Testimony of Philip G. Joyce

Professor of Management, Finance and Leadership

University of Maryland, School of Public Policy

Before the Committee on Homeland Security and Governmental Affairs

United States Senate

On

“The Costs and Impacts of Crisis Budgeting”

March 13, 2013

Chairman Carper, Senator Coburn and Members of the Committee:

Thank you for asking me to testify today on this important topic. I congratulate this committee for deciding to highlight the subject of the apparently invisible, yet insidious, effects that budget uncertainty creates for both federal agencies and the recipients of government funds. My comments today are informed by my own 25 years of observing the federal budget process, and some recent research that I have done culminating in a report written for the IBM Center on the Business of Government.[1]

No one paying even casual attention to the twin "fiscal cliff" and "sequestration" debacles could avoid coming away with the impression that the federal budget process is not working well. It would be somewhat reassuring to think that this recent experience was exceptional, and that we could now return to normal. Unfortunately, however, it is just the latest example of a system where "normal" means limping along from one crisis and missed deadline to another.

While there are positive signs that the next crisis—the threat of a government shutdown—may be averted before the last minute, the fact that "government by continuing resolution" is now the normal way of doing business creates its own costs and problems. The insidious effects of the chronic uncertainty that routine CRs create for federal agencies and recipients of government funds are at least as worthy of attention, and may indeed be more damaging, than sequestration or brief government shutdowns. Some of these costs are financial, and some represent inefficiencies and compromised effectiveness for federal programs. All of these negative impacts are self-inflicted, however, and are entirely preventable.

In my testimony today, I will do four things:

- Review the practice of late appropriations and other actions that create uncertainty in the federal budget process;
- Discuss the specific costs and effects of this dysfunction on federal agencies;
- Describe some of the effects of uncertainty that trickle down to recipients of government funds; and
- Offer suggestions as to how these costs and effects might be reduced in order to promote more efficiency and effectiveness in government programs and agencies.

[1] Philip Joyce, *The Costs of Budget Uncertainty: Analyzing the Impact of Late Appropriations* (Washington: IBM Center for the Business of Government, 2012).

Shutdowns and Continuing Resolutions—Past Experience

The 1974 Congressional Budget and Impoundment Control Act, which created the modern congressional budget process, moved the start of the federal fiscal year from July 1 to October 1. This occurred in part to accommodate the additional steps created by the 1974 Budget Act, and in part because the Congress had a difficult time enacting appropriations prior to the start of the fiscal year. Ironically, however, the appropriations process has not gotten more timely since the 1974 Act. In fact, in only 4 of the 37 fiscal years since 1977 (the first year under the new process) have all appropriations bills been passed and signed into law prior to the start of the fiscal year.

In the first years following the advent of the new process, there were limited consequences of late appropriations, because agencies continued to operate normally even in their absence. Agencies assumed that the Congress intended for them to continue operating, and that the required funding would be forthcoming. This changed in 1980 when Attorney General Benjamin Civiletti issued an opinion that agencies did not have legal authority to spend money in absence of appropriations. After the Civiletti opinion, continuing resolutions became the norm, since they were necessary (in the absence of appropriations) in order for agencies to continue to operate. Short government shutdowns were relatively routine, but many of these occurred over holiday weekends and the impacts were not widely felt. Between fiscal year 1982 and fiscal year 1988, there were nine government shutdowns (sometimes two in a single year) but their average duration was two days.

The fiscal year 1996 budget process, however, yielded the longest government shutdowns in history, totaling 26 days. The first lasted from November 14th to November 19th, 1995, and resulted in the furlough of 800,000 federal employees in agencies covered by appropriation bills that had not been enacted. A second, much longer, shutdown commenced on December 16th, 1995, and lasted for three weeks—until January 6, 1996. This second shutdown only furloughed 284,000 federal employees; the number was reduced mainly because several more appropriation bills had been enacted in the interim.

