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# **Controlling Public Expenditure: The Theory of Expenditure Limitation**

by  
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What don't I mean by expenditure limitation? This paper is not about why governments should choose to limit spending. If governments wish to increase spending, that is obviously their prerogative. Moreover, they are, on the evidence, very good at it. Governments need no advice on doing what comes naturally. There need be no solution when there is perceived to be no problem.

The problem of expenditure limitation exists only when there is a public will but not yet a public way to hold down spending. For whatever reason, governments may wish to reduce the rate of spending increases or to hold spending to a fixed level (either absolutely or in proportion to national product or national income) and find themselves frustrated.

A desire to limit spending, of course, does not necessarily mean that citizens or governments dislike all or most or even any individual items of expenditure. They may well like each and every one considered separately and yet dislike the totals to which their desires add up. The people's preferences on totals may well be at variance with their preferences on individual programmes. Indeed, so far as one can judge from polls of opinion, this is precisely the state of the public mind: most expenditures are approved but total spending is disapproved. Reconciling these incompatible demands constitutes the contemporary political problem of public spending.

In this context, control over spending signifies that governments are able to set totals and stick to them. Obviously, this "setting and sticking" does not happen very often. The record is rather one of unrelieved failure interrupted only occasionally and for brief periods with temporary successes. Both absolutely and relatively to the size of the economy, public spending keeps climbing.

Why, we must ask, does government grow inexorably? Why do all efforts in all OECD member countries, so far as I know, fail to slow spending for other than short periods? Obviously, there must be a lack of correspondence between the causes of growth and the methods heretofore employed to contain them. What measures, we must ask in conclusion, would be efficacious? We must ask this question because, if there are no solutions, there are, in effect, no problems. "Imperfection" can still be "perfect" in the prudential sense that there are no known ways of perfecting performance. Before we reach that dismal conclusion, which I believe is unwarranted, we want to review and reappraise existing theories on the rise of public spending.

## 1. “Where is the institutional breakdown”?

Perhaps the answer is simpler than anyone suggests: working their will through democratic procedures, people are doing and getting what they want. Otherwise, as Brian Barry states so well, it is:

*important to know if the forces of electoral competition can be expected to operate in some systematic way to give people what they don't want, or more specifically to give them something that would be defeated by some alternative in a straight vote. For this would suggest that there is some kind of internal flaw of democracy...<sup>1</sup>*

Barry is inclined to believe there is no such flaw, or if there is, not of the kind that would lead to undesired high expenditures. Those who hold opposing views are also troubled by the thought that the political process is right and they are wrong. Their perplexity is worth pursuing; according to James Buchanan and Richard Wagner:

*The question we must ask, and answer, is: why do citizens support politicians whose decisions yield the results we have described? If citizens are fully informed about the ultimate consequences of alternative policy choices, and if they are rational, they should reject political office seekers or officeholders who are fiscally irresponsible. They should not lend indirect approval to inflation-inducing monetary and fiscal policy; they should not sanction cumulatively increasing budget deficits... Yet we seem to observe precisely such outcomes...<sup>2</sup>*

*There is a paradox of sorts here. A regime of continuous and mounting deficits, with subsequent inflation, along with bloated public sector, can scarcely be judged beneficial to anyone. Yet why does the working or ordinary democratic process seemingly produce such a regime? Where is the institutional breakdown?<sup>3</sup>*

Where indeed?

May I say as long and as loud as I can that I emphatically do not subscribe to theories of bureaucratic conspiracy or manipulation by politicians to explain the growth of public expenditure. “What”, Barry says, “could anyone hope for from a system characterised by a collection of rogues competing for the favours of a larger collection of dupes?”<sup>4</sup> I wish to puncture the preposterous Parkinsonian proposition that bureaucrats expand their programmes indefinitely by hoodwinking the population. Were these programmes not deeply desired by strong social elements, they would not prosper. It is not the conspiracy theory, but the Pogo theory (named after the comic strip character) that is applicable: *we have seen the enemy and they is us.*

## 2. A critique of conspiracy theories

The elegant theory of bureaucracy propounded by William Niskanen is far more intuitively appealing and aesthetically pleasing. By what criteria, he asks, are bureaucrats judged and rewarded? The difference between the results they achieve and the resources their agencies consume are not among them. Bureaucrats can not appropriate savings; neither can their agencies carry over funds. Rather their opportunities for promotion, for salary, and for influence increase with size irrespective of success. So they will want more (much more) for their agencies and programmes than citizens would prefer under similar circumstances.<sup>5</sup> So far so good. But why would citizens as voters elect governmental officials who would go along with this? If citizens think taxes are too high or expenditures too large, what stops them from using the ballot box to enforce these views?

