

Public Budgeting Systems

8th
EDITION



Robert D. Lee, Jr.
Ronald W. Johnson
Philip G. Joyce

these elements. A system may be thought of as a network typically consisting of many different parts with messages flowing among the parts. The elements of systems interact with each other to produce system results, or consequences, and the network of interactions may produce the same set of results through several different paths, or the same path may from time to time produce different outcomes.⁴⁷ Budgeting systems involve political actors, economic and social theories, numerous institutional structures, and competing norms and values, all of which produce outputs in patterns not immediately evident from studying only budget documents.

Budget System Outputs. In a budgetary system, the outputs flowing from the network of interactions are budget decisions, and these vary greatly in their overall significance. Not every unit of the system will have equal decisional authority or power. A manager of a field office for a state health department is likely to have less power to make major budgetary decisions than the administrative head of the department, the governor, or the members of the legislative appropriations committees. Yet each participant does contribute some input to the system. The field manager may alert others in the system to the emergence of a new health problem and in doing so, may contribute greatly to the eventual establishment of a new health program to combat that problem. Modern information technology and the greater emphasis on responsibility at all levels of the organization for achieving results means the lower-level staff in an agency are much more influential than they have been in the past. Even actors not in the formal budgeting system may influence the decisions. For example, doctors and hospitals, who are part of surveillance for early detection of avian flu, in effect are providing inputs to the budgeting system.

Like the outputs of any other system or network, budget decisions are seldom final and more commonly are sequential. Decisions are tentative, in that each decision made is forwarded for action to another participant in the process. This does not mean that all decisions are reversible. Major breakthroughs, such as passage of the Elementary and Secondary Education Act of 1965, which provided substantial federal aid to education, are abandoned only in response to powerful political pressure.⁴⁸ The George W. Bush administration's No Child Left Behind Act, which reauthorized major elements of federal assistance to elementary and secondary education, continued most of the key elements of the original 1965 legislation, although giving great emphasis to testing student achievement as a means of ensuring accountability at the classroom level.⁴⁹ Likewise, the introduction of prescription drug care into Medicare in 2006 was only after years of debate and proposals. Despite dissatisfaction, eliminating such hard fought programs is nearly impossible. Subsequent budget decisions, therefore, are in large part

bounded by previous decisions. The subsequent decisions tend to center on the question of changing the level of commitment—allocating more resources, fewer resources, or different kinds of resources—to achieve desired levels of impact or different types of impact.

System Interconnectedness. Another feature of a system is that a change in any part of it will alter other parts. Because all units are related, any change in the role or functioning of one unit necessarily affects other units. In some instances, changes may be of such a modest nature that their ramifications for other parts of the system are difficult to discern. However, when major budgetary reforms are instituted, they assuredly affect most participants. For example, if one unit in the system is granted greater authority, individuals and organizations having access to that unit have their decisional involvement enhanced, whereas those groups associated with other units have diminished roles.⁵⁰ Thus, each individual and institution evaluates budget reforms in terms of how political strengths will be realigned under the reforms.

Information and Decision Making

Types of Information

To serve the multiple functions described in the preceding section, budgeting systems must produce and process a variety of information. Most of the major reforms, whether attempted or proposed, in public budget systems have been intended to reorganize existing information and to provide participants with different types and greater quantities of information. Basically, two types of information exist: program information and resource information. The latter type is more traditional. People are accustomed to thinking of budgets in terms of resources, such as monetary units and personnel. A budget would not be a budget if it did not contain dollar, ruble, or other monetary figures. Similarly, budgets commonly contain data on employees or personnel.