While a thorough discussion of this shutdown is beyond the scope of this hearing, later studies estimated a financial cost of $1.4 billion (mostly resulting from paying employees retroactively for work that was not done), in addition to substantial effects on service delivery. For example, almost 400 National Park Service facilities were closed, affecting 7 million visitors. Further, the Social Security Administration did not process about 200,000 applications for benefits, and 800,000 toll-free calls went unanswered.

This 1995/1996 shutdown was the last one experienced by the federal government. This does not mean, however, that the appropriations process has operated smoothly since then. In fact, we have experienced government by continuing resolution every year since 1997; increasingly there have been more of these per year, and they have extended further in to the fiscal year. For the 15 fiscal years between 1998 and 2012, there were an average of six CRs per year (the high point was fiscal year 2001, when there were 21) and CRs, on average, covered an average of 3 months (excluding the two years—2007 and 2011--in which there were full-year CRs). For fiscal year 2013, of course, the government is operating under a six month CR that expires on March 27th.

Effects of Budget Uncertainty and Crisis Budgeting on Federal Agencies

The failure to enact timely appropriations creates an environment of substantial uncertainty for federal agencies, and for recipients of federal funds. The focus—by the public and the news media—tends not to be on this routine dysfunction and the problems that it creates, but on the immediate crisis—how do we avoid going over the fiscal "cliff", or how do we avoid a government shutdown, or how do we prevent a debt default? The effects of funding delays caused by routine CRs, however, are significant.

Budgeting is about planning for the future. Any organization—whether it is the federal government, a state or local government, or a business—needs to have some notion of the funds that it will have available in order to effectively budget, and manage. The more certainty that exists, the better informed the decisions are, and the more effective the result. For the federal government, late appropriations and "government by CR" have created a number of specific problems:

- CRs have various effects on government personnel, including hiring freezes that create skill gaps in crucial areas, and morale and turnover problems, often as a direct result of employees feeling as if they are pawns in a larger political game over which they have no control.
- Because CRs require the continuation of current activities, agencies have trouble responding to many new problems and are required to keep funding outdated or ineffective programs.
- CRs may require governments to engage in short-term contracting, which significantly increases contracting workload and overhead costs. In addition, delays in contracting can lead to higher costs for individual contracts and also higher costs resulting from less competition.
- Investments that are not made—in people (as training is cancelled or deferred) or infrastructure (in the form of deferred maintenance) lead to higher future costs.
- Agencies waste a great deal of time preparing for potential government shutdowns and CRs, and then complying with them after the fact.

Delayed Hiring and Personnel Actions, and Morale Issues. Because personnel costs are such a substantial portion of many agency budgets, managing delays in funding necessitates reducing personnel spending. This often leads to hiring freezes or across-the-board cuts. Hiring freezes can create skill gaps in parts of the agency where turnover is greatest. This means that a hiring freeze can end up robbing the agency of personnel working in higher priority programs, or can have an unintentional differential effect if vacancies are concentrated in particular programs, projects, or activities.

In cases where funding delays lead to concerns that a shutdown or sudden budget reduction may follow (as occurred in 2011, and is happening now) agencies may be required to prepare furlough plans and to send out furlough notices to employees. This can have unintended consequences, even in cases where the furloughs are unlikely to actually take effect. Some employees may respond to furlough notices by spending otherwise productive time seeking other employment. Those who end up leaving (because of fear of furlough, or because they are just fed up) are likely to be those who were just hired or who have other options. In either case, they are not necessarily the ones that an agency would choose to terminate if the agency was focused on performance considerations.

Freezing Priorities in Place. Continuing resolutions also create problems in cases where agencies are attempting to shift priorities to respond to some immediate challenge facing them. If an agency has identified a need to shift personnel from one area to another, to address some area of immediate concern, this can delay its ability to respond. This is complicated further by the sheer amount of time that it can take to fill a position. A position that is approved in February or March might not be filled until August or September.

A 2009 GAO report on the effect of CRs cited numerous examples of this behavior.[2] For example, the Federal Bureau of Investigation (FBI) delayed filling existing positions in order to fund annual pay raises, annualize pay for previous year's hiring, or to cover increased costs of retirement, health insurance, or other employee benefits. GAO found other examples where hiring delays affected the number of FDA food inspections, the ability to maintain or improve the ratio of corrections officers to inmates, and the ability to process claims for veterans' benefits.

