilities. Accounts for business-type activities of the entity, which are operated for the general benefit of the public, but are expected to support themselves from their own revenue.
   b. Internal service fund: includes the financing of goods or services provided by one agency or department to other agencies or departments of the government on a cost-reimbursement basis, like the operations of a motor vehicle maintenance department.
3. Fiduciary Funds: account for assets held by a government as a trustee for others. Fiduciary funds include (1) pension funds that are used to pay public employees' retirement benefits and (2) trust funds that are used to pay for management of resources, and their use is usually tightly controlled.

In a mature fiscal system, an independent auditor prepares an evaluation of government financial operations at the end of the fiscal year. If the auditor renders a so-called clean opinion, then the way that the government prepared its financial report is considered to have been fair and accurate. Among other things, the auditor's report requires that the agency's statements be prepared according to GAAP. Clean budget processes also bring all government operations together, regardless of the fund structure, in order to preserve the comprehensiveness of public financial decisions.

Accounting Basis: Cash or Accrual

The accounting basis—the method of matching revenues and expenditures over time—may be cash (revenue posted when cash is received, expenditure posted when cash payment is completed), full accrual (revenue posted when earned, expenses posted when good or service is used), or modified accrual (revenues posted in period in which they are measurable and available, expenditure posted when liability is incurred). The traditional standard, cash accounting, records money inflows when received and spending when money is disbursed, generally following the flows of the government checkbook. Those flows can substantially lag changes in the true condition of the government, and capital assets (buildings, highways, etc.) require a cash payment when they are acquired, but no purchase payments over their many years of useful life. GAAP requires a modified accrual basis for governmental accounting, in which inflows are called revenues, not the receipts of cash accounting, and outflows are called expenditures, rather than the disbursements of cash accounting. The revenue measure requires an estimate of taxes owed, but not yet paid; the expenditure measure requires inclusion of purchases for which payment has not yet been made. Expenditure is recorded when liability is recognized, generally meaning when the good or service is delivered to the purchaser and normally well before any check is written to pay for the purchase. GAAP also requires that individual government operations expected to be self-supporting use full accrual accounting, the method of the private sector. In full accrual, outflows, called expenses, are recorded in the period in which benefit is received from the resource.[37]

The accrual basis provides more information for decision makers and for managers, particularly in regard to the distribution of cost over time, and is not susceptible to end-of-year cash manipulations. It has the capacity to place costs properly in the relevant period. Only a handful of national governments around the world prepare financial statements on an accrual basis, although that is the evolving pattern for American state and local governments, and even fewer provide for depreciation of their capital assets in their accounts. The federal government does prepare the *Annual Financial Report of the United States Government* and that is done on an accrual basis, but it is not clear that the report matters much to either the public or government decision makers. The cash basis controls flows of cash and does not distribute cost accurately to periods, but it is less complex than the accrual system and is less subject to fundamental manipulation for impact on financial statements. As *The Economist* summarizes, cash "is far harder to disguise or invent."[38] Either system can be functional, depending on the needs of the entity.[39]

Comprehensive Annual Financial Report (CAFR)

The CAFR is a general-purpose report produced to meet the information needs of public officials, citizens, auditors, and investors. It is expected to be a publicly available document that encompasses all funds and accounts controlled by the government entity. It is comprehensive in depth and breadth, reported in sufficient detail to provide full disclosure, and inclusive of all funds and accounts. The report includes

[37]Accrual accounting applies in the preparation of financial reports. Accrual concepts can also be applied in the budget process. Accrual budgeting is used in some countries, including Australia, New Zealand, the Netherlands, Switzerland, and the United Kingdom, and partly used in many more. M. Peter van der Hoek, "From Cash to Accrual Budgeting and Accounting in the Public Sector: The Dutch Experience," *Public Budgeting & Finance* 24 (Spring 2005): 32–45; and Jon R. Blondal, "Issues in Accrual Budgeting," *OECD Journal on Budgeting* 4, no. 1 (2004): 103–19.

