TENTH EDITION

PUBLIC BUDGETING SYSTEMS

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Dedicated to

Ann, Rob, Tatiana, Craig, Dan, Cameron, and Bob

and to

Sally, Ron and Amber, Jennifer and Scott, Zac, Landen, Lucas, and Abi

and to

Rita, Christopher, Mariah, and Samuel

In addition, the authors dedicate this new edition to the thousands of students, colleagues, and practitioners with whom we have associated throughout our professional careers.

Brief Contents

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Preface

This is a general book on public budgeting. Its purpose is to survey the current state of the art of budgeting among all levels of government in the United States. Where their inclusion is llustrative, examples from other countries and from some nongovernmental organizations are used. In addition, we emphasize methods by which financial decisions are reached within a system and ways in which different types of information are used in budgetary decision making. We stress the use of program information in a political system because budget reforms for decades have sought to introduce greater program considerations into financial decisions made in an inherently political process.

Budgeting is considered within the context of a system containing numerous components and relationships. A problem of such an approach is that because all things within a system are related, it is difficult to find an appropriate place to begin. Although we have divided the text into chapters, the reader should recognize that no single chapter can stand alone. Every chapter mentions some topics and issues that are treated elsewhere in the book.

A discussion of budgeting may be organized in various ways. Historical or chronological sequence is one possible method of organization, although this approach would require discussing every relevant topic for each time period. Another strategy is to arrange topics by level of government, with separate sections for local, state, and federal budgeting. Such an approach again would involve extensive rehashing of arguments and information. Yet another approach is to focus on phases of the budget cycle from preparation of the budget through auditing of past activities and expenditures. Rigid adherence to this approach would be inappropriate because the budget cycle is not precisely defined and many issues cut across several phases of the cycle. Another approach would be to organize the discussion around the contrast between the technical and political problems of budgetary decision making.

The organization of this book is a combination of these approaches. Although we have not formally divided the book, readers will see that the chapters easily group into five sections plus an appendix discussing the beginning of the COVID-19 recession. The first four chapters lay out an overall framework for budgeting, budget decisions, and budgeting systems. The discussion is of U.S. budgeting, but the framework is applicable for the most part to any budgeting system whether national, state, or local, or whether it is in Europe or any other continent. Chapter 1, *Introduction*, begins with the concepts of budgets and budgeting systems. It provides a general discussion of the nature of budgetary decision making, including distinctions between private and public budgeting, the concepts of responsibility and accountability in budgeting, the possibility of rationality in decision making, and the nature of budgeting and budget systems. Chapter 2, *The Public Sector in Perspective*, addresses the issues of the size of the public sector and the arguments about what is appropriate for the public sector versus the private sector. It reviews the scope of the public sector, the magnitude of government, the sources of revenue, and the purposes of government expenditures.

Chapter 3, *Government, the Economy, and Economic Development* goes into detail, primarily for the United States, in discussing government's responsibilities for and impacts upon the overall health of the economy. Specific attention is given to the government's role in periods of economic recession, the two most recent recessions being the Great Recession of 2007–2009, the worst recession since the Great Depression, and the COVID-19 recession that may replace the Great Recession as the worst recession since the Depression. Because the book's manuscript was being finalized at the onset of COVID-19, most of the material on the COVID-19 recession is in a special appendix. Only the first two quarters of this recession are covered.

Budget cycles are the topic of Chapter 4, which summarizes the basic steps in budgeting: preparation and submission, approval, execution, and auditing. Chapter 4 forecasts the more detailed discussions in the following two groups of chapters. Together the first four chapters provide a basic framework for the remainder of the book.

The next six chapters are organized around budget decision-making processes and the principal actors involved from the initial steps of budget preparation through budget approval by legislative bodies. These chapters set up the subject of budget decisions for the annual, recurrent budget, also called the operating budget. The topics are revenues and expenditures; reform efforts that have focused on improving annual budget decisions; and detailed budget preparation and approval. A separate chapter is devoted to the U.S. congressional approval process and its outcomes. In these six chapters we treat budget decisions on both the preparation and approval sides, and on revenues and expenditures. We note that reform efforts have focused almost exclusively on the expenditure side.

The purpose of these six chapters is to provide the reader with an understanding of the types of deliberations involved in developing a proposed budget. Chapter 5, *Budgeting for Revenues: Income Taxes, Payroll Taxes, and Property Taxes*, considers the different sources from which governments obtain their funds, the criteria for evaluating revenue sources, and specific sources such as income, payroll, and property taxes. Chapter 6, *Budgeting for Revenues: Transaction-Based Revenue Sources*, continues the discussion of revenues by considering sales taxes, user fees, and the like. Chapter 7, *Budget Preparation: The Expenditure Side*, discusses early budget reform efforts and contemporary approaches to developing proposals for funding government programs, including the use of performance information to inform decision making. Chapter 8, *Budget Preparation: The Decision Process*, examines the process of putting together a budget proposal that includes recommended revenue and expenditure levels and then reviews the types of budget documents that are used in government.

Chapters 9 and 10 deal with the budget approval process. Chapter 9, *Budget Approval: The Role of the Legislature*, provides a general account of the processes used by legislative bodies. Chapter 10, *Budget Approval: The U.S. Congress*, separately treats the special factors and problems associated with congressional budgeting.

The third grouping contains two chapters that concentrate on the execution, audit, and evaluation phases of budgeting. Chapter 11, *Budget Execution*, considers the roles played by the chief executive, the budget office, and the line agencies. The chapter discusses the topics of tax administration, cash management, procurement, and risk management. Chapter 12, *Financial Management: Accounting, Reporting, and Auditing*, presents the basic features of accounting systems and processes, reviews the various types of reports that flow from accounting systems, and explains the types of audits that are conducted. These chapters provide considerable detail on how budgets actually are implemented once the formal decision cycle through approval is complete, and how honesty and integrity are attained, or at least sought, through the accounting, reporting, and auditing systems and processes.

The fourth group of chapters focuses entirely on systems for making long-term investment decisions and financing long-term capital assets, in contrast to the previous six chapters that focus mainly on the annual operating budget. Of course much of the political processes involved in decisions on the annual operating budget apply to capital budget decisions as well. However, Chapters 13 and 14 deal only with decisions to purchase assets or make investments that will not be consumed or exhausted in a single year and, in many cases at the state and local level, will be financed over a long time period, sometimes as much as 20 to 30 years.

Chapter 13, *Capital Assets: Planning and Budgeting, Analysis, and Management*, examines capital budgeting as a decision process. Decision processes that focus on long-term capital budgeting and methods for financing capital investments differ significantly from decision processes for the annual revenues and expenditures discussed in Chapters 5 through 10. Decisions about capital budgeting actually occur throughout the budget process, although capital programming occurs during budget execution. Chapter 14, *Capital Finance and Debt Management*, considers the financing of long-term capital investments through debt and equity instruments.

The final chapter is separate unto itself in that it is more about the interactions among levels of government—in the United States, federal, state, and local—and not on specific decision processes. Chapter 15, *Intergovernmental Relations*, examines the financial interactions among governments, the types of fiscal assistance in use, and possible means of restructuring intergovernmental relationships.

The book closes with some brief concluding remarks on themes that can be expected to receive considerable attention from budgeting practitioners and scholars in the next several years. The bibliographic note provides guidance on keeping informed about changes in the field of budgeting.

Overall, this edition retains much of the structure of the ninth edition. As with that edition, this *Tenth Edition* includes increased attention to some topics, such as the longer-term results of the massive fiscal and monetary programs that were put in place to combat the Great Recession's effects. Many chapters look at various aspects of the growth in size of the annual budget deficit and the overall national debt. In particular, the chapters on budgetary decision making and approval discuss the consequences of an increasingly partisan climate that has hampered the ability to complete budget approval on a timely basis. Various revenue sources, capital budgeting, and state and local debt management also receive additional attention. This text also reflects the continuing impact of the need to combat potential and actual acts of terrorism and of the large increase in the costs of natural disasters and their human and economic impacts. Text, tables, and exhibits have been completely updated.

Drs. Lee and Johnson began the first edition as faculty members in the Institute of Public Administration at The Pennsylvania State University. Ten editions later, Dr. Lee is Professor Emeritus of Public Administration and Professor Emeritus of Hotel, Restaurant, and Recreation Management at The Pennsylvania State University. Dr. Johnson has retired as Executive Vice President for International Development and Senior Policy Advisor at RTI International. This *Tenth Edition* is now the fourth edition in which Dr. Philip G. Joyce plays a key role as an integral member of our writing team. He is Professor of Public Policy and Senior Associate Dean at the University of Maryland's School of Public Policy. The COVID-19 pandemic affected the completion of the book in some ways. Drs. Lee and Johnson had more flexible schedules to incorporate early information on the COVID-19 recession into the book, including adding the appendix. Dr. Joyce, as a senior associate dean, experienced the challenges of keeping a major university functioning for students converting to online instruction midway through the semester, while still managing his roles in this new edition.

Our hope is that this new edition will be useful to readers from many backgrounds and with widely diverse purposes.


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Acknowledgments

Having gone through nine previous editions, this *Tenth Edition* is the product of numerous individuals, not just its three authors. We are indebted to current and former colleagues at The Pennsylvania State University, RTI International, and the University of Maryland. Colleagues and students at other institutions, including a variety of colleges and universities, have provided valuable advice. Practitioners in the United States and many developing countries have helped refine our understanding with real-world situations. In preparing the book, we received considerable advice from expert practitioners in the executive and legislative branches of federal, state, and local governments and from their counterparts in nonprofit organizations. The responsibility for the final product, of course, belongs to us alone.

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CHAPTER 1

Introduction

Budgeting involves the selection of ends and the means to reach those ends. That is true for public budgeting, family budgeting, and budgeting in all types of other organizations. This text is about complex governmental institutions that make decisions about the ends to be pursued and securing the means to achieve those ends while operating in a complex world economy and society. The book considers budgets, budgeting systems, and budgeting processes; the nature of the decisions that are made; and the processes by which those decisions are made. Budgeting has always been about information. In contemporary society, information is available to politicians, public servants, and the public in vast quantities. Sorting out what information is available, relevant, and necessary to making budgetary decisions, and then assessing the accuracy and even truthfulness of what is purported to be information, is not a simple task. It is easy to see why many have characterized the twentieth and twenty-first centuries as “the information age.”[1] Budget systems are about gathering the best information available, whether that information be primarily of a technical nature or of a political nature, and bringing that information to bear on decisions about allocating resources to purposes.

A household budget in simpler times was a box with envelopes. Each envelope was labeled with the “purpose” (groceries, school lunches, clothing, gas for the car, etc.). In each envelope was cash, put in the envelope when a paycheck was cashed or any other income came into the household. That was the budget, containing the ends, or purposes, and the means, cash. Budgeting was estimating what the income would be for the month or taking stock of the money already on hand after cashing the paycheck and deciding how much to place in each envelope.

Today, organizations, governments, and other institutions such as churches do the same thing, but with larger purposes and resources. Public budgeting involves the division of society’s economic and financial resources between the public sector and the private sector, as well as the allocation of such resources among competing public sector needs. Public budgeting systems are systems for making choices of ends and means. These choices are guided by theory, by hunch, by partisan politics, by narrow self-interest, by altruism, and by many other sources of value judgment, including perceptions of the public interest and even avarice. It is not unusual for politicians to be accused of making public budget decisions because it will contribute to their private wealth.

Public budgeting systems work by channeling various types of information about societal conditions and the private and public values that guide resource allocation decision making. Complex channels for information exchange exist. Through these channels, people process information on what is desired, make assessments of what is or is not being achieved, and analyze what might or might not be achieved. Integral to budgeting systems are intricate processes that link both political and economic values. In making decisions that ultimately determine how resources are allocated, the political process uses sometimes bewildering and often conflicting information about values, actual conditions, and possible condition changes. This text analyzes procedures and methods—past, present, and prospective—used in the resource allocation process.

This chapter examines some basic features of decision-making and budgeting systems. First, some major characteristics of public budgeting are explained through comparing and contrasting with private forms of budgeting. Second, the development of budgeting as a means of holding government accountable for its use of society's resources is reviewed. Next, budgets and budgeting systems are defined. Finally, the role of information in budgetary decision making is considered.

Distinctions Regarding Public Budgeting

Budgeting is a common phenomenon that involves the allocation of what are invariably scarce resources. To some extent, everyone does it. People budget time, dollars, food—almost everything. The family hardware store budgets, Walmart budgets, and governments budget. Moreover, important similarities exist in the budgeting done by large public and private bureaucracies.[2]

Budgeting includes the following:

1. setting goals and objectives;
2. allocating the resources necessary to achieve those objectives;
3. monitoring the expenditure of those resources;
4. measuring progress in achieving objectives;
5. identifying weaknesses or inadequacies in organizations; and
6. controlling and integrating the diverse activities carried out by numerous subunits within large bureaucracies, both public and private.

