



# TARGET-BASED BUDGETING

How setting clear spending targets can transform the budget process



## SUMMARY OF KEY IDEAS | SHAREABLE INFOGRAPHIC



# TARGET BASED BUDGETING

**TARGET-BASED BUDGETING (TBB)** gives departments a clear spending target for their plans. To receive more funding, departments must submit a decision-package to central budget authorities, who compare packages from across the government. Winning packages are given funding just for that year. The autonomy granted to departments to develop their spending plans within the target reduces the budgetary game play and zero-sum competition that can characterize a traditional budget. The possibility of receiving more funding via decision-packages provides an avenue for departments to make their case for more funding and for central budget authorities to carefully evaluate proposals for new spending. The temporary nature of additional funding paired with firm spending targets keeps spending within available revenues.

## BENEFITS & CHALLENGES

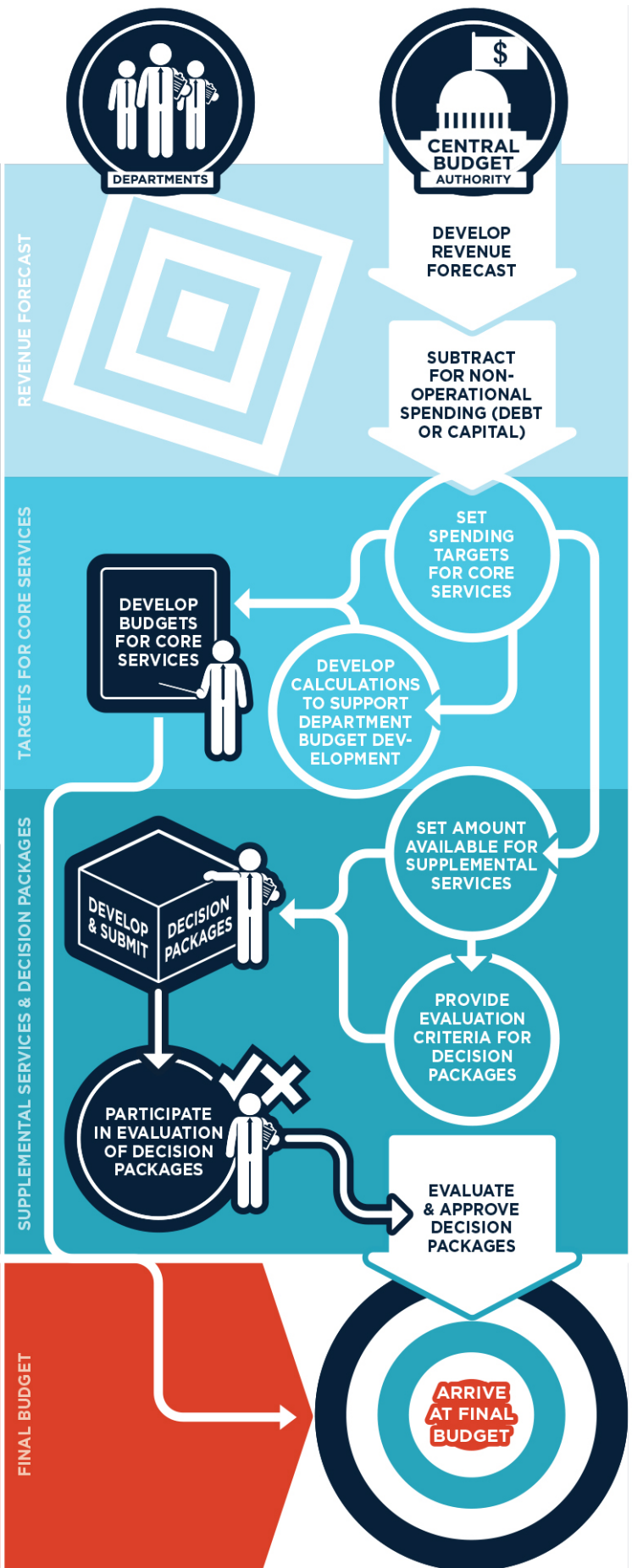
**CONTROL SPENDING GROWTH.** By setting the target for core spending below total available revenue, TBB controls spending on its “core” services. Reviewing decision packages ensures that supplemental services are valuable uses of government funds.

**CLEAR BOUNDARIES.** Defining spending targets communicates core services, department budgets, and the budget for decision packages, including clear criteria for evaluating them.

**REDUCE “BUDGET GAMES”.** TBB gives departments significant control over their budget. This allows departments to let their guard down because their core budget is not part of a zero-sum competition with other departments.

**FORECAST STRENGTH & WEAKNESS:** Because the forecast determines the spending target for core services and the amount available for decision packages, TBB will expose any lack of confidence in the forecast.

**REDUCING “SLACK” IN THE BUDGET.** Traditional budgeting often includes significant padding. Padding can act as a safeguard against unplanned, unavoidable costs, but also can make it harder to balance the proposed budget. TBB encourages departments to reduce padding.





## ABOUT THE AUTHOR

- **Shayne Kavanagh**, Senior Manager of Research, GFOA
- **Janet Dutcher**, DPA, MPA, CPA, CGFM, Mono County Director of Finance
- **Drew Corbett**, Principal, DKG Consultants

## CONTRIBUTORS

- **Chris Constantin**, Town Manager, Town of Los Gatos, CA
- **Krystle Lindberg**, Deputy Finance Director & Budget Officer, City of Providence, RI
- **David Goldman**, Deputy City Administrator/Finance Director, City of Oak Harbor, WA
- **Kevin Knutson**, Sr. Vice President, Strategic Government Resources

## ABOUT GFOA

The Government Finance Officers Association (GFOA) represents over 21,000 public finance officers throughout the United States and Canada. GFOA's mission is to advance excellence in government finance. GFOA views its role as a resource, educator, facilitator, and advocate for both its members and the governments they serve and provides best practice guidance, leadership, professional development, resources and tools, networking opportunities, award programs, and advisory services.

## ABOUT THE RETHINKING BUDGETING PROJECT

Local governments have long relied on incremental, line item budgeting where last year's budget becomes next year's budget with changes around the margin. Though this form of budgeting has its advantages and can be useful under circumstances of stability, it also has important disadvantages. The primary disadvantage is that it causes local governments to be slow to adapt to changing conditions. The premise of the "Rethinking Budgeting" initiative is that the public finance profession has an opportunity to update local government budgeting practices to take advantage of new ways of thinking, new technologies, and to better meet the changing needs of communities. The Rethinking Budgeting initiative will raise new and interesting ideas like those featured in this paper and will produce guidance for state and local policy makers on how to local government budget systems can be adapted to today's needs. We hope the ideas presented in this paper will spur conversation about the possibilities for rethinking budgeting. The Rethinking Budgeting initiative is a collaborative effort between the Government Finance Officers Association (GFOA) and International City/County Management Association (ICMA).

To learn more, visit [gfoa.org/rethinking-budgeting](https://gfoa.org/rethinking-budgeting).

