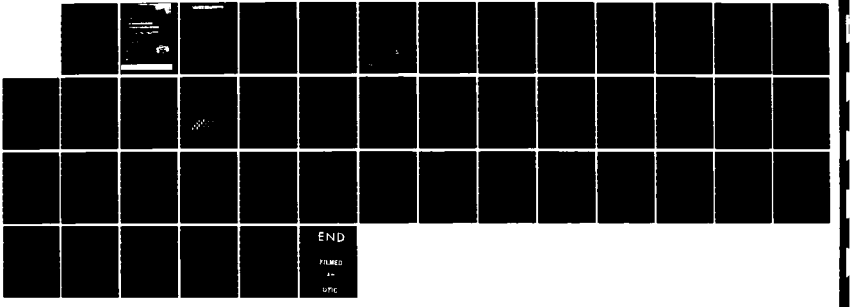
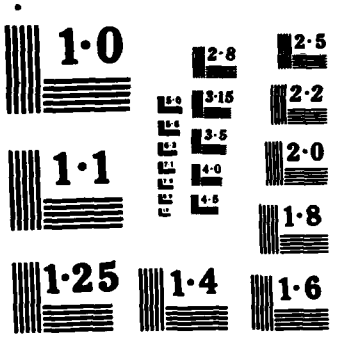
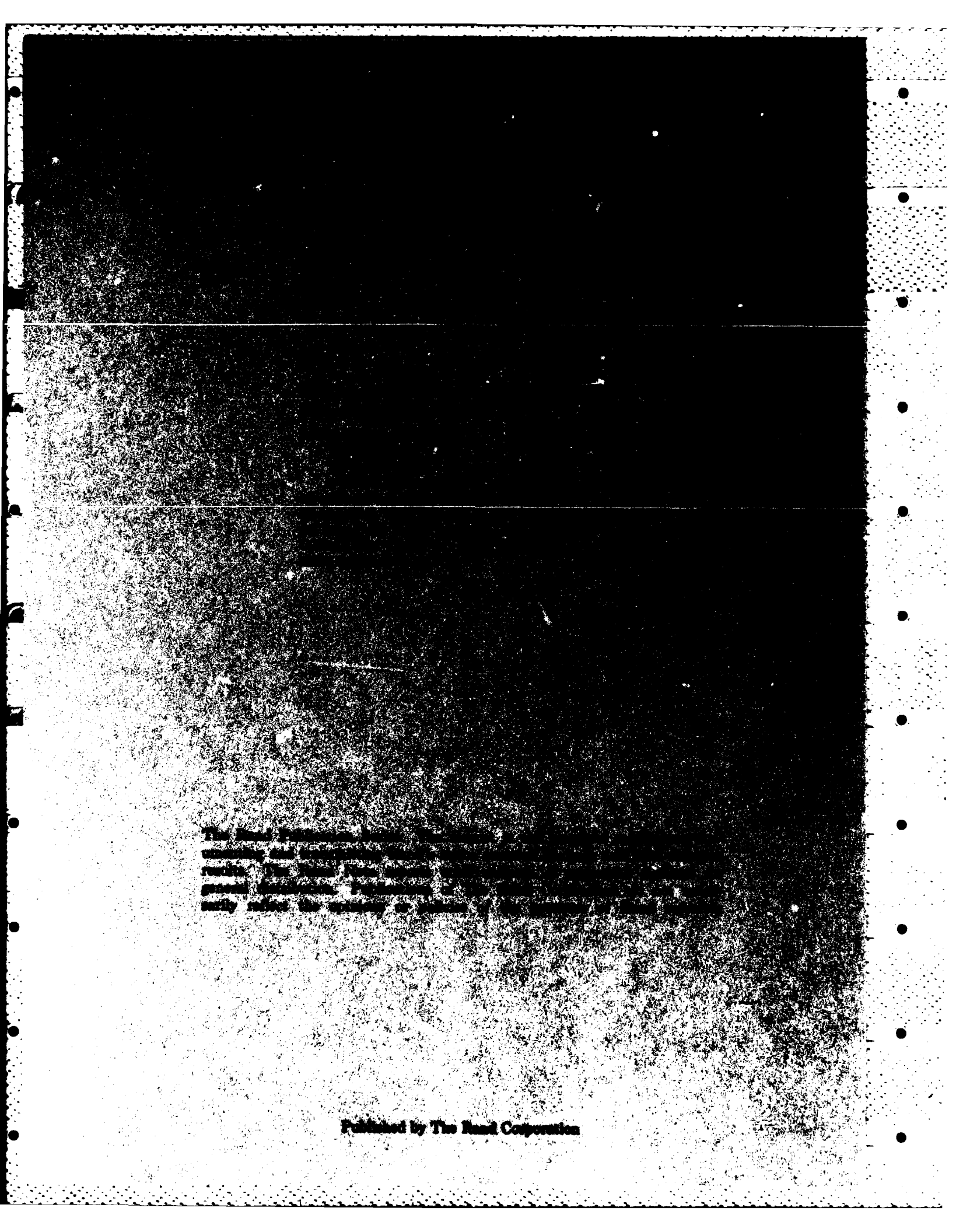
AD-A162 912 AIR FORCE OUTLAY CONTROL: MANAGEMENT IMPLICATIONS AND OPTIONS(U) RAND CORP SANTA MONICA CA H G MASSEY ET AL. NOV 85 RAND/R-3269-AF F49620-86-C-0008 1/1

UNCLASSIFIED F/G 5/1 NL







Published by The Rand Corporation

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE	READ INSTRUCTIONS BEFORE COMPLETING FORM
1. REPORT NUMBER: R-3269-AF	2. GOVT ACCESSION NO.: AD-A162 912
	3. RECIPIENT'S CATALOG NUMBER
4. TITLE (and Subtitle): Air Force Outlay Control Management Implications and Options	5. TYPE OF REPORT & PERIOD COVERED
	6. PERFORMING ORG. REPORT NUMBER
7. AUTHOR(s): H. Massey, A. Barbour, E. Dews, L. Malmstrom R. Petruschell, R. Stanton, J. Waters	8. CONTRACT OR GRANT NUMBER(s): F49620-86-C-0008
9. PERFORMING ORGANIZATION NAME AND ADDRESS: The Rand Corporation 1700 Main Street Santa Monica, CA 90046	10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
11. CONTROLLING OFFICE NAME AND ADDRESS: Requirements Programs and Studies Group (AF/RDQM) Ofc, DSC/R&D and Acquisition HQ USAF, Washington, DC 20330	12. REPORT DATE: November 1985
	13. NUMBER OF PAGES: 34
14. MONITORING AGENCY NAME & ADDRESS (If different from Controlling Office)	15. SECURITY CLASS. (of this report): Unclassified
	15a. DECLASSIFICATION/DOWNGRADING SCHEDULE

16. DISTRIBUTION STATEMENT (of this Report)

Approved for Public Release; Distribution Unlimited

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

No Restrictions

18. SUPPLEMENTARY NOTES

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

Air Force Budgets
Air Force Procurement

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

see reverse side

DD FORM 1 JAN 73 1473 EDITION OF 1 NOV 65 IS OBSOLETE

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

thesis

This ~~report~~ documents a study of Air Force financial management options and management implications of the use of outlay controls in the U.S. government budget. It explores the possible range of outlay controls that might be instituted, examines constraints on the Air Force in trying to manage programs within such controls, and suggests courses of action and an overall management strategy for effectively coping with outlay controls should they be imposed. It identifies three steps that would have to be taken in preparation for the institution of outlay controls: (1) initiate work to bring outlay planning considerations into the program planning and budgeting process (including improved forecasting and tracking methods); (2) identify intra-year adjustment measures and their effects, and establish a priority list for them; and (3) establish a central authority for deciding when to implement intra-year adjustment measures and which specific measures to use.

R-3269-AF

Air Force Outlay Control

Management Implications and Options

H. G. Massey, A. A. Barbour, E. Dews, L. D. Malmstrom,
R. L. Petruschell, R. E. Stanton, J. J. Waters

November 1985

A Project AIR FORCE report
prepared for the
United States Air Force

Rand
1700 MAIN STREET
P.O. BOX 2138
SANTA MONICA, CA 90406-2138

PREFACE

This report documents a briefing on a Rand study of Air Force financial management options and management implications of the use of outlay controls in the U.S. government budget. At present, the government forecasts outlays, based on budget obligational authority, and tracks outlays for purposes of managing federal borrowing; but strict controls are not imposed on annual outlays by departments or by the government as a whole. Widespread concern over the size of annual budget deficits has raised the possibility that controls may be instituted as part of the budget process in the near future. Rand undertook the study for the Air Force to help understand and document the implications of outlay controls in advance of any government decision to impose them.

