SECTION 809 PANEL | Streamlining & Codifying Acquisition

809 PANEL TESTIMONY - END-YEAR SPENDING IN DOD

Testimony for Dr. Allan Burman

Senate Homeland Security and Government Affairs Committee (HSGAC)

Federal Spending Oversight and Emergency Management (FSO) Subcommittee

Hearing on End-Year Spending, 2017-09-20

Chairman Paul, Ranking Member Peters, and other members of the subcommittee: Thank you very much for this invitation to speak about the important issue of end-year federal spending surges. I will provide the subcommittee with an overview of some of the trends the Section 809 Panel has observed in Department of Defense (DoD) acquisition spending and briefly present some of the options the panel is considering for addressing the issue.

A little about my background: I served as administrator for federal procurement policy under Presidents Reagan, Bush and Clinton, and served on the Section 800 Panel and Service Acquisition Reform Act Panel—predecessors to the Section 809 Panel. I am currently president of the firm Jefferson Solutions and chairman of the Procurement Round Table.

Section 809 Panel

I represent the Section 809 Panel, established by Congress under the FY 2016 National Defense Authorization Act to review and provide recommendations on defense acquisition reform. In the course of our work, we intend to provide specific, data-driven recommendations that will:

- Enable DoD to be more adaptable in the face of a rapidly changing threat environment;
- Make DoD a more attractive customer in the new, dynamic defense marketplace;
- Enable DoD to use scarce resources more efficiently;
- Simplify the acquisition process so goods and services can be purchased in a timely manner without unnecessary burden; and
- Incentivize the defense acquisition workforce to make sound, mission-driven decisions.[1]

Since the Section 809 Panel was established, we have formed about a dozen research teams to look at key issues affecting defense acquisition. These issues include barriers to entry, key characteristics of successful programs, IT acquisition, and budgeting practices.

[1] Advisory Panel on Streamlining and Codifying Acquisition Regulations, "Section 809 Panel Interim Report," May 2017, https://section809panel.org/wp-content/uploads/2017/05/Sec809Panel_Interim-Report_May2017_FINAL-for-web.pdf, accessed September 7, 2017.

I lead the team looking at budget issues. Key research topics for us include portfolio-level budget management and the reprogramming process. We have also focused in particular on the incentives that produce end-year spending and the effects of end-year spending on effectiveness and efficiency in defense acquisition.

Defense Acquisition in Context

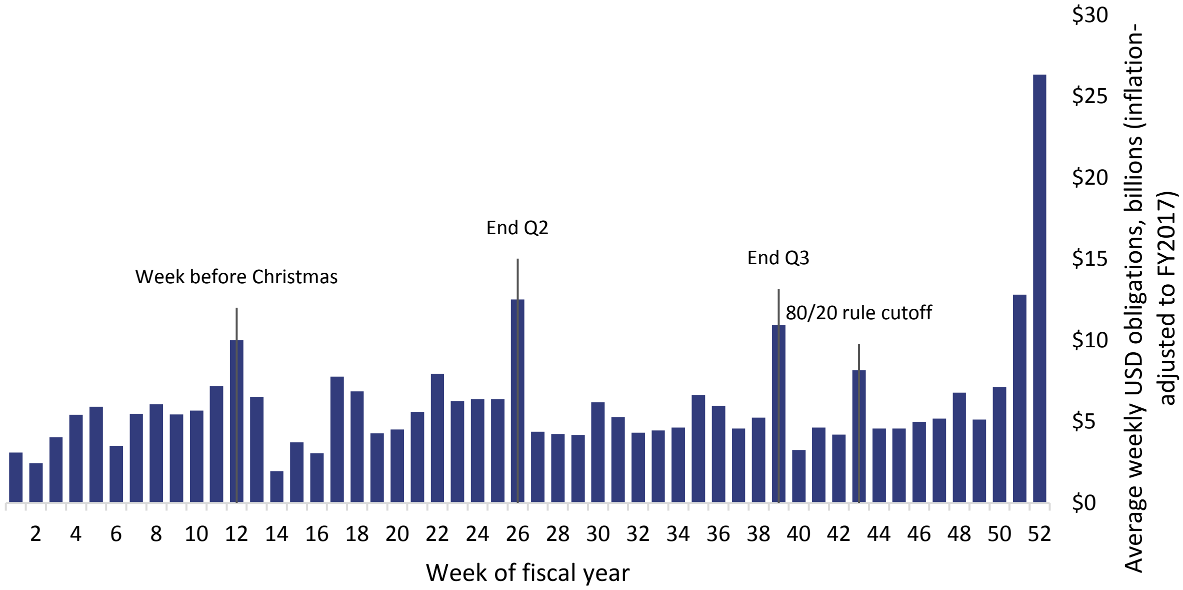
To put defense acquisition spending into context, in FY 2016 the U.S. government expended approximately $3.8 trillion. Of this total, DoD spending accounted for about $565 billion, or 15 percent. In FY 2016, DoD obligated $298 billion toward procurement of products and services—more than half of its total outlays for that year. In other words, defense acquisition on its own represented around 8 percent of all annual agency spending.[2]

