

## September Grasshoppers: Why Federal Agencies Spend so Much at the End of the Fiscal Year

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*In a field one summer's day a Grasshopper was hopping about, chirping and singing to its heart's content. An Ant passed by, bearing along with great toil an ear of corn he was taking to the nest. "Why bother about winter?" said the Grasshopper; "[W]e have got plenty of food at present." But the Ant went on its way and continued its toil. When the winter came, the Grasshopper had no food, and found itself dying of hunger, while it saw the ants distributing every day corn and grain from the stores they had collected in the summer. Then the Grasshopper knew: "It is best to prepare for the days of necessity."<sup>1</sup>*

### I. Introduction

Aesop's fable of the ant and the grasshopper illustrates how safeguarding surplus resources, as the ant did, leads to increased security in times of future need. Although this may be prudent behavior for most economic decisions, the federal budget process does not reward ant-like behavior.<sup>2</sup> In fact, this behavior is disincentivized.<sup>3</sup>

For federal agencies that operate on annually expiring budgets, the month of September signals the end of the current fiscal year and the approach of a new budget. If an agency does not spend all of its funds by the end of September, Congress may reduce its future baseline budget.<sup>4</sup> The potential reduction of future budget baselines acts as a disincentive for agency budget surpluses.<sup>5</sup> Because of this disincentive, Aesop's intended lesson does not offer much guidance for federal agencies. Predictably every September, federal agencies act like grasshoppers and spend whatever may be left of their budgets.<sup>6</sup>

This article argues that disincentives for budget surpluses, in conjunction with the policy of expiring funds, promotes inefficient spending by federal agencies each

September. Though Aesop's fable emerges from a world distinct from the world of federal spending, understanding the causes of both ant-like and grasshopper-like economic behaviors gives perspective to the problem of wasteful year-end spending by federal agencies. The discussion examines the current budget process through the lens of economic psychology, highlighting parallels between the fraud triangle theory<sup>7</sup> and inefficient federal spending. Finally, the article shifts to suggest several possible ways to address the issue while evaluating the merits of each. While there are different types of fraud, waste, and abuse that can occur in federal spending, the scope of the following discussion is limited to one particular type: wasteful expenditures that would not have occurred but for the pressures put on otherwise responsible federal employees by the policy of expiring federal funds.

### II. Background

At the start of each calendar year, the executive branch collects from each federal agency a budget proposal for the next fiscal year. The President uses the budget proposals from each agency to create a single federal budget proposal for the

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<sup>1</sup> AESOP RETOLD BY JOSEPH JACOBS, *THE HARVARD CLASSICS*, vol. 17, part 1, at 36 (Charles W. Eliot ed., New York: P.F. Collier & Son, 1909–14) (c. 6th century B.C.E.).

<sup>2</sup> See, e.g., D. ANDREW AUSTIN, CONG. RESEARCH SERV., RL34424, *THE BUDGET CONTROL ACT AND TRENDS IN DISCRETIONARY SPENDING 2* (2014); Jeffrey B. Liebman & Neale Mahoney, *Do Expiring Budgets Lead to Wasteful Year-End Spending? Evidence from Federal Procurement* (Nat'l Bureau of Econ. Research, Working Paper No. 1948, 2013); Charles J. Whalen, *Should the US Government Adopt a Biennial Budget?* 2 (The Levy Inst., Working Paper No. 128, 1994), <http://www.levyinstitute.org/pubs/wp128.pdf> (discussing wasteful spending in federal government).

<sup>3</sup> See generally Michael F. McPherson, *An Analysis of Year-End Spending and the Feasibility of a Carryover Incentive for Federal Agencies* (Dec. 2007) (MBA Professional Report, Naval Postgraduate Sch.), <http://www.dtic.mil/dtic/tr/fulltext/u2/a475973.pdf> (supporting the idea that the federal budget process creates disincentives for saving and incentives for spending).

<sup>4</sup> Memorandum from Office of the Sec'y of Def. to Sec'ys of the Military Dep'ts, et. al., subject: U.S. Department of Defense Management of Unobligated Funds; Obligation Rate Tenets 1 (10 Sep. 2012), <http://www.scribd.com/doc/152945898/Defense-Department-memo-on-management-of-unobligated-funds> [hereinafter DoD Unobligated Funds Memo].

<sup>5</sup> See McPherson, *supra* note 3.

<sup>6</sup> See, e.g., David Fahrenthold, *As Congress Fights over the Budget, Agencies Go on Their 'Use It or Lose It' Shopping Spree*, WASHINGTON POST (Sept. 28, 2013), <http://wpo.st/uWu80>; Matthew Sabas, *'Use It or Lose It' Shows There's More Room to Cut Spending*, HERITAGE FOUNDATION (Nov. 14, 2013), <http://blog.heritage.org/2013/11/14/use-lose-shows-theres-room-cut-spending/>.

