Handbook of Government Budgeting

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During the 1970s the financial plight of a number of urban areas, particularly New York and other northeastern cities, prompted the study of what have been called fiscal stress and cutback budgeting. In its simplest interpretation, cutback budgeting refers to reducing spending, increasing revenues, and changing budgetary processes to meet fiscal constraints. Moreover, it is a subset of a broader response to fiscal stress called cutback management (Levine, 1978). Although various analysts have elaborated on this simple definition, cutback budgeting and cutback management typically refer to real and perceived revenue constraints, and to the actions taken by politicians and agency managers to cope with these reductions in resources.

Although the terms fiscal stress and cutback budgeting were initially applied to America's cities, since that time every level of government in the United States, as well as in most countries throughout the world, has experienced fiscal constraints that have forced significant changes in budgeting practices, financial management, the administration of public services, and even in the expectations of what the proper responsibilities of government are in society.

Before examining cutback budgeting in more detail, it is worth noting that both the academic study and the practice of budgeting have confronted resource scarcity in virtually all times and places. Rarely, if ever, have politicians and managers had access to all the revenues they thought necessary to meet various demands and needs. Perhaps only during the Gilded Age of the 1880s, with its huge budget-surplus-producing tariffs, or during the 1960s, with its...
rapid economic growth, has the federal government truly been awash with excess funds. In most other years, governments have been significantly exercised in their attempts to balance budgets and perhaps provide for a small rainy-day surplus.

In one of the worst years of the Great Depression, for example, Clarence Ridley and Orin Nolting (1933) offered a practical guide entitled How Cities Can Cut Costs at a meeting of the International City Manager’s Association in Chicago. The two authors were heavily influenced by the Progressive movement’s emphasis on strong mayors and managers, and by the routinized search for efficiency associated with scientific management and performance budgeting. After calling for administrative centralization, they identified economies in every major governmental activity. In the case of refuse collection, for example, they urged that “costs should be studied to determine the most economical area of collection, the best route lay-out, and the most efficient combination of men and equipment” (p. 16). Despite the shift by some governments from performance to program and other reformed budgetary processes, many of Ridley and Nolting’s recommendations would be echoed forty years later. Their preference for depoliticized ways to administer public programs cheaply also resonates in today’s administrative environment.

Budgeting, therefore, has always been about the possibility of cutting, reallocating, rationing, and making priorities in the use of funds. Budgeting has also involved managers’ creatively searching for new revenues and, as Aaron Wildavsky (1964) and more recently Jones and Euske (1991) described, employing strategies to defend their existing resources while perhaps asking for a little bit more funding. All of these elements may be found in what has come to be called cutback budgeting.

At the same time, however, cutback budgeting is qualitatively different from budgeting in other times. For one thing, cutback implies that agencies have become accustomed to growth in revenues and spending, and that significant adjustments in process, organization, and politics are required to address a new fiscal regime. In this sense, the era of cutback budgeting is generally compared to the mid-1960s, when a healthy economy and a relatively generous federal government aided state and local governments through revenue sharing plans. Also, cutback budgeting usually refers to conditions in which cuts are more than small marginal changes, in which fiscal stress demands deep reductions in spending and tight constraints on revenues.

**DEFINITION OF FISCAL STRESS**

Cutback budgeting is generally regarded as a response to fiscal stress, but what exactly is meant by fiscal stress varies among observers. In her review of cut-
back budgeting. Naomi Caiden (1990) expressed concern that scholars had failed to reach agreement on what truly constitutes fiscal stress, and practitioners often viewed it as little more than the need for additional revenues. Meanwhile, Allen Schick (1980) and Roy Bahl (1990) pointed out that even a balanced budget may not constitute a proper indicator of fiscal health. Indeed, despite contemporary reports of large budget surpluses at both the municipal and state levels, with an estimated $14.2 billion accumulated by state governments in 1997, many of these governments have put themselves in the black only after many painful years of deep budget cuts and program reductions.

Moreover, there are degrees of scarcity, each with its own set of problems and responses. Schick recommended looking at a government's ability and willingness to borrow, tax, and obtain other revenues, as well as its perceived need to spend. Bahl noted that some measures of government deficits and surpluses, such as the National Income Accounts, create distortions because they aggregate data. Better objective measures, he suggested, include bond and credit ratings. In a review of eight of these measures and studies of urban fiscal health conducted during the late 1970s and early 1980s, including Standard & Poor's ratings and the Department of Housing and Urban Development's fiscal analyses, Bahl found that seventeen cities were identified in at least two of the surveys. Fifteen of these cities were located in the northeast or Midwest, which suggests that during this period urban fiscal stress reflected a broader regional problem.

In addition, a more subtle form of fiscal stress arises when governments have adequate aggregate resources for programs but cannot reallocate them to cope with shifting patterns of programmatic demand. In this situation, some programs may enjoy excess resources while others are severely crammed. Naturally, politically popular programs are hard to cut, while those with low political profiles cannot attract additional resources even when the programs need those resources to function properly.