Budgeting is the manifestation of an organization's strategies, whether those strategies are the result of thoughtful strategic planning processes, the inertia of long years of doing approximately the same thing, or the competing political forces within the organization bargaining for shares of resources. Once resources are allocated through the budgetary process, the organization's strategies become apparent even if they have not been articulated as strategies. A citizen who wants to know the long-term goals and strategies of their local government can normally find it in two places. The first is the town's vision (goals) or strategies, usually found on the town's website (either on the home page or a linked page). The second place is the town's budget, very likely also on the town's website. The result may be surprising, as sometimes how the town spends its money, as made visible in the budget, does not always appear to match the priorities as stated in the town's vision. The link between how tax dollars will be spent and the vision may not be clear.

Budgeting means examining how the organization's resources have been used in the past, analyzing what has been accomplished and at what cost, and charting a course for the future by allocating resources for the coming budget period. Whether this process is done haphazardly or after exhaustive analyses, whether it is carried out by order of the chief executive officer or requires the extensive input of citizens, it is still budgeting.

Public budgeting is also about assigning responsibility for accomplishing the results intended by the executive and legislative actors that ultimately set the budget. The mayor and the council, the governor and the legislature, the president and the Congress do not actually perform the work required to achieve results. Budgets are generally executed by individuals in large bureaucracies. Budget allocations identify not only the amounts to be spent and the intended purposes of those expenditures, but also the unit within the bureaucracy—and by implication, the individuals managing that unit—responsible for achieving the intended results. In the contemporary age, in which much of the value in any process, whether producing a commercial good or producing a public service, is in the information or knowledge applied, responsibility for budget decisions and budget implementation is vastly more complicated. First, the information available to the decision makers, whether they choose to use it or not, is much more extensive. Second, decision-making processes are highly visible to citizens and other stakeholders. Thus, for practical reasons, and because strong central government controls are politically less feasible than in the past in most countries, budgetary decisions are more decentralized than ever.

Public and Private Sector Differences: Objectives

Resource Availability

Important differences exist between the private and public spheres. In the first place, the amount of resources available for allocation in the budget process varies greatly. Both family and corporate budgeting are constrained by a relatively fixed set of available resources, even if vastly different in size. Income is comparatively fixed, at least in the short run, and therefore outgo must be equal to or less than income. Of course, income can be expanded by increasing the level of production and work, such as a member of the family taking a second job, or temporarily by borrowing, but the opportunities for increasing income are limited.

Governments, in contrast, are bound by much higher limits. In the United States, at least, government does not use nearly all the possible resources available. Only in times of major crises, such as World War II and the Great Recession (2007–2009), has the government of the United States begun to approach upper limits on its resources. In 1943, the federal deficit was 27% of the economy's total production (gross domestic product or GDP); it exceeded 20% in the next 2 years as well. Much of the economy's total production was spent directly and indirectly on the war effort. Rationing, price controls, and other measures were imposed to severely limit private sector consumption and, in its place, to allocate most of society's resources to the government. In the Great Recession, the federal budget deficit was almost 10% of GDP in 2009 and exceeded 8% in both 2010 and 2011.[3] Total debt (also called gross debt) outstanding is the cumulative debt owed by the government at any one time. During and immediately following the Great Recession, government borrowing, on top of decades of annual budget deficits, resulted in total government debt equal to or greater than total GDP. Borrowing during the recession had a different purpose, of course—to stimulate the economy and to put money in the hands of producers and consumers. (See the chapter on government and the economy for discussion of total or gross debt and debt held by the public, the latter being smaller than total debt, and the uses for each of the two concepts; the chapter on government and the economy and the chapter on budgeting for the U.S. Congress for a more detailed discussion of federal deficits and debt; and the chapter on capital finance and debt management for discussion of state and local government borrowing and debt.) The coronavirus pandemic, like the Great Recession, had major impacts on society's resources. The effects on public sector debt and the overall economy likely will last long after the health crisis ends.

During times not characterized by crisis, much of the total economy is left to the private sector, with government using only a fraction of society's workforce, goods, and services. In 2010, combined federal, state, and local government expenditures amounted to 36% of total GDP, with about three-fifths of that from the federal government. That percentage was several points higher, a result of government stimulus programs to combat the recession, than the 25% to 30% that was typical prior to that recession. Since 2010, all government spending in the United States has generally been about 32% to 33%.[4] That percentage is still on the lower end compared to most industrialized countries.[5] Government has the power to determine how much of society's total resources will be used for public purposes.

Profit Motive

Another major distinction between private and public budgeting is the motivation behind budget decisions. The private sector is characterized by the profit motive, whereas government undertakes many things that are financially unprofitable.

In the private sector, profit serves as a ready standard for evaluating previous decisions. Successful decisions are those that produce profits (as measured in dollars). Some companies, of course, focus on short-term profits, while others may take a longer-term view, but in the end, failure to achieve a profit or at least break even means the company goes out of business.

The concept of profit, however, can lead to gross oversimplifications about corporate decision making. Not every budget decision in a private firm is determined by the criterion of making an immediate profit. Corporations sometimes forgo profits in the short run. In the case of price wars, they attempt to increase their share of a given market even if it means selling temporarily at a loss. At other times, they incur large debts and take other, apparently unprofitable, actions to combat a hostile takeover, an attempt by an outsider to purchase enough stock to exercise control over a corporation's assets. Their major objectives are sometimes to produce a good product and to build public confidence; they have enough confidence in their pursuit of customer service that the result will be sustained, long-run profits.

At other times, corporations undertake actions for mainly social motives, wishing to make a contribution to the society that sustains their corporate existence, a concept known as corporate social responsibility.[6] Corporate social responsibility has grown in the decades since 2000 to be a significant motivation in many companies. Beyond the profit motive, many social objectives are important to employee retention and in positioning a company in the competitive market. Workforce diversity, equal opportunity, climate change, standards imposed on suppliers, customer data privacy, and many other issues affect corporate resource allocations and business practices now more than ever in history.[7] Still, in private sector firms, revenues must exceed costs over the long run.

Large firms also budget significant resources for research and development (R&D) activities, only a few of which will eventually lead to a product that generates large sales and profits. An R&D division can be evaluated over the long term by how many of its developments contribute to profits, but this kind of evaluation is difficult. Often, the results of R&D are subtle improvements in existing products, so measuring the amount of investment relative to the incremental profit gain is impossible. In this regard, private budgeting for R&D is no less difficult than the federal government's support of R&D. Overall, the evidence is that investing in R&D yields positive returns on that investment.[8]

Regardless of the role profit plays in the private sector, government decision making in general lacks even this standard for measuring activities. Exceptions to this generalization are government activities that yield revenues. State control and sale of alcoholic beverages, whether undertaken for profit or for regulation of public morals, can be evaluated, like any other business, in terms of profit and loss. Similarly, the operation of a water system, a public transit authority, or a public swimming pool can be evaluated in business profit-and-loss terms. This does not mean that each of these should turn a profit—after all, operating a public swimming pool may be the result of a decision to provide subsidized recreation to a low-income neighborhood whose residents cannot afford other private recreational alternatives. The budgeting process, however, can be used to assess the operation as a business to clarify the subsidy level and to aid decision makers in comparing costs with those for other public services provided free of direct charge. (See the chapter on capital assets.)

Nevertheless, most private sector budget decisions pertain to at least long-term profits, and most public sector budget decisions do not. Governments undertake some functions deliberately instead of leaving them to the private sector. Public budgetary decisions, for example, frequently involve allocation of resources among competing programs that are not readily susceptible to measurement in dollar costs and dollar returns. For example, there are no easy means of measuring the costs and benefits of a life saved through cancer research, although the value of future earnings is sometimes used as a surrogate measure of the value of life. The U.S. government undertakes large programs to control or eradicate malaria and other tropical diseases in Africa, based not on economic or financial returns, but on a broad concept of the public interest in eradicating diseases that affect low-income populations in developing countries. Addressing some diseases, such as Ebola and coronavirus that may have originated in other countries, serves not only a broad concept of the public interest but also to reduce the threat to the United States as the disease spreads. Nor is there a ready means of clearly separating private incentives from public incentives. For example, public budget spending on biomedical research in the United States has been just over 40% of total spending. Public sector spending, mainly through the various National Institutes of Health, is mainly for basic research and discovery; private sector spending is more concentrated on developing drug and other treatments and bringing them to market.[9]

Just because most public sector activities are not intended to be profitable does not mean that business-like measurement of results in relation to costs is useless. Although not susceptible to bottom-line or profit-and-loss measurement, many government programs are able to measure their results in terms of output (efficiency) and outcome (effectiveness). The disease eradication programs undertaken by the U.S. government in other countries, for example, can and are measured by the efficiency and effectiveness with which the programs are implemented. The chapter on the expenditure side of budget preparation includes an extensive discussion of the use of performance measures in federal-, state-. and local-level programs.

Public and Private Sector Differences: Services Provided

Public Goods

Some government services yield public or collective benefits that are of value to society as a whole, whereas corporate products are almost always consumed by individuals and specific organizations. When Ford Motor Company produces automobiles, people buying the automobiles use them to meet their own personal needs. When the Departments of Defense and Homeland Security produce a network for preventing nuclear devices from entering the nation's ports, that network benefits the public in general. Economists call these kinds of products and services *public goods*. They have two properties. The first is *nonexcludability*. Once the defense network is in place, no one can be excluded from its benefits, even if they are unwilling or unable to pay for them.[10] The second is *nonrivalness*. One person's use of the good or service does not diminish another person's use. For example, a second person can "consume" national defense without lessening the benefits that the first person gets from that public good. Of course, few public products and services qualify as pure public goods, and many goods and services produced by governments are also produced by the private sector. Police protection is a public service, but communities, companies, and individuals also purchase various forms of protection against crime from private security companies.

Externalities

Another class of government services consists of those from which individuals can be excluded but for which the benefits, or costs, extend beyond those who are the immediate targets of the service. When Ford Motor Company sells a car, its stockholders enjoy the benefits of the profits, but those profits do not spill over to society at large. However, when a child is educated through a school system, not only does the child benefit, but society's productive capacity is also enhanced. Many private schools educate children for a profit, and the owners of the schools enjoy the benefits of the profits in addition to the benefits experienced by children and society. However, it seems unlikely that these same for-profit schools would willingly provide equivalent education to all children who cannot make tuition payments. Economists label the benefits that spill over to the rest of society *externalities*. Governments provide at least some services that produce significant externalities because the private sector would provide these only to the extent that profit could be made. Education, if left entirely to the private sector, would presumably be available only to those who could pay or would be provided in insufficient quantity and quality for the needs of society. Government actions, or inactions, also may produce negative externalities. Reducing regulations requiring private companies to limit harmful releases into the air and water may save those companies money and increase their profits, but the health impacts from release of toxins are a negative externality, or cost, imposed on the population.

Pricing Public Services

Defining just what is clearly public in nature and determining what the private sector presumably cannot or will not provide is controversial. Notions of what are public services and what should be left to the private sector change over time. Many services, especially at the state and local level, once thought to be exclusively public were converted to private services or to public services provided by private firms on a contract basis when federal assistance dropped dramatically during the 1970s through the early 1980s.[11] That trend continued when state and local budgets shrank dramatically in the two recessions of the first two decades of the 2000s, though there is some evidence that smaller jurisdictions or smaller private contracting for public services has waned somewhat, while large contracts seem to be increasing.[12]

This trend advanced throughout many countries with public sectors even larger than in the United States. The Margaret Thatcher government (1979–1990), in privatizing many formerly public services, such as the water utilities, throughout the United Kingdom, served as a model for the early 1980s movement in the United States and around the world (See the chapter on capital finance for a discussion of various forms of privatization and private participation in public services.)

This type of conversion is not a new idea, but public sector budget pressures have changed the landscape to require those who benefit directly from a government service to pay for its cost. For example, in the 1990s, the U.S. Coast Guard stopped providing towing services to disabled boats unless a genuine emergency existed; it began notifying private operators, who charged the cost to the disabled boats' captains. That practice cut back significantly on calls for towing in general, with prices providing a rationing mechanism. What is private and what is public varies over time, and public budgeting is affected by those variations.

Other Public and Private Sector Differences

Whatever objectives, other than profit, that private corporations may have, to stay in business they must seek economic efficiency and obtain the greatest possible dollar return on investments. In contrast, governments may be intentionally inefficient in resource allocations, undertaking services that the private sector would be reluctant to provide at all. For example, government-financed medical care for the elderly may be inefficient in the sense that other government programs, such as education and infrastructure investments, provide greater economic returns to society, but it has been agreed that at least some support should be provided to the elderly. Governments are also charged with other unique responsibilities, such as intervention in the economy during periods of economic decline. (See the chapter on government and the economy.)

Another difference between private and public organizations lies in the clientele and the owners of the means of production. In theory, at least, both corporations and governments are answerable to their stockholders and clients. In the private sector, these individuals can disassociate themselves from firms by selling their stocks or not purchasing a company's products. Their counterparts in the public sector are denied this choice except through the extreme act of moving to another governmental jurisdiction. Private stockholders expect dollar returns on their investments, and if they are not satisfied, they sell their shares. Because government costs and returns are not so easily evaluated, the electorate has no simple measure for assessing the returns on the taxes they pay, and they have no means to sell their shares. Even so, many state and local governments provide annual reports to citizens that are similar in purpose to stockholder reports. These reports emphasize the investments government is making and the benefits citizens are receiving in lieu of profits. Of course, from time to time the stockholders of corporations and of governments force management to change, the latter through regular elections.

