Fiscal constraints will challenge government for the foreseeable future. While this might seem daunting, budget pressures can foster opportunities to innovate, offering powerful incentives to rethink traditional approaches to mission support and service delivery. Within this context, it is critical to identify innovative ways to reduce costs while maintaining and improving performance. In addition, rethinking how to finance information technology (IT) and other investments can help agencies leverage rapidly evolving offerings in areas ranging from cloud and “as a service” computing models to real-time review and response to cybersecurity threats. Finally, government can reap the benefits of innovation and efficiency through a more refined approach to measuring and capturing cost savings.

Innovation in Cost Reduction: Lessons from the States

Federal leaders can learn much from state experiences. Earlier this year, the IBM Center released *Managing Budgets During Fiscal Stress: Lessons for Local Government Officials* by Jeremy M. Goldberg, University of San Francisco, and Max Neiman, University of California at Berkeley. This report describes how California’s budget experiences over the past several years can provide lessons learned and roadmaps for other federal, state, and local governments, who face fiscal constraints. Like many local governments across the nation, cities and counties in California have been impacted heavily by the economy in recent years. The report makes recommendations for local governments across the nation. These include:

- Identify and address structural deficits in a finely grained manner, leaving no major budget category unexamined. For federal budgets, this includes programmatic areas as well as functional categories—appropriated dollars, working capital and franchise funds, and even user fees.
- Foster citizen engagement to encourage widespread dissemination of fiscal information, thus enhancing the legitimacy of public policy choices. Significantly, this recommendation complements findings that innovation can be a key lever to thrive in a cost-constrained environment. It encourages employees and citizens to identify new ways of doing business that do not require spending on outdated processes without questioning whether they are still needed.

Budgeting For the Fast Pace of Technological Change

The traditional federal budget process takes up to 30 months. Agencies start to plan their request in spring before presenting a budget. The president presents a budget the next winter, then Congress begins enactment the following October: almost 18 months after the initial planning or later given the many continuing resolutions as outlined in the IBM Center report *The Costs of Budget Uncertainty: Analyzing the Impact of Late Appropriations* by Professor Phil Joyce at the School of Public Policy within the University of Maryland.
Finally, after all this the agency often spends much of their budget toward the end of the next fiscal year (30 months after initial planning).

In an Internet age, when technological advances are made in months rather than years, the traditional budget process lacks the flexibility agencies need to capture the benefits of innovation. Fortunately, there are established ways that agencies can work with Congress to enhance their ability to leverage new commercial technologies. Agencies can use “working capital funds” or “franchise funds.” These approaches often allow dollars to be carried over, across years, enabling more flexibility in spending.

Today, a number of agencies use these techniques to provide shared services to other federal agencies. The agencies that provide shared services retain a constant capital flow to support continued delivery of quality shared services; also, agency buyers use working funds to make an investment that could not have been foreseen during long-term budget planning and/or where the timing of the investment requires a flow across fiscal years that is known in advance. Technologies offered through “as a service” models, such as cloud-based services purchased at regular intervals based on buyer demand, can be tailored to an agency’s current needs. Of course, pursuing such a step requires early and ongoing transparency with agency stakeholders (including OMB, Congress, GAO, and inspectors general) as to the means, risks, and benefits of using such an approach.

Agencies can apply these techniques in a variety of settings—through pilots on projects funded by annual appropriations or greater use of flexible spending accounts. Agencies can also collaborate with industry to identify ideas for savings, perhaps using challenges and prizes to promote innovation. Contracts can be written to create incentives

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**Franchise Funds**

Franchise funds are government-run, self-supporting, businesslike enterprises managed by federal employees. Franchise funds provide a variety of common administrative services, such as payroll processing, information technology support, employee assistance programs, public relations, and contracting.

Franchise fund enterprises are a type of intragovernmental revolving fund. Such funds all have similar legal authority and operations and generally provide common administrative services. An intragovernmental revolving fund is established to conduct continuing cycles of businesslike activity within and between government agencies. An intergovernmental revolving fund charges for the sale of goods or services and uses the proceeds to finance its spending, usually without the need for annual appropriations.

The original operating principles for franchise funds included offering services on a fully competitive basis, using a comprehensive set of performance measures to assess the quality of franchise fund services, and establishing cost and performance benchmarks against their competitors—other government organizations providing the same types of services. The Government Management Reform Act of 1994 authorized the Office of Management and Budget to designate six federal agencies to establish the franchise fund pilot program.

*Source: GAO documents*
for industry partners to pursue innovative activities that may involve rapid experimentation, and ultimately are focused on finding better ways to achieve results while lowering costs.

**Measuring and Capturing Cost Savings**

For any steps government takes to improve efficiency and value, it is important that executives establish baselines to measure the cost savings of those steps. To understand how much can be saved, it is important to understand the full baseline costs, which in government are different and often more complex than in the private sector. Most government programs run off a cost baseline that includes a subset of appropriations for the larger department, salary and expense accounts not associated with the program, and sometimes working capital or franchise funds. Piecing these sources together to understand current costs is not a trivial exercise.

Once the baseline is understood, a second challenge involves developing financial models and methods that can capture savings off the baseline accurately. The federal government has experimented occasionally with “share in savings” contracting as a way to operationalize this measurement. This is a framework that incentivizes companies to achieve the measured savings over time, from which contract payments are made.

Even if clear savings opportunities emerge and there is financial transparency for the opportunity, barriers to savings capture and reinvestment exist. Federal budget law requires that agencies have sufficient funds on hand to cover the costs of a contract upfront (including termination costs). This requirement makes the use of a gain-sharing approach less attractive. In addition, federal agencies must generally spend all of their money in a given fiscal year, while savings often take months or years to materialize. Overcoming such barriers will likely require the use of prototypes and pilots to demonstrate the art of the possible, building support for pilots and understanding how success can scale more broadly.

*Editor’s Note: An expanded version of this article will appear in The Public Manager.*