The authors are not recommending controls; rather, their purposes in the study were to explore the possible range of outlay controls that might be instituted, to examine constraints on the Air Force in trying to manage programs within such controls, and to suggest courses of action and an overall management strategy for effectively coping with outlay controls should they be imposed. In addition to these concerns of direct interest to Air Force management, this report contains information of possible interest to a broader policy community (in the Congress, the Office of Management and Budget, and other executive agencies) that will decide whether and how to apply outlay controls in the government.

This study was undertaken under the sponsorship of the Air Force Comptroller, under the Project AIR FORCE Resource Management Program project "Air Force Resource and Financial Management Issues for the 1980s."

SUMMARY

The Air Force is tightly constrained in its ability to control the timing of current outlays (payments to government employees and to vendors supplying goods and services) **by the structure of federal finances and by government policies concerning contractual arrangements and prompt payment of bills.** Hence, public pressures for direct government control, brought about by concern over the large annual federal budget deficits, could create problems for Air Force financial management. **The Air Force could achieve a modest improvement in leverage over current outlays without a major overhaul of its financial management procedures.** The main steps that would have to be taken to improve leverage are:

- Establishment of a central Air Force Board focus for outlay control decisionmaking.
- Use of outlay targets in the planning, programming, and budget formulation process.
- Preparation of a contingency list of actions to be taken when adjustments to the current year's outlays are required.

The government's financial structure and the relationship between Congress and the Executive branch in financial procedures constrain the ability of government agencies to control or adjust current outlays. The principal reasons are:

- Congress provides funding in the form of obligational authority, and agencies manage their budgets primarily through obligations (orders and contracts for goods and services, and accrued pay for government employees), rather than through outlays (which occur after delivery of goods and services).
- The timing of vendor deliveries and requests for payment is not entirely within the control of the agency placing the order.

- Many obligations (especially in procurement) have lead times of three years or more between placement of the order and final delivery and billing for the finished product.
- Even obligations with short lead times before outlays (e.g. current pay and day-to-day operating expenses) may be difficult to change quickly without incurring added costs.

Past U.S. experience with emergency outlay controls demonstrates that little can be done to reduce overspending during budget execution, and that upward adjustments of outlays (when underspending occurs) can also be difficult without planning.

- Attempts to force major changes in outlays may conflict with other important policies (e.g. responsibility to pay bills) or result in higher costs (e.g. from cancellation or termination charges).
- Other undesired side effects may include disruption of the schedules for future forces, of the readiness of currently operating forces, and of program balance and coordination.

British experience (1980-81) with emergency outlay reduction measures indicates that outlay budgeting (as practiced in the United Kingdom) does not in itself make major outlay reductions in the current year any easier or less disruptive.

Outlay control in the United States will probably be an adjunct to rather than a substitute for obligation budgeting. Financial management under outlay budgeting appears to require greater budgetary discretion for the Executive branch than is likely to be acceptable to Congress. Under nonemergency conditions, outlay budgeting in the United Kingdom relies primarily on planning (in outlay terms) to anticipate outlay limitations and avoid the need for major outlay adjustment actions in the current budget year.

Planning for expected future outlay limitations should be the key to any system of increased outlay control for the Air Force. Obligations would remain as the principal means of managing finances.

Some improvements to current outlay tracking and forecasting would be required, however. Planning should eliminate the need for large adjustments to outlays within the current year, but some increased leverage over current outlays should be provided. **The costs of outlay adjustments implemented on short notice** (in dollar terms or in their effects on readiness or program slippage) **cannot be avoided entirely; but they can be reduced by planning and evaluating specific measures and providing the decisionmaking authority with a prioritized list.** This process would also provide a clear picture of the "price" to be paid by the government for a particular level of near-term outlay adjustment.

CONTENTS

FIGURES

I. INTRODUCTION

BACKGROUND

Widespread concern over the size of annual federal budget deficits in recent years has brought increasing attention to ways of controlling the spending of U.S. government agencies and bringing the total level of federal expenditures into balance with annual revenues. Various forms of "balanced budget" or other deficit-limiting proposals have been put forth in Congress. In meeting such limitations, the main choices for the government will concern which programs to cut or which taxes to change. These will, of course, be difficult choices; but another and subtler matter of choice arises in the government's management (and measurement) of its own compliance with deficit limitations, namely the form of budget currency to be used. Deficits are measured in terms of the excess of *outlays* from the Treasury over the *receipts* taken in--essentially cash paid out versus cash taken in. But the U.S. budget is formulated, approved, and managed in terms of *obligational authority*, which only indirectly affects the level and timing of outlays. Some form of direct controls on outlays, instead of or in addition to current controls on obligational authority, may be required for management of the spending side of the deficit equation.

The Air Force has occasionally been asked (as have other federal agencies) to control the level of outlays for its activities in a particular fiscal year--sometimes to reduce outlays and sometimes, as part of a policy of fiscal stimulation, to increase them. But the Air Force (like the services generally) is ill-equipped to change its outlay levels on short notice, other than by small amounts, without serious adverse consequences to ongoing operations and acquisition programs. Obligations are the basic mechanism of financial control in the Air Force, and they are often entered into far in advance of the actual delivery of goods and services. Outlays occur when payments are made, either upon delivery of the items ordered or as periodic progress payments during the course of a major production or construction project; hence payments may occur months or years after the time when

obligations were made. Outlays in any period are thus governed largely by earlier periods' obligation actions in combination with the (largely independent) actions of contractors and vendors. What would happen if the Air Force were faced with a government policy requiring that annual outlay levels be closely controlled?

The Office of the Comptroller of the Air Force posed this question as a research topic for Rand. Among the related questions asked in this connection were: Could the Air Force revise its financial control policies to provide closer control over outlays (using, for example, outlay authority instead of obligational authority as the controlling mechanism for financial transactions)? Could outlay budgeting be used for Air Force activities, as is done in many other national governments? What would be the implications of such changes for Air Force financial management policy? What would be the implications for the planning and management of Air Force operations and of development and acquisition programs? What constraints--policy, legal, and practical--affect the Air Force's ability to control outlays? This report presents the findings of Rand's outlay control research, offers suggestions for how the Air Force might prepare for outlay control policies, and discusses the costs in relation to the benefits to be derived from outlay control.

BUDGET TERMINOLOGY

We will define our terms fairly rigorously, as they are used in formal presentations of federal budget information.[1] (Unfortunately, most of these same terms are used with much less rigor--both inside and outside of the government--in public debates over budget issues.) The three most important forms of budget currency for this discussion are *budget authority*, by which Congress and the President control the programs and amounts to be spent by government agencies; obligations, by which the agencies, in conducting their programs, obligate the

[1]For a more complete discussion of government budget process and terminology, see (1) *A Glossary of Terms used in the Federal Budget Process, and Related Accounting, Economic, and Tax Terms*, General Accounting Office, March 1981; and (2) *The Budget of the United States Government, Fiscal Year 1985*, 1984, part 6 "Perspectives on the Budget," and part 7 "The Budget System and Concepts." The *Budget* is published annually, and the discussion of the budget process in Chapters 6 and 7 is included in every year's publication.

government for current and future payments from the Treasury; and outlays, by which the Treasury Department pays government vendors, contractors, and employees.

Congress must provide *obligational* or *budget authority*, usually in the form of *appropriations*, to federal agencies before they can obligate the government for (current or future) payment of money. The appropriations are, in effect, lines of credit, which agencies draw on in making *obligations*--essentially contracts for goods and services--over time. *Outlays*, sometimes called *expenditures*, are made when the Treasury writes a check or otherwise pays for the delivery of goods or services ordered through valid obligations.

Appropriations provided to an agency in a given fiscal year's budget are usually time-limited; that is, the amount appropriated for the fiscal year (FY) is available for obligation only for a specified period of one, two, or more years, and the "line of credit" expires at the end of that period. Appropriations for pay of personnel and for operations and maintenance in the Air Force are one-year funds. Those for research and development are two-year funds, for procurement three, and for construction five-year funds. The latter categories have longer times because of the long standing *full-funding* budget policy, which provides that appropriations for most major construction and procurement projects must cover the entire cost expected when a project is initiated, even though obligations and outlays for the project may extend well beyond the fiscal year in which the appropriation is made. The relationships among these budget components are shown in Fig. 1, which depicts the cumulative obligations and outlays over time against a single year's appropriation. The patterns shown are typical of an Air Force procurement appropriation. Other appropriation categories, or specific contracts or cost elements within an appropriation, could have obligation and outlay patterns extending over different periods of time.

