

PUBLIC **BUDGETING** **SYSTEMS** NINTH EDITION

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Dedicated to
Ann, Rob, Tatiana, Craig, Dan, Cameron, and Bob
and to
Sally, Ron, Jennifer, Zac, Landen, Lucas, Abi, Scott, and Amber
and to
Rita, Christopher, Mariah, and Samuel



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Preface

This is a general book on public budgeting. Its purpose is to survey the current state of the art of budgeting among all levels of government in the United States. Where their inclusion would be illustrative, examples from other countries and from some nongovernmental organizations are used. In addition, we emphasize methods by which financial decisions are reached within a system and ways in which different types of information are used in budgetary decision making. We stress the use of program information because budget reforms for decades have sought to introduce greater program considerations into financial decisions.

Budgeting is considered within the context of a system containing numerous components and relationships. One problem of such an approach is that because all things within a system are related, it is difficult to find an appropriate place to begin. Although we have divided the text into chapters, the reader should recognize that no single chapter can stand alone. Every chapter mentions some topics and issues that are treated elsewhere in the book.

A discussion of budgeting may be organized in various ways. Historical or chronological sequence is one possible method of organization, although this approach would require discussing every relevant topic for each time period. Another strategy is to arrange topics by level of government, with separate sections for local, state, and federal budgeting. Such an approach again would involve extensive rehashing of arguments and information. Yet another approach is to focus on phases of the budget cycle from preparation of the budget through auditing of past activities and expenditures. Rigid adherence to this approach would be inappropriate because the budget cycle is not precisely defined and many issues cut across several phases of the cycle. Another approach would be to organize the discussion around the contrast between the technical and political problems of budgetary decision making.

The organization of this book is a combination of these approaches. Although we have not formally divided the book, readers will see that the chapters are separated into five sections. The first four chapters lay out an overall framework for budgeting, budget decisions, and budgeting systems. The discussion is of U.S. budgeting, but the framework is applicable for the most part to any budgeting system whether national, state, or local, or whether it is in Europe or any other continent. Chapter 1, *Introduction*, begins with the concepts of

budgets and budgeting systems. It provides a general discussion of the nature of budgetary decision making, including distinctions between private and public budgeting, the concepts of responsibility and accountability in budgeting, the possibility of rationality in decision making, and the nature of budgeting and budget systems. Chapter 2, *The Public Sector in Perspective*, addresses the issues of the size of the public sector and the arguments about what is appropriate for the public sector vis-a-vis the private sector. It reviews the scope of the public sector, the magnitude of government, the sources of revenues, and the purposes of government expenditures.

Chapter 3, *Government, the Economy, and Economic Development*, has been relocated in this *Ninth Edition* from its place at the end of previous editions. This chapter goes into detail, primarily for the United States, in discussing government's responsibilities for and impacts upon the overall health of the economy. Specific attention is given to the most recent recession that began in 2007, the worst recession since the Great Depression. Budget cycles are the topic of Chapter 4, which summarizes the basic steps in budgeting: preparation and submission, approval, execution, and auditing. Chapter 4 forecasts the more detailed discussions in the following two groups of chapters. Together the first four chapters provide a basic framework for the remainder of the book.

The next six chapters are organized around budget decision-making processes and the principal actors involved from the initial steps of budget preparation through budget approval by legislative bodies. These chapters set up the subject of budget decisions for the annual, recurrent budget, also called the operating budget. The topics are revenues and expenditures; reform efforts that have focused on improving annual budget decisions; and detailed budget preparation and approval. A separate chapter is devoted to the U.S. congressional approval process and its outcomes. In these six chapters we treat budget decisions on both the preparation and approval sides, and on revenues and expenditures. We note that reform efforts have focused almost exclusively on the expenditure side.

The purpose of these six chapters is to provide the reader with an understanding of the types of deliberations involved in developing a proposed budget. Chapter 5, *Budgeting for Revenues: Income Taxes, Payroll Taxes, and Property Taxes*, considers the different sources from which governments obtain their funds, the criteria for evaluating revenue sources, and specific sources such as income, payroll, and property taxes. Chapter 6, *Budgeting for Revenues: Transaction-Based Revenue Sources*, continues the discussion of revenues by considering sales taxes, user fees, and the like. Chapter 7, *Budget Preparation: The Expenditure Side*, discusses early budget reform efforts and contemporary approaches to developing proposals for funding government programs. Chapter 8, *Budget Preparation: The Decision Process*, examines the process of putting together a budget proposal that includes recommended revenue and expenditure levels, and then reviews the types of budget documents that are used in government.

