

MEMO #2: BUDGETING STRATEGICALLY

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Abstract: *Facing prolonged slow growth and fiscal austerity, the federal government must make more effective use of limited public resources and mobilize private investment to achieve the most important national objectives. This requires a more strategic approach to fiscal choice, using information on expected costs and returns to the economy over a long horizon. The budget's decision-making should be organized around enduring missions and long-term social goals. For selected goals, the relevant portfolio of spending, tax expenditures, legislative and regulatory mandates, and other policy tools should be regularly shaken to separate wheat from chaff. Each review should include non-federal partners and be conducted with full transparency, public hearings, and input from all stakeholders. Expert panels should be asked to review evidence on social benefits from recommended changes in policy and resource use and advise on effective implementation of the recommended strategy. At the completion of each review, the President's budget and legislative agenda for the next fiscal year should incorporate policy changes estimated to achieve breakthrough returns and accelerated progress toward the priority goal.*

In the face of its greatest fiscal challenge, the federal government's budget process as we have known it since 1974 has collapsed. It seemingly cannot function in the face of wide partisan and ideological divisions that exacerbate the conflict already inherent in a system of shared and dispersed authority. The annual appropriations process designed to make detailed choices about hundreds of important programs has practically seized up. Bigger choices about how to slow health care spending growth, deal with unemployment and sluggish recovery, or reform a tax system widely regarded as unfair and a drag on growth are being deferred.

If we continue budgeting this way – cutting spending or raising new revenues without a careful eye to the Nation's long-term interests and the sustainability of its commitments – we risk a period of slow growth and austerity that could cripple all efforts and threaten our position in the world. If instead we manage fiscal challenges strategically, we will be able to more effectively reallocate public and private resources to growth-sustaining investments vital for long-term fiscal stability.

To make effective use of its limited public resources and to mobilize private investment to achieve its most important national objectives, the United States needs an approach to fiscal choice that is more strategic in its scope and capacity to prioritize. It needs a new, rigorous review process that analyzes the base of current resource use and alternatives using

information on expected costs and returns to the economy over a long horizon. Put simply, given the hard choices ahead, the federal government needs to learn how to budget strategically.

To budget strategically means to direct resources to the highest priority policy objectives and to find the most effective and efficient means to realize those objectives. It requires being more far-sighted (see memo on “Budgeting for the Long Term”), taking into account the implications of current policy for the government’s ability to meet future needs. And it requires taking a much broader view of the federal budget than we are used to. This way of approaching the federal budget would be a dramatic change from the current practice of enacting policies and appropriations piecemeal with little regard for the long-term costs or social benefits of those actions.

A strategic approach to budgeting requires a broader conception of what the budget is and does. Herbert Stein, former chair of the Council on Economic Advisors, once observed: “Sensible decisions about those expenditures can only be made after considering the total national provision for those purposes, and not just the federal provision.” To correct serious omissions from the budget process, including regular review of tax expenditures and regulations, Stein proposed that “we should budget the . . . GNP [i.e., the entire economy] before we start budgeting [what] the federal government spends.”

One benefit of a strategic approach is that it highlights non-budgetary ways—such as regulation—in which government influences allocation of national output. As an alternative to new spending, existing spending can be designed to be more productive by nudging or incentivizing major changes in non-federal policy and private behavior.

A strategic approach recognizes the complementary roles state and local governments and other federal partners play in shaping how society’s resources are used. Most of what the federal government does to improve the environment, expand opportunities and provide health care for the poor, build infrastructure, bolster homeland security, or pursue many other policy goals is done through various partnerships, with a mix of federal and non-federal resources and people.

Budgeting will always remain a political process of balancing conflicting values, views of government and its role, and material interests. However, the process can be organized in a way that helps policymakers decide how to pursue their policy goals with better results through smarter allocation of limited resources.

We will know we are budgeting strategically when big commitments are made in a form that permits accountability for results and are backed by the resources and legislative authorities

necessary for their achievement. Resources will have been reallocated on a large scale from low-priority, unproductive uses to high-return investments. Making such strategic choices will increase the productivity of federal investments and have an accelerating effect on the achievement of major improvements in Americans' well-being, opportunity, and personal safety, and the Nation's competitiveness, growth, and security.