End-Year Spending Surges in DoD

If defense acquisition funds were obligated evenly across each point in the fiscal year, we would expect to observe about 8 percent in each month and about 2 percent in each week. Instead, we saw in September 2016 – the final month of the fiscal year – obligations of more than 14 percent of the annual total. In the final week of the fiscal year – from September 24 to 30 – DoD obligated about 7 percent of the annual total.[3]

[2] Office of Management and Budget Table 3.2, Outlays by Function and Superfunction 1962-2022, https://www.whitehouse.gov/omb/budget/Historicals, accessed September 7, 2017.
Federal Procurement Data System, https://www.fpds.gov, accessed September 7, 2017.
[3] Federal Procurement Data System, https://www.fpds.gov, accessed September 7, 2017.

Weekly DoD contract obligations, average FY 2012 to FY 2016[4]



These end-year surges are particularly concentrated in certain areas of DoD. For instance, we observe relatively large surges in information technology as well as building construction and maintenance.

Reasons for surges across different economic sectors vary. For instance, some stakeholders have suggested to us that IT surges exist because of the ease with which IT products can be purchased on short notice—allowing an easy way to obligate dollars at the last minute.

With respect to building construction and repair, other stakeholders have told us that at any given time there are many facilities in need of repairs. This situation leads to a large and lengthy work backlog, and uncertainty about whether a given project will receive funding until the last minute—hence the end-year surges.

For the Department of the Air Force and the Department of the Navy, September obligation surges in FY 2016 were much lower than for the Army. However, the absence of large *end*-year spending surges does not mean there are no end-period surges in *mid*-year. We see Air Force and Navy surges at the end of March, mid-way through the fiscal year, suggesting the existence of service-level policies that simply alter the dates at which surges occur.

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[4] Data from Federal Procurement Data System, https://www.fpds.gov, accessed April 28, 2017. Average of weekly totals from FY2012 to FY2016. To ensure comparability of data, each weekly period contains the same days of the week. The first day of the fiscal year (or first two days for leap years) are omitted. Figures in FY2017 USD, adjusted for inflation using DoD Non-Pay Deflators from Comptroller Greenbook.

Key Research Questions

Clearly, DoD faces a pattern of end-period spending surges similar to those we observe in many other agencies. This pattern raises three major questions, which the Section 809 Panel intends to further research and report on in coming months:

- Do end-year defense acquisition spending surges indicate a problem? Is end-year contract spending less effective or less efficient than contract spending at other points in the year?
- What incentives are spurring these surges? Are acquisition professionals incentivized to spend more at end-year by certain laws, regulations, and policies?
- What can Congress and DoD do to mitigate any negative effects from end-year surges?

These are all complex questions. The Section 809 Panel's budget research is ongoing, but at this point I can lay out the basics of existing research and provide some of our preliminary findings from data analysis and interviews with DoD stakeholders.

Are End-Year Surges Bad?

Are end-year spending surges a problem for DoD?

It is our view that end-year spending surges are not a problem in and of themselves. They are produced by certain incentives, and it is those incentives that may represent problems for the government and DoD. If we wish to solve those problems, we must address the root causes of behavior. If we focus solely on smoothing out spending across the fiscal year, we run the risk of treating a symptom rather than the problem itself.

We have spoken to individuals in DoD who do not believe end-year spending indicates a major problem. Some have stated that the quality of products and services procured at end-year is no different from any other time of year.

Others suggest that end-year spending may be used to purchase lower-quality products and services than spending at other points in the year, but this may not be a problem. This argument presumes that acquisition professionals have high-priority and lower-priority lists of items, all of which are needed but some of which are more needed than others. Officials may buy high-priority items as soon as they are able, but avoid spending money on lower-priority items in case an emergency requires the rapid reallocation of that money. In this case, the end-year spending would buy items that are less immediately critical for DoD operations but will still be needed eventually.

There is a substantial body of analysis – including work by Dr. Jason Fichtner – suggesting that end-year spending may provide less efficient acquisition outcomes than spending at other points in the fiscal year.[5] A well-known study several years ago included analysis of federal IT spending that showed a correlation between lower-quality IT projects and end-year spending.[6] We have heard anecdotal evidence and statements from senior defense officials that support this conclusion.

What Causes End-Year Surges?

What causes end-year and end-period surges? Why does the DoD acquisition community obligate more money at the end of certain periods than within those periods?

