



MANAGING *the*  
MILITARY  
*more* EFFICIENTLY

Potential Savings Separate from Strategy

Matthew Leatherman | Barry Blechman | Russell Rumbaugh

STIMSON





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MAY 2013

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## EXECUTIVE SUMMARY

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This report is a compilation of recommendations made in recent years by many boards, commissions and study groups that have proposed efficiencies in how the U.S. Department of Defense spends money.

If implemented fully, the recommendations would save nearly \$1 trillion over a decade, though it is virtually impossible they will all be adopted. The proposals face varying degrees of political opposition – some intense – and some recommendations are contradictory.

We are not endorsing any of the specific options but, by compiling the proposals, we have created a resource that frames the many calls for efficiencies, providing context that the broader debate on defense spending is currently missing.

The recommendations are organized into three critical areas: personnel compensation, manpower utilization and procurement practices.

### **Personnel Compensation**

Members of the armed forces make great sacrifices and willingly risk their lives to defend the United States. The nation has a sacred obligation to keep faith with what they were promised. Yet any given pay or benefit is just a policy – not something inherently sacred.

Many studies have found that the Pentagon could better provide service members with the care and compensation they deserve by adopting better management practices. Options for better-managed compensation include:

- Adjusting the formulas for cash compensation growth.
- Pegging pay to specialization in high-demand areas.
- Transferring non-cash compensation into cash compensation.
- Curtailing the pool of health care beneficiaries.
- Increasing health care fees and cost-sharing.
- Modernizing military retirement.

### **Manpower Utilization**

The volunteers who step forward to serve in the U.S. Army, Navy, Air Force and Marines are the military's most important assets. They should be used as effectively as possible.

Examples of better manpower utilization taken from the recommendations compiled in this study include:

- Streamlining duplication and redundancy.
- Reducing the number of personnel providing overhead support.
- Using members of the military to perform inherently military functions.
- Trimming civilian manpower and contractor support.
- Better balancing between the active and reserve components.



## Procurement Practices

The Pentagon has spent more than \$360 billion on contracts in each of the last three years, but has drawn criticism for not always spending these funds wisely.

The Government Accountability Office's "high risk list" has included defense weapon systems acquisition since 1990, defense contract management since 1992 and defense financial management since 1995.

Recommendations to improve Defense Department procurement include changing the ways that:

- Contracts are constructed.
- The acquisition workforce is managed.
- Best practices are chosen.
- Requirements are generated.

In a time of tight budgets across the federal government, the key defense budget issue facing policymakers today is not whether to cut, but where to cut.

Before cuts are made to military readiness, force structure, or needed weapons, some of the changes like those in this report should be implemented. If the United States is to have the best defense possible, it must spend its defense dollars in the most effective and efficient ways possible.









## ACKNOWLEDGEMENTS

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## MANAGING THE MILITARY MORE EFFICIENTLY: POTENTIAL SAVINGS SEPARATE FROM STRATEGY

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Regardless of the amount that the U.S. spends on its defense, funds should be spent as efficiently as possible. Everyone can agree with such a statement, but it's easier said than done. Nowhere is the axiom about one person's trash being another's treasure truer than in the defense budget. Each line is there because someone defends it. If that champion disappears, another advocate will immediately step up to shift the money left behind.

Nevertheless, efficiencies are possible. A July 2011 Defense Business Board (DBB) report determined that "substantial budget cuts (5 to 15 percent) can be achieved without affecting future mission readiness if there is an intense focus on reducing 'overhead and infrastructure' spending."<sup>1</sup> Countless authoritative boards, commissions and study groups have suggested ways to save money in defense without compromising military capabilities.

This report offers a top-level overview of that work. All of the options presented here have appeared elsewhere. They did not originate with Stimson nor does Stimson specifically endorse any of them. No one is likely to embrace them all – indeed, some issues are so complex that experts have made contradictory suggestions – but most will find some choices and savings that they can accept. Importantly, this report identifies efficiencies that might be possible irrespective of what kind of strategy the United States pursues. The efficiencies are organized into three parts: personnel compensation, manpower utilization, and procurement practices.





## REFORMING PERSONNEL COMPENSATION

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U.S. military personnel make great sacrifices for our country, and the United States has a sacred obligation to those in uniform who serve their country. Their compensation must align with what they were promised.