[2]Government Accountability Office (2009). *Continuing Resolutions: Uncertainty Limited Management Options and Increased Workload in Selected Agencies*, September.

The fiscal year 2011 budget delays, leading up to a final agreement that was not reached until April 2011, is illustrative of the compromised government effectiveness that can occur. Media reports indicated that DOD needed to raid procurement budgets in the first half of the year in order to fund pay and benefits, resulting in deployed troops not getting needed equipment, the cancellation of 20 ship overhauls by the Navy, and deferred aircraft maintenance. There were nondefense effects as well. In State College, Pennsylvania, a newly built $7.5 million air traffic control tower, sat empty in the spring of 2011 because the Federal Aviation Administration lacked the funding to hire the air traffic controllers to staff it.

In addition to preventing new starts, CRs typically require activities that are ongoing to be continued. In other words, in addition to prohibiting agencies from doing NEW things, CRs also prohibit them from ceasing funding for OLD things. Recently, the Department of Justice, for example, had decided to stop funding the National Drug Intelligence Center in Johnstown, Pennsylvania. Since they could not plan for a specific date to cease operations, the passage of a CR required them to continue operating until the regular appropriation became law.

<u>Changes in Contracting Practices.</u> Because late appropriations have become the "new normal" for agencies, they have adjusted their spending patterns to accommodate. The agencies interviewed by GAO in 2009 each reported that they delayed contracts. The Veterans Health Administration (VHA) said that they did not start nonrecurring maintenance projects, but instead waited until the regular appropriation was received. Delays can also lead to a rush to obligate at the end of the year. VHA reported to GAO, for example, that in 2006 they obligated 60 percent (about $248 million) of a $424 million nonrecurring maintenance budget in September, the last month of the fiscal year. This rush creates a greater potential to make mistakes, which may lead to wasted funds and adverse audit findings.

In addition to delaying contracts, many agencies also are forced to enter into multiple contracts for a much shorter time period (instead of one yearly contract), so that the duration of the contract can more-or-less match the duration of the CR. For example, BOP awarded a contract in 1997 to an optometrist to provide care for a prison. Under a regular appropriation, this would have been a one-year contract. Instead, there were three contracts covering only the first quarter of the year: 1) October 1 to November 16; 2) November 19 to December 14; and 3) December 17 to December 21. This kind of short-term contracting creates substantial additional workload—more contracts means more work, higher administrative costs, and greater opportunity for errors and waste.

These changes in contracting practices often lead to increases in costs. The Bureau of Prisons (BOP) reported to GAO that a CR lasting longer than 3 to 4 months typically negatively affects the quality of competition. In addition, delayed contracts may have higher prices. BOP said that awarding contracts later prevented the agency from locking in prices and therefore increased costs. In one case (the McDowell Prison facility in West Virginia), this resulted in about $5.4 million in additional costs. The precision of this estimate is exceptional; most agencies know that costs are higher, but are unable to confirm specific dollar amounts of increased costs.

Along these same lines, it seems quite likely that many contractors dealing with the federal government include a "risk premium" in the rate that they charge for contractual services, because they cannot negotiate reliable multi-year commitments without fear of funding interruption. Federal agencies pay more for services than an equivalent private firm would pay for the same service. While the existence of such a premium is widely assumed, it is difficult, if not impossible, to estimate it with any precision.

<u>Failing to Invest in Training, Travel and Maintenance.</u> In addition to controlling personnel costs, agencies operating under conditions of funding uncertainty turn to other alternatives for saving funds. These options would share one characteristic in common—they would represent areas in which the agency has discretion to delay or forego funding.