Conventional accounting systems provide much of the information that public organizations use for budgetary decisions. This type of information is limited to the internal aspects of organizations, e.g., the location of organizational responsibility for expenditures and the resources purchased by those expenditures. When the decision-making system incorporates information about the results or implications of programs, one must leave the boundaries of the organization to examine consequences for those outside it. This step requires more extensive and more explicit clarification of governmental goals and objectives (see Chapter 6) and increases the importance of analysis.⁵¹ This feature of budget reforms, such as

program budgeting, zero-base budgeting, managing for results, and performance budgeting, with their emphasis on program information and priority setting, has generated the most heat among critics of budget reform.⁵²

Decision Making

Much of the criticism of reform has involved the argument that reform of decision-making systems must take into account the limitations on human capabilities to use all the information that might be collected and analyzed. Although sometimes subtle differences distinguish theories of decision making, the various theories can generally be classified into three basic approaches: pure rationality, muddling through or incrementalism, and limited rationality.⁵³ An early application of these notions to public sector decision making was Graham Allison's study of the Cuban Missile Crisis, *The Essence of Decision*, in which he characterized three models as rational, organizational, and governmental/political.⁵⁴ These are descriptive theories as well as prescriptions for how decisions ought to be made.

Rational Decision Making. Decision making according to the pure rationality approach consists of a series of ordered, logical steps. First, all of an organization's or a society's goals are ranked according to priority. Second, all possible alternatives are identified. The costs of each alternative are compared with anticipated benefits. Judgments are made as to which alternative comes closest to satisfying the relevant needs or desires. The alternative with the highest payoff and/or least cost is chosen. Pure rationality theories assume that complete and perfect information about all alternatives is both available and manageable. Decision making, therefore, is choosing among alternatives to maximize some objective function. The rational choice model is built on microeconomics and the notion of the individual actor making an optimal choice to maximize the decision maker's utility.

The applicability of the rationality model is limited, and few argue that it is a description of how ordinary human beings make most decisions. It is most consistent with notions of technical or economic rationality, where objectives can be stated with some precision and the range of feasible alternatives is finite.⁵⁵ Also, the model can be of use where accurate predictions of behavior are possible, such as in the private market, where assumptions regarding rational behavior can be used to predict future economic trends.⁵⁶

As a description of how government budgeting works, the pure rationality model is obviously misleading. Meeting the complete requirements of even a few of the steps is impossible. It has been argued that the costs of information are so high as to make it rational to be ignorant; that is, to make decisions on the basis of a limited search and limited information. Some attempts at budget reform have been criticized as attempts to impose an unworkable model, pure rationality, on

government financial decision making. The use of program information has been a particular target for criticism.⁵⁷ However, this criticism is somewhat misdirected in that it is not so much the information search cost that is limiting, but rather the individual decision maker's perspective. Public budgeting decisions are made in a larger political context with numerous actors involved, a more complicated situation than the clear-sighted approach toward an agreed-upon objective that is the essence of the rational choice model.

Incrementalism. The second approach to decision making, muddling through or incrementalism, has been advocated by critics of pure rationality, such as Charles E. Lindblom, Aaron Wildavsky, and others.⁵⁸ According to this view, decision making involves a conflict of interests and a corresponding clash of information which result in the accommodation of diverse partisan interests through bargaining. "Real" decision making is presumed to begin as issues are raised by significant interest groups that request or demand changes from the existing state. Decision making is not some conscious form of pure rationality, but is a process of incrementally adjusting existing practices to establish or reestablish consensus among participants. Alternatives to the status quo are normally not considered unless partisan interests bring them to the attention of the participants in the decision-making process. There is only a marginal amount of planned search for alternatives to achieve desired ends. The decision process is structured so that partisan interests have the opportunity to press their desires at some point in the deliberations. Decisions represent a consensus on policy reached through a political, power-oriented bargaining process.

The most important characteristic of the muddling through, or incrementalist approach, is its emphasis on the proposition that budgetary decisions are necessarily political. Its descriptive appeal is that it more accurately depicts a process in which numerous actors, each with a different point of view, negotiate and bargain for a consensus. The larger the issue, the more difficult it is to achieve consensus for radical change, which results most often in incremental adjustments to the status quo. Whereas a purely rational approach might suggest that budgetary decisions are attempts to allocate resources according to economic or other "objective" criteria, the incrementalist view stresses the extent to which political considerations outweigh calculations of optimality. The strongest critics of many budget reforms have tended to equate those reforms with seeking to establish the pure rationality model or a solely economic model, a description rarely accepted by those proposing budget reforms. As will be seen throughout this book, any "real" budget reform is forced to accommodate the political nature of decision making. In reality, elements of rationalism and incrementalism pervade the budgetary process.⁵⁹

Limited Rationality. The third approach to decision making, a compromise between the other two approaches, is called limited rationality. This model recognizes the inadequacies in the assumptions behind the pure rationality description of decision making as applied to complex problems. While acknowledging the inherent constraints of human cognitive processes, limited rationality does not suggest that a deliberate search for alternative approaches to goal achievement is of no avail. Searching for alternatives is used to find solutions that are satisfactory but not necessarily optimal.