"Expenditures" is used in this report as a synonym for outlays. "Obligational authority" is used as a synonym for budget authority. "Funds" will refer generally to appropriations and obligations against which outlays may be made, and specifically to certain appropriation-like budget categories (revolving and management funds) that will be subjects of discussion later in the report. "Spending," as used in

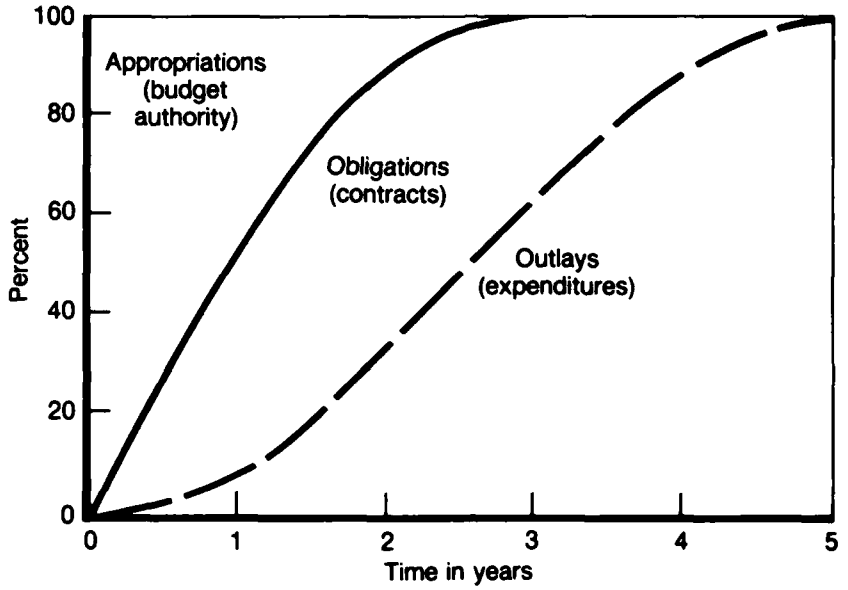


Fig. 1—Appropriations, obligations and outlays (single year's budget)

public and media discussions of government finances, sometimes means obligations, sometimes outlays, and sometimes a vague mixture of both. We have tried to avoid the term in the remainder of this report except when the context makes it clear what type of budget component or currency is involved.

The analogy of contracts, with specific vendors and for specific goods and services, is useful for describing obligations, as is the analogy of bills for vendor actions that create the immediate demand on the government for outlays. But individual contracts and bills are not required for all such transactions. Obligations for "pay and allowances" of government employees, for example, accrue over time as employees perform their duties. Outlays for pay and allowances are generated more or less automatically when periodic paydays arrive.

THE OUTLAY CONTROL PROBLEM

Financial management policy and procedures in the Air Force are dominated by the obligation process--particularly as regards the *timing* of financial transactions. Obligations against an appropriation-FY account must be made, by law, within the stated dollar and time limits.

Outlays are limited in the *amount* that may be paid against a given obligation (appropriation-FY account), but the *timing* of outlays and the total outlays against all accounts in a given time period are governed primarily *by the rate at which bills are presented*. In any time period, the Air Force has substantial balances of unobligated budget authority and prior years' obligations for which bills have not yet been presented; hence a large fraction of the bills due and the outlays made in a given fiscal year are consequences of decisions made and actions taken months and even years in advance.

As procurement and other long lead-time programs grow relative to pay, current operations and maintenance, and other components of the Air Force budget with short lead times, the proportion of "uncontrollable" outlays grows. They are uncontrollable to the extent that law or policy forbid abrogation of commitments and vendors (rather than the Air Force) determine the timing of deliveries and bills. Figure 2 shows how these proportions have been changing in recent years. The heights of the bars in each row are proportional to the outlays occurring in the indicated fiscal year and appropriation category. The shading shows the fraction of the year's outlays arising from: (a) the current year's

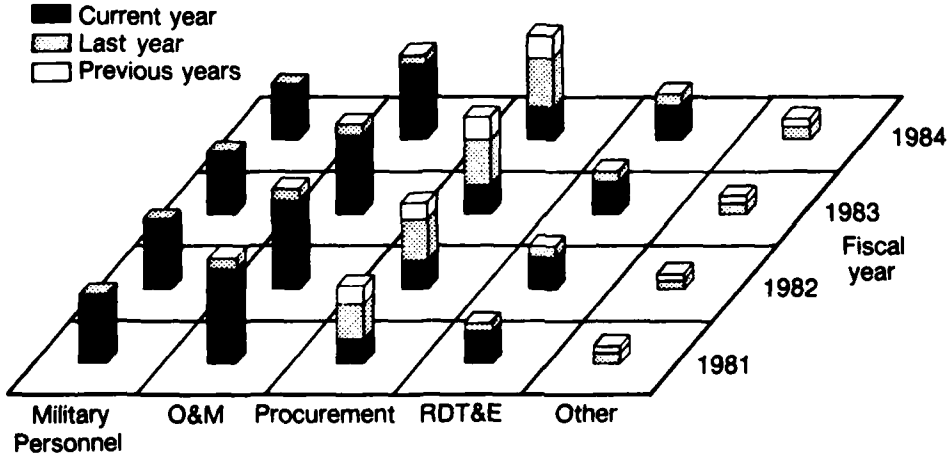


Fig. 2—Distribution of AF outlays by appropriation year and type

appropriation, (b) the immediately previous year's appropriation (outlays in FY 1984 from FY 1983 appropriations), and (c) earlier years' appropriations. Recent growth in procurement is increasing the proportion of current outlays from earlier years' appropriations, and this trend will almost certainly continue for several more years, because procurement is still growing faster than shorter lead-time categories of budget authority.

Under present policies, the Air Force's role in controlling outlays in a fiscal year is largely a passive one. Most of the major decisions with regard to force levels, procurement quantities, personnel levels, and operating rates are constrained (fiscally) only by annual obligational authority targets. Execution of approved budgets is carried out by adhering strictly to obligational authority limits; and outlays follow directly from the flow of bills, pay and allowance earnings over time, and other valid employee and vendor demands for payment. The Air Force (with the aid and direction of the Office of the Secretary of Defense) makes outlay forecasts at the beginning of each fiscal year, based on previous and current appropriations and historical outlay "patterns" (percentage outlays by year). Actual outlays are tracked against these forecasts by the Office of Management and Budget (OMB) and the Department of the Treasury. However, the actual flow of outlays is usually left to follow its own course. Deviations from targets are most often met by changes in the targets, and the only overt actions usually taken to adjust outlays are small bookkeeping adjustments in the last quarter of the year.

Outlay "control" of the type implied above (using forecasts based on anticipating and planning for outlay requirements, but with no major intervention to change them) can probably be improved but does not appear to be a major problem. The *problem* in outlay control arises if the government needs or wants to make sizable increases or decreases in the level of outlays and quickly--within the current fiscal year. We will refer to this as *intra-year* outlay control in the rest of this report. Some of the draft proposals for a "balanced budget" or for other forms of spending (outlay) limitation could, if adopted, create situations where intra-year outlay adjustments would be required. To

see what options the Air Force might have available to meet such requirements, we looked at the constraints that inhibit outlay control today and asked what the consequences would be if, where feasible, some of these were relaxed. We also looked at past government attempts at intra-year control and at outlay budgeting and control in foreign governments.

One of the questions that arose early in our study was, what budget form would be used under outlay controls? Would the government switch from the current obligation-based budget to a "cash" or outlay-based budget? For several reasons, we concluded that a move to strict outlay-based budgeting is not likely. The conclusion was largely drawn from observations of Canadian and U.K. experience with outlay budgeting and from previous government debates and experiments with alternative budgeting systems. These observations are discussed in Sec. II.

The assumption that outlay controls, if adopted, would be overlaid on the basic obligation-based budget system in place today underlies the Air Force outlay control recommendations we present in Sec. III. The general approach is discussed there as are several potential implementation problems. We concluded that, although much of the responsibility for outlay control would fall on the financial management community, many of the consequences of outlay control actions fall outside the arena of financial management. Other elements of the Air Force and Air Staff would have to be involved in decisionmaking for both long-term outlay planning and intra-year outlay adjustment actions, as these plans and actions could affect force structure modernization plans and current training and readiness.

