Testimony of

Allison Stanger Russell Leng '60 Professor of International Politics and Economics Middlebury College

At a Hearing on "Treasury's Use of Exceptional Contracting Authority"

Before the Congressional Oversight Panel September 22, 2010

Distinguished members of the Congressional Oversight Panel, I am grateful for the opportunity to share some thoughts with you here today. It is an honor and a privilege to do so.

I'd like to begin by applauding the Congressional Oversight Panel for the important work it has done to date in illuminating the contours and challenges of an enormously significant deployment of taxpayer money. The Troubled Asset Relief Program [TARP] was in many ways a bipartisan miracle, a heroic and rare instance of Democrats and Republicans working together for the common good. It sent a clear message that the weight of the US government was behind the financial system, so there was no point in betting against it. In saving the financial system, the TARP served the interests of every American. Yet as this panel has repeatedly pointed out, the manner in which the TARP was executed and the optics associated with its wholly opaque implementation have left an unfortunate legacy. The economic experts who testified before this panel all emphasized the moral hazard created whenever some firms are deemed "too big to fail." I'd like to argue here today for a broader understanding of the moral hazard that the implementation of the TARP has illuminated: our acceptance of emergency (extra-budgetary) government contracting as standard operating procedure, and our failure to come to terms fully with the moral and political implications of that development. New legislation may well be in order to confront that challenge. But we can begin by demanding that the existing laws be upheld.

The Oxford English Dictionary defines a moral hazard as "the effect of insurance on the likelihood of the insured event occurring; the lack of incentive to avoid risk where there is protection against its consequences." Emergency spending that becomes routine poses a moral hazard, because the costs associated with it (waste, fraud, and abuse) slowly eat away at the trust upon which American democracy depends. We today fund long-term counterinsurgency operations through a series of supplemental appropriations. We stabilize the financial system by granting Treasury emergency contracting authority. We revitalize the economy with an emergency stimulus package. These measures may all have been necessary, but they have one feature in common. Because they all involve

1

¹ Congressional Oversight Panel, September Oversight Report: Assessing the TARP on the Eve of its Expiration, September 16, 2010, especially pp. 95-99. http://cop.senate.gov/documents/cop-091610-report.pdf

extra-budgetary outlays, they have the cumulative effect of rendering our governance and our government's spending patterns wholly opaque.

This dearth of transparency, in turn, creates at least the appearance of another moral hazard with the benefit of hindsight. Wall Street financiers are perceived to have used taxpayer monies to enrich themselves after having taken excessive risks, while ordinary Americans have been left largely to fend for themselves. Since few clear incentives exist to encourage elites to think beyond their own narrow self-interests, why should the average taxpayer trust the privileged to sacrifice for the common good? The result is Main Street's growing distrust of both Washington and Wall Street. In implicitly assuming that the privileged elite is comprised of angels, it is as though we have embedded moral hazard in the very fabric of our politics.²

How did this come to pass? Much attention has been paid to the role that big money plays in our politics, from the huge sums spent on lobbying to the influence of campaign contributions. But there is an additional pressure point for corporate influence: Government is now often wholly dependent on the private sector to go about its daily business. Government's increasing reliance on contractors has fed a vicious circle that over time has resulted in a federal government that has been effectively hollowed out. The federal government had the same number of full-time employees in 2008 as it did in 1963, yet the size of the population has doubled and the federal budget in that same period of time has more than tripled in real terms. Every federal contract and grant needs to be managed, yet our government currently lacks the capacity for appropriate oversight. Layer trillions of dollars of contracting for the wars in Iraq and Afghanistan, the TARP, and the stimulus package on top of that general picture and you have the perfect storm.

The last decade was marked by an explosion in outsourcing the work of government to the private sector. In 2000, the Department of Defense spent \$133.2 billion on contracts. By 2008, that figure had grown to \$391.9 billion, an almost three-fold increase. In 2000, the State Department spent \$1.3 billion on contracts and \$102.5 million on grants. By 2008, grant spending had grown to \$2.7 billion and contract spending had grown to \$5.6 billion. In 2000, USAID spent \$0 on grants and \$478.6 million on contracts. By 2008, those figures had climbed to \$5.5 billion and \$3.3 billion, respectively (source: USAspending.gov).

