

Financial Decision Making in Washington

Focus on DoD

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Why Should You Care?

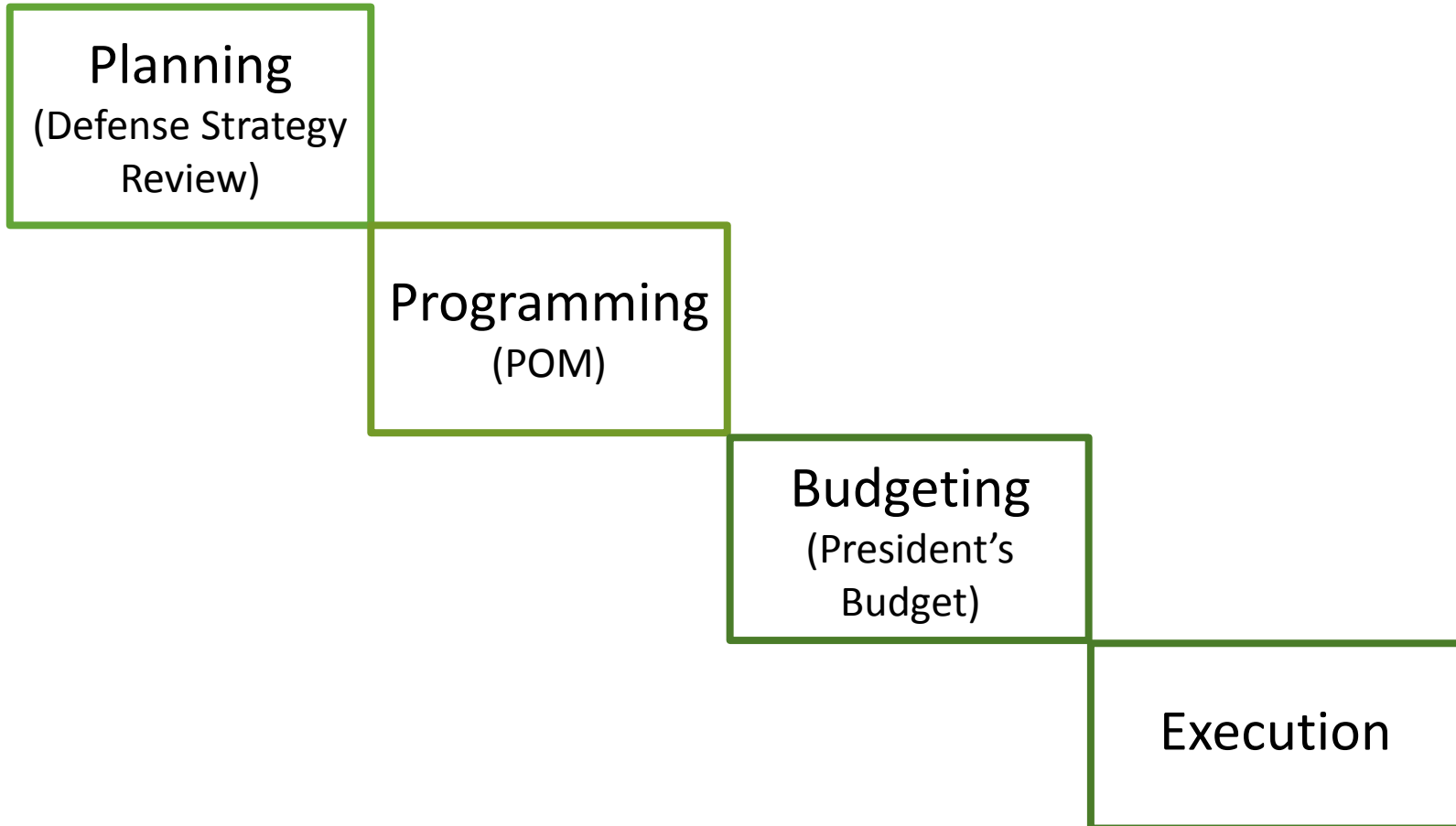
- Understanding financial decision making processes permits you to:
 - Anticipate problems
 - Propose most practical solutions
 - Explain issues to your bosses/colleagues
- **Bottom line: Understanding processes will help your career**

