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THE ADVANTAGES OF TWO - YEAR BUDGETING FOR THE PENTAGON

INTRODUCTION

Two-year budgeting is offered more and more frequently as a solution to the backlog of budget problems that Congress annually accumulates. Properly developed, two-year budgeting also could enhance U.S. national security. A two-year defense budget would allow Congress time for more effective oversight. It would lower real unit costs by bringing more certainty into the procurement process. It would allow more time for reflection on major issues. If two-year appropriations were coupled with even longer-range binding budget resolutions, more stability, effectiveness, and savings might be brought to the defense marketplace.¹

The current year-to-year budget process causes turbulence in defense programs that results in business uncertainty, higher costs, and time overruns. This turbulence also creates uncertainty among allies and difficulties for U.S. strategy planners.

Moving to a multiyear budgeting approach, however, is not without its problems. For one thing, Article I, Section 8, of the U.S. Constitution, enumerating the powers of Congress, specifies that no appropriations "To raise and support armies... shall

¹ Even greater savings and effectiveness would be achieved if this multiyear budgeting were coupled with other budget reform proposals. See J. A. Stockfish, "Removing the Pentagon's Perverse Budget Incentives," Heritage Foundation Background No. 360, June 19, 1984.

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be for a longer term than two years." For another thing, prerogatives built up over the years in Congress and the Defense Department will have to be overcome. Still the U.S. can no longer afford to forgo the increases in effectiveness that could be obtained through multiyear authorization and biannual appropriations.

HOW THE BUDGET PROCESS WORKS TODAY

Under the Congressional Budget Act of 1974, all budgeting now progresses in the following stages:

- o The Administration's budget request--for the fiscal year beginning the following October 1--is submitted to Congress in January.
- o The germane committees and subcommittees review this budget proposal, hold hearings, and then arrive at authorization levels for the various programs. These are to be reported by May 15.
- o While this committee work is proceeding, the budget committees consider the whole Administration request and report to the floor (by April 15) a Budget Resolution which sets targets for the next fiscal year, and the two years beyond, for each of the various functions of the federal government. (By law this first--"non-binding"--resolution was to be followed by a second resolution that is "binding" for the upcoming year. In practice only the first resolution is now enacted.)
- o With the guidance of the authorizations and the budget resolution, the appropriations committees and subcommittees complete their hearings and mark-ups of appropriations bills and report them to the floor. Congress is expected to complete action on all of this before October 1, the start of the new fiscal year. (Without completed action on appropriations bills, continuing resolutions are necessary to keep the government operating. In recent years continuing resolutions of various durations for different governmental functions have become almost commonplace.)

COST AND EFFICIENCY

The current process leaves little time for defense contractors to plan, let alone execute, a contract. They can seldom reap the benefits that could accrue from economic production rates, stable employment levels, planned subcontract procurement, and more carefully thought out capital investments. Jacques S. Gansler (defense analyst and former Deputy Assistant Secretary of Defense) has estimated that the lack of multiyear funding and

resultant budget and labor instability cost the nation at least 6 percent of production expenditures--several billion dollars annually.² The economies of scale, the efficiency of multiyear contract planning, the savings associated with keeping trained and competent manpower, and the advantages of informed, minimum risk investment generally are sacrificed in a system of one-year procurements. A few multiyear contracts have been grudgingly allowed by Congress--six out of twelve sought by the Administration in 1983, only seven out of sixteen in 1984. Among these were an Army helicopter, the UH60; an Air Force fighter, the F-16; and a high mobility vehicle to replace the "jeep."

Except for these multiyear contracts in military procurement, risks and uncertainty are factors each year when the budget and each of its lines are once again scrutinized by one level of government after another.

This process, business soon learns, requires hedging. Managers are inclined to focus on short-term sure profit. They are less willing to invest in plant and production equipment that could mean substantial, long-term savings when they must plan with assurance only one year at a time. When their vision beyond that is impaired more by bureaucratic politics and policies than by a changing interpretation of the military threat or emergent technology, prudent executives will insist on a larger return to offset the greater risk. In the defense industry--where the annual production rate for many items is well under 100 units --the cancellation of only a few units can have drastic impact. The uncertainty is compounded as the numbers are jerked up and down as the process winds to a conclusion--usually at the last possible moment. Industry--and ultimately the taxpayer--pays a high price for the instability that is part and parcel of the one-year budget cycle.