[38]"Badly in Need of Repair," *The Economist* 362 (May 4, 2002): 67.

[39]A number of countries that moved to accrual accounting have recently become concerned by some lack of transparency thus created, and others have delayed a move for similar reasons. Andy Wynne, "Accrual Accounting for the Public Sector—A Fad That Has Had Its Day?" *International Journal on Governmental Financial Management* 8 (2008): 117–32. What makes sense for private businesses may not be transferrable to governments.

three sections: an introductory section that seeks to explain the structure of the government, the nature and scope of its activities, and the specific details of its legal environment; a financial section that provides a comprehensive overview of the government's operations and includes an independent auditor's report on the finances; and a statistical section that provides details on government operations and its major financial trends. The CAFR should provide a comprehensive and reliable single source of information about the finances and structure of the government, with financial data presented according to generally accepted accounting principles, so that an external observer can understand the situation of that government without having to do additional research on definitions or context. This report gives a complete overview of finances, prepared according to GAAP, and is critically interesting to those involved in public capital markets. In other words, people who might be loaning money to the government really want to know what the financial condition of the government is, and the CAFR gives them the basic information they want to find out.

Budgets and Political Strategies

Budget decisions, both spending and taxing, are intensely political. They do not spin out of an analytic "black box" programmed by purveyors of information technology and program analysis. Presidents, governors, mayors, and other public executives cannot ignore political forces when they develop their fiscal proposals, and legislators certainly do not ignore these forces as they pass budget laws.[40] Understanding the budget process is vital for shaping public policy, and so is the analysis necessary to innovate and implement programs most likely to be in the public interest. But budget proposals do need to be delivered and defended in a political environment: truth and beauty alone will not save the day. Hence, an understanding of some strategic behavior is important for practitioners of the budget process.

The Incrementalist Insight

The incrementalist concept holds that budgeting is mainly a process of political strategy. It downplays the public-service-delivery attitude of models from public finance economics and the attempts at rationality from policy analysis. As outlined by Aaron Wildavsky and Naomi Caiden,

[40]Natural disasters are about as nonpolitical as can be—hurricanes and tornados, for example, are indifferent to the political affiliation of their victims. However, research shows that rates of disaster declarations are higher in states of greater electoral importance, the rate of disaster declaration is higher in election years than in nonelection years, and states with congressional representation on the committees with oversight over the Federal Emergency Management Agency receive larger relief payments than states lacking that voice. Even with natural disasters, spending is driven by politics. Molly D. Castelazo and Thomas A. Garrett, "In the Rubble of Disaster, Politicians Find Economic Incentives," *The Regional Economist* (July 2003): 10–11. This article summarizes several studies of disaster declarations and payments.

> The largest determining factor of this year's budget is last year's. Most of each budget is the product of previous decisions. The budget may be conceived of as an iceberg; by far the largest part lies below the surface, outside the control of anyone. Many items are standard, simply reenacted each year unless there is a special reason to challenge them. Long-range commitments have been made, and this year's share is scooped out of the total and included as part of the annual budget.... At any one time, after past commitments are paid for, a rather small percentage—seldom larger than 30 percent, often smaller than 5—is within the realm of anybody's (including congressional and Budget Bureau) discretion as a practical matter.
>
> Budgeting is incremental, not comprehensive. The beginning of wisdom about an agency budget is that it is almost never actively reviewed as a whole every year, in the sense of reconsidering the value of all existing programs as compared to all possible alternatives. Instead, it is based on last year's budget with special attention to a narrow range of increases or decreases. General agreement on past budgetary decisions combined with years of accumulated experience and specialization allow those who make the budget to be concerned with relatively small increments to an existing base. Their attention is focused on a small number of items over which the budgetary battle is fought. Political reality, budget officials say, restricts attention to items they can do something about—a few new programs and possible cuts in old ones.[41]