Moreover, spending that traditionally has been classified as "uncontrollable," such as interest on public debt or entitlements, may significantly limit decision makers' ability to redistribute resources. Unfortunately, public debt costs typically rise with interest rates just in advance of recessions, and recessions also lead to more retirement and morbidity. As Pierson (1994) notes, universal entitlements are often the hardest programs to cut openly. Consequently, discretionary spending is usually what gets cut during periods of fiscal stress. Yet politicians have attempted covert attacks on entitlements during the last two decades, for example, by disguising cuts as changes in eligibility, such as raising the retirement age for social security, or as changes in inflation adjustments, as occurred in Canada, where the income level at which old age pension becomes taxable is adjusted for inflation by only an annual maximum of 3 percent.
CAUSES OF FISCAL STRESS

If fiscal stress may be identified by various objective measures, as well as by the perceived needs of politicians and managers, what are its origins? Stress has both socioeconomic and political origins, which often are present simultaneously, often interact, and often exacerbate each other. Depending on the specific government and the period analyzed, one source may be more important than others.

Socioeconomic Sources

Socioeconomic decline is characterized by a host of social and economic ills befalling a government. These ills include decline of industrial bases, middle-class emigration, lower-class immigration, stagnant or shrinking tax bases, and increased demand for services; all of these maladies have seriously hurt many older urban areas (Muller, 1975; Levine, Rubin, and Wolochojian, 1981; Rubin, 1982; Pammer, 1990). The parallel international phenomenon is the erosion of domestic industrial bases through flight to low-wage, newly industrializing economies and the parallel in-migration of casualized workers (Sassen, 1988).

Exacerbating broad patterns of socioeconomic decline is the gradual shift of most economies toward services, which are harder to tax than industrial activity. Taxes on services have proved very difficult to enact in places as diverse as Florida, Japan, Canada, and Australia because of political resistance from the buyers and producers of such services. Furthermore, to the extent that many personal services are carried out on a cash basis, such taxes are also hard to implement administratively.

In contrast to secular declines in revenue, the business cycle also often causes fluctuations in public revenues and expenditures (Bahl, 1990). Because Chapter Seven in this volume, by Michael Wolko, discusses this in great detail, we will only note here that the revenue flows of subnational governments are strongly procyclical. International bond markets place similar constraints on the smaller European and Australasian economies. Only the U.S. federal government now has an unconstrained ability to fund cyclic additions to its deficits.

The political concern, bordering on obsession, with international economic competitiveness has also become a powerful justification for constraining government expenditures and revenues. Just as the private sector has undergone downsizing in an effort to enhance productivity, efficiency, and profits, so too has the public sector. Where deficit reduction was once seen as primarily promoting domestic economic health through reductions in domestic inflation and interest rates, cutting back government is now seen as enabling countries to improve their economic standing in the world in terms of credit ratings, access to

global bond markets (Dull, 1989; Sinclair, 1992). Investment has been cut in the interest of the public sector, which has resulted in the steady erosion of the public services that citizens enjoy. In these instances, the domestic financial markets and the international financial markets exert a powerful influence on fiscal policy.

Political sources of stress are derived from the demand for public services and the costs that arise from these services. On the demand side, interest group dynamics, pressure for public goods, and in national and subnational settings, the political competition and the work rules for public workers all act to increase the costs of inefficient public policies and the overstaffing or redeploying resources (Dulles, 1980; Levine, Rubin, and Wolochojian, 1981; LaPalombara, 1975).

Politicians also find it difficult to resist the pressures for expanding social programs. Federal programs, such as supplemental security payments to expand the social safety net, or expansionist policies to enhance economic growth (Lamont, 1969; Derthick, 1980), are particularly subject to the demands of interest groups. Politicians respond more to groups and constituencies that demand public funds than to a valuable source of revenue, a dynamic powerfully illustrated by Doolittle (1983), in which local governments use public funds on all levels of government.

The supply side of fiscal problems is also rationalized by a great variety of forces. The growing cost of social programs causes, depending on the perspective of the analyst, the political theorists, for example, the overstaffing of the public sector, or the inability to reduce the public sector and maintain the status of the public sector and public service employees, who actively resist the latter.

Whereas rationalist theory views public actors as responsible for and competent managers of fiscal stress.
global bond markets, and inward investment flows (Kennedy, 1987; Friedman, 1989; Sinclair, 1997). The concerns for competitiveness and for attracting investment have also led to tax cuts, which of course put further pressure on spending. In the most extreme cases, such as in Ontario, Canada, 20 percent cuts in income taxes were tied to similar cuts in spending. Because this kind of pressure is politically mediated, it is worth considering more political causes of fiscal stress.

