

BUDGETING AND FINANCIAL MANAGEMENT

Public budgeting and financial management are concerned with allocating limited resources to problems that governments and other public organizations face. Just as you establish a personal budget to track your income and expenses and, just as businesses create budgets to aid in decisions affecting profits and losses, so do public organizations employ budgets to help in planning and management. Public organizations must carefully and responsibly manage large amounts of money and other resources—taking in taxes and other revenues, purchasing goods and services, investing surplus funds, and managing debt wisely.

From the point of view of the manager or citizen trying to influence public policy, the budget is an extremely important tool for planning and control. To manage public programs effectively, you must be able to manage resources, both practically and politically. In this chapter we focus on the budget process from the standpoint of the individual public manager, examining how budget decisions are made and how you can influence budgetary outcomes. Although much of the budget process is highly charged politically, specific technical knowledge about budgeting systems will give you a distinct advantage.

The elaborate systems that public organizations have developed to manage their fiscal affairs are relatively recent. Prior to 1900, revenues were easily sufficient to cover the expenses of government, and financial management was merely record keeping. As the scope of government grew and new demands were placed on its resources, the need for more sophisticated systems of decision making became apparent. Moreover, repeated instances of corruption and waste made more effective control over the public's resources necessary.

In establishing its executive budget process through the Budgeting and Accounting Act of 1921, the federal government followed the lead of several local and state governments that had already taken similar actions. This municipal reform movement emphasized the budget process as a means of bringing order to public spending; consequently, by the 1920s, most big cities had established a formal budget process. Similar developments were also occurring at the state level. In 1910, Ohio became the first state to require an executive budget; within the next decade, similar actions took place in most other states. At the federal level, a special Commission on Economy and Efficiency, known as the Taft Commission, recommended establishing an executive budget in 1912; the recommendation was implemented nearly a decade later.

Since the 1920s, the federal budget has grown in both size and complexity, as have budgets at the state and local levels. This growth means that budgeting and financial management have come to involve far more than keeping a record of income and expenses. Today,

how government spends its money affects many other areas of the economy; consequently, the budget is an instrument of fiscal policy. Moreover, the budget is a primary expression of government priorities; it constitutes a record of the decisions that are made concerning various public policies.

Networking

General information on budgeting and financial management can be found at www.gasb.org and at www.nasbo.org.

The Budget as an Instrument of Fiscal Policy

Budgets express the public policy choices of governments and others. Among these are choices with respect to the impact of the public sector on the economy. *Fiscal policy* is concerned with the impact of government taxation and spending on the economy generally. Before the Great Depression, little attention was paid to how the federal budget affected the economy, which was presumably regulated by the *business cycle*. Periods of economic growth featuring inflation and high employment were followed by periods of recession or depression featuring deflation and unemployment. Meanwhile, the federal government sought to balance its budget each year—that is, to make revenues and expenditures approximately equal.

Economists soon began to realize, however, that this pattern of government spending was influencing the economy in a negative way. In periods of economic growth, government revenues naturally increased. In an effort to balance the budget, taxes could be lowered to the level of expenditures; in periods of economic decline, the budget was balanced by lowering spending to meet the lower revenues. The unanticipated result was to increase citizens' income during good times and decrease their income in bad times—just the opposite of what would be desirable. Government taxation and spending had the effect of accentuating economic instability.

Economists such as the British scholar John Maynard Keynes argued, in contrast, that all else being equal, positive government action could lead to greater economic stability. A key to Keynes's analysis was the relationship between inflation and unemployment. Keynes noted that periods of rapid economic growth are typically accompanied by high inflation, which is harmful to individuals because it lowers their purchasing power, especially if they are on fixed incomes. On the other hand, periods of economic decline are typically accompanied by high unemployment, which not only hurts individuals but also lowers revenues for government. In either case, government action aimed at achieving greater stability might be both possible and desirable.

There are many ways the federal government can influence the economy, but one important way is simply by varying its own spending or, somewhat more indirectly, by raising or lowering taxes. The capacity of government spending patterns to influence the

economy so dramatically is not hard to understand if you recognize the enormous role of government in the economy. The gross domestic product (GDP), the rate of inflation, and the rate of unemployment are the key indicators of economic health. *Gross domestic product*, a measure of total economic output, is measured by the market value of goods and services. Almost three-quarters of our current GDP is private in nature, but about one-quarter (about 24.7 percent in 2010) is based on government spending. Based on revenues, the U.S. federal government is the single largest organization in the world, almost 10 times the size of Walmart, Exxon, or Chevron (top three in the Fortune 500). Obviously, decisions at the federal level play an important role in the health and stability of the economy generally.

The key relationships are these: (1) If the economy is experiencing rapid growth—with high inflation and low unemployment—the government might seek to “cool off” the economy by taking money out of the economy through lowering spending, raising taxes, or both. This limits private demand and slows economic growth. On the other hand, (2) if the economy is experiencing recession or depression—with falling prices and high unemployment—the government might want to stimulate the economy by putting more money into circulation, through increasing spending, lowering taxes, or both. This stimulates private demand and increases economic growth. Creating a surplus, as might occur in the first case, would help restrain private spending during prosperity; creating a deficit, as might occur in the second case, might stimulate spending during a recession.

Cumulative state and local spending also affects the economy. State and local government expenditures constitute close to 12 percent of the GDP and must be taken into account in discussions of fiscal policy. If the federal government cuts taxes, but also cuts aid to states and localities, those governments may find it necessary to raise taxes themselves, thus offsetting any economic gains caused by lower federal taxes.

Patterns of spending in many states and in major cities do have some effect on the local economy, and consequently, state and local officials are becoming more cognizant of their role in fiscal policy and especially economic development. These governments, however, often don't have the tools or authority to make certain kinds of decisions. For example, all the states except Vermont have either constitutional or statutory provisions requiring a balanced budget. (Various political leaders, especially Republicans in Congress, have recently called for a balanced budget amendment at the federal level as a way to eliminate deficit spending; however, at this point, no legislation has passed.) Such a proposal, though attractive in a symbolic sense, would limit the flexibility of the federal government in seeking to influence the economy. In any case, it is clear that the budget process has important effects on the economy that must be anticipated when structuring overall patterns of public spending.

The Budget as an Instrument of Public Policy

Although the overall pattern of spending represented in a government budget has an important effect on the economy, individual entries in the budget represent important choices with respect to public policies of all types. The budget is, essentially, a measure of

support (or lack of support) for specific programs. Those in favor are funded; those out of favor are not. For this reason, discussions of budgetary priorities are of special importance to political leaders, government officials at all levels, and representatives of various interests in society. As a manager, you will need to understand both where the money comes from and where the money goes.

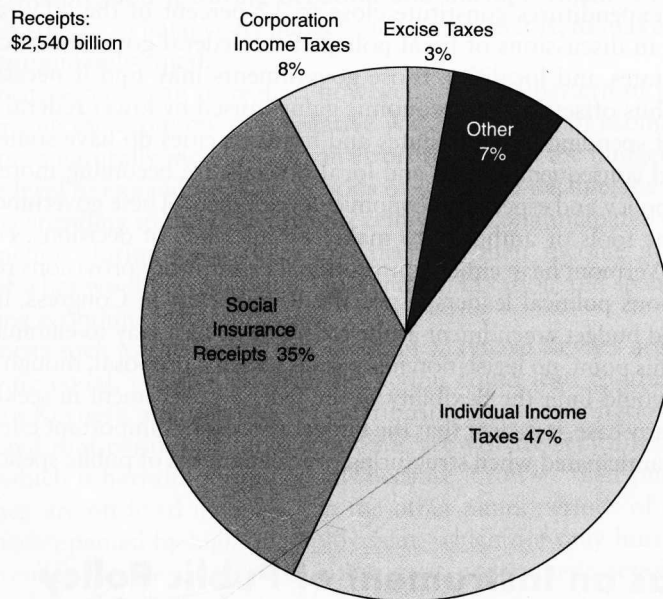
Where the Money Comes From

Governments obtain funds either from their own sources or through transfers from other governments to operate programs deemed important. There are a variety of ways governments can raise their own revenues, including levying taxes and charging individuals or groups for specific services (see Figure 5.1). Because all public programs are affected by the way governments raise revenues, and because revenue administration is itself an important part of public administration, you will find it helpful to understand the way taxes are structured.

Developing tax policies requires attention not only to the level of taxes being taken from individuals or groups, but also to the fairness, efficiency, and simplicity of the tax system. Everyone agrees that the tax system should be fair and that everyone should pay

FIGURE 5.1

The Federal Government Receipts: Fiscal Year 2011



SOURCE: Analytical Perspectives, Budget of the US Government, FY 2013 (Table 15.1 Receipts by Source—Summary, p. 187), retrieved March 19, 2012, from www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/receipts.pdf.

his or her "fair share." But what exactly does that mean? Some argue that people should pay according to the benefits they receive; others argue that those who have a greater ability to pay should in fact pay more.

One way to approach the issue is to think in terms of the relationship between one's tax rate and one's income (vertical-equity concept). A tax structure is *proportional* (or "flat") if it taxes everyone at the same effective tax rate. If an effective tax rate is applied to a \$20,000 income (yielding \$2,000) and the same rate is applied to a \$200,000 income (yielding \$20,000), even though the amounts differ, the tax is proportional to the amount of income. A tax is *progressive* if it taxes those with higher income at a higher effective tax rate. Income tax is often cited as progressive. For example, a person with a \$20,000 income and tax rate of 10 percent will pay \$2,000 in taxes; another individual with a \$200,000 income might be taxed at 10 percent for the first \$20,000 (yielding \$2,000), 20 percent for the next \$80,000 (yielding \$16,000), and 50 percent for the remaining \$100,000 of income (yielding \$50,000). The total tax paid on \$200,000 will be \$68,000, or an effective rate of 34 percent. Finally, a tax is *regressive* (such as sales taxes) if it taxes those with lower incomes at a proportionally higher effective rate than those with higher incomes. For example, if an individual with a \$20,000 income buys a car and pays \$500 in taxes, then the effective tax rate for this individual relative to his income is 2.5 percent. If another individual with a \$200,000 income buys the same car and pays \$500 in taxes, then the effective tax rate for that individual relative to his income is 0.25 percent.

Individual Income Tax All methods of taxation involve application of a *tax rate* to a particular *tax base*; the product of these yields *tax revenue*. The individual income tax is the single most important tax in our country. It calls for individuals to add up all income from taxable sources, reduce that amount by certain deductions or exemptions, and then apply a tax rate to that base to arrive at the individual's income tax. The current federal income tax, for example, applies rates between 10 and 35 percent to six income brackets.

All advanced industrial nations use some form of income tax. In the United States, income tax is the primary source of revenue for the federal government and is used to a lesser extent in many states and some cities. In most cases, a higher rate is applied to higher incomes, making the income tax a progressive tax. For nearly thirty years after its passage in 1913, the federal income tax applied only to a fairly small number of high-income people. With the advent of World War II, deductions were reduced significantly and higher rates applied.

Managing the task of collecting income tax from everyone in the country is obviously difficult. Yet the Internal Revenue Service (IRS) has developed a relatively efficient mechanism for collection and does so at a cost of about one-half of 1 percent of the revenues produced. Key to the existing system is the requirement that each individual calculate his or her own tax liability. IRS auditors then select a few returns for closer inspection, concentrating on those with unusual features. The extent of compliance with tax regulations in this country, though far from complete, is considered comparatively high.

Corporation Income Tax The corporation income tax, also a progressive tax, actually predates the individual income tax by several years and, for most of the last century, was a key

source of federal revenue. Its proponents justify it as a way of taxing capital accumulation that is not specifically distributed to individuals. Moreover, the corporation income tax is needed to support the individual income tax; without it, individuals could simply keep their income in corporations and avoid paying income taxes. Though most states have corporation income taxes, the tax is far more substantial at the federal level, currently at 35 percent, though there are many proposals to reduce the corporate tax in return for closing loopholes in the tax. Yet, even before these proposals, corporation income tax has been declining in contrast to other sources of revenue. Where it once yielded more revenue than the individual income tax, the corporation income tax has declined to only about one-tenth of federal revenues.

Payroll Taxes Taxes on payrolls support a variety of Social Security and other social insurance programs, such as unemployment compensation and medical care for the aged. (Do not confuse these specific taxes with the general income taxes that may be deducted from a payroll check.) These programs are primarily financed by taxes paid either by the employer or by the employer and employee in equal amounts. Payroll taxes overall are regressive because there is a flat rate, with no deductions or exemptions, and maximum amounts above which taxes are not required. Payroll taxes at the federal level, which support social insurance, now constitute the second largest source of federal revenue.

Sales and Excise Taxes Both sales and excise taxes are applied to goods and services. *Sales taxes* are applied to a broad range of goods and services at either retail or wholesale levels and are a popular source of income at state and local levels. There are significant variations in sales tax rates and in items covered by sales taxes—for example, some jurisdictions exempt food, clothing, and medicine from sales tax. *Excise taxes* are applied to the sale of specific commodities such as gasoline, tobacco, or alcohol; they are the primary form of consumption tax at the federal level. Typically, excise taxes are applied at specific rates (such as two cents per gallon of gasoline), but they may be applied to the total sales price. Some excise taxes are, in effect, user charges that help support particular activities. Gasoline taxes, for instance, are typically used to support highway construction and maintenance. A major issue concerning sales and excise taxes is that of equity. Because the poor consume a greater portion of their income than the rich, the burden of consumption taxes tends to fall more heavily on the poor, so the taxes are regressive. These taxes also tend to penalize certain groups, such as those with large families or those just starting a household. On the other hand, these taxes tend to provide more stable revenues, something that is especially important at state and local levels.