Dramatic changes in federal expenditure programs, beginning with the end of the Cold War, the Republican Contract with America in the mid-1990s, the beginning of wars in Iraq and Afghanistan, the Katrina hurricane disaster, the Great Recession of 2007–2009, and other political and economic changes in the recent past, have raised some questions about whether the federal budget process is as simple as Wildavsky and Caiden claim. There have been dramatic fiscal changes within extremely short time periods. But the facts remain that some policies—and resulting expenditure and revenue implications—do remain in place over the years; that most spending agencies at all levels of government do begin their new budget development by considering their approved budgets and the changes that should be made to them to adjust to new operating conditions; that budget comparisons in central budget offices, in legislative committees, and in the media are made between the proposed and prior-year budgets; and that the most rational place to get insights about the near future is from the immediate past. Information from looking at incremental change—positive or negative, big or little—ought not to be ignored simply because there have been major shifts in the direction of government spending, especially federal. Looking at change is a tool, not a religion, after all. Indeed, some states and many local governments build budgets from percentage increments to the historical budget base (the prior-year budget) in accord with some notion of fair shares to each agency. In many administrative systems, the base is assumed when the next budget cycle begins.[42] Of course, some local governments are so poorly staffed that they really don't know how to do anything better.

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[41] Aaron Wildavsky and Naomi Caiden, *The New Politics of the Budgetary Process,* 3rd ed. (New York: Longman, 1997), 45.

[42] What is certainly incremental is tax law. For most major taxes, a tax code is adopted, and it remains in effect until explicitly changed or repealed. Tax changes are made by amending the existing code rather than by adopting a whole new tax. That is completely incremental.

Roles, Visions, and Incentives

Service-delivery choices in the budget process involve several roles, each with different approaches and biases. Participants in the budget process recognize and expect those approaches and are aware of the errors, incentives, and organizational blind spots inherent in each. The major attitude orientations are those of operating agencies, the office of the chief executive, and the legislature. All participants in the budget process seek to provide service to the public without waste. Each, however, works from different perspectives, resulting in different incentives and different practical definitions of that objective. A full understanding of the budget process obviously requires recognition of those roles.

1. **Operating agencies.** Operating agencies (e.g., the Fish and Wildlife Service, the Department of Parks and Recreation, or Immigration and Customs Enforcement) spend money for the delivery of government services. These agencies focus on the clientele they serve. It is unreasonable to expect an agency to be concerned with services provided by other agencies or to be interested in relative priorities among other agency services. The agency probably is not much concerned with comparisons of service cost with service value. The agency recognizes the value of services it provides to its clients and ordinarily tries to increase those services regardless of overall budget conditions of the government. There will be a virtually limitless expanse of service opportunities, many of which go unfunded simply because other uses of public resources are of higher priority to those making fiscal choices. Agencies, however, seldom recognize those competing uses and often complain about their own lack of resources. Large agencies have both operating people who have little direct contact with the budget and budget people who have little direct contact with service delivery. Both groups, however, can be expected to have essentially the same point of view and clientele orientation. Operating agencies usually have identifiable proponents in the legislature—particular people who support the agency in hearings and in committee deliberations—but it is seldom appropriate for the agency to make direct proactive contact with those people in an effort to go around budget decisions made by the chief executive. In most situations, the operating agency is not responsible for raising the revenue that it spends for delivery of services and accordingly can be excused for regarding those resources as free. Service to clientele is the principal focus.
2. **Chief executive.** The office of the chief executive, whether that of president, governor, mayor, or whatever, has budget specialists acting on its behalf. The offices have different names (federal: Office of Management and Budget; state: state budget agencies; etc.), but their function and role are the same regardless of name and level. Analysts in that agency conform to the chief executive's priorities, not their own. The analysts pare down requests from operating agencies until total spending is within available revenue. Reductions are typical for items (1) not adequately justified, (2) not closely related to achieving the agency's objective, and (3) inconsistent with the chief executive's priorities. Whereas agencies have a clientele orientation, the chief executive (selected

by the entire population) must balance the interests of the total population. Thus, priorities for an individual agency should not be expected to coincide with those of the chief executive because specific client-group priorities seldom match those of the general public. The interests of Corn Belt farmers, for instance, are not the same as those of the general population. And the chief executive is going to be responsible for raising revenue, so she is going to be doing some balancing that simply is not part of the operating agency viewpoint.