Section IV presents some conclusions and a strategy for gradually moving toward outlay controls in the Air Force. We emphasize that the government has not yet adopted outlay controls of the type anticipated by this report, nor is it our intent to promote them. When and if outlay control policies are adopted, they could range from little or no direct control (e.g., continued management by obligation control, but with outlay targets used in the planning process) to very strict controls (e.g., single-year outlay targets requiring intra-year outlay adjustments). The gradual strategy we recommend would work first in the area that would be important to either extreme--improved outlay

forecasting and planning with increased attention to outlays. Advance preparations for intra-year outlay adjustment measures (whether or not the measures are used) would provide important information on the expected monetary and other costs) and benefits (outlay effects) of specific measures. This information would be essential for policymakers to weigh the overall value of outlay controls against their costs.

II. OUTLAY CONTROL EXPERIENCE IN THE UNITED STATES AND FOREIGN GOVERNMENTS

U.S. GOVERNMENT OUTLAY CONTROLS: EISENHOWER ADMINISTRATION, 1957-1958

Financial management organization and practice in the government are rooted in the Constitutional provisions for the laying and collecting of taxes and the borrowing and coining of money. The role of legislation in financial affairs was enunciated by the first Secretary of the Treasury, Alexander Hamilton:

> The design of the Constitution in this provision was, as I conceive, to secure these important ends,--that the *purpose*, the *limit*, and the *fund* of every expenditure should be ascertained by a previous law. The public security is complete in this particular, if no money can be expended, but for an *object*, to an *extent*, and *out of a fund*, which the laws have prescribed.[1]

During most of the last 50 years, the legislative phase of the annual budget cycle has been initiated by the submission to Congress of the *President's Budget*--the President's proposal for new appropriations (which require new legislation) and estimates of revenues and outlays for the forthcoming fiscal year. Congress normally debates and revises these proposals and arrives at final budget legislation, which, when enacted, provides obligational authority for agencies to enter into new programs. The various government departments then proceed to make obligations against the combined new and old unexpired appropriations and make payments (outlays) against both new and previous years' obligations.

This process was interrupted by an unusual occurrence early in 1957--a President's virtual renunciation of his own budget. Toward the end of FY 1957, then Secretary of the Treasury George Humphrey became alarmed by the continuing high level of Treasury expenditures, with

---

[1]Quoted in F. W. Powell, *Control of Federal Expenditures--A Documentary History, 1775-1894*, The Brookings Institution, Washington, D.C., 1939, p. 133.

resultant pressure on the debt ceiling. Because he and President Eisenhower had jointly declared that they would balance the budget by appropriations and budget limitations (which they thought had been accomplished in the FY 1957 budget), they became frustrated by the levels of outlays they were seeing. Furthermore, they were reluctant to ask Congress for an increase in the debt ceiling after having firmly and successfully fought for budget limitations.

Defense outlays (expenditures), in particular, were running at higher levels than had been forecast. In part the President and Secretary--being new to federal finances--failed to understand that reductions in appropriations might not translate into immediate reductions in expenditures. In this case the problem was compounded by the fact that Korean War appropriations for defense in the amount of some $30 billion in unobligated (but still unexpired) authority were still on the books. With the war over, these unexpired appropriations were being used to procure new weapon systems, especially by the Air Force, which had the bulk of the appropriations.

With the President's approval, Secretary Humphrey took drastic action and imposed severe limitations, especially on DoD programs, in the summer of 1957, including:

- Across-the-board cuts in military contract awards
- Reductions in production rates for weapons programs (stretch-outs)
- Restrictions on contractors' use of overtime
- Reductions in progress payment rates
- Imposition of manpower cuts
- Initiation of base closure actions.

The Secretary's actions were directed at more than just the expenditure problem, but bringing a halt to the apparently uncontrolled overspending in outlays was a major objective. Many of the actions taken, however, were strong public statements of resolve but had little hope of providing immediate reductions in outlays. The reductions in contract awards and production rates created severe problems for defense contractors in planning for workforce sizes and materials orders, but

the effects of these actions on outlays would not be seen in any significant degree for many months. Similarly, manpower reductions and base closures could be initiated immediately but would produce little effect on outlays in the near term, because of termination and closing costs and delays in implementation. (Where part-time workers could be released immediately, outlays could be affected earlier.)

The other major actions taken on defense contractors--especially the mandated reductions in progress payment rates--had drastic and chaotic consequences for the contractors, particularly in the aerospace industry in Southern California. Progress payments (which provide partial reimbursement of costs to manufacturers as they build aircraft, ships, tanks, and other major hardware and construction items) were then essential to finance the work of many major contractors. Most of the capital assets (plants and equipment) of the aerospace industry were built and still owned by the government at the time, and financial circles were not prepared to provide the large sums required by the manufacturers (with not much collateral available) to replace the progress payment moneys they had been expecting. With large labor forces, which still had to stay in place to continue production, and large subcontract commitments for materials and subassemblies, the manufacturers faced problems very much like those faced by the government in reducing their immediate cash needs.

The overall results of this government attempt to make immediate and sizable reductions in outlays were decidedly negative both in the very limited success in reducing actual outlays and in the resultant disruptions and other costs of the actions taken. These outlay control actions were, of course, of an emergency nature rather than part of a disciplined and well-developed approach to managing outlay levels over an extended period of time. But before such an approach could be instituted and before many of the measures had much of a chance to have the desired (outlay reducing) effect, the launch of the Russian Sputnik on October 4, 1957, caused a dramatic shift in spending priorities. By early 1958, the concern about high outlay levels for defense largely disappeared, and most of the actions taken earlier were rescinded.

The experience of the Eisenhower administration is instructive in showing some of the pitfalls in ad hoc outlay controls, but it is not necessarily a precedent for what could be done under an established system of outlay management. It does, however, illustrate some of the basic constraints on intra-year outlay adjustments that the government faced at that time. The limited immediate effects on outlays result from the fact that both the government and contractors make advance commitments as a normal way of doing business. Changing these commitments on short notice usually involves some kind of termination costs--in dollars, in the disruption of programs, or in both. The Executive branch is constrained partly by the needs of maintaining good business relationships and partly by policy and legal financial constraints. There have been several changes in the government's financial management system since 1957. Some of them have further constrained the Executive branch's budgetary discretion and further limited the actions that the Executive can take to make intra-year outlay adjustments.

RECENT U.S. OUTLAY EXPERIENCE AND CHANGES IN THE BUDGET SYSTEM

Since the Eisenhower era, there have been no repeats of such drastic steps by the government when outlays exceed expectations. In recent years it has been more typical for the administration and Congress to become concerned when outlay levels fall below expectations. Most of the changes in law and policy regarding the federal budget have further limited the Executive's ability to *reduce* outlays on short notice, but some of these changes could limit the Executive's leverage for upward outlay adjustments as well. The major legal changes since 1957 that could affect outlay control are:

- Extension of the full-funding principle to more programs
- Limits on appropriation life
- The Congressional Budget Control and Impoundment Act of 1974
- The Prompt Payment Act

The full-funding principle was in use in 1957, but it is applied much more widely today, particularly in DoD programs. In 1957, the Air Force could contract for partial construction of an item. This fact left open the option of cancelling a procurement or construction program (to reduce outlays) before complete items were produced, although cancellation penalties might be incurred. Under today's full-funding policy, the terms of contracts are generally longer (because fully completed items must be produced), and cancellation penalties may be higher.[2]

Appropriations with unspecified expiration dates (called no-year appropriations) were much more used in 1957 than today. Almost all DoD appropriations today are limited to a one, two, or three-year life for obligations (outlays may continue to be made against the accounts for an additional two years beyond the obligations period). This policy has the beneficial effect of reducing the buildup of large unexpired balances of obligational authority (which we saw was a major cause of trouble in the Eisenhower outlay crisis), but it also limits the ability of a department to reduce outlays by indefinitely postponing obligations. The Impoundment Act reinforces this constraint by requiring that the Executive obligate the full amount of appropriations unless Congress grants specific approval to withhold some or all of the funds.

The Prompt Payment Act was passed by Congress in 1983 as a means of ensuring that federal agencies pay bills in a timely fashion and not pass financing problems of the government onto its vendors. The Act does not actually forbid late payment of bills, but it provides that vendors are entitled to interest payments if bills are not paid within 30 days of presentation to the government. The interest payments must come from existing appropriations. This policy, combined with cash management policies of OMB (to keep borrowing costs down, agencies are

[2]The full-funding policy helps avoid the foot-in-the-door tactics that agencies were accused of when they contracted for small parts of what ultimately might become very large procurements. This benefit comes at the expense--probably a justifiable one--of some reduction in the ability of the Executive to reduce outlays by outright cancellation of obligations.

urged not to pay bills too early) makes for a narrow window for the timing of outlays, largely governed by the timing of vendors' bills.