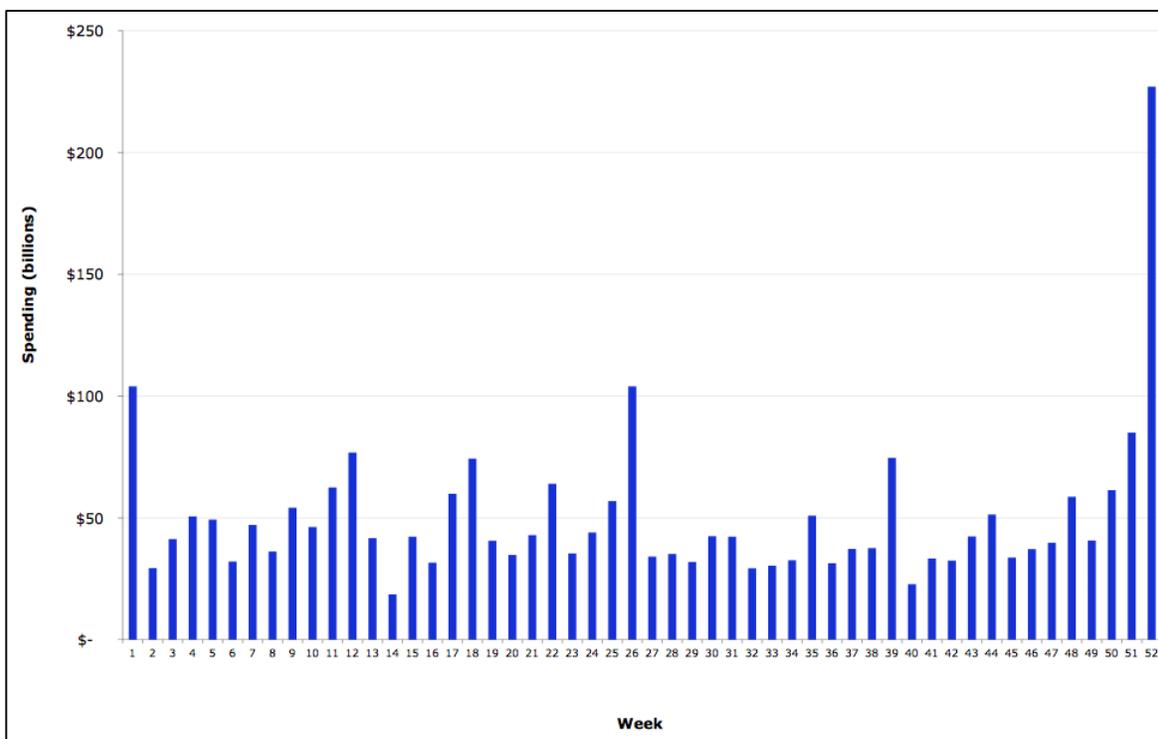
<sup>7</sup> See discussion *infra* Part III.A (discussing Donald Cressy development of the fraud triangle theory to explain why employees commit financial crimes in the workplace).

entire executive branch, and submits the proposal to Congress for review and adjustment before it can become law.<sup>8</sup> Not long after the President sends the overall budget proposal to Congress, agencies submit justifications of their individual budget requests to Congress and must provide detailed accounts of past spending—including records of unobligated funds and budget surpluses.<sup>9</sup> Many agencies share the view expressed by the former Under Secretary of Defense (Comptroller), Robert F. Hale, and Under Secretary of Defense for Acquisition, Technology and Logistics, Frank Kendall, that “Congress has used unobligated balances as a means to reduce our budgets.”<sup>10</sup>

Federal spending in 2014 was approximately \$3.5 trillion, which can be roughly separated into interest payments of about \$230 billion, mandatory spending of \$2.11 trillion, and discretionary spending of \$1.17 trillion.<sup>11</sup> The Federal discretionary spending “covers the costs of the routine activities commonly associated with such federal government functions as running executive branch agencies,

congressional offices and agencies, and international operations of the government.”<sup>12</sup> With limited statutory exceptions, almost “all spending on federal wages and salaries is discretionary.”<sup>13</sup> Federal grants, equipment and other asset purchases, and contractor service support are also funded with discretionary spending.<sup>14</sup>

The fiscal rules of purpose, time, and amount restrict how agency officials can spend discretionary funds. The purpose statute requires agencies to apply appropriations only to the objects for which the appropriations were made, except as otherwise provided by law.<sup>15</sup> Agencies have a limited time to obligate funds and “must incur a legal obligation to pay money within an appropriation’s period of availability. If an agency fails to obligate funds before they expire, they are no longer available for new obligations.”<sup>16</sup> The Antideficiency Act prohibits any government officer or employee from “obligating, expending, or authorizing an obligation or expenditure of funds in excess of the amount available in an appropriation, an apportionment, or a formal subdivision of



**Figure 1 Dollars spent on Federal Contracts by Week**

<sup>8</sup> MICHELLE D. CHRISTENSEN, CONG. RESEARCH SERV., RS20152, THE EXECUTIVE BUDGET PROCESS TIMETABLE (2012).

<sup>9</sup> MICHELLE D. CHRISTENSEN, CONG. RESEARCH SERV., RS20268, AGENCY JUSTIFICATION OF THE PRESIDENT’S BUDGET (2008).

<sup>10</sup> DoD Unobligated Funds Memo, *supra* note 4, at 1.

<sup>11</sup> AUSTIN, *supra* note 2, at 2.

<sup>12</sup> *Id.* at 1.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> See 31 U.S.C. § 1301 (2006); see also U.S. DEP’T OF DEF., 7000.14-R, DOD FINANCIAL MANAGEMENT REGULATION, vol. 14, ch. 2, para. 020202.B (Jan. 2009) [hereinafter DOD FMR].

<sup>16</sup> See 31 U.S.C. § 1301 (2006); see also DOD FMR, *supra* note 15, para. 020202.B.

funds.”<sup>17</sup> In addition, agencies may only obligate funds for bona fide needs. The Defense Acquisition University explains the bona fide need rule as a law that “requires appropriated funds be used only for goods and services for which a need arises during the period of that appropriation’s availability for obligation.”<sup>18</sup>

There is ample anecdotal evidence that this budgeting system leads to increased spending at the end of the fiscal year.<sup>19</sup> The National Bureau of Economic Research published a study authored by Jeffrey Liebman and Neale Mahoney that examined federal procurement contracts. They analyzed five years’ worth of federal procurement data and found that 8.7% of spending occurs in the last week of September alone, which is 4.9 times greater than the rest-of-year average, and well above the 1.9% of spending that would occur if spending were uniformly distributed throughout the fiscal year.<sup>20</sup>

As Figure 1 shows,<sup>21</sup> the end-of-year spike in spending is apparent when measured by dollars. When measured by number of contracts instead of dollars spent, 5.6% of contracts are executed in the last week of September.<sup>22</sup> Additionally, Liebman’s research confirms that contracts awarded during the end-of-year spending rush are 2.2 to 5.6 times more likely to be lower in quality.<sup>23</sup> This drastic increase in spending—and on contracts of lower quality—mimics the wasteful grasshopper.