The matter appears to be no different on the domestic front. USAspending.gov's home page used to show (more on this oblique reference below) that 76 percent of federal spending in 2009 was on contracts and grants. Figures for the Department of Health and

2

-

² Madison wisely pointed out in Federalist 51: "If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself."

³ USAID's problematic past accounting practices are currently on full public display at USAspending.gov. No data on grants are provided for FY2000-2006. All numbers were retrieved from USAspending.gov on December 1, 2009.

⁴ Data quality appears extremely variable, but for general trends, it can suffice. I use 2008 numbers for the comparison, since 2009 aggregate numbers are still a moving target.

Human Services, for example, dramatically illustrate both the explosive growth in contracting and the complete inadequacy of existing federal accounting systems to track government spending in any sort of reasonably transparent and accurate way. In 2000, the Department of Health and Human Services spent \$4.1 billion on contracts. By 2008, the same figure had more than tripled to \$13.1 billion. However, in December 2009, USAspending.gov listed HHS spending at \$405.7 billion on grants in 2000 and just \$264.7 billion in 2008. That 2008 aggregate figure was flagged with a different color, indicating awareness of an obvious problem with data quality.⁵

	Contracts	Contracts	Change in	Grants in	Grants in	Change in
	in 2000	in 2008	Contracts	2000	2008	Grants
Defense	\$133.2	\$391.9	294%	\$2.3	\$4.6	200%
	billion	billion		billion	billion	
HHS	\$4.1	\$13.1	320%	\$405.7	\$264.3	-65%
	billion	billion		billion	billion	
USAID	\$478.6	\$3.3	690%	0	\$5.5	N/A
	million	billion			billion	
State	\$1.3	\$5.6	431%	\$102.5	\$2.7	2634%
	billion	billion		million	billion	

Viewed in this light, the problems of TARP spending that the COP has rightly identified are very much associated with government-wide problems. The business of government is increasingly in private hands, and, there is broad consensus that the current federal contracting system is antiquated, ill equipped to deal with the surging demands placed upon it. What we know about Treasury's network of contractors and financial agents reflects this trend. According to the GAO, the number of contractors that supported TARP administration and operations grew from 11 at the start to 52 by October 2009—a 473 percent increase in but one year's time. It is not unfair to say that the TARP was a bailout of the financial system administered by the financial system, with all the potential conflicts of interest that inevitably arise when the regulators are simultaneously the regulated.

The underside to this sweeping privatization of government power has become all the more apparent as the gap between the fortunes of Wall Street and of Main Street has widened. Since virtually every contract and grant represents jobs in some representative's district, focused lobbying can deliver bigger and bigger rewards. Special interest campaign contributions make the difference in every reelection campaign, with predictable consequences. The rapidly spinning revolving door between government and

_

⁵ The table that follows comes from David Litman and Allison Stanger, "Acquisition in Crisis: Transforming Workforce and Process in the Public Interest," White Paper for a forum organized by the Partnership for Public Service, January 2010. Numbers have not been adjusted for inflation.

⁶ GAO, Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges, October, 2009. http://www.gao.gov/products/GAO-10-16/.

business is a standing invitation to corruption. The one interest that goes underrepresented in this mix is the public interest.

Writing in Federalist 10, founder James Madison saw what he called the "mischief of factions" being neutralized as the plethora of special interests in vast colonial America cancelled one another out through both federalism and representative government. In twenty-first century America, however, government by contract instead encourages inside the beltway special interests to coalesce and carry the day. Government by contract means that government is entirely dependent on the private sector to conduct its daily business, so effective oversight is too often hostage to a corporate bottom line. Whenever the economy falters, the profit motive encourages businesses to cut safety and security measures unless government insists that they not do so, and our disdain for bureaucracy makes it difficult for government to secure the staffing it needs to ensure that these shortcuts are not taken. Congress and the White House can therefore have the best of intentions yet be unable to escape the quagmire that government itself has in part created through its incessant outsourcing. To be sure that my basic point is not misunderstood, there is no partisan villain in this tale, no conspiracy. We have together constructed a system that no longer functions as the founders intended.

