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HOW TO SAVE MONEY AT THE PENTAGON WHILE IMPROVING THE NATION'S DEFENSE

INTRODUCTION

The President's Blue Ribbon Commission on Defense Management--the so-called Packard Commission--reported its findings on how to improve Pentagon management to Ronald Reagan at the end of last month.¹ A couple of days earlier, Reagan had appealed to the American people to support his military program to counter the growing Soviet threat.

These two events are related closely. For intelligent defense management reform pays off double: it not only saves money; but more important, it improves the combat capabilities of the U.S. military forces. Such improvement is essential if the U.S. is to counter the continuing buildup in Soviet nuclear and conventional military force.

Pentagon management and procurement reform is long overdue. Giving it particular urgency is the Gramm-Rudman-Hollings deficit reduction law. No longer can Congress or the Defense Department ignore the need to make changes in the way the Pentagon purchases weapons, supplies, and other materials. If a budget were not passed in time to prevent the Gramm-Rudman ax from falling, indiscriminate and severe cuts in defense spending could impair U.S. security.

The good news is that defense savings can be achieved without harming national security. Some \$14 billion to \$15 billion could be saved in this year's defense budget alone by such rigorous defense management and procurement reforms as multiyear contracting, greater

1. An Interim Report to the President by the President's Blue Ribbon Commission on Defense Management (Washington, D.C.: The White House, 1986), hereinafter referred to as the Packard Commission.

use of commercial products, and contracting out more Pentagon business to private firms.² Savings could total tens of billions of dollars over the long-term if these and such other reforms as closing down unnecessary bases, improving inventory management, and making weapons procurement more competitive were instituted. All that is required is for Congress and the Defense Department to have the courage to change those practices that are inefficient and wasteful.

A DEFENSE STRATEGY FOR GRAMM-RUDMAN

The overriding principle governing defense spending in the Gramm-Rudman environment is to address first the threat to national security and then to construct a defense budget meeting this threat in the most cost-effective way. Reforms in the way the Pentagon develops, buys, and manages weapon systems, moreover, can lead not only to enormous savings but to improved weapon systems. If the Pentagon could be persuaded to see the need to combine improved military effectiveness--i.e., better use and organization of forces--with improved efficiency in the procurement of weapons, the net result could very well be more military capability for less money.

This can be achieved by:

1) Increasing defense spending by at least 5 percent (after inflation) in fiscal 1987: The Soviet threat is still growing. It does not diminish proportionately to the rising U.S. deficit. Real increases in U.S. defense spending also are necessary to persuade America's West European allies to meet their commitment to NATO for a 3 percent real annual defense increase.

2) Adopting rigorous management and procurement reforms: There now is no doubt that the Pentagon's procurement system needs improving. Concluded the Packard Commission: "With notable

2. This is a conservative figure because it is derived only from known estimates. It is based on a Heritage Foundation staff proposal for cutting defense spending, which includes restructuring the retirement system, consolidating and/or closing military bases, and reforming the procurement system. The \$14 to \$15 billion figure includes the fiscal year 1987 Heritage defense reduction proposal (\$13.3 billion) plus additional annual savings (between \$1 and \$2 billion) accrued from general management reforms applied specifically to the Department of Defense. For more on the Heritage proposal (especially the recommendations regarding the retirement system), see Slashing the Deficit: Fiscal Year 1987 (Washington, D.C.: The Heritage Foundation, 1986), p. xxiii; and Slashing the Deficit: Fiscal Year 1985 (Washington, D.C.: The Heritage Foundation, 1984), pp. 27-29.

exceptions, weapon systems take too long and cost too much to produce. Too often, they do not perform as promised or expected."³

3) Avoiding across-the-board cuts: The automatic sequestration process of the Gramm-Rudman deficit reduction amendment must be avoided. Such a mindless across-the-board cut ignores strategic, tactical, and operational priorities.

4) Cutting force levels must be a last priority: Reducing weapons programs and U.S. force levels or changing U.S. strategic priorities to meet budget constraints should be at the bottom of the list for meeting Gramm-Rudman deficit reduction targets.