### III. Discussion

In a commercial market, the ant-like inclination to save, or “spend less now so we can spend in the future”<sup>24</sup> is rewarded.<sup>25</sup> However, Liebman’s research gives empirical support to the notion that things work differently in the world of federal appropriations.<sup>26</sup> This section uses Cressey’s fraud triangle to help explain how the policy of expiring discretionary funds and the fear of budget reduction make September grasshoppers of federal agencies.

#### A. Fraud Triangle

Donald R. Cressey developed the fraud triangle theory in an attempt to explain why employees embezzle funds, or commit like crimes.<sup>27</sup> According to Cressey, “there are three factors that must be present at the same time in order for an ordinary person to commit financial fraud: pressure, opportunity, and rationalization.”<sup>28</sup> Cressey’s theory explains how ordinary employees—as opposed to career criminals—might come to embezzle money under the right circumstances.<sup>29</sup>

Inefficient spending for unselfish reasons might be easier to rationalize for the ordinary person than outright embezzlement. While wasteful year-end spending is not embezzlement, still, the pressure and rationalization factors of the fraud triangle are all systemically created with a federal use-it-or-lose-it policy. It is unsurprising that the federal budget process leads to wasteful spending, even from employees with the best of intentions. Cressey explains:

Trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property.<sup>30</sup>

The current use-it-or-lose-it federal budgetary policy for expiring one-year appropriations creates both pressure and rationalization on federal employees that are charged with purchasing goods and services. There is pressure to spend the appropriated funds by a relatively arbitrary artificial deadline: the end of the fiscal year. If the money is not spent in time, then it will be taken back.<sup>31</sup> To add to this pressure and also create convincing rationale for wasteful spending, there is a belief that unspent funds are used as justification for reducing

<sup>17</sup> 31 U.S.C. § 1341(a)(1)(A); see also DoD FMR, *supra* note 15, para. 020202.D.

<sup>18</sup> *Bona Fide Need Definition*, DEF. ACQUISITION UNIV. (Apr. 7, 2015), <https://dap.dau.mil/acquipedia/Pages/ArticleDetails.aspx?aid=b2f52b87-8cc1-4639-87af-b8941f72d965>.

<sup>19</sup> See sources cited *supra* note 6.

<sup>20</sup> Liebman & Mahoney, *supra* note 2, at 2.

<sup>21</sup> *Id.* at 38.

<sup>22</sup> *Id.* at 10.

<sup>23</sup> *Id.* at 3. (“Projects that originate in the last week of the fiscal year have 2.2 to 5.6 times higher odds of having a lower quality score.”)

<sup>24</sup> Paul Webley & Ellen K. Nyhus, *Inter-temporal Choice and Self-control: Saving and Borrowing*, in *THE CAMBRIDGE HANDBOOK OF PSYCHOLOGY AND ECONOMIC BEHAVIOUR*, 105, 105-31 (Alan Lewis ed., 2008).

<sup>25</sup> Sonia M. Livingstone & Peter K. Lunt, Psychological, Social and Economic Determinants of Saving: Comparing Recurrent and Total Savings, 12 J. ECON. PSYCHOLOGY 621, 621-41 (1991).

<sup>26</sup> Liebman & Mahoney, *supra* note 2, at 1.

<sup>27</sup> *The Fraud Triangle*, ASS’N OF CERTIFIED FRAUD EXAM’RS, <http://www.acfe.com/fraud-triangle.aspx> (last visited Jan. 11, 2016).

<sup>28</sup> *Id.*

<sup>29</sup> DONALD R. CRESSEY, *OTHER PEOPLE’S MONEY* (1973).

<sup>30</sup> *Id.* at 30.

<sup>31</sup> See Robin Mordfin, *A Simple Way to Reduce Wasteful Government Spending*, CAPITAL IDEAS MAG. (Nov. 18, 2013), <http://www.chicagobooth.edu/capideas/magazine/winter-2013/a-simple-way-to-reduce-wasteful-government-spending>.

the allotted funds in the next fiscal year.<sup>32</sup> In order to avoid budget reductions in the future, otherwise honest federal employees are incentivized to spend all that has been allotted to them whether there is a bona fide need or not.<sup>33</sup>

The use-it-or-lose-it budget policies provide pressure on federal agencies as well as put them in a position where inefficient and wasteful spending can be rationalized. On the other hand, the budget policies do reduce the opportunity for any fiscal wrongdoing by putting extra restrictions in place.<sup>34</sup> But, in so doing, the pressure and rationalization legs of Cressey's fraud theory remain, just waiting for the opportunity to complete the triangle.

There is some warranted criticism of the theory's simplicity and its inability to explain all types of fraud (for example, crimes committed by financial predators).<sup>35</sup> In spite of its limitations, Cressey's theory rings true for explaining the ordinary employee spending behaviors that may range from questionable to criminal. For this reason, the fraud triangle offers insight into why federal employees—who are honest in all other transactions in their personal and professional lives—may be intentionally wasteful.