Corporate budgetary decision making is usually more centralized than government decision making. Corporations can stop production of economically unprofitable goods, such as a fast-food restaurant chain phasing out a nonprofitable menu item.

Given the nature of the public decision-making process, however, governments encounter more difficulty in making decisions both to inaugurate programs and to eliminate them. For example, though there was an apparent large majority consensus for more than two decades that the Medicare program that assists the elderly in financing health care should include some form of prescription drug coverage, it was not until 2006 that a program was finally implemented.

Responsible Government and Budgeting

The emergence and reform of formal government budgeting can be traced to a concern for holding public officials accountable for their actions.[13] The government performance monitoring movement represents the most recent manifestation of a rather ancient concern that public officials be held accountable for their actions. No matter the particular reform terminology in vogue, in a democracy, budgeting is a device for limiting the powers of government. Two issues recur in the evolution of modern public budgeting as an instrument of accountability: responsibility to whom and for what purposes.

Responsible to Whom?

Responsibility to Constituency

Basically, responsibility in a democratic society entails constituents holding their officials answerable, usually through elections. Elected executives and legislative representatives at all levels of government are, at least in theory, held accountable through the electoral process for their decisions on programs and budgets. In actuality, budget documents are not the main source of information for decisions by the electorate. Obviously, most voters do not diligently study the U.S. budget before casting their votes in presidential and congressional elections. However, when the government's share of the total economy grows, it is increasingly clear that voters do hold elected representatives responsible for the overall performance of the economy and often for the impact of a budget deficit, if any, on the economy. That the electorate holds presidents responsible for the economy was evidenced in 1992 by President George H. W. Bush's defeat in his bid for reelection. Eight years later, the 2000 election showed that even during a booming economy, many voters were more concerned about apparent ethical and moral lapses in the White House than their happiness with the economy. Not all elections turn on the state of the economy or the government budget. The rhetoric of Donald Trump's successful 2016 presidential campaign focused more on the concept of America's standing in the world and the concerns among disaffected blue-collar working-class families that the government did not care about them.

State and local governments have specific creditors: the purchasers of bonds issued to finance long-term capital improvements. The interest rates that state and local governments must pay on their bonds are affected by their ability to provide creditors with convincing evidence of their creditworthiness. Hence, financial institutions that purchase bonds and ratings institutions that rate state and local bonds are important constituents to whom these governments are accountable. (See the chapter on capital finance and debt management.)

The other accountability mechanisms are the concepts of *separation of powers* and *checks and balances* as means of providing for responsible government. Power is divided among the executive, legislative, and judicial branches, and each provides some checks on the others. Although the president is held responsible to Congress for preparation and submission of an executive budget, only Congress can pass the budget. Specifically, the U.S. Constitution, in Article 1, Section 9, states that "no money shall be drawn from the Treasury, but in consequence of appropriations made by law…."

Even that strong constitutional language is challenged from time to time. President Donald Trump reallocated funds appropriated to the Defense Department to the project to build a wall on the U.S. southern border, citing presidential emergency powers. A lower court ruled that this reallocation violated federal law. The Supreme Court in a 5-4 decision stayed the injunction issued by the lower court, on the technical grounds that the parties bringing the suit may not have been the proper plaintiffs.[14] In most states and many localities, the chief executive has a similar responsibility to recommend a plan for taxes and expenditures. The legislative body passes judgment on these recommendations and subsequently holds the executive branch responsible for carrying out the decisions. Local government practice varies more because some local governments do not have an elected chief executive.

Development of the Executive Budget System

The development of an executive budget system for holding government accountable was a long process that can be traced as far back as the Magna Carta in 1215. The main issue that resulted in this landmark document was the Crown's taxing powers. The Magna Carta did not produce a complete budget, but concentrated only on holding the Crown accountable to the nobility for its revenue actions.[15] At the time, the magnitude of public expenditures and the use of these funds for public services were of less concern than the power to levy and collect taxes. It was not until the English Consolidated Fund Act of 1787 that the rudiments of a complete system were established. A complete account of revenues and expenditures was presented to Parliament for the first time in 1822.[16]

The same concern in eighteenth-century England for executive accountability was exhibited in other countries and carried over to the American experience even prior to the ratification of the Constitution in 1789. Fear of a strong executive branch was evidenced by the failure to provide for such a branch in the Articles of Confederation in 1781. Fear of "taxation without representation" probably explains why the Constitution is more explicit about taxing powers than the procedures to be followed in government spending.

Modern Executive Budgeting

By the beginning of the twentieth century, changing economic conditions stimulated the demand for more centralized and controlled forms of budgeting. E. E. Naylor wrote that before this time there was little "enthusiasm for action … since federal taxes were usually indirect and not severely felt by any particular individual or group."[17] By 1900, however, existing revenue sources no longer consistently produced sufficient sums to cover the costs of government. At the federal level, the tariff could not be expected to produce a surplus of funds, as had been the case. Causes of this growing deficit were the expanded scope of government programs and, to a lesser extent, waste and corruption in government finance. The latter is often credited as a major political factor stimulating reform.

Local government led the way in the establishment of formal budget procedures. Municipal budget reform was closely associated with general reform of local government, especially the creation of the city manager form of government. In 1899, a model municipal corporation act, released by the National Municipal League, featured a model charter that provided for a budget system whose preparation phase was under the control of the mayor. In 1907, the New York Bureau of Municipal Research issued a study called Making a Municipal Budget that became the basis for establishing a budgetary system for New York City.[18] By the mid-1920s, most major U.S. cities had some form of budget system.

Substantial reform of state budgeting occurred between 1910 and 1920. This reform was closely associated with the overall drive to hold executives accountable by first giving them authority over the executive branch. The movement for the short ballot, aimed at eliminating many independently elected administrative officers, resulted in governors being granted greater control over their bureaucracies. Ohio, in 1910, was the first state to enact a law empowering the governor to prepare and submit a budget. A. E. Buck, in assessing the effort at the state level, suggested that 1913 marked "the beginning of practical action in the states."[19] By 1920, some budget reform had occurred in 44 states, and all states had a central budget office by 1929.[20]

Simultaneous action occurred at the federal level, and much of what took place there contributed to the reforms at the local and state levels. The Budget and Accounting Act, which established the new federal system, was passed in 1921.[21] In the interim, deficits were recorded every year between 1912 and 1919, except for 1916. The largest deficit occurred in 1919, when (largely because of the need to finance World War I) expenditures were three times greater than revenues ($18.5 billion in expenditures as compared with $5.1 billion in revenues). During this period, vigorous debate centered on the issue of whether budget reform would, in effect, establish a superordinate executive over the legislative branch. In 1920, President Wilson vetoed legislation that would have created a Bureau of the Budget and a General Accounting Office on the grounds that the latter, as an arm of Congress, would violate the president's authority over the executive branch. The following year, President Warren G. Harding signed virtually identical legislation, creating both agencies and imposing the requirement that an executive budget be presented to the Congress.

Thus, an executive budget system was established, despite a historical fear of a powerful chief executive. In 1939, as a result of recommendations made by President Franklin D. Roosevelt's Committee on Administrative Management (the Brownlow Committee), the Bureau of the Budget was removed from the Treasury Department and placed in the newly formed Executive Office of the President. This shift reflected the growing importance of the Bureau in assisting the president in managing the government. The Budget and Accounting Procedures Act of 1950 reinforced the trend of presidential control by explicitly granting the president control over the "form and detail" of the budget document.[22] The Second Hoover Commission in 1955 endorsed strengthening the president's power in budgeting as a means of restoring the "full control of the national purse to the Congress."[23] A president, who had full control of the bureaucracy, could be held accountable by Congress for action taken by the bureaucracy.

One of the stated goals of the reform movement was to bring the sound financial practices of business to the presumably disorganized public sector—a goal often expressed by current reformers. Available evidence, however, indicates that business practices were not particularly exemplary at the beginning of the twentieth century, suggesting that the reforms were largely invented in the public sector rather than being transferred into government from the outside.[24] It remains popular to advocate bringing good business practices to government, but the corporate accounting scandals at various periods in modern American history and the subprime mortgage investment practices of the major financial market institutions that led to the Great Recession suggest that private practices are not always exemplary.

Responsible for What?

Revenue Responsibility

The earliest concern for financial responsibility centered on taxes. As indicated earlier, the Magna Carta imposed limitations not on the nature of the Crown's expenditures, but on the procedures for raising revenue. The same concern for the revenue side of budgeting was characteristic of the early history of budgeting in this country. The Constitution is more explicit about the tax power of the government than about the nature or purposes of government expenditures.

Expenditure Control, Management, and Planning

The larger the budget has become, the more the concern has shifted to expenditures. Increasing emphasis has been placed on the accountability of government for what it spends and for how well it manages its overall finances. Expenditure accountability may take several different forms. Budgeting scholar Allen Schick described the focus on accountability in U.S. budgeting as having gone through three stages by the 1960s.[25]

The first stage he characterized as concern for tight control over government expenditures. The most prevalent means of exerting this type of expenditure control is to appropriate by line item and object of expenditure. Financial audits are then used to ensure that money is, in fact, spent for the items authorized for purchase. This information focuses budgetary decision making on the things government pays for, such as personnel, travel, and supplies—the objects of expenditure—rather than on the accomplishments of government activities. In other words, responsibility is achieved by controlling the resources or input side.

Schick's description of the second stage was that of a management orientation, with emphasis on the efficiency of ongoing activities. Historically, this orientation is associated with the New Deal (Franklin Roosevelt administration) through the First Hoover Commission (1949). The emphasis was on holding administrators accountable for the efficiency of their activities through methods such as work performance measurement. Budgeting by activity achieves accountability by measuring the activities carried out for the money expended.

The third stage of budget reform Schick identified was based on the post–Hoover Commission concern regarding the planning function served by budgets. The traditional goal of controlling resource inputs may be accommodated in the short time frame of the coming budget year. Managerial control over efficiency, although aided by a longer time perspective, also may be accommodated in a traditional budget-year presentation. The planning emphasis focuses on a longer time frame. Many objectives of government programs cannot be accomplished in one budget year; a multiyear presentation of the budget is thus necessary to indicate the long-range implications, both financial and program results, of current budget decisions.

The advent of program budgeting in the 1960s, with its focus on multiyear planning and the ultimate results of government programs, was the culmination of the planning focus on outcomes that must be measured outside the government itself. Control-oriented information like objects of expenditure and managerial-oriented information such as the outputs produced by government activities (and the costs to achieve those outputs) do not really require measurement outside the orbit of governmental agencies. A focus on outcomes requires much more extensive information that is not generated by the accounting system. Understanding outcomes requires information about what happens as a result of government expenditures. Typically, these outcomes are achieved only by commitment of resources over many budget years.

Some services provided by government lend themselves well to measures of accomplishment, and some do not. Federal responsibilities for defense and foreign policy certainly have visible consequences, but narrowing down to particular budget decisions on expenditures and defense or foreign policy outcomes is both conceptually and practically difficult at best. Local government services such as water, streets, solid waste collection and disposal, and so forth are much more susceptible to results measurement. The planning approach epitomized by program budgeting reforms stressed outcome measurement over a multiyear horizon. Are society's ends being achieved as a result of program expenditures? (See the chapter on the expenditure side of budget preparation for more extensive discussion of focusing on the results of government expenditures.)

Financial Management, Financial Condition, and Program Performance

Since those three stages were first characterized in the 1960s, additional improvements in using information to ensure responsible government budgeting have become standard practice. Some have suggested that these efforts since the 1960s constitute additional or new stages of budget reform. One author has offered up prioritization, characterized by budget cutbacks in both federal and state government budgeting in the 1980s, as a fourth stage, and accountability, emphasizing performance measurement, as a fifth stage.[26] Another has suggested a similar fourth stage, labeling it limitation, emphasizing the attempts in the 1980s to shrink the federal budget and state taxing and expenditure limitations.[27] (See the chapter on budgeting for revenues and taxes.)

While budgeting at the federal, state, and local levels continues to change in terms of emphasis and focus, the labeling of additional stages is somewhat in the eye of the beholder. It is difficult to discern a major difference between *limitation* and *control*, for example. It is also clear that some additional budgetary analysis and planning tools have become important in public budgeting systems since the three-stages description was first put forward. One of these is performance measurement and performance management, which enhances the ability to budget for the achievement of results. Another is financial management, which entails greater attention to the financial soundness of public sector institutions and new and enhanced tools to measure and report on financial soundness. Measuring financial health and increased use of business-like financial management tools enhances the ability of elected leaders to exert control over resources.