Political Sources

Political sources of fiscal stress can be divided into three categories: the demand for public goods, the supply of public goods, and ideological pressures on the public sector.

On the demand side, public officials are often vulnerable to constituent and interest group demands for services, despite limited resources or a need to reallocate resources. Employee unions are particularly cited in U.S. urban settings and in national negotiations in other developed economies with strong social democratic movements. Moreover, the structure of government and particularly the work rules for government personnel may themselves produce expenditure inefficiencies while limiting the ability of officials and managers to control costs or redeploy resources (Meltzer, 1971; Stanley, 1972; Levine, Rubin, and Woloshin, 1981; Ladd and Yinger, 1989).

Politicians also routinely shift costs to other jurisdictions while taking credit for expanding services or transfers. During the 1960s and 1970s, growth in federal transfer payments and grant programs encouraged state and local governments to expand their services and increase their expenditures (Sundquist, 1969; Derthick, 1970, 1975). Park (1994), for example, noted that central cities are particularly sensitive to changes in federal aid, while counties and suburbs respond more to state assistance. When these programs were cut in the 1980s, a valuable source of revenue for these governments was reduced (Nathan and Doolittle, 1983). Meanwhile, entitlements and mandates impose required costs on all levels of government (Weaver, 1988; Kettl, 1992).

The supply side of providing government services has often been characterized by a great variety of bureaucratic pathologies with either malign or benign causes, depending on the theoretical orientation of the analyst. Public choice theorists, for example, regard bureaucrats as revenue and expenditure maximizers (Downs, 1967; Niskanen, 1971; Meyer and Quigley, 1977). In this view, the inability to redeploy resources flows from bureaucrats who seek to expand their status and power by expanding their administrative authority and turf, and who actively resist redeployment.

Whereas rational choice theorists and their bureaucratic expansion models view public actors as self-interested and maximizing in their pursuits, the incompetent manager model sees politicians and public managers as often inept
and unable to administer complex organizations. In some cases, as in Washington, D.C., a public agency such as the city school district may receive more than adequate resources, but incompetent management may drive the agency into the red (Stanley, 1976; Martin, 1982; Rubin, 1987; Curry, 1990; Powell, 1997).

Finally, the ideological transitions that occurred in developed countries during the 1970s greatly affected the policies and programs of the public sector. Conservative attacks on activist government have largely focused on public spending and taxing. Populist "tax rebellions," such as Denmark's 1973 "earthquake" election or California's Proposition 13, have restrained revenue growth, while similar efforts have capped expenditures through spending limits and balanced budget requirements. This kind of tax and expenditure legislation has cramped fiscal policy at all levels of government (Buchanan and Wagner, 1977; Wildavsky, 1980; Kemp, 1980). A politics of controlling deficits and restraining government, which was most visible during the Reagan Revolution, has dominated federal budgeting throughout the 1980s and 1990s (Savage, 1988; White and Wildavsky, 1989; Pierson, 1994). The core of this ideological transformation is a profound distrust of politicians and the political system, which is why these rebellions have proceeded through citizen referenda and have culminated in tax and expenditure legislation.

**RESPONDING TO FISCAL STRESS: THE PRACTICE OF CUTBACK BUDGETING**

Politicians and managers at every level of government have employed a variety of budgetary strategies and techniques in response to fiscal stress. These techniques are generally labeled cutback budgeting, which in its simplest interpretation refers to reducing spending, increasing revenues, and changing budgetary processes to meet fiscal constraints. Moreover, as noted earlier, cutback budgeting is a subset of a broader response to fiscal stress called cutback management (Levine, 1978).

Cutback budgeting was of course practiced before academics coined the term. In his study, for example, of how school districts manage and seek out additional revenue sources, Porter (1973) identified two strategies at work: multipocket budgeting and marginal mobilizing. When practicing multipocket budgeting, school administrators first employed those funding sources on which higher authorities had placed the greatest number of administrative restrictions or which were dedicated to specific uses. Meanwhile, funds with greater flexibility were saved for later use as unforeseen and unfunded contingencies arose. In marginal mobilizing, administrators focused their revenue raising efforts on the most likely sources of income. Schools that suffered from fiscal stress en-

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For Schick, the fac-
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gaged in significantly different mobilizing activities than richer districts. Thus, both multipocket budgeting and marginal mobilizing constitute creative ways in which managers confronted constrained and shrinking resources.

The literature on local governments from the early 1970s also identified how managers engaged in privatization, outsourcing, and contracting among public entities as ways of responding to fiscal stress. Bish (1971) analyzed how local governments utilized these practices, and he noted that in order for these governments to cope with restrained resources they had to overcome the boundary problems associated with decentralization. One solution was shared agreements among public agencies that essentially centralized such financial decisions as purchasing while in the process preserving the bargaining rights of smaller governmental units.