#### B. Pressure from the Policy of Expiring Funds

The policy of expiring funds creates an artificial environment of external pressures.<sup>36</sup> These artificial pressures discourage even those with a strong internal propensity to save resources from doing so. An article in *The Fiscal Times* describes how “the system [of expiring funds] typically creates panic for federal workers scrambling to spend millions of dollars before they run out of time.”<sup>37</sup> Moreover, the current policy rewards the spending behavior by creating counter-intuitive incentives and disincentives.<sup>38</sup> The reward for spending all that has been allocated is justification for equal or larger budgets in subsequent years.<sup>39</sup>

In 1980, the Comptroller General of the United States described a problem with federal budgeting policy in a restricted report to the Honorable Stewart B. McKinney:

Unfortunately the existing budget system has certain characteristics that, while not intended to do so, serve as incentives to spend all unobligated funds before year-end. For those funds that lapse at year-end, the manager sees no benefit in saving since the Congress may or may not return tax dollars saved in the following fiscal year. For example, we recently reported that managers with large unobligated balances near the end of a fiscal year may use them on low priority projects, unplanned projects or services, or shortcut the procurement process rather than lose the funds.<sup>40</sup>

People—including federal employees—make choices every day about expending resources and saving resources.<sup>41</sup> Some people are more likely than others to act based on internal values and external factors and exhibit resource-saving behavior.<sup>42</sup> But Cressey's fraud theory shows that the combination of pressure, opportunity, and rationalization created by the policy of expiring funds will make September grasshoppers of anyone responsible for spending money—even people who are naturally inclined to save.

#### C. Fear of Future Budget Reduction

Federal agencies fear that surpluses will be held against them when Congress considers future budget baselines. In fact, an official Department of Defense (DoD) memo offered sympathy to spending authorities, noting that “the threat that funding will be taken away or future budgets . . . reduced unless funds are obligated on schedule is a strong and perverse motivator.”<sup>43</sup> The memo also offers encouragement to “rethink how we approach managing mid-year and year-end obligations and to change to types of behavior we reward or punish.”<sup>44</sup> The encouragement of the memo, however, is

<sup>32</sup> See *id.*; see also discussion *infra* Part III.C (noting fear that budget surpluses will cause future budget reductions).

<sup>33</sup> McPherson, *supra* note 3, at 7.

<sup>34</sup> *Id.*

<sup>35</sup> *The Fraud Triangle*, *supra* note 27.

<sup>36</sup> McPherson, *supra* note 3, at 6 (“This annual deadline entrains a huge effort on federal agencies that plan months in advance to execute as much authority as possible—or lose it.”).

<sup>37</sup> Brianna Ehley, *Reckless Federal Shopping Spree Could Squander \$50 Billion*, THE FISCAL TIMES (Sept. 30, 2014), <http://www.thefiscaltimes.com/Articles/2014/09/30/Reckless-Federal-Shopping-Spree-Could-Squander-50-Billion>.

<sup>38</sup> Jason J. Fichtner & Robert Greene, *Curbing the Surge in Year-End Federal Government Spending: Reforming “Use It or Lose It” Rules*,

MERCATUS CTR. AT GEORGE MASON UNIV. (September 2014), [http://mercatus.org/sites/default/files/Fichtner-Year-End-Spending\\_1.pdf](http://mercatus.org/sites/default/files/Fichtner-Year-End-Spending_1.pdf).

<sup>39</sup> See DoD Unobligated Funds Memo, *supra* note 4, at 2 (finding “Managers who release unobligated funds to higher priorities will not automatically be penalized in their next year’s budget with a lower allocation and may be candidates for additional funding to offset prior year reductions”).

<sup>40</sup> U.S. GOV’T ACCOUNTABILITY OFFICE, PAD-81-18, FEDERAL YEAR-END SPENDING: SYMPTOM OF A LARGER PROBLEM 4-5 (1980) [hereinafter GAO YEAR-END SPENDING].

<sup>41</sup> See Webley & Nyhus, *supra* note 24, at 105-31.

<sup>42</sup> Joan Finegan, *The Impact of Personal Values on Judgments of Ethical Behavior in the Workplace*, 13 J. BUS. ETHICS 747, 747-55 (1994).

<sup>43</sup> DoD Unobligated Funds Memo, *supra* note 4, at 1.

<sup>44</sup> *Id.*

dampened by an acknowledgement that the fear of future budget reductions is real.<sup>45</sup>

This mixed message is also found in a 1965 address from President Lyndon B. Johnson:

When an agency speeds up spending in the last few weeks of the fiscal year, in the absence of clear and compelling reasons, the practice looks like an attempt to use up funds which otherwise would lapse. We cannot expect our employees to believe that cost reduction efforts are serious if they see evidence of opportunistic spending in the last days of the fiscal year.<sup>46</sup>

Despite encouragement to dismiss the fear of budget cuts and return unspent funds, the Government Accountability Office (GAO) notes that “even for funds that do not lapse there appears to be little incentive to save. Under current practices, agencies run the risk of having future appropriation requests reduced if large fund balances remain unobligated at the end of a prior fiscal year.”<sup>47</sup> And the signaling effect is magnified “when current spending is explicitly used as the baseline in setting budgets for the following year.”<sup>48</sup>

So, whether or not the fear correlates with anything written into policy, the same DoD memo that offered encouragement admits that the fear is justified by recent history: “for the past several years, Congress has used unobligated balances as a means to reduce our budgets.”<sup>49</sup> An article from *The Fiscal Times* captures the way this fear leads to a rationalization to spend, saying that “since agencies cannot carry over unspent funds, the idea is use-it-or-lose-it. If they do not spend the money, Congress may not allocate as much the following year.”<sup>50</sup>

Though “fear of economic uncertainty” and “pessimism about the economy” in a commercial market would likely cause reduction in spending, the market of federal appropriations causes some backwards reactions. In the case of use-it-or-lose-it funds, federal employees are less likely to save any funds past the fiscal year. They fear that any savings will mean that their agency will have to make do with less next fiscal year.<sup>51</sup>