Particular pays and benefits are just a policy and not something inherently sacred by themselves, however. There may be more efficient ways to provide service members with the care and compensation they deserve. The Tenth Quadrennial Review of Military Compensation (QRMC), published in February 2008, found that:<sup>2</sup>

In general, this system works effectively to attract and retain the high-quality personnel needed in the uniformed services of the 21st century. That said, there is room for improvement to increase the system's flexibility and better enable force managers to respond to changing requirements in support of national security missions. Improvements can also increase member choice, serving to enhance recruiting and retention efforts in the uniformed services.<sup>3</sup>

Options in this section represent ways military compensation might offer better care for service members yet also achieve savings; e.g., adjusting the formulas for cash compensation growth; pegging pay to specialization in a high demand area; transferring non-cash compensation into cash compensation; revising the working-age retiree health care cost-sharing ratio, fee structure, and beneficiary pool; and modernizing the retirement plan.

### **Adjusting the Formulas for Cash Compensation Growth**

There are two commonly used measures of military compensation. Basic Military Compensation (BMC) represents just the salary that a service member earns, while Regular Military Compensation (RMC) also incorporates housing and food allowances, as well as income tax advantages.<sup>4</sup> Even the broader RMC formula excludes significant elements of a service member's compensation package. The Tenth QRMC proposed expanding the definition of military pay to better account for how service members are compensated.

This assessment [of compensation adequacy] has been based on a comparison of cash compensation between the [military and civilian] sectors... But this approach leaves out several very important components... Benefits to service members are substantially more valuable than those typically offered in the civilian sector, and members can also receive tax advantages not available in the private sector. Taking these additional components into account shows that service member compensation is much more generous relative to civilian compensation than the traditional comparison of cash pay would suggest.<sup>5</sup>

It was on these grounds that the Tenth QRMC recommended that the military health care benefit, retirement benefit and tax advantages from state jurisdictions and Social Security be included when comparing military and civilian compensation.

Whether military and civilian compensation can appropriately be compared is a sensitive question, given the dramatically different demands of military service. Although approaching the issue with a different charge and perspective than the Tenth QRMC, the Eleventh QRMC still found that “[average enlisted] RMC is higher than the wages of 90 percent of comparable civilians.”<sup>6</sup> Meanwhile, “average officer earnings correspond to about the 83rd percentile wages for the combined civilian comparison groups.”<sup>7</sup>

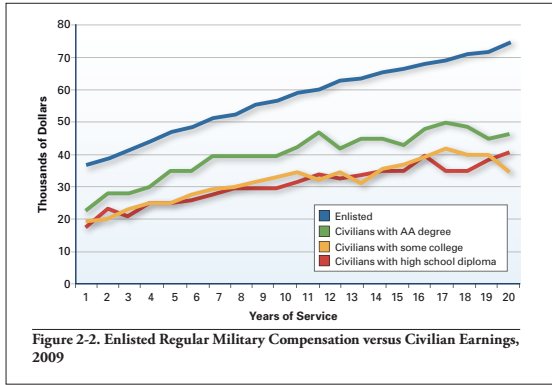


Figure 2-2. Enlisted Regular Military Compensation versus Civilian Earnings, 2009, Report of The Eleventh Quadrennial Review of Military Compensation, June 2012, p. 27

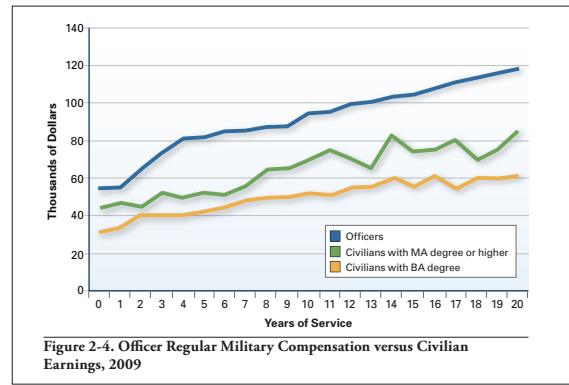


Figure 2-4. Officer Regular Military Compensation versus Civilian Earnings, 2009, Report of The Eleventh Quadrennial Review of Military Compensation, June 2012, p. 29

This differential may support the Pentagon’s FY2014 budget request to slow the growth of military compensation, in this case to 1 percent rather than the 1.8 percent increase seen by private industry employees.<sup>8</sup> If extended over time, this perhaps could generate savings even if the Pentagon also adopted a companion recommendation from the Tenth QRMC to peg regular military compensation to the 80th percentile of civilian compensation.<sup>9</sup>

Congressional Budget Office (CBO) research found the same imbalance favoring military compensation. It determined in January 2011 that “the typical enlisted person receives more cash compensation [salary, allowances, and subsidies] than three-quarters of comparable federal civilians.” Additionally, “the disparity for officers exceeds the disparity for enlisted personnel,” and it “grows with increasing years of experience.”<sup>10</sup> Rather than recalculating the military formula, as the Tenth QRMC proposed, CBO examined a budget option that would limit military pay increases over 4-5 years to half a point below the accepted measure of inflation, with Selective Reenlistment Bonuses available to personnel in occupations with shortages.<sup>11</sup>