Travel and training are frequent candidates for cutbacks or delays. One agency representative reported that the agency simply avoided sending staff to training in the first quarter of the calendar year. The later that the final appropriation is received, the more that training budgets (and therefore training) is likely to be reduced. In DOD, for example, training and the agency's key challenge of maintaining force readiness are inexorably related. The various forms of budget uncertainty (the threatened government shutdown, and the debt ceiling impasse) led, in some years, to measurable reductions in DOD training. The Air Force, for example, predicted that CRs and planning for a shutdown in 2011 reduced flying hours by ten percent, and other active duty personnel interviewed in 2011 reported that the near shutdown led to the cancellation of training exercises.

Foregone maintenance also increases costs. There is little question that failing to properly maintain any asset reduces its useful life. This can have two possible impacts. It could simply take the asset in question out of service, thus depriving citizens of the benefits that would otherwise be received. Perhaps more likely, it will lead to future costs as the asset wears out more quickly. A very clear example of this potential comes from the 2011 funding delay, when the Navy cancelled seven ship-repair contracts, at a savings of $62 million (McCabe, 2011). Even if these repairs occurred in a later fiscal year, their deferral could clearly have operational and cost implications.

<u>Wasted Time and Effort, Leading to Reduced Effectiveness and Efficiency.</u> Aside from increasing costs, continuing resolutions and funding delays invariably created additional work and cause agencies to take actions that compromise their efficiency and effectiveness.

A good place to start here is with the process of preparing for shutdowns, and for living with CRs. Staff in federal agencies, OMB, and the Congress spend a non-trivial amount of time preparing for things that usually do not happen (in the case of shutdowns) or which do happen, but which waste a lot of time in trying to lessen counterproductive or even illegal effects (in the case of a CR). In 2011 and in the current year, OMB asked agencies to prepare shutdown plans. When this happens, both the OMB and federal agencies spent a great deal of time developing these plans and reviewing them, which is a complete waste of time unless the shutdown actually takes effect.

Preparing for CRs can also frequently be time consuming. One of the most time-intensive processes involves dealing with anomalies, which are specific exceptions to the general limitation on funding in CRs. Since, by definition, these anomalies are exceptions to the general rules governing a CR, many agencies invariably think that their peculiar circumstances deserve exceptional treatment. It is often quite difficult, however, to get the Congress to go along with anomalies. This leads to lots of negotiations between OMB and agencies over which things can and cannot be appropriately be included as anomalies.

These inefficiencies do not stop the moment that the CR is enacted. Agency budget offices, and OMB, are involved in lots of conversations around budget execution once the CR is law. Many of these discussions are designed to determine what can and cannot be done, and when something is a continuation of a current activity and when it represents something new. Agency budget officials often have to spend inordinate time responding to inquiries about what is and is not permitted under a CR. The GAO case study agencies indicated that there were four types of administrative tasks most often affected by CRs:

- Issuing guidance to programs and offices;
- Providing information to Congress and OMB;
- Creating, disseminating and revising spending plans; and
- Responding to questions and requests for additional funding above the amount allotted.

There are no precise estimates of the costs of these tasks. GAO reported that VHA estimated that a one-month CR results in over $1 million in lost productivity at VA medical facilities and over $140,000 in additional costs for the VA contracting office.

Effects of CRs on State and Local Governments and the Private Sector.

The federal government provides substantial funds to state and local governments, in the form of grants, and to the private sector, in the form of contracts. The increased uncertainty, and the increasing length of time covered, by CRs has created increased costs and uncertainty for these sectors as well.

Federal grantmaking agencies reported to GAO, for example, that CRs that extended beyond about mid-February tended to delay discretionary grant announcements, thus pushing back both application review and award. In some cases, grants were cancelled, even though the funds were eventually provided. A compressed application period can also decrease the quality of application and review, and discourage some potential recipients from applying for grants out of fear that they will have insufficient time to prepare grant applications, which can be complicated and time-consuming.

Agencies that award grants must decide, if operating on a long-term (more than three months but less than a full year) CR, whether to suspend grant application processes until an appropriation is received or to go ahead with them, pending a final appropriation. In the former case, there may not be enough time available for potential recipients to prepare applications and for agencies to process them in the second half of the year. Therefore, what appears to be a delay may result in a cancellation of the grant program, at least for the current year. In the latter case, there is a risk that, if the funds are not ultimately provided, the agency could have applications in hand but no funding for the program. This occurred in fiscal year 2011 with the Department of Education’s Teaching American History program.