The rationalization to spend is simple. It can be looked at as the better of two bad choices. An employee can easily justify some waste at the end of the year on some questionable

expenses if it means that the organization avoids a reduction in the next budget. McPherson describes the incentive as an “incentive to spend as much as possible for survival’s sake.”<sup>52</sup> A *Washington Post* article quotes Senator Coburn as he expresses agreement with this bleak view: “The way we budget [money] sets it up, because instead of being praised for not spending all your money, you get cut for not spending all your money. And so we’ve got a perverse incentive in there.”<sup>53</sup>

#### IV. Addressing the Problem—Perspective on Surpluses

Several proposed solutions could help reduce the incentive for end of fiscal year wasteful expenditures due to our current expiring funds policy.<sup>54</sup> These can be placed into two categories. One type of solution focuses on reducing existing disincentives for agency budget surpluses, which reduces the pressure and rationalization legs of the fraud triangle.<sup>55</sup> The second type of solution focuses on creating incentives for agency budget surpluses. While these incentives may indirectly serve to curb certain elements of the fraud triangle, the intent behind each proposal is to create positive incentives to save rather than eliminating incentives to waste.

Each of the following proposed partial solutions assumes that budget surpluses can benefit the federal government and ultimately the nation and that wasteful government spending has a detrimental effect in the long run. Each proposed solution is also intended to do at least one of three things: reduce existing disincentives for agency budget surpluses, increase agency incentives to have budget surpluses, and decrease the pressure-filled spending deadlines.

##### A. Reduce Existing Disincentives for Agency Budget Surpluses

###### 1. Prohibit the Use of Surpluses as Justification for Future Budget Reductions

Currently agencies have a valid concern that if they do not spend all they are allocated in a fiscal year, it may be used

<sup>45</sup> *Id.*

<sup>46</sup> Memorandum from President Lyndon B. Johnson on “June Buying” by Federal Departments and Agencies to Cabinet and Heads of Agencies, THE AMERICAN PRESIDENCY PROJECT AT UC SANTA BARBARA (May 20, 1965), <http://www.presidency.ucsb.edu/ws/?pid=26982> [hereinafter June Buying Memo].

<sup>47</sup> GAO YEAR-END SPENDING, *supra* note 40, at 4-5.

<sup>48</sup> Liebman & Mahoney, *supra* note 2, at 1.

<sup>49</sup> DoD Unobligated Funds Memo, *supra* note 4, at 1.

<sup>50</sup> Ehley, *supra* note 37.

<sup>51</sup> See Liebman & Mahoney, *supra* note 2.

<sup>52</sup> McPherson, *supra* note 3, at 6.

<sup>53</sup> Fahrenthold, *supra* note 6.

<sup>54</sup> See generally Liebman & Mahoney, *supra* note 2; McPherson, *supra* note 3 (proposing and analyzing several solutions).

<sup>55</sup> See CRESSEY, *supra* note 29.

as justification to reduce their future budget.<sup>56</sup> This concern creates a powerful disincentive to have any real budget surplus. Significant budget surpluses can be regarded as budgeting failures under this system; however, “exhaustive spending may be regarded not only as the hallmark of a successful year, but a key criterion by which executives and financial managers are judged effective.”<sup>57</sup>

The current rationale for budget reduction based on past surpluses is that an agency that only obligates part of its allocated budget has been allocated too much; therefore, it will be reduced accordingly in the future.<sup>58</sup> This rationale only makes sense when cost fluctuation is not considered. Operational costs may fluctuate significantly from year-to-year. These fluctuations may occur for many reasons.<sup>59</sup> Market price changes, personnel shifts, and unforeseen maintenance and repair costs may cause fluctuations to agency operational costs. When agency operational costs are lower than predicted, budget surpluses are possible. Budget surpluses can then be used to reduce future costs.<sup>60</sup>

Reduction in future budget allocations is a negative repercussion and agencies might spend less if this negative repercussion did not exist.<sup>61</sup> If showing a budget surplus at the end of the fiscal year did not carry with it any negative repercussions for the agency, there would be less incentive to participate in the traditional mad-dash spending that often occurs in September.

Even though the concept is simple, it still requires a fundamental shift in budgeting rationale. Surpluses are a good thing and should not be assumed to be a result of improper budgeting. When an agency does not spend all of the money it has been given, it is a positive and should not suffer negative repercussions. Instead, the default assumption should be that agencies with budget surpluses are good stewards of taxpayer dollars. Agencies that end up spending less than they were allocated should gain credibility. These agencies should not have their budgets slashed in the future.

They have demonstrated that they do not spend for the sake of spending and are more likely to return any surplus.

If congress looks at surpluses as a positive, then an agency provides evidence of good stewardship if it obligates the needed portion of its budget and returns the surplus. These agencies that demonstrate good stewardship should not be punished with reduced budgets because that encourages wasteful spending. If agencies do not spend wastefully and return excess funds, over-allocation should be less of a concern.<sup>62</sup> In his 1965 address, President Johnson talks about returning money as a good thing:

I see nothing at all wrong in returning unused appropriation balances to the Treasury. Last year, we turned back \$805 million when the Fiscal Year ended and I hope that this practice may be the rule, rather than the exception. I do not want “June Buying”<sup>63</sup> to become a way of circumventing our cost reduction efforts. “June Buying” may be an ancient practice—but that does not justify it or excuse it.<sup>64</sup>

A congressional self-imposed prohibition of the use of surpluses to justify future budget reductions is consistent with current spending regulations that agencies must already follow. The Federal Acquisition Regulation (FAR) prohibits cost-plus-a-percentage-of-cost contracts. Under a cost-plus-a-percentage-of-cost contract, the federal contractor is rewarded with profits that increase proportionally as the total project costs increase. Thus, the contractor has an incentive to drive costs up so they are rewarded with more profits. Federal agencies are prohibited from entering into cost-plus-a-percentage-of-cost contracts because they incentivize contractors to spend more than is necessary.<sup>65</sup>

Similar to cost-plus-a-percentage-of-cost contracts, disincentives for agency budget surpluses also incentivize more spending. Thus, a prohibition against using surpluses as budget reduction justification is a rational and necessary step towards addressing inefficient September spending.<sup>66</sup> While

<sup>56</sup> See *supra* Part III.C (noting fear that budget surpluses will cause future budget reductions).

