OUTYEAR BUDGETARY CONSEQUENCES OF AGENCY COST SAVINGS:

INTERNATIONAL PUBLIC MANAGEMENT NETWORK SYMPOSIUM

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ABSTRACT

At the end of November 2004, well-known and highly respected scholar Steven Kelman of the Kennedy School of Government at Harvard University asked a question about research on outyear budgetary consequences of agency cost savings. Kelman's question stimulated a dialogue on the topic on the IPMN listserver that is represented in this symposium, in roughly the order in which comments were transmitted, with only minor editing. The dialogue tells much about current views on the utility, or lack thereof, of research on outyear savings and the wisdom of allowing agencies to carry-forward savings from one year to another.

INTRODUCTION

At the end of November 2004, well-known and highly respected scholar Steven Kelman of the Kennedy School of Government at Harvard University asked a question about research on outyear budgetary consequences of agency cost savings. Kelman's question stimulated a dialogue on the topic on the IPMN listserver that is represented in this symposium, in roughly the order in which comments were transmitted, with only minor editing. The dialogue tells much about current views on the utility, or lack thereof, of research on outyear savings and the wisdom of allowing agencies to carry-forward savings from one year to another.

THE DIALOGUE

1. **Steven Kelman, Harvard University**

Does anybody know of any academic research (either empirical or policy proposal-type) on the issue of what happens to government agency budgets at time t+1 if they achieve cost savings (e.g. efficiency savings) at time t? The widespread perception inside the US government (and I suspect elsewhere?) is that efficiency savings at t will invariably lead to a l00% tax on the savings at t+1 -- i.e. that if an agency saves $l0 million, its budget the following year will be reduced by $l0 million. People inside government regard this, not surprisingly, as a strong disincentive ever to achieve such savings, and would like to be able to be allowed to keep at
least some of the savings to plow into program delivery.

Is there any academic work on this topic, broadly conceived -- ranging from "does this really actually happen?" (Or is it an urban legend) to "are there any ways to deal with this problem?" While multiyear budgeting in some sense just extends the pain (you can

keep savings for 2 years, but no more), I'd be interested in any research that empirically or theoretically addresses the consequences of multiyear budgeting on government agency behavior.
Thanks in advance for your help thinking about this!

2. Dan Williams, Baruch College

Hi Steve. I am curious about the implied assumptions in your question. For the most part, government agencies are not corporations or anything like a corporate form. You, of course, know that their assets and income are really the assets and income of their parent government. Occasional earmarking or special funds may produce deceptive perceptions otherwise, but it is deception as becomes all too clear in fiscal emergencies.

So, I don't quite get the question about 100% tax. In a typical government (I am afraid I was a budget director in a state agency in Virginia before I became a professor), the budget authority expires at the end of the budget year. Left over money is not left at the agency; it is expired spending authority. It doesn't matter why it is left over: savings, incidental balances, and failure to deliver programs gross over estimation of need, or something else. They all lead to the same thing, expired authority. In most cases no one's going to be sure which explanation really sticks (except for incidental balances) without an audit -- a more than the typical end of year audit. --I am absolutely certain you know all this. --It would hardly be wise for the parent government to leave spending authority from a prior year budget with the agency under these circumstances. And besides, what is it spending for, the year is over, everything that money can be used for in that year is in the past. Of course, if you have unrestricted spending authority for a substantial sum of money for discretionary decisions in the future, that's nice. But what if you spend it before the (hypothetical-enhanced) audit is over and then it turns out you didn't really have efficiencies, you just didn't deliver services...

At the state and local level, unrestricted discretionary funds seem almost corrupt. Does the federal government have anything like this?

Now, maybe you don't mean to keep this prior year spending authority. Maybe you are anticipating that when the agency saves a hypothetical $10 million, the central budget office will naturally REDUCE the agency's recurrent operating budget in future years by $10 million. Perhaps you are suggesting the agency might or might not have a leg up in keeping the $10 million recurrent for other pressing needs or even service expansion. Is that what you are asking about? That is, indeed, an interesting empirical question. The really smart agency would go a step further, right, and just do what it could to keep quiet about the savings and use it up on pressing needs and service expansions without seeking overt permission. Thus, when it would come time to calculate the recurrent budget, there would be no savings. Wouldn't that have to be part of the empirical question, as well?

3. Larry R. Jones, Naval Postgraduate School

Steve:
Generally speaking, US federal government budget execution is guided by the perception on the part of budget spending agencies that if they don't obligate 100% of what they are appropriated by Congress then OMB and the congressional appropriation committees (House and Senate) that approve their appropriations may assume they did not need all that was appropriated and "mark" their budgets (make cuts) accordingly. Therefore, the agency view is "spend it or lose it." Still, in some cases cuts follow under-execution while in others budgets are not reduced. Why are cuts made in some cases and not others? One might hypothesize a number of explanations but developing and sustaining good relations to gain the confidence of those who control your budget are keys, as Wildavsky pointed out in 1964 in The Politics of the Budgetary Process. However, I do not know of any empirical work in public budgeting that explores the questions you pose.

Proposals have been made to extend the period of obligation for one year appropriations from one year (as per current appropriation law) to two years. This would permit savings achieved in year 1 to be carried forward to year 2, with end of year close-out of these accounts at the end of year 2. End of year 1 status reporting to Congress and OMB would be required but accounts would remain open for obligation into and through the second year. I have argued in favor of this approach with staff of GAO and CBO because I believe it would give agencies much needed flexibility and help to eliminate some wasteful practices (spending money on low priority items) that result from end of year obligation "blitzes." The end of the year spending rush by agencies is intended just to get money spent so that the agency obligation rate (for the account or accounts for which obligation authority expires after one year) approximates 100%. A change to a 2 year period for obligation would not result in multi-year budgeting -- this is a separate issue. Under the option I have proposed, Congress would continue to appropriate annually. The only difference is that money made available to agencies in one year accounts could be spent over a 2 year period. This change could be made with a simple modification of appropriation law by Congress.

4. Richard Dawe, Naval Postgraduate School

Steve/Dan,

My experience is from Defense Working Capital Fund management in the department of defense which is a bit different than a more typical appropriated budget activity whether in a defense agency, state government agency or department. Although in a working capital fund one must stay within an AOB or budget approved by the DOD Comptroller, you have a bit more flexibility in how such savings or efficiencies might be applied to emergent, priority unfunded requirements. This flexibility, in my opinion and experience, is authorized by higher authority (and the Congress) to allow managers of these funds require greater means for agility to react to changing defense requirements and missions that are supported by their activities, products and services. As such, working capital funds do have some ability to leverage cost avoidance and savings through efficiencies (in the year of execution) which absolutely allows a greater incentive for organizational members to constantly strive to become more efficient.

They, like all organizations to my knowledge, always have execution year unfunded requirements that they otherwise not have the reserves to cover.

Having said this, one must of course always be very careful not to violate purpose, time or amount constraints imposed by Congress which would lead to an Anti-Deficiency Act violation. As a corollary comment; prior to my current position as an Assistant Professor of budget and financial policy, and working capital fund management background, I was responsible for operational U.S. navy budgets/funds and I agree with the premise of Steve's question, that current practice, at least in DOD, provides incentive to spend out all remaining funds because it will almost surely result in a budget mark (reduction) in the following budget. In my opinion, there is absolutely a need for research or informed inquiry to evaluate incentives and any existing disincentives in government budgetary processes, and in the DOD in particular.

5. Rob Laking, Victoria University of Wellington

Don't be afraid, Daniel. All us ex-budget directors think the same way - the surplus belongs to the taxpayer. Although it's never really been clear to me why the natural rhythm of public spending should equate to the time it takes the earth to circle the sun. The interesting question is as you say what sort of behavior does this produce in response from departmental budget managers? My impression is from an analysis of the NZ quarterly expenditure reports that it can produce quite a strong sawtooth effect: departments manage cautiously in the early part of the year and when they realize they are going to undershoot they accelerate spending in the last quarter. That gives rise to the well-known phenomenon of the desperate call for consultant bids in April-May (we have a June budget year).