I reject the conspirational views of the left, known as “false consciousness” or of the right called “fiscal illusion”, not because they are wholly wrong but because a partial truth is often worse than none at all. Poorly stated, the doctrine of false consciousness alleges that the mass of people in a capitalist country are indoctrined to prefer policies contrary to their real interests by a biased transmission of culture, from schools to churches to the media of communication. No doubt all of us mistake our interests: no one can jump out of his skin and pretend that he was born anew, untouched by human hands or immune from the presupposition of his society. None of this, however, signifies that others have a “true consciousness” enabling them to claim authoritatively that they know what is better for us than we do when we do it. In any event, in the current context, false consciousness would signify that expenditures are too low rather than too high, led by corporate propaganda to prefer private to public spending, which is not, as social workers says, the presenting problem.

Stripped of its surface of complex calculation, everyone can understand fiscal illusion, because no one understands ramifications of innumerable taxes and expenditures.<sup>6</sup> And citizens may systematically underestimate what they pay and what the government spends. That they pay a lot directly and indirectly, however, is obvious to the people. An example is the Witness Proposition 13 in California. Undoubtedly, in view of the unfathomable billions involved, citizens also underestimate the costs of various programmes. Since it would take only a few minutes for them to find out, however, I am not persuaded this matters much. Illusions exist, no doubt, but I do doubt whether they result in the euphoric feeling of escape from taxation.

Both false consciousness and fiscal illusion serve the function of explaining to followers why a left or right wing movement fails. They are the doctrines of inveterate losers. It can't be that people are against us, it must be

they are misguided. If they had the right information, would the people decide with full consciousness and without illusion to make the right (or is it left) choice?

Other observers of sound mind and sane disposition, find the public sector underfinanced. In explaining “Why the Government Budget is too Small in a Democracy”, Anthony Downs argues that a fully informed majority would want larger expenditure. This is so because voters (who politicians try to please in party competition) are consistently misinformed; they perceive the tax burden they bear far more severely than the advantages of programmes, many of which do not benefit them personally. This poor perception leads to the erroneous conclusion that government costs more than its programmes are worth.<sup>7</sup> The difficulty with Downs is that the opposite assumption – benefits are palpable and appear to be free, because they are not paid for in cash, whereas taxes have to be paid anyway or are hidden in the price of the commodities – appears equally plausible. Were Downs correct, it would be hard to explain why taxing and spending, spending and taxing, go up and up instead of down and down. Since total taxes and spending are widely perceived to be too high, not too low, an expenditure limit tied to economic growth would appear well aimed to restore the relationship between individual items and total expenditures, whatever the reasons they have drifted apart.

Arguing that society was affluent but public facilities were starved, John K. Galbraith insisted that individuals were indoctrinated by advertising into artificial wants – consumption for its own sake. Government, by contrast, he claims, is unable to advertise. Citizens would be better served, he claims, if they gave more income to government for public purposes.<sup>8</sup> Aside from the fact that advertising is not always successful and that people in countries without advertising appear to have remarkably similar preferences, the great question is why what Galbraith wants or what government does is superior to private preferences. Governmental advertising, in the form of public relations, actually is ubiquitous; Galbraith’s complaint must really be that it is ineffective. Is he arguing that politics is superior to economics? Not quite. Is he saying that some wants are superior to others? No doubt. What, then, distinguishes his or my preferences from yours and theirs?

Another view, with which I also disagree, though, like the others, only in part, is Gordon Tulloch’s theory that “the growth of the bureaucracy to a large extent is self-generating”.<sup>9</sup> The trouble with bureaucrats is that they vote: the more of them there are, the more votes they have, the larger they grow. In support of this hypothesis, (un)certain evidence may be adduced. Civil servants on average are more likely to vote than other people. Governments are much more labour intensive than private industry, not only where they perform services, as Baumol’s theory of increasing costs suggest,<sup>10</sup> but across-

the-board. And the larger the size of government, the higher its proportion of administrative costs. All this is tantalising but far from conclusive. Bureaucrats are by no means a majority. If I am correct in believing that in their role as citizens they don't like big government much more than the rest of us, they wouldn't vote for expansion in general. It's only their part of the public purse they defend. Indeed, according to poll data, 47% of state employees in California said they voted for Proposition 13. The grand queries remain: why don't the rest of us stop them or, even better, why don't their private stop their public selves?

### 3. Doing it to ourselves

The Pogo theory, by contrast, is that we-the-people (including citizens, politicians, and civil servants) are doing this to ourselves. This is a co-operative game. We don't like it – who said that people necessarily like what they do to themselves – but we do it. How? Why?

It is not only the big bad bureaucrats and their political protectors, but, as the song says, “you and me babe” that's at the root of our own problems. All of us are pure as the driven snow, it's just that we keep pushing expenditures up. Citizens like some of those programmes, indeed they do. Not all, of course, but enough to want to see them go up. Unfortunately, the only way to do that is to push everything up, partly because that's the price of support from other citizens (you provide the scratch for my programme and I'll provide the scratch for yours), partly because that's the necessary exchange with politicians who support our programmes but others as well, partly because there is usually no way to express a position in total spending aside from the items that make it up. Citizens want some spending more than others; they want their priorities to prevail; among these priorities is a preference for lower expenditure. Only the existence of the referendum route in California permitted voters to say that real estate taxes were too high without simultaneously having to repudiate their political parties or their representatives in the state legislature who they may still have preferred on other grounds. Public policy requires not only an aim but an avenue of redress.

