Budget Watcher's Blues

Introduction to the Section on Budgeting and Finance

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1. The Call for a Budgetary Theory

The appeal of Valdimer Key for a budgetary theory marks the interest in public budgeting in modern history. He 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, in Hyde & Shafritz 1978, p. 20]. A couple of 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* that changed the budgetary landscape almost completely[2]. He argued that the allocation of scarce resources is not a matter of arithmetics or calculation, but a matter of power. On top of that he claimed that of incrementalism offered both the best description of and prescription to the budget process, introducing now common words as the 'base' and 'fair share' in the vocabulary of budget watchers [Wildavsky 1964][3]. Soon, incrementalism became the dominant theory of public budgeting in America and, strange 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 least mixed, if not to say weak [LeLoup 1978; Rubin 1988].

The incremental nature of the budget is further challenged in the period of economic decline in the 80s 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, p. 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[4] - did not provide much relief requiring more targeted spending cuts. Consequently, micro-budgeting was counterbalanced by macro-budgeting [LeLoup 1988], setting norms for the reduction of the budget deficit and/or public expenditures, changing the rules of the game

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2 It is hard to find a book on public budgeting without any reference to his work.
3. In all fairness I should note Verne B. Lewis already mentioned that instrumentalism in his contribution to [the discussion about] a budgetary theory [Lewis 1952].
4. The sequestration introduced by the Gramm-Rudman-Hollings amendment was built upon automatic across-the-board cuts.

and, noteworthy, the relative strengths of the players of the game[5]. 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 the Planning, Programming, Budgeting System [PPBS] and Zero-Base Budgeting [ZBB] has got much more attention than the design of a grounded theory. Unfortunately, we have to conclude that our insight in the process of public budgeting and cut-back management is still anecdotal and fragmented, though we know a lot more than Valdimer Key when he ventilated his call for a budgetary theory.

2. The Battle on the Balanced Budget

The attempt to balance the budget is still relatively young though James Savage has argued that balance is deeply rooted in the American history [Savage 1988]. In the mid 80s the Gramm-Rudman-Hollings [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 [BEA] would not have passed without the GRH-amendment. The movement became only 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 Price winner James Buchanan may have failed, but both parties reached a *statutory* arrangement to balance the budget.

A few years later the European countries followed suit when the heads of state and government 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 for the budget deficit, which is one of the standards for the qualification for the Economic and Monetary Union [EMU][6], was first set at 3 per cent of Gross Domestic Product [GDP] and later at the Amsterdam summit [1997] further reinforced to a *'budgetary position close to balance or in surplus'*[7]. In addition, the budgetary policy of the European member states is going to be directed by the 'principle of prudent fiscal policy making', introducing numerical rules that basically curb government expenditures in order to avoid that windfalls on the revenue side are spent instead of being used for debt reduction. All efforts are geared to fiscal consolidation in order to avoid debt accumulation [OECD 2010a].

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5. 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].
6. The other criteria being participation in the Exchange Rate Mechanism [ERM] for more than two years and the reduction of the inflation rates, the interest rates and the public debt.
7. The budgetary policy of the European member states is geared to country-specific medium-term objectives [MTO] requiring a reduction of the underlying structural budget deficit adjusted for the cycle by at least 0.5% of GDP per year.

3. Budgetary Reform

The process of budgetary reform has been driven for some time by the New Public Management [NPM] movement inducing, inter alia, a revival of performance budgeting. Taking the traditional line-item budget as point of reference Christopher Pollitt and Geert Bouckaert discern a trajectory of budgetary reform that is completed by the adoption of accrual budgeting [Pollitt & Bouckaert, 2004: 69-70]. Only a few OECD-countries have gone through the full cycle as the constraints of both the strict and broad interpretation of performance budgeting [Schick 2003: 101] have become clear. The scope of is basically limited to homogeneous outputs which are rare in the public sector, the link between inputs and outputs, respectively outcomes is rather weak and there is not much empirical support for the impact of performance information on – either allocative or technical – efficiency Van Nispen & Posseth 2009]. The NPM movement might be over the hill [Dunleavy 2005; OECD 2010b], but what is new at the horizon beyond performance budgeting?

The financial crisis and notably the situation in Greece mark a crossroad in the field of budgetary reform. On the one hand, the financial crisis is providing a window for change – to quote Barack Obama's chief of staff Rahm Emanuel: *'you never want a serious crisis to go to waste … [it] is an opportunity to do things you think you could not do before'* [Seib 2008] – as illustrated by the creation of a so-called European Semester that allows the European institutions to assess the draft budget and to come up with recommendations before it is submitted to national parliaments. In addition, the European Commission has issued the so-called 'six pack' of proposals for reinforcement of European governance [Van Nispen 2011]. On the other hand, the room for budgetary innovation is small as the financial crisis is absorbing almost entire intellectual creativity and physical capacity for budgetary reform and, not to say, to overcome the resistance of the spending departments. The jury is still out. The time will learn the outcome of the trade-off between reform drivers and reform capacity.

4. The organization of the Section

The first chapter by Mark Hallerberg is about the changing role of institutions, more precisely 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.

The second paper by Rita Hilton & Phil Joyce takes a historical angle, looking at the current revival of performance budgeting or rather performance-informed budgeting. A survey of the OECD shows that a lot is going on in the field, but that might be only 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 that 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, leaning on evidence of a survey of the OECD recording a growing interest. However, one may question the utility since only a small portion of the budget is applicable for accrual budgeting.

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