Performance Management

Performance measures associated with work activities and with long-term results are not new, as already noted. However, performance measurement has evolved and expanded since the 1980s. Program budgeting was much more an approach for the executive to gain greater understanding and control over spending by focusing on plans and results. Today, performance measurement and management have a strong emphasis on public reporting on progress and redefining programs based on citizen response to the measured progress. This emphasis on public reporting is a logical extension of the broader concept of *accountability for results* that characterizes budgeting systems and reforms in budgeting. Newer information tools are focused on external communications. Local government budgeting increasingly focuses on performance budgeting as the major tool for communicating with the public and garnering public support for the budget.[28] With or without a complete budgetary system overhaul such as program budgeting entails, all levels of government in the United States, and especially state and local government, typically have extensive performance management systems.[29]

Performance management emphasizes setting objectives and then motivating managers to be entrepreneurial in their pursuit of those objectives. Of course, although managing growth and achieving efficiencies is such a strong focus in performance management, the tools also may be used in government to shrink programs for other than managerial reasons. Other countries also have given the same emphases to results-oriented or value-driven budgeting as a primary tool in increasing the efficiency and reducing the size of the public sector.[30]

Financial Management

Another feature that has seen heightened focus is the financial health of the governmental entity or the entire government. There are two facets to this: (1) improved public reporting on the financial condition of government, and (2) a significant focus on the value and condition of long-lived assets such as infrastructure systems. Publicly traded corporations have always had to answer to their stockholders for the financial condition of the corporation, and privately held companies, at a minimum, must demonstrate sound financial condition to secure debt financing from lenders. But the application of financial management concepts to focus on the financial condition of government agencies was new in the late 1980s. The emphasis has been on creating tools for measuring the financial condition of government, adapted from private financial and managerial accounting practices, and new mechanisms for ensuring that the government remains in a sound financial position.

One of the motivations behind the concern to hold government accountable for its long-run financial position was the New York City budget crisis of the mid-1970s. Following on the heels of that near-bankruptcy, both financial institutions that purchased municipal bonds and citizens who wondered about their own cities sought to improve the reporting of the long-term financial position of governments. (See the chapter on intergovernmental relations for discussion of managing financial crises at the local government level.) At the time, the general operating budget and related accounting reports often did not reveal the overall financial position of the government entity. Now, virtually every large local and state government in the United States, as well as the federal government, routinely produces reports, often with much public fanfare on their financial condition.[31] Despite major improvements in government financial analysis and reporting, massive catastrophes such as Detroit's declaration of bankruptcy in 2013 can and do occur.[32] (See the chapter on intergovernmental relations for discussion of managing financial crises at the local government level.)

Fixed Asset Management

Concern at the federal level has led to a much greater emphasis on fixed asset management and increased attention in the annual budget to investments in long-lasting assets. The Governmental Accounting Standards Board Statement No. 34 (GASB 34) requires state and local governments and other public entities to report on their fixed assets (see the chapters on financial management and capital assets). Some government expenditures are really investments in future economic productivity. Others primarily consume resources with little hope of any future payoff. Investment means creating additional productive capacity, such as improving transportation networks that reduce the cost of private sector economic activity through more efficient means of transportation and upgrading education systems that enhance the long-term intellectual ability of students to develop new products and new processes. (See the chapters on financial management and capital assets.)

All governments budget for these activities, but not all government budgeting systems make explicit the consumption-versus-investment tradeoffs in budget decisions. While most state and local governments employ formal capital budgeting techniques, federal agencies typically do not, although in specific types of investments, such as information technology, formalized capital investment planning and analysis are required.[33] (See the chapter on capital assets.)

Most of the emphasis in this text is on the budget as an instrument for financial and program decision making at all levels of government—federal, state, and local. The one responsibility that most sharply differentiates federal budget decisions from state and local decisions is the federal government's responsibility for the overall state of the economy. Not only does the federal budget allocate resources among competing programs, but it is also an instrument for achieving economic stability and growth (see the chapter on government and the economy). The responsibility to use the federal budget as an instrument of economic policy has been a part of the federal budgetary process since the Employment Act of 1946.[34] (See the chapter on government and the economy.)

Budgeting is an important process by which accountability or responsibility can be provided in a political system. As has been discussed, responsibility varies both in terms of the people to whom the system is accountable and in terms of its purposes. Given the various forms of accountability and the types of choices that decision makers have available to them, different meanings can be attached to the terms *budget* and *budgeting system*. Depending on the purposes of a budget, decision makers will need different kinds and amounts of information to aid them in making choices. The following sections focus on the kinds of information required for different budgetary choices and the kinds of procedures for generating the necessary information.

Budgets and Budgeting Systems

What Is a Budget?

Budget Documents

In its simplest form, a budget is a document or a collection of documents that refers to the financial condition and future plans of an organization (family, corporation, government), including information on revenues, expenditures, activities, and purposes or goals. In contrast to accounting statements, which are mainly retrospective in nature, referring to past conditions, a budget is prospective, referring to anticipated revenues, expenditures, and accomplishments. Of course, budgets always contain some information about past revenues and expenditures that is consistent with accounting records. Historically, the word *budget* referred to a leather pouch, wallet, bag, or purse. More particularly, "In Britain the term was used to describe the leather bag in which the Chancellor of the Exchequer carried to Parliament the statement of the Government's needs and resources."[35]

The status of budget documents is not consistent across political jurisdictions. In the federal government, the budget normally means the president's budget recommendation and, as such, has limited legal status. It is the official recommendation of the president to Congress, but it is not the official document under which the government operates. As discussed in the chapter on Congress and budget approval, the official operating budget of the United States consists of several documents—namely, appropriation acts and laws authorizing mandatory spending and revenues. In contrast, local budgets proposed by mayors may become official working budgets adopted in their entirety by the city councils.[36]

In still other instances, there may be a series of budget documents instead of one budget for any given government. These may include (1) an operating budget, which handles the bulk of ongoing operations; (2) a capital budget, which covers major new construction projects; and (3) a series of special fund budgets that cover programs funded by specific revenue sources (see the chapter on financial management). Special fund budgets commonly include those for highway programs financed through gasoline and tire sales taxes. In such cases, revenue from these sources is earmarked for highway construction, improvement, and maintenance. As another example, fishing and hunting license fees may constitute the revenue for a special fund devoted to the stocking of streams and the provision of ample hunting opportunities. (See the chapter on financial management.)

The format of budget documents also varies. Overall, budget documents tend to provide greater information on expenditures than on revenues, which are usually treated in a brief section. On the expenditure side, budgets are multipurpose, in that no single document and no single definition can exhaust the functions budgets serve or the ways they are used. At the most general level, budgets can be conceived of as (1) descriptions, (2) explanations or causal assertions, and (3) statements of preferences or values.

Budgets as Descriptions

Budgets are first descriptions of the status of an organization, whether it is an agency, a ministry, or an entire government. The budget document may describe what the organization purchases, what it does, and what it accomplishes. Descriptions of organizational activity are also common in budget documents. Expenditures may be classified according to the activities they support. For example, a revenue department may be concerned with initial tax collection, taxpayer assistance, and audit/enforcement. Another type of description, organizational accomplishments, states the consequences of resource consumption and work activities for those outside the organization. For example, successful job placements for individuals finishing a vocational rehabilitation program constitute one type of outcome or consequence of a public expenditure. These statements require external verification of the effects of the organization on its environment.

As descriptions, budgets provide a discrete picture of an organization at a point or points in time, in terms of resources consumed, work performed, and external effects. The dollar (or euro or pound sterling) revenues and expenditures, according to these types of descriptions, may be the only quantitative information supplied. Alternatively, information may be supplied about the following:

1. the number and types of personnel;
2. the quantity and kinds of equipment purchased;

3. measures of performance, such as the number of buildings inspected, or the number of acres treated; and
4. measures of impact, such as the number of accidents prevented, the amount of crop yield increases, and so forth.

Generally, the more descriptive material supplied, the more the organization can be held accountable for the funds spent, the activities supported by those expenditures, and the external accomplishments produced by those activities. Much of the history of budget reform reflects attempts to increase the quantity and quality of descriptive material available both to decision makers and to the public.

Budgets as Explanations

When they describe organizations in terms of purchases, activities, and accomplishments, budgets also at least implicitly serve a second major function—explanation of causal relationships. The expenditure of a specific amount for the purchase of labor and materials that will be combined in particular work activities implies the presumed existence of a causal sequence that will produce desired results. Regardless of how explicit or how vague the budget document or the statements of officials may be, budgetary decisions always imply a causal process in which work activities → consume resources → to achieve goals. Some organizations may have little accurate information about accomplishments, especially public organizations whose accomplishments are not measured in terms of profit and loss. Governments may choose not to be explicit about particular results because they are difficult to measure, politically sensitive, or both. Regardless of the availability of information or the willingness of an organization to collect and use it, the budget is an expression of a set of causal relationships.

Budgets as Preferences

Budgets are statements of preferences. Whether intended or not, the allocation of resources among different agencies, among different activities, or among different accomplishments reveals the preferences of those making the allocations. These may be the actual preferences of a few decision makers, but more often they are best thought of as the collective preferences of many decision makers arrived at through complex bargaining. Preferences reflect, if not any one individual's values, an aggregate of choices that become the collective value judgment for the local government, state, or nation.

What Is a Budgeting System?

Systems

Budgeting can best be understood as a kind of system, which the Business Dictionary defines as:

> An organized, purposeful structure that consists of interrelated and interdependent elements (components, entities, factors, members, parts, etc.). These elements continually influence one another (directly or indirectly) to maintain their activity and the existence of the system, in order to achieve the goal of the system.[37]

Budgetary decision making consists of the actions of executive officials (both in a central organization such as the governor's office or the mayor's staff and in executive line agencies), legislative officials, organized interest groups, and perhaps unorganized interests that may be manifested in a generally felt public concern about public needs and taxes. All these actions are related, and understanding budgeting means understanding the interrelationships. Such understanding is best achieved by thinking in terms of complex systems.

A system may be thought of as a network typically consisting of many different parts with information flowing among the parts. The elements of systems interact with each other to produce system results, or consequences, and the network of interactions may produce the same set of results through several different paths, or the same path may from time to time produce different results.[38] Budgeting systems involve political actors, economic and social theories, numerous institutional structures, and competing norms and values, all of which produce outputs in patterns not immediately evident from studying only budget documents.

Budget System Outputs

In a budgetary system, the outputs flowing from the network of interactions are budget decisions, and these vary greatly in their overall significance. Not every unit of the system will have equal decisional authority or power. A manager of a field office for a state health department is likely to have less power to make major budgetary decisions than the administrative head of the department, the governor, or the members of the legislative appropriations committees. Yet each participant does contribute some input to the system. The field manager may alert others in the system to the emergence of a new health problem and, in doing so, may contribute greatly to the eventual establishment of a new health program to combat that problem. Modern information technology and the greater emphasis on responsibility at all levels of the organization for achieving results means the lower-level staff in an agency are much more influential than they have been in the past. Even actors not in the formal budgeting system may influence the decisions. For example, doctors and hospitals, who are part of surveillance for early detection of the latest flu, in effect are providing inputs to the budgeting system. When a crisis develops, the issue becomes one of who knew what and when and what was done. The Flint, Michigan, water crisis that developed in 2014 and continued into 2020 arose from an effort to reduce city water costs but resulted in contamination of the water distribution system and possibly the spread of Legionnaires' disease.[39]

Like the outputs of any other system or network, budget decisions are seldom final and more commonly are sequential. Decisions are tentative, in that each decision made is forwarded for action to another participant in the process. This does not mean that all decisions are reversible. Major breakthroughs, such as passage of the Elementary and Secondary Education Act of 1965, which provided substantial federal aid to education, are abandoned only in response to powerful political pressure.[40] The No Child Left Behind Act,[41] which reauthorized major elements of federal assistance to elementary and secondary education, continued most of the key elements of the original 1965 legislation, but the Every Student Succeeds Act of 2015 substantially reduced the federal role to funding support for state-controlled initiatives.[42] Likewise, the introduction of prescription drug care into Medicare in 2003 was only after years of debate and proposals.[43] Despite dissatisfaction, eliminating such hard-won programs once in place is nearly impossible. Subsequent budget decisions, therefore, are in large part bounded by previous decisions. The subsequent decisions tend to center on the question of changing the level of commitment—allocating more resources, fewer resources, or different kinds of resources—to achieve desired levels of impact or different types of impact.

System Interconnectedness

Another feature of a system is that a change in any part of it will alter other parts. Because all units are related, any change in the role or functioning of one unit necessarily affects other units. In some instances, changes may be of such a modest nature that their ramifications for other parts of the system are difficult to discern. However, when major budgetary reforms are instituted, they assuredly affect most participants. For example, if one unit in the system is granted greater authority, individuals and organizations having access to that unit have their decisional involvement enhanced, whereas those groups associated with other units have diminished roles.[44] Thus, each individual and institution evaluates budget reforms in terms of how political strengths will be realigned under the reforms.

Information and Decision Making

Types of Information

To serve the multiple functions described in the preceding section, budgeting systems must produce and process a variety of information.

Most of the major reforms, whether attempted or proposed, in public budget systems have been intended to reorganize existing information and to provide participants with new and greater quantities of information (see the chapter on the expenditure side of budget preparation). Basically, two types of information exist: program information and resource information. The latter is more traditional. People are accustomed to thinking of budgets in terms of resources, such as monetary units and personnel. A budget would not be a budget if it did not contain dollar, ruble, or other monetary figures. Similarly, budgets commonly contain data on employees or personnel. (See the chapter on the expenditure side of budget preparation.)