Bureaucrats are not better. Just because they actively want more or passively can't resist, doesn't mean they want government to grow, at least not so fast. It's just that everybody's doing the same thing or they can't get theirs without going along with those other programmes. Like the citizenry (hell, they are the citizenry, at least a good part of it) bureaucrats bid up the cost of government without hardly knowing they are doing it. As the hero used to say in those old-fashioned seduction scenes, when he was inexperienced and she was eager, “It's bigger than the both of us”.<sup>11</sup>

Legislatures or Cabinets (singly or together) also enjoy spending more than saving. Like the rest of us, they enjoy eating except when they weigh it all together. Of all those writing on these subjects, William Riker's explanation of legislative expansion of the public sector comes closest, in my view, to the correct spirit. Riker says:

*I think it is probably the case that, if everyone (or if all rulers in a society) agreed to do so, they could obtain the benefits of reducing the size of the public sector. But no such agreement occurs and our question is to explain why it does not. The explanation I offer is that rulers are trapped in a system of exchange of benefits that leads to disadvantageous ... results.*

*The system works this way:*

*Step 1: Some legislators (or the leaders of some identifiable group with access to legislators) see an opportunity for gain for some of the legislators' constituents by the transfer of some activity from the private sector to the public sector. Usually such gain involves the transfer of a private cost to the public treasury... Typically, of course, the beneficiaries of the transfer are relatively small groups of citizens and only a minority of legislators have constituents in the benefiting groups. Typically also there exist other groups and other minorities of legislators who see opportunities for private gain in other transfers from private to public sectors. The combination of several minorities of legislators acting to benefit constituents are enough to make a legislative majority and so together they can produce significant expansions of the public sector.*

*Step 2: Such a coalition would be a socially harmless (though perhaps unfair)... But, of course, this successful coalition is only one of many. Entirely different coalitions, some overlapping, some not, obtain other kinds of transfers to the public sector: coalitions around public works, around military bases and contracting, among regulatory bodies and the favours they pass out to various small economic interests, etc. Beyond economic interests there are ideological interests around which legislators can ally themselves to win support by satisfying deeply felt values of some constituents: racial, ethnic, linguistic, religious, moral, patriotic, etc. – all of which can be promoted by expansions of public sector activities.*

*The consequence is that nearly every conceivable interest, economic and political, has some legislators promoting their own fortunes in future elections by promoting governmental service to that interest.*

*Step 3: Since each citizen with one or several interests served by these (usually minority) coalitions of legislators benefit as the coalitions succeed and since each legislator benefits in some degree from the gratitude thus generated in marginally important voters, nearly everyone benefits from successful actions to expand the public sector. Consequently, every legislator has a driving motive to form more or less ad hoc majority alliances of these minority coalitions in order to obtain some*

public benefits for every interest represented in the alliance. Were a legislator to refrain either from promoting some minority interests or from joining in larger alliances to obtain benefits, he (and his constituents) would merely suffer the costs of paying for the benefits for others while obtaining no benefits for themselves.

Yet in the end the society has a greatly expanded public sector with very high costs and considerable inefficiencies. It seems very likely to me that these disadvantages are so great that nearly everybody is worse off than if the public sector expansion had never taken place. It might be supposed, therefore, that everybody would have a motive to agree to forego public sector benefits – and indeed they do. But an agreement for a grand coalition for abstinence seems well-nigh unenforceable. Everyone has a motive to desert the grand coalition in the hope of getting some public sector benefit before others do so.<sup>12</sup>

The only difference between us is one of emphasis: Riker sees the governors doing in the governed and I see all of us in it together. Why did this not happen in the past and why is it happening now?

#### **4. Decline of Madisonian Theory**

In what he called the theory of a “compound republic”, James Madison expressed his hope and belief that the large geographic size of the country, as well as the variety of its peoples, would retard the formation of factions (which we would call pressure groups) acting adversely to the interests of others. It would, he thought, be too difficult for them to organise, confer, and act unless they were numerous and until they had secured widespread agreement. Organised interests would be few in number but large in size, reflecting in the very process of formation a general interest likely to be in accord with a shared view of justice. In his own words:

*The smaller the society, the fewer probably will be the distinct parties and interests composing it; the fewer the distinct parties and interest, the more frequently will a majority be found of the same party; and the smaller the number of individuals composing a majority, and the smaller the compass within which they are placed, the more easily will they concert and execute their plans of oppression. Extend the sphere, and you take in a greater variety of parties and interests; you make it less probable that a majority of the whole will have a common motive to invade the rights of other citizens; or if such a common motive exists, it will be more difficult for all who feel it to discover their own strength, and to act in unison with each other. Besides other impediments, it may be remarked that, where there is a consciousness of unjust or dishonourable purposes, communication is always checked by distrust in proportion to the number whose concurrence is necessary.<sup>13</sup>*

Modern technology has undermined these Madisonian premises. It is far easier and cheaper for people to get together than ever he could have imagined. Groups aiming at government are more numerous and specialised than they were and this process of differentiation shows no signs of stopping. All around the western world, articulation of interest increases with size of population, frequency of interaction, and growth of government, which makes it worthwhile to get together.

