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Improving U.S. Budget Choices

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The best case for new methods of budget choices is that governments often do not serve us very well. One obvious manifestation of the poor performance of government is the incoherence of the budget process—the sum of decisions on the parts is not consistent with decisions on the total. For the U.S. Federal budget, this incoherence is manifested at three levels: The President reviews the total budget twice each year, first to set planning targets and later to determine the formal budget proposal; after each review, however, numerous decisions are made on individual programs that are not consistent with the synoptic reviews.

In the last few years, Congress established a total outlay ceiling and then proceeded to approve individual programs that exceeded the ceiling.

Our political processes suggest an increasing demand for individual programs, but opinion polls indicate a substantial and increasing popular concern about total Federal spending. The incoherence of the budget process will not be resolved, even in an evolutionary way, unless the benefits and costs of individual programs are jointly considered, both by those who express a demand for these programs and by their political representatives.

Some appreciation of the unique problems of government budgeting is gained by a comparison with those of business firms. Any budgeting system depends on information concerning the following questions: How well are we doing? How can we do better? Measurement of the value of output and, in turn, the measurement of profits is possible only because a business firm sells its output at a unit rate. A profit-seeking objective is a necessary condition to make these methods relevant to the firm's decisions.

Governments, however, do not face the conditions that make the economic calculus and good accounts relevant to a business firm. There is no

objective valuation of the output or measurement of profits. In addition, there is no frequent objective indication of the overall performance. A government, in effect, is a non-profit monopoly that provides services to its members at a zero price, is financed by lump-sum charges, and makes its budget decisions on the basis of information about cash disbursements and the anticipated vote of the members. New methods for government budgetary choices, to be valuable, should focus on these unique characteristics of government.

Why did the formal PPB (Planning-Programming-Budgeting) system, as instituted in the U.S. Federal government in 1965 and recently abandoned, fail to significantly improve the process of making budget choices? Most importantly, because it failed to recognize the particular characteristics of political and bureaucratic institutions.

The four fundamental problems of the formal PPB system, I believe, are the following:

1. *The Program Format.* A large part of the discussion and controversy about the PPB system concerned the search for the one "best" aggregation of

This Issue in Brief

The "incoherence of the budget process" is a major manifestation of the poor performance of the Federal government, says Dr. Niskanen.

He analyzes the failure of the PPB (planning-programming-budgeting) system, begun in 1965 and recently abandoned, to improve the process of making budget choices.

This article then summarizes some of the changes that can improve the information analysis for budgetary choices, given the general characteristics of the present structure of government.

government activities by program categories. This search proceeded on the assumption that there is a single or dominant objective toward which each program contributes and that the review process would be best organized by jointly reviewing all activities that contribute to each separable objective. In fact, of course, most activities contribute to several objectives. On net, most of the effort to develop one "best" program structure was, and would still be, useless.

2. *The Planning Orientation.* Proposals that the Federal government should "plan" its activities for a longer period than the authorization or appropriation cycles have been made for many years. This planning orientation became an integral feature of the PPB system for the domestic agencies although it was not, contrary to popular understanding, an integral feature of the defense programming system. A planning system is future oriented and implies that the organization is making binding decisions for the future. A programming system, in contrast, is present oriented and implies that the organization is making a binding decision only for the minimum incremental period. The important distinction between planning the future and presenting the future implications of present decisions was unfortunately lost in the hurried development of the PPB system for the domestic agencies. The political decisionmakers, however, both by constitutional limitation and by inclination, are not prepared to make binding decisions for more than the minimum incremental period and, thus, the planning orientation reduced the credibility of the whole PPB system.

3. *The Institutional Assumptions.* The early PPB advocates naively asserted that a PPB system is politically neutral—that it does not inherently favor or threaten any program, institution, or political position. This could have been dismissed as naive propaganda by otherwise wordly men, if it were not that the value of a PPB system is strongly dependent on a consistency of objectives among the several parties in the review process.