During the 1970s, the administration's initial estimates of outlays (made six to nine months before the start of the fiscal year) were commonly too low, and estimates made 12 months later (in the middle of the fiscal year) were high compared with actual outlays for the year. Congress was also engaged in molding a new set of procedures for dealing with the budget, which placed greater emphasis on the role of outlay estimates in Congress's establishment of budget ceilings. The Congressional Budget Act of 1974 incorporated these new procedures and established the Congressional Budget Office (CBO). CBO was asked to examine the reasons for the outlay misestimates, particularly for the large shortfall in FY 1978.[3] The study attributed more than half of the $8.4 billion shortfall in 1978 to outlays for DoD programs and called for better accuracy in outlay rate forecasts by DoD and other agencies. A similar large outlay shortfall occurred in FY 1984. In both cases DoD procurement appropriations contributed heavily to the shortfalls. This may stem from difficulty in obligating funds as rapidly as historical rates might suggest when large increases are made in procurement appropriations. It is apparently difficult to increase contracts and activities quickly, just as it is difficult to decrease them.

With the passage of the Congressional Budget Act, Congress played a much greater role in setting limitations on appropriations and outlays. However, the main role of the outlay ceiling in Congressional budget resolutions is restricting Congress from considering legislation that would violate the ceiling. Consistent underestimates of outlays could prevent Congress from considering desirable legislation or could undermine the discipline of the process. Underestimates of outlays also create the problem of higher than necessary borrowing costs for the Treasury Department when it borrows for expected short-term cash needs that don't materialize.

---

[3] *Estimates of Federal Budget Outlays*, Congressional Budget Office, February 1978. *Analysis of the Shortfall in Federal Budget Outlays for Fiscal Year 1978*, Congressional Budget Office, March 1979.

Thus various policies and legal constraints make it difficult for the Air Force and other agencies of the government to control their outlays in the near term. Annual budgets (in obligational authority) lay the course, but they do not provide direct control over the timing of outlays. The obligation-based budget and financial system used in the United States is quite rare. Outlay budgeting appears to be the norm among the national governments of other non-Communist countries. We examined budget practices in the United Kingdom to see what procedures are followed to manage outlays on a regular basis. We were also able to examine an outlay (overspending) crisis situation in the United Kingdom.

OUTLAY BUDGETS AND EXECUTIVE POWERS

The government of the United Kingdom uses an outlay-based budgeting systems, as do most Westminster-style parliamentary systems. With minor exceptions, the "funds" voted by the legislatures in those countries are available for expenditure only during a single fiscal year. One of the keys to successful outlay budgeting systems is the greater degree of authority over spending accorded the Executive in those countries, compared with the strictly constrained authority available to the Executive branch in the United States. Some of the more important of these powers are:

- Latitude to transfer funds within and among programs
- Authority to rescind, impound, or defer obligation of funds
- Authority to budget for contingencies
- Latitude to adjust outlay targets
- Authority to pay interest for short-term deferrals of bills
- Relaxed use (or total absence) of full-funding principle.

In the United Kingdom, outlay budget estimates are prepared by the Executive departments and presented to Parliament for deliberation and approval prior to the beginning of the fiscal year. Because outlays arise both from actions taken in the current year and from contracts made in earlier years, there are uncertainties in the outlay estimates,

and the Executive requires powers like those above to manage the finances. Some of these powers are granted directly, but others arise because of the special relationship between the Executive and the Parliament under a Westminster-style system. The Executive has considerable latitude in financial matters, even where parliamentary approval is required, because failure of Parliament to support and approve the Executive's actions on a major issue risks the fall of the government and could well bring on a general election.

It may seem coincidental that the parliamentary form of government provides these powers to the Executive, but financial operations under an outlay budget almost demand them. Impoundment of funds (i.e., withholding action on programs for which the legislature has approved the spending of moneys) and reprogramming of expenditure authority from one program to another give the Executive flexibility to make adjustments when unexpected variations in outlay requirements for ongoing programs reduce the remaining budget available for new programs. When actual outlay requirements are far out of balance with planned activities, the government of the United Kingdom can and does use Executive powers to terminate contracts, slow them down, or stretch out payments (with accompanying interest expenses). Ultimately, however, the power the Executive uses most often in these situations is the authority to adjust the (outlay) budget, for example, by obtaining supplementary appropriations one or more times in the course of a single fiscal year. Authority and flexibility are important to the successful execution of an outlay-based budget, but to provide it in the United States would require the relaxation of several budgetary principles (limited reprogramming authority, severely restricted impoundment of funds, full-funding of procurement) to which the U.S. Congress seems firmly committed.

A greater degree of Executive discretion seems to be a necessary part of the operation of an outlay budget system; hence adoption of an outlay budget system in the United States could require numerous, highly unlikely changes in the relationship between Congress and the administration. Moreover, as the next example will demonstrate, even a government operating under an outlay budget can encounter problems in controlling current outlays.

BRITISH OUTLAY CONTROL CRISIS IN FY 1980-1981

It is customary in the United Kingdom for the government to accommodate to outlay overruns that occur from time to time by means of supplemental appropriations that provide the (single-year) funds required. But in the 1980-81 fiscal year, the Conservative government, when faced with a large impending overrun, made a strong effort to prevent or at least substantially reduce the overrun. The British government's budget is stated in terms of outlays, but the outlay levels for a given year are estimated on the basis of previous and new commitments entered into by the government. In 1980-81 the British economy was in recession, and one of the consequences was that contractors who would normally have considerable amounts of private sector work shifted resources to government contracts to keep the workforce employed. Goods were delivered more quickly and in larger quantities than had been planned, and larger than expected bills were presented to the government.

The Conservative government wanted to avoid a growing budget deficit and so took measures in many areas of the budget. The Ministry of Defence (MoD), of course, was responsible for a large share of the work on which current outlays arose from contracts entered into previously. The MoD took some quite drastic measures in an attempt to reduce its outlays, including:

- Total moratorium on new contract awards
- Outright cancellation of some contracts
- Gentlemen's agreements to slow the rate bills
- Freeze on most hiring of civilians
- Halting of automatic ordering of goods (by turning off the computers)
- Change in the bill-paying cycle.

The moratorium on new contracts was instituted early--a measure that was important in its symbolic effect but held little hope for reducing current outlays. Naturally, exceptions were made, but the level of authority required to approve exceptions was much higher than

before. In the ordering of common use goods, orders are normally placed automatically when stock levels reach specified points (similar to the practice used for stock-funded items in the U.S. Department of Defense). Stopping this automatic ordering of goods could be done only by shutting down the computers.

In most of the cases where contracts were simply canceled, the bulk of cancellation charges fell in the following year. In others, as a concession to avoid canceling contracts, the government used informal negotiations with contractors to slow down the delivery of goods and services and the presentation of bills. Hiring freezes for civilians were instituted to make small reductions in pay and allowance costs.

What in the end turned out to be the measure having the greatest effect on the year's outlays was a one-time shift in the government bill-paying cycle. This effectively postponed one (bi-weekly) period's bills until the following fiscal year.

As in the case of the Eisenhower administration in the United States, the British attempt to make sudden adjustments to outlays was quite disruptive of defense programs and operations, even though the British had warning early in the fiscal year of possibly unexpectedly large outlays. In general, the measures taken had only a modest effect on outlays during the fiscal year when the measures were adopted. Disruption came in the form of both higher costs of purchased goods (e.g., because of contract stretchouts and cancellations) and diversion of management attention from other pressing matters.

The measure that had the greatest effect on outlays was a card that could be played only once; the shift in the bill-paying period could not be used repeatedly in future years in similar crises. The outlay-reducing effects of most of the other measures were postponements of payments until the following year (or years), and some measures actually increased the total outlays when summed over a period of years.