If modern means of communication were unanticipated, the reversal of political causality, comparable perhaps to redirecting magnetism, was not even dreamed about. Factions exerted force on government, not the other way around. Government might resist but it could on no account create a faction. These might, in Madison's famous phrases, be sown in the nature of man, but not at the behest of government. The more government does for or to industry and individuals the more they have to do to it. Instead of imagining industry instigating action by government, for instance, we now know that often government acts and industry reacts, its own organisation being a response to an interest government has, by its behaviour, newly created. So too do other levels of government organise after they observe incentives created by the central government.<sup>14</sup> Indeed, government now pays citizens to organise, lawyers to sue and politicians to run for office. Soon enough, if current trends continue, government will become self-contained, generating (apparently spontaneously) the forces to which it responds.

Think of public programmes as spheres existing in policy spaces. When these spaces are unoccupied, new programmes have only their own consequences to consider. As these programmes grow larger and are joined by others, they bounce off one another. The larger the number of big programmes, therefore, the more they bang into others, the more varied and indirect their consequences become. Past progress, moreover, creates future problems. Just as yesterday's pneumonia victim is today's geriatric problem, the medical inflation we suffer from today is a direct result of subsidizing hospital construction, encouraging comprehensive coverage, and otherwise flooding the medical market with money, thereby driving up prices. New programmes – cost containment, second opinions on surgery, restriction of hospital beds, on and on – become necessary in order to cope with past consequences. When programmes get big, involving millions of people and billions of dollars, they become such a large part of their sectors that, by their very presence, they alter its outcomes.

The larger government grows, the more policies become their own causes. The more government does, the more it needs to fix what it does. The larger government gets, the less it responds to events in society and the more it reacts to the consequences of its past policies. In an era of big government, policies increasingly become their own causes. Thus big government

exacerbates the spending pressure it has difficulty overcoming. If it appears to be moving in opposite directions – pushing spending up and down simultaneously – that is only the truth.

How is co-ordination carried out? Since they can not predict the consequences of their activities, the sectors of policy adopt a cybernetic solution. They tacitly agree to cope with the consequences caused by other agencies just as the others agree to cope with theirs. The cost of co-ordination is reduced to a minimum. What about the centre? The centre becomes another sector, specialised to macroeconomic management. In return for deference on adjusting the economy, it agrees (again, tacitly) not to interfere in agency operations, which, in any case, are too many and misunderstood to be dealt with in detail. This is how, as government grows more centralised, in the sense that there are super-departments, the centre disappears.

This line of sectors, each with a hand on the shoulder of the one nearest to it, could be described as engaging in a game of reverse musical chairs – when the singing stops there are extra chairs to fill. Their golden rule is that each may do unto the other as the other does unto it so long as there is more for both. The litany is well-known: doing well deserves more and doing badly deserves mountains of money because these unfortunate conditions must be alleviated. What must never happen to shatter the chain is for one sector to take resources from another. “Beggars thy neighbour” is verboten. The rule of “fair-shares”, dividing increases over the prior year and decreases from requests equally among agencies is characteristic.<sup>15</sup> Extraordinary programmes, with special appeal, may go up so long as others do not go down. There is, in the language of evolution, selection “up” but not “out”. Thus defence will not decrease but be kept constant while welfare grows. How are these happy accommodations possible? Because the public sector has been able to solve its internal problems both by absorbing the growth and decreasing the share of the private sector.

Summing up the system of incentives in central government spending, addition is easier than subtraction. Whenever there is a crunch, administrative agencies will add on the costs of their programmatic proposals; they will not, unless compelled, subtract one from the other. Subtraction suggests competition in which there have to be losers; addition is about co-operation in which (within government) there are only winners. When the economy produces sufficient surplus, spending grows painlessly; when there isn't quite enough to go around, spending grows noiselessly as inflation increases effective taxation or tax expenditures and loan guarantees substitute for amounts that would otherwise appear in the red. The budget grows. A downward dip now and again does not slow its inexorable progress.

The proximate causes of expenditure increases, of course, vary with the times. Earlier it was defence, more recently it has been social welfare,<sup>16</sup> soon it will be something else. Where there's a way, there is a will to spending. No sophisticated person doubts that as some spending declines, other sources will take its place. After all, our purpose is not to account for declines that never took place, but to explain the apparently inexorable upward trend of totals. The substance of spending is, therefore, for this particular purpose, less important than the observation that there is no law of budgetary gravity – what goes up need not (and almost never does) go down.