Unfortunately, neither James Madison's proposed extended sphere remedy for the ill effects of factions nor Adam Smith's invisible hand promises any relief from this pernicious laissez-faire brew. If Congress and business continue to pursue their own short-term interests unchecked, it can only lead us to financial ruin and the American people's complete loss of faith in our government. Rescuing government by the people from the current government by checkbook is a project for a generation, but we need to get started now. We can begin by distinguishing between wartime and peacetime contracting, recognizing the unique perils that inevitably arise when the profit motive goes to war, as well as the uncharted territory we have entered in Iraq and Afghanistan, where some things that never should have been outsourced have been (such as moving armed security). But above all, the imperative of radical transparency in all government-business transactions has never been more important. Accountability and our cherished value of self-government now completely depend upon it.

Across the board, then, our unwavering faith in free markets and a penchant for outsourcing have outstripped government's capacity to monitor and assess the effectiveness of its own spending. When government does not have the employees inhouse to manage the flow of tasks and money to private actors, it sees itself as having no choice but to resort to what I have elsewhere called "laissez-faire" contracting. Government engages in laissez-faire contracting when it entrusts the private sector with the program design, management, and oversight of the taxpayer dollars it provides. In

⁷ The term "government by contract" comes from Jody Freeman and Martha Minow, ed., *Government by Contract: Outsourcing and American Democracy* (Cambridge: Harvard University Press, 2009).

⁸ Allison Stanger, Testimony before the Commission on Wartime Contracting in Iraq and Afghanistan, June 18, 2010. http://www.wartimecontracting.gov/docs/hearing2010-06-18_testimony-Stanger.pdf

⁹ Allison Stanger, *One Nation Under Contract: The Outsourcing of American Power and the Future of Foreign Policy* (New Haven, CT: Yale University Press, 2009), p. 163.

this sense, the TARP's emergency contracting authority can be understood as a license for laissez-faire contracting. Bailout funds could be disbursed to private entities who would then decide how best to deploy them to achieve the TARP's goals. Problems arose when the TARP's goals and those of individual firms did not wholly coincide.

The flawed premise of laissez-faire contracting is that market forces are engines of pure efficiency with which government should not intervene—save to bankroll private forces and let them work their magic. It reflects an "ideology according to which the interests of Big Finance and the interests of the American people are naturally aligned – an ideology that assumes the private sector is always best, simply because it is the private sector, and hence the government should never tell the private sector what to do, but should only ask nicely, and provide handouts to keep the private (financial) sector alive." Elites should be trusted to uphold the public interest in their behind-closed-doors dealings, especially when issues are too complicated for ordinary Americans to understand. For this world view, transparency is a time sink that gets in the way of the substantive work, which needs to be done yesterday, so it is transparency that is often the first casualty. But viewed from the outside, one man's time sink is another's instrument of self-government. There can be no self-government when the work of government is largely hidden from public view.

. Until very recently, data on the broadening scope of government-wide procurement were unavailable to the general public. That changed in 2003 with the launch of the General Services Administration's Federal Data Procurement Service (FPDS), which made data on contract spending (both for-profit and not-for-profit) available to registered users. Since FPDS issued annual reports and made them publicly available on its web site, its launch marked the start of a new era of relative transparency.

In 2006, the Federal Funding Accountability and Transparency Act (FFATA) took things a step further when it instructed the White House Office of Management and Budget to create and maintain a searchable database that covers all federal spending in a user-friendly way. The Federal Funding Accountability and Transparency Act of 2006 required "full disclosure of all entities and organizations receiving Federal funds." It is admirably straightforward legislation that comes in at under five pages, with no fine print, making it a symbol of as well as a catalyst for transparency. FFATA stipulates that all information on how taxpayer money is spent is to be provided on "a single searchable web site, accessible by the public at no cost to access" that includes basic information regarding the allocation of federal funds and the purposes to which they are designated. 12

To public acclaim, FFATA's offspring USAspending.gov came online one month ahead of schedule, in December 2007. For the first time, the public could see in detail how the federal government spends taxpayer money. The web site crossed all sorts of

bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s2590enr.txt.pdf.

