

## BUDGETING IN THE PUBLIC SECTOR

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**Annotation.** *Public choice theory assumes that not only voters but also elected officials and public administrators engage in self-interested, maximizing behavior. In this article explored the implications of that theory for the behavior of public voters, but the model also has some implications for the supply responses of the public sector that are reflected in budget- making.*

**Key words:** *budget, budgeting forecast, expenditure forecast*

A **budget**, whether for a school district, the US government, or a household, is a spending plan that is based on expected revenue and setting priorities for the quantity and quality of services to be provided and/or the transfers to be made. The development of budgets involves three elements:

- a revenue plan, including a forecast of revenues available from existing sources and any proposed changes to the revenue system;
- expenditure forecasts and requests from the various agencies and departments for continuing funding and new projects, which must be evaluated and prioritized in some fashion, including the use of cost-benefit analysis and related techniques;
- a procedure for dealing with any gap between revenues and expenditures, how best to use any surplus or how to address any projected deficit.

The expenditure side of the budget has to address both on-going programs and proposed new programs. Some kinds of expenditures are forecast in ways similar to revenue forecasting, while others are budgeted and limited to the budgeted amount. Unexpended budget funds in the operating budget normally expire at the end of the fiscal year, giving agencies an incentive to “spend it or lose it” toward the end of the fiscal year. If an agency fails to spend most of its budget, not only does it lose the unexpended funds, but there is also a good chance that next year’s budget will be reduced. As a result, there is often a frenzy of spending in federal agencies in August and September (May and June in state agencies) in order to use up their budgeted funds and protect their budget for future years.

Spending for entitlements can be forecast (but not controlled) based on past experience and knowledge about the age distribution and family composition of the population. There is very little flexibility in this category of spending unless the legislature chooses to alter the parameters of the program, for example, the income limits for eligibility for food stamps, or the reimbursement rates for Medicaid and Medicare.

Forecasts for spending on prisons, public education, and health clinics are also based on the expected number of participants, which in turn reflects such relevant data as crime rates, the age distribution of the population, and the number choosing or needing to use public health clinics. Strictly speaking, these outlays are forecast rather than budgeted, because if the amount that must be spent on all those who qualify exceeds the budgeted amount, those additional expenditures will be normally be made. There may be ways to economize at the margin with crowded cells, crowded classrooms, or long lines at health clinics that deter people from coming, but the opportunities to adjust are limited. Unless the legislature is willing to reconsider, there is additional spending that must be made to accommodate these clients of the system.

Because state and local governments are required to balance their operating budgets, they tend to be much more cautious about creating entitlements than the federal government, but a larger share of their spending is for specific services that reflect the size, growth, and age distribution of the population, which drives their budgets in much the same way. Entitlement programs and population-driven services are a major reason for the continuous adjustments in the federal budget surplus or deficit forecast—and it still turns out to be a surprise at the end of the fiscal year!

Expenditure forecasting, like revenue forecasting, lends itself to the development of econometric models and other statistical forecasting techniques. Among the major variables in this forecasting model are expected inflation rates (using some specialized indicator such as the GDP deflator for the federal or state and local government component of GDP) and expected population growth, both in general and in specific age categories. For public schools, the relevant age category is ages 5–18; for prisons, about 18–30 (the prime crime ages); for Medicare, over 65 and especially over 85. Particular categories of expenditures may have other forecasting elements as well, such as heating and cooling costs, construction costs, or even hurricane forecasts for coastal states.

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