Property Taxes Taxes on personal property are widely used at the local level and provide about half of local government revenues. Administration of a property tax involves assessment of an individual's property, most often land and buildings, and then the application of a tax rate. About half the revenue generated by the property tax derives from residential property and half from businesses. Although the property tax is a proportional tax, it is progressive in its effect (those who spend more on housing pay more),

administration is difficult and has often not been highly professional. Moreover, recent tax limitations have severely restricted the capacity of local governments to raise additional revenue through the property tax.

Other Revenue Sources There are, of course, a variety of other sources of government revenues. Whereas public organizations have often charged fees for the use of specific government services, recent limitations on other tax revenues have made such charges increasingly attractive, especially at the local level. For example, fees for the use of parks and recreational facilities are becoming increasingly important. Another recent development in terms of revenues at the state level is the use of lotteries. Nearly half the states and several local governments now conduct lotteries, which provide a highly visible, but relatively small and unstable, source of funds. Lotteries are also highly regressive in their effect (because poorer citizens tend to play the lotteries more); indeed, they are more regressive than even the sales tax.

Nonprofit organizations, which lack the power to tax, derive revenues from quite different sources and, indeed, engage in a wide variety of efforts to support their programs. Obviously, membership organizations depend in large measure on member dues for revenue, but such organizations, along with many others, have recently sought to diversify revenues. Although grant funding remains an important source of revenue for many nonprofit organizations, recent reductions in federal social service programs have seriously limited grant opportunities for many nonprofits. Additional sources of funds include donations (from individuals, corporations, and foundations), sales of goods and services (from books to coffee cups), and joint enterprises involving commercial firms (such as insurance plans or “affinity” credit cards).

Networking

For the budget of the United States, and how to get to the budgets of other governments, see the Department of the Treasury at www.ustreas.gov. For details on the current fiscal year federal budget and access to historical budget data, go to www.gpoaccess.gov/usbudget/index.html.

Where the Money Goes

While government revenue figures are staggering, they hardly match up to the demands on governments at all levels. There simply isn't enough money to meet every need or cure every problem, even if money alone were the solution. Instead, difficult choices must be made each year about which programs will be funded and at what levels. The choices made through the public policy process are reflected in the government's budget. The budget, therefore, stands as a record of the government's priorities.

What Would You Do?

You are the director of motor vehicle registration for your state. Your agency, with offices scattered across the state, is responsible for registration and licensing of cars, trucks, and other motor vehicles. About six months into the fiscal year, the governor announces that all state agencies will have to finish the fiscal year with expenditures 5 percent less than originally budgeted. You have already spent half your yearly budget allocation, so the reduction means you actually have to cut spending by 10 percent over the next six months. What would you do?

But government priorities are always shifting. As new conditions arise, new programs are proposed and old programs are expanded or contracted. The emphasis the federal government gives to various areas sometimes has reflected the condition of the country and the world, as in the large percentage of national resources devoted to national defense during periods of international conflict.

We can also trace budgetary changes over shorter time spans to see the policy priorities of various presidents, governors, mayors, or other public officials. Restrictions, however, have been built into the federal budget over the years that somewhat limit the choices any president or Congress can make. For example, Congress has passed a variety of *entitlement programs* that provide specified benefits to those who meet certain eligibility requirements. For example, legislation might provide benefits to people above a certain age or below a certain income level. The implication, supported by several judicial rulings, is that individuals are entitled to or have a right to certain benefits (primarily social welfare benefits).

For these programs, Congress essentially agrees to provide whatever money is necessary from year to year to ensure a certain level of benefits to all eligible people. Legislation is typically written so that new action is not required each year to keep the program going. Only a projection of likely beneficiaries is needed to determine the level of expenditures for a given year. Unless Congress takes specific steps to limit benefits or eligibility—something that legislators are reluctant to do—funding of these programs is practically automatic.

These programs vary in size over time. In a recession, for example, unemployment would be high, and spending for unemployment compensation would rise. Similarly, the changing character of the population—for example, a larger number of older Americans—would also change the amount of money required to provide benefits to that group. Moreover, most entitlement programs have now been indexed to the cost of living (or related measures) so that benefit levels automatically rise with inflation. (Over the past decade, Congress has passed major expansions of indexing in Social Security and Medicare.) Expenditures for entitlement programs thus increase almost every year. The Congressional Budget Office (CBO) projects that under current law, federal spending on Medicare and Medicaid measured as a share of GDP will rise from 4 percent in 2007 to 12 percent in 2050 and 19 percent in 2082—which, as a share of the economy, is roughly equivalent to the total amount that the federal government spends today (CBO, 2007).

Such programs constituted just over 50 percent of the proposed fiscal year 2013 federal budget, with Social Security amounting to 20 percent of the entire budget. When they are combined with farm price supports (also indexed), interest on the national debt (which must be paid), and expenditures based on previous commitments, these so-called *uncontrollable expenditures* constitute almost two-thirds of the federal budget.

The remainder of the federal budget might be termed *discretionary spending*; meaning the president and Congress are open to make changes in this relatively small portion of the budget. This includes defense spending (about 18 percent) and domestic discretionary spending (only about 19 percent). These are the areas that generate the most difficult policy choices.

From Deficits to Surplus and Back

A great deal of political debate in the 1980s and early 1990s centered on strategies for controlling the federal deficit. However, by 2000, a booming economy and fiscal measures taken by Congress in the late 1990s changed the debate from how to control the deficit to ways to spend a growing budget surplus. To understand this change in fortune, it may be helpful to examine some of the deficit reduction methods employed by the federal government during the past decades.

Let's begin with the deficit. As noted, traditional economic theory does not necessarily disapprove of public borrowing; indeed, there may be benefits to deficit spending in particular years. But at some point, a growing deficit becomes unmanageable, especially as interest payments become a substantial part of government spending. Large deficits are generally thought to limit both short-term and long-term economic recovery, especially because they limit private investment. Moreover, large deficits contribute to an understandable lack of public confidence concerning their political leaders' ability to deal effectively with the budget.

The budget deficits of the Reagan years were substantial. The administration's accumulated debt exceeded that of all previous administrations combined. By 1984 it became clear that if no further actions were taken to reduce the deficit, by the end of the Reagan years, the accumulated deficit would total over \$2.6 trillion. Interest payments alone would require one out of every six federal dollars. Facing this prospect, Congress passed the Gramm-Rudman-Hollings Act of 1985. Under this legislation, deficit targets were set for each of the next five budget years and aimed at reducing the deficit to zero in 1990 (though a later amendment pushed the target to 1992). Unfortunately, the president and Congress were overly optimistic in their economic projections and employed several questionable budget techniques to evade the restraints set by Gramm-Rudman-Hollings.

With the deficit still out of control in 1990, President Bush and Congress faced very difficult budget deliberations. For the 1990 budget, the Gramm-Rudman-Hollings law had targeted an annual deficit of no more than \$110 billion. By October, when the fiscal year began, there was still no agreement on the budget. (As we will see, it is not unusual for a federal fiscal year to begin before the year's budget is approved.) Consequently, automatic, across-the-board spending cuts were applied to all federal agencies.

Finally, in late November, a deficit-reduction plan was approved that would bring the projected deficit below the Gramm-Rudman-Hollings target. The plan that was agreed to, however, contained a number of provisions that appeared to be budgetary “smoke and mirrors.” The biggest reduction item was to simply maintain for another 130 days the across-the-board cuts that had been imposed in October. Many observers read this as a failure of the administration and Congress to come to grips with the hard choices that deficit reduction requires.

As part of the budget agreement, the Budget Enforcement Act (BEA) was passed to police the deficit even further. The BEA set annual ceilings on several categories of discretionary spending, with violation of the caps requiring across-the-board cuts. BEA also required that legislative actions affecting mandatory spending not increase the deficit in any year. (This is known as the “pay as you go” provision.) Though these provisions seem to have had the desired effect on the budget process, the deficit continued to grow, driven in part by incorrect economic assumptions and in part by increased spending for health-care programs and the savings and loan bailout.

Networking

Check out the National Debt Clock at www.brillig.com/debt_clock and the Department of the Treasury’s FAQs about the budget at <http://www.treasury.gov/Pages/default.aspx>.

In 1997, the Clinton administration led a bipartisan effort in Congress to pass yet another landmark piece of legislation aimed at balancing the federal budget. The budget agreement was originally scheduled to eliminate the deficit by 2002, phasing in \$121 billion in spending cuts over a five-year period. Much of the savings were planned to come from reductions in Medicare payments to health providers and hospitals. An additional \$55 billion was to have been saved each year through mandates imposed on future spending bills. The budget agreement also featured \$95 billion in tax cuts over the five years, including credits for higher education, relief for families with children, and reductions in capital gains.

When President Clinton signed the measure into law, few would have imagined that in less than three years the Congressional Budget Office would be projecting a budget surplus. But the federal government turned the tide, thanks to a variety of factors—including old-fashioned good luck. One of the most significant contributors to the government’s change in fortune came in the “dot-com” craze of 1999–2000, as thousands of Internet companies went public on the stock market, leading to a dramatic increase in tax revenues and an overall expansion in the American economy. Reductions in military spending in the wake of the cold war also helped, as the government was able to invest its resources in more productive areas (Uchitelle, 2000, p. A1). The net outcome was a projected surplus of \$81 billion, scheduled to materialize during the next decade. This is a far cry from the crisis years of the early 1980s.

The Bush Tax Plan President George W. Bush seized upon the opportunity afforded by this emerging surplus to advance one of the key themes in his election platform: a reduction in federal taxes. Given the estimates early in the year from both the Congressional Budget Office and the president's Office of Management and Budget, few could stand in the way of the new administration's drive for sweeping tax reform.

The administration's original plan called for a \$1.6 trillion cut in the federal income tax, but even the president's most ardent supporters on Capitol Hill cautioned that it would be extremely difficult to pass such an enormous reduction plan. Recognizing the importance of a victory on his administration's first key policy initiative, President Bush worked with lawmakers to pare down the original proposal and gain the necessary votes. The final measure, which was signed into law on June 7, 2001, featured a \$1.3 trillion tax cut to be phased in over the next decade and a fundamental restructuring of federal income taxes.

Supporters of the plan said that reducing the tax burden on the American public, particularly with the projected federal surplus, was a way to return "an overcharge" to taxpayers and to curb federal spending. For example, House Majority Leader Dick Armey said, "The addicts are going to have to take the cure. We're no longer going to get stoned on the other people's money" (Stevenson, 2001, p. A1). Proponents also argued that the tax rebates, which the IRS began sending out in the summer of 2001, would help to stimulate an economy that had declined sharply in the preceding months.

Some of the central elements of the Bush plan included reducing personal income tax rates, phasing out the estate tax, increasing the child tax credit (and expanding the number of low-income families eligible for this credit), and increasing the contribution limits to 401(k) and individual retirement accounts. For nonprofits, the tax reduction plan that finally passed Congress lacked many of the provisions from the original Bush proposal that would have encouraged increases in charitable giving.

Critics of the Bush tax plan in the governmental sector predicted that it would prove to be too much, too soon. Senator Tom Daschle, who became majority leader when the Democrats took control of the Senate in June 2001, said, "We think this is good short-term politics. [But] it is disastrous long-term policy" (Stevenson, 2001, p. 26). Daschle and others suggested that the plan would not leave enough in reserve to cover the cost of upgrading the military, much less the substantial reforms to Social Security and Medicare that remained on the horizon. And even the president's own economic advisers moved away from their original optimism, saying that the more cautionary estimates of the federal surplus, which were released just weeks after the tax plan became law, would require Congress to revisit some of its main provisions.

Even so, President Bush succeeded in pushing through three more major tax cuts aimed at reducing revenue by \$1.9 trillion over a ten-year period. Unfortunately, the surplus did not materialize, and spending far outstripped revenue to produce high levels of debt. During the Bush administration, economic recessions, terrorist attacks, and corporate scandals, coupled with the tax cuts and new spending for military action in Iraq and Afghanistan, put the federal government further and further into debt. Instead of the surplus forecasted at the beginning of the Bush administration, there were federal budget

deficits each year beginning in 2002, and in January 2009, just before President Bush left office, the Congressional Budget Office projected a deficit of \$1.2 trillion for FY 2009 based on a continuation of the Bush administration policies and the effects of the financial collapse of 2008 (Tritch, 2011). Overall, under the Bush administration the total federal debt increased from \$5.7 trillion in January 2001 to \$10.7 trillion in December 2008 (United States Department of the Treasury).

Obama and Economic Recovery The deep recession spurred by the financial collapse in 2008 framed the context for the incoming Obama administration. One of President Obama's first acts was to sign into law the American Recovery and Reinvestment Act (ARRA) in February 2009, a \$787 billion economic stimulus package that included spending on job preservation and creation, health care, education, and energy; investments in infrastructure; tax breaks; expanded unemployment benefits; and a host of other programs designed to halt further economic deterioration.