Agenda

- Financial decision making in the Pentagon
 - Overall process
 - Service decision making
 - OSD decision making
 - Special processes
- Financial decision making in Congress
- Decisions during budget execution
- Tough financial decisions ahead

Steps in Overall Process

(Planning, Programming, Budgeting, and Execution)



How Financial Options Are Selected

- Capture major policy choices
 - Usually includes last year's plan
 - “Goldilocks” options
- Feasibility
 - Within DoD
 - Acceptable outside DoD (OMB, White House, Congress)
- Meet budget targets
 - Focus today on larger issues

Information Normally Presented

- Description of option
- Budget changes (relative to latest President's budget)
 - ✓ Budget year always included, almost always five-year costs
 - ✓ Occasionally steady state or accrual costs
 - ✓ Almost always in nominal dollars
- Quantitative assessment of effects
- Qualitative assessments of effects
- Views of influencers

Information Must Fit on a Few Slides

SAMPLE

Limit 2014 Military Raise to 1%

○ **Savings:** (\$M compared to PB 13 President's Budget)

| FY14 | FY15 | FY16 | FY17 | FY18 | FY14-18 |
|------|------|------|------|------|---------|
| 469 | 626 | 631 | 640 | 656 | 3,022 |

○ **Pros:**

- Military pay is competitive
- Reduction not likely to cause future recruiting/retention problems
- Avoids further cuts in force structure, readiness, modernization

○ **Cons:**

- Could be viewed as erosion of benefits at war

Process for Making Decision

-- Air Force as Example --

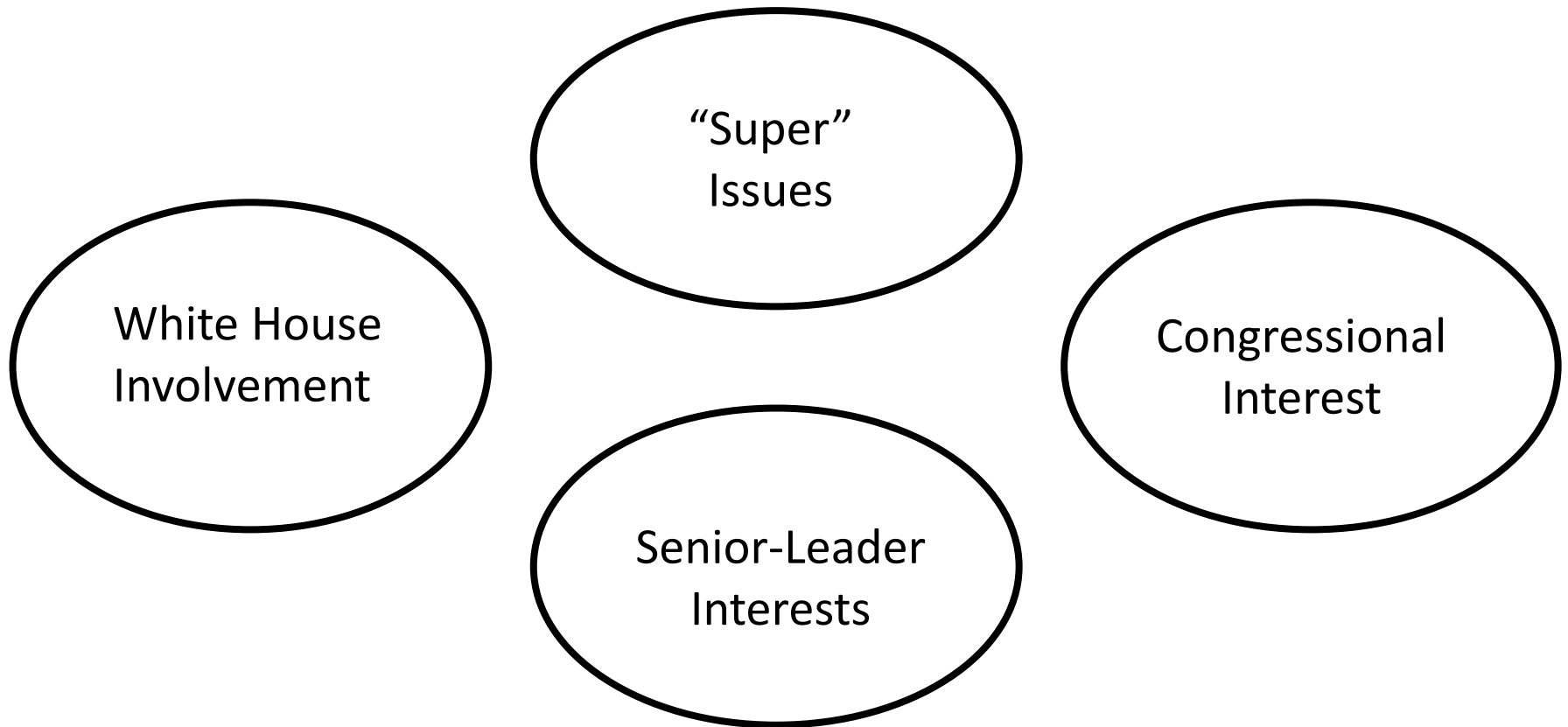
- Panels
- Intermediate level review
- Air Force Board
- Air Force Council
- Service Secretary and Chief