The fundamental spending and revenue choices available to governments facing fiscal stress were outlined by Wolman (1980). Governments could reduce spending by cutting budgets according to object of expenditure, function, or program area, or by transferring functions, deferring spending, or defaulting. Revenues could be raised by increasing taxes and user fees, by liquidating assets, and by seeking revenue transfers from other governments. One question raised by Wolman was, What kinds of cuts are governments most likely to make given fiscal stress? In a summary of research he found that programs that were wholly locally funded would be the first to be trimmed, especially public works, parks and recreation, and sanitation.

The rules of cutting were also explored by Meltzner (1971), who found that budget analysts in local governments established their own lists of what should be cut. After following the incremental method of examining the previous year’s spending, the analysts targeted the increment and then cut in the following order: personnel, equipment, previously cut items, new facilities, and departments with “bad” reputations. Still other researchers identified attempts at rationally prioritizing cuts. Priority scaling, for instance, is one technique that rank orders political and managerial preferences, thereby saving valued programs from reductions while intensifying cuts in other governmental activities (Aldie, Mallen, and Foster, 1983).

In addition to these studies of agency and local-level decision making, the cutback literature produced broader interpretations of how fiscal stress influences budgeting practice and theory. In a series of three seminal articles, Schick (1983, 1986, 1988) assessed the theoretical consequences of fiscal stress in the form of decremental budgeting, microbudgeting adaptations at the level of administrative units, and macrobudgeting adaptations in national budgetary systems and processes.

For Schick, the fiscal stress of the 1970s and 1980s signaled the end of incremental budgeting as postulated by Wildavsky. Whereas incrementalism depended on budgetary growth for its familiar components of fair shares and
growing budget bases, fiscal stress, Schick argued, changed the nature of budgeting and rendered the incremental model obsolete. In place of incremental growth, politicians and managers faced decremental reductions. Incrementalism was distributive in that claimants received a slice of an expanding pie; it was stable in its decision-making process; and it was calming in its effect on politics. Decrementalism was redistributive in that claimants fought for what they could get from a shrinking pie; it was unstable in its decision-making process; and it contributed to political conflict. Decrementalism shifted the focus of budgeting from the increment to the base. It thus changed the nature of politics from fights about distributing gains to fights over how to calculate the appropriate baselines and inflationary adjustments for a static budget. Depending on the outcome of political fights over the appropriate baseline, cuts could be made in discretionary spending rather than in the more politically untouchable entitlements, while programmatic eliminations could be avoided even in discretionary accounts in favor of across-the-board reductions.

The end of incrementalism was also reflected in the rise of new forms of budgeting, particularly zero-based budgeting (ZBB) and program budgeting (PPBS). Both ZBB and PPBS were intended to improve the choices of decision makers, particularly in light of constrained resources, by stripping the budget down into new decision elements, whether they be programmatic functions or “decision packages.” Both reforms have experienced problematic results. The essence of ZBB, for example, requires recasting the budget into decision packages, with each package spelling out the goals, purposes, and financial requirements of the program. A common problem with ZBB, however, is determining the optimal number of packages. If packages are too small in that their programmatic and budgetary elements are too discrete, the number of such packages will overwhelm the decision makers; if the packages are too large, they may create overlapping programs, thus violating one of the purposes of ZBB. The time, resources, and extra paperwork generated by these reforms may cause decision makers to revert, consciously or not, to incrementalism (Novick, 1965; Hinrichs and Taylor, 1969; Broden, 1977; Worthley and Ludwin, 1979).

Schick’s observations on micro and macro budgetary adjustments were based on widespread transformations taking place in Western industrial countries, largely in response to fiscal stress. At the micro level, he identified many of the cutback techniques that had long been evident in the United States, namely budget freezes, across-the-board cuts, reduced hiring, marginal reductions in entitlements and transfer payments, raised user fees, the tightening of eligibility standards for program beneficiaries, the loosening of expenditure categories to enable greater flexibility, an increase in program analysis, and the rise of spending targets, sometimes in the form of target-based budgeting (Rubin, 1991). At the macro level, a number of European nations began to adopt many of the budgetary lessons that Americans had painfully learned in the effort to control federal deficits. In particular, Schick argued, the need for long-term focusing all limited fiscal targets, the power of fiscal targets, the need for fiscal targets, which were verified by the bureaucratic terms, reétat control, became the national effort in curbing deficits from national programs, ones favoring decreases.

New proposals in Europe, continued Schick, were in conjunction with the Performance Review and regulation, biennial budgeting, and earmarked funds. The legislative branch then could limit and spending cuts.

**CUTBACKS**

The new methods have rationalized the budgeting process. These four changes are associated with these efforts. All of these programs, based on reductions within legislative expenditures, are sources of public revenue, while sometimes increasing it.

