

migration into positions where new views can be implemented. The major possibility for your most rapid success is government. It is not the perfect vehicle for social rejuvenation; but it is the one which is most accessible to you. It will not stand the strain of revolution, but it will yield to intelligent and persistent internal pressure for change. You can, I believe, exert a healthy pressure for a new approach to public policy,

including educational policy, which is free from the myopia which insists that our system cannot be structurally improved because it is already superior. You already have allies, you know, in the ranks of government. While they may not be in the majority, there are many who are confident that your influence will be healthy and progressive. Along with them, I look forward to your arrival.

## WHY NEW METHODS OF BUDGETARY CHOICES? ADMINISTRATIVE ASPECTS

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*Editor's note:* This is a slightly revised version of a presentation made by Mr. Niskanen, assistant director for evaluation, OMB, to the International Institute of Public Finance in Nuremberg, Germany, September 14, 1971.

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### What "New" Methods?

A good analyst, according to the textbooks, always addresses a broader question than the one posed. An appropriate introduction would be to first address the question, "What new methods of budgetary choices?" The new methods at issue, presumably, are microeconomic analysis, program accounts, and the related planning, programming, and budgeting concepts. At this time, however, these methods are no longer new. More importantly, the U.S. experience with these methods suggests that, as yet, they have neither substantially changed nor significantly improved the process of making budgetary choices.<sup>1</sup>

After over 30 years of formal cost-benefit evaluation of water resource projects, most new projects yield only a nominal return, supplying subsidized water to grow subsidized crops. The progressive improvement in the evaluation guidelines have been eroded by looser estimates of costs and benefits, and most everyone seems satisfied; analysts have their principles, politicians have their "pork," and water users have their projects. Most

of the U.S. federal budget was reorganized on a program accounts basis over 20 years ago; this reduced one of the constraints on efficient management without improving the incentives of government managers. Cost-effectiveness analysis has been used to review defense programs for around 15 years, and a formal PPB system has been used for 10 years; for all that, it is not obvious that the efficiency of the U.S. defense program has improved over that period. A formal PPB system was instituted by the major domestic agencies over five years ago; this system was not effectively integrated with the regular review processes, and the formal elements of this system have recently been abandoned. This experience does not provide a basis for concluding that these "new" methods have either reformed or improved the process of making budgetary choices.

Some of the advocates of these methods contend that the budgetary process would have been even less satisfactory without the use of these methods, but this assertion is untestable. Others complain that these methods would have been more effective if it were not for institutional and political constraints, but this assertion begs the important issue. Other advocates of these methods, including myself, contend that they have a substantial *potential* value that will depend on their integration with the regular review processes and a recognition of the important institutional and political conditions that affect budget choices.

### Why New Methods?

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 this 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? For business firms, standard accounting methods and the market valuation of the equity provide moderately good answers to the first question; the accounts plus a rather simple economic calculus also contribute to answering the second question. The value of these methods, however, is critically dependent on the institutions of the business community. 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. And free entry is a necessary condition to protect the public interest.

Governments, however, do not face the conditions that make the economic calculus and good accounts relevant to a business firm. Most government agencies do not sell their output at a unit rate; as a consequence, there is no objective valuation of the output or measurement of profits. In addition, there is no frequent objective indication of the overall performance of a government. As a rule, the expenditure accounts measure cash disbursements, not costs, as they do not measure accrued assets and liabilities. A balance sheet could be developed for government agencies; this is seldom done, however, as the liquidity and credit rating of government is more dependent on its ability to tax and print money than on its net asset

position. The objectives of political and bureaucratic institutions are not widely understood, but it is clear that these objectives do not provide consistently strong incentives to use the economic calculus. And finally, governments are monopolies and have the power to maintain that status. A government, in effect, is a nonprofit 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. Neoclassical welfare economics focused on the imperfections of the market economy and how to alleviate these imperfections. What is now needed is a "new welfare politics" to focus on the imperfections of the government economy and how to alleviate these imperfections. The first case for new methods of budget choices is that our present processes do not work very well. The second case must be that some new methods would work better.

#### "Administrative" Problems

Why did the formal PPB 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 the political and bureaucratic institutions of government. I will use the term "administrative" problems to describe the range of problems that developed between the PPB system and these institutions, but, as will be developed, many of these problems are analytic and conceptual problems of the PPB system and some of the problems are institutional problems.

