

# Theoretical Approaches to Public Budgeting

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## FEATURES AND FUNCTIONS OF A PUBLIC BUDGET

A significant development in the intellectual history of the 20<sup>th</sup> century has been the explicit recognition by economists, politicians and the public at large of the importance of government in the operation of the economy.<sup>1</sup> The public budget generally reflects the policy of the government toward the economy.<sup>2</sup> Public budget is a forecast of governmental expenditures and revenues for the ensuing fiscal year, which may or may not correspond to the calendar year. Except for primitive economies, the budget is the key instrument for the expression and execution of government economic policy. Public budgets have wide implications for the national economy. By budgets governments exercise their allocative, stabilization and distributive functions.<sup>3</sup> They are, therefore, political as well as economic documents and are products of the political processes by which competing interests in any nation achieve agreement.

Although the major budgetary decisions that effect the performance of the economy and the national debt are usually made by the central government, most countries have local or state (provincial) governments. These are responsible for the provision of various services and have the authority to raise revenues through taxation or to borrow on their own account. This devolution of authority is greatest in the United States, where the majority of provision of civilian services is carried out at state or local levels and where states have a tradition of being individual decision-making units. In the United Kingdom, by contrast, local authority spending is constrained by rules set by the central government. Local authorities are also limited in their ability to borrow and to raise taxes, which are set by the central government. (The budget of the European Union is an example where authority for major spending, particularly for agricultural support, has devolved to a transnational body.)

The difficulty of discussing *budgeting as a policy process* lies basically in the difference between discussing private sector companies or individuals and government budgeting. Although the process of preparing and discussing a public budget has progressed considerably during the 20<sup>th</sup> century, it is in a number of senses still inferior to the way budgeting is carried out by private sector companies or indeed by individuals. Commercial practice is governed by a series of well-defined rules, and firms are required to produce a balance sheet, a profit and loss account and to monitor their cash flow carefully. The

total indebtedness of a company is monitored closely by its shareholders, who are also critical of future forecasts of profits and growth. Individuals who fail to budget adequately are equally closely monitored by bank managers and credit agencies, and those with complicated affairs can draw upon skilled professional help.

The *accountability of government*, even in a well-developed democracy, is in reality considerably less acute, or certainly less clear, than that of companies to their shareholders or individuals to their various creditors. As a result, public budgeting is frequently of lower quality than is the norm in the private sector. Forecasts of receipts and expenditures are often wildly at variance with reality; changes to accounting practices are sometimes made for cosmetic political purposes and certain distinctions, such as those between capital and current expenditures, are frequently blurred deliberately. These criticisms of the public budgetary process are more valid in some countries than in others.

According to Aronson and Schwartz (1981) the extent of the budget amounts and the operating programs on which they are based is the dividing line between the private and the public sectors. The budget stipulates which goods and services are to be supplied to the public by the authorities and which are to be supplied by the private sector. The decision on who is to supply what and who is to receive what should be a reflection of the community's values, preferences and priorities. Therefore, the budget is a political document through which money is appropriated according to value judgments and the budget process is a political process that takes place within a political arena (Gildenhuys, 1997).

Thornhill (1984) summarizes the most important features of a public budget as follows:<sup>4</sup>

- The budget, after its approval by the legislative authority, is enforceable.
- The results of most of the objectives to be realized by the budget are not quantifiable.
- The budget brings together a variety of considerations.
- As the objectives of action taken by public institution differ widely from those of private organizations, the processes for determining the content of a public budget are therefore unique.
- Authorities do not always adapt their expenditure to fit their available revenue.

It may therefore be stated that a public budget is an instrument at the disposal of the legislative authority. It enables to guide the economic, social, political and other activities of a community in a certain direction in order to realize predetermined goals and objectives, the results of which are not always quantifiable. The budget also contains all of the measures needed to subordinate the executive authority to the legislative authority as the representative of the voters and taxpayers. The features of a public budget ensure the unique foundation on which its preparation, approval and execution are based. In public administration the budget serves as a decision-making instrument by which priorities are set, goals and objective are established, operating programs are compiled and control

exercised. A budget document is the final product in the budget process and it should be suitable for consideration and approval by the legislative authority, while the execution of its contents should realize public objectives. The quality of the budget depends on the accuracy of the supporting data, the quality of the methods used and the expertise as well as the integrity with which it has been compiled. As a result of the broad spectrum of services that an authority has to render, however, budgets can offer only a synoptic picture of their financial implications. Therefore, a compromise has to be made in the budget document between the requirements for adequate, accurate information and for manageability (Kotzé, 1979).<sup>5</sup>

Gildenhuis (1997) recognizes the functions of a public budget as follows:

- The budget is a policy statement declaring the goals and specific objectives an authority wishes to achieve by means of the expenditure concerned. It is public policy expressed in amounts of money and is the actual embodiment of policy and of implied policy objective. In policy-making, realization of the most important objectives and aims should receive priority. As a policy-making document, the budget generally contains a definition of both the quantity and the quality of the envisaged service delivery. However, no normative guidelines exist by which priorities may be scientifically determined, thus that is the result of political expedience.
- The redistribution of wealth is one of the most important functions of a public budget. It requires that total integration should exist between the two sides of the budget—revenue policy and expenditure policy—in order to comply with a fiscal policy for the redistribution of wealth.
- For the administrative authority, the budget is a work program on which each department can base its own operational work program. This function of the budget demands that the structure of objectives, the activity schedule, the resource schedule and the financial schedule is clearly expounded in the budget documents.
- The budget serves as a source of information for everyone concerned; the information contained in the draft budget document is necessary for its consideration and, after approval, serves as the most important source of information to the administrative authority for executing its functions.
- The budget also serves as a coordinating instrument by which government activities can be integrated, because it is supposed to contain all the information on the policies, objectives and activities of the government in one document.
- The budget is also a control instrument to be used by the legislative authority over the executive authority and by the executive authority over the administrative authority and even for internal control within a single component of the administrative authority. Two types of administration control are important in this regard, namely, *a priori* control and *ex post* control.

## EVOLUTION OF A THEORY?

The applicability of the word “theory” in this area is a far cry from its usage in the social sciences, particularly in economics. This has been explicitly recognized by the quasi patron saint in the field, Wildavsky, who said: “...a normative theory of budgeting would be a comprehensive and specific political theory detailing what the government’s action ought to be at a particular time. Given that the budget represents the outcome of political struggle, a normative theory of budgeting suggests the elimination of any such conflict over the government’s role in society. Such a theory, therefore, is utopian in the fullest sense of the word: Its creation and acceptance would mean the end of politics.”<sup>6</sup>

Much of the literature on public budgeting emanates from the United States, where in the 1960s “incrementalism” became the dominant theory of budgeting. Incrementalism is a style of policy-making based on small, marginal changes from existing policies. It contends not only that comprehensive rationality is impossible, but also that policies are seldom changed radically as a result of extensive reviews.<sup>7</sup> It is a tendency of government to tinker with policies rather than to question the value of continuing them. Considering the work of Wildavsky (1964), Fenno (1965) and others, budget processes were seen as stable, predictable, changing little from year to year and based on well defined roles that could be represented by relatively simple decision rules. They argue that a process which concentrates on an increment is preferable to one that attempts to review the whole budget because it moderates conflict, reduces search costs, stabilizes budgetary roles and expectations, and reduces the amount of time that officials must invest in budgeting, thus increasing the likelihood that important political values will be taken into account. The term incrementalism promises budgetary growth within most of the program and expenditure increases. Statistical analysis of incremental outcomes typically measures the amounts and rates of increase. Descriptive studies concentrate on the tactics used to augment the basic in “small steps.” However, incrementalism offers little explanation as to how decisions are made or how the increment is divided (Schick, 1983).

By the late 1970s incrementalism was seriously challenged as a theory of budgeting (LeLoup, 1978) because of the narrowness of its analytical focus and changes in the environment and processes of budgeting. “When a theory applies to all situations at all times without the possibility of disconfirming evidence, it is no longer a theory and of little use for explanation or even description.”<sup>8</sup>

As economic and social intervention by governments has increased, the limitations of incrementalism as a budgeting practice have become increasingly apparent. A number of techniques or attempts to reforming budget systems have been introduced to make decisions more rational. These techniques have been applied with different speeds by local and regional governments as well.

Evolution of budget theory and policy-making shows that undeniable progress has been achieved, often on modest fronts and with reasonably simple techniques. A key development in budget theory has been the differentiation between *microbudgeting and macrobudgeting* and the inherent tension between them (LeLoup, 1988). “Macrobudgeting—high level decisions on spending, revenue and deficit aggregates and relative budget share, often made from top to down. Microbudgeting—intermediate level decisions on agencies, programs, and line-items, usually made from the bottom up.”<sup>9</sup> Both levels of analysis are interested in how power is structured in budgetary processes as well as being exercised and expressed through budgetary choices. “The basic conceptualization of budgeting has shifted from a cycle of micro-level, incremental executive requests and legislative actions to a complex series of political responses to short-term economic changes and projections of relatively inflexible long-term trends in outlays and revenues. Key questions now concern how to balance micro-decisions within macro-level parameters. *No grand theory of budgeting has emerged*, but we are closer to explaining the budgetary process....”<sup>10</sup>

## RULES AND NORMS FOR PUBLIC BUDGETING

The recent experience of budgeting and policy-making has left behind a substantial body of rules, norms and practices, which are routinely applied or pursued in most countries, because they are widely recognized as workable and reasonably efficient and are required by international organizations and/or financial markets (Lacasse, 1996). Budget norms are explicitly formulated; their compliance or non-compliance is easily observable and, often sanctioned by financial markets.

