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Sequestration Plus One: Early Indicators of the Federal Contracting Environment in the Era of Sequestration

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In recent reports, the CSIS study team has examined the profound effect of sequestration on FY2013 contract obligations, with Department of Defense (DoD) contract obligations declining by 16 percent in a single year. CSIS has repeatedly emphasized that FY2014 data would be necessary to begin to understand whether the trends seen in 2013 represented a fundamental change to the federal contracting environment, or were just a one-year anomaly driven by the sequestration mechanism. The non-defense accounts provide an early window into federal government contracting one year removed from sequester, as FY2014 DoD contracting data will not be available, complete, and reliable via the Federal Procurement Data System (FPDS) until late winter/early spring. This paper will examine the trends in non-defense contracting for 2014 in the context of sequestration, in order to provide an initial, rough picture of the post-sequestration federal contracting environment.

The data show a small but broad-based rebound across the non-defense federal contracting agencies in FY2014, approaching FY2012 obligation levels in most cases.[1] Most notably, while federal products contract obligations were nearly steady in 2014, and services contract obligations increased moderately, non-defense research and development (R&D) contract obligations declined three times as steeply in 2014 as they did in 2013. Coupled with the significant decline in DoD R&D contract obligations in 2013, this data lends credence to concerns that federal R&D contracting is being disproportionately impacted under sequestration.

Overall 2014 Federal Non-Defense Contracting Trends

Federal non-defense contract obligations have been trending steadily downwards since their peak of $190 billion in 2010, declining by 6 percent in each of the subsequent two years. Interestingly, overall federal non-defense contract obligations declined at that same rate, 6 percent, under sequestration in 2013, to $156 billion. This relatively minor sequester-year impact for overall federal non-defense contracts is in line with what the study team observed in the most recent update of CSIS's series of reports on Department of Homeland Security (DHS) contracting trends[2]—namely, that non-DoD agencies were (to varying degrees) able to distribute the anticipated impact of sequestration over the course of 2012 and 2013, while DoD was forced to shoulder the majority of the impact just in 2013. For DoD, 73 percent of the decline in contract obligations between 2011 and 2013 was concentrated in FY2013, while for non-defense contract obligations, that share

[1] All data for this analysis is drawn from the publicly accessible Federal Procurement Data System, via the USASpending.gov portal. All dollar figures are in constant 2014 dollars (final 2014 OMB deflators are not yet available, so this analysis uses the latest estimated 2014 deflators to convert all dollar figures into constant 2014 dollars). For additional information about the CSIS contracting data analysis methodology, see https://csis.org/program/methodology.
[2] Jesse Ellman and Gregory Sanders, *U.S. Department of Homeland Security Contract and Grant Spending and the Supporting Industrial Base, 2004–2013* (Washington, DC: CSIS, June 2014), http://csis.org/publication/us-department-homeland-security-contract-and-grant-spending-and-supporting-industrial-ba.