Once upon a time budgets used to be balanced. What has happened, we may ask, to throw them out of kilter?

## 5. Balancing the budget versus balancing the economy

Following the rule of a balanced budget was an effective mechanism for keeping expenditures down. The dislike of raising taxes exerted restraint on expenditure. Deficits were tolerated during emergencies – wartime and recession. But politicians expected retribution if they didn't obey the rule. The value of a balanced budget had been eroded on one side by technical developments: the replacement of the old cash budget with an administrative budget (including a wide variety of transactions, all sorts of trust funds and transfer payments) has made the meaning of a particular level of deficit problematical. The larger the size of the total budget, the more important small differences in estimates become. Application of the rhetoric of investment (distinctions between spending “above- and below-the-line” and capital versus operating budgets) has proved unfortunate. Capital items turn out to be almost anything; investment budgets mean economic development agencies whose real rationale is higher spending. Worse still, their power depends on seizing control of a portion of the budget and calling it their own, thus depriving Finance Ministries of financial flexibility.

To say that public officials once believed in the doctrine of the desirability of a balanced budget may seem like answering one question with another. What we want to know is why this doctrine was believed and acted upon and then abandoned. All these questions may be answered by focusing on the doctrine that replaced it, the neo-Keynesian idea of balance called full-employment surplus, a doctrine under which there would almost always be a deficit. The balanced budget was everything the full-employment surplus was not.

The attraction of Keynesianism itself is easy to understand. It involves just two variables – spend more when the economy is too slow, spend less when it is going too fast – that politicians on the run believe they can understand and, what is more important, can manipulate. The full-

employment surplus is even more attractive. Don't just balance the budget, dummy, balance the economy! Why worry about a purely technical balance when you are leaving resources and people underutilised. Spend to save. Old-fashioned ideas about the government being like the family, which must not spend more than it takes in, or inflation being connected to using debt financing and money creation to cover deficits, went by the boards. Eventually, higher levels of economic activity would generate greater revenues to bring the budget into balance. Today, the arrival of "stagflation", i.e. simultaneous unemployment and inflation, threatens to undermine the entire Keynesian edifice. For us, however, the important thing is that once balancing the economy becomes the norm, expenditure can undergo enormous expansion with the blessing of economic doctrine. The full-employment surplus, in a word, was a license (almost a commandment) to spend.

There is nothing like making a virtue into a necessity; as the politically expedient became the economically essential, spending became its own reward. And, during a period of rising affluence for many OECD member countries, the pleasure of increased spending did not cause a corresponding pain in taxation. Though the ideological rationale has come under increasing attack, and economic growth has slowed or disappeared, all accompanied by substantive inflation, however, spending still does not slow down. Efforts to limit spending are notoriously difficult to implement. In order to understand why total spending still exceeds desired levels, it will be useful to review the major approaches to limitation, without going into details inappropriate for a short paper.

## **6. Budgeting by volume**

Budgeting can be done not only in cash but by volume. Instead of promising to pay so much in the next year or years, the commitment can be made in terms of operations performed or services provided. Why might anyone want to budget in volume (or constant currency) terms? One reason, obviously, is to aid planning. If public agencies know they can count not on variable currency but on what the currency can buy, that is, on a volume of activity, they can plan ahead as far as the budget runs. Indeed, if one wishes to make decisions now that could be made at future periods, so as to help assure consistency over time, stability in the unit of effort – so many applications processed or such a level of services provided – is the very consideration to be desired.

So long as purchasing power remains constant, budgeting in cash or by volume remains a distinction without a difference. However, should the value of money fluctuate (and, in our time, this means inflation), the public budget must absorb an additional amount so as to provide the designated volume of

activity. Budgeters lose control of money because they have to supply whatever is needed. Evidently, given large and unexpected changes in prices, the size of the budget in cash terms would fluctuate wildly. Evidently, also, no government could permit itself to be so far out of control. Hence, the very stability budgeting by volume is designed to achieve turns out to be its major unarticulated premise.

Who pays the price for budgeting by volume? The private sector and the central controller. Budgeting by volume is, first of all, an effort by elements of the public sector to invade the private sector. What budgeting by volume says, in effect, is that the public sector will be protected against inflation by getting its agreed level of services before other needs are met. The real resources necessary to make up the gap between projected and current prices must come from the private sector in the form of taxation or interest for borrowing. In other words, for the public sector, volume budgeting is a form of indexing against inflation.