## USE OF GENERATIVE ARTIFICIAL INTELLIGENCE IN THIS REPORT

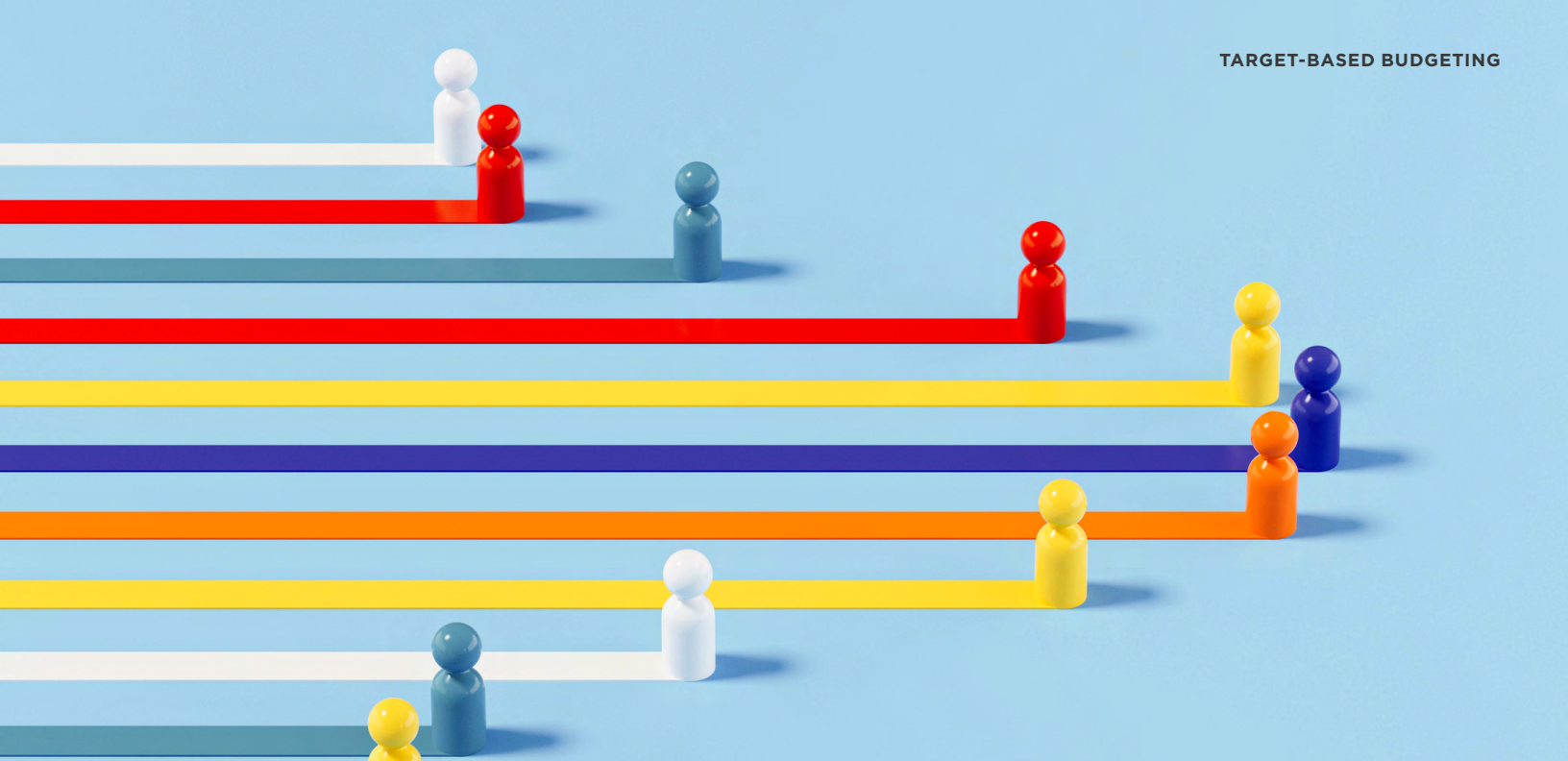
Generative Artificial Intelligence (AI) tools, primarily ChatGPT4, were used to help develop the report. Primary uses of the AI tools include:

- Development of ideas for the outline of the report
- Generation of text for a few specific purposes. Text generated directly from generative AI is clearly labeled as such in the report where the contribution from AI is material. Examples of immaterial contributions would be suggestions from AI on wording choices, grammar, etc.
- Review of final report and to give suggestions to make language more accessible for the intended audience.

GFOA acknowledges the limitations of AI-generated information, including potential biases and other limitations of generative artificial intelligence. All data, ideas, etc. from ChatGPT4 that were used in the report were independently verified/validated by the author(s) and not taken at face value.

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**F**acing multimillion-dollar budget deficits, where spending growth outpaced revenue growth by more than 2-to-1 in a typical year, the finance director of Mono County, California, seized an opportunity when the chief administrative officer position turned over. Up to that point, the budget process had been tense. Departments would pad line items in their budget requests, while the county's budget authority would question each department's spending on office supplies, dues, publications, and travel expenses. This created a vicious cycle, where the budget office micromanaged department budgets, causing departments to ask for more than they needed, leading to even more micromanagement.

**The tension in the budget process was, really, much ado about nothing. It was manufactured by a process that encouraged self-defeating behavior by the participants.**

As a result, the finance director saw a budget process fraught with passive-aggressive gameplay in a tense environment where cuts were needed for the county to adopt a balanced budget. However, the budget deficits felt illusory since actual deficits rarely materialized at year end. The tension in the budget process was, really, much ado about nothing. It was manufactured by a process that encouraged self-defeating behavior by the participants. In fact, the county realized surpluses and built up a large fund balance. This was not necessarily a positive outcome. It sapped the credibility of central budget authorities. For example, participants asked themselves: why go through the tense budget process and argue about the need for

cuts if we usually have surplus at the end of the year and have a large fund balance? It also created challenges, such as trying to negotiate sustainable compensation packages with organized labor in the context of large surpluses and fund balances.

Over the next three years the finance director tried assigning fixed allocations to departments, allowing each to decide how to divide their funds among budget line items in any way they wanted. The results were surprising. The county benefited from an 81% reduction in the *projected* budget

deficit, and the new administration adopted a structurally balanced budget the following year. Departments found creative ways to operate while saving the county money. Departments began working together. For example, one department sharing an unused portion of its budget to help another solve its shortfall.

Without realizing it, this finance director used target-based budgeting (TBB) — a budget methodology successfully used by local governments of all sizes since the 1970s.<sup>1</sup> Cincinnati, one of the first to experiment with TBB, claimed it as the “budget of the future.”<sup>2</sup> TBB is not as well-publicized as performance budgeting, zero-based budgeting, or priority-based budgeting.<sup>3</sup> Nevertheless, the results can be profound. TBB helped Mono County eliminate the stress related to balancing the adopted budget and avoided excessive surpluses that are a sign of poor planning. They changed the budget process from departments A) jousting and posturing to preserve or increase their budgets to B) working together for the greater organizational good.

This paper explores target-based budgeting, its advantages and challenges, and how to use it to enhance your budget process.

## TBB Basics

We’ll start with a brief overview of TBB. Central budget authorities give departments a **target** for their **core services**. That target is often **less than** the **total budget** from the previous year. The total budget is core services **plus** supplemental services.