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 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. This search

also assumed that there are obvious, generally accepted objectives against which activities could be assessed. In fact, of course, most activities contribute to several objectives. Moreover, this is probably requisite for initial and sustained approval of the activities. The coalition necessary for approval will include people who support the program for different reasons — some who desire one or more of the program outputs, some who desire the placement of a facility or contract in their district, etc. The development of the PPB accounts faced the choice between program categories that were too broad to be operational or were specific to each activity, generally opting for very broad categories. 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 five-year defense program displayed only the future implications of present decisions and did not represent either a commitment or a prediction of future activity levels and budgets. Present decisions, of course, do restrict or modify the set of possible future decisions, but need not restrict this set to the one presented in the five-year program display. This 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 decision makers, 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. A PPB system implicitly assumes a traditional Weberian model of the bureaucracy and political system in which the objectives of all parties are consistent and the review process is only a sequential filtering of the original proposals. This model may accurately describe some governments (although I am skeptical), but it does not describe the relations between the agencies and the review authorities in the U.S. federal government except, possibly, during a generally perceived crisis. 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 adversary process also describes the relations between the President and his appointed department heads; the first Director of the Bureau of the Budget described the members of the cabinet as “the vice presidents for spending and, as such, the President's natural enemies.” In this context, any information and analysis system which “illuminates” the activities and effectiveness of the proposing agencies is a threat to those agencies and will be resisted or subverted. Information is not a product of nature, like gold to be found and refined, but is the product of a human and social process. An agency will submit only that information that can be effectively mandated and that which it believes will serve its own interests. In the early years of the PPB system, the Bureau of the Budget frequently asked the agencies to perform studies that questioned their fundamental program and bureaucratic interests; one should not be surprised that the responses to these requests were usually indefinitely deferred, obscure, or self-serving. I do not personally know of any way to structure an objective review process in an adversary environment. A good understanding of the bureaucratic and political institutions of government, however, can be used to make an adversary process work better.

## 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 substantial contributions that analysts can make: the "defense" model and the "national income" 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 most 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 governments?
- (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. It may be valuable for the federal government to finance some research on the production of local public goods, because this research itself may be a national public good, but the value of this research will be realized only by the final production units and their constituents. An understanding of the operational environment, the relevant technology, and simple maximization techniques is often sufficient for defense analysis. In contrast, an understanding of social and institutional behavior plus a normative theory of government in a federal system is often necessary for domestic program analysis. The analyses of federal domestic pro-

grams, to be relevant, requires a shift from "systems analysis" to "political economy."

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 "national income" model has no normative content 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. Many of the high-return public projects are in high income growing areas, but the political system reveals a preference for projects in low-income declining areas. Many of the high-return "human resource" programs are specific to healthy young adult white males, but the political system reveals a preference for helping the aged, the young, the disabled, and minority groups.

In our system, at least, distributional considerations are the essence of politics, and the "national income" model's exclusive focus on allocative conditions often leads to either incorrect decisions or rejection of the analysis. Only when the same group bears both the costs and benefits or the losing group is sufficiently compensated does even the best cost-benefit analysis provide a sufficient basis for decisions on public investment activities. 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, nonmonetizable 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. As a rule, to make best use of scarce analytic resources, analysts are best advised to start any study with a

recognition of the distributive preferences of the political system for which they work.

One final problem of making budgetary choices for the U.S. federal government should be mentioned, although this problem is not specific to the PPB system. The preparation of the national budget is unusually and, I believe, unnecessarily complicated by consideration of the presumed fiscal impact on aggregate demand. This concern sometimes leads desirable activities to be deferred during high-demand periods and more often leads to approval of many undesirable activities in response to the political pressures generated by a weak economy. I suggest that this is an unnecessary complication for two reasons: First, budgetary decisions are most strongly affected by fiscal considerations at the peaks and troughs of economic fluctuations, but their effects are usually delayed for a year or more. At best, for any given fiscal effect on aggregate demand, the budget is a very blunt instrument for this purpose and, at worst, the budget may be destabilizing. Second, there are increasing doubts whether, for any given money supply, there are *any* fiscal effects on aggregate demand under conditions the United States has experienced since World War II. But this problem deserves another paper. On net, my own preferences would be to make public expenditure decisions independent of their presumed effect on aggregate demand.

### Some Suggested Changes

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. Analysts, by themselves, cannot change the structure of government and the necessary consensus for these structural changes will not develop in the near future. Analysts who work for a government, thus, are best advised to accept its general structure as given and to make those changes in their own role that will improve their effectiveness in these conditions. At the same time, I encourage the better public policy analysts in other institutions to devote more attention to the analysis of alternative structures of government. The remainder of this paper summarizes some of the changes that can improve the information analysis for budget-

ary 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.); and region (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, and 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. Consideration 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. The review authorities also should have a sufficient independent evaluation capability to serve as a

deterrent to poor agency studies, as an example, and to maintain their competence.

- (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 distributive 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 responsive. 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.

#### Note

1. Most of this article is directly specific to the federal government of the United States. The author's comments are probably less relevant to governments that perform different functions and/or have substantially different political institutions.

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