What Will the Impact of Sequestration be on Defense-Wide Budget Accounts?

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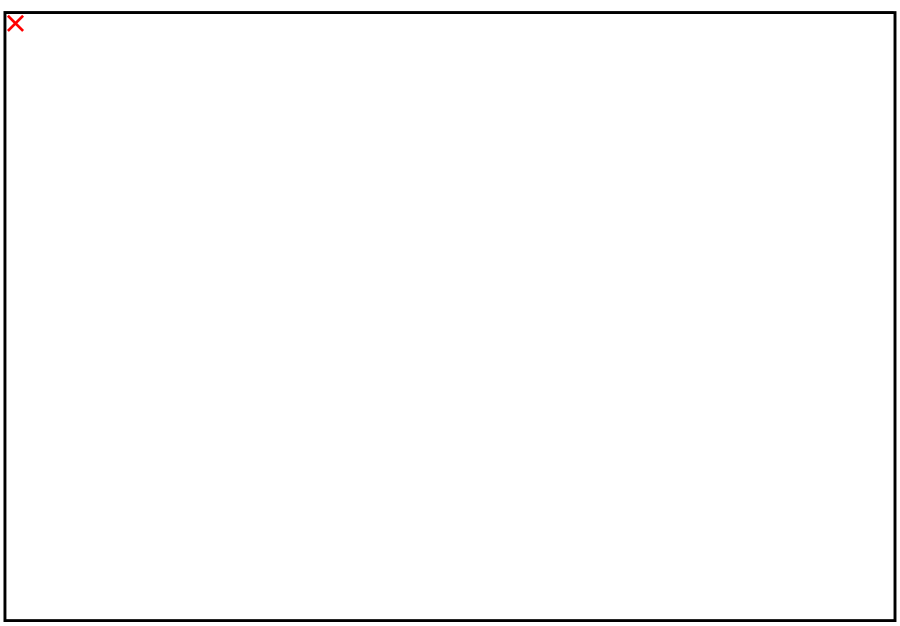
August feels different this year. Late summer in DC is typically slow, but it is also filled with anticipation for an uptick in business activity the final month of the federal fiscal year. This year, however, is filled with complications. When Congress kicked the can of divisive budgetary matters to the September-October 2013 timeframe, it made sure that the end of the summer would be hot with simultaneous debates about the debt ceiling, enacting sequestration, and the 2014 budget. As a result, this August feels more like Groundhog Day than it does the end of a sleepy DC summertime. The issues facing Congress have become so onerous that House Speaker John Boehner has **already thrown in the towel** and called for a short-term Continuing Resolution. Surely no one will be surprised if/when Boehner's brief CR is extended once Congress finds that it cannot rise above partisan lines to agree on a FY 2014 budget.

Because no one knows what the budget picture will look like in FY 2014, Deputy Defense Secretary Dr. Ashton Carter issued a memo in late May instructing the DoD to prepare for **three separate budget scenarios**: 1) operations at funding levels requested in the President's FY 2014 budget request, 2) operations at 5% below those levels, and 3) operations at 10% below those levels. The third scenario takes into account a cut of $50 billion due to sequestration. Unlike FY 2013, the 'good news' this year is that the DoD will have the flexibility to choose where the cuts fall (vs. the uniform percentage cuts across budget accounts required for FY 2013). Commanders and agency heads across the department are therefore looking at program portfolios to determine what should stay and what must go.

Where Are Cuts Likely to Fall?