6. Daniel Williams, Baruch College

Rob: So it seems we are looking at 4 options, so far. (1) Actually holding onto the actual budget authority for the saved money (like a little bank account), which is approximately what Rich Dawes says he does/needs and the upshot of Larry’s 2 year spending for one year appropriations. (2) Getting/Not getting “marked” for the subsequent years. (3) Reprogramming before anyone gets wind of the possibility of getting marked for subsequent years (and before the savings materialize in the current year). (4) Wasteful year end spending to avoid getting marked for subsequent years (consultants as you say; I’ve seen it as new desks and chairs). (5) Getting marked, but being first in line (or near the front of the line) for the freed up cash.

At the moment, I can’t think of any more options, but I am sure someone else will soon.

The popular reading on this topic suggests that #4 happen at every agency every year and we need #1 to fix it. Except in special circumstances, I would think #1 is a very bad idea, but #5 might not be so bad an idea. Rob, we us rotation around the sun, ‘cause we don’t have to do anything to get a recurrent period longer than a legislative hearing.

7. Larry R Jones, Naval Postgraduate School

Thanks Dan. Explain why you believe what you identify as option # 1 is a bad idea. You are the first person out of a number I have discussed it with to reject this approach -- GAO and CBO have been supportive. However, they indicated that the real issue is to persuade congressional appropriators that the idea would not disadvantage them. Option 5 that you support (as do I) is simply the status quo. ---

8. Colin Talbot, University of Nottingham

I have read some of the other exchanges but I thought I'd go back to Steve's original question - to which the answer is - yes. There are lots of international examples of various forms of flexibility. It is worth just making a bit of conceptual clarification tho:

- annual budgets might be varied by allowing "end year flexibilities" (as in the UK) where unspent money can be rolled over or even brought forward, within limits;

- where agencies generate income budgets can be (i) budget + income goes straight to treasury/finance ministry; (ii) net of costs - i.e. agency retains money to defray its costs including extra costs generated by extra work (i.e. income generation) (iii) 'trading accounts' where an agency has to cover its expenses - in this case it can also either pay over all surpluses or keep an agreed percentage to reinvest In Jamaica the new executive agencies usually had a 50/50 split on surpluses)

- where agencies are allowed to keep a proportion of savings made from cost cutting or efficiency gains (in the current UK "Gershon" £21.5 billion program departments keep all the efficiency savings which are meant to go back into improved public services).

None of these, it seems to me, violates any principle whatsoever about it being "taxpayers money". If it is applied to agree public purposes (agency/department mission) within agreed limits, there is no private gain - just a flexible policy which involves some incentives. How much flexibility and for how long is clearly a matter for political decision but its not a fundamental breach of any sensible principle I can think of.

On another issue - I agree with Peter Singer that the whole notion of "taxpayers money" is deeply misleading (see his critique in his "The President of Good and Evil - Taking George Bush Seriously). Property rights over money are far more complicated than that.... but let's not go there at the moment.
Cheers

9. Steve Kelman, Harvard University

This has been a great dialogue, and I am really appreciative to all that have already contributed. I need to sit down and read through all the responses more carefully, so I can react more intelligently.

Two quick thoughts and one quick question:

1) We should distinguish between having to return the money at the end of the budget year and consequences for future budget years. Only if an organization can keep time t savings in some sort of fund, this becomes the same issue.

2) I thought the comment that "every budget person believes the savings belong to the taxpayer" is probably a correct account of the view of budget people -- is this so outside the US as well -- but it is, in my view, unfortunate, because it leads to a situation where the savings don't get
generated in the first place. I wonder as an empirical matter whether this is the view of professional budget civil servants, but not necessarily of ministers and (in systems where this is relevant) elected officials/appropriators.

3) Do I gather from the various comments so far that there is no scholarly research on this topic?

10. Fred Thompson, Willamette University

There are a lot of notions extant about whether public-sector managers should enjoy a somewhat longer fiscal leash than they are used to. In several OECD countries, budgets are set for several years at a time, giving public-sector managers a longer planning horizon and more discretion about exactly when to spend money and for what. Furthermore, in Denmark and Finland, managers can carry over cash they do not spend out of current budgets to the next, rather than have it clawed back by a tight-fisted treasury. The aim is to end the "spend it or lose it" culture
that afflicts many expense centers – in business as well as government Michael Barzelay's book *Breaking Through Bureaucracy* (1992) talks about the experience of the State of Minnesota's experiment with similar practices. In California under a similar regime, by and large, the effects were positive.

But Steve asked an empirical question: Does the failure to obligate funds actually result in a redefinition of an agency's base and therefore lead to future reductions in the agency's budget? Or is this merely an urban legend? In my experience, working closely with one very large government agency of the US, I can say it wasn't true there and that it could not have been true given the timing of the budget formulation process. Budget proposals were formulated during the prior fiscal year and enacted into law well before the books closed on the current year. How could the failure to fully obligate funds have affected its budget allocations? No way. I have observed much the same phenomenon in California, Oregon, and Canada. Given the timing of the budget formulation and enactment process and the timing of fiscal reports, this has to be an urban legend. Unfortunately, I don't know of any empirical research that would settle the issue.

There is an empirical literature on the behavioral consequences of budgets, but most of it focuses on business (See below). One reason for this is that there isn't much variation in budget practice in government. Most budgets are discretionary spending budgets. One cannot explain any variance if there is no variance to explain.

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11. Clay Wescott Asian Development Bank

One promising approach giving US agencies an incentive to achieve savings is a pilot contracting approach for IT projects. Under this approach, called share-in-savings, contractors invest their own funds up front, and are paid - up to a fixed dollar amount - from the savings generated. Thus, agencies don't have to wait for a budget allocation to undertake a project intended to increase efficiency. The risk to the contractor helps to ensure that projects undertaken are well conceived and implemented.

ref. 1996 Clinger-Cohen Act and E-Government Act of 2002, Sections 210 and 317 www.gsa.gov/shareinsavings

12. Rob Laking, Victoria University of Wellington

One empirical observation from personal experience. My first and only job as a chief executive in the NZ public service (I retired out of it) was as head of a small Ministry created out of a larger organization. It had both policy advisory and service functions. Because it was a new organization, the budget was effectively zero-based. We also made some significant operational savings in the first couple of years of operation. I found myself with a lot more budget than I could possibly spend and I agreed to a fairly significant reduction in my baseline. What that admittedly special case underlines I think is that precisely defining efficient cost functions for operational outputs is, in most public organizations, a fairly inexact science. The NZ Treasury has over the last decade had two strategies for dealing with this problem (well, problem from the perspective of the Treasury, anyway): (1) to extract what it has blandly called a "productivity dividend" usually by holding a nominal budget figure and letting real value erode due to either general inflation or relative cost creep; (2) periodic baseline reviews - usually when there has been a restructuring or from the government's perspective mismanagement of budget allocations.

And (in response to Professor Talbot), I'll read Singer's book but I always understood that the barons voted the money to the king for the war and not for anything else. The converse seems to me to follow that - in the admittedly implausible event he didn't spend it - he would have to give it back. Given that it is an inexact science that seems to me to be a fundamental principle of parliamentary appropriations.

13. Daniel Williams, Baruch College

This message responds to Larry, Fred and Steve not necessarily in that order. It will eventually get sent to the IPUMAN Listserv, too, but since the listserv doesn't recognize my current sending email address and the server at Baruch doesn't allow external users (except with a lot of difficulty), that will be awhile unless one of you post this along the way...