The new president, who began his term with a budget deficit that was larger than any since World War II, set out in his 2010 budget proposal to capitalize on what he called a "once in a generation" opportunity to reverse "an era of profound irresponsibility that engulfed both private and public institutions" (OMB 2009, p. 1). The budget proposal included measures intended to help jumpstart the economy and stabilize the country's financial system, including appropriations to buy toxic bank assets, expand a consumer loan program, and continue funding for the Troubled Asset Relief Program (TARP), a program that was signed into law by President Bush in October 2008 to address the subprime mortgage crisis by buying assets and equity from financial institutions. President Obama's 2010 budget proposal also addressed the overhaul of the nation's health-care system and called for investments in clean energy, education, and the country's infrastructure (Calmes, 2009).

One of the issues facing the Obama administration early on was whether to extend the tax cuts enacted under President Bush, which were set to expire in December 2010. Critics of the cuts argued that these cuts spurred an increase in income inequality, that they played a pivotal role in the budget deficits that began in 2002, and that, contrary to predictions, they failed to encourage economic growth. Others, however, contended that the tax cuts created higher marginal rates for the very wealthy and actually generated an increase in federal tax receipts from 2004 to 2007. After a great deal of debate, during which it was projected that extending the cuts through 2020 would add more than \$3 trillion to the national debt, these cuts were extended for two years.

The Obama budget proposal for FY 2013, released early in 2012 and totaling \$3.8 trillion, called for \$4 trillion in cuts over ten years and \$1.5 trillion in tax hikes for households earning more than \$250,000. It included \$7.5 billion in administrative cuts and increased funding for education, rail and road construction, electric cars, and general research and development. Provisions included ending the Bush tax cuts, restoring the estate tax to 2009 levels, increasing the tax rate on dividends for the wealthy, and instituting the "Buffet Rule," which would subject those earning more than \$1 million to a tax rate of at least 30 percent (Lee & Paletta, 2012). The budget also called for elimination

of tax breaks for oil and gas companies; caps on discretionary spending; reforms to Medicare, Medicaid, and other health programs; and mandatory savings in a variety of areas. An analysis by the Congressional Budget Office noted that under the 2013 budget proposal, the deficit for 2012 would equal \$1.3 trillion, or 8.1 percent of GDP. This would decline to \$977 billion in 2013, or 6.1 percent of GDP; fall further relative to GDP in subsequent years to 2.5 percent in 2017; and then increase to 3.0 percent of GDP by 2022. The estimated accumulated federal debt as of the end of FY 2011 (September 30, 2011) was \$14.8 trillion, for which the government incurred \$454 billion in interest expenses during FY 2011 (United States Department of the Treasury). President Obama's proposed 2013 budget put forward a balanced plan of spending cuts and revenue increases that reduce the deficit by more than \$4 trillion over the next decade, including \$1 trillion in spending cuts he signed into law in the summer of 2012.

For an outline of the issues that these presidents have struggled with, see the box "Exploring Concepts: Issues in Budgeting."

Exploring Concepts

ISSUES IN BUDGETING

1. The fiscal health of the federal government, particularly in light of unprecedented deficits
2. The struggles of state and local governments to balance their budgets in both the short term and the longer term
3. Pressures on spending at all levels of government, particularly focused on two areas—health care spending, which affects all levels of government, and education spending, the effects of which are felt primarily at the state and local level
4. Concerns about revenue structure and reliance on various sources, particularly intergovernmental revenues and sales tax revenues
5. The problems created by the need to deal with (and finance) an aging infrastructure
6. The influence of financial and performance data on budgeting decisions
7. Institutional and organizational responses to the management of the finance and budget function

SOURCE: Phillip G. Joyce and Scott Pattison, "Public Budgeting in 2020: Return to Equilibrium, or Continued Mismatch between Demands and Resources?" *Public Administration Review* 70 (2010): s24–s32.

State and Local Expenditures

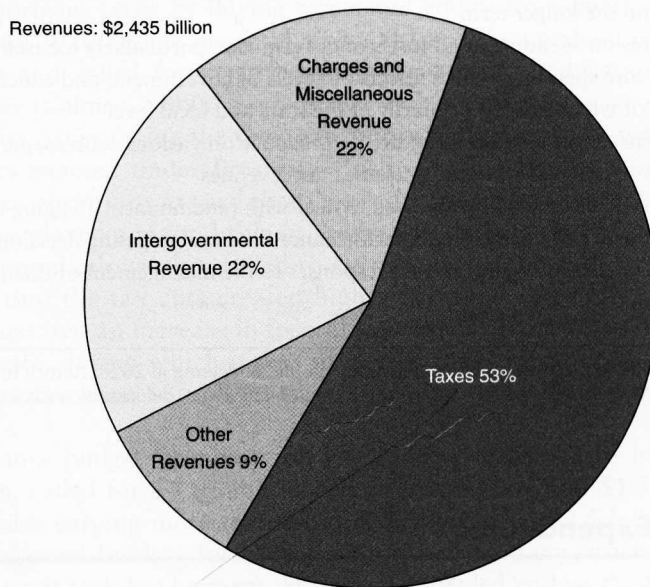
Expenditure comparisons at the state and local levels are complicated by our system of intergovernmental transfers. In education, for example, the federal government provides money directly to individuals (in the form of student grants and loans), but it also transfers large sums to state and local governments. States spend money directly (for colleges

and universities), but they also transfer money received from the federal government and some raised at the state level to local governments, primarily to support education. Consequently, local governments provide less than 30 percent of the money spent on education in this country and actually are involved in spending 70 percent of that money.

State and local revenues come from several sources, taxes being foremost among these (see Figure 5.2). The majority of tax receipts collected for state and local governments are sales and gross receipts taxes (34.1 percent), property taxes (33.4 percent), and individual income taxes (21.3 percent) (U.S. Census, 2009). But, of course, as we would expect, state and local revenues declined significantly during the recession. Overall, tax revenue declined 4.5 percent in 2009, to \$1.3 trillion. Individual and corporate income taxes saw the largest declines in 2009, at 11.3 percent and 19.2 percent, respectively (U.S. Census, 2009). This has caused governments at the state and local level to experience significant fiscal stress and to limit spending in vital areas such as education and health care.

Other areas of spending are significant, too. If we include intergovernmental transfers spent at the state and local levels in our calculations of state and local spending, the following patterns emerge: States spend the greatest portion of their funds on education, with public welfare next, followed by highways, health, and natural resources. At the local

FIGURE 5.2
State and Local Revenues, Fiscal Year 2009



NOTE: Total exceeds 100 percent because of sampling errors.

SOURCE: U.S. Census Bureau, Appendix Table A-1, State and Local Government Finances Summary 2009, retrieved March 19, 2012, from http://www2.census.gov/govs/estimate/09_summary_report.pdf.

level, the largest amount again is spent on education, with health, public works, and social welfare next. Because of intergovernmental transfers, federal fiscal policies can have a significant impact on state and local governments. Cuts at the federal level directly affect not only federal agencies, but also state and local governments that depend on federal funding. In fact, in a statement by the National Council of State Legislatures, states have an “incalculable stake” in the manner in which the federal government balances its budget (see www.ncsl.org/statefed/fedbud.htm#FederalGrants).

The Budget as a Managerial Tool

As a public manager, you will find that the budget process is critical to your success and that of your agency, quite simply because it establishes the level of funding for your programs. A variety of steps are required to enable an agency to spend money. First, legislation must be passed and signed by the chief executive to authorize the program. This *authorizing legislation* permits the establishment or continuation of a particular program or agency. (Authorizing legislation usually covers multiple years or is even open-ended, although some programs, such as the space program, require new authorization each year.) Next come *appropriations*, whereby the legislature sets aside funds and creates budget authority for the funds’ expenditure. Only after both steps have been taken can an agency spend money in pursuit of its stated objectives.

In most cases, governments use a *fiscal year* as their basic accounting period. The federal fiscal year begins on October 1 and runs through September 30 of the following year. The fiscal year carries the name of the year in which it ends; thus, fiscal year 2013, or FY 2013, begins October 1, 2012, and ends September 30, 2013. States and localities differ widely in terms of fiscal years; some follow the federal pattern, whereas others start July 1 (as did the federal government until 1976). Still others match the fiscal year to the calendar year. Kentucky and a few other states actually have a two-year-long fiscal year because their legislatures meet and pass a budget only every other year.

The fiscal year is the key period in which money is spent, but a variety of steps must be taken before and after the fiscal year that can affect an agency’s expenditures. The budget must be developed, typically by the chief executive (president, governor, mayor) and transmitted to the legislature; it must be approved by the legislature (hopefully) prior to the beginning of the fiscal year; it must be executed during the fiscal year; and it must be reviewed and audited following the fiscal year. At any given point in the budget cycle, there are actually several budgets being worked on. While one budget is being executed (say, FY 2012), another (FY 2013) is being formulated and approved, while another, (FY 2011) is being audited.

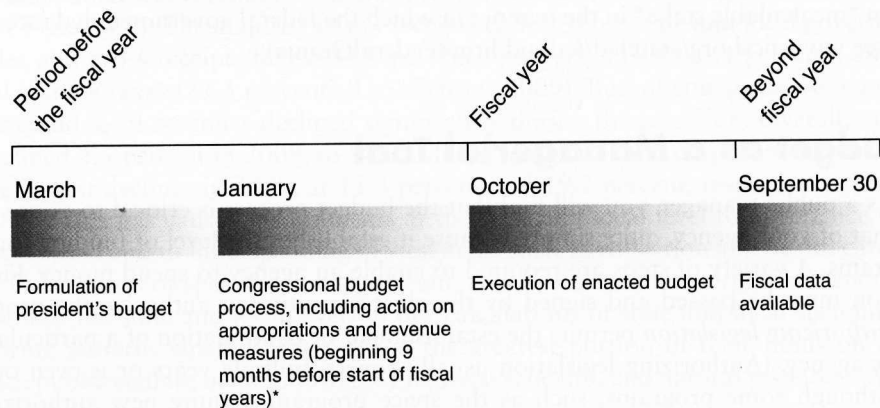
Budget Formulation

In the federal government and in many state and local jurisdictions, the chief executive has primary responsibility for preparing the budget. The budget cycle (see Figure 5.3) typically begins with a letter from a central budget office to agencies outlining the timetable for

FIGURE 5.3

The Budget Cycle at the Federal Level

Major Steps in the Budget Process



*If appropriation action is not complete by September 30, Congress enacts temporary appropriations (i.e., a continuing resolution).

preparing the budget, transmitting forms for use in the process, and indicating any policy concerns of special priority for the fiscal year. The agencies then prepare their own budget requests and forward them to the central budget office for review (see the box "Take Action: Financial Management: The Program Manager's Role"). Often a series of meetings (or sometimes hearings) are held to negotiate differences in the views of the central budget office (reflecting the priorities of the chief executive) and the agencies. Finally, the budget document is prepared by the central budget office and transmitted by the chief executive to the legislature for approval.

In some jurisdictions, responsibility for preparing the budget may not lie completely with the chief executive, and the budget cycle may vary accordingly. In many states, for example, responsibility for budget formulation may be shared among the governor, other elected officials, and members of the legislature. Cities with a strong mayor form usually give responsibility to the chief executive, whereas cities that operate under other forms tend to disperse budget authority. The city manager usually prepares the budget in council-manager cities, though typically with substantial input from the mayor and other council members.

The Office of Management and Budget (OMB) is the central budget office at the federal level and has evolved from an office established in 1921. Originally called the Bureau of the Budget, it was renamed by President Nixon in 1970 to reflect an emphasis on management concerns in addition to budgetary responsibilities. At the outset of the budget process, OMB collects information on projected revenues for the coming fiscal year and on the outlook for the economy. In addition, OMB develops information on the progress of the current year's budget, as well as the budget being considered

Take Action**FINANCIAL MANAGEMENT:
THE PROGRAM MANAGER'S ROLE**

Many in government think financial management is the responsibility of financial offices, accountants, and the like. Most program managers, in particular, feel they do not have to be concerned with financial management.

WRONG. Nothing could be further from the truth. Successful program managers appreciate that, in government, they have the responsibility for financial management. They understand what this entails, and thus have a far better chance of successfully delivering their programs despite reduced budgets.

What is financial management? It is nothing more than obtaining and effectively using funds and other resources to accomplish the goals and objectives of the organization. It typically entails:

- Defining people, materials, and services for achieving a program's goals and objectives.
- Defining the sources of resources that can be used to fund the program's costs.
- Obtaining the resources.
- Managing and minimizing the costs.
- Obtaining results from the expenditure of the resources.
- Preventing waste in the expenditure of the resources.
- Reporting accountability for both the use of resources and delivery of the results.

SOURCE: Harold I. Steinberg, "Improving Financial Management: The Program Manager's Role," *PA Times* 20, no. 11 (November 1997): 1. Reprinted by permission of the author.

by Congress. After a beginning consultation with the agencies to assess their program priorities, OMB works with the president to establish basic policy guidelines for developing the budget.