Departments are given a large measure of **autonomy** to design their budget for **core services**. If they stay within their target, central budget authorities do not closely manage the department’s core budget. In addition to the budget for core services, departments can compete for extra funding for **supplemental services**. They submit **decision packages** to central budget authorities, who evaluate and compare them against one another. Departments with winning decision packages are given additional budget authority for that year.

The basics are always a good starting point. Next, we’ll dive into the nuances that arise when putting TBB into practice.

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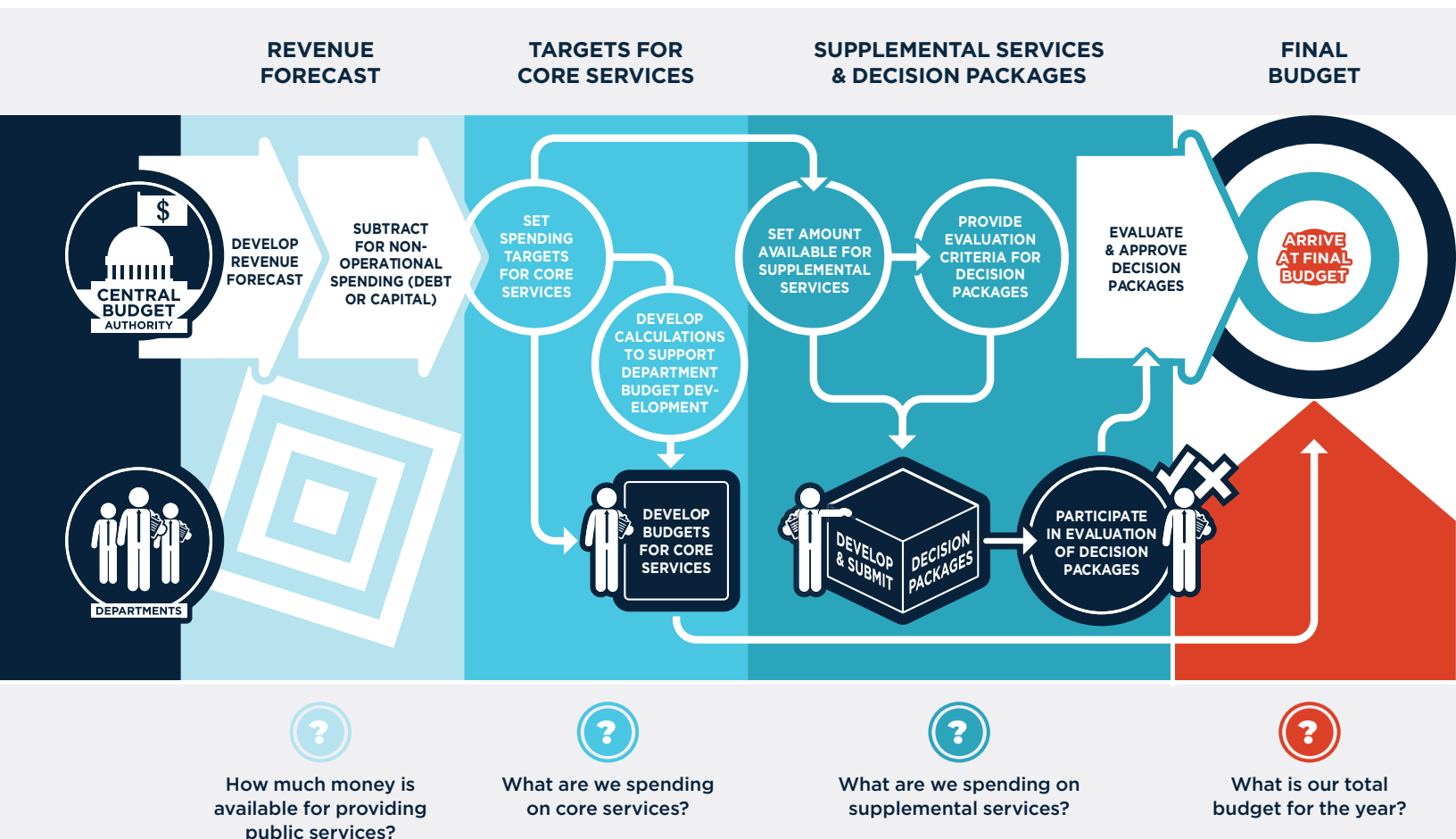
## TBB Process

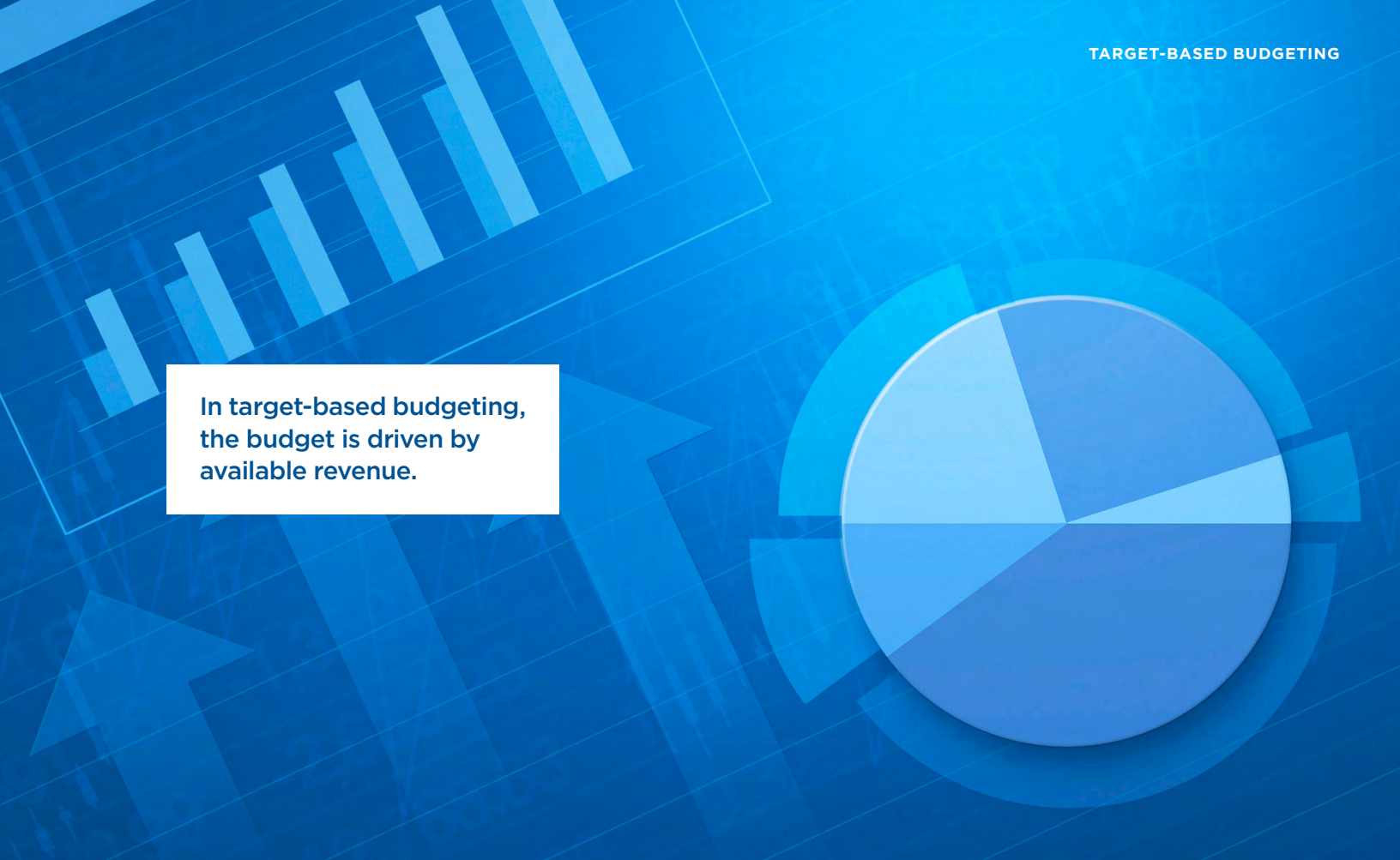
Exhibit 1 provides a process map for TBB. The two lanes represent the roles of the central budget authority and departments. The map covers four essential parts of TBB and the central question for each:

