

# **Chapter Three**

## **Creating a Strategic Approach to Budget Decisions**

By F. Stevens Redburn

## Creating a Strategic Approach to Budget Decisions

Our governing institutions must be reformed in order to meet the enormous tasks we face as a nation. At the core of any well-functioning government is a budget process that policymakers can use to make big decisions about resources in a rational, informed way:

- How much government?
- Paid for how, by whom, and when?
- What are the highest priorities for limited resources?

A properly functioning budget process would help stabilize and reduce the federal government's debt and do so intelligently by eliminating low-priority and ineffective public spending and tax expenditures (tax code provisions that work like spending programs), by investing in public assets to support stronger economic growth, and by reforming our tax system to collect revenue more efficiently and reduce its drag on private investment. If we cut spending without a strategic approach or raise tax rates without tax reform, we risk a period of slow growth and austerity that could economically cripple the country and threaten our position in the world. If instead we manage fiscal challenges strategically, we will be able to more effectively reallocate public and private resources to growth-sustaining investments vital for long-term fiscal stability.

In the face of its greatest fiscal challenge, the federal government's budget process as we have known it since 1974 has collapsed. It seemingly cannot function in the face of wide partisan and ideological divisions that exacerbate the conflict already inherent in a system of shared and dispersed authority.<sup>1</sup> The annual appropriations process used to make detailed choices about hundreds of important programs has practically seized up. Bigger choices about how to slow health care spending growth, deal with unemployment and slowing workforce growth, or modernize the tax system are being deferred. Increasingly, fiscal choices are made outside the normal budget procedures. But closed-door leadership negotiations and ad hoc temporary structures, such as the Joint Select Committee (also known as the Super Committee) established by the 2011 Budget Control Act, cannot substitute for a regular, comprehensive, orderly review of all elements of the budget.

A breakdown of familiar budget processes may create an opening for reform. The Peterson-Pew Commission on Budget Reform and others have proposed changes to make the process more organized, disciplined, far-sighted, transparent, and smart.<sup>2</sup> These reforms include setting fiscal targets in statutes, adopting fiscal rules and procedures to enact and sustain a multi-year plan to meet the targets, providing mechanisms to force policymakers to agree and enforce their decisions once made, and improving information on both costs and benefits of alternative policies and resource uses to inform decisions.

Beyond these reforms, the United States needs an approach that is more strategic in its scope and capacity to prioritize the use of resources. It needs

a new, rigorous review process that makes usable and uses information that we either now collect or could collect on the costs and expected results of alternatives. Put simply, given the hard choices ahead, the federal government needs to learn how to budget strategically.

## **Toward a Strategic Approach**

A more strategic approach to the budget would direct resources to the highest priority policy objectives and find the means to most efficiently and effectively realize those objectives. It would be more far-sighted, taking into account the implications of current policy for the government's ability to meet future needs. And it would take a much broader view of the federal budget than we are used to. This way of thinking about and approaching the budget would be a dramatic change from the current practice of enacting policies and appropriations piecemeal with little regard for the long-term costs or social benefits of those actions.

A strategic approach to budgeting requires a broader conception of what the budget is and does. Herbert Stein, former chair of the Council on Economic Advisors, once observed: "Most of the federal government's expenditures are for purposes that it did not serve 60 years ago and that are also served by the private sector and by state and local governments. Sensible decisions about those expenditures can only be made after considering the total national provision for those purposes, and not just the federal provision." To correct serious omissions from the budget process, including consideration of tax expenditures and regulations, Stein proposed that "we should budget the . . . GNP before we start budgeting [what] the federal government spends."<sup>3</sup> One benefit of a strategic approach is that it highlights non-budgetary ways—such as regulation—in which government can influence the allocation of national output.