5

Simon Johnson, Congressional Oversight Panel, September Oversight Report: Assessing the TARP on the Eve of its Expiration, September 16, 2010, p. 120. http://cop.senate.gov/documents/cop-091610-report.pdf.
 Federal Funding Accountability and Transparency Act of 2006 http://frwebgate.access.gpo.gov/cgi-

¹² Federal Funding Accountability and Transparency Act of 2006. http://frwebgate.access.gpo.gov/cgibin/getdoc.cgi?dbname=109_cong_bills&docid=f:s2590enr.txt.pdf.

divides. Not only did Barack Obama, then just the junior Senator from Illinois, and Sen. Tom Coburn, the Republican from Oklahoma, co-sponsor the legislation, but the Office of Management and Budget partnered with OMB Watch, a non-profit organization founded to keep OMB honest, to devise the new web site's software.

The new web site dramatically expanded the scope and quality of information available to the public on contracting and subcontracting. It allowed me, a Vermont resident, to get a good understanding of basic issues without a security clearance. The legislation mandated that OMB's database be expanded by January 2009 to include information on subcontracts and subgrants. USAspending gov relies on FPDS contracting numbers, but corrects for inaccuracies it detects in its by-agency figures before presenting them to the public. ¹³

FFATA was long overdue. Despite the tremendous amounts of money involved, government needed a push to launch a concerted effort to track those flows accurately. Putting together a government-wide system for tracking contracts and subcontracts was spurred by FFATA and remains a work in progress.

Which brings me to the reason I have been using the past tense in referring to agency contracting and grants figures, and my data come from December 2009, not 2010.

The answer is that some time in early 2010, USAspending.gov's platform and interface were totally redesigned. The makeover is supposed to endow USAspending.gov "with greater capacity for fulfilling FFATA requirements." However, the site's FAQs do not include any references to this revamping or the reasons for it. Unless one, like me, had done extensive work with the previous web site, the user would indeed have no idea that anything at all had changed.

What has changed? I am still in the process of answering this question, but one significant change caught my immediate attention and deserves mention here. The old version of USAspending.gov used to have a page entirely dedicated to subcontracts and linked to the home page. The FAQ section told the user that FFATA mandated that information on subcontracts be provided to the public by January 1, 2009. The subcontracts page reported that the site was "under development;" it provided a clear place-holder for important forthcoming information. Today, there is no subcontracts or subgrants page linked to the home page. The category does not even exist in the menu of choices. The extensive references to FFATA and what it by law requires have completely vanished. In short, the old site made it clear that important data were missing and soon to be forthcoming; the new site's architecture makes no explicit reference to aspects of FFATA that have yet to be fulfilled.

¹³ Allison Stanger, "Your Tax Dollars at Work: If You Can Find Them," Washington Post, May 18, 2008.

¹⁴ Office of Management and Budget, "Open Government Plan," April 7, 2010, pp. 10-11. http://www.whitehouse.gov/sites/default/files/microsites/100407-omb-opengov-plan.pdf

Given recent revelations that US taxpayer money has been flowing through subcontracts into the pockets of the Taliban ¹⁵, the evaporation of the subcontracts page is troubling. Without transparency in subcontracts, we are effectively pouring taxpayer money into a black hole in Afghanistan, with no real means of knowing how well that money is likely to be spent or even who is receiving it. ¹⁶ Similarly, without publicly available information about how TARP monies have been used, the TARP is a comparable black hole. FFATA required that information on subcontracts be made available to the public by January 1, 2009 and the old web site made that clear. The new web site effectively camouflages that shortcoming. But FFATA's thwarted intention remains obvious.

The current absence of sub-award transparency is but one aspect of FFATA that has yet to be fulfilled. Despite FFATA's single searchable web site imperatives, both the transparency initiative for the TARP (www.financialstability.gov) and for the stimulus package (www.recovery.gov) have been treated as independent domains, each with separate web sites. One could argue that this preserves the distinction between extraordinary and ordinary spending, but the separateness also effectively camouflages the true dimensions of the government's financial flows. Financialstability.gov and recovery.gov were an important step in the right direction, but the spirit and letter of FFATA mandates an integrated whole and a single web site, and this should be our future goal. The American taxpayer needs one stop shopping for reviewing government spending patterns, whether extraordinary or otherwise. Put another way, these now independent entities should feed into USAspending.gov.