- **Revenue Forecast:** How much money is available for providing public services?
- **Targets for Core Services:** How much are we spending on core services, and which services are core?
- **Supplemental Services and Decision Packages:** What are we spending on supplemental services, and which proposals (decision packages) for supplemental services will be approved?
- **Final Budget:** What is our total budget for the year?

This section will walk through these parts of TBB.

EXHIBIT 1 | PROCESS MAP FOR TBB





In target-based budgeting, the budget is driven by available revenue.

**The revenue forecast is central to TBB.** This may seem unremarkable. Doesn't every budget include a revenue projection? Yes...but, the traditional budget focuses on expenditures. Its foundational question is: "What did we spend last year?" The revenue forecast determines what incremental spending increases (or reductions) are possible based on available resources. In the traditional budget, past spending patterns drive budgeting while the revenue forecast sits in the background.

TBB starts with a different question: "How much money is available for providing public services?" The answer allows a government to set the spending targets that TBB gets its name from. Thus, in TBB, the budget is driven by available revenue, so the forecast moves to the foreground.

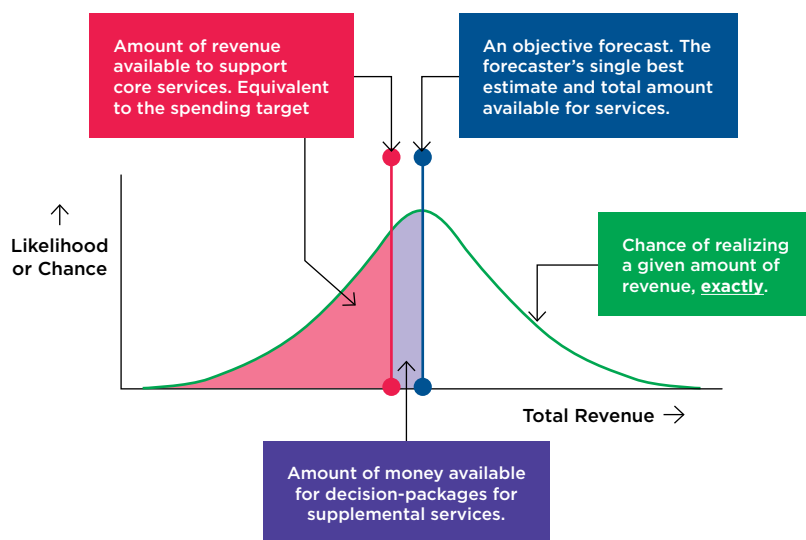
The techniques of revenue forecasting are beyond the scope of this paper. However, you can learn more about forecasting and how to build trust and credibility as a forecaster in [\*\*Informed Decision-Making Through Forecasting: A Practitioner's Guide to Revenue Analysis.\*\*](#)

Let's address a common concern about leading the budget process with the revenue forecast: uncertainty. All forecasts will be wrong; it's just a question of how much. TBB insulates against this uncertainty with decision packages for supplemental services. Core services are based on a more certain portion of the revenue forecast. Each decision package selected beyond the core services relies on less certain revenue. Decision-makers can select decision packages up to the point where they are no longer comfortable with the risk that the supporting revenue might fall short. They can also use savvy risk-management strategies, like delaying spending on certain supplemental services until later in the year, once it's clear whether the revenue will materialize.

Exhibit 2 on the following page provides an illustration.



EXHIBIT 2 | THE REVENUE FORECAST RELATED TO SPENDING TARGETS



### INTERPRETING CHANCE ON A BELL CURVE

On a bell curve, the peak represents the median value. Thus, there is a 50% chance that the total revenue will be less than this value and a 50% chance it will be greater. However, the chance of the forecast being exactly what the forecaster predicted is effectively zero.

An aggressive forecast moves the blue line to the right, which means there is now more than a 50% chance of realizing *less* revenue than the new location would suggest. A conservative forecast moves the blue line to the left. This predicts less total revenue, but the chances of receiving at least that amount exceed 50%.

Let's start with the green line, which represents the chance that a local government will receive any given amount of revenue. This line comes from the forecaster's revenue estimates and takes the shape of a bell curve. While most government forecasters don't think about their forecast in this way, a bell curve is a good way to show how forecasts work in practice. The forecaster's best guess of what the revenue will be is represented by the peak of the curve. However, the forecaster also knows that even their best guess will not be 100% accurate. Instead, there is a range of outcomes. Revenues are more likely to be closer to the best guess and less likely to be further off. This is why the green line slopes downward as we move away from the best guess.

Let's now focus on the blue line. This line represents the adopted revenue forecast, which is the total available spending under TBB. In Exhibit 2, the blue line intersects the peak of the green curve. This reflects the most objective best guess of revenues that will be available. If we moved the blue line to the right, it would signify a more aggressive budgeting strategy, assuming more revenue than the best guess. The diagram shows that the chance of being correct decreases as we move to the right of the best guess.

We can now focus on the red line. This line represents spending on core services and also corresponds to the red shaded area under the green curve. This amount is less than the total revenue forecast.

Finally, the area between the red and blue lines, shaded in purple, represents the funds available for supplemental services. The closer we get to the blue line, the less likely it is that we will be able to realize at least that level of revenue. Hence, it may be wise to employ risk management strategies as total spending approaches the blue line. So, the uncertainty in the forecast is really on the margin because local governments rarely experience large revenue decreases unless faced with an unusual event like a severe recession. This purple margin is often pressured by proposals to expand services. TBB determines the margin and invites budget decision-makers to make savvy choices about how to use that funding.



Before moving on, we should recognize that uncertainty also affects traditional budgeting. For instance, if the forecast suggests that every department can increase their budget by 5% but then actual revenue only supports a 3% increase, then the government has a problem! This issue is usually addressed through conservative forecasting. Conservative forecasting can work but it has its drawbacks, such as incurring opportunity costs by underfunding important public services or discrediting the finance officer if elected officials are expecting objective forecasts.\*

In Exhibit 2, a conservative forecast would be represented by shifting the blue line to the left on the green curve (lower than the peak). This *reduces* the assumed total revenue available but *increases* the chance of achieving at least the forecasted revenue amount. The problem for TBB is that a conservative forecast requires reducing the funds for decision packages and/or core services. Thus, TBB tends to favor objective forecasts. The downside risk of *objective forecasts* can be offset through *conservative budgeting* strategies, such as:

1. Setting the target for core spending below the objective revenue forecast.
2. Employing risk management strategies for decision packages, like delaying the execution of lower-ranked packages until later in the year, once it's clear whether the forecasted revenue will be realized.