3. **Legislature.** The priorities of elected representatives can be expected to follow their constituents' priorities. Representatives are concerned with programs and projects serving the people who elect them. It is not reasonable to expect representatives to consistently take an overall view of agencies or agencies' programs. Representatives focus on a specific subset of the population, as is the case for operating agencies. Representatives, however, are oriented to a region rather than a specific client group. Most electoral regions do, of course, contain numerous client groups. And there is a strange lack of cost sensitivity here. Although legislatures will ultimately need to take the unpopular action of paying for government programs with taxes, legislators lose track of cost when arguing for delivering programs to their constituents—the benefits of the program are primarily to people in the legislative district, while the costs are borne by people throughout the state or nation. That diffused cost can make projects that are nationally unattractive extremely popular to the locality.

Forsythe offers another guide for chief executives in understanding the budgetary vision of legislators: "assume that legislators will apply a simple calculus in reviewing your budget proposals: they will want to take credit for spending increases and tax cuts, and they will want to avoid blame for budget cuts and tax increases."[43] The rule may not work all the time in every legislature—sometimes legislators take an ideological stand that all government is bad and happily cut spending—but otherwise it is a reasonable beginning assumption. It is particularly difficult to find legislators in favor of tax increases, especially of broad-based taxes that are not entwined in a complex package. Fiscal responsibility in practice seldom resonates with the general public.

Strategies

Budget proposals must be championed within operating agencies to be included in the agency request, within the administration for inclusion in the executive budget, and within the legislature to receive appropriation. A number of strategies, defined by Wildavsky and Caiden as "links between intentions and perceptions of budget officials and the political system that both imposes restraints and creates opportunities for them,"[44] are regularly used in these processes at every level of government and, indeed, in many different countries. They may also be considered devices for marketing and communicating the agency position.

[43]Forsythe, *Memos*, 48.
[44]Wildavsky and Caiden, *New Politics*, 57.

Two strategies are always in use for the support of budget proposals. The first is cultivation of an active *clientele* for help in dealing with both the legislature and the chief executive. The clientele may be those directly served (as with farmers in a particular program provided by the Department of Agriculture) or those selling services to the particular agency (such as highway contractors doing business with a state department of highways). The best idea is to get the client groups to fight for the agency without having the agency instigate the action when the chief executive proposes the reduction; such instigation would look like insubordination, and the agency might ultimately suffer for it. Agencies unable to develop and mobilize such clientele find defending budget proposals difficult. The media can also deliver the support indirectly, but only with some preparations; agencies normally get coverage because they have bungled something.[45] A strategy can help: "Try to stay in the news with interesting stories that do not put the agency in a bad light and that help you maintain good relations with reporters. Then, when you come close to budget time, you can give them press stories that show how well the agency has done with limited resources, and how well its pilot programs are working. Unstated is the premise that with a little more money you could do wonderful things and that if you are cut the public will lose valuable services."[46] The National Aeronautics and Space Administration (NASA) is a master at using the media to deliver its story through the budget process and serves as a model for any agency interested in learning how the strategy is played. With the exception of some reporters for the national papers of record—*The New York Times, Washington Post,* and *Wall Street Journal,* in particular—journalists are remarkably uninformed about government finances and are extremely susceptible to manipulation by interest groups and agencies. Websites, including those offering blogs, are often more specialized, and their writers may have great expertise, but they often have considerable political bias and are subject to no editorial supervision, so they can be both valuable and dangerous.

