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On

“Prudent Planning or Wasteful Binge? A Look at End of the Year Spending”

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Chairman Paul, Senator Baldwin and Members of the Subcommittee:

Thank you for asking me to testify today. As someone who has spent more than 30 years practicing and studying budgeting at all levels of government, I can say that the issue of end-of-year spending is one that is not peculiar to the federal government, or even particularly to government. Any organization that attempts to control resources by limiting the amount that can be spent in a particular time period is likely to create incentives for behaviors that lead to the acceleration of spending as the period of control draws near. The “use it or lose it” circumstance that leads to end of year spending is a result of these incentives. Thus, there is little question about whether the phenomenon exists. The question of the extent to which the practice is wasteful is much harder to answer.

My testimony will make four main points:

1. End of year spending is caused by several factors, including prudent budgeting, a desire by agencies to spend the resources that they have been provided and a desire to protect the budgetary base against future reductions.
2. End of year spending is not inherently wasteful, but certainly there are examples of waste that is caused by a desire to spend money quickly before it is lost. Sometimes, however, end of year spending is actually the result of prudent budget planning, because agencies want to be sure that the resources are there before they choose to spend. For the federal government, end of year spending is confined to a relatively small portion of the discretionary portion of the budget; the documented waste in the major entitlement programs overwhelms any credible estimate of waste caused by end of year spending.
3. While end of year spending occurs across all levels of government, the incentives to spend all available resources are particularly present at the federal level because of the uncertainty that is created by the chronic failure of the Congress to enact appropriation bills in a timely fashion. The documented costs of late appropriations are also likely far in excess of any waste that is created by end of year spending.
4. The bottom line is that enacting appropriation bills on time, thus ending or minimizing the routine practice of “government by continuing resolution” would have much more positive effects than reducing end of year spending, while at the same time reducing the incentives of agencies to delay spending until late in the year. There are other reforms

that have been suggested, including allowing agencies to “keep” a portion of otherwise lapsing funds, but there are questions about whether these reforms would actually change spending incentives.

### What Causes End of Year Spending?

The federal fiscal year runs from October 1 to September 30<sup>th</sup>. The majority of appropriated funding is only available for one year, therefore funds must be obligated by the end of September. If they are not, agencies will be unable to access the funds, and instead must rely on the following year’s appropriation. In fact, the most significant cause, by some margin, of end of year spending is the simple fact that complying with the laws that govern federal spending and the constraints of the appropriations process necessitates some holding back of funds during the year. The interaction of the Anti-deficiency Act (which prohibits spending without an appropriation) and the anti-impoundment statutes (which require the spending of appropriated funds) creates a situation where agencies must set aside funds to deal with unanticipated expenses. As the end of the fiscal year approaches, the danger of surprises recedes and funds are set free. This kind of end of year spending is simply a byproduct of the availability of funds for a limited time period. Nonetheless, it is true that unobligated funds cannot be carried over into a subsequent fiscal year, which does create a “use it or lose it” situation.

In addition to the fact that agencies must engage in prudent fiscal planning and that the funds will disappear if not used, agencies may choose to accelerate spending at the end of the year in order to avoid a reduction in their base budgets for the following fiscal year. Budget agencies--such as the Office of Management and Budget (OMB) at the federal level--and legislative appropriations committees frequently use not the prior year appropriated level but a prior year spending level in constructing the “base” for future budgets. Thus, the failure to spend the full budget during a given fiscal year has budgetary effects that go beyond the current fiscal year to affect resources available in the future as well. This does create an additional incentive to spend all available resources.

This is not a situation that is peculiar to the federal government. Because virtually all governments operate under fixed budget constraints by fiscal year, the incentives for end of year

spending can exist. In fact, the International Monetary Fund has highlighted this as a problematic practice in some other countries, and this phenomenon is often observed at the state and local level. My own employment history includes a five-year stint working in the Illinois executive budget office, and I can tell you that June (the last month of the state fiscal year) was a very busy month as we considered requests by agencies to transfer funds between line items as they attempted to spend all available resources.

### How Big a Problem is End-of-Year Spending?

In evaluating the practice of end of year spending, there are two relevant questions. The first is whether end of year spending is a significant phenomenon. The second is how costly or wasteful the practice might be.