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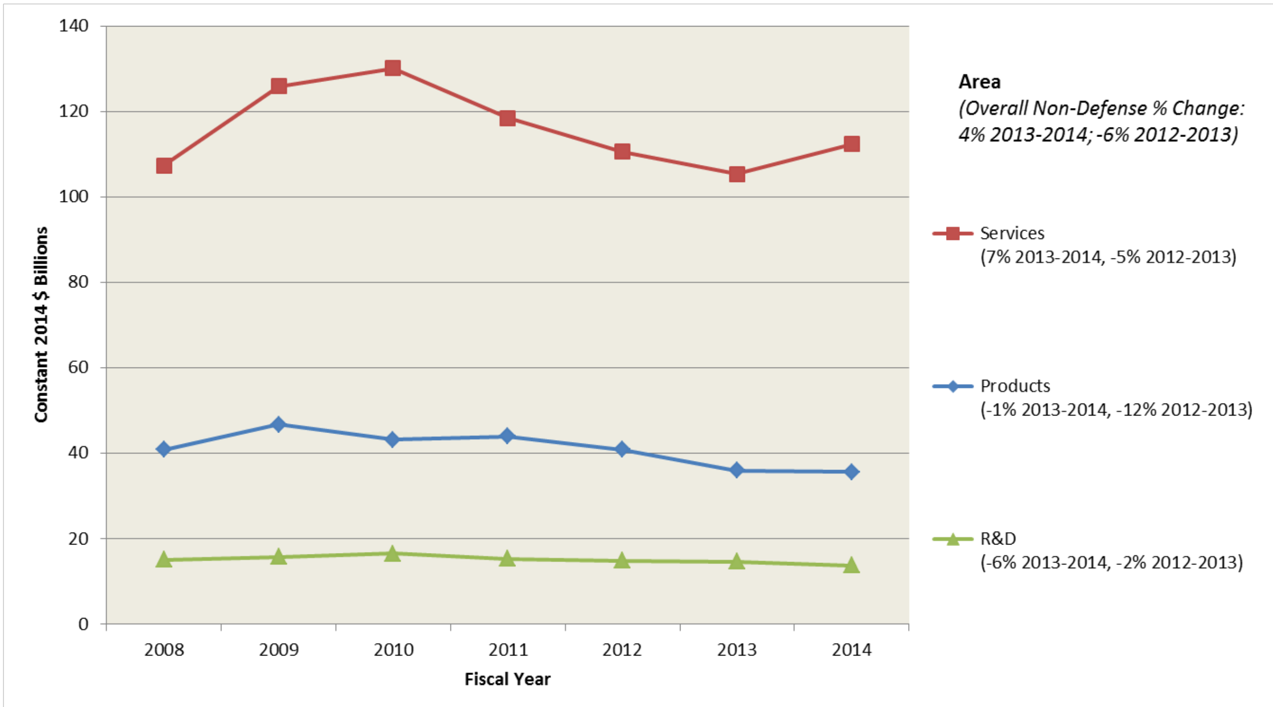
was only 48 percent.[3] It may also be true that non-defense agencies pushed back some contracting work into FY2014 to comply with FY2013 budget limits, as reports indicate was the case with DoD.

In 2014, overall non-defense contract obligations rebounded somewhat, increasing by 4 percent to $162 billion. As Figure 1 shows, that increase was limited to services contracts, while products were flat and R&D declined notably.

Figure 1: Non-Defense Contract Obligations by Area, 2008–2014



Source: FPDS; CSIS analysis.

Non-defense services contracts, which had been declining steadily since their peak in 2010, declined by 5 percent under sequestration from 2012 to 2013, slightly less than did overall non-defense contracts. Between 2013 and 2014, services contract obligations increased by 7 percent, rising to $112 billion, which exceeds the 2012 obligations level. This rise in services contract obligations was driven by large increases in medical (MED) services (16 percent), equipment-related services (ERS) (15 percent), and information and communications technology (ICT) services (11 percent), with more modest increases for facilities-related services and construction (FRS&C) (7 percent) and professional, administrative, and management support (PAMS) services (3 percent).

Non-defense products contract obligations, which represent a much smaller share of overall contracting activity than in DoD, declined sharply under sequestration (-12 percent), and failed to rebound in 2014 (-1 percent). And R&D contract obligations, which declined by only 2 percent under sequestration, fell by 6 percent in 2014.

[3] Note that there was wide variation among the major non-defense contracting agencies—only 16 percent of the Department of Homeland Security's 2011–2013 decline occurred in FY2013, while NASA and the Department of Energy saw cuts concentrated in FY2013 to an even greater degree than DoD.