The revenue forecast is the basis for setting spending targets, but allowances must be made for nonoperating costs that revenues need to cover. For example, debt payments and planned cash-financed capital spending are key considerations. These costs should be deducted from the revenue forecast to determine the total amount available for spending under TBB.

Using the adjusted amount of available revenue, the central budget authority **sets a target for spending on core services for each department**. These core services are *not* based on what a department spent the previous year. Rather, the core reflects the essential services that a department can provide within the available revenue.

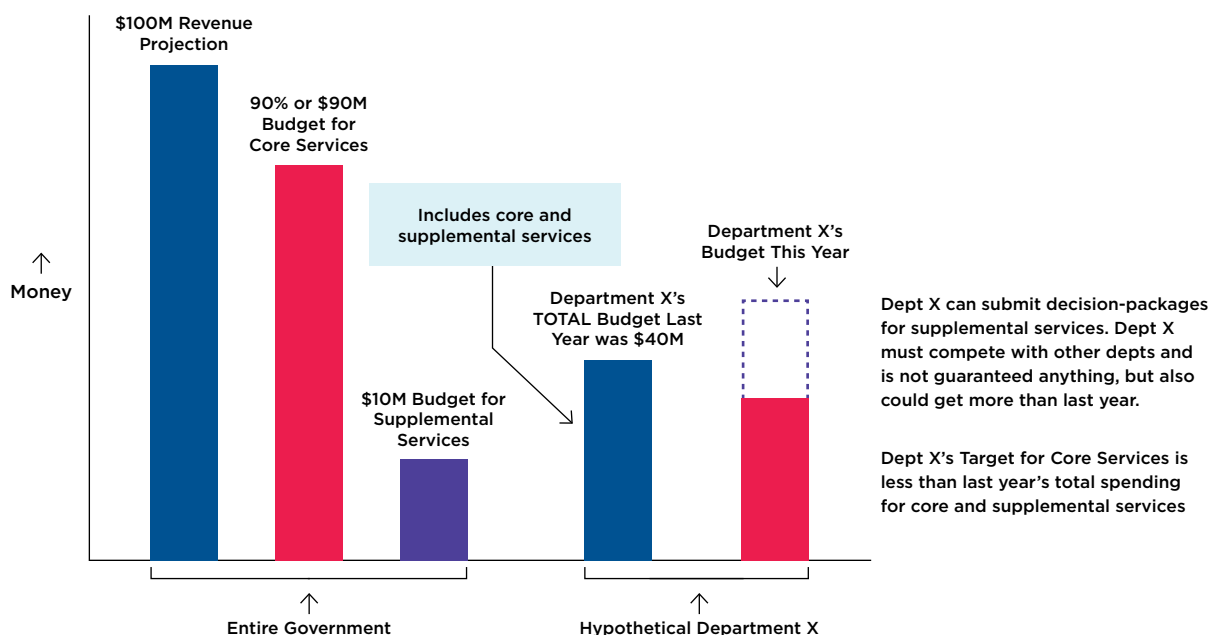
The core services are not based on what a department spent the previous year. Rather, the core reflects the essential services that a department can provide within the available revenue.

In TBB, department managers decide which services qualify as core services. The central budget office sets a spending target, and the managers decide which services fit within that target. The central idea behind TBB is that the cost of a department's core services is often *less than* the previous year's **total budget**. This is because departmental budgets include costs that aren't part of the core services. Examples include, but are not limited to:

- **Special one-time projects.** These are expenditures that do not recur annually.
- **Services beyond the core services.** This could include entire programs or "premium" service levels for a core program.
- **Inefficiencies.** A complex operation like a local government will inevitably have some inefficiencies.

\*As explained in [Informed Decision-Making Through Forecasting](#), **if** actual revenues consistently exceed forecasted amounts **and** elected officials are not on board with a conservative forecasting strategy, **then** the finance officer's credibility may be at risk because elected officials may feel they are not being provided with reliable guidance.

EXHIBIT 3 | ILLUSTRATION OF HOW CORE SERVICE TARGETS ARE DERIVED



Typically, the total budget for core services is set at 85% to 95% of the available revenue. Exhibit 3 illustrates this using a 90% target.

The choice of target depends on several factors. The most practical is the amount of available revenue. For example, if the government is facing financial distress, it may need to lower the target. This could require retrenchment tactics and spending cuts. In contrast, during times of revenue growth, the target may be higher, though still below the previous year's **total budget**. This helps keep the expansion of core services affordable over the long term.

If a government has been using TBB for several years, another key consideration is the size of a department's core budget in prior years. The value of TBB does not come from continuously squeezing a department's core budget. Once a core budget is established, keeping it constant is often the best strategy. This reduces stress in the budget process for all involved. Rather than worrying about what spending to slash to fit within a shrinking core budget, participants can look for ways to improve spending efficiency to include more within the core budget.

For example, Pinellas County, Florida, found that departments became more interested in process improvement to gain efficiencies, which made room in the core budget for other spending. Of course, the county budget office was happy to support this growing interest. This highlights a key benefit of TBB: it incentivizes departments to find efficiencies, enabling them to fit other items within their core budgets.

In a traditional budget process, more efficiency might lead to a budget cut. Central budget authorities might reallocate the savings when they see that a department needs less money to achieve the same thing. In TBB, the spending target is constant, and it is up to departments to manage within it.

Another factor in setting the target for core spending is the level of involvement central budget authorities want in evaluating spending decisions. High targets (e.g., closer to 95%) call for less involvement from central budget authorities. Departments will have larger budgets for core services to make their own budget decisions within. Lower targets give departments room to propose decision packages, which are evaluated by central budget authorities.

Finally, many governments face costs that rise faster than revenues. This might suggest that a government should raise the target for core services to cover rising costs, thereby also reducing the amount available for decision packages. We suggest using this strategy only after considering other options. An advantage of TBB is that it requires governments to confront hard trade-offs, leading to better decision-making about the use of public funds. If costs rise faster than revenues, the options are to:

An advantage of TBB is that it requires governments to confront hard trade-offs, leading to better decision-making about the use of public funds.

1. Raise new revenues.
2. Require departments to find efficiencies or economize on core services (i.e., keep the target the same).
3. Limit the consideration of new ideas (i.e., reduce the budget for decision packages in favor raising core spending targets).

Long-term forecasts can highlight the risk of expenditure growing faster than revenues so that countermeasures can be adopted. This helps to maintain spending targets as is.

Now let's review the two key advantages to how TBB sets the budget for core services.

First, a successful budget process requires cooperation among stakeholders. However, it is unrealistic to expect everyone to **fully** subordinate their individual decision-making to the group or to prioritize the interests of the entire government over their own department. Giving departments the **autonomy** to design their budget within the core services target allows them to make independent decisions while keeping spending across all departments within affordable limits. This approach achieves broad cooperation in keeping the total budget affordable while still allowing departments flexibility to manage their own affairs.