Networking

Federal organizations involved in budgeting and financial management include the Office of Management and Budget at www.whitehouse.gov/omb, the Congressional Budget Office at www.cbo.gov, and the Government Accountability Office at www.gao.gov.

These guidelines are communicated to the agencies, along with detailed forms for budget requests. In turn, managers in the various agencies assess their program priorities and decide on the necessary level of funding for accomplishing objectives in the next fiscal year. Starting about September, a period of negotiation occurs with OMB. The central budget

office represents the president's policy concerns and usually takes a generalist perspective, in contrast to the more narrow, specialized interests of the agency representatives. About November or December, the president becomes more actively involved in the budget process and makes final decisions with respect to both revenue and fiscal considerations and individual program needs.

The final budget document, which is submitted to Congress early in the new year, represents the culmination of a long process of analysis and interaction among a wide variety of groups. Obviously, given the magnitude and complexity of the federal government, the process of budget formulation at that level is the most complex in this country. But the difficulties of reconciling different and competing interests in the budget process are significant at all levels of government. In addition, chief executives at the state and local levels face constraints not found at the federal level. For example, as we noted above, almost all governors are required by constitution or statute to submit a balanced budget to the legislature, making it essential that they project anticipated revenues as closely as possible.

Budget Approval

The budget approval phase begins with submission of the budget to the legislature and ends with approval of the budget. The legislature, in most cases, can approve, disapprove, or modify the chief executive's budget proposal; it can add or eliminate programs; and it can alter methods of raising revenues. Remember that first programs must be authorized and then money appropriated for their implementation. In some cases, appropriations are contained in one bill that is debated, amended, and passed by the legislative body. In other cases, appropriations may be divided among several different appropriations bills.

The budget submitted to the legislative body is first sent to the committee or committees responsible for appropriations. These committees review the submitted document and hold hearings involving agency personnel, representatives of interest groups, other legislators, and private citizens. After consideration by the full legislative body, the bill as amended is passed and sent to the chief executive for signature (where approval is required). In the case of bicameral legislatures, the bill is sent to the other legislative body for similar consideration. If there are differences in the bills produced by the two houses of the legislature, the differences are worked out in a conference committee, and the bill is passed again by the two houses and sent to the chief executive.

Again, there are wide variations in the approval process from jurisdiction to jurisdiction. At the federal level, granting budget authority—the authority to obligate funds for immediate or future *outlays* (government spending)—can come about in several ways. Budget authority for most programs must be granted annually through passage of an appropriations bill. Congress has voted permanent budget authority for some programs, so funds become available each year without further congressional action.

In addition, within any given fiscal year, some outlays will be based on obligations made in previous years. Thus, total budget outlays for any fiscal year include previously granted budget authority, authority granted through appropriations for the current year, and money obligated in previous years for spending in the upcoming fiscal year, minus outlays deferred to later years.

Under procedures established by the Congressional Budget Act of 1974, Congress considers budget totals before considering individual appropriations measures. Based on work by the budget committees of both houses, a first *concurrent resolution* (a resolution of both houses not requiring the president's signature) is passed by May 15. It establishes targets for total revenues and total spending authority within various functional areas for the upcoming fiscal year. Although the president is not formally involved in this part of the budget process, consultation frequently occurs so that all parties will be informed of developments in the approval process. In some cases, the various parties even agree on a set of budget totals to be honored by both the president in his budget submission and Congress in its approval process.

Congressional review of appropriations requests begins in the House of Representatives, where the Ways and Means Committee considers revenue estimates and the Appropriations Committee (through various subcommittees) reviews spending recommendations. Appropriations are considered within twelve different appropriations bills covering groups of departments and agencies within related functional areas. After initial passage by the House, all tax bills and the twelve appropriations bills are forwarded to the Senate for consideration. Differences in the appropriations measures coming from the two houses are worked out in conference committee and, following approval by both houses, are forwarded to the president for signature. The two budget committees are charged with drawing up a second concurrent resolution—this one binding in nature—setting limits on total spending. Finally, a separate *reconciliation bill* attempts to reconcile individual actions in taxes, authorizations, or appropriations with the totals.

While the budget process as outlined here seems fairly straightforward, in practice, there are many variations. Indeed, arguing that the budget process has become more policy-laden or politicized over the last decades, Irene Rubin writes, “At the national level, in recent years, the term *budget process* has become oxymoronic, because a process suggests a list of rules, followed in sequence, known by the participants, and repeated from year to year. But the reality is that the budget process has been invented on the fly, during the year” (Rubin, 2011). If action on appropriations for the fiscal year is not completed by the beginning of the fiscal year (October 1), Congress enacts a continuing resolution, which permits the government to keep operating until an appropriations measure is passed.

What Would You Do?

The budget of the Parks and Recreation Department that you head is stretched to the limit. The city council seems unwilling to add any resources to support new programs you think would benefit the community. You have called a staff meeting to consider alternative sources of revenue, but now you are wondering if the council will be offended if you try to come up with funds on your own to do something they chose not to support. What would you do?

Throughout its consideration of the budget, Congress is aided by the work of budget committee staff members (whose numbers have grown substantially in recent years)

and by the Congressional Budget Office. This agency provides basic budget information and its own economic forecasts and indicates to Congress how its conclusions differ from those of the executive branch. Such differences have, in several years, led the Congressional Budget Office to predict a more substantial budget deficit than that anticipated by the administration.

An increase in staff capabilities has been among the most important developments in the legislative approval process in most states and some larger cities. Legislative budget staffs vary in structure and composition—partisan or nonpartisan, centralized or decentralized, joint (both houses) or single house, and so on. Their responsibilities usually include analyzing the governor's budget, forecasting revenues and expenditures, and developing alternatives to the executive budget. In all cases, greater staff capabilities have considerably aided the resurgence of state legislative involvement in the budget process.

One important feature of the approval process at the state level is the existence in most states of the *line-item veto*. (The line-item veto allows the executive to veto specific items in an appropriations bill rather than having to decide between “all or nothing.”) Such authority has been sought at the federal level by recent presidents, and President Clinton became the first chief executive granted such capacity when the federal Line-Item Veto Act (Pub. L. 104–130) took effect in January 1997. The act, though stopping short of extending full constitutional line-item veto power, gave the president authority to strike items from a federal appropriations bill without having to veto the entire piece of legislation. The Clinton administration, like its Republican predecessors, argued that the powers granted under the act would enable the president to make significant cuts in federal spending. Proponents added that a great deal of time and energy would be saved because the executive and legislative branches would not have to renegotiate an entire budget when only specific items were at issue.

Despite the value inherent in such a measure, the Supreme Court invalidated the federal act in *Clinton v. City of New York* (1998), stating that although there may be procedures for amending or repealing federal statutes, the process must be consistent with the constitutional powers afforded each branch of government (see *Immigration and Naturalization Services v. Chadha* [1983]). In the case of the line-item veto, the president simply did not have the constitutional authority to amend or repeal a spending bill passed by Congress. In the absence of any suitable formulation that would meet the constitutional test, it appears that the federal line-item veto will wind up a historical anomaly (Joyce, 1998).

Budget Execution

The budget execution stage, generally coinciding with the fiscal year, is that part of the budget cycle in which the agencies of government carry out agreed-upon programs and policies. The execution stage involves public administrators in all aspects of the management process—planning, analysis, personnel management, communication, and other interpersonal skills.

Basic financial controls are exercised during the budget execution phase through the mechanism of *apportionment*, a process by which funds are allocated to agencies for specific portions of the year. Typically, the central budget office asks for submission of

spending plans indicating what money the agencies anticipate spending in each quarter of the year. Because the agencies may not have received all they wanted in the appropriations process, the apportionment mechanism also acts as the basis for required changes in programs and policies. As soon as there is agreement between the central budget office (acting on behalf of the chief executive) and the agencies on the changes embodied in the apportionment plan, agencies begin receiving *allotments* to spend within a given period.

To ensure that funds are expended for the purposes for which they were intended and that there is enough money budgeted to cover a proposed expenditure, a *preaudit* (a review in advance of an actual expenditure) is usually required. Depending on the jurisdiction, the preaudit may be conducted by an agency's own budget office, by an independent agency, or even by an elected state official. Once approval has been given, the treasurer will "write a check" for the expenditure.

Even though budgets are not passed until just before (or even well into) the fiscal year, important changes may occur during the year that require changes in an agency's budgeted expenditures. Some changes may require greater funding—for example, when an unexpected natural disaster, such as a drought, places special burdens on farmers. If the need must be met prior to the next budget cycle, the president and Congress can work together to provide a *supplemental appropriation*, a bill passed during the fiscal year to add new money to an agency's budget for that fiscal year. Such a bill may simply provide more money for existing programs or money for a newly authorized program.

There are also devices, used primarily by chief executives as a matter of administrative discretion, to restrict agencies' spending below budgeted amounts. Presidents throughout the nation's history have sought to limit agency spending by *impoundment*—withholding—of funds authorized and appropriated by law, typically in the case of emergencies or where the purpose of the money had been achieved and budgeted funds still remain. At the state level, governors regularly withhold agency funds when revenue projections fall below levels on which the budget was based.

The 1974 Budget Act sought to clarify matters by defining two types of legal impoundments. The first, a *deferral*, is a decision by the president to withhold funds for a brief period. In such circumstances, the president must inform Congress, and either house of Congress may veto the action. The second, a *rescission*, is a presidential decision to withhold funds permanently; a rescission must receive the positive approval of both houses of Congress. Through these devices, Congress has sought to maintain its involvement in budget execution while at the same time allowing some administrative discretion to the president. (Not surprisingly, recent presidents, including President Clinton and President Bush, have argued for expanded rescission authority.)

Because situations change, public managers are often accorded some flexibility in the use of allocated funds. Money originally allocated for salaries and wages, for example, might be shifted (with appropriate approvals) to an equipment and expense category. On a broader scale, some agencies engage in *reprogramming*—that is, taking money appropriated for one program and diverting it to another that emerges as a higher priority. This strategy must be undertaken with great care because of legal and ethical implications and because efforts to subvert the legislature's intention are likely to incur retribution in the next year's budget process.

Audit Phase

The final phase of the budget process is the postexecution or audit phase. *Postaudits* take place following the end of the fiscal year and are concerned with verifying the correctness and propriety of agency operations. These audits were originally designed to ensure financial control; as such, they focused on accuracy of record keeping; compliance with statutes; and uncovering of fraud, waste, and mismanagement. More recently, the concept of auditing has been broadened to include *performance auditing*—analyzing and evaluating the effective performance of agencies in carrying out their objectives. Three purposes are served by postaudits: (1) financial viability, as indicated by efficient use of resources; (2) compliance with statutes and other limitations; and (3) program performance, including the results of program operations.

Agencies themselves can carry out audits; we have already seen how the auditing work of inspectors general has revealed waste and fraud in some agencies. There is a clear trend toward broader use of independent agencies. Moreover, to maintain detachment in the review of executive agencies, the postaudit function is increasingly being attached to the legislative rather than the executive branch. In 1921, for example, the federal government created the General Accounting Office (GAO) as a support agency of Congress, although President Wilson had previously vetoed such legislation on the grounds that the officers of such an agency should be answerable to the executive rather than the legislature. Recall that the GAO was originally concerned primarily with the financial auditing of selected federal agencies; however, more recently, it has not only changed its name—to become the Government Accountability Office—but it has extended its activities to include program evaluations as well.

At the state level, organizational arrangements vary; however, the trend toward having postaudit agencies attached to the legislature is clear. In 1938, there were five states in which the audit function was part of the legislative branch; in 1960, there were fifteen; today, there are more than forty. A large number of states retain an elected state auditor, whose office often goes beyond detached analysis and becomes embroiled in political controversy. Finally, a number of large cities, including Dallas and Seattle, have developed legislative postaudit functions.

Approaches to Public Budgeting

To be an effective tool in management and decision making, the budget must present information about the purposes of the proposed activity and resources to be expended. There are a variety of different ways to present such information. Some approaches to budgeting, for example, are based on the assumption that budget decisions are (and should be) largely *incremental*—policy makers start with the given situation (last year's budget) as a base and make only marginal adjustments to that base. Following this approach, managers build budgets by asking for limited increases in spending rather than focusing on major programmatic concerns. Similarly, the legislature focuses on individual expenditures rather than the “big picture.” According to proponents of incrementalism, this approach is an accurate representation of the actual behavior of decision makers and is an appropriate way to maintain balance among different interests represented in the budget.

In contrast, other budget theorists argue for a more rational, comprehensive, and programmatic approach.

Budgets can be categorized according to the purposes they serve. In a classic work, Allen Schick (1987) suggested that budgets can have at least three different purposes, all of which are reflected in any approach to budgeting. These purposes are planning, management, and control.

Planning involves the determination of organizational objectives and the development of strategies to meet those objectives; *management* involves the design of organizational means by which approved goals can be translated into action, as well as developing the staffing and resources necessary for execution; *control* refers to the process of ensuring that operating officials follow the policies and plans established by their superiors. According to Schick, each attempt at budget reform changes the balance among the three purposes—sometimes inadvertently, sometimes deliberately. Understanding how budgets are put together will help you present an effective case for program changes.