PROCUREMENT REFORMS

Perhaps the greatest defense savings can be gained from making changes in the way the Pentagon purchases its weapons, equipment, and supplies. From procurement reforms alone as much as \$8.3 billion could be cut from this year's deficit; considerably more could be saved over a three or more year period.⁴ Although complex, most procurement reforms are relatively easy to adopt since they require only a directive by the Secretary of Defense and his insistence that the Pentagon follow through with them. Among the most important procurement reforms are:

1) Multiyear Procurement

Multiyear procurement contracts reduce weapons costs. They allow more efficient planning and thus lower administrative costs. They also allow materials to be purchased more cost effectively. Multiyear procurement permits contractors to purchase components on a large scale from subcontractors and store them for future production. Most current defense contracts extend only one year at a time. The average cost savings from procurement contracts that extend three years are estimated at 10 to 20 percent of the cost of weapons systems.⁶

3. Packard Commission, p. 13.

4. Slashing the Deficit: Fiscal Year 1987, p. xxiii.

5. Robert Rector, "Getting Value for Money in Defense," Taming the Federal Budget: Fiscal Year 1986 (Washington, D.C.: The Heritage Foundation, 1985), p. 29.

6. Ibid. Also see Robert Foelber, "Cutting the High Cost of Weapons," Heritage Foundation Background No. 72, March 16, 1982, p. 7; and "The Advantages of Two-Year Budgeting for the Pentagon," Heritage Foundation Background No. 391, November 5, 1984.

The Pentagon began using multiyear procurement contracts in 1982 and estimates that \$6.2 billion has been saved so far.⁷ The Department of Defense plans to expand its multiyear procurement program this year. And the Packard Commission endorses the expansion of the multiyear procurement program for "high-priority systems."⁸

2) Competition and Dual Sourcing

As a general rule the more competition involved in a weapon's research, development, and production, the cheaper the weapon will be. Companies already are required to compete during the initial research and development phases of a project, but competition normally ends once the contract is awarded. Some procurement reformers believe that competition should extend into the production phase of the weapons system.⁹ This approach, called "dual sourcing," has some drawbacks. It can eliminate savings accumulated from large economies of scale, and it may also require higher start-up costs. Yet it may save about 30 percent in the overall costs of weapons.¹⁰ On balance, therefore, dual sourcing makes sense, particularly for weapons with long production runs.

3) Better Cost Estimates

In 1982 the Department of Defense calculated that errors in projecting the cost of weapons systems resulted in underestimating weapon unit cost by some 9 percent.¹¹ False cost estimates are a source of cost overruns. The rising annual cost of a weapons program very often can be traced back to an original underestimation of the weapon's cost. This can be remedied by 1) establishing new baseline cost estimates before full-scale production (Milestone III) begins; 2) always using the higher estimate when more than one exists; and 3) holding

7. Caspar W. Weinberger, Annual Report to Congress: Fiscal Year 1987 (Washington, D.C.: Department of Defense, 1986), p. 104.

8. Packard Commission, op. cit., p. 18.

9. Rector, op. cit., pp. 31-32.

10. Jacques S. Gansler, "We Can Afford Security," Foreign Policy, Summer 1983, p. 81.

11. This figure, however, does not include the effects of inflation, changes in weapon design, or production rate changes, all of which can raise the unit cost of a weapon.

back internal Pentagon cost estimates during bidding to dissuade contractors from proposing unrealistically low prices.¹²

4) Increased Standardization of Weapons and Spare Parts

The use of common components, equipment, and subsystems in different weapons systems would reduce costs greatly and streamline the weapons procurement process. The Grace Commission estimates that savings from increased standardization could amount to as much as \$2.3 billion a year. Greater standardization could be achieved by demanding that managers most closely associated with the various weapons programs have a greater role in reporting standardization progress.