A second ubiquitous strategy that an agency may use is developing *confidence* in the agency among legislators and other government officials. To avoid being surprised in legislative hearings or by requests for information, agency administrators must show results in the reports they make and must tailor their message's complexity to their audience. All budget materials must clearly describe programs and

[45]If I a member of the media is itself involved as the agency, it becomes more interesting for mobilizing clientele. For example, in developing the fiscal 2006 appropriation bill for health, education, and labor programs, the House subcommittee proposed a reduction of about one-quarter of the funds for the Corporation for Public Broadcasting and an end to all funding within two years. Public radio and television stations mobilized their listeners to contact their congressional representatives in a blitz of announcements throughout the nation. The full House voted by a wide margin to restore the funds even as other attractive programs in that bill—like community health care for the uninsured, literacy training for prisoners, maternity group-home funding, and so on—were being eliminated. The fifty-seven programs being terminated did not have the capacity to mobilize clientele like public broadcasting did regardless of their probable value to society. Shailagh Murray and Paul Farhi, "House Vote Spares Public Broadcasting Funds," *Washington Post,* June 24, 2005, A6. A similar saga occurred in 2011 (Elizabeth Jensen, "Public Broadcasting Faces New Threat in Federal Budget," *New York Times,* February 27, 2011), and listeners were mobilized yet again.
[46]Irene S. Rubin, "Strategies for the New Budgeting," in *Handbook of Public Administration,* 2nd ed., ed. James Perry (San Francisco: Jossey Bass, 1996), 286.

intentions. Strategically, budget presenters must develop a small group of "talking points" that concisely portray their program. If results are not directly available, agencies may report internal process activities, such as files managed or surveys taken. Confidence is critical because, in the budget process, many elements of program defense must derive from the judgments of the administrators, not hard evidence. If confidence has been developed, those judgments will be trusted; if not, those judgments will be suspect.

Contingent strategies depend on the budget circumstances, particularly whether the discussion concerns (1) a reduction in agency programs below the present level of expenditures (the budget base), (2) an increase in the scope of agency programs, or (3) an expansion of agency programs to new areas. Some strategies seem strange or even preposterous; they are used, however, and should be recognized because the budget choices involved are vital parts of government action.[47] It cannot be emphasized enough, however, that strategy and clever rhetoric alone are not sufficient; they do not matter at all if the basics of the budget—its logic, justifications, mathematics, and internal consistency—are faulty.

Several strategies are applied as a program administrator responds to proposals for reduction in base (if a program may be terminated or reduced from its existing level of operation). These include the following:

1. **Propose a study.** Agency administrators argue that rash actions (such as cutting their programs) should not be taken until all consequences have been completely considered. A study would delay action, possibly long enough for those proposing cuts to lose interest and certainly long enough for the program administrator to develop other arguments for the program.
2. **Cut the popular programs.** The administrator responds to the proposed reduction by cutting or eliminating programs with strong public support (or at least releasing to the news media plans for such action). By proposing that the school band or athletic programs be eliminated, for instance, the administrator hopes to mobilize sufficient outcry to ensure no budget cuts. The careful reviewer knows of other activities that are particularly ripe for reduction, so that the political horrors painted by the administrator do not dominate discussion.
3. **Dire consequences.** The administrator outlines the tragic events—shattered lives of those served, supplier businesses closed, and so on—that would accompany the reductions. For instance, a zoo in Boston threatened to euthanize its animals if it didn't get more state funding.[48]
4. **All or nothing.** Any reduction would make the program impossible, so it might as well be eliminated.