Because the process is more complex than that in the past, the collection of non-U.S. governmentally means slow growth, but budgeting has come to be limited in Canada, the public...
federal deficit spending through budget resolutions and reconciliation. In particular, Schick pointed to a growing centralization of budgetary processes in which fiscal norms and targets, spending ceilings, baseline budgeting with its long-term focus on inflationary and programmatic costs, and multiyear budgeting all limited bottom-up pressures to increase spending. Moreover, in the preparation of national budgets, decisions were increasingly front-loaded in that fiscal targets, baselines, and spending limits greatly strengthened the role and power of finance ministers rather than agency ministers. Schick's observations were verified by von Hagen's study of European Community nations (1992), in which budgetary processes that centralized decision making in formal institutional terms, rather than simply depending on broad norms of budgetary control, became the necessary conditions for finance ministers to succeed in their efforts in cutback budgeting. Finally, both Schick and von Hagen noted the shift from national policies that promoted Keynesian-styled stabilization programs to ones favoring deficit control.

New proposals for budgetary reform, both in the United States and in Europe, continue this emphasis on processes that promote centralized control in conjunction with more operational autonomy. Vice President Gore's National Performance Review, for example, recommends a presidential budget resolution, biennial budgets and appropriations, and restrictions on congressional earmarked funding (Gore, 1993). Meanwhile, Congress granted to the executive branch the line-item veto, a potentially powerful tool in budgetary politics and spending control.

CUTBACK BUDGETING IN COMPARATIVE PERSPECTIVE

The new methods of cutback budgeting described by Schick and others are operationalized through four interrelated changes taking place in the public sector. These four changes have in common the introduction of practices usually associated with the hard budget constraints of the private sector (Schwartz, 1994). All of these processes are intended to reduce the ability of distributional coalitions based on interest groups, public sector unions, and concentrated interests within legislatures to impede budget reductions or reallocation of budget resources (Olson, 1982). They all place greater operational stress on managers, while sometimes compensating them through increased operational authority.

Because the pace and degree of change overseas has sometimes been greater than that in the United States, an analysis of these changes will encompass selected non-U.S. examples. In U.S. political parlance, cutting the budget generally means slowing the rate of growth of total expenditures. Elsewhere, cutback budgeting has often involved deep cuts in spending. In the most extreme case in Canada, the provincial budget of Alberta has been cut 20 percent in nominal
terms from FY93–94 through FY96–97, and thus substantially more in real terms. The rapid migration of ideas such as public choice economics and of reinvention idea merchants such as Ted Osborne and David Gaebler across borders means that policy change in the United States is no longer isolated from broader world currents; Schick, for example, conducted a detailed survey of changes in New Zealand’s budgeting practices in the mid-1990s that Washington think tanks rapidly incorporated into their solutions for controlling spending (Schwartz, 1994; O’Quinn, 1996).

Hard Budget Constraints

Hard budget constraints have been used at virtually all levels of government to slow the rate of growth of expenditure or to cut expenditures in response to revenue declines. These constraints—combinations of legislative and institutional changes—all limit the ability of politicians, cabinet or portfolio ministers, agency heads, and subagency management to exceed predetermined spending limits.

Constraints on Politicians

Eighteen U.S. states and four Canadian provinces have some form of legislative limit on the imposition of taxes, and more frequently on the growth of expenditures. In ten of the U.S. states these limits are constitutional; in the remaining states and in the Canadian provinces they are merely statutory. These laws generally limit spending to a defined fraction of per capita personal income in the state. These laws hinder the ability of politicians to fund agencies’ budget overruns, even when this is politically desirable. They differ from balanced budget requirements in that they explicitly limit spending rather than simply mandating balance.

Many states and provinces have also adopted informal, cabinet-level practices that also constrain ministers’ ability to expand their department’s funding. These practices generally involve the creation of formal or informal cabinet subcommittees that have the final say on all spending and that act to redistribute resources across programs. These “inner” cabinets parallel the older, well-established use of nominally apolitical control boards or the city manager system at the municipal level. At the national or provincial level, for example, Australia, New Zealand, Alberta, British Columbia, and Ontario all have standing cabinet committees with central power over spending decisions. Of these, Alberta has the most interesting and elaborate system for disciplining politicians, and because this system has held up through four years of cutting at levels unheard of in the United States, it is worth examining briefly.

After election of a government committed to budget cuts in 1992, all ministries were told to prepare plans for two different levels of cuts, either 20 percent over four years or 40 percent over four years (Schwartz, 1997). All ministries were targeted for cuts to claim that it was necessary to avoid cuts within the cabinet. Most programs’ political units opposed the cuts, followed by the ministers and the cabinet. However, the premiers prepared the cuts, not to avoid cuts, but because cuts would provide them with more flexibility for disbelief.

This budgeting process targeted all the areas of government. The six ministers of policy committees were all forced to restructure programs. The leadership position of the minister of finance was weakened, but eventually the minister of finance gained a victory by convincing the cabinet to agree on budget cuts.