Toward a Strategic Approach

Considering where we are and the nature of our governing system and politics:

- How do we move to a budget process that is more strategic in its approach?
- How do we define and inform the main strategic choices and their expected returns with estimates of long-term benefits and costs?
- How can we organize and use that information to compare the effects of budget and policy alternatives and make better choices?

In short, what would a more strategic budget process look like if fully realized?

A strategic approach will require:

- New ways of organizing and using information;
- New decision methods; and
- Supportive reforms in both Presidential and Congressional processes.

What are some practical steps to move toward a more strategic way of budgeting? A set of new opportunities was provided by the GPRA Modernization Act of 2010 (P.L. 111-352). It requires the executive to identify selected "federal priority goals"—to improve policy outcomes that are the shared responsibility of more than one department or agency—and to plan and budget accordingly. Beginning with the FY 2013 budget process, the Obama Administration has begun to pilot this approach. After required consultations with key Congressional committees, OMB is given a mandate to set out the priority goals and designate a lead official responsible for each. Taken seriously and used boldly, this new authority could be the foundation for a more strategic approach.

To support strategic decisions and as a preamble to more detailed budget choices, those who lead the process will need to restructure much of the budget's decision-making around major enduring missions and long-term social goals. For each, a *portfolio* of related spending, tax expenditures, legislative and regulatory mandates, and other policy tools must be regularly updated to separate the substantive from the inconsequential. Analysis of costs and benefits must be rigorous and empirically grounded. For greater independence and rigor, Congressionally chartered institutions with a mission to provide technical and scientific policy

advice—such as the National Academy of Public Administration and the National Research Council—could be tasked with analyses of the evidence on benefits and costs of alternatives.

With time and work, the information used to budget and keep account of both costs and results can be reorganized around priority national goals, and analysis extended to tax expenditures. Budget development can begin with prioritization of the many important goals that the federal government pursues, with metrics tied to a comprehensive set of social indicators. New structures of accountability can be established around each major (and many lesser) policy objectives. New procedures for systematic consultation between federal and state governments can be built for shared goals.

For its part, Congress must be prepared to revise and streamline its jurisdictional responsibilities in ways that facilitate integrated authorizations for and oversight of spending, tax expenditures, and other policy tools for each major federal mission. As the Executive Branch is held accountable for performance, it must be given flexibility over the use of funds consistent with its explicit performance mandates and commitments. In Memos #3 and #4, we outline changes in the way the executive and legislative branches manage the annual budget process that would facilitate a more strategic approach and contribute in other ways to improved fiscal outcomes.

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

Recommended Actions

1. The new Administration, in consultation with leaders of the next Congress, should identify and announce a handful of high priority national objectives that will be the focus of strategic budget reviews over the coming year. The aim of each review should be to achieve a breakthrough in enhanced use of public and private resources to achieve ambitious improvements by specified dates toward a major policy objective – such as a more productive labor force; greater energy independence; or broad improvements in health, – while at the same time yielding budget savings as scored over a five-year period and or longer and social benefits far exceeding its costs.
2. Each strategic budget review should rigorously examine the full *portfolio* of current federal programs cutting across multiple agencies and departments, including tax expenditures. As alternatives to current or proposed spending, it should assess the potential use of regulations and other policy instruments to achieve a given objective. It

should also examine the contributions of states, communities, and others to achieving the objective.

3. The Administration should designate a leader responsible for convening and conducting each strategic review. Each review should include representatives of non-federal partners and should be conducted with full transparency, public hearings, and input from all stakeholders. Expert panels of the National Research Council should be asked to review the evidence on the effectiveness and relative social returns from recommended changes in policy and resource use. Advice should be sought from the National Academy of Public Administration on effective implementation of the recommended strategy.
4. At the completion of each strategic budget review, the President's budget and legislative agenda for the next fiscal year should incorporate the first stages of a proposed reform estimated to achieve breakthrough returns and accelerated progress toward the priority goal.

Under renewed Presidential reorganization authority, Congress should give fast track consideration to any reorganization legislation required to implement the recommended strategy.