[47] Important sources on strategy are Aaron Wildavsky, *The Politics of the Budgetary Process*, 4th ed. (Boston: Little Brown, 1984), chap. 3; Robert N. Anthony and David W. Young, *Management Control in Nonprofit Organizations*, 4th ed. (Homewood, Ill.: Irwin, 1988), 459–536; and Jerry McCaffery, *Budgetmaster* (privately printed).

[48] "Zoo May Close, Euthanize Animals," WCVB Boston, July 11, 2009 [http://www.thebostonchannel.com/r/20021259/detail.html].

5. **You pick.** The administrator responds that all agency activities are so vital that agency directors are unable to choose which would be reduced or eliminated if agency funds are cut. Therefore, those proposing the cut should identify the targets, thereby clearly tracking the political blame for the cut and hopefully scaring away the reduction. Anyone proposing a reduction for an agency needs a definite package proposal, in case such a strategy unfolds.
6. **We are the experts.** The agency argues that it has expertise that the budget cutter lacks. The reduction is shortsighted, based on ignorance, and thus should not occur.
7. **The Washington Monument.** A time-honored strategy of program administrators, when faced with budget problems like those associated with having no budget approved at the start of a new fiscal year or with running out of money in the midst of the fiscal year, is to respond with a dramatic gesture. In other words, the federal National Park Service says that it will close the Washington Monument, a popular tourist attraction, if the relevant appropriation bill is not passed by Congress (that is how the ploy got its name), or the local police department proclaims that it will no longer respond to vehicle break-ins because its fuel budget is being exhausted.
8. **Spread the bucks.** If the suppliers to a program can be distributed across enough legislative districts, the representatives of those districts can become valuable guardians of the program, should any executive attempt to reduce or eliminate the program. The most striking example of an application of this strategy is the defense of the V-22 Osprey, a tiltrotor aircraft capable of vertical takeoff and landing, as well as short takeoff and landing. It originated in the early 1980s as an aircraft that had some capacities of both a helicopter and a fixed-wing aircraft. The aircraft struggled with difficult development, an embarrassing tendency to crash, failure to meet performance specifications, cost overruns, and a lurking suspicion that it added no actual capability that the Defense Department needed or wanted very much. Administrations sought to terminate the program and defense secretaries tried to kill the program—but it lived on. The prime contractor for the project had made sure that subcontractors for the program were salted around key congressional districts so that people in legislative power would be trusted to make sure that the next piece of acquisition cost would be included in the adopted appropriation.

Other strategies apply when the agency seeks to continue or augment operations of its existing program:

1. **Round up.** Rounding program estimates—workload, prices, costs, and the like—upward to the next highest hundred, thousand, or million creates substantial slack when consistently done.
2. **"If it don't run, chrome it."** The budget presentation sparkles with data, charts, graphs, glittering PowerPoint, and other state-of-the-art management trappings. Much of the material may not relate directly to the decision at hand, and the base data may not be particularly accurate, but the quality of the show aims to overpower weak substance.

3. **Sprinkling.** Budget items are slightly increased, either in hard-to-detect general categories or across the board, after the basic request has been prepared. The layer of excess is spread so thinly that it cannot be clearly identified as padding. If enacted in full, the budget would allow the agency a significant operating cushion. Such a practice may leave no traces; however, surpluses might emerge during budget execution.
4. **Numbers game.** Agency administrators may discuss physical units—for example, facilities operated, grants initiated, or acres maintained—rather than the funds requested and spent. The intent is to divert attention from substantially increased spending for each unit.
5. **Workload and backlog.** Administrators often base their request on greater client demands or a backlog of unfilled requests. The argument is reasonable if the workload measure is germane to the agency's function, if the agency is doing something that needs to be done, and if the backlogs are not simply residuals of poor management of existing resources.
6. **The accounting trap.** Either side in the budget process may argue that a proposed expenditure must be made (or is forbidden) because the accounting system controls such transactions. The argument can be politically important. However, accounting systems exist to help management implement policy and to provide information for policy decisions. Policy choices should not be made difficult by the accounting system.