The premiums were seeking a share of the discipline spending, and the cabinet agreed because it was necessary to balance the budget. However, the premiums’ attempts to discipline spending were successful because the cabinet agreed to the cuts.

Tax and expenditure limits have also been legislated to provide a greater degree of discipline and to depoliticize the process of relocation of expenditure between different levels of government. In Canada, the provinces have legislated limits on their expenditures and instead of being allocated to the federal government, they are allocated to the provincial governments. In the United States, however, the federal government has legislated limits on its expenditures and instead of being allocated to the states, they are allocated to the federal government.
were targeted for cutting, making it difficult for any one ministry or client group to claim that it was being unfairly targeted. A small priorities subcommittee within the cabinet then shuffled funds among programs on the basis of the programs’ political and substantive importance. Education received the smallest cuts, followed by health, but everything else took deep cuts. The 40 percent scenarios prepared by other departments allowed their budgets to be deeply cut, but because cuts rarely approached the full 40 percent level, there was also some relief.

This budget exercise was linked to changes in the way ministries receive funds. The sixteen ministries are grouped by function under four standing policy committees (SPCs). SPCs are chaired by backbenchers (members not in leadership positions), membership is open to any backbencher, and majority vote prevails. Because many backbenchers were elected on promises of spending cuts and no tax increases, they have had an incentive to scrutinize department budgets and force cuts in order to be able to claim to voters that they have delivered on their campaign promises. The SPC structure allows backbenchers to gang up against specific ministers to force them to stick to their original budget targets by cutting what appear to be either politically or substantively marginal or unnecessary programs. The SPC system isolates ministers as spenders while converting the much larger number of backbenchers from individuals all seeking a share of the budgetary pie into a group with a common interest in disciplining spenders. Ministers meanwhile act as watchdogs of other ministers through their participation in the SPCs that do not monitor their own particular department.

Tax and expenditure legislation and fiscal centralization are statistically associated with slower rates of per capita spending and lower interest costs for general obligation bonds. U.S. states with above average growth in spending have grown at below-average levels after tax and expenditure legislation has been passed, although the direction of causality is somewhat unclear (Poterba, 1994). The purpose of tax and expenditure legislation in cutback budgeting is to depoliticize the reallocation of budget shares allocation and to move the politics of relocation into the hands of a much smaller, strategically oriented group of politicians. Like the nominally apolitical control boards of U.S. cities, legislatures and inner cabinets have their own clients.

Recent research suggests that successful cutbacks are more likely to occur under conservative rather than liberal governments (Alesina and Perotti, 1995). Unsurprisingly, right-wing governments are more likely to cut spending to bring budgets into balance, while leftist governments are more likely to tax. Successful episodes of budget cutting in New Zealand, Denmark, Australia, Sweden, and elsewhere in Canada were all accompanied by the centralization of authority for the distribution of budget shares as was done in Alberta. In contrast, in the United States, where power over the budget lies in the legislature rather
than in the cabinet, different institutional arrangements have been required to
effect budgetary discipline. The Gramm-Rudman-Hollings legislation, for ex-
ample, set upper limits on the spending of appropriations subcommittees by
way of the 602a and 602b allocation process, thereby forcing zero-sum trade-
offs on spending. These rules have promoted the centralization of budgeting, as
has occurred in other countries (Savage, 1991).

Constraints on Agencies

The centralization of allocational authority over budgets into inner cabinets
has been paralleled by a decentralization of operational authority to agencies.
Basically, the trade-off here involves giving agencies hard, fixed budgets but
shifting from strict control over inputs to a focus on agency outputs through
performance-based budgeting. The British Financial Management Initiative of
1982 is the first modern incarnation of this system.

This form of budgetary control goes under various names, such as mission
driven, envelope, block, or global budgets (Osborne and Gaebler, 1992). The
idea, however, is simple. Agencies are given a block budget, or sometimes a
block budget with subblocks for broad categories of expenditure such as "per-
sonnel-related" or "non-personnel-related" expenses, for the year. They may
spend from this budget freely—input controls having been relaxed—but they
may not come back to the central government for more money if they run out
before the end of the fiscal year. This method shifts the risks of cost overruns
from the central budget to local managers.

The more subtle forms of block budgeting give agencies significant freedom
to run themselves internally. Generally this involves decentralizing to agencies
collective bargaining when it exists, as well as pay scales, job titles, and other
personnel decisions such as hiring and firing. Many governments, however, re-
tain control over hiring in order to prevent an expansion of public sector em-
ployees. Finally, agencies can sometimes carry over budget surpluses from year
to year, which may smooth spending, encourage agencies to look for efficiencies,
and reveal "slack" to central decision makers.

