

## Section 9

# BUDGETING AND FINANCE

---

## Introduction

Frans K.M. van Nispen

### THE CALL FOR A BUDGETARY THEORY

The appeal of V.O. Key for a budgetary theory is a landmark in interest in public budgeting in modern history. Key clearly referred to a *normative* theory, raising the question: 'On what basis shall it be decided to allocate X dollars to activity A instead of activity B?' (Key, 1940/1978: 20). Early efforts to develop such a theory failed before Aaron Wildavsky took over the relay baton, issuing the first edition of his seminal *The Politics of the Budgetary Process*, which changed the budgetary landscape almost completely.<sup>1</sup> He argued that the allocation of scarce resources is not a matter of arithmetics or calculation, but a matter of power. Furthermore, he claimed that the concept of incrementalism offered both the best description of and prescription to for the budget process, introducing such now common words as the 'base' and 'fair share' into the vocabulary of budget watchers (Wildavsky, 1964).<sup>2</sup> Soon, incrementalism became the dominant theory of public budgeting in America and, strangely enough, also in Europe, where the power of the purse is with the executive rather than the legislative branch of government. Moreover, empirical support was at best mixed, if not to say weak (LeLoup, 1978; Rubin, 1988).

The incremental nature of the budget was further challenged in the period of economic decline in the 1980s due to the oil crises. It turned out that decrementalism is not simply the mirror image of incrementalism, since the base is under attack (Schick, 1983: 23). The various interest groups and stakeholders will fight the spending cuts, giving the budget process a highly political profile. The traditional way of budgeting – across-the-board cuts<sup>3</sup> – did not provide much relief, requiring more targeted spending cuts. Consequently, micro-budgeting was counterbalanced by macro-budgeting (LeLoup, 1942/1988), setting norms for the reduction of the budget deficit and/or public expenditures, changing the rules of the game and this is noteworthy, changing the relative strengths of the players of the game.<sup>4</sup> The advocates suddenly faced strong guardians, playing down the upward pressure on the budget. The success and failure of these budgetary reforms and their predecessors, like Planning, Programming, Budgeting Systems (PPBS), and Zero-Base Budgeting (ZBB), has gained much more attention than the design of a grounded theory. Unfortunately, we have to conclude that our insight into the process of public budgeting and cut-back management is still anecdotal and fragmented (Van Nispen, 1993), though we know a lot more than Valdimer Key when he issued his call for a budgetary theory.

## THE BATTLE ON THE BALANCED BUDGET

The attempt to balance the budget is still relatively young, though James Savage has argued that the idea of balance is deeply rooted in American history (Savage, 1988). In the mid-1980s the GRH Amendment (1985), creating the sequestration procedure, prepared the ground for a reduction of the budget deficit. The impact may have been modest, but it is quite clear that the more effective spending caps of the Budget Enforcement Act (of 1990) (BEA) would not have passed without the GRH-Amendment. The movement only became serious when the budget became an issue in the mid-term elections during the first Clinton administration (1994). The *constitutional* amendment, as promoted by the Noble Prize winner James Buchanan, may have failed, but both parties reached a *statutory* arrangement to balance the budget (Buchanan, 1995).

A few years later the European countries followed when the heads of state came to terms about a target for the budget deficit and a procedure for the reduction of excessive budget deficits at the Maastricht summit (1991). The reference value as one of the standards for qualification for the Economic and Monetary Union (EMU)<sup>5</sup> was first set at 3 per cent of GDP and later, at the Amsterdam summit (1997) reinforced to a '*budgetary position close to balance or in surplus*'. In five out of twelve EMU countries the revenues now outnumber the outlays. The same is true for the three non-EMU countries. The overall figure for the EU as a whole is slightly below zero (that is, in deficit).

Many differences can be identified, but the similarities between the American and European case are striking: in America the Republican party tried to amend the constitution; in Europe the heads of state changed the treaty. In both cases limits have been imposed on the budget deficit (Anderson, 1999). Besides, new procedures have been established for the reduction of the budget deficit and, even more important, the budget deficit made way for a budget surplus, mainly thanks to the recovery of the world economy. Finally, on both sides of the Atlantic a dispute has been going on about the utilization of the

budget surplus for current priorities or for a reduction of the public debt, and as such for the retirement of the Baby Boomer generation.<sup>6</sup> It seems apt to point out that, as Bernard Pitsvada has stated correctly (1996: 221), there is no simple device to cut the Gordian knot between the demands for guns and for butter.