Larry, I think the carry forward of large unbudgeted discretionary appropriations (that is what option #1 amounts to, lump sum "budgets"-but actually just appropriations, a budget implies planning) mistakes reward in the private sector setting with what a public sector organization is and does. That is why I started out in my first email pointing out that governments own the assets of public agencies. The agencies own nothing. Rewarding an agency with money is not to give it an asset. It gives it discretion over spending. I don't know any particular good reason to do that. I DON'T OPPOSE DISCRETION. But rewarding efficiency with discretion is nonsense.

Discretion should be granted based on competence, policy compatibility, proven effectiveness, the usual stuff. It should be extended in greater amounts gradually. In general, I expect many agencies have too little discretion, but rewarding efficiency with discretion in large lumps that have little to do with the rationale for discretion seems weird. Even weirder, the discretion would evaporate after a fairly brief period. Furthermore, the government's resources are limited. It doesn't make sense to allocate some of these resources with no forethought to their use just because they appear to have been achieved fortuitously. If government would adopt some USEFUL private sector practices like paying bonuses to anyone other than the top 0.1% of employees, there might be a lot more fortuitous efficiency savings at a lot lower cost than huge resource allocations with no particular policy purpose. Giving the agency the first/best opportunity to claim the "fortuitously" obtained money without a guarantee they will get it makes a lot more sense.

Fred, I agree with you that Steve asked an empirical question. That is why I, as the first person to respond, started by asking which empirical question he might be asking. I admit that I have now engaged in discussion other than just clarifying the question. But we do need to know which question might be asked. I think he has now answered that. He is interested in both questions, but is a little clearer that there are two questions.

With respect to your input, the belief that budgets get slashed when they don't get spent is so pervasive there must be some basis. There is a term for it in the federal government, according to one of the respondents in this discussion. Perhaps it isn't (always) at the legislative level? I understand that the military has some grotesquely complicated internal budgeting system, so you could be punished for efficiency way away from the political realm. As anecdotal data on punishment: In some discussion with consultants working with Medicaid agency budget directors, and with HCFA/CMS employees, it was clear to me that one of the reasons states experienced difficulties in the early 1990s and again during the last economic downturn was a self inflicted wound from punishing Medicaid/SCHIP agencies for getting too much money for program expansion/early program costs. When the "first" year costs didn't materialize (first time around it was expansion for large new populations, the second time it was starting up SCHIP), the states took back the money and carried the take back forward (so I have been told, this is an anecdote, not a claim of an empirical study). The trouble is, the agencies were right about the size of the program, they just didn't think through the difficulty of implementation. The money was needed. But states, as they do, had spent that taken back money on other things. Both times involved unfortunate coincidence with economic downturns, and severe fiscal stress. In the early 1990s the whole of many state budgets other than Medicaid SHRANK. The Medicaid instance I refer to (around 1991) is North Carolina. My knowledge comes indirectly from a consultant who may have advised or considered advising North Carolina on forecasting. I no longer remember more details. The SCHIP instance was about 1998. I spoke to a CMS employee. I recall that there was a western or mid-western state involved. In both instances I had reason to believe the "punishment" problem was more pervasive than one state.

Steve, Since Larry, Fred (I think), I and possibly other respondents are also participants in the Association for Budgeting and Financial Management list serve, one of us could cross post your question there if you would like. Please advise.

A couple more things, Larry. Of course GAO and CBO have trouble convincing legislators that option #1 would not disadvantage them. It will disadvantage them. I don't think agencies personnel think they have any priority claim or access to free up money. That's why the June 15 desks and chairs (or whatever). If THAT could be formalized and clearly signaled to the agencies, you would have a lot more cooperation.

This goes back to Larry's question of my response that it's a bad idea to just give agencies a large lump of money because they saved it in the prior year. I was thinking about that over night. Part of the reason that seems like a bad idea is that the reward for being cautious with money ("efficiency") is effectively a pat on the back and an encouragement to splurge in the next year. Seems daft.

But here is an idea. While agencies cannot have assets (re earlier discussion) they could have pseudo-assets, like this... The state could establish a statewide account for the next downturn. Rather than funding the account, when agencies save money, the savings could be placed in the account. Neither the agency nor the state would be allowed to spend the account, but the agency would be paid an income for its "capital" in the account. The income would be the highest interest rate the state had to pay during the last downturn. The money would be earmarked to the agency and the law authorizing would require the state auditor to report whether it was being used to offset general fund expenditures, which offsetting would be prohibited in the authorizing law. Until the next time experienced a downturn, the money would stay in the account and the agency would earn the income. The downturn would be defined by the typical indicators (two successive quarters of whatever). For agencies who were unlucky enough to put money in just as the downturn hit, there might be some minimum number of payout years, such as 3. With some structural rules (e.g., administered by someone who cannot be easily fired by the governor), agency discretion over this money might be somewhat protected.

Now, its a bit complicated, maybe someone else can simplify it. But this form of giving the savings to the agency, gives it to them as an asset and gives all the agencies a motivation to work together as a team in avoiding economic downturns.

14. Larry R Jones, Naval Postgraduate School

Steve:
There is research and writing on the topic in the US and elsewhere (e.g., see response by Colin Talbot that indicates practices in other nations -- but not research on it) but it isn't empirically based or tested; it is essentially descriptive and normative. I have seen nothing empirical that addresses the question you posed in your first message. I have discussed conducting research of this type with colleagues and all agree that it should be done, and all agree that there are a wealth of impediments to performing the research (e.g., access to and interpretation of data, sensitivity of those studied to revealing savings and budget methods they employ to work within and around the constraints they face, fear of consequences of others' knowing too much about their methods of budget execution, confidentiality, sample validity, etc.). These and other barriers would have to be overcome for the results to be valid and reliable, and to have some utility in contexts other than the specific agencies studied.

15. Robert D. Behn, Harvard University

Here are some thoughts on urban legends, the end-of-the-year-spending dilemma, and one jurisdiction that may gotten the incentives right. Confession. I approach this problem from the prospective of an evil line manager, a position that I held for a few brief years. My nominal
boss was the dean; my real boos was the associate dean for budget. Each year, he had only one performance target: Did he end the year in the red or the black? And I become quickly convinced that "competence, or policy compatibility [that is, mission orientation and success], proven
effectiveness, the usual stuff" were all irrelevant. The associate dean for budget would engage in all sorts of micro-management [another official engaged in actual deceit] to ensure that he met his performance target. Ii was during this era of my life that I learned or invented:
"The Law of the Forgotten Promise."

(1) The Taxpayers' Money. Clever phrase. But wait! Does the central budget office actually send the taxpayers a rebate at the end of the fiscal year? Don't be silly. The surplus doesn't belong to the taxpayer. The surplus belongs to the central budget

agency.

Behind the wonderful creed “the surplus belongs to the taxpayer” stands an important corollary: “And we in the budget office (not those incompetent, self-serving, indolent line-agency managers) know how best to spend it.”

(2) Efficiency. Why isn’t efficiency a sign of “competence”? Why doesn’t efficiency provide some data on “proven effectiveness”? If the numerator in the efficiency ratio is correctly selected, why isn’t efficiency a sign of increased “policy compatibility”?

(3) Sawtooth Spending. Why is sawtooth spending bad? To an agency manager a sawtooth-spending strategy is quite rationale. The agency head cannot carry over any unspent funds to be used for important social purposes in the next fiscal year; thus, the agency perceives that his or her organization’s ability to achieve its mission is being weakened because it failed to spend all of its allocated funds. At the same time, if the agency manager overspends the annual budget, he or she will also be punished for this personal failing, and thus the agency (and its mission) is likely to be punished as well.

The line-agency manager does not have to be too risk averse to invent the sawtooth spending strategy. For this strategy avoids two obvious punishments and, at the same time utilizes completely whatever funds are available for achieving the agency’s mission.