Block budgeting is sometimes associated with formal contracts between ser-
vice providers and the relevant ministry or department. Budget resources are
tied to the outputs specified in the contract. This kind of budgeting allows the
center to substitute contracted out or privatized versions of service provision
more easily, because it has already freed itself from any need to monitor any-
ting more than contract performance and payment. Monitoring contracts in-
volves costs and difficulties, of course. In New Zealand and other polities that
have used contracting extensively, auditors general have seen their power and
departments expand (Boston, 1995). At the same time, contracting out some-
times destroys an agency's ability to monitor contracts by eliminating person-
nel who have the specialized knowledge needed to monitor performance.

Block budgeting, of course, is not a monolith. In many instances, it has pro-
duced all manner of new rules, regulations, and structures, and analyses of
these rules make it difficult to attribute performance to the center's centraliza-

In many U.S. states and provincial public sectors, block budgeting rules, centralized
control over the hiring of personnel, and the hiring of high-quality personnel
have been in place for many years. However, the recent trend toward flex-
hire, high-quality personnel, and the creation of new flexible work sta-

This change has extended into the public sector, with new forms of flexible
work arrangements and new forms of budgeting. For example, in the United
States, the federal government has adopted a "zero-based budgeting" system
that requires agencies to justify every dollar spent, as opposed to basing
spending decisions on previous year's allocations. This has led to a greater
focus on performance and accountability, as agencies are held responsible
for the outcomes of their spending decisions.

In some cases, this has resulted in increased transparency and accountability,
with agencies being required to provide detailed information about their
spending and outcomes. This has allowed for greater public scrutiny and
increased confidence in the budgeting process. In other cases, however,
the increased focus on performance has led to conflicts with other goals
such as equity and social welfare. Balancing these conflicting goals is a
significant challenge for budgeting policymakers.
Block budgets also make it possible to use across-the-board cuts more effectively. In the past, making these cuts in the context of line-item budgets produced a great explosion of problems, as agencies found it impossible to shift money from one area to another, which produced a smaller-scale version of the reallocation problems the center faced. Furthermore, the pay freezes associated with across-the-board cuts demoralized the workforce. In contrast, block budgets make it difficult for agency managers to excuse their failures with reference to the center's overly burdensome regulation, supervision, or ignorance of the realities of personnel management. Instead, managers must allocate increasingly scarce resources between pay and other necessities. In turn, the center is able to excuse its budget cuts by saying that managers freed from tight input controls should be able to make their units operate more efficiently. In Australia in the 1980s, for example, uniform, preannounced annual budget cuts were labeled "efficiency dividends." The practice is widespread, albeit under different and less opaque names.

Block budgeting slides seamlessly into contracting out. This widespread phenomenon, practiced most extensively at the municipal level by Indianapolis, Philadelphia, and Phoenix, is only gradually spreading to other countries. If we compare countries that operate at a scale equivalent to these U.S. municipalities, however, contracting out sometimes rivals or exceeds these paradigmatic cases. For example, New Zealand and Victoria, Australia, both of which in population and economic terms are roughly the size of metropolitan Philadelphia, have extensively replaced internal public production with contracted or privatized services. When there are enough firms to support competitive tendering, competition tends to push down the real cost of services as wages, particularly for unskilled and semiskilled workers, are reduced and as permanent jobs are turned into part-time and other forms of contingent employment.

Constraints on Personnel
In many U.S. municipalities, as well as in the highly unionized national or provincial public services of many other industrialized countries, union work rules, centralized collective bargaining, and rigid pay scales have been accused of obstructing efficient use of government personnel or of making it difficult to hire high-quality skilled workers of all sorts from the private sector. In varying degrees, existing tenure, seniority, job classification, and uniform pay systems in the public sector have given way and managers have gained the power to hire and fire, to set fairly individual pay scales—including incentive pay—to set flexible work hours, and to determine individual job responsibilities. This change has extended to senior civil servants as well. These changes are paradoxically more prominent, however, in politics with relatively stable public sector budgets, and less salient in those in which simple privatization has occurred.
Thus British Columbia, for example, has maintained relatively stable budgets and public sector aggregate employment, in part because the use of enterprise bargaining, widespread redeployment and retraining of personnel, and limited incentive pay in effect gives the center the ability to redeploy resources. In Alberta and Ontario, by contrast, the provincial government has simply fired double-digit percentages of public employees, relieving pressure to get a more flexible workforce. In the United States, cities such as New York, Philadelphia, and Washington, D.C., have seen very rigid union work rules give way in the face of budget crises.

Enterprise or agency-level bargaining and individualized pay, of course, allow market pressures to impinge upon both management and the employee. Managers can offer larger salaries to retain skilled personnel who are in strong demand in the private sector, such as computer specialists. At the same time they can reward more productive employees. Explicit benchmarking of agencies against private sector equivalents, department or ministerial norms, or other public sector providers also indicates the efficiency of agency operations. The Australian Bureau of Industry Economics now devotes itself to the constant benchmarking of an extensive array of public sector agencies against global norms; Alberta and Ontario have built quality-of-service indicators into their ministries’ annual business plans; and everywhere auditors general have come into their own as the surveillance of contracted services has grown.