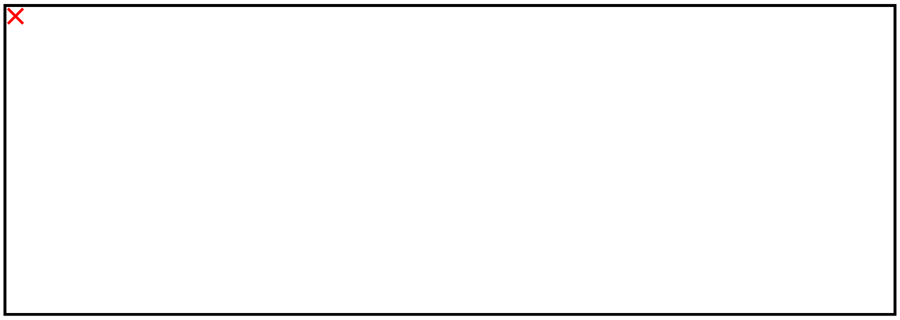
Those of us outside the process have no idea which programs are vulnerable. The best we can do is look at the budget accounts where DoD tends to spend the most and those that fund "programs of record" that tend to be mission critical and take an educated guess about the areas that might be most susceptible. In today's post I take a look at Defense Agency spending only, not spending by the Military Departments. To do this analysis I am relying on Federal Procurement Data System (FPDS) obligations data that I have parsed by Defense-Wide budget accounts. The data spans obligations over fiscal years 2011-2013, with the data for 2013 being only partially reported.

As the graphic below shows, the three largest accounts are the Defense Working Capital Fund (DWCF) with $95 billion, Defense-Wide Operations and Maintenance (O&M) with $42 billion, and Defense-Wide Research, Development, Testing and Evaluation (RDT&E) with $19 billion in obligations respectively. Beyond these three accounts the nominal amounts available for cutting dwindle rapidly. Reducing the Defense Working Capital Fund is a non-starter because these funds are generated by services provided to Defense customers. It goes without saying that DWCF levels will also be falling in the years to come as Defense customers have less to spend. This leaves Defense-Wide O&M and RDT&E as the likely major targets for budget cuts in FY 2014 and beyond. Budgets for procurement and Defense Health Programs are sure to be cut as well, but I think the axe will fall heaviest on the Defense-Wide O&M and RDT&E budget accounts.



Top 10 Major Programs Funded through the Defense-Wide O&M Budget Account

Assuming Defense-Wide O&M is most susceptible to cuts, which contracts under this budget account are vulnerable to sequestration based on historical spending? The chart below shows the top 10 contracts/contract vehicles by obligations that fall under this budget account.



As we can see, Encore II and SeaPort-e figure prominently. This suggests that active orders awarded through both vehicles have the potential to see spending cuts and cancellations as sequestration begins to bite. The Northrop contract for Joint Warfighting Center support is another case altogether. This contract was extended in March 2012, ostensibly to provide time for the follow-on **Enterprise Joint Training Support** contract to be competed. The competition for EJTS is now in source selection. One wonders if once this contract is awarded it will see only a trickle of business flow through it. Finally, the DSTS-G contract held by DRS has been replaced already by the GSA/DISA Future Commercial Satcom contract.

Top 10 Major Programs Funded through the Defense-Wide RDT&E Budget Account

Looking at vulnerable contracts/contract vehicles from the perspective of potential cuts to the Defense-Wide RDT&E budget account yields more bad news for active efforts under SeaPort-e and Encore II. In addition, some efforts under the Army's Information Technology Enterprise Solutions – Services 2 (ITES-2S) and S3 vehicles could also see funding cuts and cancellations. Keep in mind that we are talking about active efforts in most cases that are still funded through the RDT&E budget account. The other thing to consider is a decrease in the number of contracts procured through these vehicles. If yet-to-be competed contracts are ultimately dependent on RDT&E dollars, then they are likely to not be competed at all.

Although I've mentioned a few large vendors doing business with Defense Agencies, I don't mean to pick on them specifically. The reality is that big programs and high spending make big targets in this environment, and unfortunately the vendors attached to those programs tend to rise to the top of the statistical heap. All vendors whose contracts are funded through the O&M and RDT&E budget accounts are very likely to see reduced obligations in the years to come. The question is how much and what vendors will do to mitigate the impact.

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