A strategic approach requires explicit prioritization among important policy objectives, preferably tied to a comprehensive set of social indicators. Simon Johnson offers an example of strategic budgetary analysis: "The returns to higher education have greatly increased over [recent decades], and the income prospects for anyone with only a high school education (or less) are not good. If anything, the tax system should lean towards becoming more progressive—and investing the proceeds in public goods that are not sufficiently provided by the private sector, like early childhood education and the kind of preventive health care that helps prevent disruption to education . . ."<sup>4</sup>

A strategic budgeting approach also would recognize the complementary roles state and local governments and other federal partners play in shaping how society's resources are used. Most of what the government does to improve the environment, expand opportunities and provide health care for the

poor, build infrastructure, bolster homeland security, or pursue many other policy goals is done through various partnerships, with a mix of federal and non-federal resources and people.

Considering where we are and the nature of our governing system and politics, how do we get from here to a budget process that is more strategic in its approach? How do we define and inform the main strategic choices and their expected returns with estimates of long-term benefits and costs? And how can we organize and use that information to compare the effects of budget and policy alternatives and make better choices? In short, what would a more strategic budget process look like if fully realized?

A strategic approach would require:

- New ways of organizing and using information
- New decision methods
- Larger institutional reforms

One thing would not change: budgeting would remain a political process of balancing conflicting values, views of government and its role, and material interests. That process would be organized, however, in a way that helps policymakers decide how to translate their priorities into better results through smarter allocation of limited resources.

## Lessons from Other Countries

We can take lessons from other countries and some U.S. states that have reformed their budget processes to make them more performance-focused and strategic, leading often to better use of resources and different fiscal outcomes.

- The Netherlands has found performance reviews to be powerful, using them in 2009–2010 to cut budgets by 20 percent in 20 policy areas. Reviews are chaired by policy officials not responsible for the policies being reviewed. Options are presented to the government, which makes the final choices. Lack of impact evaluations and efficiency measures has hampered the exercise. However, when reviews were finished just before an election, major parties adjusted their platforms to incorporate many of the recommended options.
- In Canada, all spending is now systematically assessed over a four-year period and must demonstrate “value for money.” Strategic Reviews assess existing spending to ensure alignment with priorities, effectiveness, efficiency, and economy. New spending proposals must include clear measures of success and options for offsetting reductions elsewhere. Programs have been redefined around strategic objectives; departments are accountable for higher-level outcomes and are given more discretion about resource uses in return. The approach is being used now by the

Conservative government for decisions leading to achievement of a zero deficit by 2015.

- Most U.S. states have statute-based performance/results systems, tied in varying degrees to their budget processes, and sometimes used to redirect funds from poorly performing and low-priority programs to higher-priority and more promising uses. Virginia and Florida are among the leaders in using performance information to inform budgets. Florida's experience may be typical: it has had some success in improving legislative oversight and service delivery, but remains a work in progress.<sup>5</sup>

The federal government's experience resembles that of many state governments. It has put in place some building blocks of a performance-driven budget process, but progress has been gradual and documented payoffs remain scattered. If one generalization could be made about all experience to date, it may be that performance-informed budgeting can be introduced more fully and imposed on decisions with greater effect in parliamentary systems than in the more conflicted governance structures of divided powers and shared policy responsibility characteristic of the U.S. at both federal and state levels.

## Practical Next Steps

What are the practical steps required to move toward a more strategic way of budgeting? A set of new opportunities is offered by the GPRA Modernization Act of 2010 (P.L. 111-352). It requires the executive branch to identify selected "federal priority goals"—to improve policy outcomes that are the shared responsibility of more than one department or agency—and to plan and budget for these beginning with the FY 2013 budget process. OMB must consult with House and Senate budget, oversight, revenue, and appropriations committees on the goals' selection. And OMB is given a stronger mandate to develop an annual government-wide performance plan setting out the federal priority goals and designating a lead official responsible for each. Taken seriously and used imaginatively, such a plan could be the foundation for a more strategic approach.