5) Improvement in Quality of Procurement Officers

Military officers managing procurement projects average less than three years in their assignments. Many lack prior experience in the field.¹³ It is difficult, moreover, to attract high quality officers to procurement because military promotions are awarded primarily for command experience and not for "business functions" like contract work. This can be corrected by 1) establishing a centralized, civilian-operated agency to take over weapons procurement from the services;¹⁴ 2) creating an elite corps of procurement officers who are assured of status and promotions;¹⁵ and 3) giving civilian contracting personnel more professional status by selecting those with good business-related education and experience.¹⁶

6) Weapons Testing Improvement

Experience teaches that some U.S. military equipment will not operate effectively or at all in combat. Malfunctioning weapons systems not only waste money but, more important, endanger combat

12. The Department of Defense has already launched a number of initiatives to improve the pricing system, including the use of more realistic inflation factors in cost estimates. For details see Weinberger, Annual Report to Congress: Fiscal Year 1987, p. 106.

13. Rector, op. cit., p.35.

14. Armed Forces Journal, September 1984, p. 92; and C. Lincoln Hoewing, "Improving the Way the Pentagon Acquires Its Weapons," Heritage Foundation Backgrounder No. 396, November 28, 1984.

15. Senator Dan Quayle (R-IN) has proposed a bill to create an elite civilian procurement bureau. See "Quayle Bill Would Create Elite Corps Of Civilian Program Managers at DOD," Defense News, February 24, 1986, p. 6.

16. Packard Commission, pp. 16-17.

troops. Weapons testing could be improved by 1) adopting the Packard Commission recommendation to begin operational testing of a weapon early in the advanced stages of development and to continue through full-scale development using prototype hardware;¹⁷ 2) testing weapons under realistic conditions and with the support of the logistical structure that actually will accompany the weapon in the field; 3) evaluating weapon systems not according to some hypothetical or abstract criterion but according to existing alternatives.

7) Use of More Commercial Products

The Pentagon habitually develops weapons, equipment, and combat supplies that require components of special design or manufacture. This drives up costs because it requires a great deal of expensive specialty work and reduces economies of scale. Although the Department of Defense already has been given a directive (5000.87) to use more "off the shelf" commercial items and products, the services generally circumvent it. Using commercial products could reduce the cost of many items by an estimated 50 percent or more. Total savings could reach nearly \$1 billion per year if practiced throughout the Department of Defense.¹⁸

DEFENSE BUDGET REFORMS

There is a growing consensus that something needs to be done about the way Congress allocates funds to the Department of Defense. Complained Ronald Reagan at the release of the Packard Commission Report: "We are the only major country in the world that rewrites its defense budget every year, sometimes making detailed revisions two or three times a year."¹⁹ The result is waste and confusion in the weapons procurement process.

One way to remedy the problem would be a multiyear defense budget. Under the present system the defense budget must be approved annually. The result: Congress wrestles with the defense budget for most of the year. Defense spending becomes highly politicized, and the task of providing for the military security of the country becomes mired in such peripheral fiscal questions as how much higher defense spending might be than it was the previous year. A multiyear (say, two-year) defense budget would make the weapons procurement process

17. Packard Commission, p. 17.

18. Foelber, op. cit., p. 11.

19. "Reagan Hails Proposals on Pentagon Management," The New York Times, March 2, 1986, p. 25.

much more stable and thereby reduce its cost by introducing a greater degree of predictability into the planning, design, and production of weapon systems.

MANAGEMENT REFORMS

The Department of Defense clearly needs management reform. This was recognized by Reagan in 1985 when he formed the Packard Commission on Defense Management Reform. But the Pentagon did not wait for the Commission's findings; it launched reforms on its own. These include internal management review programs, a strict auditing program under a newly created Inspector General, and a special investigative unit to seek out procurement fraud.²⁰

Whereas procurement reforms reduce the cost of buying weapons and supplies, management reforms reduce the cost of maintaining them. Some management reform ideas are:

1) Consolidate the Acquisition Process

The Packard Commission recommends creating a new Under Secretary of Defense for Acquisitions.²¹ This is to streamline the procurement process by consolidating responsibility in one authority, a new and powerful Under Secretary only one level below the Defense Secretary. A secondary aim is to reduce the influence of the individual services on the weapons procurement process.