Technological advance requires not just the insight of design engineers, but the capabilities of manufacturing engineers as well. However, both availability and enthusiasm for these jobs are reduced by one-year cycles. It was the consensus of the industry executives and economists informally polled that at least one in every three layoffs in the defense industry is the result of the turbulence caused by the budgeting process. Surges and contractions of the work force keep people on the wrong side of the production line learning curve. By one estimate, labor stability at the plant level could save at least 3 percent of production costs--a figure rapidly approaching \$1 billion annually.³ The effective employment of manpower is a result of planning. Without it, the base of skilled manpower erodes.

² Jacques S. Gansler, The Defense Industry (Cambridge, Massachusetts: MIT Press, 1982), pp. 221-222.

³ Ibid., p. 222.

The situation is even worse, in terms of the frequency and the scope of fluctuation, for the numerous tiers of subcontractors, who race to catch up in the beginning only to have to slam on the brakes when the lines come to a halt. The longer the line of subcontractors, the more dramatic is the effect. The one-year budget system promotes confrontation, uncertainty, cost and time overruns, and instability in the marketplace.

Program stability is an indispensable element in reducing cost and meeting delivery targets. Conversely, turbulence is a major factor in escalating costs and excessive delay. The limited number of multiyear contracts approved have demonstrated this. The Army's UH60 Blackhawk helicopter, for example, was produced under a three-year contract that began in 1982. It has come in ahead of schedule and under cost. A second three-year award is in the process now.

Developing, testing, producing, and distributing of even the simplest product obviously is improved by planning. The more complex the product, the more crucial planning and time to plan become. Two major factors dictate the nature of the planning process: time and the number of unknown variables. A one-year authorization/appropriation process severely constrains the time available for planning, and simultaneously increases the number of unknowns. Congress has grown accustomed to the "cliff hanger" approach to budgeting--nothing, seemingly, can be decided until the very last possible moment. Careful and competent planning under these circumstances is impossible. The more that is known, however, the better judgment becomes. A two-year budget cycle could raise the level of judgment and, as a consequence, lower the unit cost by allowing stable, economic production levels and reduced inventories.

THE TWO-WAY STREET

Multiyear budgeting could have a positive impact on U.S. relations with NATO allies. Of late, there has been a great deal of discussion about the sharing of the defense burden, two-way streets, and the need of the Western alliance to avail itself of the competitive advantages inherent in the U.S. economic system. One of the most difficult problems for U.S. allies is the fluctuation in the annual U.S. appropriations process.

If the U.S. is to take advantage of the cost reductions inherent in burden sharing, it must open up the system to allied industry, but this will require a far more stable cycle than is currently the case. Of all the industrialized democracies, only the U.S. is burdened with one-year budgeting.

STRATEGY IMPLICATIONS

Strategy should dictate force structure--the numbers of necessary personnel and weapons. This implies long-term commitments to programs and policies. The lack of program stability generated by a one-year budget cycle prevents the military from doing effective long-range strategic planning in much the same way it prevents proper planning in industry. The lack of stability forces both to focus on the short range. Annual budgets--dictating the possible, rather than reflecting the necessary--now drive strategic plans. There is no long-term focus. The "outyears" of the five-year plans--the years beyond the first fiscal year of the budget--grow increasingly fictitious as they are further removed from the single year under budget consideration.

The pressures of the legislative process in general and the defense program in particular preclude the proper interface at the planning level. Time pressures are too great to ensure a melding of understanding among responsible officials. A two-year cycle would be a significant improvement. A two-year cycle would ease timing problems, spread the work load, and permit policy deliberation and the integration of more fully articulated strategies. One extra year more than doubles the period for effective planning. Real plans cannot be completed until the budget process is complete--until appropriations are provided. That has more and more frequently occurred only immediately before, or even after, the new accounting period has begun. Planning eats up time--sometimes months--that should have been spent in execution. A two-year budget would add twelve full months to the execution phase.