The Line-Item Budget

Those who established the first systematic governmental budgeting schemes were concerned primarily with assuring the public that expenditures were properly made and accounted for. Consequently, the systems they designed emphasized the control function. Because all agencies purchase essentially the same kinds of goods and services, it was argued, account classifications could be designed that would be broadly applicable to various agencies or departments. It would then be possible for auditors to apply uniform criteria to evaluate the expenditures of all.

In what is called a *line-item budget*, categories of expenditures are listed with amounts allocated to each. Typically, line-item budgets are organized by departments, so that the budget for one agency might look something like this:

Organizational Unit: XXXXX			
Expenditure Code	Category/Subcategory	2011	2012
100	Salaries and wages	2,585,400	2,879,000
200	Other operating expenses	887,250	1,102,000
2100	Travel	150,000	200,000
2200	Supplies	250,000	370,000
2300	Utilities	88,000	93,000
2400	Maintenance	78,500	89,000
2500	Other	320,750	350,000
Total		3,472,650	3,981,000

The cost of each object of expenditure is generally based on the agency's past experience and analysis of expected changes during the budget year. Because personnel costs (salaries, wages, and other personal services) typically constitute over half the budget, special attention is given to projected staffing changes, and such changes are often appended to the budget. (Our example projects, among other things, the addition of new personnel during the upcoming year.)

The line-item budget continues to be widely used because it is easy to understand and offers political leaders the more palatable option of reducing items (such as travel) rather than eliminating "programs." Moreover, it is well suited to incremental decisions, which make only minor modifications in the previous budget. However, because the line-item budget focuses on expenditures and not on their results, it is of little benefit to planning or management.

The Performance Budget

The 1930s proved a turning point with respect to public budgeting. The federal budget grew tremendously, the Bureau of the Budget became attached to the White House, and, in general, greater attention was paid to the executive management of government agencies.

This interest in management was paralleled at the state and local levels, where efforts to relate budget presentations to programmatic activities had been under way for some time. The result was a new approach to budgeting: the performance budget.

The *performance budget* is organized around programs or activities rather than departments. It includes various performance measurements to indicate the relationship between the work actually done and its cost. As the Hoover Commission described it, a performance budget "would analyze the work of government departments and agencies according to their

CourseReader Assignment

Log in to www.cengage.com and open CourseReader to access the reading:

Read "What Do We Talk about When We Talk about Performance? Dialogue Theory and Performance Budgeting," by Donald P. Moynihan.

As we have noted in this chapter, there is a great deal of emphasis on performance measurement and performance budgeting in public organizations today. The PART program was one effort to emphasize performance in the federal government. Here it provides the opportunity for the author to explore the concept of performance in more detail.



Moynihan writes that what constitutes performance to some might mean something quite different to others. Try to come up with examples of where this might be the case in public policy in your local area. How would you expect the different meanings of performance to affect the measurement of performance? And how would you expect the measurement of performance to affect the development of new policies?

functions, activities, or projects. It would concentrate attention on the work to be done or the service to be rendered, rather than the things to be acquired." Because it focuses on the relationship between available resources and the work to be done, performance budgeting is well suited to the purposes of management.

To construct a performance budget, the manager must first determine appropriate program categories, such as highway safety, and then break down that program into appropriate subprograms, such as school visitations or advertising programs. It is then necessary to establish detailed work measures for each activity—for example, a highway safety program might anticipate twenty-seven school visitations during the course of the year. These data would then be related to the cost of making such visits. In its most detailed presentation, a performance budget requires identifying the work activity, establishing an output unit, calculating the cost of each unit, and projecting the units required and the associated costs for the coming year.

Although performance measures are obviously helpful in making budgetary decisions, not all organizations can easily develop such information. A license bureau can report the number of licenses issued and fairly easily calculate the cost per license issued, but a research unit or a group promoting civil rights would find its work much more difficult to measure. Performance budgeting also tends to concentrate on quantity of work rather than quality.

Finally, performance budgeting somewhat diffuses organizational responsibility because one program or function may be located in several different units. "Public information," for example, may involve work in the mayor's office, police department, fire department, and elsewhere. To sort out costs by department, one would need to construct a crosswalk or matrix of expenditures. A matrix might place various activities on one dimension and departments on another.

Activities	1	2	3	Total
Division A	\$10,000	\$20,000	\$15,000	\$45,000
Division B	12,000	16,000	10,000	38,000
Division C	5,000	12,000	13,000	30,000
Total	27,000	48,000	38,000	

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A matrix could also be constructed relating activities to traditional objects of expenditure; such calculations are typical in performance budgets.

Program Budgeting

Another approach to budgeting had its origins in the Department of Defense in the early 1960s. Soon after taking office as secretary of defense, Robert McNamara discovered that his ability to manage the department was severely restricted by the lack of coordination between planning and budgeting. Each service (army, navy, air force) prepared its

own annual budget, reflecting its own priorities, and then submitted the documents to the secretary. This plan failed to give proper attention to systemwide issues. But, equally important, because the budgeting system was based on a one-year time frame, it bore little relation to the multiyear projections of the department's planning and analysis staff. The development of major weapons systems, for example, involves research and development, assembly, and operations over many years. Yet, this fact was not clearly reflected in the annual budget submissions.

McNamara instituted a new approach, which came to be known as the *planning-programming-budgeting system (PPBS)*, an effort to connect planning, systems analysis, and budgeting in a single exercise. In the Department of Defense, PPBS began with the identification of nearly 1,000 program elements, each grouped under one of nine major programs or missions—that is, strategic retaliatory forces, continental air and missile defense forces, civil defense, and so on. Not only was extensive study required to identify the right combination of program elements to support each mission, but, once having established the combinations, units in the department were required to submit detailed analyses of proposed program changes. In addition, the new budget system was designed to cover a nine-year period and to show detailed projections for the first six years.

President Johnson was so impressed with the operation of PPBS in the Department of Defense that he ordered the new system extended to all federal agencies. Each cabinet-level department was asked to identify a limited number of purposes to be served by the agency and then to organize budget requests around those themes. The Department of Health, Education, and Welfare (HEW), for example, chose topics such as “social and rehabilitation services” that cut across several agencies within HEW. Costs for each program element were projected five years into the future, and extensive documentation justifying each element was required, especially in areas undergoing significant changes. Most agencies were able to develop their budgets using the new approach, but there was considerable confusion in the implementation of PPBS. As a result of this confusion, and for a variety of other political reasons, President Nixon formally terminated PPBS in 1971.

During its relatively short tenure, PPBS attracted great attention, with many cities, states, and other countries embracing the new technique. PPBS not only emphasized the planning aspect of budgeting, but it appeared to bring greater rationality and comprehensiveness to the budget process. These goals, however, were accomplished at great cost. Substantial numbers of new staff members were needed, both in the central budget office and in the various agencies, to provide the kind of analysis PPBS required. The process proved extraordinarily time-consuming. Consequently, very few full-blown PPBS systems remain, although many of the principles of PPBS have been incorporated into other approaches, often under the more general label *program budgeting*.

There are important differences between performance budgeting and program budgeting. “As a general rule, performance budgeting is concerned with the *process of work* (what methods should be used), while program budgeting is concerned with the *purpose of work* (what activities should be authorized)” (Schick, 1987, p. 53). Moreover, although both systems urge measurement of work being done, performance budgeting is more likely to employ measures related to the work (for example, the number of tons of garbage collected) and a program budget might concentrate instead on measures related to the purpose of the

work (for example, the rate of infectious disease in the community). Performance data are of great interest to individual managers who seek to improve productivity, but legislators and other policy makers are more likely to be interested in the purposes of various activities.

Outcome-Based Budgeting

A recent trend in government budgeting involves increasing the level of accountability for public resources. Citizens, elected officials, and administrators want to be able to determine how much is being spent on each program or agency and the return on the public's investment—that is, the substantive impact of each policy. In practical terms, this requires linking budget information with some type of a performance measurement system. The resulting budget enables administrators to track levels of expenditures and report on the outcomes being achieved.

Unlike performance budgeting mentioned previously, outcome-based budgeting goes beyond looking at mere issues of productivity and unit cost and assesses the long-term impact of each policy, program, or agency within its targeted area. Though based on quantitative measures, *outcome-based budgeting* determines the qualitative results of government initiatives. Many government agencies have incorporated outcome-based budgeting within their strategic planning processes, making it possible to observe the level of resources needed to reach goals and objectives and then use that information for budget decision making.

In Catawba County, North Carolina, local officials used outcome-based budgeting to enhance their government's system of service delivery. The county in the past few years had experienced limited growth in revenues; yet, during this time the call for human services continued to rise. County leadership responded by handing decision-making authority to agency administrators, challenging them to reduce costs while more effectively meeting citizen demands. Those who achieved 90 percent of their goals would be able to apply their savings to unrestricted needs. Catawba County administrators embarked on a citizen-driven, outcome-based system of budgeting to ensure that resources were targeted to meet specific community goals. Over time, they not only saved money but also enhanced government responsiveness (and received an award from the Government Finance Officers Association in 2010 for their efforts).

We will see later the way performance or outcome measurement has affected the conduct of the public's business at all levels of government. For now, we should simply note that the current federal budgeting system, like most at the state and local levels, is a combination of elements from several of the approaches we have discussed. What is most important is not whether one particular system or another is being used, but rather what political and administrative choices underlie the selection of a particular budget approach. That is, what are decision makers trying to emphasize by using the type of budget they select?

Budgetary Strategies and Political Games

Despite all attempts to rationalize the budget process, public budgeting is an inherently political activity. The changing demands on government and its programs, the shifting interests that are brought to bear in policy decisions, and the many different actors

(and personalities) that are part of the budget process mean that budget decisions will always occur in a highly charged political environment. Because agency managers typically (and properly) believe in the programs they operate and would like to see the programs be of even greater benefit to the public, they tend to become advocates of an agency position, often seeking to expand the size and scope of the agency's work.

If you can deal effectively with the political environment in which budgeting occurs, you will likely be more successful in expanding, or at least maintaining, your agency's programs. (There are, of course, many cases in which you will be judged on your capacity to hold the line on expenditures or to manage program reductions.) Whatever your intent, understanding the politics of the budgetary process will be helpful.

In discussions of budgetary strategies, two basic concepts will help orient your thinking. The first is the notion of program base. The *base* refers to those elements of an agency's program that everyone expects will be continued from year to year. Under normal circumstances, the program's base is assumed to remain pretty much the same from one year to the next and is not subject to special scrutiny. Having an activity approved for one year is one thing; having that activity considered a part of your agency's base budget is far more important. A second concept is that of receiving a *fair share* of the overall budget. Managers often measure success in terms of whether their program receives a proportionate amount of any increases or decreases that the government generally supports. Agency personnel often work for years to build a base that they consider a fair share of the overall budget.

As we saw earlier, budget requests typically originate with the agencies. They are then reviewed and often changed by a central budget office (acting in behalf of the chief executive) and submitted to the legislature for approval. In constructing a budget request, you need to take into account several different types of expenditures. As mentioned previously, many departments at the federal level have a large budget component that is essentially uncontrollable or fixed. The Department of Health and Human Services (HHS), for example, which administers many entitlement programs, has a large percentage of its budget that is fixed. A second part of an agency's budget is likely to be devoted to *adjustments for inflation*. The rising cost of utilities, telephones, postage, and other essential services must be taken into account, either absorbed in the base or covered by increased expenditures. Finally, some part of the agency's budget is discretionary, subject to increase or decrease according to the agency's priorities. The discretionary portion of the budget allows you to decide which new programs to propose and which existing activities to recommend for more (or less) funding. Understanding these categories will help you argue for changes in a particular budget.

Strategies for Program Development

These choices lead to strategic questions you must answer in building a budget—including the important question of what total amount to request. Although an overall budget is likely to differ only incrementally from that of the previous year, some agencies are clearly more assertive in their requests than others. They are more willing to request large increases rather than small ones. How assertive an agency should be, however, is conditioned by several factors.

Support from the chief executive (the president, governor, mayor, and so on) is highly important, whether the support is advocacy for a particular program or more generally interest in a particular field, such as law enforcement. Legislative support is also highly important. Agency personnel work throughout the year to maintain contact with key legislative leaders and to build the kinds of alliances that will be helpful in supporting programs of mutual interest. Finally, your personality—especially your willingness to take risks and defend risky choices—will play a strong role in deciding how much to request.

Aaron Wildavsky, who wrote a landmark study of the politics of the budgetary process (1988), suggested three other strategic elements that affect the nature of the request and help build political support for it. The first of these is *clientele support*. The support of client groups and other associations interested in the agency's work will be helpful in developing testimony and lobbying in behalf of programs. An agency that is confident of the testimony of "satisfied customers" or able to show support for proposed changes will likely fare much better than others. Obviously, the most effective way to build support is to serve a client group well, but agencies may also try to stimulate supportive clientele to communicate with legislators about the agency's good work.

Wildavsky's second element of political support is the *confidence* of higher executives and legislative officials in your character and ability. The magnitude of government budgets is so great that higher officials or legislators simply cannot know all the details necessary for making a purely rational analysis. At some point, they must simply trust the manager. Managers who enjoy a good reputation are typically more successful, especially in dealings with the legislature. One administrator commented, "If you have the confidence of your [appropriations] subcommittee your life is much easier and you can do your department some good; if you don't have confidence you can't accomplish much and you are always in trouble" (Wildavsky, 1988, p. 105). There are many ways to build confidence, but highly successful managers seem to agree that integrity (telling the whole truth) and responsiveness (keeping in touch and responding completely to inquiries) are particularly important.