Second, a successful budget requires some **self-skepticism**. This means past decisions and historical precedents are not automatically accepted as the basis for future budgets. Rather, they are examined to ensure they remain relevant and affordable. The spending cap on core services encourages departments to be self-skeptical about their spending. Departments are much more likely to gain approval for spending within their target, giving them an incentive to find areas to cut spending and find efficiencies so they can fit other items within the target amount.

We should also recognize the disadvantages of TBB.

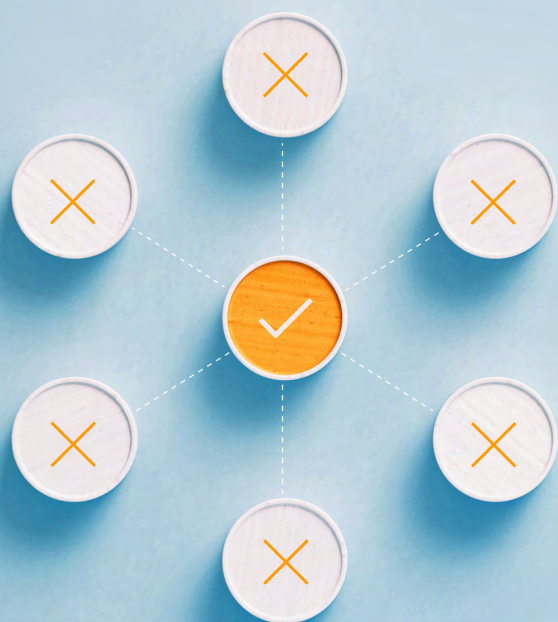
First, the process of setting targets is simple; however, it's also somewhat arbitrary. While there is a method to target setting, it is not tied to a rigorous evaluation of how much money is needed to achieve the government's goals or prioritizing services based on community needs and preferences.




The second disadvantage is that because departments are free to set core services within the target, elected officials and the public have limited input into what is considered “core.”

There are embellishments to TBB that could help mitigate these disadvantages; however, they may come at the expense of simplicity. That said, governments could:

- 1. Develop a service baseline.** Since budgeting typically focuses on expenditures like salaries, benefits, and commodities, it’s common for local governments to lack knowledge of the exact services a department provides. Thus, governments could establish a service baseline, which is a listing of services provided. For example, budget decision-makers might not realize that a public works department handles road repair, snow removal, graffiti removal, tree services, and maintenance of public buildings. A service baseline would help show decision-makers which services are included in the “core” services. You can see [an example from Loudoun County, Virginia, here](#).
- 2. Review the external and self-imposed mandates governing how services are provided.** This could include contractual requirements, like labor agreements, as well as professional “best practices.” A common argument for a service to be “core” is that the government is required to provide it. It is also common for the scope of the requirement to be exaggerated.<sup>4</sup> For example, the letter of the law may not require the service at all, or it may only require a lower level of service than what the government is currently providing. Knowing what is truly mandated helps avoid the portfolio of core services from being weighed down by mistaken mandates.
- 3. Create performance measures describing the level of service provided.** These might include the number of people served, the number of units produced, or measures of output or quality. This could be useful for TBB, as core services may not need to be the “platinum” or “gold” version — perhaps “silver” will do. For example, while standard daytime hours for library branches might qualify as core, extended evening hours might not. The budget authority could consider an upgrade from “silver” to “gold” as part of a decision package.



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The central budget office should either provide assumptions for departments to use or pre-calculate budget estimates for nondiscretionary spending.

Though departments are free to develop their budget for core services, central budget authorities must set boundaries and guidelines beyond the spending target to ensure efficiency and consistency across the budget.

For example, the central budget office should either provide assumptions for departments to use or pre-calculate budget estimates for nondiscretionary spending. For example, departments should use consistent assumptions for the rate of inflation for specific commodities, like fuel, and apply contractually obligated cost escalators across all departments. The budget office could calculate costs that require specialized expertise, such as total personnel costs (including fringe benefits like healthcare and pension contributions), internal charges, or other items that are outside the discretion of department managers to change.

Another topic requiring guidelines is personnel changes. In theory, departments should have latitude to design their core service budgets, including personnel changes. However, practical limits must be adhered to. Labor contracts are one example. Another might be human resource policies, such as position classifications and pay grades. Also, full-time positions in local government are often a quasi-fixed cost — once filled, governments are often reluctant to eliminate them. As a result, increasing the portion of a department's budget for full-time employees may reduce the flexibility of the government's cost structure. That said, central budget authorities should work with departments to accommodate personnel budgets within core services, provided those changes comply with contractual and legal obligations, align with organization-wide policies, and support good long-term financial management.

Before concluding our discussion of core services, a final note on overhead services: Internal support departments should also be subject to TBB and the same budget scrutiny as other departments. While this might make overhead costs for operating departments fluctuate, a rough estimate of internal support service costs should suffice for TBB.

Let's move on to the next step of TBB, which is **evaluating decision packages**.

Departments can submit decision packages, requesting some portion of the budget for supplemental services. The department proposes a package of potential service enhancements that budget decision-makers can accept or reject. The request could be for a new program not included in the core services budget or for an enhancement of services already in the base budget.

As we saw in Exhibit 3, the difference between the forecasted revenue and the target budget for core services is the amount available for supplemental services. In the example, projected revenues total \$100 million. Core services are targeted at 90% of that amount. This leaves \$10 million for supplemental services.

While the budget for core services does not receive much scrutiny from budget officials beyond setting the initial target, the decision packages do receive their scrutiny. Departments will likely submit more decision packages than funds available, which is why decision packages need to be evaluated and prioritized. In this way, TBB is similar to zero-based budgeting (ZBB) and priority-based budgeting (PBB), which also ask departments to submit decision-packages for decision-makers to consider and prioritize. The key difference is that ZBB and PBB apply this to all or most of the government's spending. TBB does this with a limited amount. The total revenue available minus core spending targets gives us the amount available for supplement services and is typically 5% to 15% of total spending.

**A sense of fairness is important for the budget process to be repeatable year after year.**

There is no ideal way to evaluate decision packages, but there are four principles of "procedural justice" to observe. These principles help ensure that participants view the evaluation process as fair, which increases the chance that they will accept decisions that don't go their way. A sense of fairness is important for the budget process to be repeatable year after year. Without it, participants may try to subvert it. The principles are:

- 1. Give everyone the chance to provide input.** Many local governments have had success with evaluation methods by involving all departments in the review of decision packages. This helps everyone see themselves as part of the team.
- 2. Use clearly defined evaluation criteria.** Clear rules are needed to manage conflict. Criteria for evaluating decision packages may include alignment with the government's high-priority strategic objectives, the potential for future cost savings, and feasibility of implementation.
- 3. Have a transparent decision-making process.** Transparency allows everyone to see what others are doing. It fosters confidence that the agreed-upon process is being followed. When people believe that rules are being followed, that decisions are not arbitrary, and that no one is receiving special treatment, they are more likely to accept the outcomes. This can be achieved by including both central budget authorities and department managers in the evaluation process. This way, everyone sees the process from start to finish.
- 4. Have a way to recognize and correct mistakes.** No process is perfect. Provide opportunities to address imperfections. This can be as simple as asking at the end of the evaluation meeting, "Is there anyone who cannot live with the decisions we made today?" and then addressing any concerns that are raised.