Process for Making Decisions

-- OSD --

- Identify issues (CAPE/Comptroller and Services)
 - Issues usually have a sponsor
- Review and negotiation
 - Budget changes reasonable
 - Assessments of pros/cons complete and balanced
 - **Building consensus**
- Review by Office of Management and Budget
 - DoD review unique in government
- Deputy Secretary decision meeting
- Secretary of Defense involvement

Is That How It *Really* Works?



Summary of Pentagon Financial Decision Making

- Process organized around options and information
 - Choice of options
 - Budget changes
 - Pros/Cons
- Reviews shape options
 - Service level
 - OSD review
 - Deputy Secretary decision (or SecDef)
 - Office of Management and Budget

Where to Get More Information

Praise for DoD Budget Process

- Based on analysis
- Multi-year focus
- Relatively transparent
 - All parties' views heard
- Runs on time (usually)

Outside Assessments Generally Positive

Agenda

- √ Financial decision making in the Pentagon
- Financial decision making in Congress
 - Process as designed
 - Process since FY10
 - Deal making
- Decisions during budget execution
- Tough financial decisions ahead

Congressional Process As Designed

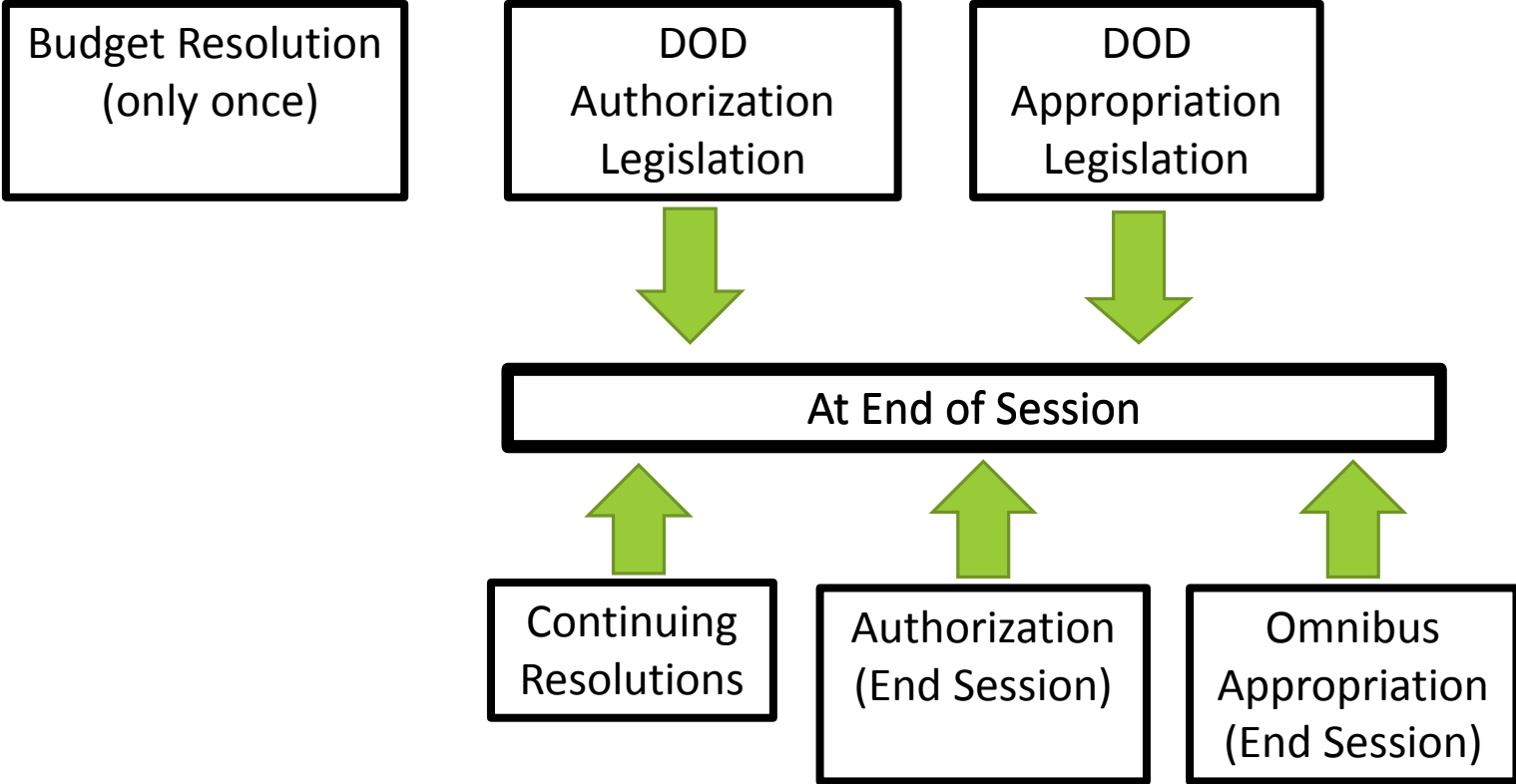
(Discretionary Spending)

Budget
Resolution
and
Reconciliation
(April)

Authorization
Legislation
(Summer)

Appropriations
Legislation
(by October 1)

Congressional Process Since FY10



Steps at Each Stage

- Committee/subcommittee hearings
- Committee/subcommittee markups and votes