Conventional accounting systems provide much of the information that public organizations use for budgetary decisions. This type of information is limited to the internal aspects of organizations—for example, the location of organizational responsibility for expenditures and the resources purchased by those expenditures. When the decision-making system incorporates information about the results or implications of programs, one must leave the boundaries of the organization to examine consequences for those outside it. This step requires more extensive and more explicit clarification of governmental goals and objectives and increases the importance of analysis. These features of budget reforms, such as program budgeting, zero-base budgeting, managing for results, and performance budgeting, with their emphasis on program information and priority setting, have generated the most heat among critics of budget reform.[45]

Decision Making

Much of the criticism of reform has involved the arguments that reform of decision-making systems must take into account the limitations on human capabilities to use all the information that might be collected and analyzed and the strong influence of political considerations.[46] Although sometimes-subtle differences distinguish theories of how decisions are made, the various theories are often classified into three basic approaches: pure rationality, limited or bounded rationality, and incrementalism.[47] An early application of these notions to public sector decision making, still used in military leadership programs, is Graham Allison's study of the 1962 Cuban Missile Crisis, *The Essence of Decision*, in which he characterized three models as rational, organizational, and governmental/political.[48] These are descriptive theories as well as prescriptions for how decisions ought to be made.

Rational Decision Making

Decision making, according to the pure rationality approach, consists of a series of ordered, logical steps. First, an organization's or a society's numerous goals are ranked according to priority. Second, all possible alternatives are identified. The costs of each alternative are compared with anticipated benefits, and judgments are made as to which alternative comes closest to satisfying the relevant needs or desires. The alternative with the highest payoff and/or least cost is chosen. Pure rationality theories assume that complete and perfect information about all alternatives is both available and manageable. Decision making, therefore, is choosing among alternatives to maximize some objective function. The rational choice model is built on microeconomics and the notion of the individual actor making an optimal choice to maximize the decision maker's utility.

The applicability of the rationality model is limited, and few argue that it is a description of how ordinary human beings make most decisions. It is most consistent with notions of technical or economic rationality, where objectives can be stated with some precision and the range of feasible alternatives is finite.[49] Also, the model can be of use where accurate predictions of behavior are possible, such as in the private market, where assumptions regarding rational behavior can be used to predict future economic trends.[50]

As a description of how government budgeting works, the pure rationality model is obviously misleading. Meeting the complete requirements of even a few of the steps is impossible. It has been argued that the costs of information are so high as to make it rational to be ignorant—that is, to make decisions based on a limited search and limited information. Some attempts at budget reform have been criticized as attempts to impose an unworkable model, pure rationality, on government financial decision making. The use of program information has been a particular target for criticism.[51] However, this criticism is somewhat misdirected in that it is not the information search cost that is limiting. The widespread availability of electronic information searches and sophisticated software to analyze both quantitative and qualitative information make information search cost less of a limiting factor. The more limiting factor is the limited capacity of the decision-making system to process the information in a given budget cycle. Public budgeting decisions are made in a larger political context with numerous actors involved, each with their own perspectives. This is a much more complicated situation than the clear-sighted approach toward an agreed-upon objective that is the essence of the rational choice model.

Limited or Bounded Rationality

The second approach to decision making is called limited rationality, or sometimes bounded rationality. This model recognizes the inadequacies in the assumptions behind the pure rationality description of decision making as applied to complex problems. While acknowledging the inherent constraints of human cognitive and political processes, limited rationality does not suggest that a deliberate search for alternative approaches to goal achievement is of no avail. Searching for alternatives is used to find solutions that are satisfactory but not necessarily optimal.

Limited rationality suggests that large forces are marshalled at times for major change, and incremental adjustments are made at other times for issues that do not generate demand for substantial departure from the status quo. Decision theories do differ in how they view the values that decision making serves and the capacities of decision makers to serve those values. One model assumes virtually no limits on human capacities for processing information, another suggests that decision making should be sensitive only to partisan political interests, and still other attempts to strike a balance between the other models. The history of budgeting and budget reform, we argue, reflects the tensions among these approaches to decision making.

Incrementalism

The third approach to decision making, incrementalism, sometimes labeled muddling through, is more akin to the organizational and political processes of actual decision making identified by Allison. It has been advocated as more realistic by critics of pure rationality, such as Charles E. Lindblom, Aaron Wildavsky, and others.[52] According to this view, decision making involves a conflict of organizational and individual interests and a corresponding clash of information that results in the accommodation of diverse partisan interests through bargaining.

"Real" decision making is presumed to begin as issues are raised by significant interest groups that request or demand changes from the existing state. Decision making is not some conscious form of pure rationality, but a process of incrementally adjusting existing practices to establish or reestablish consensus among participants. Alternatives to the status quo are normally not considered unless partisan interests bring them to the attention of the participants in the decision-making process. There is only a marginal amount of planned search for alternatives to achieve desired ends. The decision process is structured so that partisan interests have the opportunity to press their desires at some point in the deliberations. Decisions represent a consensus on policy reached through a political, power-oriented bargaining process.

The most important characteristic of the muddling through, or incremental, approach is its emphasis on the proposition that budgetary decisions are necessarily political. Its descriptive appeal is that it more accurately depicts a process in which numerous actors, each with a different point of view, negotiate and bargain for a consensus. The larger the issue, the more difficult it is to achieve consensus for radical change, which results most often in incremental adjustments to the status quo. Whereas a purely rational approach might suggest that budgetary decisions are attempts to allocate resources according to economic or other "objective" criteria, the incremental view stresses the extent to which political considerations outweigh calculations of optimality. The strongest critics of many budget reforms have tended to equate those reforms with seeking to establish the pure rationality model or a solely economic model, a description rarely accepted by those proposing budget reforms. As will be seen throughout this text, any "real" budget reform is forced to accommodate the political nature of decision making. In reality, elements of rationalism and incrementalism pervade the budgetary process.[53]

It is evident that many decisions are indeed incremental, and clearly each budget decision does not require a thorough review of all options and careful calculations of the possible outcomes of each option. Yet major decisions that depart dramatically from the past are made from time to time in the budgetary process. Nonincremental change, especially at the macro level, addressing major deficits and surpluses, does occur.[54] And, of course, major events such as terrorist threats and creating a new agency such as the Department of Homeland Security cause nonincremental change, although the core of federal budgeting did not change significantly after September 11, 2001.[55] Furthermore, decision makers often do attempt to achieve public values and are motivated more by the social and economic problems their agencies must address than by bureaucratic budget maximizing and interest-group pressures.[56]

Summary

Public budgeting involves choices among ends and means. Public budgeting shares many characteristics with budgeting in the private sector, but it often requires the application of criteria different from those used by private organizations. Chief among these differences is that few public sector decisions can be assessed in terms of profit and loss. Private sector decisions, in contrast, ultimately must consider the long-run profit-or-loss condition of the firm.

Budgeting systems involve the organization of information for making choices and the structure of decision-making processes. Public budgeting systems have evolved as one means of holding government accountable for its actions. Budgetary procedures are developed to hold the government in general accountable to the public, the executive branch accountable to the legislature, and subordinates accountable to their managers. Budgetary procedures also are developed to specify what the executive is accountable for. Concern for the financial solvency of some city governments and the size of the federal budget deficit and total debt have led to reform proposals to use budgeting as a device for holding governments accountable for their long-term financial position. Renewed interest is evident in citizens demanding that governments report regularly on their performance.

Budgetary systems work through information flows. However, each participant in the budgetary process pays selective attention to information. The various theories of decision making differ in terms of how much information decision makers are willing and able to consider. The decision-making approach that seems best to characterize budgetary systems is the limited rationality approach. This approach underlies the discussions throughout this text.

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CHAPTER 2

The Public Sector in Perspective

Depending on how we are affected personally by government and our general philosophical views about the roles of the public and private sectors, we have different and sometimes contradictory views about the public sector. Some may think it is too big; some may think it is too small. Often, we do not think of the government at all, except when government intrudes in obvious ways. Federal income tax filing time in the United States is one of those intrusions, and it often leads one to say: "Government is too big; I pay too much in taxes." The Great Recession and the coronavirus crisis were two dramatic events that led most people to demand faster and more massive responses from both federal and state governments.

One danger of generalizing about the size of the public sector of society is that any single generalization necessarily ignores important information. Although the statement "government is vast" may be valid, it fails to recognize the difficulties in determining what is and is not government or the fact that government is also small in some respects. The chapter explores three main topics. The first is the relative sizes of the private and public sectors of society and the reasons for the growth of government. The second is the magnitude of government and the historical growth of local, state, and federal finances. The third section contrasts the purposes of government expenditures with the sources of revenue used by the three main levels of government in the United States.

Relative Sizes of the Private and Public Sectors

Basic to all matters of public budgeting is the issue of the appropriate size of the public sector. This issue is inherently political, not only in the partisan sense but also in the sense that it involves fundamental policy questions about what government should and should not do, and what it can and cannot do. At stake are a congeries of competing public and private wants and needs and competing philosophies of the role of the public sector in society. Many of the framers of the Constitution wanted to keep the central government small to protect individual liberty. However, other early leaders, such as Alexander Hamilton, sought a more active role for the new government.[1]

Reasons for Growth

Value Questions

The issue of size relates to the values of freedom and social welfare. Keeping government small has been advocated as a means of protecting individuals from tyranny and stimulating individual independence and initiative. In contrast, critics charge that sometimes reliance on the private sector causes the underfinancing of public programs and the failure to confront major social problems.[2] Some people argue that the behavior of large mortgage lending institutions in the years immediately prior to the Great Recession was in part caused by placing too much faith in an unfettered—or more precisely, unregulated—private sector.

The U.S. political system, of course, is not structured in such a way that any single and overriding decision is made as to the size of this sector. The multiplicity of governments makes it virtually impossible to reach any single decision about overall governmental size. Decisions relevant to size are made in a political context within and between the executive and legislative branches and among the three major levels of government—local, state, and federal. Decisions by all these branches and levels of government contribute to an ultimate resolution of the question, but the resolution is really a result of tallying many individual choices. And any time we decide to measure the size of the public sector, we are only capturing a snapshot at that point in time. Significant changes in public sector size occur over time, sometimes quite rapidly.

Government Responses

Why government expands has been the subject of extended debate.[3] One of the two main reasons is that government is being "responsive" to the demands of society. Wagner's law of increasing public spending, originally proposed in the 1880s, holds that economic growth creates demands for new activities that government alone can perform.[4] The second reason is that government has a supposed propensity to grow. In this case, government grows as a result of empire building by government bureaucrats, supported by political leaders.[5] Among the numerous factors suggested as stimulating responses from government are the following:[6]

- *The need for collective goods.* Because defense, homeland security, disaster response, and some other programs benefit all citizens and cannot be handled readily by the private sector, the government becomes involved. When wars occur, governments grow; after the conflict, they tend to remain larger than during the prewar period. Education is another important collective good. Educated people tend to be more productive and increase the total wealth of the society, and the private sector cannot be relied on to provide an appropriate level of public education.
- *Demographic changes.* Increases in total population and in the number of newborns and the elderly stimulate the creation and expansion of government programs.
- *Changes in living patterns.* As people move from rural to urban areas, and then from cities to suburbs, demands for government services follow them. Governments must then provide more schools, roads, public utilities, and public safety.
- *Externalities.* Industrial firms, which are concerned mainly with making a profit, may pollute the air and water. Government is expected to control the social costs arising from these private actions.
- *Economic hardships.* Depressions and other negative economic situations stimulate the growth of government.
- *High-risk situations.* When risks are high, the private sector is unlikely to invest large quantities of resources, so government is called upon to support programs. Examples include the development of nuclear energy as a source of electrical power, dealing with a worldwide pandemic, and the creation of the space program. Once the risks of certain aspects of space activity became manageable as a result of government intervention, commercial interests engaged in space research and moved into the launching of private vehicles and satellites.
- *Technological change.* With the advent of new technology, government has provided support, as in the case of roads and airports, to accommodate improved transportation modes and information highways, such as the Internet, and to regulate new industries, as in the case of railroads, radio, and television.

These reasons are helpful in explaining why government is necessary and why it has expanded over time, but they do not give a single answer to the question of whether the size of government at any one point in time is too large, too small, or just right. Proposals to expand or contract the scope of the public sector also reflect many political considerations. Principally, any proposal for the expansion of services that results in an increase in taxes is likely to have unfavorable political repercussions. Therefore, the size issue always relates to both government expenditures and revenues (taxes, user charges, and fees). Decision makers, no matter how crude or approximate their methods of calculating, attempt to weigh the merits of coping with the current situation with the available resources against the merits of recommending new programs that may alleviate problems but at the same time raise the ire of taxpayers. The appeal of Donald Trump in 2016 to reduce government's domestic and foreign commitments caught the imagination and matched the beliefs of many voters, enough perhaps to turn sufficient numbers of voters who normally voted for Democratic candidates to elect him the 45th President. Of course, campaign promises of presidential candidates to reduce the size of government, or to introduce new programs, are easier to promise than to achieve.

Private and Public Sector Boundaries

Major problems are encountered when attempts are made to gauge the sizes of the public and private sectors and to distinguish between one government and another. Government has become so deeply involved in society that one may frequently have difficulty discerning what is not at least quasi-public. Moreover, governments have extensive relationships with each other, to the point where a discussion of any single government becomes meaningless without a discussion of its relationships with other governments.