**Competition and User Fees**

Many of these changes would be meaningless if agencies did not face real competitive pressures or have to compete for consumer dollars in a marketplace. Market pressures are ultimately what make it possible to deliver the same level of services with fewer resources. Either agencies find internal productivity gains or, by imposing user fees, generate revenues sufficient to cover the shortfall from their old budgetary levels.

User fees are now widespread and have begun to replace more general tax increases. U.S. parks now charge substantial access fees, for example. Medical care financed by quasi-insurance-like schemes such as Medicare in the United States or Canadian provincial medicare have seen premium increases, more and larger copayments, and in some cases more queuing as care is managed by third parties.

**THE LESSONS OF CUTBACK BUDGETING**

The overarching response of the public sector to fiscal stress in the era of cutback budgeting is the increasing centralization of the budgetary process at all levels of government throughout the industrialized world. Whether the devices are spending targets, shared resources at the top of the budgetary decision-making hierarchy or outside the hierarchy, a new democracy in decision making has been created more by the budgetary process than by the budget.

Cumulative decentralization and the rush to assemble privatized competitive bids for scarce public resources has sometimes meant that even relatively good local providers, like schools and hospitals, have been forced to undergo financial restructuring or dropping of programs or services, changing the fiscal profile of public expenditure into a completely different one. The budgetary decision-making process has been decentralized in its effects, managers deciding what programs to cut and how.

Among these, the most impressive have been the efforts of competition proponents to introduce competition in the field of competition bidding in government services. A generation of competition has not been the result, but a new model of competition and management, and a new approach to government contracting has been created.

These changes have been an attempt by governments to manage programs that were becoming unfashionable. Not surprisingly, they have been met with resistance. Should governments ask the same question of the traditional side of the budget? Should the primacy of “price” be challenged by the primacy of “quality”? Should Proposition 13 be replaced by Proposition 13.

Centralization of authority, particularly at the centers of government, has been the hallmark of the budgetary process through the nineteenth century. It is true even for local governments. For example, the Alberta government in the mid-1980s consolidated its budgetary control over municipalities and school boards, and had its directorates as is integrated into its budgetary processes. Flexibility for personnel management and budgetary strategy...
spending targets, ceilings, or reconciliation, politicians who allocate scarce resources at the macro level have centralized the process to help insulate budgetary decisions from interest groups and other claimants, both inside and outside the legislative process. These new procedures impose constraints on decision makers, managers, employees, and other vested interests, all in order to create more fiscal and political flexibility in what is essentially the global public budget.

Cumulatively, these changes have made the public sector more closely resemble private sector enterprises. Private sector enterprises routinely have to bid for scarce investment resources from central management, are refused additional resources when they overshoot their budgets and run losses, and eventually go bankrupt if they cannot generate a clientele or compete against other providers. In this sense, cutback budgeting exhibits a cultural side as well as a financial one. Particularly at the agency level, cutback budgeting is about changing the culture of the public sector from a procedural, input-control mentality into a customer service, least-cost-by-any-reasonable-means mentality. The budgetary and management changes associated with cutback budgets force managers to consider the real, long-term costs of programs and their associated spending. Conversely, only in a very few localities, New Zealand being foremost among these, have managers been asked to calculate rates of return for the capital invested in their departments. Nonetheless, the critical similarity of cutback budgeting in government to budgeting in the private sector is the introduction of competition for resources and clients, and in some instances real fear that an agency will be shut down.

These changes make it possible to consider the financial trade-offs among programs that in the past would have been subject primarily to political tests. Not surprisingly, where budgets have been cut in nominal terms, the question, Should government really be doing this? frequently arises. Private sector firms ask the same question every day. Cutback budgeting thus is simply the operational side of the general decline in both the power of the public sector and the primacy of "private" as opposed to "public" consumption that started with Proposition 13 in California in 1978.

Centralization is a two-edged sword, however. On the one hand, greater concentrations of political and administrative authority are required in the budgetary process to confront this ongoing, hostile fiscal environment. This holds true even for line managers, who should attempt to centralize the resources under their purview in order to exert the same kinds of control over their subordinates as is imposed upon them. On the other hand, these managers require administrative flexibility in order to succeed in realizing their organizational goals. Flexibility is required to administer standard agency functions, such as personnel management and purchasing, but it is also necessary to select proper budgetary strategy, to determine, for example, whether there should be across-
the-board cuts, freezes, or targeted reductions. Managers also require flexibility in their programmatic accounts, so that funds may be reprioritized to true areas of need. Finally, because raising revenue is often a more difficult political task than freezing or cutting spending, managers would also benefit from greater flexibility in their opportunities to create new revenue flows, an organizational trait that is also characteristic of the private sector.

References


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