Programs and agencies develop an institutional momentum. Proposals for a new program entail special challenges because the new program lacks any such momentum. Some budget processes even place new programs in a separate decision structure that considers new programs only after available revenues have covered all requests from existing activities. Other processes cause trouble for proposed programs simply because clients and constituents who could provide political support have not yet developed. Some strategies are characteristic of the new proposal:

1. **Old stuff.** Administrators may disguise new programs as simple extensions or growth of existing operations. When the new operation has developed an institutional foundation (directors, clients, and political allies), it can be spun off into an independent life, having been nurtured through early development by existing agency operations.
2. **Foot-in-the-door financing.** A project starts with a small amount of funding, possibly under the guise of a pilot or demonstration program or as a feasibility study. Modest amounts build each year until the program is operational and has developed a constituency. By the time full costs are identified, it may be more economical to spend more money to finish the task rather than irretrievably abandoning the costs sunk into the project. Here is a classic example: In 1991, the Royal Thai Air Force purchased a squadron of F-16 fighters. The military lacked sufficient money to make the purchase, so the planes were purchased without engines. Delivery was scheduled for 1995, which left plenty of time to gather the extra funds. But a new Thai government took office in 1992. Although it wanted to exert control over military spending, its options were to approve more money for the engines or to pay for nonflying (probably undeliverable) airplanes. Rather than getting no return from the $560 million spent on airplanes, training, and a new radar system, the purchase was approved—even though the new government sought to constrain military spending and to devote its scarce resources to domestic use.[49]
3. **It pays for itself.** Supporters of new programs sometimes argue that the program will produce more revenue than it will cost. Although many revenue department activities may do just that, the case is made in other areas as well. Examples include arguments made by law enforcement agencies concerning collections of fines and, with growing frequency, by economic development departments concerning induced tax collections from economic activity lured by the project.
4. **Spend to save.** Expenditure on the proposal would cause cost reduction somewhere else in the government. The net budget impact would be nil, or even positive, if spending $1 in agency A would allow spending to be reduced by $1 or more either in that agency or somewhere else in government. Whether that claimed spending reduction actually would occur is another argument.
5. **Crisis.** The proposal may be linked to a catastrophe or overwhelming problem—AIDS, economic underdevelopment, homelessness, homeland security, and so on—even though the link may be tenuous, simply because the agency perceives that such proposals are less likely to be reduced. But an agency must use caution because skeptics will question why it did not deal with the problem before it reached crisis proportions. A substrategy that might merit a category of its own is "Tie it to Terror." For many years (at least since 1966), the National Park Service has sought an underground visitors center at the Washington Monument. When the proposal emerged again in 2003, its name had changed from "Washington Monument Visitors Center Plan" to "Washington Monument Permanent Security Improvements." One critic observes: "As soon as you say that it's for security, any project—however questionable—is able to move forward because everyone is afraid that one of these great monuments might be destroyed on their watches. But in reality, [the underground proposal] has nothing to do with security."[50] At least so far, it hasn't gotten the visitors center and the link between the center and security still is being used as justification.
6. **Mislabeling.** The actual nature of a program may be hidden by mixing it with another, more politically attractive program. Examples abound: military installations may have blast-suppression areas that look strangely like golf courses; university dormitories or office buildings may have roofs that have seats convenient for viewing events on the football field; the rigid upper-surface covers for the new sewers may support vehicular traffic. These

[49] Cynthia Owens, "And Now They'll Sneak in Orders for Aviation Fuel and Parachutes," *Wall Street Journal*, January 28, 1993, C-1.
[50] Monte Reel, "Washington Monument Dispute Resurfaces," *Washington Post*, August 4, 2003, A01.

strategies, however, require an essentially supportive environment; all key participants in the budget process must be in agreement on the proposal because budget people remember and make allowances in later years.