Statistical data on government revenues and expenditures fail to reflect adequately the size of government. For instance, the entire political campaign process is clearly governmental in that substantial sums of money are spent to elect people to political offices. These funds are not recorded as government expenditures, but nonetheless are "governmental" in nature.[7] Federal Election Commission statistics show that spending in the 2016 presidential election exceeded $1.8 billion, about the same as the last campaign with no incumbent running, and more than four times the amount spent in the 2000 election.[8] Also, the size of government tends to be understated in cases where government activities require relatively little money and personnel but have a substantial impact on the private sector or other governments. This is especially true with respect to regulatory activities, such as the federal government's control of interstate commerce, occupational safety, and environmental health.

Nonexhaustive Expenditures

It can be misleading to rely exclusively on revenue and expenditure data for measuring size for another reason. Sometimes the assumption is made that all government expenditures represent a drain on the private economy. In fact, government expenditures can be nonexhaustive as well as exhaustive. Exhaustive expenditures occur when government consumes resources, such as facilities and manpower, that might otherwise have been used by the private sector. Nonexhaustive expenditures occur when government redistributes or transfers resources to components of the society instead of consuming them. Interest payments on the national debt, unemployment compensation, aid to the indigent, and old-age and retirement benefits are major examples of nonexhaustive government expenditures. Nonexhaustive expenditures, while not consumed by government, generally are redistributive, namely moving money from one group of people to another.

Another form of nonexhaustive expenditures is investment for the future, whether for capital facilities (see the chapter on capital assets) or for services, as in education for children. Government aid to small businesses, support of research and development, and similar activities are forms of investment in future economic development. As a result of these kinds of expenditures, the cost of government is less than the total dollar figures reported in budgets. Some money that is spent by governments will generate future revenue for both society and its governments.

Effects on the Private Sector

Government expenditures have specific effects on industries, occupations, geographic regions, and subpopulations. These effects are especially evident in the field of defense. During the Cold War, clusters of firms and their employees became highly dependent upon defense outlays, resulting in what President Dwight Eisenhower in 1961 decried as the military-industrial complex. The role of defense contractors in the Iraq and Afghanistan wars, or more generally the war on terror, if anything has magnified Eisenhower's concern about the interdependency between the defense industry and military budgets. Over a decade after 9/11, disbursements to contractors comprised about 57% of total military spending.[9] The case could be made that a dangerous symbiotic relationship developed between the military, with its penchant for new weaponry, and corporations eager to supply such weaponry. Periodic scandals in defense contracting offer seeming confirmation of the fears expressed by President Eisenhower.

The effects of defense are particularly pronounced regarding employment, despite the downsizing that has occurred since the end of the Cold War. In 2019, civilian employment in the Department of Defense accounted for just over 0.4% of the private sector labor force. In addition, in 2019 the federal government employed more than 1.3 million active duty armed services personnel. Total military and civilian defense employment constituted 1.2% of total U.S. employment in 2019.[10] Those figures are almost unchanged over the past 15 years.

The effects of defense expenditures on the private economy also have been substantial. Defense expenditures account for a significant percentage of private sector jobs in various industries. The creation of defense-related jobs entices people into educational programs that help them develop the requisite skills. As a result, people are attracted to technical career fields that are dependent upon continued defense spending. These people suffer or flourish based on which policies prevail.

Geographic and Industry Effects

Military research, development, and procurement are of such great magnitude that many specific industries and corporations become quasi-public institutions. In 2017, the Department of Defense obligated $320 billion in total contracts. Of this amount, 93%, or $299 billion, was for work performed in the United States. These contract values were considerably down from 2008, which had $401 billion in contracts for work in the United States and $21 billion for work outside the United States.[11] Defense expenditures greatly influence the private sector—in firms that engage in shipbuilding, aircraft construction, and telecommunications, to name just three examples—and the importance of defense expenditures on the private sector increases in periods of defense buildup. Besides providers of military equipment, such as Boeing, General Dynamics, General Electric, and General Motors, numerous consulting and research and development firms are dependent on military expenditures. Nondefense contracting firms are similarly dependent, with 60% to 80% of their revenues coming from government contracts. The role of contractors in Iraq and Afghanistan in performing what had historically been military functions, and in the massive reconstruction programs, received special attention from government watchdog agencies, such as the Government Accountability Office, and the appointment of Special Inspector Generals for Iraq and Afghanistan in the face of charges of poor oversight, waste, fraud, and simply an excessive reliance on contractors mounted.[12]

Employees of these varied private sector firms, judging from their length of service on government projects, are doing work that otherwise would be done (and, in many cases, used to be done) by career civil servants. One difference between these contractors and the civil servants they supplant is that the pay of managerial staff in these firms is often higher than that of similarly trained government employees. Professional salaries, such as for engineers and scientists, tend to be relatively equal, because government must meet private sector salaries to recruit and retain professionals.

Another difference is that private sector employees do not necessarily constitute an ongoing expense to the government. These workers are not protected by civil service laws and are ineligible for government pension benefits. Furthermore, when these workers' services are not needed, government has no obligation to them as it would to its own employees. When partial government shutdowns occur, contractors possibly go without payments and in turn do not pay their employees who normally work on government contracts.

The geographic effects of defense expenditures are equally important because they are not uniformly distributed throughout the nation. In 2017, the Department of Defense spent \$407 billion on payroll and contracts within the United States. Five states—California, Virginia, Texas, Maryland, and Florida—accounted for \$173 billion, or about 43% of that total.[13]

Defense, while the most striking example of private dependence upon public outlays, is not the sole example. Highway construction also involves large sums of public money. The employees of construction firms specializing in bridge and highway construction are, in effect, government employees. The same is true for suppliers of road-building equipment. A related size measure is the role of contracted personnel producing public services in place of federal employees. In 2015, an estimated 4.3 million individuals worked for federal agencies and on federal programs as contract or grant employees.[14]

In some cases, the impact of government on an industry is greater as a result of what government does *not* do than what it *does* do. The federal government's choice not to tax interest paid on home mortgages (see the chapter on budgeting for revenues and taxes), for example, has a far greater effect on the housing industry than all federal expenditures for public housing and redevelopment.

The lack of clear-cut distinctions between the public and private sectors and between one government and another is evident in education. Elementary and secondary education are a function of local governments (cities, towns, counties, school districts), but about one-half of the funds used by these districts comes from state governments, with additional funds coming from local sources of revenue, primarily property taxes, and some funds from the federal government. The states have the primary role in funding public higher education, with important federal support, especially in the form of student aid and research financing. Governments also selectively subsidize private colleges and universities. Private corporations also make important contributions to both public and private schools. In 2002, the U.S. Supreme Court ruled that it is constitutional for governments to use public funds to provide vouchers to parents whose children attend private or parochial schools.[15] Since that ruling, some states have adopted statutes permitting school vouchers, but most have not.

In addition, the level of funding may understate the degree of federal involvement in elementary and secondary education. The federal government can, as a condition of the receipt of federal assistance, insist that state and local governments adopt policies they might otherwise have chosen not to adopt. The best recent example of this was the federal No Child Left Behind Act, which forced state and local governments to adopt specific accountability standards in the form of testing requirements in order to continue to receive federal funds.[16] Under the constitutionally provided federal system, the national government cannot directly compel states and localities to establish such standards, but the threat of the loss of federal funds is sufficient to encourage most to go along with the federal requirements. The Every Student Succeeds Act, replacing No Child Left Behind, substantially reduced the federally imposed testing requirements, providing funding for state-designed testing and other accountability programs.

Subpopulation Effects

Taxes and expenditures affect different subpopulations in different ways. In the example given earlier of the federal government allowing income tax deductions for interest paid on home mortgages, the middle and upper classes benefit far more than lower-income groups, who are typically renters rather than homeowners. This tax expenditure—namely, the government's not taxing something that could be taxed—has a redistributional effect in favor of the middle and upper classes (see the chapter on budgeting for revenues: income taxes, payroll taxes, and property taxes).

Government actions also have important effects on generations, including those yet to be born. Taxing and spending policies can help or harm children (born and unborn) through health and education programs, the working-age population through transportation programs, and the elderly through government-sponsored nursing care and the like. Future generations benefit from government programs that encourage investment in economic development, but excessive debts that governments may accumulate may harm these same people in the future.

The Magnitude and Growth of Government

There are many ways to measure the magnitude of government, but measurements of dollars and people are generally the easiest. By focusing on revenues, expenditures, and numbers of employees, we can use comparable standards in contrasting governments with each other and with private organizations. These measures, then, are the main ones used in this section. While care has been taken in making these comparisons to obtain the most recent and accurate data possible, some of the data here must be considered approximate.[17]

Revenues

One approach to assessing the size of government is to compare many governments with each other, as well as with large private sector organizations. **Table 2-1** makes such comparisons, using revenues or receipts, which allows comparisons among private and public organizations.[18] The table ranks the 25 largest governments and industrial corporations in the world, as measured by revenues. Eleven of the 25 are governments, with the U.S. federal government ranked first. Significantly, 14 of the world's 25 largest organizations are not governments at all, but are instead private sector corporations (all multinational), with Walmart coming in as the eighth largest. No U.S. state governments make the list of 25; California is the closest, but 23 global corporations' revenues were higher than California's.

Figure 2-1 shows central government revenue as a percentage of gross domestic product (GDP) for 2017 for Organization for Economic Cooperation and Development (OECD) countries, excluding two countries with no data for 2017. On that list, the United States ranks sixth from the bottom, probably surprising to most U.S. citizens. Note, however, that the figures are for central government revenues only. Many OECD countries are unitary states, so that all government revenues are central, whereas government in the United States, as noted in this chapter, includes substantial financial roles for state and local governments. Thus, comparing the U.S. federal government only with countries that have no state and local governments is somewhat misleading. Adding state and local revenues to federal revenues and dividing by GDP moves the United States three more places up the list, but it is still near the bottom. One other observation is important, and that is that the revenue figures do not consider borrowing. U.S. expenditures as a percentage of GDP are considerably higher—37%—than U.S. revenues—16%—due to expenditures financed by borrowing (see the chapter on government and the economy for a discussion of deficits and debt).

A comparison of organizations in the United States only also demonstrates the significant size of the governmental sector, although in the past decade, the growth of U.S. corporations has pushed all but one state government out of the list of the 20 largest organizations in the United States (see **Table 2-2**). California ranks 15th. If we consider the top 50 U.S. organizations, New York State would be ranked 35th.[19]

These statistics dramatically underscore the need for caution in generalizing about governments or private corporations. It is necessary to recognize the important differences in the functions of government and industry and the methods by which these organizations make decisions (see the introductory chapter discussion of public

Table 2-1 Twenty-Five Largest Governments and Industrial Corporations in the World by Revenues, 2017

Rank	Governments	Revenues (Billions of Dollars)	Private Corporations
1	United States (Federal)	$3,316.2	
2	Japan	$1,516.2	
3	Germany	$1,387.0	
4	France	$1,194.3	
5	United Kingdom	$874.0	
6	Italy	$792.1	
7	Canada	$532.8	
8		$500.3	Walmart
9	Spain	$441.5	
10	Australia	$362.0	
11		$348.9	State Grid
12		$327.0	Sinopec Group
13		$326.0	China National Petroleum
14	Netherlands	$322.0	
15		$311.9	Royal Dutch Shell
16		$265.2	Toyota Motors
17		$260.0	Volkswagen
18		$244.6	BP
19		$244.4	Exxon Mobil
20		$242.1	Berkshire Hathaway
21	Sweden	$236.6	
22		$229.2	Apple
23		$211.9	Samsung
24		$205.5	Glencore
25		$201.2	United Health Group

Governments: Organization for Economic Cooperation and Development (2018). *Revenue statistics: 2018*. Retrieved May 5, 2019, from https://read.oecd-ilibrary.org/taxation/revenue-statistics-2018/total-tax-revenue-in-billions-of-us-dollars-at-market-exchange-rates_rev_stats-2018-table26-en#page1; U.S. Government U.S. Council of Economic Advisors (2019). *Economic report of the president*. Washington, DC: U.S. Government Printing Office, 552. Corporations: Global Finance (2019). *World's largest companies*. Retrieved May 5, 2019, from file:///C:/Users/rwjoh/Documents/PBS%2010/Info%20Resources%20multiple%20chapters/World's%20Largest%20Companies%202018%20_%20Global%20Finance%20Magazine.html

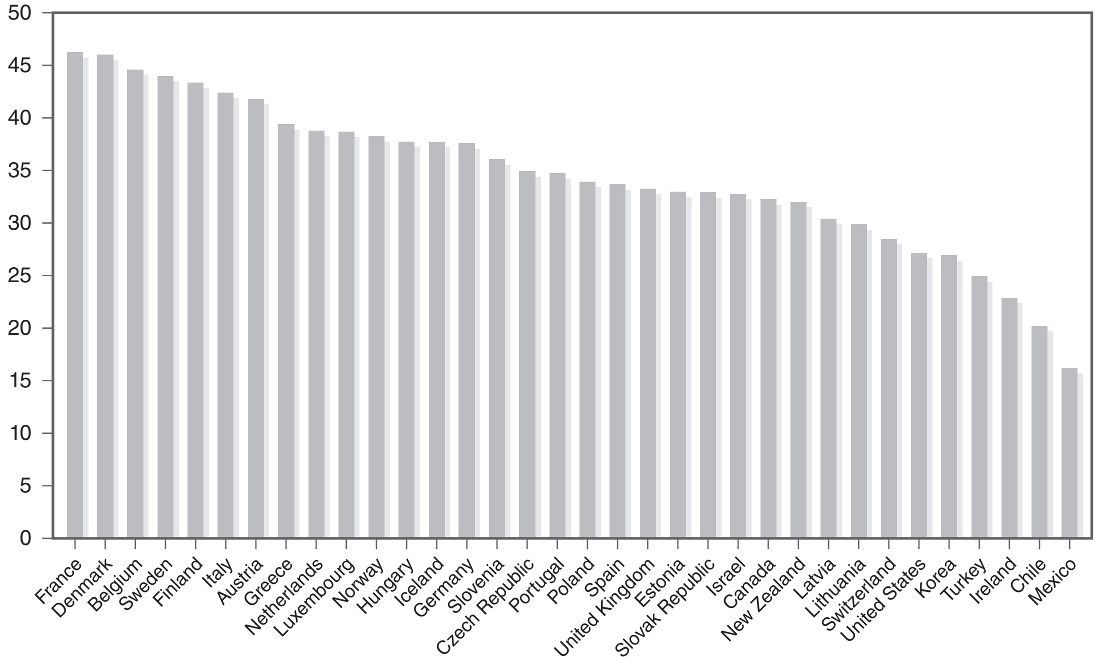

Figure 2-1 Central Government Revenue as Percent of GDP: Selected OECD Countries 2017.