On the first point, a look at aggregate spending obtained from the Center on Budget and Policy Priorities suggests that the last quarter and last month of the fiscal year do not appear to result in more spending than other portions of the fiscal year. Data from Monthly Treasury Statements for 29 fiscal years (1986 to 2014) indicates that, on average, 24.8% of outlays occurred in the last quarter of the fiscal year, as opposed to 25.2% in the last quarter if they had occurred evenly throughout the year. September outlays totaled 7.9% of the total, as opposed to 8.2% if they had occurred evenly.<sup>1</sup>

Therefore, in aggregate, there appears to be no increase in the rate of spending at the end of the fiscal year. Looking at all outlays, however, may mask the real phenomenon. That is, end of year spending is not a phenomenon that affects mandatory spending, which (including interest) represents two-thirds of all federal spending. Rather it affects only the discretionary part of the budget; even then, it only occurs in salary and expense accounts. Moreover, a lot of money in salary and expense accounts goes for paying salaries of employees, and the examples of waste that usually surface do not typically involve deciding to hire employees at the end of the year, but rather doing things like entering into contracts, or purchasing physical assets, or sending employees to training. To that end, a 2014 study by the Mercatus Center compared the

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<sup>1</sup> Unpublished data obtained from the Center on Budget and Policy Priorities, based on analysis of Monthly Treasury Statement between 1986 and 2014.

percentage of contract expenditures across 15 federal departments in fiscal year 2013. That study found that, across the board, expenditures were significantly higher, as a percentage of total yearly contract expenditures, both in comparison to a constant average but also compared to the prior month. For example, the Department of Health and Human Services spend 29 percent of their contract budget in September, compared to 12 percent in August. In the Department of Veterans Affairs, the numbers were 21 percent and 8 percent; in the Department of Defense, the comparable figures were 18 percent and 7 percent.<sup>2</sup> The significance of this finding is not just in the comparison between the two months, but to the fact that a straight-line monthly average would be 8.3%.

Thus, it certainly does seem that end-of-year spending is a real phenomenon, at least for particular kinds of expenditures. However, the mere fact that spending tends to be back-loaded for these particular types of expenditures does not by itself mean that the spending is wasteful. If agencies are buying things late in the year merely to spend money, or to pad their budgetary base, that is almost the definition of waste. If instead they are managing their funds in an effort to ensure that they live within the budgets they have, and not making choices to spend until they know that the funds are clearly available, that sounds more like prudent management than wasteful spending. It is nonetheless probable that agencies spend money on some things that could not stand close scrutiny. Such spending is not defensible, and should not be defended. If one is to get a handle on the real problem, however, it is important to be clear about the distinction between “end of year” and “wasteful”, as the two are not synonymous. The key question here has to do with the quality of spending, not the timing.

In addition, it is important to put end of year spending in context. If one takes the GAO High Risk List as an indicator of the places in the federal budget where the government has significant fiscal exposure, surely the effect of wasteful end of year spending, to the extent that it exists, pales in comparison to the magnitude of many of the items on that list. Consider two of many possible examples. First, GAO has placed IRS tax enforcement on the list, focusing on the \$385 billion annual tax gap that could be narrowed by enforcement. Second, Medicare and Medicaid

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<sup>2</sup> Jason J. Fichtner and Robert Greene. “Curbing the Surge in Year-End Federal Government Spending: Reforming “Use It or Lose It” Rules.” Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, September 2014.

improper payments had an estimated cost of almost \$80 billion in fiscal year 2014.<sup>3</sup> Thus, even if there is some waste that occurs from discretionary spending at the end of the year, it is far exceeded by the fiscal exposure on the revenue and mandatory parts of the budget.

It is important to be clear, however, that any spending for the sake of spending, or simply to protect future resources, is not just a squandering of taxpayer money. It also does a lot of damage in terms of the credibility of the federal government and the faith that citizens have in that government. Thus, even though I would argue that end of year spending is not a very important contributor to government waste, it may still be important to determine how to create incentives to reduce the practice.

### What Can be Done?

Assuming, then, that the Congress believed that it wanted to curb the practice, what CAN be done? In my opinion, the most important single change to current practice would be to enact appropriation bills on time, in order to create more certainty in the appropriations process. That is, while the motivation for end of year spending is certainly in part the same for the federal government as for other governments (the need to delay spending until funds are available, the desire to make full use of available funds, and an incentive to protect the budgetary base) there is an additional impetus for the practice at the federal level. I believe that the substantial uncertainty that exists from year to year concerning both the timing of appropriations and the level of those appropriations has pushed even more spending to later in the year and has created even more incentives to make use of all available resources in the current fiscal year.

In March of 2013, I testified at a hearing held by the full committee that was inspired by then-Chairman Carper's interest in highlighting the harmful effects of the uncertainty that is caused by the continued delays and dysfunction in the federal appropriations process. I based this testimony on a 2012 report that I had authored, which was itself informed partially by some good work that GAO had done three years earlier.<sup>4</sup> In my testimony, I discussed the apparently

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<sup>3</sup> Government Accountability Office, *High Risk Series: An Update*, GAO-15-29d0, February 2015.

<sup>4</sup> Philip Joyce, *The Costs of Budget Uncertainty: Analyzing the Impact of Late Appropriations* (Washington: IBM Center for the Business of Government, 2012); Government Accountability Office

invisible, yet insidious, effects that budget uncertainty creates for both federal agencies and the recipients of government funds. This uncertainty is caused by the practice of limping along from one crisis to another--the “fiscal cliff” debate of 2011 and the government shutdown brinksmanship of 1996, 2013, and this year are the main recent exhibits.