Chapters 9 and 10 deal with the budget approval process. Chapter 9, *Budget Approval: The Role of the Legislature*, provides a general account of the processes used by legislative bodies. Chapter 10, *Budget Approval: The U.S. Congress*, separately treats the special factors and problems associated with congressional budgeting.

The third grouping contains two chapters that concentrate on the execution, audit, and evaluation phases of budgeting. Chapter 11, *Budget Execution*, considers the roles played

by the chief executive, the budget office, and the line agencies. The chapter discusses the topics of tax administration, cash management, procurement, and risk management. Chapter 12, *Financial Management: Accounting, Reporting, and Auditing*, presents the basic features of accounting systems and processes, reviews the various types of reports that flow from accounting systems, and explains the types of audits that are conducted. These chapters provide considerable detail on how budgets actually are implemented once the formal decision cycle through approval is complete, and how honesty and integrity are attained, or at least sought, through the accounting, reporting, and auditing systems and processes.

The fourth group of chapters focuses entirely on systems for making long-term investment decisions and financing long-term capital assets, in contrast to the previous six chapters that focus mainly on the annual operating budget. Of course much of the political processes involved in decisions on the annual operating budget apply to capital budget decisions as well. However, Chapters 13 and 14 deal only with decisions to purchase assets or make investments that will not be consumed or exhausted in a single year and, in many cases at the state and local level, will be financed over a long time period, sometimes as much as 20 to 30 years.

Chapter 13, *Capital Assets: Planning and Budgeting, Analysis, and Management*, examines capital budgeting as a decision process. Decision processes that focus on long-term capital budgeting and methods for financing capital investments differ significantly from decision processes for the annual revenues and expenditures discussed in Chapters 5 through 10. Decisions about capital budgeting actually occur throughout the budget process, although capital programming occurs during budget execution. Chapter 14, *Capital Finance and Debt Management*, considers the financing of long-term capital investments through debt and equity instruments.

The final chapter is separate unto itself in that it is more about the interactions among levels of government—in the United States, federal, state, and local—and not on specific decision processes. Chapter 15, *Intergovernmental Relations*, examines the financial interactions among governments, the types of fiscal assistance in use, and possible means of restructuring intergovernmental relationships.

The book closes with some brief concluding remarks on themes that can be expected to receive considerable attention from budgeting practitioners and scholars in the next several years. The bibliographic note provides guidance on keeping informed about changes in the field of budgeting.

Overall, this edition retains much of the structure of the eighth edition with the major exception of grouping *Government, the Economy, and Economic Development* together with the other three chapters that establish the overall framework for public budgeting systems. As with the eighth edition, this *Ninth Edition* includes increased attention to some topics, such as the recession that started in 2007 for which massive fiscal and monetary programs were put in place to first arrest and then to combat the recession's effects. Various revenue sources, capital budgeting, and state and local debt management also receive additional attention. This text also reflects the continuing impact of the need to combat potential and actual acts of terrorism and of the large increase in the costs of natural disasters and their human and economic impacts. Text, tables, and exhibits have been completely updated.

xii **PREFACE**

Drs. Lee and Johnson began the first edition as faculty members in the Institute of Public Administration at The Pennsylvania State University. Eight editions later, Dr. Lee is Professor Emeritus of Public Administration and Professor Emeritus of Hotel, Restaurant, and Recreation Management at The Pennsylvania State University. Dr. Johnson has retired as Executive Vice President for International Development and Senior Policy Advisor at RTI International. This *Ninth Edition* is now the third edition in which Dr. Philip G. Joyce plays a key role as an integral member of our writing team. He is Professor of Management, Finance, and Leadership at the University of Maryland's School of Public Policy.

Our hope is that this new edition will be useful to readers from many backgrounds and with widely diverse purposes.



Acknowledgments

Having gone through eight previous editions, this *Ninth Edition* is the product of numerous individuals, not just its three authors. We are indebted to current and former colleagues at The Pennsylvania State University, RTI International, and the University of Maryland. Professor Joyce was ably assisted in the preparation of this edition by two research assistants from the Maryland School of Public Policy—Michael Gallaher and Evan Cook; Gallaher also assisted Dr. Johnson in searching out updated data for Chapters 2 and 3. Colleagues and students at other institutions, including a variety of colleges and universities, have provided valuable advice. Practitioners in the United States and many developing countries have helped refine our understanding with real-world situations. In preparing the book, we received considerable advice from expert practitioners in the executive and legislative branches of federal, state, and local governments and from their counterparts in nonprofit organizations. The responsibility for the final product, of course, belongs to us alone.