As an aftermath of this experience, a formal inquiry was held in the MoD to make recommendations for the avoidance of such crises in the future. The primary conclusion of that inquiry was that outlay forecasting techniques should be improved to provide higher-confidence forecasts and longer warning times so that earlier and less disruptive actions could be taken to control the level of outlays. The inquiry

also recommended that MoD contracts be written in some cases to provide limits on the rate at which work would be performed or flexible arrangements to permit changes in work or production rates.[4]

LESSONS FROM U.S. AND U.K. OUTLAY CONTROL EXPERIENCE

Both U.S. and foreign government experience indicate that making major changes in the current year's outlays is difficult no matter what the form of the budget and financial system. This fact holds even with an Executive branch having great discretionary power over obligations and expenditures. Lack of leverage stems from the fact that most of the factors that drive outlays in a given year are set in motion at or before the beginning of the year (e.g., contractual obligations, manpower levels, operating rates), and altering those factors takes time. When governments try to make major adjustments during budget execution, overall (money) costs can increase, and the costs in disruption to ongoing programs are likely to be great. What appears on the surface to be strictly a financial management issue can have consequences in many other areas.

Government finances under outlay-based budgeting systems appear to require more flexibility and discretionary power on the part of the Executive branch than is likely to be permitted by the U.S. Congress. Furthermore, the outlay-based system seems to offer few advantages in making substantial intra-year outlay adjustments. Even if the U.S. government decides to adopt some form of outlay control, obligational authority will probably continue to be the basis for budgeting and managing finances.

Governments operating under outlay-based budget systems formulate their plans in terms of annual outlays constrained by expected annual revenues; and they rely primarily upon their planning and monitoring processes to maintain the proper outlay flow rate, rather than upon late and disruptive adjustments when faced with imminent overruns. *Planning in outlay terms is the key means of controlling outlays under this scheme.* This should be the key to any strategy for outlay control in the Air Force as well. Major changes in near-term outlays will still be

---

[4]*The Study of Control of Expenditure 1981*, Open Government Document 81/01, Ministry of Defence, United Kingdom, November 1981.

difficult, but advanced planning and the development of measures to expand or to reduce spending rates can provide a greater degree of control over future outlays, including the possibility of fairly major changes when sufficient lead time is available. *Because such measures will have wide-ranging consequences, they will have to be developed with the involvement of other Air Staff offices in addition to the financial management community.*

III. PROPOSED MEASURES FOR AIR FORCE OUTLAY CONTROL

AN AIR FORCE OUTLAY CONTROL PROPOSAL

If current trends persist in the United States, the pressures to bring some form of outlay control to government finances may be irresistible. The experience reviewed above did not suggest that strong outlay controls (or full outlay budgeting) would adapt well to the American system. And ad hoc controls would clearly be costly and would probably give little leverage on outlay levels within a fiscal year. An outlay control system for the Air Force requires three elements: (1) operation within the current obligation-based budgeting system, (2) early visibility of possible conflicts with outlay limitations, and (3) some degree of intra-year adjustments while avoiding the more costly consequences of short-notice, ad hoc measures.

The proposal we put forth here would retain the basic planning and financial management scheme used currently in the Air Force but would address the need to control outlays in two ways: (1) Outlay targets would be incorporated explicitly in the Planning, Programming and Budgeting (PPB) process, probably as an adjunct to the currently used obligational authority targets; and (2) contingency planning would be done for intra-year outlay adjustment measures, both to permit quick adjustments when required and to assure that the costs of the measures would be understood beforehand. Incorporating outlay targets in planning and budget formulation would ensure that programs were consistent with revenue (and borrowing) expectations. Contingency planning for outlay adjustment measures would help reduce the costs (monetary and other) of such adjustments and would also provide a better basis for policymakers to judge when and if adjustments would be worth their costs.

Several implementation issues need to be considered if outlay control is adopted by the Air Force in this form. We have divided these into four categories, which will be discussed in turn below: (1) bringing outlay planning into the PPB system, (2) improved outlay forecasting methods, (3) extensions to financial information systems,

and (4) preparations for mid-course outlay adjustment measures. The first and last of these issues would involve many elements of the Air Force and the Air Staff; the other two are primarily the concern of the Air Force Comptroller community.

OUTLAY PLANNING IN PPB

A fairly modest change in the current PPB process will allow for outlay limitations. Programs and budgets are developed at present under a series of time-phased Total Obligational Authority (TOA) targets. Outlay projections of the final proposed five-year program and budget are normally made quite late in the PPB cycle. If outlay targets were used earlier in the process, potential conflicts between desired programs and the expected outlay limitations would be highlighted. Alternatives could be examined much as they are today, but some shift in focus would be required of various Air Force and Air Staff components who now deal almost exclusively in the TOA requirements of alternatives. Both outlays and TOA implications of proposals would have to be estimated. Both the TOA and the outlay targets would have to be considered. The degree to which emphasis shifts toward outlay targets would depend upon how stringent were government control policies and how much of the responsibility for meeting limitations were assigned to the Air Force.[1]

Once a five-year force structure and program consistent with the targets were settled on, the current year's budget would still be put forth in appropriation (TOA) terms. And the appropriation and obligation process would still be used to control finances for budget execution. *If* the outlay targets are consistent with the government's fiscal goals, *if* the budget (in TOA terms) is consistent with the outlay targets, and *if* forecasting methods are reasonably good, then there would seldom be need to make mid-year adjustments to change the current year's outlays, and adjustments to future years' outlays could be handled in the next cycle of program and budget development. This smooth running of the system may seem to be dependent upon too many

[1]Because of the Congressional Budget Act, Congress today (and the CBO) operate somewhat in this fashion, trying to assure that appropriation actions and outlay goals are consistent.

"ifs," but this is the way federal government finances operate most of the time today. *The main adjustment that is required is the explicit use of outlay targets in the planning process.*

These changes would probably not eliminate all need for intra-year adjustments, however, because there are uncertainties inherent in cost and inflation estimates and in the relationship between the time streams of obligations and outlays. There also may be a need for intra-year changes in the outlay goals themselves. If balanced-budget or deficit-limiting requirements are legislated, such mid-year goal changes might be necessary to match outlays to unexpected declines in revenues produced by changes in economic activity. Revenues are probably even more difficult to forecast than outlays.

IMPROVEMENTS TO OUTLAY FORECASTING METHODS

Outlay forecasts within DoD have been remarkably accurate over the last several years. However, some refinements in forecasting methods may be necessary to capture the important differences in the outlay implications of program and budget alternatives. The forecasting methods would need to capture these differences; but if they are to be applied during program exercises, they also need to be easily and quickly applicable. A few examples taken from historical Air Force obligation and outlay data will demonstrate the kinds of differences in outlay timing and the level of disaggregation we believe would be appropriate.

Forecasts of Air Force outlays are now based on outlay patterns at the appropriation level similar to the patterns shown in Fig. 3 for three subcategories of the 3010 (Aircraft Procurement) appropriation. The patterns represent cumulative outlays (percent of total amount appropriated for the fiscal year) over time, from the beginning of the year of appropriation. The graphs are from a composite of data from fiscal years 1979-1982. Each of the three subcategories shown constitutes a major fraction of the total aircraft procurement appropriation. As can be seen, they have outlay patterns that are sufficiently different from one another to suggest that the overall pattern could be greatly affected by shifts in the proportion of funding for each category.

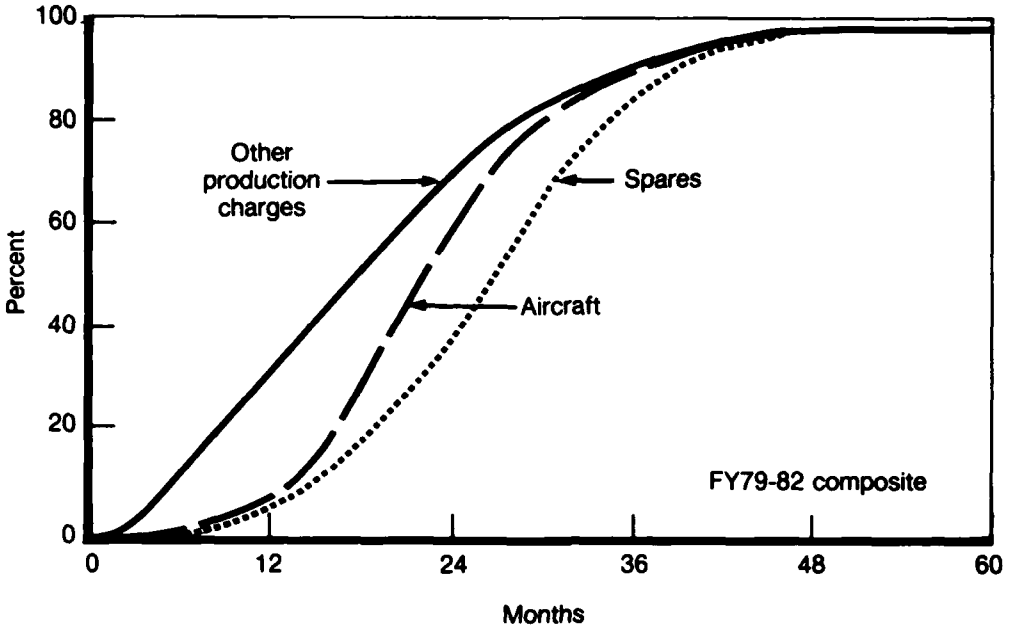


Fig. 3—Outlay patterns by subcategory, 3010 application

The graph in Fig. 4 for the "Other Procurement" (3080) appropriation shows even more dramatic differences in the outlay patterns for its major subcategories than those for Aircraft Procurement. Most of the Base Operations and Maintenance Equipment category is carried in "Special Programs" accounts, and current outlay forecasting methods usually do provide for different outlay patterns for these accounts. However, we believe that the other two categories shown on the chart are sufficiently different that they too should be treated separately.