APPROACHES TO MULTIYEAR BUDGETS

Multiyear defense budgeting requires consideration of each of the three areas of congressional budget action: the budget resolution, authorizations, and appropriations. Reducing the frequency of the executive and legislative confrontation would allow more time for careful consideration of proposals at each of these steps, and consequently, improved accountability. Proponents of various multiyear budgeting proposals have addressed these areas in different ways. In 1982, Alice Rivlin, then Director of the Congressional Budget Office, recommended moving toward two-year authorizations and appropriations. She also recommended making the out-year targets of the budget resolution binding. "In practical terms," she said, "this could be implemented by requiring multi-year scorekeeping and by requiring future presidential budgets and budget resolutions to be compared to the baseline established by the out-year figures."⁴ This would

⁴ Alice Rivlin, Testimony, August 19, 1982, Hearings before the Senate Governmental Affairs Committee on the Budget Reform Act of 1982 (S.2629).

enable both Defense and its industry contractors to forecast accurately the funds available in the out-years.

The Grace Commission, too, recommended a biennial budget for all programs and multiyear appropriations for selected long-term programs or activities. The constitutional prohibition against defense appropriations for periods exceeding two years, however, would limit the applicability of the latter feature.⁵

Jacques S. Gansler also has called for binding budget resolutions. Under his proposal, the budget would be subject to some sort of broad, annual review, but that review would be constructed in a way to discourage alteration. This would mean that the total obligation authorized for each major budget or program category would be binding for two to three years at a time. The executive would be required to keep its annual budget consistent with the prior year's concurrent resolution, although there would be some means for the President to submit an alternative budget if he wished. This process would remove some flexibility from the budget process, Gansler admits, but adds, "that is exactly the intent, since flexibility is the inverse of stability."⁶

Gansler's main concern is controlling the growing uncertainty that the budget process has spawned. His concern is well placed. Proposals currently before Congress, however, have aimed more at restoring rationality to the budgeting process itself. One approach is to retain the current process but spread it over two years. In the first year, the Congress might enact a non-binding budget resolution and authorization bills; in the second year, it could produce a binding budget resolution and the associated appropriations. Typical of this type of proposal is the "Budget Procedures Improvement Act" (S.12) introduced by Senators Wendell Ford (D-KY) and Dan Quayle (R-IN). This approach would ease the burden on Congress by spreading out the work, but it would have the disadvantage for planners of spreading out the period of uncertainty.

A more promising approach would be to have Congress agree in the first session to a single binding budget resolution that would prescribe spending and revenue limits for a two-year period beginning the following January. The subsequent appropriations bills would cover the same two-year period. Senator William Roth (R-DE) has offered a "Budget Reform Act" (S.20) similar in nature to this proposal.

Such a proposal promises improved program stability. The binding two-year budget resolution passed in the spring followed

⁵ President's Private Sector Survey on Cost Control, "Report on Federal Management Systems," Spring-Fall 1983, pp. 178-179.

⁶ Jacques S. Gansler, "Reforming the Defense Budget Process," Public Interest, Spring 1984, p. 67.

by appropriations would be operative for planning for the two years it is in effect plus the period before it takes effect. This would be a vast improvement over the situation today when delays in passing appropriations bills usually mean that the authority to execute programs exists for less than twelve months at a time.

CONCLUSION

There is a ground swell for efficiency in defense procurement. Changing to a two-year defense budgeting system is one avenue to improvement. A new relationship between resource allocation and strategy must be forged, which allows planning, policy, and strategy to take the lead. A two-year budget cycle will not ensure wisdom; a two-year budget cycle will not insulate the nation from the heat of executive/legislative confrontation; a two-year budget cycle will not ensure more cooperation with NATO, and it will not eliminate either the federal or the balance-of-trade deficit. It will, however, go a long way toward achieving each of these goals. A two-year budgeting process that adds stability and more certainty for planners--in industry, Defense, and State--is a first step that needs to be taken.

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Defense Assessment Project Papers:

- No. 1. Theodore J. Crackel, "Reforming 'Military Reform'," Heritage Back-grounder No. 313, December 12, 1983.
- No. 2. Robert K. Griffith, "Keeping the All-Volunteer Force Healthy," Heritage Backgrounder No. 353, May 18, 1984.
- No. 3. J.A. Stockfish, "Removing the Pentagon's Perverse Budget Incentives," Heritage Backgrounder No. 360, June 19, 1984.
- No. 4. Mackubin Thomas Owens, "The Utility of Force," Heritage Backgrounder No. 370, August 1, 1984.
- No. 5. Richard L. West, "Military Compensation: A Key Factor in America's Defense Readiness," Heritage Backgrounder No. 387, October 18, 1984.

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