Third, agency officials can take certain tactical positions to attempt to develop or protect their favorite programs. One approach, verging on the unethical but nonetheless common, is *budget padding*—that is, proposing a higher budget than is actually needed. Agency officials assume that after the central budget office and legislature cut the budget, you will have what you wanted in the first place. Another strategy is one Wildavsky terms the "camel's nose." The manager asks for a small amount to begin a program, then later treats this program as part of the base and argues that it would be unfortunate to lose the money already invested by not finishing the job (Wildavsky, 1988, p. 115).

Over the past couple of decades, many programs at all levels of government have experienced lower revenues and more limited funding. In some cases, such as in the social services, programs have been reduced or eliminated. In other cases, changes such as the termination of revenue sharing at one level of government have resulted in lower revenues at another. In still other cases, popular efforts to limit either revenues or expenditures, such as Proposition 13 in California, have limited government funds. Many public managers have had to turn their attention from developing new programs to maintaining or even reducing existing ones. This has been referred to as managing fiscal stress or, where serious reductions have occurred, cutback management.

As you would expect under retrenchment conditions, many managers have used budgetary tactics of the sort outlined by Wildavsky to lessen the impact of fiscal stress on their agencies (Wildavsky, 1988, p. 113). Any attempt to resist cuts is risky because it can quickly undermine the manager's credibility. Under conditions of long-term fiscal limitations, resistance to cuts is simply not a realistic option for many managers. Other ways of dealing with fiscal stress have been tried with some success:

- Following a *multiyear plan* to preserve the administrative capacity and the capital investment of the jurisdictions.
- *Targeting* cuts in specific programs rather than cutting across the board (all programs cut at the same percentage).
- *Smoothing out* the impact of the cuts (lessening their immediate effect). Smoothing out may occur by improving productivity, so the organization can accomplish more with less, or by generating new revenues, such as imposing new user charges for services.

Aspects of Financial Management

Although those in public organizations need to budget their resources, they must also attend to other aspects of managing the public's money. They must be concerned with the long-term financing of buildings, roads and highways, and equipment; they must carefully plan and manage borrowing; they must ensure against future losses; and, in all cases, they must try to get the most for the money they spend.

Networking

Professional associations for budgeting and financial management can be found at www.aabpa.org, www.abfm.org, and www.gfoa.org.

Capital Budgeting

In addition to budgeting annual expenditures, public policy makers and managers need to invest in facilities and equipment that will be used over a period of time. For example, government is primarily responsible for developing and maintaining the country's public works *infrastructure*—streets and highways, tunnels and bridges, sewers and water treatment facilities, and so on. Governments invest in a variety of major facilities, including schools and universities, hospitals and mental health centers, public housing, and correctional institutions. Innumerable equipment purchases (especially military equipment at the federal level) are intended for long-term use. Expenditures on items that will be used over a period of several years are called *capital expenditures*.

Budgeting for capital expenditures is similar to the process of budgeting for annual expenditures, but it differs in some ways. In most jurisdictions, except the federal government, capital expenditures are treated in a separate budget called a *capital budget*.

Most states have a separate capital budget, and nearly all give special treatment to capital expenditures in budget presentations. Nearly all major cities and most local governments use a capital budget. For many years, the federal government treated capital spending merely as part of the regular budget. Only recently has it begun to provide a special analysis of capital spending. There is still not a separate capital budget at the federal level, though the issue continues to be debated.

The primary argument in favor of separate consideration of capital items is that the benefits of these items are spread over future generations, so it is not unreasonable to share the burden of repaying the money borrowed. A separate capital budget may also encourage more long-term thinking—the lack of which is often decried in the annual budget process. On the other hand, the capital budget can become a political “pork barrel,” in which each legislator seeks to gain his or her share of projects (and their funding). A capital budget can become a device for avoiding fiscal responsibility by pushing expenditures that should be faced immediately into an indefinite future. Whether a separate budget is developed or not, one should keep in mind the relationship between capital and operating expenditures. Building a new swimming pool, for example, implies that annual expenditures will be forthcoming in future years to keep it operating.

What Would You Do?

A friend who is a city manager once commented that he liked to put a “radio” item in each budget—an item that would make a lot of noise and attract attention but could be “unplugged” easily. He said that after the council focused all its attention on that item and it was finally removed, everything else would be approved with little question. You are preparing your budget for presentation to the council. What would you do?

Ideally, a capital budget develops in the context of a fairly comprehensive planning process, undertaken either for the government as a whole or by the various agencies within their functional areas (such as health or criminal justice). Whether or not a planning process is in operation, an important intermediate step (and one followed by nearly all governments considering capital projects) is development of a capital investment program—a timetable indicating various projects to be undertaken, schedules for their completion, and methods of financing. A capital investment plan is usually written to cover a three- to five-year period and is moved forward each year. Georgia, for example, has a capital budget that is mainly a gathering of capital outlays by agency and project category, as these have been requested by various agencies’ submissions to the budget office. For each category, budget makers identify the financing source and also the sources of funding over the length of the request.

To undertake such a plan, government decision makers often solicit proposals from agencies and then try to bring order to the resulting submissions. Among the criteria they might use would be whether the project is essential, especially for health and safety; whether the project fills a gap in existing services; whether it builds effectively on existing

services; and whether it meets an unforeseen emergency need. Because financing for capital projects is usually spread over many years, as are the benefits, complete analysis of each project is likely to involve detailed consideration of both costs and benefits over time.

Debt Management

One part of the capital budgeting process is careful consideration of the source of funding. Some jurisdictions try to operate on a “pay as you go” basis, paying in full for all projects during the fiscal year in which they are authorized. (One variation of this idea is the accumulation of money in a sinking fund, something like a Christmas Club account, which is then used to pay for the needed improvement.) Other jurisdictions may be willing to borrow money for a project, either because waiting to accumulate funds would simply take too long or because the costs as well as the benefits of the project should be spread over a period of years—a “pay as you use” approach.

Borrowing is often used to finance capital improvement projects; but borrowing may be employed to meet a variety of other needs as well. In some cases, anticipated revenues will simply not be available at the time spending is necessary. To solve the resulting cash flow problem, governments undertake short-term borrowing. (In more questionable cases, money is borrowed from future years’ revenues to pay operating expenses within the current year.) Borrowing is also used for emergency needs; for example, a natural disaster, such as fire or flood, might require funds far beyond the capacity of the annual budget. Especially when such spending will be used to reconstruct facilities that will have long-term benefits, borrowing may well be justified. Finally, at least at the federal level, borrowing is sometimes justified as a way of stimulating the economy.

Governments may undertake various types of borrowing. The primary mechanism for financing government debt is the issuance of a *bond*—that is, a promise to repay a certain amount (*principal*) at a certain time (*maturity date*) at a particular *rate of interest*. One of the most common bonds is the *general obligation bond*, which pledges the “full faith and credit” of the jurisdiction—in other words, the government provides as security all its revenues and resources. In contrast, *revenue bonds* promise as security the anticipated revenues that a capital project will produce. Revenue bonds might be issued based on the future toll receipts of a new highway or on the gross receipts of a new municipal sports complex.

Both from the standpoint of a jurisdiction and of potential investors who might purchase the bonds, it is helpful to know something about the jurisdiction’s *debt capacity*. For example, you would want to know the value of a city’s resources combined with the ability of its government to provide payment. As a service to investors, several firms provide bond ratings for cities and other jurisdictions. The ratings are also important to the jurisdiction because a lower rating means higher costs of borrowing for the government. Standard and Poor’s reference guides rate bonds in descending quality from AAA to AA to A to BBB to BB, and so on. Cities or other government units that carry high ratings will be more successful than others in selling their bonds. (The effect of credit rating reductions at the federal level was recently demonstrated when Standard and Poor’s lowered the U.S. credit rating to one level below AAA. The credit rating company said

“political brinkmanship” in the 2011 debate over the debt had made the U.S. government’s ability to manage its finances “less stable, less effective and less predictable” (*Washington Post*, 2011).

Risk Management

Public organizations are subject to a variety of risks that can prove extremely costly. For example, in one city an individual lost control of his car, bounced off a guardrail, and ran into a ditch. The driver suffered serious injuries and then sued the city for several million dollars, arguing that the guardrail had been improperly installed. Similarly, a city employee with no previous health problems began to suffer back pain on the job. After several operations, high medical bills, and physical therapy, he was given disability retirement at age twenty-six. Another city was sued by residents who lived near the municipal airport because the noise of aircraft landing and taking off supposedly lessened the value of their property. Over the years, cases such as these involving civil damages, breach of contract, workers’ compensation, and related legal problems have cost cities, states, and other jurisdictions millions of dollars.

Risk management is concerned with how public organizations anticipate and cope with these risks. A first step in risk management is to identify potential areas of loss and then to attempt to reduce the probability of losses occurring. Risk reduction programs might include improved work safety, periodic inspections of physical property owned by the city, and employee health programs. But, whatever the success of risk reduction efforts, losses do occur. The government has a variety of options for meeting losses: paying from operating funds or financial reserves, levying special taxes to cover the loss, or even floating bonds.

In anticipation of losses, many public organizations purchase insurance from private firms. In recent years, this option has become more difficult, as insurance rates for governments and other public organizations have risen dramatically and put many traditional forms of insurance beyond reach. (The difficulty of purchasing insurance has also led some jurisdictions to eliminate uninsured services such as recreation programs.) Another possibility, however, is *self-insurance*, the development of an insurance pool by the jurisdiction itself. Many governments are larger than insurance companies, so such an undertaking is not only financially feasible but also provides some administrative control and flexibility that is not present when private firms are used. An increasingly popular means of self-insurance involves pooling risks in a shared program operated by several municipalities.

Purchasing

A final aspect of financial management in public organizations is the purchase of goods and services. Because public organizations are typically not equipped to produce all the goods and services they require (and in most cases would not find it financially feasible to do so), they must acquire some goods and services from the private sector. Like individuals and businesses, public organizations want to get the most for their money. But at the

same time, because government purchasing involves such substantial sums of money and is capable of influencing the structure of the market generally, public purchasing must also take into account social and political goals.

Governments have often found that centralizing purchasing in one agency, rather than having each agency buy what it needs, results in considerable savings. For one thing, a central purchasing unit can buy in sufficient volume to get better prices; for another, those in the purchasing unit can develop expertise with respect to pricing, business conditions, and market practices. Finally, experts in purchasing are likely to be more successful in the negotiating process. Although individual agencies occasionally complain that their specific needs are not met by the purchasing unit, most state and local jurisdictions use centralized purchasing operations.

In most cases, a purchasing unit circulates and advertises the government's needs and solicits bids for the required goods and services. The resulting bids are evaluated in terms of cost, and the lowest bid is usually, though not automatically, chosen. Consideration is also given to the quality of the product and to the ability of the firm to actually deliver the goods or services in a timely fashion. In addition, purchasers are often required to give special preference to certain groups, such as minority-owned firms or in-state companies. Several jurisdictions often join together to cooperate in purchasing activities. In some instances, several local governments may form a common purchasing unit; in other cases, prices negotiated by the state purchasing office are available to local governments as well.

Accounting and Related Information Systems

Keeping track of the revenues and expenditures of government and other public organizations is an enormously complex task. Not only are there billions of dollars to record and report, but the presentation of financial information must serve several purposes at once. Certainly financial data should be developed and reported in such a way that public officials can be held accountable for the use of public funds. At the same time, the accounting and reporting system should provide managers with information they can use to operate their organizations more efficiently and effectively. This dual requirement means that financial information should correlate closely with other managerially relevant material, such as personnel data or productivity measures.

Government Accounting

Accounting, whether in the public or private sector, is simply “the process of identifying, measuring, and communicating economic information to permit informed judgment and decision making by users of the information” (Berne & Schramm, 1986, p. 12). But because the purposes of public organizations differ from those of private organizations, accounting practices also differ. Those in public organizations are generally not concerned with making a profit; rather, they tend to focus on achieving a balance between revenues and expenditures—what comes in and what goes out. There are some exceptions, such as

public corporations, hospitals, and water companies, which are more like profit-seeking groups; however, in nearly all public organizations, accountability is more important than profit maximization.

Governmental accounting systems reflect these different purposes. The cornerstone of accounting in the public sector is the allocation of resources to various funds, each of which is designed to record transactions within a particular functional area and to ensure that funds are used in accordance with the purposes sought. (Use of such funds is uncommon in the private sector.) The funds typically reflect policy makers' intent in authorizing certain activities and appropriating funds for them. The legislature may decide, for example, that certain gasoline taxes should be used exclusively for highway maintenance—in which case a separate fund might be created to keep track of money produced by the tax and spent for highways. In all cases, a primary concern is that the accounting system show whether the organization's activities have been consistent with the purposes for which they were created. Several broad types of funds are used in public organizations:

1. *General government funds* are used to account for most of the ordinary or routine functions of government. Most important among the general government funds is what is called the *general fund*, which handles the “unrestricted” funds of government, those not restricted to specific purposes (and typically allocated to other funds). The general fund is the dominant fund in most jurisdictions and handles most of the government's operational activities. Related general government funds might include those that account for special revenues, like a dedicated gasoline tax, or those that monitor expenditures for capital projects.
2. *Proprietary funds* are used to account for government activities or enterprises that more closely resemble private business in their orientation toward profit. This does not mean that all agencies employing funds are required to make a profit; indeed, they may break even or perhaps require a subsidy. What is implied is that a measure of profit is possible and usually desirable in such operations; examples include a local transit system or a state printing operation.
3. Finally, *fiduciary funds* are used when the government must hold assets for individuals (such as those in a pension fund) or when the government holds resources to be transmitted to another organization (such as property taxes that a county collects for a city).