Given an irreducible amount of uncertainty in the system, not every element can be stabilised at one and the same time. Who, then, will be kept stable and who will bear the costs of change? Within the government the obvious answer is that spending by agencies will be kept whole. The central budget office bears the brunt of covering larger expenditures and takes the blame when the budget goes out of control, *i.e.* rises faster and in different directions than predicted. In Britain, where budgeting by volume went under the name of the Public Expenditure Survey, the Treasury finally responded to years of severe inflation by imposing cash limits, otherwise known as the traditional cold-cash budget. Of course, departmental cash limits include an amount for price changes, but this is not necessarily what the Treasury expects but the amount it desires. The point is that the spending departments have to make up deficits caused by inflation. Instead of the Treasury forking over the money automatically, as in the volume budget, departments have to ask and may be denied. The sectoral spenders, not the central controllers, have to pay the price of monetary instability.<sup>17</sup>

## 7. Multi-year budgeting

Multi-year budgeting has long been proposed as a reform to enhance rational choice by viewing resource allocation in a long-term perspective. Considering one year, it has been argued, leads to short-sightedness – only next year's expenditures are reviewed; over-spending – because huge disbursements in future years are hidden; conservatism – incremental changes do not open up larger future vistas; and parochialism – programmes tend to be viewed in isolation rather than in comparison to their future costs in relation to expected revenue. Extending the time-span of budgeting to three

or five years, it is argued, would enable long-range planning to overtake short-term reaction and substitute financial control for merely muddling through. Moreover, the practice of rushing spending to use up resources by the end of the year would decline in frequency.

Much depends, to be sure, on how long budgetary commitments last. The seemingly arcane question of whether budgeting should be done on a cash or a volume basis will assume importance if a nation adopts multi-year budgeting. The longer the term of the budget, the more important inflation becomes. To the degree that price changes are automatically absorbed into budgets, a certain volume of activity is guaranteed. To the degree agencies have to absorb inflation, their real level of activity declines. Multi-year budgeting in cash terms diminishes the relative size of the public sector, leaving the private sector larger. Behind discussions of the span of the budget, the real debate is over the relative shares of the public and private sectors – which one will be asked to absorb inflation and which one will be allowed to expand into the other.

A similar issue of relative shares is created within government by proposals to budget in some sectors for several years, and, in others, for only one. Which sectors of policy will be free from the vicissitudes of life in the short-term, the question becomes, and which will be protected from them? Like any other device, multi-year budgeting is not neutral but distributes indulgences differently among the affected interests.

Of course, multi-year budgeting has its positive parts. If control of expenditure is desired, for instance, a multi-year budget makes it necessary to estimate expenditures far into the future. The old tactic of the camel's nose – beginning with small expenditures while hiding larger ones later on – is rendered more difficult. Still, hard-in, as the British learned, often implies harder-out. Once an expenditure gets in a multi-year projection it is likely to stay in because it has become part of an interrelated set of proposals that could be expensive to disrupt. Besides, part of the bargain struck when agencies are persuaded to estimate as accurately as they can, is that they will gain stability so as not to be subject to sudden reductions according to the needs of the moment. Thus, control in a single year may have to be sacrificed to maintaining limits over the multi-year period; and, should the call come for cuts to meet a particular problem, British experience shows that reductions in future years, (which are always “iffy”) are easily traded for maintenance of spending in the all-important present.

The longer the term of the budget the less the control. Lengthening the cycle simply increases the commitments for future spending. If limits are what are wanted, it is not spending but limits on spending that should last for years.

## 8. Structural margins and balanced budgets

One such effort is the “structural budget margin” developed in the Netherlands. Due to dissatisfaction with the Keynesian approach to economic stabilisation, as well as disillusionment with its short-term fine-tuning, the Dutch sought to develop a longer term relationship between the growth of public spending and the size of the national economy. Economic management was to rely less on sudden starts and stops of taxation and expenditure, and greater effort was to be devoted to controlling public spending. The Dutch were particularly interested in a control device because of the difficulty of getting agreement to hold down expenditures in coalition governments. Spending was to be related not to actual growth but to desired growth, with only the designated margin available for new expenditure.<sup>18</sup>

Needless to say there are differences in definition of the appropriate structural growth rate and it has been revised up and down. Since the year used as a base makes a difference, that has also been in dispute. As we would also expect, there are disagreements over calculation of cash or volume of services with rising inflation propelling a move toward cash. Moreover, since people learn to play any game, Conservative governments used the structural budget margin to hold down spending and Socialists used it to increase it, for then the margin became a mechanism for figuring out the necessary increases in taxation.<sup>19</sup>

Would mandating a balanced budget help hold down spending? Balanced budget proposals are at once too rigid and too weak. Their rigidity prevents varying spending and taxation for counter-cyclical purpose. Their weakness lies in the permission they give for any level of spending, however high, so long as it is matched by revenues.

Balanced budget proposals also fall afoul of the rule of parsimony and the injunction against temptation. Limitation of any kind will be difficult enough without trying to control twice as much. Spending limits will inexorably lower tax rates and achieve budget balance over time without opening up new loopholes. By working with revenues as well as expenditures, for instance, manipulation of estimates of tax receipts joins the list of ploys by which expenditure may be increased without appearing to do so. In the case of the balanced budget, two temptations (on the revenue as well as the spending side) are worse than one.