- Floor amendments and votes
- Conference committee
- Final floor votes
- Presidential approval
 - Veto process

Why Can't Congress Meet Deadlines?

Strong Views
on Budget
Issues

Partisanship



Stalemate

Summary of Congressional Process As Designed

Budget
Resolution
and
Reconciliation
(April)

Authorization
Legislation
(Summer)

Appropriations
Legislation
(by October 1)

Agenda

- √ Financial decision making in the Pentagon
- √ Financial decision making in Congress
- ➔ Decisions during budget execution
 - Fundamental shift: policy to law
 - Normal process
 - Special laws lead to turmoil
- Tough financial decisions ahead

Fundamental Shift

Budget
Formulation
Governed
by
Policy

Budget
Execution
Governed
by
Law

Normal Budget Execution Process

- Key Steps for DoD Budget

- Appropriation
- Appportionment
- OSD “holds”
- Commitment (sometimes)
- Obligation
- Expenditure
- Review of execution success

- Services/agencies manage most execution activities

- OSD oversight

- Reprogramming process important

Special Laws Alter Normal Process

- Budget Control Act of 2011
 - Established budget caps for defense/non-defense
 - Invoked sequestration (BBEDCA 1985)
- Subsequent laws modified caps

Caps + Stalemate = Budget Turmoil

Nature of Turmoil*

- Sequestration in 2013
- Shutdown in 2013
- Numerous shutdown planning efforts
- Multiple budget plans (some years)
- Continuing resolutions every year
- Critical reprogrammings

* Robert Hale, "Budgetary Turmoil in DoD", Brookings, August 2015.