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The fundamental relation between an agency and a review authority in our system is an adversary relation in which the objectives of the two parties are quite different. An agency will submit only that information that can be effectively mandated and that which it believes will serve its own interests.

PPB System Models

Termed Irrelevant

4. *The Analytic Models.* Most of the analyses of domestic programs, particularly in the early years of the PPB system, were based on analytic models that were (and are) irrelevant to the problems addressed. Two types of analytic models were particularly mischievous and led to discrediting the significant contributions that analysts can make:

a. *The "defense" model.* Many of the analysts supporting the PPB system had earlier worked on military programs, and they uncritically applied their "defense" model to domestic programs. National security is the characteristic national public good; there is little reason to question the role of government, more specifically a national government, in supplying this service. The characteristic analytic problem of defense programs is a production problem—how to produce a certain defense output at the minimum cost? For domestic programs, however, there is more reason to question the role of the Federal government, and most domestic agencies, with a few exceptions, do not produce the final public good. The Federal government, for example, finances and regulates the nation's health, education, transportation, and police systems, etc., but does not produce or operate these systems. For the domestic programs, the appropriate sequence of analysis should be the following:

- (1) What is the most appropriate role of government relative to market and other private institutions, in this area?
- (2) What is the most appropriate role of the Federal government, relative to the many other units and types of government?
- (3) What is the best Federal instrument to achieve the specific objective expressed by the national political process, given the behavior of the other relevant parties?

Only if the answers to this sequence of questions indicates Federal production of some public service does the production or "systems analysis" problem even become relevant to Federal policy. The analyses of Federal do-

mestic programs, to be relevant, require a shift from "systems analysis" to "political economy."

- b. *The "national income" model.* The implicit assumption of many domestic program analyses is that the objective of public policy is to maximize the income (or the wealth) of the nation. This model has no normative context except for those conditions where one person or the state owns all of the nation's wealth or where public policy is invariant to the distribution of income or wealth—conditions for which only allocation decisions are relevant. For decades, however, the traditional cost-benefit analyses of water resources projects have concluded that projects that benefit one group more than they cost some other group are, in some sense, desirable, whether or not the losing group is compensated. Many of the analyses of education, manpower, and health programs have been based on a "Human capital" model that implicitly assumes that public policy should maximize the value of the nation's stock of human capital—as if we are all slaves of the state or of some accounting construct such as national income. In many cases, this model generates dramatically incorrect results, in terms of the distributional preferences expressed by the political system. For most activities, analysts should either restrict the alternatives considered to those with the same distributive consequences or restrict their conclusions to reporting the estimated costs, benefits, non-monetizable effects, and the distributive consequences. Analysts who claim to do more are either naive or are confusing their own political preferences with their analytic results.

Good Analysis Needs Different Formats

At best, I believe, better information and analysis can make a significant but not substantial improvement in the performance of government. More substantial improvements will require changes in the structure of government, changes that will differ depending on the present characteristics of each government. The remainder of this paper summarizes some of the changes that can improve the information analysis for budgetary choices, given the general characteristics of the present structure of government.

1. *Development of an Analytic Data System.* As described above, I believe that the development of one best format for displaying and reviewing the activities of government is neither possible nor desirable. In contrast, it is important to develop

several different formats to reflect the different decisions that are made by different people at different times, and the multiple objectives of most government activities. The several formats for aggregating the budget and activity levels that would prove valuable, I believe, include at least the following:

a. *Agency and appropriation.*

This is the necessary format for the final budget review as the final budget decisions by both the President and Congress are made at this level. This is also a necessary format for management and financial control.

b. *Program.*

A flexible program format is valuable, but it is not necessary that the program aggregations be either mutually exclusive or exhaustive. A somewhat different program aggregation is valuable depending on the issue addressed.

c. *Beneficiary groups.*

It is often valuable to aggregate budget and activity data by the following affected groups:

Income class

Demographic group—aged, young, minority races, veterans, etc.