Moreover, sawtooth spending may also be socially optimal. Public agencies operate with a variety of explicit and implied constraints. In the previous paragraph I alluded to two: (a) we don’t want public agencies to overspend their annual budget allocation, and (b) we don’t want public agencies to underspend their annual budget allocation. Or, what is operationally the same thing, these two constraints may only be implicit; that is, we may simply permit the managers of public agencies to believe that, if they overspend or underspend their budget allocation, they and their agency’s mission will suffer. Once we have consciously created these two constraints (or once we have permitted the emergence of a wide perception that these two constraints exist), we may also conclude that we want the managers of public agencies to follow a sawtooth spending strategy.

(4) Wasteful End-of-the-Year Spending. Why is end-of-the-year spending automatically wasteful? Why do we assume that the funds spent during the last month of the fiscal year are more wasteful than the funds spent during the first month? Why do we assume that when an agency director decides to spend any unobligated funds during the last month of the year that he or she will spend it on wasteful things rather than useful things?

Several years ago, I visited a large facility that repaired a large fleet of municipal vehicles. My hosts pointed out the tires piled in every corner and explained that they had just been purchased at the end of the fiscal year? Was this wasteful? Or was the manager simply being smart? What might have happened if the agency’s managers had not bought the tires but, instead, had turned back the taxpayers’ money to the central budget office? What might have happened if the fleet's tire wore out at an unusually rapid rate during the coming fiscal year? Wouldn't a fleet-management agency need tires during the coming year? Wasn't buying the tires simply a way of carrying over this year's savings into the coming year? Wasn't it a perfectly intelligent strategy?

(5) Sawtooth Spending (continued). Again: Why is sawtooth spending bad? After all, a sawtooth pattern in expenditures is not being the same as a sawtooth pattern in the consumption of real resources. The agency may order all N of its tires during the last month of the fiscal year, but utilize this resource at a rather uniform rate (roughly N/12 per month) over the entire fiscal year.

Suppose that the agency manager had bought all N tires at the beginning of the fiscal year? Would we think this was an intelligent spending strategy? Of course not. We would criticize the manager for not holding back enough funds for the emergencies and other contingencies. Suppose the manager bought N/12 tires per month? Would we think this was an intelligent spending strategy? No. We could easily criticize the manager for failing to purchase all the tires at once to get a volume discount?

(6) Some slightly different but real legends. I know of three examples in which public agencies that had saved money only to have it taken away. I'm not talking about having a lower budget allocation in the next fiscal year. I'm talking about losing money already in the budget.

After Orange County went bankrupt, the new county manager invented the "Robin Hood" plan. Any agencies with surplus funds were required to give them back. Of course, in a financial crisis, this makes immediate short-term sense. (See http://www.governing.com/poy/1998/ptmitter.htm.) But what lesson did the city's line managers learn?

During the late 1990s, South Carolina actually permitted state agencies to carry forward savings from one year into the next. When the recession hit in 2001, however, the state immediately called in all the accumulated savings. (See: http://www.governing.com/view/vu090301.htm. Note the additional comment from city manager from Sandy, Oregon.) Again, what lesson did the state's line managers learn?

My third example comes from a colleague who was the head of a school at a large state university. Again, line managers were given the opportunity to carry forward savings into a new fiscal year.But, again, when a fiscal crisis hit, what did the provost do? You guessed it.

These three examples are slightly different from Steve Kelman's the original issues. They are not about agencies that spent less than their allocation in year T only to have their budgets reduced in year T+1.These three stories are about agencies that had deal; If they were conscientious, if they didn't engage in end-of-the-year spending (wasteful or not), they could use their savings to pursue their mission in the next year. Unfortunately, these stories represent three more examples of "The Law of the Forgotten Promise."

(7) Getting the Incentives Right. The state of Washington has managed to encourage savings with its “Savings Incentive Program.” Created in 1997, it permits a state agency to carry over half of its savings (with some exceptions) into future fiscal years to be spend on one-time projects (such as technology or training) that will improve the agency’s effectiveness or efficiency in pursuing its mission.

And how did Governor Locke get the state legislature to institutionalize this approach? He earmarked the other half for education. This made it difficult for legislators to vote against the proposal. And it made it difficult for legislators to terminate the program — given that there is now another stakeholder, the state’s education establishment, which benefits directly (or, at least, perceives that it benefits directly) from the incentives in the program.

I don’t know how effective Washington’s program has been. But it is certainly worth some research. Here are a couple of links:

http://www.ofm.wa.gov/budget/info/savings2001/overview.pdf

http://www.ofm.wa.gov/budget/info/savings2004/2004memoandinstructions.pdf

(8) Urban Legends Empirical Evidence, and Operating Reality. Is the spend-it-or-lose-it legend a myth or reality? Unfortunately, it doesn’t take too many examples to create the myth. Indeed, once people even learn about a few of these examples, the urban myth becomes the operating reality. Even if research could prove that there existed no empirical evidence for the myth, would this research change the spending strategies of (intelligent, if slightly risk-averse) line managers?

16. Irene S. Rubin, Northern Illinois University, (Professor Emerita)

Bob, let me give the other side of one of your examples. Suppose the agencies learn to commit every cent, because they could lose the resources they have been tucking away against an emergency in a rescission or reprogramming action. Having committed every cent, the rescission or emergency occurs, and they don't have any money set aside they can give back. That doesn't mean the rescission or emergency goes away, it means they have to find money at a fairly high rate at the middle or toward the end of the fiscal year. This often translates to unpaid furloughs, disruption of work plans, delay in work product, layoffs of temporary staff where possible, cancellation of contracts, delays of purchases or stretching out of bill payment, often making vendors wait for months for their money, turning off heat or lights, or air conditioning--there are only a limited number of ways of saving money late in the fiscal year, and they are nearly all highly disruptive and not productive in the sense of improving efficiency. You could well ask what managers learn from experiences such as that. What some of them learn is to always have some temporary staff, so there are some resources that can be cut late in the year; they learn to leave some positions unfilled until they know the budget levels reasonably firmly, they learn to delay contracts or let them gradually during the year, even when that might mean not letting them at the best time of the year in terms of cost savings.

What may look inefficient to some may be reasonable adaptation to the environment, and less inefficient than the alternatives.

17. Daniel Williams, Baruch College

Bob,

While you start out by suggesting the agencies should be able to keep the current year savings, a more careful review (by the time you get to item 7) shows you get to pretty much the same place I have been arguing, agencies should get a priority opportunity to make good usage of the savings. If we aren't going to ask agencies to make plans for how they are going to use large sums of money, we might as well just get rid of budgets and allocate money on popular approval of governmental sector.

As to some of your other questions:

a.) Efficiency is a measure of management competence. Perfectly competent managers can be sharply contrary to elected officials on policy matters. "Expert advice" (all too often, scientized policy preferences of managers) gets rejected all the time. If the managers aren't happy, they can go elsewhere, stay and knuckle under, or subvert to the degree they are willing to risk their jobs. None of these necessarily risk efficiency. But they certainly affect discretion. If you are the decision maker and are constantly rejecting expert advice, you would hardly be wise to give the same manager a large sum of efficiency savings to implement unspecified initiatives over the upcoming year.

b.) Of course saw tooth spending is rational. It's bad if it interferes with the delivery of services. Suppose the service needs are most pressing at the beginning of the fiscal year.

c.) I suppose Steve may have asked about empirical evidence because he agrees with you that urban legend can have consequential effect, even if it's based on a handful of quite unusual cases. The only thing you can do about urban legend is obtain empirical evidence and make it well known.

d.) You seem to think that all the "don't give it back to the agency" response is coming from central budget agency champions. I was a budget director of a line agency for almost a decade. I think "Taxpayer's money" is a meaningless notion. I believe that all too much of what is written about budgeting is from the perspective of central budget offices or legislatures, rather than the people who do most of the work, the line agencies. But, agencies are not corporations. Nobody seems to get this. Agencies don't have money, just to have it. Money is only spending authority and it should come with a purpose. "Give it back" suggests something else. By the way, your condition as a line manager reporting to a dean in a ?private? college could be different. Private agencies do have money just to have it.