Substantial evidence, cited by some of the giants in budgeting (Wildavsky) and decision making (Lindblom), indicates that many decisions are indeed incremental, and clearly each budget decision does not require a thorough review of all options and careful calculations of the possible outcomes of each option. Yet major decisions that depart dramatically from the past are made from time to time in the budgetary process. Non-incremental change, especially at the macro level addressing major deficits and surpluses do occur.⁶⁰ And, of course, major events such as terrorist threats and creating a new agency such as the Department of Homeland Security cause non-incremental change, although the core of federal budgeting did not change significantly after September 11, 2001.⁶¹ Furthermore, decision makers often do attempt to achieve public values and are motivated more by the social and economic problems their agencies must address than by bureaucratic budget maximizing and interest-group pressures.⁶²

Limited rationality suggests that large forces are marshalled at times for major change, and incremental adjustments are made at other times for issues that do not generate demand for substantial departure from the status quo. Decision theories do differ in how they view the values that decision making serves and the capacities of decision makers to serve those values. One model assumes virtually no limits on human capacities for processing information, another suggests that decision making should be sensitive only to partisan political interests, and still another attempts to strike a balance between the other models. The history of budgeting and budget reform, we argue, reflects the tensions among these approaches to decision making.

Summary

Public budgeting involves choices among ends and means. Public budgeting shares many characteristics with budgeting in the private sector, but it often requires the application of criteria different from those used by private organizations. Chief among these differences is that few public sector decisions can be

assessed in terms of profit and loss. Private sector decisions, on the other hand, ultimately must consider the long-run profit or loss condition of the firm.

Budgeting systems involve the organization of information for making choices and the structure of decision-making processes. Public budgeting systems have evolved as one means of holding government accountable for its actions. Budgetary procedures are developed to hold the government in general accountable to the public, the executive branch accountable to the legislature, and subordinates accountable to their managers. Budgetary procedures also are developed to specify what the executive is accountable for. Concern for the financial solvency of some city governments and the size of the federal budget deficit and total debt have led to reform proposals to use budgeting as a device for holding governments accountable for their long-term financial position. Renewed interest is evident in citizens demanding that governments report regularly on their performance.

Budgetary systems work through information flows. However, each participant in the budgetary process pays selective attention to information. The various theories of decision making advanced differ in terms of how much information decision makers are willing and able to consider. The decision-making approach that seems best to characterize budgetary systems is the limited rationality approach. This approach underlies the discussions throughout this book.

Notes

1. Warsh, D. (2006). *Knowledge and the wealth of nations: a story of economic discovery*. New York: W.W. Norton.
2. Downs, A. (1967). *Inside bureaucracy*. Boston, MA: Little, Brown.
3. U.S. Office of Management and Budget (2007). *Budget of the United States government: fiscal year 2007, historical tables*. Washington, DC: U.S. Government Printing Office, 313.
4. Porter, M. & Kramer, M. (2006). Strategy and society: the link between competitive advantage and corporate social responsibility. *Harvard Business Review*, 84, 78–92.
5. Hsieh, P. et. al. (2003). The return on R&D versus capital expenditures in pharmaceutical and chemical industries. *IEEE Transactions on Engineering Management*, 50, 141–150.
6. U.S. Congressional Budget Office (1993). *CBO staff memorandum: a review of Edwin Mansfield's estimate of the rate of return from academic research and its relevance to the federal budget process*. Washington, DC: U.S. Government Printing Office. Mansfield updated that research in 1998, showing similar results. Mansfield, E. (1998). Academic research and industrial innovation: an update of empirical findings. *Research Policy*, 26, 773–776.