In addition to being perceived as fair, the evaluation process should strive to make the best decisions possible for the use of taxpayer money. To do so, the budget officer can apply their **decision architecture** skills to design an evaluation process that helps decision-makers reach savvy and wise decisions. Below are four skills of a decision architect and how they apply to evaluating decision packages.

1. **Widen option sets.** People tend to frame choices narrowly, such as option “A” or “B” or “go” or “no-go.” Rather than limiting the evaluation of decision packages to yes/no, create opportunities to take only part of a package or combine packages to create other solutions. This approach supports creative and flexible thinking. For example, encourage departments to cooperate on joint decision packages.
2. **Test assumptions.** Decision packages often rely on assumptions about the effectiveness of proposed spending in achieving desired outcomes. These assumptions can be tested by including decision criteria to evaluate how strong the evidence is for the program’s potential to deliver the intended results.
3. **Choose the highest value options.** Apply evaluation criteria that consider factors such as alignment with strategic goals, potential for reducing future operating costs, and the strength of the evidence supporting the anticipated results.
4. **Create trust in the process.** This role of the decision architect reinforces the importance of procedural justice but also speaks to creating trust in the process, such as treating all participants with respect and ensuring they feel their participation was “worth it,” once the process is over.

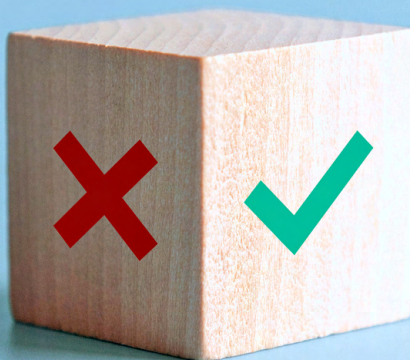
The budget officer can apply their decision architecture skills to design an evaluation process that helps decision-makers reach savvy and wise decisions.

At the end of the TBB process, the budget for core services plus the budget for supplemental services fits within the revenue forecast, thereby forming a **balanced budget**.



#### WHAT IS STRATEGIC?

TBB implies that most of what local government does is part of a baseline of public services. A relatively small portion is truly strategic. Hence, there is no attempt to align core services with a larger strategic vision. That is reserved for decision packages for supplemental services. You can read more about this beyond how it relates to TBB in GFOA’s [Rethinking Strategic Planning](#).



## Benefits and Challenges of Target-Based Budgeting

Now that we've seen the TBB process, let's explore its benefits and challenges so that local governments can make a clear-eyed assessment of its potential for their circumstances.

### Benefits

Foremost, TBB controls spending growth. A fundamental challenge to local government financial sustainability is when new spending is added to the budget and then continued year after year without question. This “layering on effect” can lead to a bloated and unaffordable budget.

By setting the target for core spending below total available revenue, TBB ensures careful evaluation of what qualifies as “core” and helps maintain the value of core spending. Reviewing proposed decision packages ensures that supplemental services are valuable uses of public funds.

TBB also provides clear boundaries. As the saying goes, “Good fences make for good neighbors.” TBB provides the fences in several forms:

- Core services and budgets for each department.
- A clear budget for decision packages as well as criteria for evaluating them.
- A revenue forecast is used to define the boundary for spending. If decision-makers want to expand the amount for spending, then the government must raise extra revenue.

Boundaries are an important part of decision architecture. TBB often produces better decisions by eliminating options that might not turn out well. For instance, the three boundaries above help prevent a government from spending beyond its means over the long term, not just in the current budget cycle.

Earlier, we noted that TBB gives departments more autonomy. The target for core services gives departments some degree of certainty about their spending. They have significant control over their budget for core services. This allows departments to let their guard down a bit because this portion of their budget is no longer a zero-sum competition with other departments. A zero-sum competition occurs when departments compete for limited resources, where one department's gain comes at the expense of another's loss. This can give rise to undesirable behaviors. The leading example is “budget games” — when departments try to subvert the budget process or deceive others for their own advantage. One example is the “Padding Play,” or asking for more than what is needed. This allows the player to “give up” part of their request without losing what they really want. The Padding Play doesn't have much use in TBB since the amount of money available for a department's core services is a fixed **target**. There might be some incentive to pad the cost of a decision package. Though, because they are optional services that are compared to all other options put forth, a decision package with an inflated price will look bad next to those with realistic prices.

Discouraging gameplay helps departments focus on more productive behaviors, like getting the most out of their target for core services and putting forth high-quality decision packages. That said, TBB is not a cure-all for budget games. For a more comprehensive approach to addressing budget games, refer to GFOA's [Budget Games](#) report.

Autonomy benefits the budget office by freeing it from the need to micromanage budgets. This allows it to focus on larger issues, such as the local government's revenue outlook, the sustainability of its cost structure, and making savvy and wise decisions about supplemental services.

Discouraging gameplay helps departments focus on more productive behaviors, like getting the most out of their target for core services and putting forth high-quality decision packages.





## Challenges

The first major challenge is that TBB will expose weak points in an organization's budgeting process. To be clear, these are **not** new problems caused by TBB; rather, TBB reveals problems a conventional budget process papers over.

TBB places greater attention on the revenue forecast, and that's the first potential weak point. The forecast determines the spending target for core services and the amount available for decision packages. This will expose any lack of confidence in the forecast.

In a traditional budget process, a lack of confidence in the forecast is often addressed by forecasting conservatively — or underestimating the expected revenue. TBB creates pressure to produce a more objective forecast since it directly determines the funds available for core services and decision packages.

While an objective forecast creates some risk that actual revenues may fall short, this risk can be managed. GFOA's **Informed Decision-Making Through Forecasting** shows how to build confidence in revenue forecasts and how to manage the risks associated with it.

Another area TBB exposes is the use of reserves for revenue stabilization and budgetary contingencies. Traditional budgeting often includes significant padding. A target-based budget tends to have less padding because there are fewer incentives to use the “Padding Play” budget game.

Padding is not entirely inefficient — it can act as a safeguard against unplanned, unavoidable costs. Local governments provide insurance for these costs by **establishing a contingency amount that is pooled for all departments**.

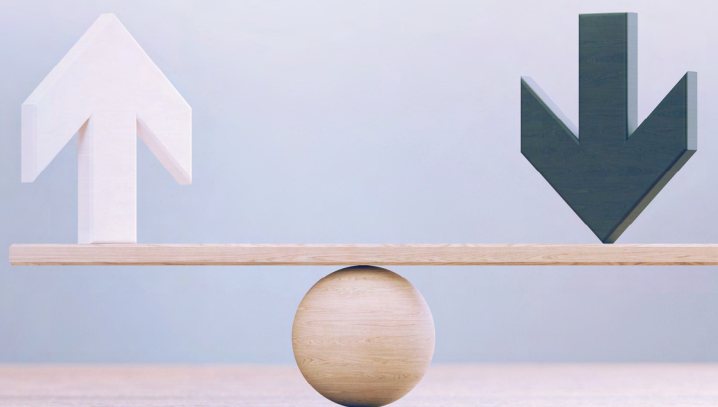


The forecast determines the spending target for core services and the amount available for decision packages. This will expose any lack of confidence in the forecast.