7. **What they did makes us do it.** An action taken by another entity may place demands on the agency beyond what could be accommodated by normal management of existing programs. If school libraries were to be closed and teachers continued to assign reference work, local public libraries might argue for new programs to accommodate student requests for assistance. Harsh federal sentencing guidelines for certain classes of drug offenses means that new federal prisons must be built.
8. **Mandates.** Some external entity (a court, a federal agency, the state, etc.) may legally require an agency action that would entail greater expenditure. Rather than rearranging operations to accommodate the new requirement, an agency may use the mandate as an argument for additional funds. The agency may in fact have requested that the external entity issue the mandate as a budget strategy. The approach can be compelling, but analysts need to determine the grounds for and authority of the mandate and the extent to which revised operations can accommodate the mandate before simply accepting the argument for an increased budget. The approach also has applications for base expansion and, if the time frame is sufficient, for defense against cuts.
9. **Matching the competition.** Agencies often compare their programs with those operated by others and use the comparison as a basis for adding new programs. (Seldom does the comparison lead to a proposal that some programs be eliminated because similar agencies do not have them.) The argument is also used to expand existing programs.
10. **It's so small.** Program proponents may argue that a request is not large enough to require full review, that its trivial budgetary consequences do not make the review a reasonable use of time. Those who understand foot-in-the-door financing are naturally wary of such arguments and generally respond that smallness makes activities natural candidates for absorption by the agency without extra funds. Everett Dirksen, a senator from Illinois of many years ago, holds everlasting fame for saying: "A million here, a million there, pretty soon you're talking about real money." Of course, inflation has changed the idea to billions, not millions—and it starts with small stuff.
11. **It's the local economy.** Public projects are often supported on the basis that they will bring local economic development and prosperity. For instance, the development of a local arts program may be supported because of the incomes it will generate and the business activity that spending from those incomes will create. But this impact is not the result of the arts program. It is the result of spending. Building a new city dump would have the same outcome in terms of incomes and business activity. Legitimate arguments for an arts program need to hinge on the services of the arts program, not impacts that are generic to any spending (particularly spending financed by those from outside the locality).

Conclusion

The budget process is where choices about the allocation of public resources get made. The flow of budget decisions from plan to expenditure is accomplished in a four-phase cycle involving executive preparation, legislative consideration, execution, and audit. Although budgets are constructed and approved in a political environment, it is not clear that appropriations are the simple product of adding a small increment to the prior-year appropriation. There is at least some room for attempts at rational choice in budget structures. Later chapters will prepare you to do the tasks required in the budget process and to understand how the process is carried out in practice.

QUESTIONS AND EXERCISES

1. The relative size of government has been a continuing public policy concern. Size and growth questions have been important at the state and local levels, as demonstrated by several state referenda to limit federal, state, or local expenditures. Some evidence for those discussions can be drawn from data on trends of spending activity, using information from the Department of Commerce's National Income and Product Accounts and the Census Bureau's Government and the Bureau of Economic Analysis website (www.bea.gov). From those sources, prepare answers to these questions about the size of government in the United States.

   a. Has the public sector grown relative to the private sector? How does the size of the federal government compare with that of state and local governments? (A benchmark for comparison is the percentage of GDP or personal income accounted for by the appropriate sector.)
   b. Which sectors have grown fastest? Compare growth of the public sector in your state with that of its neighbors and of the nation. Why might a comparison based on expenditure growth differ from one based on employment?
   c. Calculate national defense spending as a percentage of total federal government outlays and as a percentage of GDP. Can you identify the impact of the end of the Cold War and the beginning of the wars in Afghanistan and Iraq on these data?
   d. Which functions account for the greatest share of federal, state, and local government expenditures? Does the pattern differ much among states?
   e. What is the relative significance of local government expenditure compared to state government expenditure in your state? (Make the comparison first counting state aid to local government as state expenditure. Then omit that portion from state expenditure.) How does your state compare with its neighbors and the nation?