Mikesell (1991) has also stated that new budget reform techniques are consistent with the classical principles for appraising budgets.<sup>11</sup>

- 1) *Comprehensiveness*. The budget should include all receipts and outlays of the government. The single process would thus include all activities of the government.
- 2) *Unity*. All spending and revenue-collecting parts should be related to each other. Consistent evaluation criteria should be applied to any expenditure, regardless of the government area in which it is located.
- 3) *Exclusiveness*. Only financial matters should be in the budget. (Modern analysts recognize, however, that almost every governmental action has financial implications.)
- 4) *Specification*. The budget should be executed as it is enacted. Cavalier changes should not be made during the budget year.
- 5) *Annuality*. The budget should be prepared every year for the next year of agency existence.

6. *Accuracy*. Forecasts should be as reasonable as possible and the document should be internally consistent.
7. *Clarity*. The budget should describe what is proposed in understandable fashion. The document, in an effort to encompass all, should not bury policy intent in line-item detail.
8. *Publicity*. The budget in a representative democracy should not be secret. The budget contains the expenditure plan (as well as the revenue estimates) of the government. It is clearly contrary to the underlying principles of a democracy that such important choices are made without complete public consideration.

According to Lacasse (1996), the three most important budget related rules are: *comprehensiveness* and a *multi-year perspective* in budget elaboration, and the capability for *monitoring implementation* so as to further *accountability* and timely adjustments. (The two latter partly correspond with specification, clarity and publicity.) These issues in budget office-center relations all fall under the three categories of harmonization, complementarity and co-responsibility, as discussed above.

On the other hand, Wildavsky and Caiden (1997), argue that to understand what was happened to budgeting in our time consider the radical changes in the norms of desirable behavior that used to guide budgeters. According to them, budgets emerged at the beginning of the nineteenth century as the result of reforms that replaced centuries of muddle and mismanagement with expenditure control based on norms of annularity, comprehensiveness, legislative appropriation, audit and balance. Public budgets today are evaluated against their *long-term implications*, they consist of many different kinds of spending, and they are unbalanced, uncertain and dependent on circumstances beyond their control.

As far as the norm of *comprehensiveness* concerns, the rule could be rewritten as: every penny whose allocation is made via the political process, not the market, should be recorded and presented for assessment in the budget. Very little dispute has arisen around this rule at the theoretical level, however, in practice this is a much more demanding rule. This rule has been broken by direct loans, loan guarantees, tax preferences, off-budget companies, open-ended entitlements and other devices (Wildavsky and Caiden, 1997).

For instance, over the last two decades, the reintegration of special funds into a “normal” budgetary perspective has been one of the biggest changes in implementing this rule. There is also an increasing tendency to treat commercial activities carried by departments and public enterprises for what they are—in other words, the distinctions between commercial and public policy functions have been sharpened. (Privatization has helped on this front.)

Other categories like tax expenditures, guaranties and regulations are not likely to be overcome soon. Implicit guaranties, such as unfunded pension obligations or guaranties

to the banking and financial system institutions remain outside the budgetary purview. It is not even clear how they could be included. As well, debate is still going on the very legitimacy of the concept of tax expenditures. The attempts to design and use a regulatory budget have also failed. On the other hand, one can argue that tidying these “loose ends” up might increase the complexity of the budget to such a degree, that it could defeat its very objective of improving transparency and accountability (Lacasse, 1996).

The issue between budgeting and policy-making is more than a straightforward problem of disharmony. The key to the solution—that is to the continuation of the last decades’ evolution towards really comprehensive budgets—probably lies in rigorous budgetary laws and rules.

Apart from the temptations to go off-budget, the other important issues seem linked to the choices between regulations and expenditures or between direct expenditures and tax expenditures. Budgeting of tax expenditures, even in a primitive fashion, is rare, while regulatory budgeting has not traveled far from the textbooks and amounts to little more than good intentions (Lacasse, 1996).

The chronological counterpart of the comprehensiveness rule is the *annuality* versus *multi-year budgeting*. The latter demands to reconcile the annual budget with multi-year policy commitments. This apparently contradictory injunction is important in two respects: for new or reformed policies, and for the cross-impacts of policies. In both cases, the elaboration of the current budget demands accurate cost forecasts.