Turmoil Harmed DoD

- Mission degradation
 - Wartime activities protected
 - Readiness harmed
- Furloughs
 - Harmed training, depot work, more
- Wasted money
 - \$400 million just during shutdown
- Wasted time
- Adverse effects on employee morale

Turmoil Continues

- House legislation “borrows” from OCO and ends OCO on April 30, 2017
 - Supplemental would be required early next year
 - President has threatened veto
- Senate amendment will hike OCO
- Likely result this year
 - Yet another continuing resolution
 - Hopefully Congress will finish during lame-duck session

Summary of Budget Execution

- Governed by law
- Organized sequence of events (normally)
 - Apportionment
 - Obligation
 - Expenditure
- Recent special laws have caused turmoil
 - Budget Control Act of 2011

Where to Get More Information

Agenda

√ Financial decision making in the Pentagon

√ Financial decision making in Congress

√ Decisions during budget execution

➔ **Tough financial decisions ahead**

- **Topline levels and ending sequestration**

- **Future of OCO**

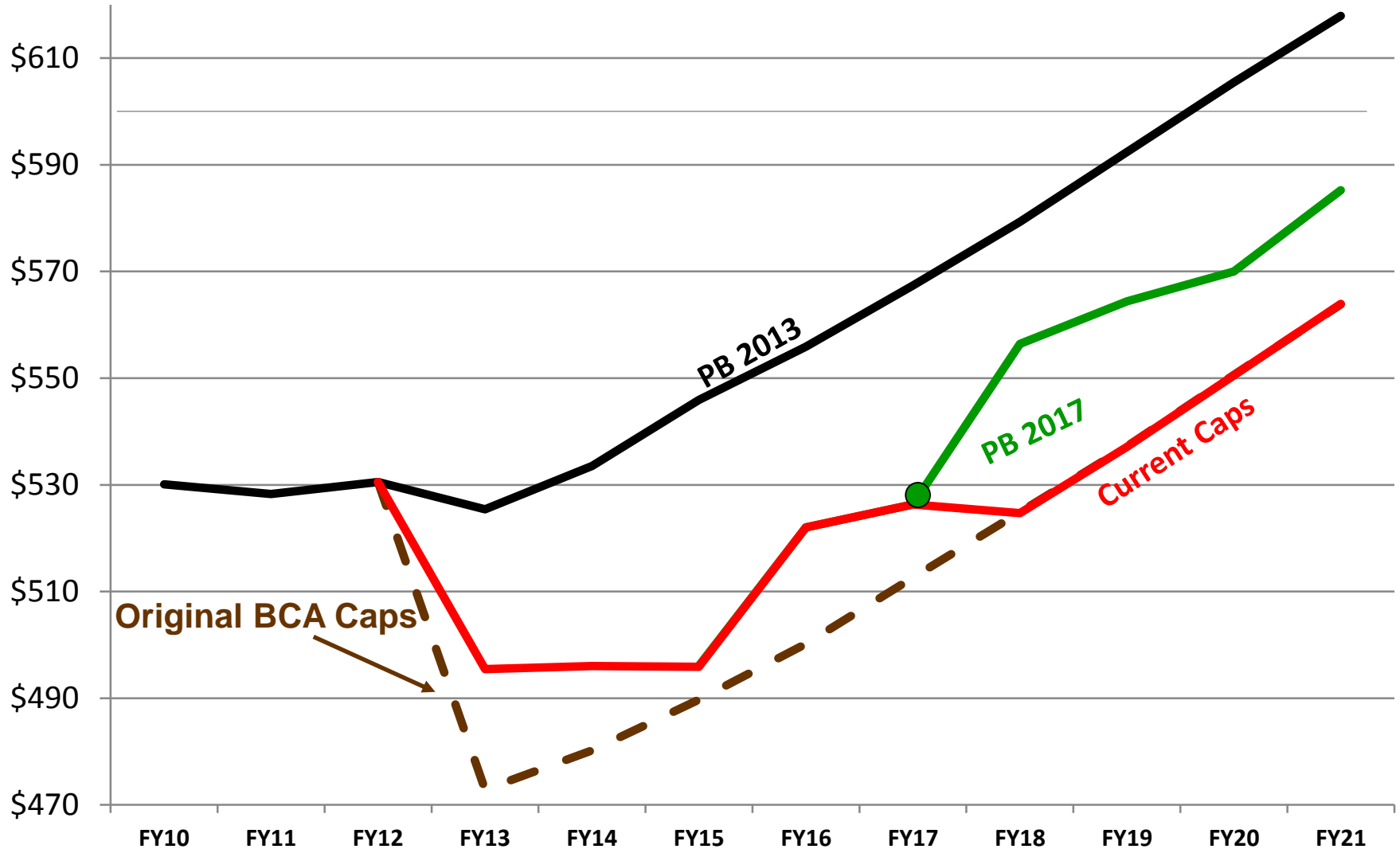
- **Accommodating the bow wave**

- **Controlling operating/support costs**

- **Limiting end-year spending “spree”**

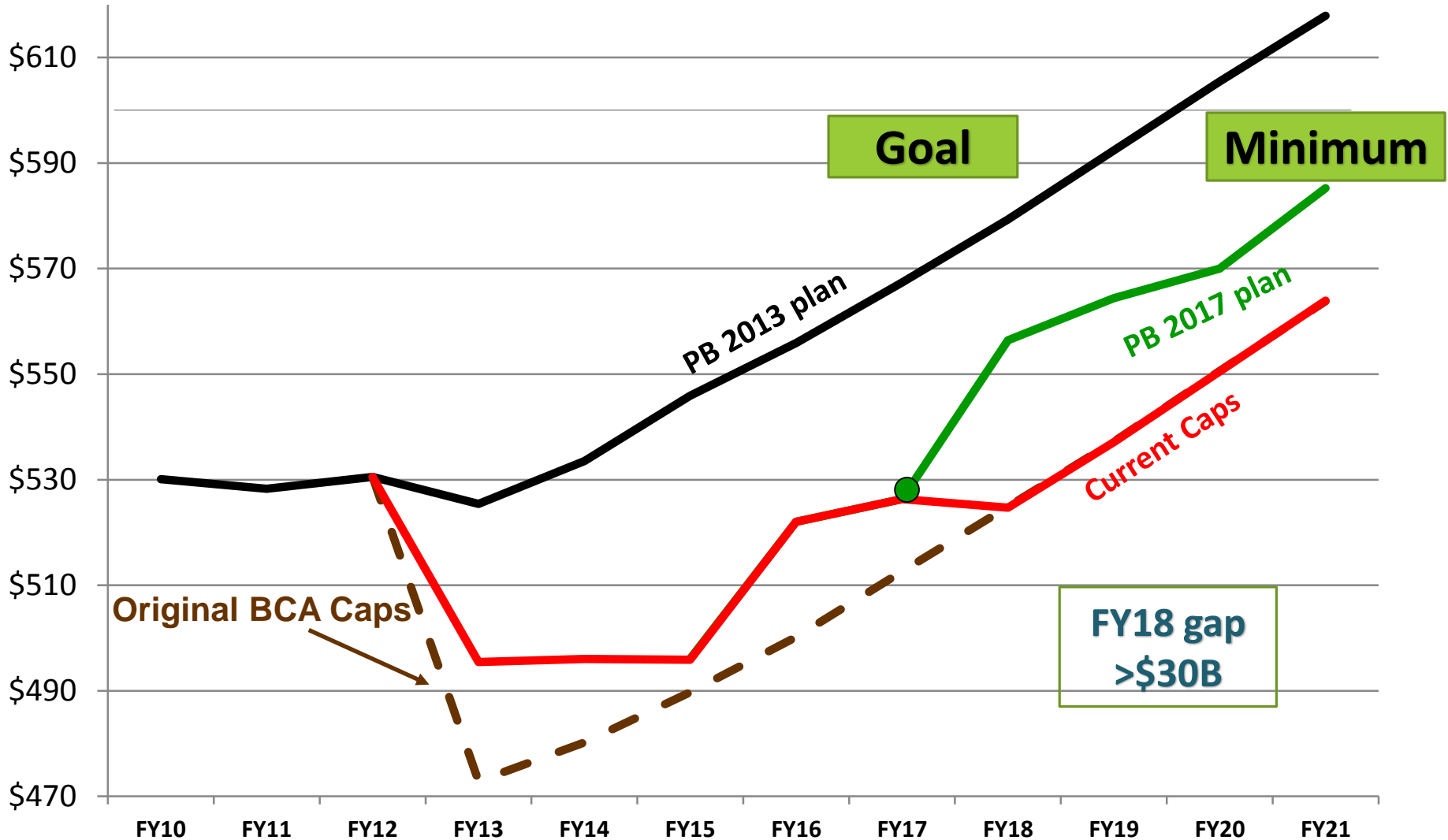
Defense Budget Picture Today

(Dollars in Billions)



Defense Funding Goals

(Dollars in Billions)