2) Consolidate Contract Administration

The Grace Commission calls for consolidating all Pentagon contract administrative activities into a single organization reporting to the Under Secretary of Defense for Research and Engineering. The Grace Commission estimates that this would save \$185 million over three years, with most of the savings coming in the third year.²²

3) Contract Out

A myriad of regulatory obstacles now inhibit the Pentagon from hiring private firms to provide services, a process known as

20. Weinberger, Annual Report to Congress: Fiscal Year 1987, p. 114.

21. Packard Commission, op. cit., p. 16.

22. President's Private Sector Survey on Cost Control: Report on Procurement/Contracts/Inventory Management, Spring-Fall 1983, p. 103.

contracting out. An expanded Pentagon program for contracting out commercial and industrial activities could save between \$450 million and \$1.3 billion this fiscal year and as much as \$4.5 billion per year after five years.²³ One way to increase contracting out is suggested by Senator Warren Rudman, the New Hampshire Republican. He plans to introduce a bill requiring that all commercial activities in the Department of Defense be subject to contracting out. Though this may seem Draconian, it may be the only way to achieve the optimum savings from contracting out.

4) Reform Automatic Data Processing

If the services were willing to make a relatively high initial investment in new automatic data processing systems, significant net reductions could be made in the long run. Example: the Grace Commission estimates that a net \$5 billion could be saved in the next decade, or an average of \$500 million annually, if the Navy's automatic data processing systems were modernized.²⁴ For the Army, Grace estimates \$827 million in savings over three years.²⁵ And for the Air Force, the savings could amount to \$580 million over three years.²⁶

5) Improve Management of Inventory

The Grace Commission estimates that reducing Pentagon inventories could result in very large savings. Reducing inventory levels could save as much as \$6 billion over three years, with savings coming mostly in the second and third years.²⁷ The Pentagon claims that

23. The lower figure of \$450 million is based on the full implementation of a Pentagon contracting out program for employees scheduled for this fiscal year's A-76 review, i.e., for 35,000 positions. The higher figure is based on contracting out 100,000 positions, which would require an expanded A-76 review program. See Office of Management and Budget: Management Report (Washington, D.C., 1986), p. 74. Some information from the National Council of Technological Service Industries, Washington, D.C.

24. President's Private Sector Survey on Cost Control: The Department of the Navy, p. 126.

25. President's Private Sector Survey on Cost Control: The Department of the Army, p. 121.

26. President's Private Sector Survey on Cost Control: The Department of the Air Force, op. cit.

27. President's Private Sector Survey on Cost Control: Report on the Office of the Secretary of Defense, op. cit., Section 2.

improvements in the way that it handles spare parts already have saved more than \$2.5 billion over the past two years.²⁸ Making other management improvements in inventories, such as extending the tours of officers in inventory and providing new automated systems, could save \$1 billion over five years for the Navy alone. There, of course, would be start-up costs for the automated systems.²⁹ Savings would accrue from inventory reductions, fewer losses of inventory items, and the reduced personnel requirements arising from greater automation.

6) Repeal Congressional Obstacles to Management Efficiency

Legislative obstacles impede efficient management of the Pentagon. The Service Contract Act, enacted in 1965, requires payment of prevailing wage rates to workers covered by a service contract. The Davis-Bacon Act of 1931 requires that workers on public works projects, too, be paid prevailing wages. Repealing these bills would result in significant savings. Though estimates vary, savings could exceed \$3 billion a year if³⁰ applied to all contracting employees of the Department of Defense.

CONGRESSIONAL OVERSIGHT REFORMS

A major contribution to Pentagon inefficiency and waste is congressional micromanagement and interference. Advises Ronald Reagan: "Instead of scrutinizing every paper clip, bolt and bullet, Congress should give more thought to our overall defense needs and strategy."³¹ This could be remedied by:

1) Consolidating the Congressional Authorizing and Appropriations Committees

To consolidate the oversight and spending responsibilities of congressional defense committees, reformers have recommended

28. Weinberger, Annual Report to Congress: Fiscal Year 1987, p. 108.

29. President's Private Sector Survey on Cost Control: The Department of the Navy, p. 107.

30. This figure is derived from Grace Commission estimates for the Air Force extrapolated over the entire Department of Defense. See President's Private Sector Survey on Cost Control: The Department of the Air Force.