18. Allan J. Borwick, Budget Officer, City of Tracy, CA

Some thoughts pertaining to budget savings. When a legislative body approves an agency budget for a fiscal year, the budget is sometimes described as a contract between the legislature and the agency. The legislature will authorize and appropriation $xx,000,000 in funding for the agency, and in return the agency will provide a certain level of public services for the nation, state, or community. Normally, the appropriations are specific, while the service level and expected performance are not specified.

However, once the budget is approved, agencies tend to regard the budget, not as a contract, but as an entitlement. We have $xx,000,000, which is our to spent or encumber before the end of the fiscal year. Performance? What?

Before you can talk of any budget savings, you have ask whether or not the agency has "earned" its budget by delivering certain levels of public service.Yes, agencies can achieve budget savings by not spending their entire budget. But have they delivered an apportinate level of service? Budgets when adopted will need to specific service levels and unit costs. At year end, budget earnings would then be determined by multiplying the actual service units produced times the budgeted unit costs (as per the "budget" contract). If agency expenses are less than the earnings; then, there are savings to which the agency can be said to have an entitlement to. If earnings and expenses are equal, the agency is on-budget. If expenses exceed earnings,
the agency is over budget. Of course, the agency could still be within its budgeted appropriation, but with expenditures and performance both below expectations.

In many cases, where there are budget savings, they result from reduced performance, not efficiency or cost reductions. Salary savings due to vacanies (and waiting for the personnel department to do the recruitment process) means that the amount of work done is less than budgeted. If it's done, without overtime or temporary help costs, it raises the question of whether the vacant position is really needed in the agency.

So, without some sort of performance budgeting, the traditional practice that unspent and unencumbered operating budget appropriations lapse at the end of the fiscal year is justified. It also must be remembered that at the same time the agency receives a new annual appropriation, which is probably more than the previous. Of course, the agency's staff fear that annual expendituresunder budget may result in their base budget being lower in future years due to the budget savings. Whether this happens or not depends on the methodology used by the central budget office to compute the base budgets in future years.

The method I use in establishing agency base budgets is a follows. For non-personnel expenses, the agency is given at least the same $ amount as in the adopted budget, minus any one-time items. But also, an increment is estimated for the future rate of inflation for the upcoming fiscal
year. Then, this increment is given, if past spending levels, adjusted for inflation, equal or exceed the increment. If the levels are less than the increment but more than the adopted $ figure, a smaller increase is given. The increment is the maximum increase for the base; (but, in a subsequent phase of the budget process, agencies can request

augmentations to the base). So, with this method, past "budget savings" in the agencies budget does hold down increments in their future base budgets; but, there is no direct reduction of agencies budgets.

Personnel expenses for the base budget are computed separately based upon authorized staffing and projected compensation levels as set by adopted personnel regulations or labor agreements. Sometimes, an estimate is used for the future, if the regulations or agreements do not cover the future. Generally, personnel expenses increase annually. However, turnover in some cases reduce the amount of the increase, with new personnel costing less than retiring personnel. So, past "budget savings" on personnel expenses does not effect future budgets for regular full-time positions.

19. Thomas Gardner, DPA Administrative Services Director (Finance), City of Ventura, California

This is a subject that is near and dear to my heart. As a budget manager for 25 year in local government I have observed, as a teacher (Doctorate from USC) I have taught budget practices. I have not found any empirical research on this subject. I would be glad to join any such effort.

Some observations:
Reinventing Government perpetuated this assumption about departments not being able to keep carry over (or savings). While it was a popular book I have always shared with my student its shortcomings in term of disciplined research. Ted was a City manager who I have known for years, and was unaware of many practices of other types of agencies.

Research difficulties:

What do we mean by agency and is that the norm?
.

Federal and State governments work very differently than Local governments. And this is one are where the rules may be quite different. For example in a fund accounting system, and "enterprise" or Internal Service funds keep their fund balances and carry them over as a mater of routine. So the disincentive is non-existent. Special revenue funds, capital funds etc. are also treated the same way. In most organizations these funds are whole agencies or parts of agencies. The same is generally true of such funds at the state and federal level.

What do we mean by savings? In many cases agencies want to keep "the saving". But saving come from a variety of sources:

Salary savings (retirement etc.) The State of California for many years and many cities budget salaries at 100%, and don't budget an expected salary saving due to routine turnover. To allow agencies to keep this, is just allowing over budgeting and encouraging it as a way to accumulate agency instead of Institutional savings accounts.

Saving on Capital project. Many CIP are funded at 120% that is the project cost and a 20% contingency. The contingency is often a function of "standard practice" This roles over thousands some time millions in over budgeted resources.

Saving from over budgeting. One County in California instituted "you save it you keep it", and in the first year the Sheriff saved millions. Insiders pretty well knew it was all from a padded budget that was always spent in the last several months for "goodies and overtime". Now it was available for pet project s that would never have been approved in a competitive evaluation of cross department needs

The annual "rat hole" where the agency annually rebudgets their internal contingency. That nest egg just in case we need it. At end of year it is swept and then the appropriation rebudgeted each year. To allow An Agency to accumulate this, then rebudget would encourage the "rat holes" to get even bigger.

Fairness between departments or agencies.

Some departments or agencies have a greater ability to generate "savings." Those with revenues can under estimate and pocket the difference, others with High Personnel cost and little flexibility are very tight with little expense saving. They see themselves as "losers" in a system where the rewards go to "good managers" who are able to save $.

And there is a lot of is lots variations in-between.

There is an underlying assumption regarding the research, which is that we should reward good managers, and that a good manager is one that saves money. So one of the research questions has to be: is it real saving created by efficient management techniques that should be rewarded or just mismanagement or luck? Secondly what do the systems that adopt a save it and keep it create as second order consequences and incentives.

Finally, organizations that are in layoff ode or cut back, usually don't have the "luxury' of letting some units accumulate $ while others are cutting resources.

I would be willing to carry this further if anyone is interested.

20. Cindy L. Michael, Manager of Finance & Operations, Franklin County Office on Aging

As a budget analyst for the Franklin County Board of Commissioners, we found that the "savings" or "dropped appropriations" or "unused budgeted amounts" were ignored and not incorporated in forecasting cash balances. This resource, if backed by actual revenues, was established, by practice vs. actual policy, to be used for only one-time purchases. On-going expenditures cannot rely on agencies not spending annual budgeted amounts. Same goes with revenues that exceed estimates if there is no guarantee that the source of funds will continue.
Zero-based or a modified zero-based budgeting process also reduces or eliminates excess expenditures from year to year.

21. Jim Nordin, Former Federal Government Financial Manager

Here are some random thoughts, all anecdotal (empirical only in the sense that the universe is one) and from a paramedic point of view. I was a financial manager in the Federal government for about 20 years. I also have a D.P.A. from USC.

In the Federal government (as in most states and locals and non-profits) there are GENERALLY one-year appropriations. The nature of the appropriations law is that funds appropriated for a single year can NOT be spent in any other year - or rather, can not be spent for activities attributable to any other year. (If expenses for year 3 are discovered in year 5, year 3 funds can still be used to pay for them, assuming year 3 funds are still available. In the Federal system, there is a five year limit on this.) However, as Dr. Gardner points out, all "business-type" funds are generally exempt from this restriction. In addition, there are several multi-year appropriations at the Federal level (mostly in DOD) to pay for huge projects that naturally take more than one year (nuclear submarines or aircraft carriers).