Within each fund there is an accounting of the resources available and the flow of funds in and out of the account. There are *assets*—what the government *owns*; and, there are *liabilities*—what the government *owes*. Assets include items such as cash, capital facilities, equipment, and money owed to the government; liabilities include items such as bills that the government has yet to pay. When the organization's liabilities are subtracted from its assets, the remainder is called a *fund balance* (and may be expressed either in positive or negative terms). An organization with \$2,525,000 in assets and \$2,300,000 in liabilities has a fund balance of \$225,000. Note that a fund balance does not mean the amount of cash on hand, but rather signifies a relationship between all assets (including cash) and all liabilities. Broadly, the fund balance is the key measure of the viability of the operation monitored by the fund and is one of many items contained in financial reports issued by governments and other public organizations.

Both accounting practices and financial reporting are guided by standards referred to as “generally accepted accounting practices.” The Governmental Accounting Standards Board (GASB) was established in 1984 to develop standards for accounting and financial reporting at the state and local levels. The GASB has been especially attentive to multiple users of public financial information, including citizens, taxpayers, legislative bodies, upper-level executives, labor and employee groups, interest groups, contractors, and the press. Again, an important characteristic of governmental accounting is that it must serve multiple purposes, including accountability within a democratic system.

Computer-Based Information Systems

The emergence and widespread use of computers in tracking financial data as well as other program-relevant information has led to a “quiet revolution” in the analysis and use of information in public organizations. Not only do computers make easier the accumulation and manipulation of vast amounts of data, but they also greatly facilitate analysis of those data in terms that are meaningful to decision makers at all levels. Computers have also increased the probability that information can be provided when it is needed, not weeks later. Consequently, a great deal of attention is being given to the design and implementation of computer-based information systems in the public sector and to the political and organizational implications of such systems. Applications in the area of financial management have led the way in these efforts.

A distinction is often made between management information systems and decision support systems. *Management information systems* collect and summarize routine information as a basis for structuring decision making. Relevant databases might include budgetary information, expenditures for salaries and wages, and personnel data. The system might be asked, for example, to produce a list of employees eligible for salary increases based on length of service in the agency. *Decision support systems*, on the other hand, are interactive systems that can assist in the solution of unstructured or nonroutine problems. These systems allow the manager to manipulate data within the system to produce a specific analysis for a particular decision, or provide optimization models to use in analyzing a particular policy recommendation. Although most public organizations are developing management information systems of various sorts, the development of decision support systems is receiving increased attention.

Applications of computer-based information systems are as wide-ranging as the work of public organizations. Most organizations are quickly becoming familiar with the use of spreadsheets and statistical packages for budget analysis, financial management packages for revenue and expenditure forecasting, and accounting packages for fund accounting and analysis. But far more extensive applications of information technology (IT) have been developed in government agencies, as we will see later.

At the state and local levels, one of the most interesting developments in information technology has been the design and implementation of information systems integrating budgeting, personnel, performance reporting, and auditing. Several states have led this

process of integration, including Michigan, Oregon, Texas, Wyoming, and Washington. Efforts of this nature reflect an overall shift on the part of states toward more sophisticated systems of accounting. State governments over the past decade have used information technology to enhance their capacity to generate more detailed financial and productivity data, thus allowing for extensive analyses at a programmatic level and a link between expenditures and actual performance.

To the extent that budgetary and performance data are made available to the chief executive and other top managers on a timely basis, more effective management decisions may be possible. In addition, freeing budget analysts from the more mundane aspects of budgetary procedures should allow more attention to planning and analysis.

Similar developments have occurred at the local level. Baltimore, Maryland, has implemented a comprehensive accounting and performance measurement system, called Citistat, to track (virtually in real time) the productivity and fiscal efficiency of city departments. In a room lined with large projection screens and computer terminals, Baltimore's mayor, Stephanie Rawlings-Blake, meets biweekly with top aides and department heads to hear the latest reports on the city's service delivery. If a department's numbers lag behind its performance targets, the manager must account to his or her peers for the difference. "If we only looked at performance every year at budget time, I'd be old and gray before anything would change. Citistat brings the sense of urgency we need around here," said previous mayor Martin O'Malley (cited in Swope, 2001, p. 20). Thus far, the information system has contributed to significant improvements in public safety and public health, as well as opened new doors for collaboration between city departments.

Whether Citistat or similar IT initiatives will create across-the-board improvements for public organizations remains to be seen. Some argue that change of this nature requires far more than increased capacity to handle information. Moreover, the implementation of these types of systems may have negative consequences on the organizational culture and relationships within affected agencies.

Summary and Action Implications

Budgeting and financial management in public organizations have a lot in common with those activities elsewhere. But there are also important differences, most of which flow from the necessity for public organizations to be accountable to elected officials and, ultimately, to the people.

The centrality of the budget to any organization can hardly be underestimated; if you want to know what's going on in an organization, look at where the money is going. Establishing budget processes that reflect the organization's priorities, while securing appropriate levels of involvement from those who want to affect the budget, is extremely important. Finding ways to present budgetary information clearly and comprehensibly is a great aid to decision makers and to the public. Finally, developing mechanisms to ensure that the public's money is being spent both efficiently and responsibly is essential. You will find that knowing the technical side of the budget

process—being able to follow the budget process and clearly understand preparation, administration, and review—will be extremely helpful as you try to influence the operations of your organization.

If you work in a central budget office, you will find that the period during which the budget is formulated is intense, and your technical expertise will be put to the test. But you will also recognize that you are playing an important role in shaping public policies. Similarly, if you are managing an agency, you will place your imprint on the policies and directions of your organization through the budget process. Your skill in presenting and supporting requests for programs may determine whether or not they are undertaken.

The budget process at the federal level, and in some state and local jurisdictions, is integrated with a process for long-range planning. Federal agencies are asked to provide certain projections for the two-year period following the year for which the budget is being prepared, thus adding an element of long-range planning to the process.

Budgets and financial management systems are important tools for planning, prioritizing, and operating public programs, as well as important mechanisms for accountability and control. Public access to budgets and financial statements allows citizens to see how their interests are reflected in the actual conduct of government. Budgets and other financial documents that clearly show what is happening in an agency are a necessary part of operating in the public interest.

STUDY QUESTIONS

1. Discuss how government uses the budget to affect fiscal policy.
2. Describe some of the ways government obtains funds for operation. Identify the various types of taxes that governments use.
3. How does the government spend the money it collects?
4. The budget cycle consists of four major phases. Discuss government's role in the budget cycle and the components of each phase.
5. Allen Schick suggests three different purposes of the budget. Identify and define these purposes.
6. Compare and contrast the different types of budgeting processes.
7. Explain the two basic concepts of budgetary strategies.
8. Political influence has a major impact on the budgetary process. What are some of the strategies managers use to influence the budget process?

9. Financial management is an important part of fiscal activities. Discuss some of the concerns fiscal managers deal with, including capital budgeting, debt management, risk management, and purchasing.
10. Discuss the broad types of funds that public organizations use.

CASES AND EXERCISES

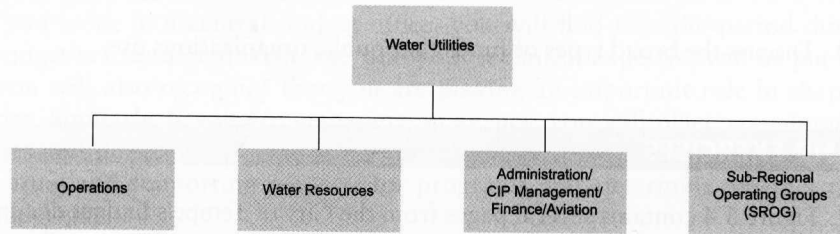
1. Figure 5.4 contains several pages from the City of Tempe's budget document. Analyze these budget pages from the perspective of (1) a city council member who will have to make decisions about which city services to fund; (2) the public works department director, who wants to improve services to the community; and (3) an average citizen interested in seeing whether the city's tax dollars are being put to good use. For the purposes of each viewpoint, how complete and clear is the information? Does the budget tell you what you want to know in order to act? How might the budget presentation be improved? To what extent is any local government's budget a reflection of the particular locality?
2. Consider the following case: You are Mike Smith, chief procurement officer for a major university. Work generated by your staff of twenty procurement specialists includes writing proposals to vendors and evaluating the vendors' bids. To write those bids, the procurement specialist works with someone from the university agency who is knowledgeable about the project. Tom Drake, a procurement specialist, is currently working with Kathy Kline of the Communications Department to develop a bid proposal to purchase a new campuswide telephone system that includes a quick-dial feature. The university's current telephone system was installed fifteen years ago by Regional Telephone. Over the last few years, Regional and one other vendor have sold add-on equipment to five of the university's fifteen departments. This add-on equipment is expensive and represents a major investment to the five departments, one of which is the Communications Department. Departments that have the quick-dial equipment are pleased with the results; departments that do not have quick dial cannot afford it and are unhappy with Regional.

Tom has updated you on the status of the proposal. The communications office has insisted throughout the proposal process that the new phone system must be capable of using the existing quick-dial equipment. Tom tells you that if that is the case, only Regional and two or three other vendors would be able to bid on the system. Six other vendors with their own quick-dial equipment would not be able to respond to the bid. Tom explains that in some cases, a whole new system was less expensive than hooking up one of Regional's systems to existing quick-dial equipment. Tom also tells you he has heard that several staff members from the Communications Department have threatened to quit if the bid goes to a company other than

SOURCE: Case 2 was provided by Bill Carney.

FIGURE 5.4

City of Tempe: Water Utilities Department



Department Purpose:

To provide the residents, businesses and visitors of Tempe with a reliable and economical supply of drinking water that meets or exceeds all federal, state and local standards of quality, and to protect the health, safety and overall environment of our community through wastewater and storm water management and the collection and disposal of household hazardous materials.

Department Description:

The Water Utilities Department is responsible for Operations, Water Resources, Administration, and SROG. The Operations Division is comprised of Plant Operations, Field Operations, Environmental Services, Environmental Health & Safety, and Security. Water Resources is responsible for the water conservation program, Tempe Town Lake, and hydrology services. The Administration Division includes Capital Improvement Program (CIP) management, Finance, and Aviation. The Sub-Regional Operating Groups (SROG) division is responsible for administration of the SROG program.

FY 2006-07 Budget Highlights:

Funding was approved for laboratory supplies and testing, compound meter replacement, sewer cleaning, and a rate study for water, sewer and irrigation. In addition, funding for two temporary intern positions was approved to address an increased workload at the Household Products Collection Center (HPCC).

Expenditure by Type	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget
Personal Services	\$ 9,878,309	\$10,846,863	\$10,805,993	\$11,510,134
Supplies and Services	12,055,360	12,825,110	13,348,528	14,036,150
Capital Outlay	229,835	222,100	384,933	283,200
Internal Services	3,684,064	3,375,861	3,372,724	3,309,785
Contributions	1,000			
Expenditure Total	\$25,848,568	\$27,269,934	\$27,912,178	\$29,139,269
Per Capita	\$158.65	\$165.91	\$169.82	\$175.75

Expenditures by Division	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget
Operations	\$16,327,978	\$17,574,531	\$18,175,519	\$19,079,336
Water Resources	607,459	1,073,629	892,387	1,052,672
Administration/CIP Management/Finance/Aviation	4,516,225	4,216,435	4,444,003	4,604,428
SROG	4,396,906	4,405,339	4,400,269	4,402,833
Total	\$25,848,568	\$27,269,934	\$27,912,178	\$29,139,269

Authorized Personnel	2004-05 Actual			2005-06 Revised			2006-07 Budget		
	Full Time	Perm FTE	Temp FTE	Full Time	Perm FTE	Temp FTE	Full Time	Perm FTE	Temp FTE
Operations	113	0.50		117	1.00		116	1.00	
Water Resources	4			4			4		
Admin./CIP Mgt./Finance/Aviation	12		0.49	11	0.50	0.49	12	0.50	0.49
SROG	1			1			1		
Total	130	0.50	0.49	133	1.50	0.49	133	1.50	0.49

(Continued)

FIGURE 5.4 (Continued)

Related Strategic issue: Neighborhood Quality of Life and Public Safety				
Goal:	To provide a safe and adequate domestic water supply to all citizens in Tempe, while at the same time minimizing cost			
Objective:	1) To monitor increases in water treatment costs for the Johnny G. Martinez and South Tempe Water Treatment plants; and 2) maintain an Operating and Maintenance Cost per 1,000 gallons treated under eighty cents			
Measures (Comparative Benchmark)	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget
Total Water Treatment Operating and Maintenance Cost	\$9,186,874	\$10,995,858	\$10,995,858	\$10,849,927
Number of Customer Accounts	41,532	41,532	41,532	42,000
Total Gallons Treated (Million Gallons)	15,152	18,800	17,563	17,900
Operating and Maintenance Cost per 1,000 gallons treated	\$0.61	\$0.59	\$0.63	\$0.61
Operating and Maintenance Cost per customer account	\$221.20	\$264.76	\$264.76	\$258.33

Related Strategic issue: Neighborhood Quality of Life and Public Safety				
Goal:	To reduce operating and maintenance costs of the wastewater collection system			
Objective:	To achieve wastewater collection costs that are less than \$10,000 per mile			
Measures	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget
Total Wastewater Collection Operating and Maintenance Cost	\$3,153,522	\$3,445,996	\$3,445,996	\$3,453,689
Miles of Mains in Collection System	500.0	502.2	502.2	502.2
Operating and Maintenance Cost per mile	\$6,307	\$6,862	\$6,862	\$6,877

Related Strategic issue: Neighborhood Quality of Life and Public Safety				
Goal:	To minimize the number of resident complaints related to water quality and respond to those complaints within twenty-four hours			
Objective:	To maintain low resident complaints and to respond within twenty-four hours			
Measures	2004-05 Actual	2005-06 Budget	2005-06 Revised	2006-07 Budget
Taste and Odor Complaints	6	N/A	17	<17
Hardness Complaints	2	N/A	1	<1
Other Complaints	9	N/A	5	<5
Response within twenty-four hours of the complaint	100%	N/A	100%	100%

SOURCE: City of Tempe Annual Budget, July 1, 2006, through June 30, 2007, Performance Budget (pp. 194–195). Retrieved April 7, 2007, from www.tempe.gov/budget/FY%2006-07%20docs/5%20Performance%20Budget.pdf.