But budget balancing does force us to face an issue hitherto hidden by the assumption that the purposes of expenditure limitation need not be discussed. It does matter whether limits are desired in order to reduce taxes or to avoid inflation or to keep the public or private sectors in some sort of correspondence. It matters because the level of the limit would be set differently. If the purpose is to reduce the size of the public sector, the limit

would be lower than to keep revenues and expenditures (or debt, if one prefers) within hailing distance of one another. The level of the limit is a matter of political philosophy.

## 9. Is item-by-item intelligent?

Up until now I have not specifically stated the most obvious and direct mode of expenditure limitation – acting intelligently on major items of expenditure. If you and I believe that expenditures are too high, the argument goes, we should say specifically which ones should be cut and by how much. If you want to cut expenditures, you must cut programmes. Simply stated, these words have much to command them. I know, I've used them myself. Talk about improving efficiency, reducing overlap or duplication, perfecting procedures, which may be valuable as far as it goes, ordinarily does not involve substantial sums that quickly cumulate into large savings. You only fool yourself if you think nibbling at the edges is a substitute for the main meal. I do not regret having gone along with this argument on micro-matters but, as I have suggested and will now state directly, analysing individual items is misleading as a general guide to limiting expenditures.

For one thing, that is what we have always done; “item-by-item” got us where we are today. There must be something wrong with it or we would not want to change. For another, the lack of a limit, especially since the decline of the balanced budget ideology, means that items need not compete with one another. Comparison of increments at the margins might indeed be intelligent if it ever happened. But we know better. What really happens is that each item is not compared but added to the others; and what we want is to substitute some subtraction for all the addition. How?

Who would take the lead in reducing expenditures? Each sector of policy is concerned with its own internal development. More money makes it easier to settle internal quarrels. Those who believe more is better for their agency or their clientele come to this position naturally. Those who favour radical restructuring of programmes soon discover that this is exceedingly difficult to do without sweetening the pie. The price of policy change is programme expansion. All internal incentives work to raise expenditures.

Suppose you and I agree to cut our preferred programmes in the common interest. What good would that do unless everyone else does the same? If “our” loss is “their” gain, why should we play this game?

The political process is biased against limiting spending item-by-item. Were substantial spending desired by strong and lasting majorities, the rules of the political game permit this preference to be registered in budgetary decisions. Spending is simple. Even in the face of indifference, letting things go on as they are automatically leads to increases. But should there be an

opposite opinion, reflecting a desire to slow down spending, it does not have an equal opportunity to manifest itself in the budget. There is no way for slow spenders to get together to enforce equal sacrifice so that the general rule becomes part and parcel of the calculus involved in individual spending decisions. To increase spending, no co-ordination is necessary; to decrease it, an enormous amount.

What about devices designed to compel consideration of lower spending? Programme budgeting is not among these because it is designed to get good programmes not less expensive ones. PPB has no budget limit. Zero-base budgeting is designed to lower spending on individual items, but it contains no overall constraint. Spending may slow down on some items only to rise on others.

“Sunset laws”, known mostly in America, require that agencies expire after a number of years, instead of continuing indefinitely, unless there is an affirmative vote. Because sunset legislation does not get at the causes of continuance but only at their outward appearance, it fails to affect anything except small and defenceless units. Termination, as Robert Behn has written,<sup>20</sup> requires a terminator. It requires political attack and political defence. None of this is forthcoming. The assumption that government grows because no one is looking is absurd. It is worse than foolish, because it deflects attention from deep-seated difficulties on the grounds they are due to inattention. Actually, attention is focused on all agencies that matter by those who are affected by what they do. Since there are so many agencies and more programmes, the whole exercise becomes *pro forma*. Because no advice is given or incentive offered on how to overcome entrenched interests, “sunset appreciation for beginners” is a lousy course. Why should public officials who spend all their waking hours establishing new programmes and defending old ones suddenly take the pledge?

So far, it appears, we have learned only a few little truths about limiting expenditures. Cash controls are better than volume; one year is preferable to many; exhortation for better budgeting is no substitute for incentives that would make it worthwhile for the participants in the process to spend less. Such incentives need to apply to everyone for a long time in order for it to be worthwhile for anyone to participate.

It appears that we have reached a dead end. If there were an effective ceiling, every participant would have to accept the prospect of getting less. The very thing that is desired – expenditure limitation itself – appears to be its own requisite. To see why expenditure limitation involves us chasing our own tails, so to speak, a feeling common among would-be controllers, let us conduct a little mental experiment.

## 10. “Gedanken Experimenten”

Imagine that there were an expenditure limit to which all governmental activities were subject for at least a decade and from which no one could escape. Would budgetary behaviour be different? What would happen inside government and outside in society?