A fundamental driver of behavior to not "save" currently is the basic requirement in governmental accounting that the budget be incorporated into the accounting system. This requirement would exist if there were bi-annual appropriations or even multi-year appropriations. Private corporation's budget and people lose jobs for going over budget and people are sometimes rewarded for coming in under budget. What is different is that the financial statements of private corporations do not require budget vs actual comparisons. If managers are "evaluated" (in financial statements) on their ability to match budgeted vs actual expenditures, then there is an incentive to have them match and therefore to have spending orgies at year end. Yet common sense would dictate that the chances of actual expenditures matching budget estimates created at least 30 months before the end of the spending year should be minimal. I can't accurately predict what I w ill do tomorrow; I certainly can't accurately predict what will happen two years from now.

There is a very real fear that unspent funds will not only be lost for the current year, they will be lost for all future years. No good deed goes unpunished.

Yet, as Dr. Gardner points out, surpluses are as likely to be the result of budget padding or dumb luck as they are of "good management." We used to budget for commercial conference calls and then found out GSA had a conference call service that was essentially free. Suddenly we saved about $1,000 from our budget. Good management? That was certainly our claim! Probably dumb luck.

My point in all this is that we should be careful the cure isn't worse than the disease. The requirement to compare budgeted to actual expenditures has unintended consequences for behavior. Allowing agencies to retain "savings" will have consequences - some of which will be unintended - as well. My objection to NPMs preaching for keeping savings is that it doesn't take into account possible unintended consequences. If agencies are allowed to keep savings, then I suggest that the scheme under which this happens be developed using Elmore's backward mapping. What behavior is desired at the agency manager level? What incentives/policies will result in that behavior? Don't create a policy that "should" work. Create the policy based on likely incentives at the lowest level and work your way to the highest level policy.

And then remember that American managers are very clever. They will find a way to make the policy work to their advantage.

22. Eric Herzik, University of Nevada

At risk of boasting, I published an exploratory piece on this topic several years back; "Improving Budgetary Management and Fostering Innovation" in *Public Productivity & Management Review*, 14, 3 (spring 1991.) While the piece is more descriptive, it was based on a study of Chandler, Arizona, which had adopted "Expenditure Control Budgeting" (ECB). This featured a retained savings option, which was fairly aggressively employed by various city agencies. (I have since left Arizona and have not followed up how this program worked out for Chandler over the long run.)

In terms of the problems noted by Dr. Gardner and as a partial defense of "Reinventing Government," enterprise funds are different from most other agency (and especially general fund agencies) budgets. I believe that is partly the point of Osborne and Gaebler; these more entrepreneurial funds are a model for other agencies. In terms of budget padding and differential abilities of agencies to achieve savings, this problem is anticipated (at least partially) in ECB as there is a designated "base year" budgets for all agencies. The selection of the base year is – ideally – designed to recognize such disparities. The problems noted by Dr. Gardner were also noted by the folks in Chandler (a good example of concept validity.) Still, there was an attempt to address these potential disparities in order to get past the "spend it or lose" disincentive that is built into most state and local budget systems. (And as I work fairly regularly with local agency budget officers and administrators, I can report at least anecdotal evidence that their thinking and spending behavior is influenced by this disincentive.)

23. Carl S. Terrell, Administration Manager, City of Charlotte, NC

As a practitioner with 15 years plus of public service, I generally agree to a certain extent that departmental or agency savings should revert to the General Fund. From a macro perspective, I feel that this is just good stewardship of public funds. However, if an agency has a justifiable need then a procedure should be in place that allows the agency to retain a percentage of the savings that it generated. I know that the question is not about year-end spending patterns, but how savings are handled or perceived, certainly is a driver of those patterns. For instance, the City of Charlotte for a number of years has disbursed a percentage of generated savings to its employees (the remainder to the General Fund) provided that they have met certain performance objectives. In my opinion, this practice tends to encourage savings-generation and discourage all-out year-end spending binges with the knowledge that the potential incentive payout would be smaller.

Of course another way to insure that agencies do not discretionary spend savings at yearend is for them to acquire a better understanding of the actual costs of their service delivery. Collectively, participation in savings and understanding service costs at a minimum promotes a win-win situation. Finally, I think the association is relevant, because in the absence of savings, there is no need to answer the question.

24. Clint Brass, Analyst in American National Government Congressional Research Service

I have not done empirical research on this subject. But here are some thoughts from someone who worked in a state government budget office, at the federal Office of Management and Budget, and now in the federal legislative branch (Congressional Research Service).

Mr. Borwick brought up the subject of a contract between a legislature and an agency. That is an intriguing frame for potentially looking at this issue empirically, because this topic is frequently talked about more from the perspective of executive branch officials and decision makers.

Legislatures frequently feel the need to grant significant discretion to appointees and officers in an executive branch. They often simply don't have the time or resources to budget in great detail, based on extensive analysis of the agency's needs and goals. Thus, here is a research question. Is it possible that, from the perspective of many appropriating legislators and their staffs, they view the "contract" in the frame of extensive delegation and discretion? Thus, if an agency achieves savings somehow, appropriators and their staff may not greatly care about "taxing" the savings for reallocation to other programs or deficit reduction. Instead, from their perspective, part of the contract may be an implicit understanding that "we have budgeted $X for your mission as a reflection of the public will, and if you find ways to achieve efficiencies, you may reallocate that savings internally within your agency to better achieve your mission."

It would be possible to survey appropriators and their staff to get at this question. Just speaking for myself, my sense is that in a world of bounded rationality, appropriators will frequently trust the agency to make those reallocations in ways that serve the public interest. That notion would contravene the "accepted traditional view" as posited by Dr. Kelman, at least from the perspective of some folks in the legislative branch. However, legislators would presumably still reserve the right to want insight into those decisions, to make sure they are at least consistent with the legislators' perceptions of the right thing to do. This phenomenon, to the extent it actually takes place, may also be driven in part by legislative organization, where appropriating subcommittees (at the federal level) are given an allotment which they would not like to see reallocated to other subcommittees. Some reallocation might take place within their areas of jurisdiction, however, subject to the political constraints the appropriators face, and subject to their perceptions of the right thing to do.

Governors, presidents, city managers, and their budget staffs may have very different perceptions about this question, compared to appropriating legislators. Because of the key importance of appropriators in any budget process, and setting the cultural norms for that budget process, the question of budgeting norms should probably also be investigated from the legislative perspective. Well-constructed surveys (either paper-based or in-person) might help get at that question.

25. Lynda M. Dennis, University of Central Florida

In the early 90s when at a small Central Florida city we had a "50/50 (50% stayed in fund balance and 50% was returned to responsible department) program designed to share in budget savings. To the extent there were total excess revenues (general fund), departments generating savings received 50% of their pro-rated savings. The funds were re-appropriated in the subsequent year and were used to "enhance" the departmental budget (i.e. extra computer, attend national conference, bur shirts, etc.). The CM exercised discretion over the distributions to ensure departments did not reduce services, forego routine maintenance, etc.

This program was implemented to discourage the "spend it or lose it" mentality and to encourage "smart shopping". While the finance officer in me understands the need to keep fund balance levels strong, the public administrator in me realizes departments should be "rewarded" in some way for fiscal prudence, creative financing, and operating outside of the box.

I left years ago and am fairly sure the program has been discontinued. In my subsequent transitions I was never able to get a program like this implemented in another jurisdiction.

I would also be interested in working on some sort of project related to this. In a recent study I did, only one of 200+ cities indicated they had some program in place whereby savings reverted to the responsible department.

26. Rebecca Hendrick, University of Minnesota

Lynda brings up an important related matter in this discussion regarding the need for strong fund balances. Some agencies and governments need more surpluses or slack in their budget to accommodate the risks they face. Although groups such as GASB and GFOA recommend 3-5 months worth of spending in the undesignated fund balance, financial managers and bond rating agencies know that this rule is not universal. For instance, smaller governments and those relying on sales taxes require greater surpluses. But as Tom Gardner points out, agencies and governments have many sources of savings beyond their monetary surpluses. Thus, agencies
with large capital and supplies expenditures and funding sources beyond the general fund (e.g. enterprise funds) may require lower surpluses compared to agencies with high personnel costs and little flexibility.