Answering these questions requires analysis of the many tiers through which obligation authority flows before it reaches the lowest level. Congress appropriates money for use by DoD from one fiscal year to the next. OMB, the DoD comptroller, service-level comptrollers, and lower-level resourcing authorities play roles in funding distribution as well. Once funding reaches a DoD contracting office, these tiered organizations may have divided obligation authority on a quarterly, monthly, or even weekly basis. A program manager or contracting officer may be expected to ensure the spending of a specific amount of money within a specific month or week of the fiscal year.

It appears that at both high-level and low-level tiers, these expectations are driven by a fear that budgets will be swept—in other words, reduced in a future appropriation—if funding is not fully spent by the end of the year. This fear incentivizes higher-tier authorities to create minimum obligation targets for lower-tier authorities, which in turn incentivizes the lower-tier authorities to create minimum obligation targets for the tiers below them.

One consequence of these obligation targets may be that officials fear the prospect of being caught without sufficient funding to address an unexpected emergency in a specific quarter, month, or week. This prospect would create incentives to save money until the very end of the period to which spending targets are applied, producing the surges we observe at the end of time periods.

How Should We Respond to End-Year Surges?

What options might be available to Congress for addressing the issues raised by end-year spending surges?

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[5] Jason Fichtner and Adam Michel, "Curbing the Surge in Year-End Federal Government Spending" (page 23), September 2016, https://www.mercatus.org/system/files/mercatus-fichtner-year-end-spending-v1.pdf, accessed September 11, 2017.
[6] Jeffrey B. Liebman and Neale Mahoney, "Do Expiring Budgets Lead to Wasteful Spending? Evidence from Federal Procurement," National Bureau of Economic Research, September 2013: http://www.nber.org/papers/w19481.pdf, accessed April 26, 2017.

Congress has historically addressed defense acquisition end-year surges via several means. The two mechanisms regularly written into defense appropriation law are multiyear appropriations and the 80/20 rule.

- Multiyear appropriation accounts exist for R&D, procurement, and military construction. These accounts are partly meant to provide sufficient flexibility to mitigate the incentive to hoard money until the end of the year; however, DoD applies obligation targets to these accounts in ways that effectively make the majority of funding single-year. In doing so, DoD may limit the effect that multiyear appropriations have on end-year surges.
- The 80/20 rule, written annually into appropriations bills, requires DoD spend no more than 20 percent of operation and maintenance funding in the last 2 months of the fiscal year. By limiting spending in the last two months, end-year spending may be pushed back to the end of July instead of September. By targeting end-year surges rather than root incentives, it may also represent a treatment of symptoms rather than the problem itself. In the 1980s, the Government Accountability Office testified that the 80/20 rule could result in constraints that were difficult to administer at the agency-level and failed to address the real problem.

Congress has considered—and, in some cases, implemented—other measures for addressing end-year surges. These include incentive pay for identifying wasteful spending, working capital funds, and carry-over (or rollover).

- Incentive pay for government employees who identify wasteful spending has been supported in several bills, including of course the Bonuses for Cost-Cutters Act supported by several members of this committee. Such an incentive payment system would have the advantage of directly targeting wasteful spending rather than end-year spikes themselves. This focus on the problem rather than the symptom is admirable. To make such a system effective within the defense acquisition system, however, several concerns would need to be addressed:
    1) The concern that some employees could be incentivized to adopt overly-liberal definitions of waste in hopes of a cash bonus.
    2) The concern that such a program could lead to misaligned incentives between program leadership and lower-level employees.
    3) The many levels of review within the DoD programming and budget cycles on the funds appropriated to any program—suggesting that identification of wasteful spending should occur during these reviews, with both leadership and employees involved in the program.
- In some instances, Congress has supported the establishment of working capital funds within the DoD acquisition system. By adopting a model of effectively selling products and services to the military departments, working capital funds allow for the use of non-directly appropriated funds, which may mitigate the appearance of end-year spending surges.

- Congress has, in limited cases, approved the use of carry-over within DoD. In the FY 2016 appropriations bill, Congress approved a 1-year, 1 percent carryover authority for operation and maintenance spending by the Defense Health Agency (DHA). Our analysis of DHA data showed that contract obligations in September 2016, as a percentage of the FY 2016 total, declined by approximately 3 percentage points relative to previous years. DHA's midyear obligation surge in March (which is consistently higher than the agency's September surge) also declined by about 3 percentage points.[7]

The Section 809 Panel is examining all of these approaches as potential ways to address the end-period and end-year spending problem. Thank you very much for the opportunity to testify today about this important issue. I look forward to answering any follow-up questions you might have.

[7] Federal Procurement Data System, https://www.fpds.gov, accessed September 11, 2017.