Placed in wide perspective, the purpose of expenditure limitation is to increase co-operation in society and conflict in government. As things stand, the purveyors of public policy within government have every incentive to raise their spending income while reducing their internal differences. How? By increasing their total share of national income at the expense of the private sector. Why fight among their public selves if private persons will pay? They present a bill that, in effect, must be paid by higher taxes or bigger debt. Those who view government as an engine of income redistribution to increase equality do battle against those who stress leaving resources in the private sector so as to increase wealth. Thus, conflict is transferred from government to society.

Once there was a limit, however, the direction of incentives would be radically reversed: there would be increasing co-operation in society and rising conflict in government. Citizens in society would have a common interest whereas the sectors of policy – housing, welfare, environment, defence – would be plunged into conflict.

Organisations interested in income redistribution will come to understand that the greater the increase in real national product the more there will be for government to spend on these purposes. Instead of acting as if it didn't matter where the money came from, they would have to consider how they might contribute to enhanced productivity. Management and labour, majorities and minorities, would be thinking about common objectives, about how to get more out of one another, rather than about how to take more from the other. Governmental regulations that impose financial burdens would not be viewed as desirable in and of themselves, as if they were free, but would be balanced against the loss to the economy on which the size of social services depend.

If expenditure limitation takes hold, for every major addition to federal expenditure there will have to be an equivalent subtraction. The doctrine of opportunity costs, which states that the value of an act is measured in terms of opportunities foregone, will be alive and well in government. The consequences for agencies and the supporters of their programmes will be profound. For the first time in modern history, they will know that more for one means less for the other.

The incentive to improve internal efficiency will be immense. Knowing that they are unlikely to get more and may well get less (depending on the

state of the economy and disposition of the polity), agencies will try to get the most out of what they have. Efficiency will no longer be a secondary consideration, to be satisfied if nothing else is pressing, or no consideration at all if evidence that they can do with less would reduce their future income: efficiency will be the primary path of the steady states in which they find themselves.

Two things will be happening at once; each agency will be figuring out how to defend what it has and how to steal a march on the others in getting new programmes approved. Agencies will not be able to argue (as in time immemorial) that their proposal in and of itself is desirable (for there are few programmes utterly without merit or benefit for someone) but that it deserves a higher priority than others currently being considered. They will need to demonstrate defects in other agency programmes. Naturally, these other agencies will defend themselves. Instead of interested public officials having to ferret out weaknesses in agency programmes, they themselves will do that for us.

How might not only doing but using evaluation be made in the interest of agencies. What would be in it for them? Back again we go to making government competitive by limiting resources so as to increase internal conflict. Competition will improve information. In addition to outsiders demanding that agencies evaluate their own activities, insiders will insist that they do so as well. At long last the public will have learned how to turn the sectors instead of the citizens against one another.

Limitation would enforce a useful discipline. Instead of pleading with participants to use analyses, they will have their own motive for doing so. What's more, limitation would be self-enhancing. It would be in the interest of each participant to keep the others in line. Subtraction from someone else would become the necessary handmaid of addition to oneself. The fiction that central controllers can do it all themselves would be replaced by the reality of spenders saving from one another. Who guards the guardians? They guard each other.

## 11. Practicing the theory

It's a lovely thought (some would say "pipedream") for the question of how to get from here to there, from resource entitlements, where we are now, to resource limits, where we would like to be, remains unanswered. Some countries have coalition governments that make it difficult to resist demands by one of the partners. Other countries have minority governments too weak to resist majorities. All countries have parties and politicians and pressure groups who like to pre-empt the process by making their expenditure preferences mandatory. In all, the politics of indexing proceeds apace:

Conservatives want to index taxes; Progressives want to index spending; the likely result is a double knockout in which everything (and therefore nothing) is indexed so we are back to square one.

Yet, without appearing to have learned much, we have, I think, learned a good deal. Negative knowledge – knowledge of what does not work – is not to be despised. Impossibility theorems make up much of what is valuable in science. So, reasoning backwards, we may begin the long march to limitation by looking at what won't work at all and what might.

There may be a Santa Clause but there is no method that will tell governments how much to spend on this or that or whether to spend at all.<sup>21</sup> The methods leave much to be desired and are themselves based on value premises that require defence. How much you want, moreover, depends in part on how much you can get. Totals are not merely made out of items; items of expenditure, under any rational scheme, depend on totals. Just as one would do not only more but different things with a billion instead of a million, just as where you go has to depend on what you have to get there with, a decision on totals is part of a rational choice on the parts. As the song says, "you can't have one without the other".

Instead of searching for the holy grail of budgeting, the magic method that will only evaporate in the mist, budgeters should seek procedures and processes that give spenders an interest in saving. Establishing expenditure limits is one such incentive. Are there others?

As far as expenditure limitation is concerned, practice is as poor as theory. I am not aware of any sustained effort to bring budget and finance people together to share experiences. There is no study of efforts in various countries to control spending with assessment of what happened. As a member of a peace group told me, we are "experienced failures". If we are to learn, apparently, it must be mostly from our failures.

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