In the context of the current discussion, I think the question of how many surpluses is enough for particular circumstances should be examined more thoroughly. Not much research has been done in this area, and that question is implicit in “what is the appropriate use of savings and their budgetary consequences.” Research on the question of surplus and savings also addresses an important theoretical debate between “managers” who are likely to see slack as valuable to the smooth functioning of organization (whether used manage risks or reward performance) and “economists” who see it as inefficient and wasteful. While I'm over simplifying this debate to a great extent, I think these two perspectives do exist in the field and the academy. It's also a debate I'm interested in pursuing in my own work.

Good discussion!

27. Thomas Gardner, DPA Administrative Services Director (Finance), City of Ventura, California

This separate question of reserves is a very big one. And I think that the empirical data is most lacking. I have gotten A+ rating for bonds with a 2% reserve and a 14% reserve. Many budget managers don't actually participate in the debt service process and therefore assume they need a certain reserve to get a good rating. There are many factors that affect the bond rating; your reserve is a contributing, but not a determining factor. Certainly it is easier with a high reserve. Reserves also allow many agencies to use the case as cash flow. For example if you have a 20% reserve your ability to use the cash backing that reserve for cash flow is much greater than a 2% reserve, which means you may be out for Tax anticipation bonds in the months of low revenue recovery. Therefore reserves have tow basic reasons for existing. In many cases reserves are also used to accumulate for future capital expense. For this reason it is hard to compare jurisdiction, When their budget says "reserve" what does it really mean, and how do they truly use it.

This problem was faced by California in the early 90's and again recently when they sought to tax taxes back from local governments. They used the amount of reserves as a sign of wealth (ability to pay). It turned out many were reserves for capital investment, the take away devastated some agencies capital planning efforts.

Not withstanding the capital reserve issue above, my experience, and it is limited, is that the amount of general reserves is a function of the amount of slack resources, not an empirical standard (i.e.. 2 to 3 months of operating) or a specifically planned need. When I did research as an expert witness in the Orange County/Merrill Lynch dispute, I researched about 12 or15 of California's largest counties for more than a decade. The amount of reserves varied. Counties with minimal and very tight budgets could maintain very low reserves for long periods of time. Counties with much greater resources spent more, because they had it and reserved more, because they had it. I wish I had all the research material now. How would you set up a control.

In one jurisdiction, I did a twenty year research of how they actually spent their contingencies and reserves. The finding: they didn't. Despite floods, union crisis, state budget crisis...they never dipped into reserves. It was a poor jurisdiction and the culture was you are humiliated and die,
and have to crawl into a cave for life if you touch reserves. So they didn't. They adjusted budgets in crisis by stopping spending.

In an other agency they go to contingencies pretty frequently and it kind of supports poor budgeting. " Whoops I forgot this in my budget. Council can I go to Contingency?" and they do. It is a fairly wealthy agency.

I think it is probably very much like our household budgets. Do rich people have more in a savings account as a % of income than poor people? My guess is probably.

How much should a rich person/agency have in their savings account? How much should a poor person/agency have in their bank account? And how much do they actually need?

I think there is a lot of room for research in this area and in times of cut backs it is very important indeed.

Thanks again for your time.

28. V. Susan Cox, Capital Program Manager, San Jose, CA Police Department

This is a great discussion, and if you will tolerate a voice from the "cheap seats" I believe another contributing factor to the contingency reserves (however defined by the individual governmental entity) and the use policies for tapping into the reserves is also influenced by City Council term
limits. Yes, term limits.

In the City where I work as a Capital Program Manager, there is strong pressure from the elected representatives to deliver capital projects in as minimum of a time as possible, sometimes to the detriment of the project. This is especially true for parks, libraries and community centers. When the elected representative knows that they only have two terms to make a mark and build positive impressions among the voters, parks, libraries and community centers have a major impact on how the Council rep is viewed.

This in turn pressures the capital program managers to deliver not only "on time and on budget" but in several cases without a full analysis of the community needs and program aspects. One unintended consequence is that there is little enthusiasm for the 25 year flood plan, the 25 year sanitary sewer plan and other major municipal infrastructure. "Who has time to care about the storm plan when I'll be out of office in 3 years?"

If a community has a healthy general fund balance, or other contingency reserve, the pressure to tap into that reserve grows especially when the elected representatives are 2 years away from their next election.

Hence the emphasis on delivering projects in the short term influences the use of contingency reserves that may not be based on sound economic, budget or financial policy, but on the effect of voter approved term limits.

29. Patrick J. Ryan, Director of Administration, City of Chicago, Department of Law

Interesting comments, and more interesting would be a publication resultant from any work performed here.

From a local government perspective, I adhere to the fundamentals. Budgets should be spent in the year for which the appropriation is made, and any salvage should divert back to the respective fund balance and used according to agency policy and managed by those people, usually the budget office, responsible for such. Policies should address financial crisis and/or future year spending, not a diversion of funds back to the saving department.
This is a practical methodology, due to the many implications that have been brought forth in this dialogue. Ideally, public officials must beethical and accountable. If the relationship between managers and their respective budget office is positive and based on trust (or mutual working agreement), appropriations will be based on the planned budgets as presented by managers and decided upon by the budget office in accordance with available resources. Where accountability and trust do not exist, the agency and public will suffer until measures are taken to restore such values to the respective area(s). The reward for spending is made to managers during the budget process, for producing a positive spending plan. Budgeteers and/or analysts should be held accountable to monitor wasteful and/or wise spending during fiscal periods. Applicable decisions may then be made in subsequent fiscal year appropriations as to where funding levels should be accommodate. Managers may develop cost centers for certain current year spending, which allows flexibility and award incentives for savings within a fiscal period. Sub-units may be allocated a fixed dollar amount within appropriations, and be allowed to manage these dollars themselves. Thus any savings could be used by them, within the fiscal period, for other similar categorical purchases. Such sub-units must be held accountable for their decisions, to ensure that operational needs continue to be carried out relative to their financial decisions.

Fund balances should be maintained at an approximate 6-month level, and used primarily for cash flow and emergencies. Illinois agencies that rely on tax revenues often receive these in bi-annual installments, and these are not always timely. Agencies that also rely on accrued
revenues do not receive these in a timely fashion as well, and/or they have to be processed, which takes time. A fairly strong cash flow will allow an agency to meet their financial obligations until the budgeted revenues are received and retained in the respective funding areas. If an emergency situation warrants use of funds, consideration must be given to decide what amount of funding is available, and what processes must be enacted to legally spend such funds (if not included in the fiscal appropriation). Excessive fund balances should be transferred
out and utilized per statute. If these continue to grow, perhaps an agency is taxing and/or charging at excessive rates.

Fund balances, at least in tax generated funds, should be considered when an agency sets their annual tax levy ordinance. If fund balances are excessive, the tax levy may be protested as unwarranted by watchdog groups as well as utility companies, industries and railroad companies.
If reductions are awarded, this could have a devastating impact upon agency funding levels.

There currently is no catch-all solution, other than honesty, trust, accountability, disclosure and being the best stewards possible. The practical solutions are vested in adhering to these values.

30. Will Miller, State Government Administrator

I have experience this issue first hand at the end of the last fiscal year for the state. Legislators had looked at account balances at our flagship university and decided that we did not need a higher level of appropriations since there were many accounts with balances. So our chief financial officer emptied all accounts at the end of the last fiscal year. All the funds were taken into an account in central administration.