The main point that I made in this previous testimony was that the routine practice of government by continuing resolution is the “new normal”, with very harmful and costly effects. I will not repeat my testimony from two years ago in detail, but I will say that the 2015 appropriations debate suggests that NOTHING has improved in those two years that would cause me to change any of my conclusions concerning the effects of budget uncertainty. Specifically, I would highlight a few conclusions that are directly relevant to the topic of this hearing:

1. The failure to enact appropriations on time is not a new problem. Since The 1974 Congressional Budget and Impoundment Control Act, which created the modern congressional budget process, there have only been four fiscal years (out of 40!) when all appropriations bills been passed and signed into law prior to the start of the fiscal year. The problem has only gotten worse, as the numbers of continuing resolutions, and the portion of the fiscal year covered by CRs, has increased over time.
2. While government shutdowns represent costly examples of extreme government dysfunction (OMB estimated that the 2013 shutdown resulted in \$2.5 billion to provide pay and benefits for furloughed employees who did not work), it is the routine dysfunction of government by continuing resolution that is most likely to lead to the kind of wasteful spending highlighted by this hearing. 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.
3. For the federal government, late appropriations and “government by CR” have created a number of specific problems.

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(2009). *Continuing Resolutions: Uncertainty Limited Management Options and Increased Workload in Selected Agencies*, September.

- There are human capital challenges, including exacerbating skill gaps in crucial areas, and fostering a “brain drain” as many of the best and brightest eschew or depart government service.
- CRs tend to freeze past priorities in place, even when events would dictate a change in programs or policies. For example, the fiscal year 2011 budget delays resulted in DOD needing 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.
- Continuing resolutions affect contracting practices in costly and counterproductive ways. This includes the necessity to engage in multiple short-term contracts, thus increasing overhead costs. In addition, late appropriations push many contract renewals to later in the year. This compressed contracting timetable may be the main reason for the Mercatus findings cited earlier in my testimony. Regardless of the reason, however, this rush to contract creates a greater potential to make mistakes, which may lead to wasted funds and adverse audit findings. In addition, delayed contracts may result in higher prices. In one case, the federal Bureau of Prisons (BOP) reported that delays in funding one prison (the McDowell Prison facility in West Virginia) resulted in about \$5.4 million in additional costs. It also 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.
- 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, and compromise the effectiveness of government.
- Agencies waste a great deal of time preparing for potential government shutdowns and CRs, and then complying with them after the fact. Time spent by federal agencies and OMB preparing for a shutdown is a complete waste of time unless the shutdown actually occurs, which (as



noted above) has its own costs. CRs also have accompanying administrative inefficiencies. 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 spending is permitted and not permitted—for example, when is something a continuation of a current activity and when is it something new? 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.

4. The problems caused by federal budget uncertainty are not limited to federal agencies. Many recipients of federal funds—such as state and local governments and private contractors—are also affected by federal crisis budgeting. 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. A similar story exists for contractors. 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.

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. (I would note that no state or 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.) If

appropriations were timely, would lead to better decisions since agencies would not be (at least to the same extent) rushing to make choices on contractors, grants, etc. late in the fiscal year. Therefore, **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.** One way to make it more likely that the appropriations process will operate smoothly and predictably would be to curb the process of adding policy riders to appropriation bills. In recent years, the appropriations process has been more likely to be derailed over these riders than by disputes over the level of appropriated funding.

Are there other alternatives that might be pursued to reduce wasteful end of year spending? Certainly Congressional attention to wasteful spending, like the oversight being performed by this subcommittee, can have a chilling effect across the entire government. Another alternative that has been suggested is allowing agencies to keep a portion of the funds that are unobligated at the end of the fiscal year. This was a recommendation that was made in 1993 by Vice-President Al Gore's National Performance Review. The notion was that if an agency had (for example) \$100 million that had not been obligated, they would be able to roll over \$50 million of that budget authority to the next fiscal year, while the other \$50 million would represent savings to the Treasury. This would work in theory, but I would note that if it was to lead to the kinds of effects that are desired, agencies would need to believe that neither OMB nor the Congress would adjust some future budget downward in order to account for the rolled over funds. When the NPR proposed this reform, for example, it was not at all clear whether OMB was on board with changing its behavior.

### Conclusion

End of year spending is likely a relatively minor phenomenon, at least in overall dollar terms. It can nonetheless lead to waste in government, which results in a squandering of taxpayer resources and compromises the effectiveness in government. While uncovering wasteful spending is an important function of Congressional oversight, I would suggest that providing a reliable and predictable funding stream for federal agencies would do far more to improve the effectiveness of government AND to curb the practice of end of year spending than an effort to uncover specific instances of waste. In fact, end of year spending practices are an entirely

understandable—even reasonable--response to the dysfunction and unpredictability of the appropriations process. The negative impacts of late appropriations—which extend far beyond promoting end of year spending--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.