Organization for Economic Cooperation and Development (2019). *Revenue statistics – OECD countries: comparative tables*. Retrieved May 5, 2019, from https://stats.oecd.org/Index.aspx?DataSetCode=REV#

versus private sector differences). Differences also abound within each of these types of organizations. The services provided and methods of decision making are not identical in the governments of Japan, Germany, and the United Kingdom, nor are they the same among such different private corporations as Walmart, United Health Group, and General Motors. In contrast, using the standard of revenue size may provide more insights into the operations of organizations than simply classifying organizations as public or private, national or local, and so forth. Revenue is a key measure of the economic impact of an organization—revenue collected from the private sector by governments or sales by private companies (see the chapter on government and the economy). Though not all industrial firms are like General Motors, nor are all state governments like California, all organizations of any given size, regardless of their private or public character, may exhibit some common traits, and all of a similar size represent similar proportions of the total economy. Many large private organizations in the United States, such as General Motors, received massive bailout funds during the 2008–2010 recession, further blurring private versus public distinctions. More recently, some companies, and individuals such as farmers, have received federal assistance to help offset the loss of export sales as a result of tariffs imposed by other countries on U.S. goods sold to them, in retaliation for U.S. tariffs imposed on foreign goods entering the United States.[20]

Although total revenues or expenditures are useful as approximate guides in measuring the size of government, these data need to be assessed considering the varied capabilities of societies to support government. Unfortunately, reliable international data are often unavailable. Therefore, drawing useful comparisons among international organizations is difficult.

Even given these limitations, it is obvious that the U.S. economy is one of the most prosperous in the world. The high per capita GDP in the United States, $53,129 in 2018, has allowed for both big government and a large private sector.[21] The size of federal, state, and local government receipts as a

Table 2-2 Twenty Largest U.S. Organizations by Revenues, 2018 (in Millions of Dollars)

1	United States Federal	$3,340.4
2	Wal-Mart Stores	$500.3
3	Berkshire Hathaway	$242.1
4	Apple	$229.2
5	United Health Group	$201.2
6	McKesson	$198.5
7	CVS Health	$184.8
8	Amazon	$177.9
9	AT&T	$160.5
10	General Motors	$157.3
11	Ford Motor	$156.8
12	AmerisourceBergen	$153.1
13	Chevron	$134.5
14	Cardinal Health	$130.0
15	State of California	$129.8
16	Costco	$129.1
17	Verizon Communications	$126.0
18	Kroger	$122.7
19	General Electric	$122.3
20	Walgreens Boots Alliance	$118.2

U.S. Government: U.S. Council of Economic Advisors (2019). *Economic report of the president*. Washington, DC: U.S. Government Printing Office, 552. Corporations: Global Finance (2019). *World's largest companies*. Fortune (2019). *Fortune 500*: who made the list? Retrieved May 9, 2019, from http://fortune.com/fortune500/list/; California Legislative Analyst's Office (2018). *The 2018 budget: California spending plan*. Retrieved May 9, 2019, from https://lao.ca.gov/Publications/Report/3870

proportion of GDP has remained steady at around 31% since 2005, with the significant exception of the jump up to 36% in 2010 at the end of the recession, falling back down to 31% in 2016.[22] This figure, however, is misleading in regard to the size of the public sector in that only about one-half of federal receipts go toward the purchase of goods and services—the other half is used for transfer payments and interest payments on debt.

Expenditures

Because early records on state and local finance are spotty, federal expenditure data must be used to obtain some overall perspective on the growth of government since the eighteenth century. **Table 2-3** shows federal spending from 1789 through 2019. During this period, expenditures rose from only $4.3 million in the first few years to over $4.4 trillion annually in fiscal year 2019 (bear in mind that an important contributor to this difference is inflation).

The twentieth century saw important differences in the expenditure patterns of the federal government and those of state and local governments. Federal expenditures fluctuated most, primarily because of war-related activities. The first year in which federal expenditures exceeded $1 billion was 1865, the peak year of the Civil War. Later, in response to World War I, federal expenditures jumped from $0.7 billion in 1916 to $18.5 billion in 1919, then dropped to $6.4 billion the following year. They also increased from $13.3 billion in 1941, the year the United States entered World War II, to $92.7 billion in 1945, then declined just after the war. During the Korean War, expenditures rose from $42.6 billion in 1950 to $74.3 billion in 1953, and then dropped to $68.4 billion in 1955, after the war.[23]

In general, the past century has seen a pattern where federal expenditures rose during wartime and then declined, but not to prewar levels, resulting in a cumulative increase over time. The Vietnam War era, however, departed from this pattern: federal expenditures rose both during and after the war. One of the reasons for the continued high spending from the 1960s onward was the creation and growth of large entitlement programs, such as Social Security, Medicare, and Medicaid. More recently, the Afghanistan and Iraq wars and related conflicts in Syria and Yemen resulted in increases in federal spending as a proportion of GDP, and a substantial increase in federal debt (see the chapter on government and the economy).

Table 2-3 Federal Government Expenditures, Selected Years, 1789–2019 (Millions of Dollars)

1789–91	4	1880	268	1965	118,228
1800	11	1885	260	1970	195,649
1805	11	1890	318	1975	332,332
1810	8	1895	356	1980	590,947
1815	33	1900	529	1985	946,423
1820	18	1905	567	1990	1,253,198
1825	16	1910	694	1995	1,515,837
1830	15	1915	746	2000	1,789,216
1835	18	1920	6,358	2005	2,472,205
1840	24	1925	2,924	2010	3,455,800
1845	23	1930	3,320	2011	3,603,100
1850	40	1935	6,412	2012	3,536,900
1855	60	1940	9,468	2013	3,454,600
1860	63	1945	92,712	2014	3,506,100
1865	1,298	1950	42,562	2015	3,688,400
1870	310	1955	68,444	2016	3,852,600
1875	275	1960	92,191	2017	3,981,600
				2018	4,109,042
				2019	4,412,000

Bureau of the Census, U.S. Department of Commerce (1975). *Historical statistics of the United States: colonial times to 1970*, part 2. Washington, DC: U.S. Government Printing Office, 1114; U.S. Office of Management and Budget (2007). *Historical tables, Budget of the United States Government: fiscal year 2007*. Washington, DC: U.S. Government Printing Office, 53–54. U.S. Congressional Budget Office (2019). *The budget and economic outlook: fiscal years 2019–2029*. Washington, DC: U.S. Government Printing Office, 154.

One might have expected a significant jump in federal outlays during and shortly after the recession of 2008–2010. The actual federal outlays shown in Table 2-3 do not confirm that expectation. There was a jump in outlays as a percentage of GDP from 20.2% in 2008 to 24.4% in 2008, but outlays fell off for 2010 and 2011 and then declined to around 21% of GDP.[24] Annual increases in outlays have generally been around $1.0 to $1.5 trillion annually, dropping to less than $0.5 trillion increase in 2018 over 2017. However, the amount of federal outlays financed by borrowing, rather than tax and other revenue sources, has steadily increased, contributing to large increases in the national debt (discussed in the chapter on government and the economy).

State and local expenditures, in contrast, have fluctuated less. In 1902, state and local expenditures were $1.1 billion, and they have continued to grow steadily over the past 110 years, to $2.8 trillion in 2018, with no significant reductions during any period.[25]

Important shifts have occurred in the extent to which the nation relies on different levels of government. At the turn of the century, local governments were by far the biggest spenders, followed by the federal government and then the states. During the Great Depression, federal spending spurted above local expenditures, and the gap has continued to widen. As of 2018, federal expenditures stood at $4.1 trillion,[26] compared with $2.8 trillion for state and local governments combined.[27] Caution should be exercised in interpreting these numbers, in that each includes intergovernmental transfers—namely, grants from one government to another. Of the $4.1 trillion in federal expenditures, an estimated $0.7 trillion was in federal grants to state and local governments (see the chapter on intergovernmental relations for more detailed discussion of intergovernmental transfers).[28] Though data for local governments distinct from state governments are not as readily available, in 2016, state and local government revenue included about the same $0.7 trillion in transfers from the federal government. It is good practice to net out spending from the source of an intergovernmental transfer ($0.7 trillion in federal in 2018) and assign it to the level(s) at which it is spent (state and local).

One means of looking at the growth of government over time, while controlling for price changes, is to consider government expenditures as a percentage of GDP. **Figure 2-2** shows

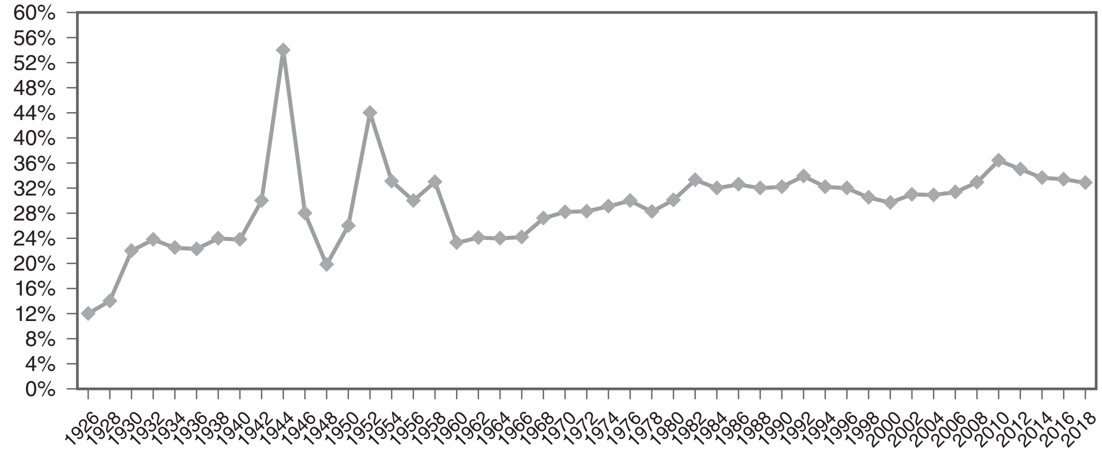

Figure 2-2 All Government Expenditures as a Percentage of Gross Domestic Product, 1926–2018.

Bureau of Census, U.S. Department of Commerce (1969). *Historical statistics on governmental finances and employment.* Washington, DC: U.S. government Printing Office, 1, 36–37; U.S. Department of Commerce, Bureau of Economic Analysis (2019). *Table B-49: Federal, state and local government current receipts and expenditures, 1968–2018.* Retrieved May 13, 2019, from https://www.govinfo.gov/app/collection/erp/2019

that, from 1926 to 2018, the cost of government rose from 12% to 33% of GDP. Increases first occurred in the 1930s due to the Great Depression, and World War II brought expenditures to an all-time high at about one-half of GDP. A sharp cutback followed in the postwar years, and expenditures dropped to a low of just under 20% by 1948. The Cold War and the Korean War occasioned another sharp increase in the early 1950s, and—after reductions in military spending in the late 1950s—the Great Society programs and the Vietnam War resulted in increased spending again during the 1960s; the spending has continued since that time. Although there has been some year-to-year fluctuation, the percentage of GDP devoted to government remained relatively stable between 28% and 34% since 1970, rising to 36% in 2010 as a result of economic stimulus programs and defense spending.