RIF (Research incentive funds) disappeared. Matching money for future grants that had accumulated over time in various departments and accounts disappeared. Any incentive for departments of faculty to think further than the end of the fiscal year disappeared. You would not believe the end of the year purchases that go on now. Every penny is spent on new computers or
equipment if it is really needed or just vaguely desired.

I have heard of cases of administrators hiding money in various protected accounts in order to do what they had planned for the coming fiscal year.

Budgeting is a very political process. Though I do understand the need for accountability, the ability to carry funds over from year to year provides some more "local" ability to plan and be entrepreneurial even with funds that are not essentially entrepreneurial. In situations like the one I have described, the losers are local decision makers and in many cases wise spending practices. The winners are the legislators who rationalize nonincreased funding and the central administration folk who get a windfall and then tighter control.

Perhaps it is not best to say what is best for all. Perhaps we can come up with some decision rules about which budget practices are best in any given situation.

31. Patrick J. Ryan, Director of Administration, City of Chicago Department of Law

I would not want to begin a debate (yet) on this issue, and understand that situations such as yours occur, based on many variables. I would be happy to provide further comments on political/administrative dichotomy issues of budgeting if this topic is taken to that level.

32. Irene S. Rubin, Northern Illinois University, (Professor Emerita)

In my experience, it is a reasonably common practice for the council and mayor to meet before the budget deliberations and talk about priorities for the upcoming year. Sometimes the same effect is gained by having budget office staff sift through council minutes to see what issues are of highest importance to them, to be sure those issues are included as appropriate in the mayor's budget proposal.

Your question as to what this does to the separation of powers has the answer embedded in it, it further blurs the line between them at the local level. However, the line was not very strong in cities to start with, especially in manager cities where the manager, who represents the executive branch, is appointed by the legislative branch and serves at its pleasure. The structure of government with a clear delineation between executive and legislative branches is strong at the state and national level (though there is some blurring in some states) but is generally much less important at the local level, without any apparent harm to governance as a result.

When the legislature can change the mayor's budget, but the mayor has a line item veto, there is surely no balance of powers, The mayor has the upper hand, even if there is separation of powers. The prebudget conference may even the playing field and may create a more balanced set of powers between the legislature and executive, and hence between the parts and the whole. Government may work better, and the intent of the design of government structures may be more nearly achieved.

I would like to hear from some cities that do this kind of consultation, about how well it works or in what ways it doesn't.

33. Mike Abels, City Administrator

I have served as an administrative officer in a city with a strong manager/council form of government. During my first two years the city’s budget process was noted by conflict between the legislative and executive branch resulting in a line item budget that was never approved before the beginning of the year with the city operating through a continuing resolution for the first two to three months in each fiscal year. Because of the breakdown in the governing process staff did not have a unified plan much less a vision to guide operations and services. A direct outcome was conflict between staff sections as they competed for short term resources as well as a complete lack of teamwork and coordination between operating departments.

We realized that the organization direction and resource utilization process was completely dysfunctional and that all stakeholders had to be involved if the situation was to be corrected. Two of the primary stakeholders were the mayor and members of the council. Staff was also an important stakeholder and became a member of the steering process that designed a new solution.

Essentially, to be successful I found you must elevate the decision process from personal opinion and interest to collective opinion that blends the individual opinions of the legislative and executive branch, and staff into an integrative planning process. In my experience the best procedure for accomplishing this is far more involved then just consultation and priority setting. Utilizing a process of strategic planning endorsed and approved by the legislative and executive branch is the only way to eliminate dysfunctional, short tem, conflict based budgeting. When properly designed the legislative and executive branch will in team with staff and citizens, be guided to identify strategic issues, and to design programs and services that will address these strategic issues. The process itself will require both the executive and legislative to give up some positional power and be willing to endorse integrative solutions for the sake of designing a successful collective plan. However, in the end through the adoption of the plan and accompanying budget document both the legislative and executive branches accomplish what they set out to do and that is to deliver more effective public services with the hopeful outcome that this will result in their reelection.

In the city I previously mentioned by successfully designing a city strategic plan we moved to a program budget that that was approved at least thirty days before the beginning of each fiscal year. The annual budget always addressed the five year action plan and all expenditures above a base level were targeted to new programs that addressed identified strategic issues and the related action plan for the issue. The one shortcoming we were less successful in addressing was the elimination of programs that were non-essential but had developed constituency support groups. The political, non-rational part of the process could not overcome this problem. Oh, and another outcome was that the city newspaper heartily endorsed the planning process as well as the budgetary outcome. The politicians, legislative and mayor looked well and they loved that positive public exposure.

So, in summary I would advocate a process that goes far beyond consultation. While they are two separate branches, the legislative and executive branch has a common interest. As such integrative planning is the only solution that will successfully solve dysfunctional conflict budgeting.

CONCLUDING COMMENTS

The dialogue demonstrates the wide variety of financial management topics and issues the participants deem to be associated with the issue of outyear agency savings and incentives to efficiency. Among the issue of note are the disagreement over the appropriate delegation of authority from central agency financial manages to line agencies, levels of trust between controllers and agencies, and accountability for responsible financial management. Some ethical dimensions of the issues discussed surfaced. Additionally, the variety of views based on local, state and federal experience is evident. It may be observed that academics at times have a different perspective on the issues and arguments from practitioners -- and that both academics and practitioners can learn much from each other's views.

There is no consensus agreement that emerged in the dialogue in response to the question raised initially by Steven Kelman. Rather, a significant range of opinion about whether savings would result if they could be carried forward and whether proposed reforms would change much of current practice. The issue of incentive to save is a critical element of the question and a wide variety of views are evident on this question. Many contributors to the dialogue acknowledge the inevitable influence of politics and political agendas as they affect financial and particularly budget behavior and strategy. The issue of what was termed, "urban legends" was raised over whether agencies had to "spend it or lose it?" in end of year budget execution. Evidence on this is mixed but many participants agree that the legend creates incentives to spend all accounts to zero by the end of the year. And where control agencies or politicians (e.g., the Governor of the State of Washington) can divert savings from agencies to other priorities, they will do so at times, particularly where savings are substantial and highly visible.

The key issue whether end of year spending is inherently wasteful was addressed significantly. Where agencies have a good "unfunded list" to guide end of year spending then perhaps waste is avoided or minimized. However, the issue of whose priorities should be met in end of year spending remains even when agencies know what they want to spend on at the end of the year. On the other hand, when agencies do not have clear end of year priorities, "efficient" (i.e., spending on the highest priority need) expenditure decisions are less likely to result. Still, one thing seems clear. When agencies are "given" new money to spend without warning on the last day of the fiscal year, the imperative to obligate on anything legal, whether needed or not, appears to be high. Does this ever happen in reality? In fact, it is a regular occurrence in the huge U. S. federal government. As a consequence, items are ordered in haste that may never be used and whose only impacts on the agency are to increase the risk of a negative audit finding and an predictable increase in inventory storage costs.

In such cases, it appear that enabling the agency to obligate funds beyond the one year period for which they are appropriated could result in increased efficiency and better use of revenues. In most agencies the amounts of funding left to be obligated on the last day of the year would, if permitted, be expended fully within the first ten working days of the new fiscal year -- or within a month after the previous fiscal year had expired. In this instance, much of the rhetoric against extending the obligation period for one year appropriations to two years, for example, seems hyper-extended and frets too much over a minor adjustment to appropriation law and current practice. Still, the issue is important because spending of the "last day -- no priority" type may be on the order of hundreds of millions of dollars in an annual budget of more than $2 trillion, roughly what the U.S. federal government now spends each year. Thus, the issue of how to spend end of year savings is not insignificant in all contexts. And, given the highly politicized nature of budgeting, if the magnitude of such spending was recognized widely, political actors would want to have some say in how accumulated savings should be spent, and rightly so given that the law gives them responsibility for taxing and spending.

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