The consensus over the fact that the budget office is a key instrument of control and should play an important role in supplying implementation feedback—indeed, in controlling implementation—is as strong as it is traditional and vague. This somewhat paradoxical situation has a variety of sources. First, institutions vary markedly between countries. Second, the very content of “implementation feedback” is a mixed-bag, ranging from compliance and integrity controls to impact evaluations. Third, basic strategies as to who should be responsible for providing such feedback to whom also vary from country to country, and substantial overlap in responsibilities exists between institutions within countries.

It is assumed that the implementation of the budget routinely and rapidly generates information as to whether the monies voted are indeed being spent within the legislated framework provided by the budget. Such implementation monitoring exists in most countries, but this basic feedback on policy implementation is often limited to financial information and is used almost exclusively by the budget office. This is rarely felt to be enough by the policy-making center, whose attention is obviously oriented towards the future, towards new policies or revised ones (Lacasse, 1996). This is the reason why analysts state that the *control of spending* has declined along with the norm of comprehensiveness (Wildavsky and Caiden, 1997).

The important issues of implementation are related to the systems, institutions and methods aimed at answering simple and age-old questions such as: Is the money being

spent efficiently? Is the money reaching those for whom it was intended? Is the policy having the intended results? Is the policy generating unwanted and undesirable effects?

The most difficult and controversial subject addressed by the above questions—namely, whether policies have had the expected impact on society and at a reasonable cost—curiously attracts the strongest consensus.

The subject of efficiency in public management—i.e., of maximizing productivity and minimizing costs in delivering existing policies—is a very political subject in which many budget offices have played a key role in the last decade, essentially as promoters of the so-called “new public management,” a concept incorporating business management styles and practices into the public sector. This reform is based on the conjunction of two elements: first, the delegation of financial authority to lower level—including in some cases virtually all aspects of personnel policy, flexibility as to the timing of expenditures, permission to substitute capital for labor and vice-versa—and, second, the introduction of performance commitments and incentives, appropriately backed up by performance measurements and sufficient power at the center to ensure accountability and control. It should be noted however that this evolution is far from being uniform among countries. (See next chapter.)

That the budget should further accountability and provide a key instrument of transparency on government action, is such a staple of budget theory that it has acquired a quasi-theological aura. Nobody is against virtue. However, the practical meaning of this principle has often remained obscure (Lacasse, 1996). The instruments used to make the budget choices and their implementation transparent differ widely from country to country. There is not any unique system likely to be applicable to all countries.

Other phenomena that used to be confined mainly to poor countries—repetitive budgeting, remaking the budget several times a year—have now become standard practices in relatively rich nations as well (Wildavsky and Caiden, 1997).

Why did the norms erode? Answering this question is not easy. The old Politics of the Budgetary Process (Wildavsky) could focus on incremental differences because the base was largely agreed. When there is a disagreement about the starting point as well as the desirable outcome of budgetary negotiation, incremental change is in trouble. Schick (1988) holds another view: prosperity declined, incrementalism has gone with it. Both budgetary norms and spending practices change together. The purpose of norms is to justify practices. The importance of budgetary norms can be seen indirectly in new practices and proposals for reform (budget resolutions, constitutional spending limits, etc.)

## NOTES

- <sup>1</sup> Issues discussed here relate to any level of government existing in a system.
- <sup>2</sup> A distinction should be made between a budget and a budget system. Whereas the *budget* refers only to the documents within which financial proposals are contained, the *budget system* refers to the relationship between the stages to be followed in order to compile the budget documents (Thornhill, 1984).
- <sup>3</sup> For a comprehensive description of these functions, see Musgrave, Richard A.: *The Theory of Public Finance*, (New York: McGraw-Hill, 1959).
- <sup>4</sup> in Gildenhuis, 1997, p.394.
- <sup>5</sup> in Gildenhuis, 1997, p.395.
- <sup>6</sup> Wildavsky, Aaron and Naomi Caiden: *The New Politics of the Budgetary Process*, Third edition, (Addison Wesley Longman, Inc., 1997), p.265.
- <sup>7</sup> Comprehensive rationality is a style of policy-making based on scientific assessment of alternative actions and conscious choice of the course of action that will yield the maximum benefit. It suggests that policies are subjected to multi-step analyses before a decision is made.
- <sup>8</sup> LeLoup, Lance T.: "The Myth of Incrementalism: Analytical Choices in Budgetary Theory," Reprinted from *Polity*, Vol. X, No. 4, summer 1978, p.502.
- <sup>9</sup> LeLoup, Lance T.: "From Microbudgeting to Macrobudgeting: Evolution in Theory and Practice," in: Rubin, Irene (ed.): *New Directions in Budget Theory*, (State University of New York, 1988), p.19.
- <sup>10</sup> p.36.
- <sup>11</sup> Howard, S. Kenneth: *Changing State Budgeting*, (Lexington, Ky.: Council of State Governments, 1973), pp.5–8. Quoted by J. Mikesell (1991) p.121.

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