Reserves are a portion of the fund balance used to insure against losses that are too big for a contingency, such as those caused by natural disasters or economic recessions. Reserves help smooth out losses in bad times and can be built back up in good times. A **risk-based analysis of reserves** can identify a “Goldilocks” amount of reserves — not too little, not too much, just right for the risks the government faces. This helps stabilize the core services target by filling gaps during significant but temporary revenue declines. It also provides a basis for using decision packages to rebuild reserves. For example, if a risk analysis suggests the right amount of reserves to hold is X dollars but the current reserves are less, this is good reason for a decision package to hold money aside to rebuild the reserve.

Finally, TBB exposes weaknesses in managing conflict during the budget process. The traditional budget dances around conflict in several ways, such as:

- **Relying on historical precedent for future spending.** The phrase “That’s the way things have always been done” is often used to dismiss challenges to the status quo and avoiding conflict that such challenges might bring.
- **Giving across-the-board increases.** By giving every department the same increase, there is no need to argue about relative sizes of increase or about reallocating resources from one service to another.
- **Using budget games.** Budget games rely on deception and subterfuge to get resources. They avoid the hard but necessary conversations about the best use of scarce resources. These hard conversations are known as constructive conflict.
- **Deferring to default assumptions.** Governments often rely on assumptions about the importance of services to direct more resources to certain activities over others. For example, in municipal governments, public safety is often the “default” priority.



A risk-based analysis of reserves can identify a “Goldilocks” amount of reserves — not too little, not too much, just right for the risks the government faces.

TBB does not defer to historical precedent because the core spending target will usually be less than last year's total spending. TBB does not give across-the-board-increases. Instead, departments propose decision packages to gain additional resources. TBB discourages budget games. Instead, it encourages autonomous, prudent planning of core service budgets and thoughtful evaluation of decision packages. TBB does not defer to default assumptions about priorities. Instead, decision packages are compared to one another using carefully designed criteria.

Let's move on from the budgeting weaknesses that TBB can expose and address the challenges of implementing it.

The first implementation challenge is defining what is "core." TBB leaves this largely to the discretion of department managers, leaving little room for input from elected officials or the public. Earlier, we described some embellishments that could add rigor and transparency to this process. While helpful, what is "core" still remains a judgment call primarily made by department managers.

**Under TBB, determining what is core often comes down to setting a target for core spending and letting departments figure out what to fit within that amount and what to request as a decision package.**

For example, Sunday library hours might be considered a core service in one government but a "nice to have" in another. Each local government must decide what is core and what is not. This could be guided in part by examining a service inventory. For instance, in the second community from our example, the service inventory could clearly show that Sunday library hours are not considered core.

Under TBB, determining what is core often comes down to setting a target for core spending and letting departments figure out what to fit within that amount and what to request as a decision package.

It is possible for core services to evolve over time. For instance, perhaps a new program funded through a decision package proves highly successful. Government officials may decide it should become a "core service." Now what? There are three options to address this situation:

- **Reallocate within the target.** The department adjusts its spending to fit the new service within its target budget by finding efficiencies in core spending and/or cutting other spending that no longer qualifies as core.
- **Increase the core budget.** The department's target for core services is increased to include the new service. However, this reduces the funds available for decision packages, perhaps limiting the government's ability to innovate and address future challenges by funding new ideas.
- **Find new revenue.** The local government finds new revenue sources to expand the core services budget while maintaining the funds available for decision packages.

None of these are the obvious "correct" answer. Budgeting rarely involves easy choices. While TBB makes these trade-offs more transparent — which is for the best — it doesn't make it any easier.

Another important implementation challenge is helping participants adjust to the idea that their core services spending target will likely be less than their total budget from the previous year. Exceptions to this are:

- The department received no funding for decision packages so did not spend beyond its core services budget last year. Revenue growth this year is sufficient to maintain core spending at the same level as last year.
- The community is growing rapidly, leading to increased revenues and service demands. Departments must expand spending just to keep up with new demand for the same services.

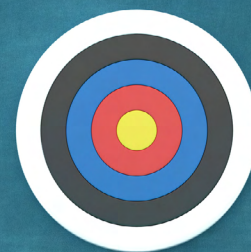
In a traditional budget, departments often view their budget as their “due.” For example, during revenue decline, it is common to hear that departments must “give up” part of their budget. This implies that they have a customary right to that funding.

TBB shifts part of the budget — the decision packages — from a customary relationship to a reciprocal one. Reciprocal relationships are mutually beneficial exchanges. Departments propose to provide valuable services beyond their core in exchange for funding. In each new budget cycle, this relationship resets, requiring departments to continually propose valuable uses of additional funding to receive supplemental funding. Moving from custom to reciprocity is a better use of public resources, but it is not an easy move.

A related challenge is the concern that TBB’s cap on core services might lead to deterioration of the services. This fear often goes unfounded for several reasons.

- As seen in Mono County’s experience, departmental budgets often contain a fair amount of padding or slack. TBB encourages departments to eliminate this slack before cutting into actual services. Central budget authorities can create a pooled contingency fund, which helps departments feel more comfortable giving up the “self-insurance” that slack provides.
- Beyond slack, local governments often have other inefficiencies they can address before cutting core services. Common examples include overestimating mandates and relying on outdated, inefficient processes and technology to deliver services.
- Decision packages help assess whether services on the edge of being “core” are truly worth the cost. If a decision package is not approved, it tells us that the services aren’t that important compared to alternative possible uses of funds.

**TBB shifts part of the budget — the decision packages — from a customary relationship to a reciprocal one. Reciprocal relationships are mutually beneficial exchanges.**







## Conclusion

Target-based budgeting encourages departments to scrutinize their spending and focus on core services. TBB transforms the budgeting process by setting clear spending targets and allowing departments to compete for supplemental services funding.

The benefits of TBB include controlling spending growth, minimizing budget games, and promoting autonomy within departments. These advantages help create a solid foundation for financial sustainability.

TBB also presents challenges. Departments must adjust to reduced core service budgets. Defining “core” services often relies on the judgment of appointed managers, which may constrain elected officials’ influence over the budget. Moreover, TBB’s emphasis on accurate revenue forecasting can be both a strength and a weakness, depending on the quality of the forecast. Finally, TBB highlights the need for managing reserves and contingencies effectively to ensure financial stability while avoiding excessive padding in budgets.

Ultimately, TBB is a powerful tool for governments looking to foster collaboration and efficiency while maintaining control over their financial future through practical budgeting constraints and careful evaluation of spending decisions.

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## ENDNOTES

<sup>1</sup> We are not the first to describe target-based budgeting. See bibliography for other sources.

<sup>1</sup> Rubin, I. S. (1991). Budgeting for our times: Target base budgeting. *Public Budgeting & Finance*.

<sup>1</sup> GFOA, for example, has published many articles and papers about priority-based budgeting and zero-based budgeting but very few about target-based budgeting.

<sup>1</sup> Hess, F. M. (2013). *Cage-busting leadership*. Cambridge, MA: Harvard Education Press.



Government Finance Officers Association  
203 N. LaSalle Street, Suite 2700  
Chicago, IL 60601  
312-977-9700 | [gfoa.org](http://gfoa.org)