Public Employment

Another way to measure the size and growth of government is to examine trends in the number of government employees. In 1816, there were fewer than 5,000 full- and part-time civilian employees in the federal service. Much growth in public employment followed the Civil War. In 1871, there were more than 50,000 federal employees, and this number doubled to 100,000 by 1881. The period of fastest growth was from the Great Depression through World War II. In 1931, there were still only 610,000 employees, but by 1945—the peak of the wartime economy—the federal civilian workforce had climbed to nearly 4 million. Within a year, however, it was reduced to fewer than 3 million employees, and since then, only once (in 1950) has the federal workforce dropped below 2 million. Federal civilian personnel averaged nearly 3 million between 1970 and 2000 but decreased to about 1.9 million by 2018.[29]

Although the size of the federal bureaucracy is extraordinarily large, the government's personnel are geographically dispersed. In 2017, California had 142,900 federal civilian employees, a figure equal to almost 20% of Alaska's population. Federal employees (excludes military personnel) are also numerous in other states, including Virginia, with 135,000; Maryland, with 130,000; and Texas, with 115,000.[30] States have become painfully aware of their dependence on federal employment during different periods of downsizing. California's federal civilian workforce was, in 2017, only about 75% of its size in 2010. Other states experienced similar decreases.

U.S.-based active duty military personnel also are concentrated in a relatively few states. California, in addition to federal civilian personnel employed in the state, also had about 185,000 active duty personnel in the state in 2017. Texas was second with over 164,000, and Virginia and North Carolina were third and fourth with just over 115,000 and 113,000, respectively.[31] Civilian employment and military employment also do not rise and fall necessarily in the same time periods.

At the state and local levels, the number of employees has also increased. State employment grew from 3.8 million in 1980 to 5.4 million in 2016. In the same period, local employment increased from 9.6 million to 14.0 million.[32] However, growth in both state and local employment had slowed in 2010 as a result of the recession and has remained steady since then. Significantly, the growth at the local level has been accompanied by a decline in the number of local governments. In 2017, there were more than 90,000 local governments, 30,000 fewer than five decades earlier. This decline is largely attributable to school district consolidation. Since 1972, the number of local governments has been increasing gradually, due mainly to increases in the number of special districts—that is, governments that typically provide a single service such as water provision or recreation services. There were almost 39,000 of these special district governments in 2017.[33]

Sources of Revenue and Purposes of Government Expenditures

In general, government does not simply get money and spend it. Rather, governments obtain revenue from specific sources and spend it on specific public goods and services. The following discussion considers the relationships between income and outgo—that is, the ways in which revenue is generated and the purposes of government expenditures.

Federal Revenues and Expenditures

The federal government obtains revenues from several different sources. The major source of revenue for the federal government is the individual income tax. In fiscal year 2018, 51% of all federal revenues came from this source. Social insurance taxes (payroll taxes for Social Security and Medicare) accounted for another 35% of the total. Corporate income taxes represent the biggest percentage change as a source of federal revenues: Corporate income taxes provided about 9% of federal revenues in 2010 and were down by one-third to about 6% in 2018.[34]

These three sources accounted for 92% of all federal revenues. This distribution represents a substantial shift from the early 1900s, when customs duties and excise taxes were the major revenue sources. Those sources now account for only 1% of total federal revenues. **Table 2-4** shows a summary of federal revenues and expenditures.

There are two main types of federal spending: discretionary spending, which is provided for through the annual appropriations process, and mandatory spending, which is provided for through "permanent" law. Discretionary appropriations provide for most of the core functions of government, including the operations of major federal departments. This category accounted for about 31% of all federal spending in 2018, and about one-half of this amount went for defense. This represents a substantial decline in the relative importance of discretionary spending from the 1970s. In 1973, 50% of expenditures were discretionary, and the figure was 65% in 1967.[35] Increased defense spending associated with military activities in Iraq and Afghanistan increased the percentage of the budget accounted for by discretionary spending. In more recent years, modernization of weapons systems and replacement of systems consumed in over a decade of war contributed to reversing the previous trend.

Mandatory spending (chiefly entitlements) accounted for about 61% of federal spending in 2018. This was a substantial increase in the proportion of the budget that went to mandatory spending since 1970, when the figure was 35%.

Table 2-4 Federal Revenues and Expenditures, 2018 (Billions of Dollars)

Revenues			Expenditures		
Source	Dollars (Billions)	Percent	Source	Dollars (Billions)	Percent
Individual Income Taxes	1,684	50.6	Social Security	982	23.9
Payroll Taxes[1]	1,171	35.2	Medicare	704	17.1
Corporate Income Taxes	205	6.2	Medicaid	389	9.5
Estate and Gift Taxes	23	0.7	Other Spending	703	17.1
Excise Taxes	95	2.9	Offsetting Receipts (3)	−259	−6.3
Total Taxes	**3,178**	**95.4**	**Total Mandatory**	**2,519**	**61.3**
Federal Reserve Remittances	71	2.1	Defense	622	15.1
Customs Duties	41	1.2	Nondefense	642	15.6
Miscellaneous Fees and Fines	40	1.2	**Total Discretionary**	**1,264**	**30.8**
Total Receipts	**3,330**	**100.0**	**Net Interest**	**325**	**7.9**
			Total Outlays	**4,108**	**100.0**

[1]Mainly Social Security and Medicare Part A.

U.S. Congressional Budget Office (2019). *The budget and economic outlook: fiscal years 2019–2029*. Washington, DC: U.S. Government Printing Office, 54, 91.

The major single entitlement—24% of total mandatory spending—is Social Security. The health entitlements (Medicare and Medicaid) together make up another 43% of all mandatory spending. The expansion of mandatory spending since the mid-1960s (fueled by the demographic shifts of an increasingly aging population and the economic shifts of increases in individuals at or near the poverty level) has increased the proportion of the federal budget devoted to mandatory spending.

The other category of federal spending is net interest. The federal government's spending on interest has increased and decreased, depending on the federal government's reliance on deficit financing and on interest rates. In 2010, it was 6% of the budget. In 1995, that figure was 15%. The reason for the much lower interest percentage in 2010, with a much larger debt, is historically low, near zero, interest rates. In 2018, net interest had grown to nearly 8%, largely as a result of deficits driven by stimulus programs and defense expenditures and expected interest rate increases. Extreme partisan differences have made it extraordinarily difficult for the U.S. Congress to reach any compromise on a balance between expenditures and revenue.

State and Local Revenues and Expenditures

State and local revenues and expenditures are summarized in **Table 2-5**. The first thing to note about state revenues shown in the table is that 30% comes from other governments, mostly from the federal government. Of their own source revenues, taxes are the largest revenue source—43% in 2016. Sales and gross receipts taxes account for 21% of state government revenue. States obtain another 16% from individual income taxes, and 16% comes from user charges, such as utility charges. Not every state taps into each of the varied revenue sources that the states use. Some states have both a sales tax and an individual income tax. Others have only one or the other,

Table 2-5 **State and Local Revenues and Expenditures, 2017 (in Millions of Dollars)**

Source	State & Local	State	State Percent	Local	Local Percent
Total Revenue	3,401,687	2,136,454	100.0%	1,805,683	100.0%
General Revenue	3,008,262	1,909,322	89.4%	1,639,390	90.8%
General Revenue from Own Sources	2,318,053	1,272,154	59.5%	1,045,899	57.9%
Taxes	1,599,514	922,856	43.2%	676,658	37.5%
Property	503,262	15,945	0.7%	487,317	27.0%
Sales and Gross Receipts	558,871	441,124	20.6%	117,747	6.5%
Individual Income	376,297	343,621	16.1%	32,677	1.8%
Corporate Income	54,259	46,202	2.2%	8,057	0.4%
Motor Vehicle Licenses	27,504	25,566	1.2%	1,938	0.1%
Other Taxes	79,319	50,397	2.4%	28,922	1.6%
Charges and Miscellaneous General Revenue	718,539	349,298	16.3%	369,241	20.4%
Utility Revenue	164,127	13,824	0.6%	150,304	8.3%
Liquor Store Revenue	9,511	8,089	0.4%	1,422	0.1%
Insurance Trust Revenue	219,787	205,221	9.6%	14,567	0.8%
Intergovernmental Revenue	690,209	637,168	29.8%	593,491	32.9%
From Federal Government	690,209	621,509	29.1%	68,700	3.8%
From State Government		15,659	0.7%	524,791	29.1%
From Local Government					
Total Expenditures	3,517,971	2,225,107	100.0%	1,838,515	100.0%
Intergovernmental	3,388	532,699	23.9%	16,340	0.9%
Direct by Function	3,514,583	1,692,408	76.1%	1,822,175	99.1%
Direct General Expenditure	2,944,651	1,373,167	61.7%	1,571,484	85.5%
Capital Outlay	299,493	121,146	5.4%	178,346	9.7%
Other Direct General Expenditures	2,645,159	1,252,021	56.3%	1,393,138	75.8%
Education and Library Services	984,948	304,714	13.7%	680,234	37.0%
Public Welfare	637,644	581,912	26.2%	55,732	3.0%
Hospitals	183,141	79,102	3.6%	104,040	5.7%

Table 2-5 State and Local Revenues and Expenditures, 2017 (in Millions of Dollars) *(continued)*

Source	State & Local	State	State Percent	Local	Local Percent
Health	96,611	44,165	2.0%	52,446	2.9%
Employment Security Administration	3,905	3,863	0.2%	41	0.0%
Veterans' Services	1,353	1,353	0.1%		0.0%
Highways	174,990	104,849	4.7%	70,140	3.8%
Other Transportation	31,837	3,914	0.2%	27,924	1.5%
Police Protection	109,210	15,003	0.7%	94,207	5.1%
Fire Protection	47,776		0.0%	47,776	2.6%
Corrections	78,017	49,040	2.2%	28,977	1.6%
Protective Inspection & Regulation	14,802	9,106	0.4%	5,696	0.3%
Natural Resources	30,805	21,508	1.0%	9,297	0.5%
Parks and Recreation	42,003	5,539	0.2%	36,463	2.0%
Housing & Community Development	50,173	8,676	0.4%	41,497	2.3%
Sewerage	55,613	1,246	0.1%	54,367	3.0%
Solid Waste Management	24,604	1,348	0.1%	23,256	1.3%
Governmental Administration	135,100	55,361	2.5%	79,739	4.3%
Interest on General Debt	104,572	44,624	2.0%	59,948	3.3%
Other General					
Utility Expenditures	224,247	27,246	1.2%	197,000	10.7%
Liquor Store	7,682	6,447	0.3%	1,235	0.1%
Insurance Trust	338,003	285,548	12.8%	52,455	2.9%
Misc., Other and Unallocable	137,548	37,544	1.7%	99,704	5.4%

Notes: (1) Duplicative intergovernmental transactions are excluded. (2) Authors/sum of state expenditures in table is $400 thousand off due to unexplained difference in source data.

Data from Bureau of the Census, U.S. Department of Commerce (2018). State and local government finances by level of government and by state: 2016. Retrieved May 19, 2019, from https://www.census.gov/data/datasets/2016/econ/local/public-use-datasets.html

and two states (Alaska and New Hampshire) have neither.

Local governments obtain about 33% of their money from other governments and the rest mainly from their own sources. Of all local revenue, 27% comes from property tax. A little over 20% is obtained from charges, miscellaneous general revenue, and utility fees. While some local governments have income and sales taxes, these sources contribute only about 8% of all local revenues in aggregate.

State and local expenditures also follow different patterns. Some expenditures that are important for the federal government are nonexistent in states and localities. For example, neither the states nor their local governments are responsible for defense, postal service, or space exploration. When looking at direct expenditures (that is, expenditures that are made directly by the government, as opposed to assistance provided to some other level), public welfare is the largest expense for states (about 26%), with education spending (primarily for higher education) ranked second. Other significant areas of state expenditure include highways and corrections.

Education spending is by far the largest category of local expenditures. The 37% spent on education is more than three times the percentage that is devoted to the second-ranked category, utility expenditure. Other significant areas of expenditure include public safety (police and fire), hospitals, and highways.

Summary

Government is indeed large. The growth pattern of the public sector has been upward and drawing a definitive line today between the public and private sectors is virtually impossible. If present trends continue, government can be expected to become even larger, albeit at a slower rate, providing more services directly or ensuring the provision of services by regulating the private sector.

Governments in the United States differ in the types of revenue sources used and main areas of expenditure. The federal government relies primarily on personal income taxes and social insurance taxes, while corporate income taxes play a decreasing role. Federal expenditures are concentrated in defense, medical entitlements, and social insurance. States obtain almost 30% of their revenue from the federal government, and the remainder largely from sales and individual income taxes. State expenditures are concentrated in education, social services, and welfare. Local governments, in contrast, receive one-third of their funds from other governments and one-fourth from property taxes, while their most expensive function is education.

Notes

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17. All illustrations in the book were prepared using the most current data available. Federal statistical series and data collection has suffered significantly since the 1980s, resulting in fewer data collections, such as detailed information on state and local government finances. When comparing across levels of government, complete data for federal, state, and local vary in availability, so some tables and figures necessarily use the most common denominator—meaning if the most recent local government data available are from 2017, then all comparisons with state and federal also use 2017 data, even though more recent federal figures may be available. Another important note is that unlike governments that are generally stable, corporations can change dramatically in size, and consequently their rankings reflected in Tables 2-1 and 2-2 may go up or down sharply within the span of a few years. This can occur, for example, as the result of a major IPO (initial public offering). Changes in corporate rankings reflect their relative successes and failures in sales and also reflect various forms of corporate mergers.
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