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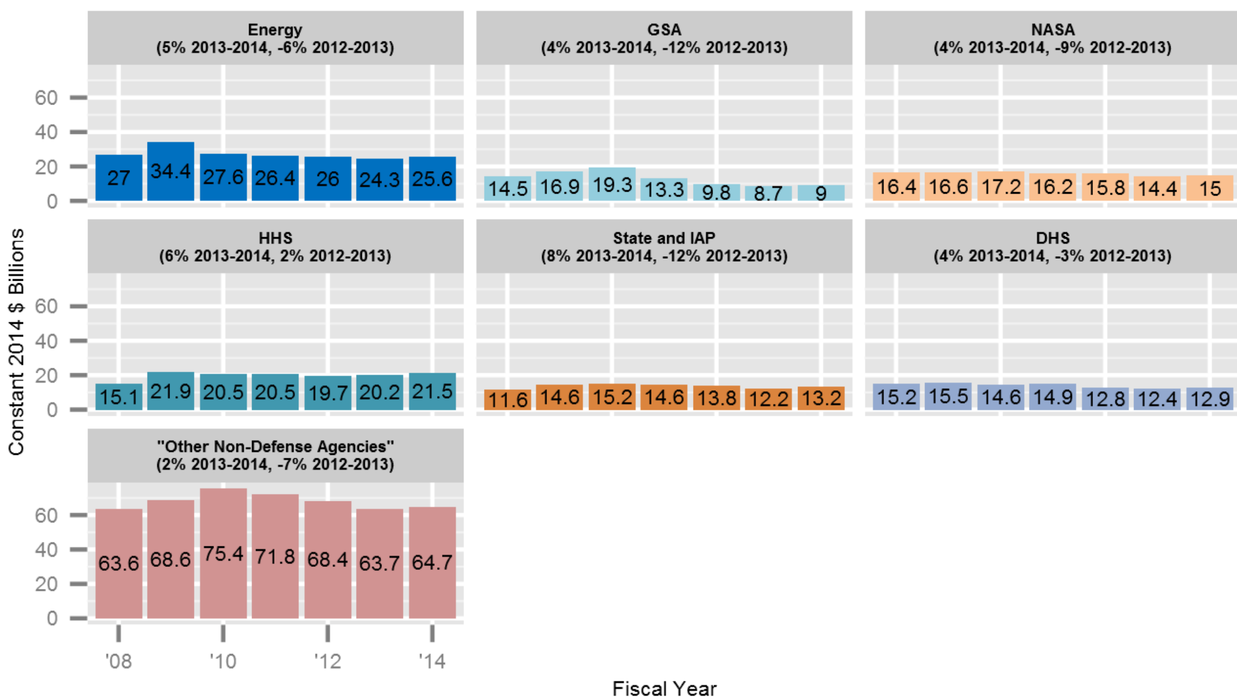
The overall picture for non-defense federal contracting agencies in 2014 shows a broad rebound for services contracts, a leveling off for products after a steep decline in 2013, and an acceleration of decline in R&D. The R&D decline is particularly noteworthy, and will be discussed with relevant agencies and in the concluding analysis of this paper.

While the overall trends tell part of the story, the universe of non-defense federal contracting is made up of a number of federal agencies, each of which was impacted differently by sequestration. The next section will examine how sequestration impacted these federal contracting customers, and whether those impacts continued in 2014.

2014 Federal Non-Defense Contracting Trends by Customer

Figure 2 breaks down non-defense federal contracting by the six largest contracting customers, in terms of contract obligations: DHS, Department of Energy (DoE), General Services Administration (GSA), Health & Human Services (HHS), NASA, and "State and IAP" (which combines contracting activity by the Department of State; the U.S. Agency for International Development, or USAID; and other small agencies related to international assistance). All other non-defense contracting agencies are aggregated into a seventh category called "Other Non-Defense Agencies." Trends for each of these seven customer categories will be discussed in brief.

Figure 2: Non-Defense Contract Obligations by Customer, 2008–2014



Source: FPDS; CSIS analysis.

Department of Energy

DoE contract obligations declined by 6 percent under sequestration, in line with the overall decline in non-defense federal contract obligations under sequestration. In 2014, DoE contract obligations rebounded, rising by 5 percent, to $25.6 billion, from $24.3 billion in 2013. Services contract obligations increased by 8 percent, products contract obligations declined by 30 percent (from $740 million to $520 million), and R&D contract obligations declined by 6 percent.

General Services Administration (GSA)

GSA contract obligations declined by 12 percent under sequestration, twice the rate of overall non-defense. In 2014, GSA saw a small rebound (4 percent), rising to $9 billion, from $8.7 billion in 2013. The main driver of this rise was a 29 percent increase in contract obligations for products (from $2.1 billion to $2.7 billion), while contract obligations for services declined by 5 percent.

It should be noted that the steep decline in GSA contract obligations since 2010, from $19.3 billion to $9.0 billion in 2014, is partially the result of inflated obligation levels in 2010 due to Recovery Act funds, but also largely the result of a data reporting change. Specifically, GSA has stopped reporting over $5 billion of contract obligations for "Lease/Rental of Office Buildings"[4] into FPDS. Though FAR 4.606(b)(3) permits agencies to not report lease activity into FPDS, this missing contract data would represent 36 percent of GSA's 2014 contract portfolio, and would account for nearly 4 percent of total 2014 non-defense contract obligations. This loss of transparency into a massive portion of GSA's contracting is concerning to the study team, and CSIS urges policy makers to take note of this significantly reduced visibility into GSA's contracting portfolio.