What further unites all three of these transparency-enabling web sites is that none currently provides information at the sub-award level, when each is required by law to do. Again, one could argue that both the TARP and the stimulus package were emergency measures, and hence exempt from FFATA requirements, but this would be tantamount to suspending the law and seems ill advised. These observations underscore a point of the utmost importance: A significant step toward getting the transparency and accountability we need is simply to demand that the spirit and letter of FFATA be upheld and that information be provided to the public in timely fashion, in the manner that FFATA specifies.

Why has the quest for transparency in government spending proven so difficult to date? For starters, the explosion of government outsourcing was not originally accompanied by the development of appropriate accounting systems for monitoring these flows. Getting the work done took precedence over ensuring that the right systems were in place to ensure that the work would be done well. Responding to the requirements of FFATA often meant being asked for data that one had not made a habit of collecting.

¹⁵

¹⁵ "Warlord, Inc.: Extortion and Corruption Along the U.S. Supply Chain in Afghanistan," Report of the Majority Staff (Rep. John Tierney, Chair), Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform, U.S. House of Representatives, June 2010. http://oversight.house.gov/images/stories/subcommittees/NS_Subcommittee/6.22.10_HNT_HEARING/Warlord_Inc_compress.pdf.

¹⁶ Allison Stanger, "Addicted to Contractors, *Foreign Policy*, December 1, 2009. http://www.foreignpolicy.com/articles/2009/12/01/addicted_to_contractors

This dynamic is only all the more pronounced under emergency circumstances. All of this is in the process of changing, and dramatic improvements have been made. But data quality was and is a persistent concern, because the government's accounting systems have not yet fully adapted to the new normal, where the majority of the government's work is in private hands. Here Congress could be enormously helpful in providing additional incentives to get us where we need to go sooner rather than later.¹⁷

I stand ready to be persuaded otherwise, but to date, I have found most concerns about the costs of transparency to be misplaced, excessively focused on the short term at the expense of the sustainable. Some say that transparency is too time-consuming and invites endless dialogue with the public. Since the latter is precisely what we need, the former is not too high a cost to bear. Others argue that full disclosure compromises business proprietary principles. But when business is serving government, other principles must trump comparative advantage and the profit motive. These concerns are all understandable. The world has changed dramatically in a short period of time, and human behavior always lags profound socioeconomic change. But to find it understandable is no reason to accept the status quo as an immovable object. We can and must do better.

In conclusion, when so much of the work of government is in private hands, standard approaches to transparency will no longer suffice. The American people need to be able to see where and how their tax dollars are spent—right through to the sub-award level. Emergency circumstances may make this more difficult, but no less imperative; the twin values of self-government and fiscal prudence depend on it. Companies as well as governments can operate with the purest of intentions, but if their most important transactions are opaque to the public, they will lose trust and effectiveness. President Obama's March 4, 2009 Presidential Memorandum ordering a government-wide review of our contracting practices was a bold step in the right direction. The next step is to ensure that the spirit and letter of FFATA are upheld.

Thank you for your attention and I welcome your questions.

¹⁷ The Lugar and Cardin transparency amendment that was included in the Dodd-Frank Wall Street Reform and Consumer Protection Act passed on July 21, 2010 is one example of such additional incentives. http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

Allison Stanger is the Russell Leng '60 Professor of International Politics and Economics and Chair of the Political Science Department at Middlebury College. Her most recent book, One Nation Under Contract: The Outsourcing of American Power and the Future of Foreign Policy, was published by Yale University Press in fall 2009. Stanger has published op-eds on this topic in the Financial Times, International Herald Tribune, New York Times, and Washington Post, and has also testified before the Commission on Wartime Contracting and the Senate Budget Committee. She is a member of the Council on Foreign Relations and the Academic Leadership Council of Business for Diplomatic Action. She was also a contributor to the Booz Allen Hamilton project on the World's Most Enduring Institutions, the Woodrow Wilson School Task Force on the Changing Nature of Government Service, and the Princeton Project on National Security. She currently serves as an advisor to the Secretary's Policy Planning Staff, US Department of State. Stanger received her Ph.D. in Political Science from Harvard University. She also holds an AM in Regional Studies-Soviet Union (Harvard), a graduate diploma in Economics (London School of Economics), and a BS in Actuarial Science/Mathematics (Ball State University). She has studied foreign languages and literature at Charles University (Prague), the Sorbonne (Paris), and the Pushkin Institute (Moscow).