A similar story exists for contractors. When stories began to emerge in 2012 that speculated about the effects of sequestration, the first effects that were discussed were the impacts on federal contractors who had already started to react to the threat of across-the-board cuts. If contractors believe that an actual shutdown, or contract cancellation, is imminent, they face difficult questions concerning whether or not to continue work, and how long they can afford to keep employees on board. Whether late appropriations will ultimately lead to layoffs depends on the contractor, and particularly on the rate of turnover. There certainly are cases, especially for small contractors, where layoffs are necessary. In 2011, for example, Penn State University's Applied Research Laboratory, heavily funded by a contract with the Navy, reported having to lay off 13 engineers due to funding reductions from the Navy associated with federal budget delays.

It is likely that the effects of uncertainty are felt more acutely by firms with the following characteristics:

- small businesses that may have less of a cushion against the delay in funding for an apparently small contract. Smaller businesses are less likely to have the capacity to "ride out the uncertainty" associated with funding delays;
- firms that work only for the government;
- firms that are funded from agencies that have primarily one-year money;
- firms funded by agencies that are more likely to receive late appropriations (some appropriation bills are more chronically late than others);
- contractors that are (especially within DOD) in the delivery stage of a given project (as opposed to development) because delivery involves more manpower.

According to contractors who deal with both sectors, the biggest difference between commercial and federal work is that for commercial work the contractual firm can make long-term commitments, whereas with a federal agency the commitment is year to year. To the extent that there are capital costs, those capital costs can be captured with certainty over a three-to-five year period. A federal contract, conversely, may be a base contract with 10 one-year options.

In the end, it is true that, in general, government work tends to be more risky than commercial work. It is made even more risky in cases where there may be some interruption in funding as a result of a shutdown or default. A 2007 study, for example, of DOD contracting delays found that nine out of twelve companies included in the study experienced a decline in company stock values as a result of these delays. It is likely that there are a significant number of contractors who are unwilling to work with the government, thus reducing competition and increasing costs.

What to Do About the Problem of Late Appropriations

Ultimately, the greatest impediment to fixing the problem of late appropriations is that their negative consequences seem to be largely invisible. Many of the same people who decry waste in government, however, may themselves be contributing to that waste by failing to provide a predictable funding stream to federal agencies and recipients of federal funds. No state of local government would be able to get away with this. Chronic funding delays would result in lowered bond ratings, increased borrowing costs, and likely political fallout. These market signals do not seem to exist in the federal budget process.

Despite the apparent invisibility of these effects, however, it should be clear that routine timely appropriations would have many positive effects on budget formulation and execution, including the following.

1. If appropriations were timely, it would improve budget planning for future years. The clearest example of this has to do with the President's budget, where if the current year appropriations are not enacted by around mid-December, it makes it virtually impossible to have reliable information on which to base proposed funding for the budget year.
2. If decisions in budget execution did not have to be made in such compressed time frames, it would lead to better decisions since agencies would not be (at least to the same extent) rushing to make choices on contractors, grants, etc.
3. Agencies could begin to plan for hiring earlier in the year which (given how long it can take to fill a position) increases the chance that they will have a full complement available to deliver priority services.
4. Investments in employees and in physical assets would be able to be protected by permitting adequate funds to be provided for employee training and maintenance of this physical capital.
5. Both the cost of contractual services and their quality would be improved if appropriations were received in a timely manner. Predictability would enable agencies to negotiate contracts at a lower price and contractors would likely deliver higher-quality service.

How can we encourage these positive effects? It is hard to avoid starting with the obvious conclusion**: Given all of the negative consequences of late appropriations, the Congress should discharge its most basic responsibility and routinely enact appropriations before the beginning of the fiscal year.** It is hard to imagine that, if the Congress viewed it as a significant priority, the roughly eight months available between the delivery of the President's budget and the beginning of the fiscal year would not provide sufficient time to enact appropriations bills. Even though the federal government is a large, complicated enterprise, and the federal budget process is a complex process, this does not provide a sufficient excuse for this failure.