<sup>57</sup> McPherson, *supra* note 3, at 6 (noting fear that budget surpluses will cause future budget reductions).

<sup>58</sup> *Id.* at 5-6; see *supra* Part III.C.

<sup>59</sup> See McPherson, *supra* note 3, at 28 (“Under the current system, these exigencies constantly throw budgets off, making a real baseline nearly impossible to determine.”).

<sup>60</sup> *Id.* at 33 (summarizing the success of the Oklahoma carryover plan in which most agencies “now have a buffer to pay for one-time expenses they would previously have used current-year appropriations for”).

<sup>61</sup> See *id.* at 36-37 (discussing reports that agencies participating in the Washington State Savings Incentive Plan felt an increased incentive to reduce “expenditures, particularly those at the end of the fiscal year” in order to build up their “revolving account for one-time expenditures”).

<sup>62</sup> See *id.* at 5-12.

<sup>63</sup> In 1965, the fiscal year ended in June as opposed to September, hence the term “June Buying.” See 31 U.S.C. § 1102 (2006) (establishing the current fiscal year beginning October 1 and ending September 30); Fiscal Year Transition Act, Pub. L. 94-274, 90 Stat. 383 (providing for an orderly transition to the new fiscal year for particular acts by specifying how the period of July 1, 1976, through September 30, 1976, was to be treated for fiscal year purposes).

<sup>64</sup> June Buying Memo, *supra* note 46.

<sup>65</sup> See FAR 16.102-c (2015) (“The cost-plus-a-percentage-of-cost system of contracting shall not be used (see 10 U.S.C. 2306(a) and 41 U.S.C. 254(b)). Prime contracts (including letter contracts) other than firm-fixed-price contracts shall, by an appropriate clause, prohibit cost-plus-a-percentage-of-cost subcontracts.”).

<sup>66</sup> See McPherson, *supra* note 3, at 40-43 (discussing interview results that suggest the fear of budget reductions could prevent other solutions from working).

seventy-five percent of the interviewees that McPherson questioned about year-end spending favored incentives that have been successfully implemented at the state-level, “much skepticism was expressed regarding the feasibility of actually enacting such a program, especially given the track record of budget-and-execution rule changes.”<sup>67</sup> In other words, the fear of future budget reductions will prevent change despite solutions that are proven to be effective.

## 2. Extend Availability of Expiring Funds

### a. Carryover

Congress could grant agencies more authority to obligate allocated funds after the end of the fiscal year.<sup>68</sup> Extending the deadline would reduce the existing pressure to spend that agencies feel during the last weeks of a fiscal year, where there is a drastic spike in agency spending and a decrease in the quality of contracts executed.<sup>69</sup> Leibman’s comparison of typical federal agencies to the Department of Justice—where a portion of the budget may be carried over to the next year—shows that a simple extension past the current spending deadline of September 30 may reduce the traditional end of year spending spike and increase the quality of contracts executed during that same time period.<sup>70</sup>

Allowing agencies to carry over unused funds also makes sense because budget legislation is often not passed on schedule. Funding gaps can cost taxpayers billions of dollars.<sup>71</sup> If agencies were able to spend money past the end of September every year, it would be easier for them to prepare for “the days of necessity”<sup>72</sup> if the federal budget is not passed on time.<sup>73</sup> When the federal budget is passed on time this would result in a funding overlap; both current year funds as well as previous year funds would be available for

obligation.<sup>74</sup> When the budget is not passed on time, potential funding gaps could be reduced.<sup>75</sup> This reduction of funding gaps means increased efficiency.<sup>76</sup>

### b. Multi-Year Budget

Wasteful expenditures could be decreased by creating budgets lasting longer than one year.<sup>77</sup> Spending deadlines assist Congress in controlling how money is spent but they also create pressure. A negative side effect of this pressure is the drastic increase in spending and decrease in contract quality as the deadline approaches.<sup>78</sup> Simply reducing the amount of these deadlines could reduce the frequency of spending increases and lower quality contracts.<sup>79</sup> If budgets were created every two years instead of annually, there would be at worst half the deadlines—and hence—half the rush periods typical of increased wasteful spending. *The Levy Institute* published a working paper authored by Charles Whalen about biennial budgeting. Whalen and other “supporters argue that a two-year budget and appropriations cycle would streamline the budget process by eliminating much procedural repetition.”<sup>80</sup> There are indications that a two-year budget would eliminate the spending rush. The former Assistant Secretary for Budget, Technology and Finance at the Department of Health and Human Services, Charles E. Johnson, stated that “he never saw it happen with two-year money, but he did see a ‘rush to obligate’ with one-year money.”<sup>81</sup>

The idea of a two-year budget is not foreign to this country and roots of it can even be seen as far back as our Constitution.<sup>82</sup> In 2011, Senator Jeff Sessions proposed that we shift to a two-year budgeting cycle.<sup>83</sup> He described the

<sup>67</sup> *Id.* at 42.

<sup>68</sup> *See id.* at 27-43 (reviewing results of budget carryover programs in both Oklahoma’s and Washington’s state governments).

<sup>69</sup> Liebman & Mahoney, *supra* note 2, at 3.

<sup>70</sup> *Id.* at 28-30.