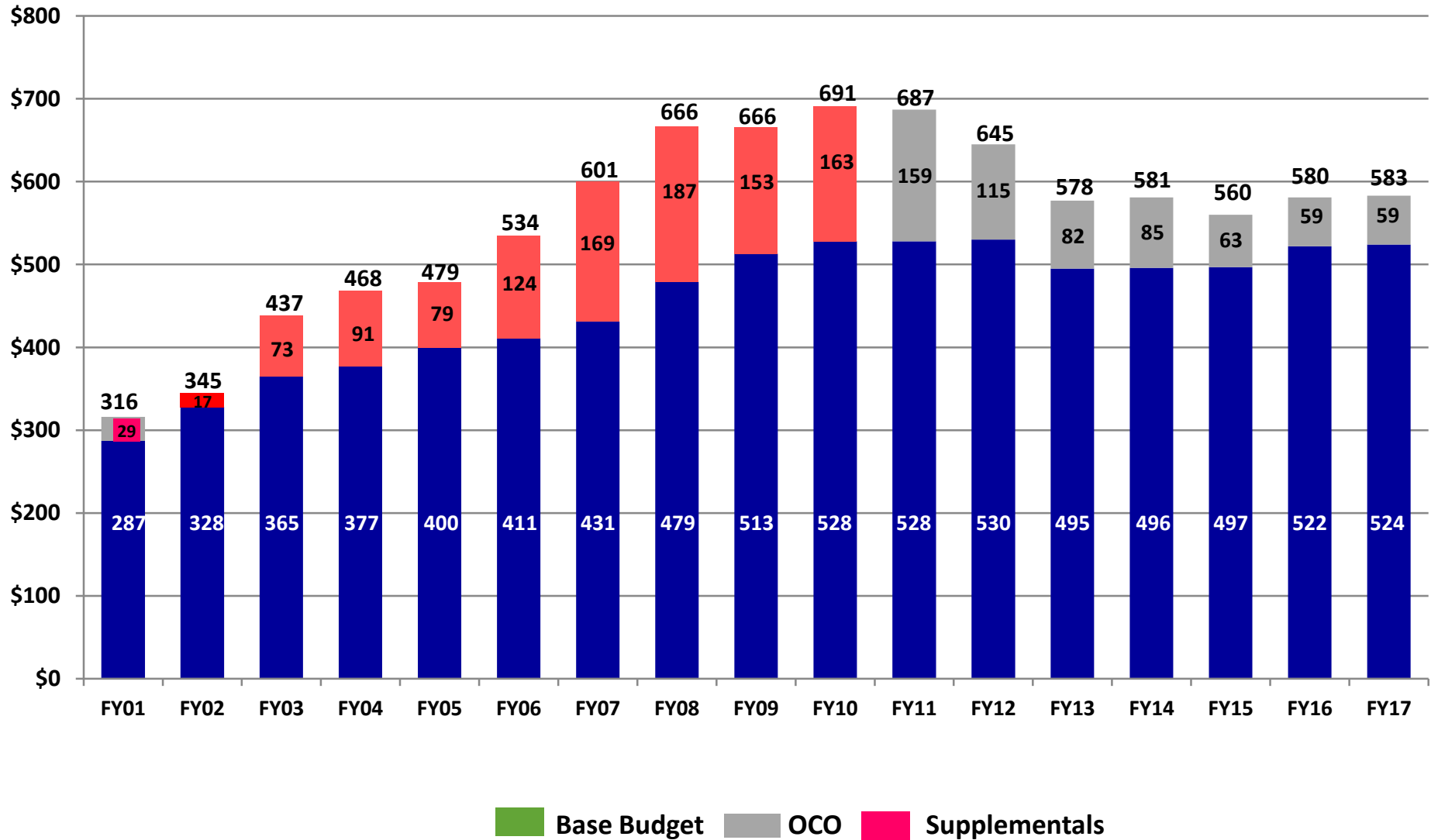


Looking Ahead on Defense Topline

- Desirable outcome
 - Broad budget deal
 - Address mandates (> 60% of federal budget)
 - Consider revenues
 - Establish higher caps for discretionary spending
 - Control deficits
 - History suggests next year is key
- Undesirable outcome
 - Continued focus on discretionary spending
 - “Muddle thru” with small budget deals

Importance of OCO

(DoD Discretionary Budget Authority in \$ Billions)



Future of OCO

- Overseas Contingency Operations (OCO) key to defense budget success
 - Intended to finance war costs
 - Not subject to caps
- Pros/Cons of OCO
 - Permitted DoD to meet warfighter needs
 - Avoided timing problems caused by supplementals
 - But increasingly used for non-war needs
- Options
 - Restrict OCO to temporary needs (most desirable)
 - Keep OCO but revise (most practical)

Bow Wave of Spending in the 2020s

- High rate production for current major weapons programs
 - F-35
 - KC-46
- New programs
 - Ohio-class replacement submarine
 - Bomber
 - Army ground combat vehicle
- Continued demand for readiness
- Growth in operating and support costs
- Additional force cuts problematic

How Big is Potential Bow Wave?

(Projected increases above FY16 funding in FY16 \$B*)



* Source: CBO Study (November 2014), adjusted

Accommodating the Bow Wave

- Added topline
- Transfers among services
- Offsetting cuts within a service
 - Further cuts in lower priority programs
- Delay start of new programs
- Reduce total buys
- Stretch programs