The major steps that would be required in implementing the improved outlay forecasting methods are:

- Develop outlay forecasting methods for subcategories of appropriations
- Maintain a current and accurate historical database on obligations and outlays
- Review and adjust forecasting methods regularly to reflect the latest experience.

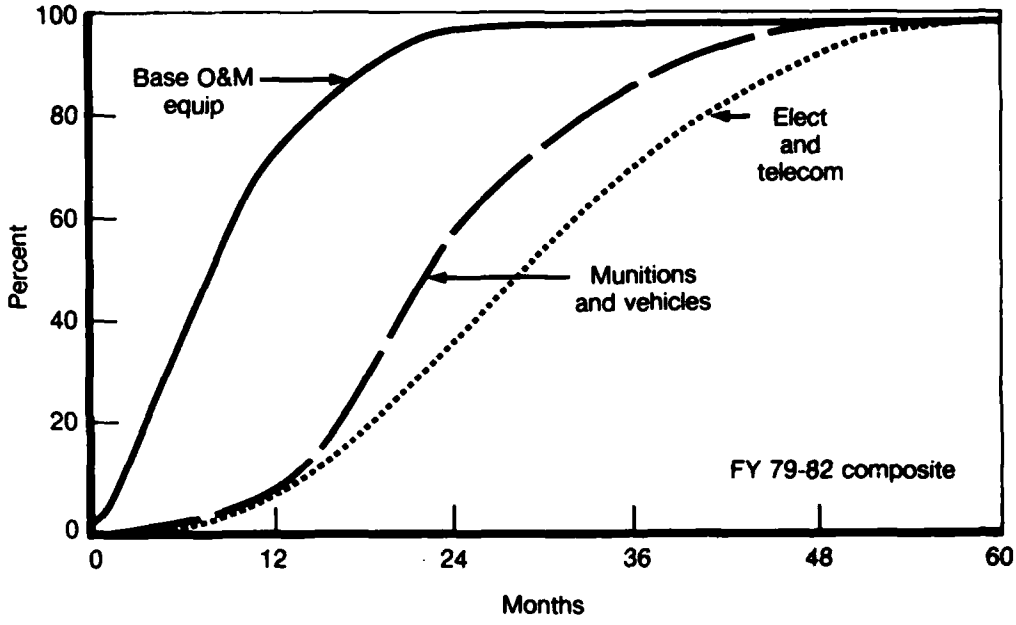


Fig. 4—Outlay patterns by subcategory, 3080 application

The preceding examples show the level of detail--perhaps three or four subcategories for each of the major appropriations--that we believe would be suitable for a forecasting method usable both for assessing the outlay implications of program alternatives and for final budget forecasts. The specific categories used would depend primarily on the commodity aggregations obtainable from accounting data and the degree to which their outlay patterns differ. We showed examples from procurement accounts above. Operations and Maintenance (O&M) is the next largest appropriation, accounting for about 27 percent of outlays in FY 1984. The O&M data we examined were divided in major command categories instead of commodities (except for a separate category for fuel). Although that breakdown could be used as the basis for outlay patterns and forecasts, we believe that a commodity breakdown would be more useful (and is probably easily obtainable from the existing accounting database).

Outlay forecasting as part of a system of planning for outlay control clearly requires maintaining a current and accurate historical database on Air Force obligations and outlays. It is unlikely that forecasting methods would be static, and regular reexamination of the

data for updating of the forecasts and forecasting system would be needed. Data at the level we reviewed for this study have been available for only a few years, and the accounting information systems may need to be changed in some areas to provide consistent and up to date information.

EXTENSIONS TO INFORMATION SYSTEMS

The information necessary to provide timely tracking of current outlays and to establish a historical base for forecasts is, for the most part, currently being collected within the Air Force and DoD. However, the information system being used needs some improvements, particularly in the areas of (1) transactions by non-Air Force agencies on behalf of the Air Force, (2) stock and industrial fund transactions, and (3) linkage of outlay timing to obligation timing. Some of these improvements and extensions to the information systems may be expensive to implement (unfortunately, we have not been able to estimate the costs of these changes). The implementation costs need to be considered in weighing the costs and value of outlay control.

Approximately 15 to 20 percent of monthly outlays from Air Force appropriations are made by Army, Navy, DoD, and other agencies that do not report directly through Air Force financial channels. The Army and Navy, for example, manage most military construction projects. Financial transactions with a vendor are often managed through a single office acting for all DoD agencies having business with the vendor. Information on these transactions is generally a month behind analogous information on transactions by Air Force offices; hence, the Air Force's picture of its outlays as of a given time is different from that seen by DoD and the Treasury. For historical purposes--i.e., for developing outlay forecasts--it would be desirable to make retroactive adjustments to monthly data to compensate for this discrepancy. For up-to-date tracking of current outlays, it would be preferable to have these transactions reported directly to the Air Force at the same time as they are reported through other channels. This might be expensive to do at present, but as the Air Force and DoD move toward greater automation and centralization of financial systems, it should be possible to provide this information to the Air Force more easily.

The Air Force Stock Fund (AFSF) and Air Force Industrial Fund (AFIF) are special appropriations-like funds (i.e., sources or obligational authority) that facilitate central purchase and management of goods and services needed by Air Force and other DoD users. Through this arrangement, the Air Force managers of the AFSF contract for bulk purchases of consumable and low-unit-price (under $3000) items and then "sell" these items to Air Force and other DoD agencies and operating units. These funds occasionally receive new appropriations for building up inventories, but for the most part the obligational authority they use comes from the constant stream of "reimbursements" (payments by users) from the agencies that buy their goods and services. The funds make "disbursements" (payments to vendors) as they receive goods and services in their central facilities.

Normally, the Stock and Industrial Funds have a net outlay (disbursements minus reimbursements) of close to zero in any year (except for new appropriations), and only the net outlays are reported through the accounting system for AFSF and AFIF accounts. Under outlay control, it would be important to maintain separate tracks of disbursement and reimbursement information both for current tracking and for forecasting. Disbursement information could then be keyed to the corresponding obligation data to improve the basis for forecasting future AFSF and AFIF outlays. This revision in the accounting system could be costly, but it could be particularly important because of the interaction between appropriated funds (especially O&M) and the stock and industrial funds. Air Force units can reduce their immediate outlays by reducing flying and other activities, which affect mostly the consumption of goods purchased from AFSF. But unless simultaneous (or advance) changes in AFSF orders were made, AFSF disbursements would continue at the same rate, and net outlays from the AFSF would increase in proportion to the reduction in reimbursements received from the operating units. In other words, Air Force activities would be curtailed or disrupted, but net outlays would remain essentially unchanged.

Finally, we believe it would be helpful, particularly in the forecasting of a given year's outlays from multiple-year appropriations, to provide additional information on the linkage between the obligations

in a given time period and the time-stream of outlays that is generated by those obligations. Currently, Air Force outlays are tracked only by account and program year (year of appropriation). Adding more detailed information relating dates of appropriations, obligations, and outlays could improve the basis for outlay forecasting, especially where the timing of outlays is strongly influenced by the timing of obligations.

To provide the appropriation-obligation-outlay linkage across all accounts, however, would mean major, and probably costly, changes to the current accounting system. In some instances it would also require major changes in financial management practices. For example, a blanket order for goods and services "as required" could be made with a vendor in one time period and another such order made in the next time period. Each such order effectively earmarks a certain amount of obligational authority, but it may be difficult to decide whether a particular payment applies to the first order or the second. Customary practice would have payments be credited against the earlier obligation until it was used up. This type of consideration greatly complicates any across-the-board attempt to report outlays against obligations within a time period; but this reporting could probably be done for selected accounts. Major procurement, R&D, and construction projects are probably the areas where most of the difficulties occur (i.e., early or late obligations causing early or late outlays). Direct reporting of obligations by time period and the outlays that correspond to them for only a few major accounts would probably provide the information needed to correct forecasts for unusual changes in obligation rates.