<sup>71</sup> *See generally* Phillip G. Joyce, *The Costs of Budget Uncertainty: Analyzing the Impact of Late Appropriations*, UNIVERSITY OF MARYLAND (2012), [http://faculty.publicpolicy.umd.edu/sites/default/files/joyce/files/the\\_costs\\_of\\_budget\\_uncertainty.pdf](http://faculty.publicpolicy.umd.edu/sites/default/files/joyce/files/the_costs_of_budget_uncertainty.pdf) (2012).

<sup>72</sup> AESOP, *supra* note 1, at 36.

<sup>73</sup> *See generally* Joyce, *supra* note 71.

<sup>74</sup> *See* McPherson, *supra* note 3, at 27.

The two-year period in question should not be confused with biennial budgeting. Unlike biennial budgeting, the Jones plan would still mandate annual budgeting according to an incremental budgetary system. The difference would be that agencies would have twenty-four months to obligate. Additionally, by commanding two years in which to obligate funds, organizations would have two fiscal-year budgets for their needs.

*Id.*

<sup>75</sup> *See generally* Lawrence R. Jones, *Out-Year Budgetary Consequences of Agency Cost Savings*, 6 INT’L PUB. MGMT. REV., 139-68 (2005).

<sup>76</sup> *See generally* Joyce, *supra* note 71.

<sup>77</sup> *See, e.g.*, Greg McDonald, *Sessions Calls for a Two-Year Budget Plan*, NEWSMAX.COM (Oct. 4, 2011, 2:04 PM), <http://www.newsmax.com/TheWire/Sessions-two-year-budget-plan/2011/10/04/id/413235/>; Laura Meckler, *Giving Government Incentives To Save*, WALL STREET JOURNAL (Jun. 7, 2010); Whalen, *supra* note 2.

<sup>78</sup> Liebman & Mahoney, *supra* note 2, at 10.

<sup>79</sup> *See id.* at 32-35 (discussing the positive results of rollover budget simulation).

<sup>80</sup> Whalen, *supra* note 2, at 11.

<sup>81</sup> McPherson, *supra* note 3, at 23.

<sup>82</sup> Liebman & Mahoney, *supra* note 2, at 25.

<sup>83</sup> McDonald, *supra* note 77.

advantages of shifting to a two-year cycle in his testimony during a Senate Budget Committee hearing, stating,

For two consecutive years, the Senate has simply refused to adopt a budget resolution. It's been 888 days. We're not passing appropriations bills—we're funding the government with stopgap measures, or cramming all our spending bills into one big omnibus . . . . [W]e can't—and we shouldn't—operate our nation's finances in this way . . . especially not during a time of financial crisis . . . . Under the current system . . . an executive agency has to begin working on its budget for the next fiscal year before the current budget has been adopted or approved . . . . Additionally, by switching to a two-year plan, it will be easier for agencies to reduce waste and conduct long-term planning.<sup>84</sup>

Some argue that the idea of extending the availability of expiring funds is simply a way to lengthen the budgeting period.<sup>85</sup> But Whalen predicts that a two-year budget would actually mean “a reduced budget workload” for federal workers over the two-year period.<sup>86</sup> Other critics argue against change because “the system appears to work well enough.”<sup>87</sup> But Whalen believes that “the combination of a longer budget period with this chance to devote additional attention to oversight and other non-budget matters is one that provides new opportunities for making policies more effective, promoting economic stability and perhaps even for reducing the federal deficit.”<sup>88</sup>

## B. Create Incentives for Agency Surpluses

### 1. Agency Incentive—Keep Funds for Future Use

Like the two-year budget, the idea of allowing agencies to keep a portion of unspent funds for future use is not a new concept.<sup>89</sup> In 2010, President Obama proposed that Congress grant “new authority that could help to discourage unnecessary spending by federal agencies, a move that comes amid rising public concern about the federal deficit. The proposed change would let agencies that save money redirect half the savings to other initiatives, with the rest going toward deficit reduction.”<sup>90</sup> Laura Meckler, in her 2010 *Wall Street*

*Journal* article *Giving Government Incentives To Save*, agrees.

Under current law, agencies are typically forced to return any unspent part of their budgets, giving them an incentive to use every last dollar even if the money isn't needed. The new policy would alter those incentives. The dollars aren't huge; at most, about \$25 billion would be subject to redirection. But officials said the goal was partly to change the mentality at the agencies.<sup>91</sup>

### 2. Individual Incentive—Evaluate on Efficiency

Creating individual incentives as well as agency incentives is an opportunity to address the issue from different angles. Agencies can do a better job of evaluating the efficiency of those employees that make spending decisions.<sup>92</sup> Going even further, efficiency could be something every federal employee is evaluated on—but not trump leadership, mission accomplishment, or other important criteria. If efficiency becomes part of every employee's evaluation, those who contributed to greater efficiency could be positively identified for future positions of greater responsibility. While a small change, evaluating federal employees on efficiency would give people incentive to be good stewards of public money.<sup>93</sup>

Arguments against this proposition may cite the fact that many federal employees serve in positions where they are unlikely to have a significant effect on agency spending or that “even if a federal agency wanted to adopt business-style efficiencies, the output of much government work is hard to measure, which would make it difficult to set performance goals for managers and workers.”<sup>94</sup> Both of these arguments, although valid, do not outweigh the importance of attempting to raise the universal value of efficiency within the federal workplace.

Out of all the proposed partial solutions, the addition of efficiency to employee evaluation criteria is perhaps easiest to first enact. While other proposed policy changes would require Congressional approval, modifying performance evaluation criteria for federal employees does not. Even if progress is slow, the costs and risks of such a change is low

<sup>84</sup> *Id.*

<sup>85</sup> See McPherson, *supra* note 3, at 49.

<sup>86</sup> Whalen, *supra* note 2, at 2.