31. "Reagan Hails Proposals on Pentagon Management," op. cit.

consolidating the congressional authorizing and appropriating functions into a single committee.³² Supporters believe that combining the authority to approve and appropriate defense budgets into a single committee, or simply stripping the appropriations defense subcommittees of some or most of their authority to outlay funds, would reduce the steps in the budget process and also the time Congress spends reviewing the defense budget. It also may reconcile the budgeting process by bringing a single perspective to bear on the many budget items.

2) Reducing the Pentagon's Report Load

The Department of Defense spends an enormous amount of time reporting to Congress. This costs a great deal of money and diverts top Pentagon officials from their primary duty of establishing and managing national defense policy. To correct this problem some reformers suggest that each member of Congress be allocated a certain amount of "reports money" for Pentagon requests.³³ A Congressman's request for Pentagon reports would be restricted by how much it costs to comply. If the cost of compliance exceeds the preestablished ceilings on "reports money," then that request will be denied. With a limited amount of request money, each member presumably would request only the most needed information from the Pentagon.

3) Focusing Congressional Hearings on Missions Instead of Budget Items

Congressional hearings focusing on specific military missions--such as nuclear deterrence, force projection, air superiority, antisubmarine warfare, and the like--instead of on defense budget items would introduce a degree of rational consideration of strategy to the way Congress allocates funds for weapons systems. Although some armed services subcommittees are already geared toward military missions--such as the Senate Armed Services Subcommittee for Seapower and Force Projection--such others as the House Armed Services Subcommittee on Military Installations are not.

32. Representative Jim Courter (R-N.J.) has proposed a bill that would transfer most of the authorities for appropriating defense funds of the House Appropriations Defense Subcommittee over to the House Armed Services Committee. See "Courter's Procurement Reform Bills Would Cut Hill Oversight Bureaucracy," Defense News, February 10, 1986, p. 29.

33. Theodore Crackel, "Pentagon Management Problems: Congress Shares the Blame," Heritage Foundation Background No. 405, January 22, 1985, p. 9.

CLOSING BASES AND SELLING EXCESS REAL ESTATE

The Department of Defense maintains 5,600 separate installations and properties throughout the world; some 4,000 are in the U.S.³⁴ Many of these are inefficiently operated or redundant. It is estimated that \$2 billion could be saved this fiscal year if unnecessary military base support operations were consolidated and superfluous bases either closed or realigned.³⁵

CONCLUSION

Reagan's much needed military program should not be jeopardized by misunderstanding the also critical campaign to eliminate waste and fraud in the Department of Defense. Responsible reform should be seen as a way of enhancing the nation's security, not as an excuse to cut the defense budget to dangerously low levels. Nor should calls for reforms, such as those by the Packard Commission, be viewed as an indictment of Defense Secretary Caspar Weinberger. The Pentagon's procurement problems are systemic and decades old. Now is not the time to assign blame for them; now is the time to do something about them.

The Gramm-Rudman budget ceilings offer an opportunity and incentive to revamp Pentagon management systems in a way that strengthens the nation's defenses. U.S. force levels or weapons systems, therefore, need not be cut to help balance the budget. To be sure, some weapons programs may be candidates for cuts--the proposed C-17 cargo plane, for example, which is not the right aircraft for the strategic airlift mission. But all such cuts should be based mainly on military grounds.³⁶ Reducing force levels or changing the nation's strategic priorities should be the very bottom priority in the struggle to slash the deficit.

The first priorities must be to make the procurement process more efficient and cost-effective, to streamline the management of the nation's defense resources, and to improve the way Congress oversees and allocates funds for defense. Such reforms could save \$14 to \$15 billion this year alone and billions more if effectively implemented over years to come.

34. Slashing the Deficit: Fiscal Year 1987, op. cit., p. 13.

35. Slashing the Deficit: Fiscal Year 1987, op. cit., p. xxiii; pp. 13-14.

36. See Kim R. Holmes, "Closing the Military Airlift Gap," Heritage Foundation Background No. 482, January 23, 1986.

In the end, the deciding factor in the analysis of the defense spending levels should be the growing power of the Soviet Union. It is Moscow's military strength and that of its allies which must determine the level of U.S. defense spending, not the size of the deficit.

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