## ORGANIZATION OF THIS SECTION

The first chapter in this section, by John Mikesell, deals with the revenue side of the budget. He raises four basic questions that each government, particularly a government of a developing country or one in transition, has to answer in the design or redesign of their system of taxation and their revenue base. He argues that governments miss opportunities to pursue more effective and efficient alternatives than those represented by the status quo by assuming that revenue policies will not change.

In the following chapter Mark Hallerberg looks at the changing role of institutions, and more precisely at rules to deal with the principal-agent problem, moral hazard and common pool resources, using empirical data collected for a report commissioned by the Dutch Minister of Finance about the European member states. He concludes that the selection and the effectiveness of institutions may be affected by the characteristics of the political system.

Rita Hilton and Phil Joyce take a historical angle in their chapter, looking at the current revival of performance budgeting or rather performance-informed budgeting. A survey of OECD countries shows that a lot is going on in the field, but that it might only be lip service. The authors identify five critical factors, notably that participants must have incentives to use performance information.

The final chapter is about the latest trend in budgeting, and has to do with accrual budgeting. It has its roots in accounting and control rather than in budgeting. The ins and outs are discussed by Leonard Kok, drawing on the evidence of a survey of the OECD member countries, recording a growing interest. However, one may question the utility since only a small portion of the budget is applicable for accrual budgeting.

## NOTES

1. It is hard to find a book on public budgeting without reference to his work.
2. In all fairness, I should note Verne B. Lewis already mentioned incrementalism in his contribution to (the discussion about) a budgetary theory (Lewis, 1952).
3. The sequestration introduced by the Gramm–Rudman–Hollings (GRH) Amendment in the United States was built upon automatic across-the-board cuts.
4. The incoming minister of Finance, Zalm, successfully launched a norm, named after him, to curb public spending at the start of the so-called Purple Coalition in the Netherlands (1994).
5. The other criteria being participation in the Exchange Rate Mechanism for more than two years and the reduction of inflation rates, interest rates and the public debt.
6. The dispute has faded away as snow under the sun, at least temporarily, since the terrorist attacks on the World Trade Center in New York and the Pentagon in Washington.

## REFERENCES

- Anderson, Barry (1999) *Budgeting in a Surplus Environment*. OECD/PUMA/SBO 1999/3/Final. Paris: OECD.
- Buchanan, James M. (1995) 'Clarifying Confusion about the Balanced Budget Amendment'. Paper presented at a conference of the National Taxpayers Association, Chrystal City, Virginia, 22 May.
- Key, Valdimer O., Jr (1940) 'The Lack of a Budgetary Theory', *American Political Science Review*, pp. 1137–44, reprinted in Albert C. Hyde and Jay M. Shafritz (eds) (1978) *Government Budgeting: Theory, Process, Politics*. Oak Park, IL: Moore Publishing. pp. 19–24.
- LeLoup, Lance T. (1942) 'From Microbudgeting to Macrobudgeting: Evolution in Theory and Practice', in Irene S. Rubin (ed.) (1988) *New Directions in Budget Theory* [wrongly titled *Budget History*]. New York: State University of New York Press.
- LeLoup, Lance T. (1978) 'The Myth of Incrementalism: Analytic Choices in Budgetary Theory', *Polity*, 10 (4): 488–509.
- Lewis, Verne B. (1952) 'Toward a Theory of Budgeting', *Public Administration Review*, 12 (1): 42–54.
- Pitsvada, Bernard T. (1996) 'A Call for Budget Reform', *Policy Sciences*, 29 (3): 213–26.
- Rubin, Irene S. (ed.) (1988) *New Directions in Budget Theory* [wrongly titled *Budget History*]. New York: State University of New York Press.
- Savage, James D. (1988) *Balanced Budgets and American Politics*. Ithaca, NY/London: Cornell University Press.
- Schick, Allen (1983) 'Incremental Budgeting in a Decremental Age', *Policy Sciences*, 16 (1): 1–25.
- Van Nispen, Frans K.M. (1993) *Het dossier Heroverweging* [The Reconsideration Files]. Delft: Eburon.
- Wildavsky, Aaron (1964) *The Politics of the Budgetary Process*. Boston, MA: Little, Brown.