<sup>87</sup> McPherson, *supra* note 3, at 49 (citing Aaron B. Wildavsky, *A Budget for all seasons? Why the traditional Budget Lasts*, 38 PUB. ADMIN. REV., 501-09 (1978)).

<sup>88</sup> Whalen, *supra* note 2, at 2.

<sup>89</sup> See 28 U.S.C. § 527 (2006) (establishing a working capital fund “without fiscal year limitation” for the Department of Justice).

<sup>90</sup> *What is “Spend It or Lose It”?*, BANKRUPTING AMERICA (Jul. 17, 2013), <http://www.bankruptingamerica.org/fact-sheet/what-is-spend-it-or-lose-it>; Meckler, *supra* note 77.

<sup>91</sup> *Id.*

<sup>92</sup> U.S. DEP'T OF DEF., INSTR. 5000.02, OPERATION OF THE DEFENSE ACQUISITION SYSTEM (7 Jan. 2015) [hereinafter DoDI 5000.02].

<sup>93</sup> See generally Finegan, *supra* note 42 (discussing ambition and how ambition can affect workplace motivation).

<sup>94</sup> Chris Edwards, *Reducing Wasteful Federal Spending*, CATO INST. (Jan. 14, 2014), <http://www.cato.org/publications/testimony/reducing-wasteful-federal-spending>.

so the measure is worth trying. Still, cultivating a culture of efficiency will only result in long term success if there were also Congressional buy-in concerning changes to the policies around one-year expiring funds.

### C. Combined Approach is Best

Eliminating the disincentive for agency surpluses is the most important component of any plan that will successfully address the inefficient spending in September.<sup>95</sup> The fear of future budget reductions is a powerful motivator that could counteract any positive agency-level incentives for surpluses or individual incentives for greater efficiency.<sup>96</sup> Hence, the elimination of surplus disincentives is the logical first step towards a successful solution to the issue.

However, a more drastic reduction of inefficient spending might be seen with a combined approach or a plan that aimed to both reduce surplus disincentives as well as create positive surplus and efficiency incentives. As long as disincentives were restricted, a combined approach that adds incentives for agency surpluses could accelerate a shift toward more efficient September spending.

A combined approach should first eliminate the surplus disincentive with a prohibition of the use of budget surpluses as justification for future budget reductions. Next, agency incentives for surpluses should be used to magnify the effects of the prohibition. Following these organizational changes, a combined approach could institute individual evaluations based on efficiency or other such tools that would incentivize efficiency for individual federal employees.

However, a full and effective solution to the problem of wasteful year-end spending must attack the issue from both sides. Without the policy changes that would mitigate the perspective of a budget surplus as something that will be punished by means of budget reduction in the coming year, it will not matter whether or not employees begin to be evaluated on efficiency. Alone, adding efficiency to employee evaluation criteria will not be enough to change the habit of wasteful spending. The potential decrease in next year's budget will be a stronger motivator. Likewise, without emphasizing the importance of efficiency when evaluating an individual employee's performance, any latitude given to

agencies as a result of policy changes may only delay existing opportunities for wasteful spending—if not create new ones.<sup>97</sup>

### V. Conclusion

The work of Liebman and McPherson helped identify the unintended consequences that expiring funds and surplus disincentives have on federal agencies.<sup>98</sup> Liebman's research in particular helped quantify the difference in spending when federal agencies are not subject to these policies such as in the case of the Department of Justice.<sup>99</sup> Cressey's fraud triangle and Livingstone's study on the causes of saving facilitated an understanding of spending behaviors from an individual economic psychology perspective.<sup>100</sup>

This discussion has focused on budgetary policy, how it inevitably leads to wasteful spending, and how wasteful spending is an inefficient use of federal resources. The proposed partial solutions seek to minimize the current inefficiencies. The hurdle to overcome is that budgetary policy is not primarily about promoting efficiency but rather more about controlling how federal funds are spent. Most of the proposed solutions would require Congress to relinquish some of its control to the agencies in order to allow them to budget more efficiently.

If Congress stopped using agency budget surpluses as justification for reduction of future budgets, the existing disincentive to have a budget surplus would decrease, and with it, the pressure to spend at the end of the fiscal year would decrease as well. Similarly, if Congress expanded agencies' ability to allocate funds past the end of the fiscal year, it would decrease the pressure to spend at the end of the fiscal year and incentivize having a budget surplus in September. Allowing agencies to keep a portion of unspent funds would incentivize budget surpluses. Enacting biennial budgets would reduce the total number of deadlines that cause spending pressures. Evaluating federal employees on efficient use of resources could increase individual agency employees' incentive to save money, leading to budget surpluses.

The current mindset of federal agencies is that they must spend all they are allocated or they risk their future budgets being reduced. Although changing that mindset will be difficult—and take a long time—it is worth trying because the

<sup>95</sup> See McPherson, *supra* note 3, at 40-43 (discussing interview results that suggest the fear of budget reductions could prevent other solutions from working).

<sup>96</sup> *Id.*

<sup>97</sup> See Edwards, *supra* note 94.

Federal managers face no profit incentive, giving them little reason to proactively reduce waste and cut costs. Indeed, without profits to worry about, federal managers often favor budget increases without any idea about whether expansion will add net value to society above the taxpayer costs . . . . Without the profit motive, there is little incentive for government workers and managers to innovate. There is less

motivation than in the private sector to try and produce better services of higher quality.

*Id.*

<sup>98</sup> See generally Liebman & Mahoney, *supra* note 2; McPherson, *supra* note 3.

<sup>99</sup> See Liebman & Mahoney, *supra* note 2, at 28-30.

<sup>100</sup> See generally CRESSEY, *supra* note 29; Livingstone, *supra* note 25.

current policies have inadvertently caused inefficiencies, wasted taxpayer dollars, and show no signs of slowing either of these down.