Regional. After fifteen years, they feel Regional is the best and only qualified vendor. Tom wants to know how he should proceed to satisfy both the university's needs and the vendors' rights to a fair bidding process.

- How should Tom proceed to ensure that all bidders have an equal chance to participate in the bid process?
- How can the procurement office avoid the practice of vendors helping buyers to write a bid proposal?
- What about Tom's responsibility to taxpayers? (Thousands of dollars would be wasted if the quick-dial equipment that has already been purchased was scrapped.)

3. The following simulation reenacts a series of budget discussions held at the University of Southern Anonymous (USA) during a time of significant budget reductions. To conduct the simulation, divide the class into five groups, each of which will represent one character in the simulation. All students in the class should read the following general description of the situation facing USA. Then members of each group should read only the character description assigned to their group. (It is important that you read only the description assigned to you.) The role descriptions of the following characters can be found after the general description of the situation in the following pages:

Vice President Cooper
Dean Berryderry, College of Liberal Arts
Dean Stevens, dean of Science
Dean Dudley, dean of Education
Dean Dollar, dean of Business

After all participants have had a chance to read the general description of the situation and the specific information pertaining to their character, each character group should meet separately for fifteen to twenty minutes. During this period, the group should (1) select a representative to play the character at a meeting to be held in Vice President Cooper's office, and (2) develop detailed strategies and information for that person to use in representing the group's interests in the meeting.

Following the individual group meetings, the five individuals selected to play the five characters should meet around a table near the middle of the room. Vice President Cooper will call the meeting to order, present any opening remarks he or she wishes to make, and then preside over the remainder of the discussion. All other students should remain quiet during this part of the simulation. During the course of the meeting, any member may request a recess to consult with his or her group (for no longer than five minutes). When the meeting in Vice President Cooper's office reconvenes, the person who called the recess will have the floor. The meeting should continue until a consensus is reached concerning the reductions or until Vice President Cooper feels the meeting is stalled and he or she will have to make a decision independently. Enjoy the discussion!

General Description of the Situation

The University of Southern Anonymous (USA) has been informed by the state administration that its budget for the current year will be reduced by several million dollars. The president of the university, I. M. Fearless, has informed Vice President for Academic Affairs Cooper that the various colleges in the university will be required to reduce their budgets by an average of 8 percent. In turn, Vice President Cooper has chosen not to implement across-the-board cuts of 8 percent for all colleges, but has discussed different target percentage reductions with each of the deans of the four colleges—Liberal Arts, Science, Education, and Business. In response to a request from several of the deans, Vice President Cooper has called a meeting of the four deans to get their reactions to his targeted amounts for each college and to find out how each college plans to implement the required reduction.

USA is a medium-sized midwestern university whose mission is providing students with a broad-based liberal arts education as well as a limited graduate program, primarily in business and education. The school serves a regional constituency in the southern part of the state, though it draws students from around the country, many of whom first heard of USA because of its reputation as a leader in intercollegiate billiards. (In fact, some cynics refer to USA as "Cue U.")

Though the university has traditionally enjoyed a good relationship with the governor and members of the legislature, President Fearless has antagonized many in the state capital with his rough and abrasive manner. Many on campus see the president as bringing the university the same administrative style he employed as a colonel in the Marine Corps. Despite these difficulties, most academic programs at the university are considered sound, with some exceptions. Similarly, many feel some programs are not suited to the mission of a regional midwestern university, notably the school's long-standing program in oceanography, which some feel is out of place because the university is seven hundred miles from the nearest ocean.

Character Descriptions

Vice President Cooper In your five years as vice president at USA, you have never faced such a difficult situation. You recognize that the university's president is in some political trouble and may be asked to resign soon. As a ploy to reduce the heat on his office, he has passed on the largest part of the budgetary reductions to you. If you can come through this situation in good shape, you will receive considerable praise and be a likely candidate for the presidency should the president be forced to resign. You will, however, need to be sure that you maintain the support of all the deans of the colleges, because their support is essential for your promotion. On the other hand, a major disruption at the university, in which you might lose support of the deans, would end any chances of your attaining your ambition. In fact, you might be fired along with the president!

Given the instructions from the president, there seems to be little you can do other than assign reductions to the colleges. After reviewing the various programs within the colleges, however, you have decided that across-the-board cuts would be inappropriate and that some colleges could indeed stand to be cut more than others. You have, therefore, assigned different reductions to each college, with Education receiving the greatest reduction (20 percent), Liberal Arts receiving the second greatest reduction (10 percent), Science next (7 percent), and Business last (2 percent). You have chosen these figures based on your assessment of the quality of programs, the quantity of students (faculty/student ratios), the nature of the programs, and their suitability to the mission of your university.

The total reductions you have assigned to the deans exceed the total the president has required you to complete. Your reasons for this strategy are twofold: (1) if any of the deans complain too loudly, you can fall back to the figure you actually need as a compromise; and (2) if you persuade all the deans to accept the assigned reduction, then you will have some money available for internal reallocations, which you would like to achieve anyway.

For the most part, you are willing to let the various deans assign reductions within their colleges as they see fit, as long as each seems to be doing a thorough job in the

assignment. Later, if there is money available, you can make other reallocations to add needed new programs or strengthen others.

However, you are personally interested in a couple of particular areas. First, your favorite uncle chairs the oceanography program. Second, your own degree is in higher education administration, and you have enjoyed periodic classroom visits to that department. Third, the governor has expressed a strong interest in the integrity of the public administration program.

Dean Berryderry College of Liberal Arts (target reduction—10 percent). You approach the meeting with the vice president with some trepidation, because you realize that your college is likely to be high on the list of cuts. You would prefer across-the-board cuts that would not place a special burden on your college. Several of your programs, however, are of minimal quality and simply have not been attracting students over the years. For example, your program in German has graduated an average of two majors per year over the past several years, with a faculty of only three. Several other programs, such as anthropology and geography, are showing similar results. These programs, however, are important to a broad-based liberal arts education. You feel that students should at least have the opportunity to enroll in such programs if they see fit.

On the other hand, there are some programs currently housed in your college you would just as soon see ended. For example, the graduate program in public administration is a professional program that you feel is inconsistent with the liberal arts perspective of the college. The total faculty salaries in this department would just about equal the total by which you need to reduce your budget. This is an obvious area to eliminate.

Next, it has occurred to you that your staff of professional advisers could be eliminated and all academic advising performed by members of your faculty. This could be accomplished with no faculty or program reductions.

You feel a natural alliance with the College of Science and would prefer to see reductions occur in either Education or Business rather than in Liberal Arts or Science. However, Dean Stevens of the College of Science has always been somewhat antagonistic toward you, perhaps because of your critical remarks about the oceanography program, which you think should be eliminated.

Finally, several personal considerations enter into your thinking. First, if the vice president were to become president, you would probably be the leading candidate for the vice presidency. You find that very attractive. Second, although you don't want to appear to favor any department, your home department, the Department of Political Science, is putting strong pressure on you to support expansion of the program. Across-the-board cuts *within* your college would make that impossible. Third, a member of your faculty was recently offended by sexual advances from the dean of the School of Business, Dean Dollar.

Dean Stevens Dean of the College of Science (target reduction—7 percent). You have conducted a thorough analysis of the possibilities for reduction within your college. You feel that by eliminating one visiting professorship, four graduate teaching assistantship positions, and two staff positions, you'll be able to accommodate the reductions. You are quite aware, however, that others see your Department of Oceanography as a primary

target for elimination. This is, however, one of your oldest and strongest programs, certainly one of the leading oceanography programs in the Midwest. You want to protect the program as it is; however, even if you are required to reduce that program, you wish to do so only by eliminating several faculty positions rather than the entire department. You also feel this program will be protected because the chair of that department is the vice president's uncle.

Several other personal considerations affect your thinking. First, you feel that the entire College of Education could be eliminated with no real loss to the university. Other programs within the state clearly produce enough graduates in that field. Eliminating the entire college would mean that no reductions would be needed in any other college. Second, you think Dean Berryderry is an idiot. You were especially incensed by Berryderry's comments about oceanography. If Berryderry can't run his own college, why should he try to run yours? Third, one of your faculty members recently was offended by sexual advances from the dean of the School of Business, Dean Dollar.

Dean Dudley Dean of the College of Education (target reduction—20 percent). You know you are in trouble! Over the past several years, enrollments have been dropping in Education to the point that you are considerably overstaffed. At the same time, other programs in the state have developed and now have better reputations. This is especially true for your Department of Higher Education Administration. Another campus in the state boasts one of the country's leading programs in this area. Your best hope is to argue for across-the-board cuts that would affect all colleges equally. Your suspicion is that the College of Business will receive the lowest reduction, and the College of Liberal Arts and the College of Science will be somewhere above. One of them would probably benefit from across-the-board cuts as opposed to targeted reductions; the other would probably lose—but you don't know which one.

In addition, several personal considerations guide your thinking. First, nearly all the athletes who are part of the school's winning billiards program are students in your college. You doubt if they could pass their coursework elsewhere. Second, the chair of the Department of Higher Education Administration has been one of your strongest critics over the years, and eliminating that department would eliminate one of your biggest problems. Third, a member of your faculty was recently offended by sexual advances from the dean of the School of Business, Dean Dollar.

Dean Dollar Dean of the School of Business (target reduction—2 percent). Though you realize that your college will have to take a token reduction, you are certain that your reduction is far less than that required from other schools. Consequently, you are highly supportive of the vice president's selective reduction and opposed to across-the-board cuts. Your college has grown by leaps and bounds in the past several years, and you are in desperate need of more faculty, not fewer. At the same time, salaries have increased dramatically in your field, and retention of capable faculty is a problem. You can probably accommodate the reductions assigned to you through minimal staff changes and will not have to fire faculty.

You see all this as a possibility for considerable reorganization of programs. One program that you would particularly be interested in bringing into the college is that

in public administration. This program is viewed with great favor by the governor and, consequently, by those higher in the university's administration. Moreover, the program would seem to be consistent with the interest of your college in management. You wonder if perhaps somewhere in all of this redistribution of money you might be able to acquire a new program. If you can discredit Dean Berryderry's interest in public administration and champion that field, you should stand a good chance of receiving support from the higher administration. All in all, you see this process as opening the possibility of adding to your college rather than reducing it. This result, however, depends on selective reductions rather than across-the-board cuts and upon reallocations *beyond* the amount required for the president's stated budget reduction.

You also have several personal concerns. First, you think both the College of Education and the Department of Oceanography (in the College of Science) could be eliminated outright and you could use the money. Second, you have heard that the chair of the Department of Oceanography is the vice president's cousin. Third, you have just met a very attractive person who is an adviser in the College of Liberal Arts. You think you are falling in love—again!

Do Not Read This Paragraph until after the Simulation.

Following the simulation, the entire class should discuss each group's strategies and tactics. Sometimes it is helpful to ask first what others thought each dean was trying to do and then ask that group to describe its strategy. Pay particular attention to strategies of cooperation and competition, as well as to strategies that have little to do with actual budget reductions. (For example, shifting a program from one location to another doesn't save the university any money.) Note also the inevitable lack of information, as well as the roles of rumor and false impressions in the budget process. (Both these features are more typical of budget decisions than you might think!) Finally, just for fun, have Dean Berryderry read the last line of his or her description, then have Dean Stevens do the same, then Dean Dudley, and then Dean Dollar.

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