NASA

NASA contract obligations declined by 9 percent under sequestration, with R&D contract obligations being relatively protected (-5 percent) and services contract obligations disproportionately impacted (-14 percent). In 2014, overall NASA contract obligations increased by 4 percent. Interestingly, this rise was primarily concentrated in products (29 percent), while services increased by only 5 percent, and R&D actually declined by 2 percent.

Department of Health and Human Services (HHS)

HHS contract obligations actually increased slightly (2 percent) under sequestration, making HHS the only major federal contracting agency to see an increase in contract obligations in 2013. This increase was driven by a 23 percent increase in R&D contract obligations, while contract obligations for products and services were both flat. In 2014, HHS contract obligations continued to rise, increasing by 6 percent in 2014, to $21.5 billion, from $20.2 billion in 2013. R&D contract obligations declined sharply in 2014 (-16 percent), while contract obligations for services increased by 15 percent, driven by large increases in MED (66 percent) and ICT (24 percent) services. HHS products contract obligations, which had been flat under sequestration, increased by 2 percent in 2014.

State and IAP (Department of State, USAID, and other International Assistance Programs)

"State and IAP" contract obligations declined by 12 percent under sequestration, the largest decline of any major non-defense contracting agency. This decline was driven by a 22 percent decline in contract obligations for products, while contract obligations for services were relatively preserved (-9 percent). In 2014, "State and IAP" contract obligations rebounded, increasing by 8 percent, the largest increase of any major non-defense contracting agency, rising to $13.2 billion, from $12.2 billion in 2013. Services contract obligations increased at the same rate as overall (8 percent), but there was significant variation among different types of services. ERS contract declined by 69 percent in 2014, after declined by 27 percent under sequestration, falling from $610 million in 2012 to just $140 million in 2014. Meanwhile, FRS&C contract obligations increased by 36 percent in 2014, after falling by nearly 37 percent between 2011 and 2013. Products contract obligations, meanwhile, rose by only 4 percent in 2014.

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[4] PSC codes X111/X1AA.

Department of Homeland Security (DHS)

As discussed above, DHS saw a relatively minor decline in contract obligations under sequestration (-3 percent), after a large (-14 percent) decline in 2012. In 2014, DHS contract obligations rose by 4 percent, to $12.9 billion, from $12.4 billion in 2013. DHS services contract obligations increased in parallel to overall contract obligations (4 percent), while contract obligations for products increased by 9 percent. DHS R&D contract obligations declined by over two-fifths (-43 percent), falling from $410 million to $240 million.

Other Non-Defense Agencies

Contract obligations by "Other Non-Defense Agencies," which is an aggregation of the non-defense contracting entities not broken out above, declined by 7 percent under sequestration. This decline was almost entirely in products (-16 percent), while services contract obligations showed no change. In 2014, contract obligations by other non-defense agencies increased by 2 percent. Services contract obligations increased by 6 percent (driven by a 13 percent increase in ICT contract obligations), while contract obligations for products declined by another 6 percent.

Final Thoughts

Given that DoD accounts for approximately two-thirds of total federal contract obligations, caution must be used when drawing conclusions about overall post-sequestration contract trends until 2014 DoD data becomes available. Still, it is possible to draw some early conclusions from the data non-defense contracting agencies. The data for FY2014 shows a definite rebound in the year after sequestration, though that rebound is primarily limited to services contracts. The rebound is far from consistent across agencies, and in most cases has not even brought obligations back to FY2012 levels. HHS is a notable exception, in that it saw minor growth in contract obligations even under the strain of sequestration, and saw that rate of growth triple in 2014.

Some categories of contracts have done notably well, particularly ICT and MED services, which both saw strong increases in contract obligations in 2014—in both cases, in fact, obligations levels are higher in 2014 than they were prior to sequestration. Services contracts in general fared relatively well over the last few years, with 2014 obligations being slightly higher than 2012 levels. The acceleration in the decline of non-defense R&D contract obligations is worrisome, as it continues trends seen in the FY2013 DoD data of R&D facing disproportionate cuts in this difficult budgetary environment. CSIS will continue to closely monitor trends in R&D contracting in future work.

Going forward, the next major indicator of what the post-sequestration federal contracting landscape will look like will come when FY 2014 DoD contracting data becomes available, complete, and reliable through FPDS over the next few months. Over the coming months, expect to see further analysis from the CSIS study team on the state of the federal contracting market in the wake of sequestration's initial impact.

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