PREPARATIONS FOR INTRA-YEAR OUTLAY ADJUSTMENTS

Because pressure for outlay control is likely to arise from high-level concerns about federal fiscal policy, we believe that a central authority--probably at Air Staff level--would be needed to deal with outlay control in the Air Force. The central outlay tracking and forecasting system would be used to determine whether Air Force outlays were acceptably within the bounds of approved targets and when near-term adjustments might be needed. Changing the flow of outlays within whatever time remains in a given fiscal year will require that decisions be made and actions implemented quickly. Hence, the central authority

would have to maintain a set of contingency plans, including: (1) expected lead time between actions and their initial outlay effect; (2) amount and timing of outlay increases or decreases; (3) long-term costs or savings from the actions; (4) effects on readiness, production schedules, or other nonmonetary costs of the actions. Through advanced planning, priorities could be established, and Congressional or Executive agencies requesting the outlay adjustments could be informed immediately of the expected consequences of the adjustments.

We have already cited some of the problems and costs to be expected if near-term adjustments to outlays are attempted. The contingency planning effort cannot eliminate these, but it should help to avoid or reduce the problems. It needs to be managed (and actions directed) at a high level, because the repercussions of many of these actions often touch agencies other than the implementing agency. A case in point is the use of flying hour or other activity rate changes to reduce outlays at Air Force bases. Because these O&M outlay reductions would reduce some revolving fund revenues, a coordinated action would be needed to reduce the expenses of the revolving funds at the same time. (In fact, the desired outlay reduction might be achieved, for a short time, by taking actions to slow down revolving fund expenditures without requiring any reductions in activity rates. This would, however, require later revolving fund expenditures to replace stocks depleted during the slow-down.)

Although the operating and pay appropriations might appear to be the best candidates for mid-year outlay adjustments (because most of their outlays do occur in the same fiscal year as the appropriation), they have important limitations. Most of the actions to reduce outlays for these appropriations (e.g., manpower reductions, hiring freezes, reduced flying, reduced travel, deferred maintenance) are the same as would be proposed if a reduction in obligational authority were mandated. Hence, if such actions were taken after the budget had been approved, they could be in conflict with Impoundment Act provisions (or could require Congressional consent). Planning, however, can probably increase the leverage available through delaying or accelerating outlays on existing unliquidated obligations. After goods are delivered such leverage is quite limited because of Prompt Payment Act and cash

management requirements, but better leverage might be acquired through contractual provisions giving the Air Force a greater say in the timing of deliveries. Provisions of this type might be effective in those few areas (mostly AFLC and AFSC and the revolving funds) where large-dollar O&M-funded contracts exist, but most O&M funds are obligated and paid out in such small amounts that hundreds or thousands of individual managers would be required to take action to have any significant effect on overall outlays. Contractual provisions to increase Air Force control over the timing of deliveries are therefore more likely to be useful in connection with major (high dollar) procurement, RDT&E, and construction contracts.

Figure 2, which showed outlays by appropriation type and year of funding, indicated that in any given year most of the outlays from procurement and construction funds (and a sizable portion of outlays from R&D funds) arise from previous-year appropriations. Because these are multiple-year appropriations, not all of the funds are obligated in the year of appropriation; hence, some opportunities for deferring obligations are available without violating the Impoundment Act. Where obligations in these areas have near-term outlay implications, this provides some opportunity to adjust current-year outlays. A planned obligation schedule would have to be maintained to permit this kind of schedule manipulation, but it might still give only modest leverage, because for many procurement and construction projects only a small part of the outlays is concentrated near the date of obligation.

As a means of increasing the regularity or the predictability of outlays arising from large dollar contracts, the Air Force could provide financial incentives to selected contractors to adhere to a planned schedule of activity. Although this, in itself, does not provide a means of intra-year control, the possible improvement in outlay predictability and the avoidance of surprises from sudden changes in outlay rates could help avoid the need to make major and traumatic adjustments.

Finally, the bulk of current procurement outlays come from obligations made in the two previous years (or from funding from those years). We suggested above that provisions might be made to delay the delivery of goods and services under O&M contracts. Similarly, priced

deferral options could be provided in large-dollar procurement contracts. Certainly this should be possible for items that are largely off the shelf (e.g., common use trucks and other vehicles), for which vendors have other customers. In the case of weapon systems and other items that are unique Air Force purchases, we observe that some multiyear procurement contracts have provided for a range of production rates, which does not appear to have high cost; but we do not know whether such provisions could be negotiated to give short-term flexibility in outlays at acceptable cost. This may be a fruitful area for experimentation, using some current contracts to see how much flexibility in rates could be made available at a given cost.

Few of the measures for achieving intra-year outlay adjustments are likely to come without cost, either in terms of the disruption of operations or in actual dollar terms. Making provisions for added flexibility in outlays will also involve some costs--whether or not the provisions have to be used--because the economy must eventually pay for the added uncertainty and risk. Planning under outlay constraints should help to reduce the need for very large adjustments, however, and planning for the rapid introduction of measures that will be used in the event adjustments are needed should help to minimize the adverse effects.

IV. CONCLUSIONS AND OVERALL STRATEGY

In setting a strategy for adapting to outlay controls in the Air Force, the first steps that would have to be taken in preparation for possible controls would be:

1. Initiate work to bring outlay planning considerations into the PPB process (including improved forecasting and tracking methods).
2. Identify intra-year adjustment measures and their effects, and establish a priority list for them.
3. Establish a central authority for deciding when to implement intra-year adjustment measures and which specific measures to use.

Steps taken to improve outlay tracking and forecasting should be valuable whether or not direct outlay control policies are introduced. Financial managment procedures for most activities would remain unchanged. The main difference would be in having a list of specific contingency measures with near-term outlay effects that could be implemented, if necessary, because of cash-flow problems. Steps would have to be taken to establish a central authority for deciding when to use the contingency measures (and which to use), because of their possible wide-ranging side effects.

Over the longer term, if the government indeed formalized outlay control policies, then the Air Force would have to formalize its outlay targeting and adjustment procedures. At that time, it might be necessary to begin implementing some of the information system improvements suggested in Sec. III. Also, new contractual arrangements to increased leverage on outlays (e.g., flexible production rate arrangements) could be explored in earnest at this time.

Neither the form nor the fact of federal outlay controls is a certainty at present, and for this reason no major changes to Air Force financial management systems are needed at this time. Furthermore, if

the government does adopt some form of outlay control, the obligation-based budgeting scheme currently in use will continue to shape the basic forms by which budgets are deliberated and approved by the Congress and carried out by the administration and Executive departments.

Both the U.S. and U.K. experiences with emergency outlay control measures indicate that major intra-year adjustments can be expensive in both dollars and disruptions of programs, and most of the ad hoc measures tried had fairly modest effects on current outlays. A regular and well-planned scheme for managing outlays can probably reduce the worst of the disadvantages of using ad hoc controls, but the fact remains that many or most of the factors and commitments driving current outlays are set in motion well before the beginning of the fiscal year. Changing outlays on short notice requires advance arrangements to make such changes (i.e., contractual flexibility) or changing a commitment after work is under way. Costs are involved in either case, and government policymakers will want to be aware of these costs in weighing the value of a near-term outlay adjustment against its price.

Governments operating under outlay budgets are also constrained by their advance commitments. They rely mostly upon planning, forecasting, and outlay monitoring to keep their outlays within expected limitations, and on executive discretion to redistribute funds or adjust outlay targets when necessary.

Planning should also be the central part of a strategy for Air Force outlay control. The most desirable form for outlay control to take for the Air Force would be for limitations in the form of outlay targets for planning. With modest changes to the PPB process and a few improvements in outlay tracking and forecasting, the Air Force should be able to continue to manage finances through obligations and have outlay levels that are suitably close to limits for purposes of national fiscal policy.

With some preparatory work on intra-year adjustment measures, it should be possible for the Air Force to improve leverage for such adjustments and still limit their costs and disruptiveness. At the same time, these preparations can provide the administration and Congress with a clearer picture of the price that will be paid for stringent outlay controls or for late changes in outlay goals during program

execution. Under any system of controls, the most effective mechanism will probably continue to be sufficient lead time to allow for the implications of major procurement and force-sizing decisions.

END

FILMED

2-86

DTIC