Sharp Growth in Operating and Support (O&S) Costs*

- Rapid long-term growth
 - Consider “cost per troop”: real O&S divided by active military personnel
 - Up 25% since 2000
 - Has grown relentlessly for past 50 years
- Causes are diverse
 - Health care costs
 - Military pay costs
 - Growth in maintenance complexity and costs
 - Training to operate and maintain more complex weapons

*O&S defined as O&M plus military personnel costs (excluding OCO)

Cost Growth Exerts Downward Pressure on Size of Force

- Budgets and force size
 - Since 2000: real base budget up 18%, size down 4% (# milpers)
 - Since 1960: real base budget up 24%, size down 44%
- Examples of actions needed
 - Health care reform
 - Limits on military pay so long as recruiting/retention sustained
 - Monitor O&S during early phases of weapons design
 - Make trade-offs early
 - Look for technology that holds down costs, especially O&S costs

Acquisition Reform Needs to Focus on Costs, esp O&S

Limiting End-Year Spending

- End-year processes seek to obligate almost all available funds
- Result
 - Spending on lower priority programs
- Tough problem to solve
 - Incentives are strong
- Approach worth trying
 - Permission to carry over small amount of O&M and military personnel funding

Summary of DoD Financial Decision Making in Washington

Budget
Formulation
(Pentagon)

Budget
Formulation
(Congress)

Budget
Execution

Understanding Process Can Help You

- Anticipate issues
- Propose practical solutions
- Explain process to your bosses and colleagues