Religion

State and local governments, urban, rural, etc.

d. *Input categories.*

Some management problems are specific to certain types of inputs across agencies and programs, so aggregations in the following categories are often valuable:

Civilian and military personnel

Government property

Transfers to individuals

Grants to other governments.

In order to develop these several types of formats for display and review, it is necessary to develop an analytic data system in which the basic data elements are sufficiently detailed and coded to provide for aggregation to each of the above formats and selected cross-classifications. Such a system is now being developed in the United States. Ultimately, this should permit the rapid and flexible aggregation of budget and activity level data in any one or more of the several formats that are useful for each policy issue.

2. *Develop a Policy Review Procedure.* Most governments make policy decisions indirectly, as a derivative of the necessary decisions on the budget details. This is the reason why the budget review process is often incoherent and why the review authorities are often unsatisfied with the total budget

although they may have approved every component. Some more formal policy guidance prior to preparation of the budget is probably requisite to making this process coherent. The U.S. Federal government has experimented with different types of "previews" as the basis for providing better policy guidance without discovering any dominant procedure. A successful policy review, I believe, will have the following characteristics:

- (a) The review format should be flexible, to focus on those major issues anticipated in the next cycle. A data system, such as described above, is necessary to support this flexible format.
- (b) The policy reviews should use a "zero base" budgeting approach to the issues addressed, but need not be exhaustive of the total budget. There is no need to provide new policy guidance for all government activities each year, but it is important to provide good policy guidance for all activities at some time.
- (c) The policy reviews should be *present* oriented, focusing only on those major decisions that must be or should be made in the next cycle. *Ex post* program evaluations are valuable only when they provide guidance on the near-term decisions. Considerations of future costs and activities should be limited to the future implications of present decisions, not as a device to force future choices to the present.
- (d) The study process should be focused primarily on this policy review, not only to spread the annual workload, but to provide for incorporation of study results in a review format in which major alternatives are considered. The study process should recognize the adversary nature of the review process. Little purpose is served by asking the agencies to incriminate themselves, except by inadvertence. The review authorities need to develop parallel sources of information—from other agencies, lobby groups, universities, etc.—to assure they are not captive of the information provided by the specific agency affected.
- (e) The policy review should force specific policy decisions on the guidance for budget preparation. It is important to avoid both the format of a "trial run" budget review and the format of an intellectual seminar; the first format is unnecessary and the second is sterile.

Some progress was made in reorganizing the Spring review of the U.S. Federal Budget along these lines this year, and further changes in this direction are anticipated.

3. *Develop a New Analytic Orientation.* The "defense" model and the "national income" model, as described above, have not proved to be very valuable as a guide for budget decisions on domestic programs. The two most important changes in the nature of program analysis are the following:

- (a) First, sort out those activities that it is important for the national government to perform, given the capabilities and incentives of private institutions and other governments. All perceived problems of the nation are not necessarily appropriate problems for the national government to resolve. For those problems for which there is an appropriate role, the analysis should focus on how to perform this role better. For those problems for which other institutions have a comparative advantage, the analysis should develop a case, which may require compensation of losing groups, for eliminating these activities; little purpose is served, I believe, in using scarce analytic resources to identify how to perform an inappropriate role marginally better.
- (b) Develop the distributional consequences of all activities for which there is reason to believe there is an uneven distribution of the potential benefits. All too often activities that are approved with the expectation of helping a specific group have substantially different distributional consequences, and knowledge of the probable effects can improve the efficiency of the political decisions. A good understanding of the distributive effects is sometimes also requisite for developing a compensation strategy to gain approval for eliminating a present activity or initiating a new activity.

These suggestions are only beginning answers to the question "How can we do better?" They do not provide a sufficient basis for optimism that better information and analysis will much improve the performance of government. At best, analysis can only amplify the external signals to which governments are primarily responsible. There may be a great "need" for analysis, in terms of the information and analysis on which budget decisions should be based, but there will be little revealed demand for analysis until it is responsive to the particular institutional processes by which government operates.