To support strategic decisions, those who lead the budget process eventually will need to restructure budget decision-making around major enduring missions and long-term social goals. For each, the portfolio of spending, tax expenditures, legislative and regulatory mandates, and other policy tools must be regularly shaken to separate wheat from chaff.<sup>6</sup> Analysis of costs and benefits must be rigorous and empirically grounded. For greater independence and rigor, congressionally chartered institutions with a mission to provide technical and scientific policy advice—such as the National Academy of Public Administration and the National Research Council—could be tasked with some analyses.

It will take time and hard work, but the information used to budget and keep account of both costs and results must be reorganized around federal missions and goals, and analysis extended to tax expenditures. Budget development should begin with prioritization of the many important goals that the federal government pursues, with metrics tied to a comprehensive set of social indicators.<sup>7</sup> New structures of accountability can be established around each major and many smaller policy objectives. New procedures for systematic consultation between federal and state governments can be built for shared goals.

For its part, Congress must be prepared to revise and streamline its jurisdictional responsibilities in ways that facilitate integrated authorizations for and oversight of spending, tax expenditures, and other policy tools for each major federal mission.<sup>8</sup> And, as the executive branch is held accountable for performance, it must be given flexibility over the use of funds consistent with its explicit performance mandates and commitments.

All of this will require not merely technical and organizational changes, but also a mental shift. We must learn to conduct our fiscal affairs in a larger way and over a long horizon, to focus as much attention on benefits as on costs, and to measure our fiscal commitments both by their sustainability and by their contribution to society's highest aspirations.

## Potential Payoffs

How will we know when we have the kind of budget process we need? We will know when the big commitments are made in a form that permits accountability for results and are backed by the resources and legislative authorities necessary for their achievement. Resources will have been reallocated on a large scale from low-priority, unproductive uses to high-return investments. For example, low-priority, unproductive spending might include tax subsidies for mortgage-financed home purchases, crop payments to agribusiness, and militarization of the southwest border, in contrast with potential high-return investments such as targeted research and development, world-class education for poor children, and next-generation energy and communications technology. Making such strategic choices will increase the productivity of federal investments and have a corresponding, measurable effect on the economy's growth, individuals' well-being, and national competitiveness.

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## Notes

1. Some will argue that the budget process is endogenous to governance structures and political processes that must be reformed before budgeting can be improved. That view implies a long wait. Conversely, if the core processes of government, most especially the budget process, can be strengthened and in turn lead to better policy choices, these successes will not hurt and might even aid reform of larger political structures. International assistance to weak states often focuses early on budgeting as a core governance function around which to build other reforms.

2. For a comprehensive set of federal budget reform proposals, see Peterson-Pew Commission on Budget Reform, *Getting Back in the Black*, November 2010. Four papers published by the Commission in December 2011 present additional reform options.

3. Herbert Stein, "Governing the \$5 Trillion Economy," *Brookings Review*, Spring 1989, pp. 16–17. Today the economy's size is measured as the Gross Domestic Product, or GDP.

4. Simon Johnson, Peterson Institute for International Economics, Congressional testimony submitted to the U.S. House Ways and Means Committee hearing on "Tax Reform and Consumption-Based Tax Systems," July 26, 2011.

5. The Results First project at Pew Charitable Trusts, led by Gary VanLandingham, monitors and works with the states on this and related problems.

6. Paul Posner has advocated for this portfolio approach, cf. his testimony at: [http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing\\_id=58505a28-8157-474b-b5de-5e5ed291ee09](http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_id=58505a28-8157-474b-b5de-5e5ed291ee09).

7. Other countries lead the U.S. in developing such indicators and using them to guide policy choices. For a survey of such efforts, see *Key Indicator Systems: Experiences of Other National and Subnational Systems Offer Insights for the United States*, GAO-11-396, March 2011.

8. Alice Rivlin, former head of both CBO and OMB, has long advocated combining authorizing and appropriations committees around functions or missions; cf. Rivlin, "The Need for a Better Budget Process," *Brookings Review*, Summer 1986, pp. 3–10. Combined committees also would need to have jurisdiction over revenue provisions related to their function or mission to provide comprehensive reviews.