To begin and end with this conclusion seems particularly unhelpful. For this reason, it is useful to consider some recommendations that start from the assumption that the Congressional appropriations process will not suddenly operate on schedule. If we are stuck with late appropriations, what can be done to minimize their effects? The following recommendations seem appropriate.

1. <u>The Congress should make more funding available on a multi-year or no-year basis.</u> At present, many agency salary and expense budgets are provided using one-year money. If agencies had the flexibility to obligate funds over multiple fiscal years, many of the specific problems caused by late appropriations would be reduced. This is not to suggest that all appropriations should permit multi-year or no-year obligations, but it would be useful to specifically review current practice with an eye toward increasing the percentage where such multi-year obligations are necessary. This might assist, in particular, those agencies with lots of grant and contract funding.

2. <u>Continuing resolutions should be prohibited.</u> This may seem like an odd recommendation, as it increases the probability of a government shutdown. In fact, it flies in the face of a more common recommendation, which is that failure to enact appropriations should result in an automatic continuing resolution (ACR). The problem is that ACRs may just become the norm; that is, this might reduce the urgency of enacting appropriations even further. Given the problems created by CRs, this would not be a good outcome. Conversely, prohibiting CRs means that the options are either a full-year appropriation or a government shutdown. Perhaps if there were MORE urgency in enacting appropriations, it would increase the odds of them being enacted.

3. <u>If CRs are to continue, it would be useful if, instead of CRs that freeze spending at the prior year level, the Congress should enact CRs that permit inflationary increases to the prior year level.</u> For those members of Congress and Presidents who believe that spending should be frozen or reduced, this would provide an incentive to reach agreement on appropriations in a timely manner, since the default would be a higher level of spending. For federal agencies, however, this would reduce the necessity of counterproductive actions having to be taken in order to live within a CR that requires spending at the prior year level. This recommendation would also reduce, but not eliminate, the need for anomalies, which should be held to a minimum in the interest of lessening the substantial effort that goes into identifying and negotiating them.

4. The Congress should avoid the temptation to micromanage the budget execution process, particularly if late appropriations are to continue to be the norm. Requirements imposed on some agencies to have spending plans approved by Congressional committees are, in the context of late appropriations, a costly "luxury" in terms of Congressional oversight. If appropriations were timely, such a review could potentially be justified. In cases where a final appropriation is not received until 3 to 6 months into the fiscal year, there is no justification for the additional delay that such a requirement imposes on federal agencies and their ability to manage funds.

5. Moreover, the Congress and President should limit CRs to only one or two per year that do not extend past the end of the calendar year. It is important to recognize that all CRs are not created equal. It matters how many there are, and it matters how long agencies have to operate under them. Short CRs (especially where there are multiple CRs lasting weeks, as opposed to months) create all sorts of problems for federal agencies that increase the odds of agency officials unwittingly violating some law or engaging in counterproductive management practices. Problems created by attempting to manage through CRs lasting 4 months, or 6 months (or more) are also well documented. If CRs are to be enacted, it is important for them to be enacted in a way that minimizes their negative effects.

It seems particularly important to focus on these improvements now for two reasons. First, the problem is becoming worse, not better. While historically the problem with late appropriations has been more one of timing than of uncertainty of the eventual funding level, recently federal agencies have found themselves in a position where both the timing and the amount are in serious question. The threat of the Budget Control Act's sequestration reductions ratchets up this level of uncertainty to a higher level. Independent of sequestration, the need to reduce federal debt will result in a less than "zero-sum" game for federal agencies; having sufficient time to plan for these budget reductions will be even more important than ever.

My main message, then, is that funding delays have costs. Some of these costs are financial, and others are felt through compromised government effectiveness. Either way, these are completely self-inflicted wounds. The negative impacts are unacceptable given the importance of the federal budget to the overall performance of the U.S. economy and the delivery of services to citizens. The Congress should do what it can to minimize these costs, even if they cannot be eliminated.