A pay freeze has also been considered as an option, albeit an aggressive one. Civil servants’ pay table, including for those at the Pentagon, has been frozen since January 2011 and is slated to remain so at least through March of this year.<sup>12</sup> The Simpson-Bowles Fiscal Commission’s illustrative option determined that holding military pay constant would save more than \$9 billion by 2015.<sup>13</sup> Dr. Stuart Rakoff and Dr. Neil Singer, a former Director in the Pentagon’s Office of Manpower Planning and Analysis and a former Deputy Assistant Director of CBO’s National Security Division, respectively, similarly found in an unpublished white paper that, “a two-year freeze on basic pay and housing allowances would generate estimated savings of \$4.3 billion.”



## Pegging Pay to Specialization in High-Demand Areas

Concentrating compensation on high-demand personnel may make savings possible. According to Rakoff and Singer:

Total pay does not vary much by specialty. As a result, basic pay needs to be high enough to meet manning targets in hard-to-fill specialties. Pay at that level, however, typically is more than sufficient to fill the requirements in other military occupations.

...An alternative approach to setting pay levels is to rely more heavily on targeted pays and bonuses to meet manning objectives in most occupations. Under this approach, across-the-board pay would be set at the minimum level needed to meet targets in the least hard-to-fill specialty, and bonuses and special pays would be used more extensively than at present for all other occupations.

Targeting pay to higher-demand specialties rather than overcompensating lesser-demand specialties could be implemented by freezing the pay table for several years and phasing in the targeted pay changes in parallel. Despite foregoing a cost-saving recommendation on this count, the Tenth QRMC acknowledged this concept with a recommendation to increase the portion of compensation above inflation that goes to special pays and incentives.<sup>14</sup>

## Transferring Non-cash Compensation into Cash Compensation

Salaries and bonuses are just two parts of a complex military compensation formula. Service members also receive a substantial part of their compensation through in-kind payments. As the Eleventh QRMC found:

For active duty personnel, cash payments comprise approximately 51 percent of average military compensation; in-kind benefits 21 percent; and deferred compensation for retirees, veterans, and survivors another 28 percent. The percentage of military compensation made up of in-kind and deferred benefits is considerably higher than the noncash portion of civilian compensation.<sup>15</sup>

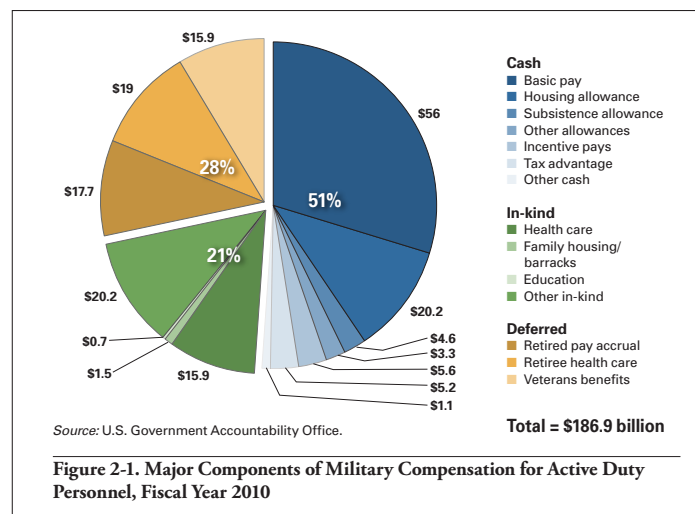


Figure 2-1. Major Components of Military Compensation for Active Duty Personnel, Fiscal Year 2010, Report of The Eleventh Quadrennial Review of Military Compensation, June 2012, p. 17

The Tenth QRMC pointed out the unique challenges of optimizing non-cash compensation, particularly that its “value is less easily understood.”<sup>16</sup> This reflected a much more general economic principle, that individuals get more utility from compensation that maximizes their choice (i.e., cash) than from compensation that limits their choice (i.e., non-tradable in-kind compensation).<sup>17</sup> One example is CBO’s option to consolidate the retail outlets on military posts and eliminate the subsidy for commissaries in favor of a cash allowance for eligible active-duty personnel. CBO estimated that this could save \$9.1 billion from 2012-21 if the annual family subsidy were \$400.<sup>18</sup>

CBO similarly examined an option in 2009 that would close the Domestic Dependent Elementary and Secondary Schools system and replace it with an \$8,600 per-student allowance, trimming \$279 million over 10 years from the Pentagon budget.<sup>19</sup> The Tenth QRMC examined this issue as well and identified larger savings by reducing an overlapping Department of Education program alongside streamlining the Defense school system.<sup>20</sup>

### Revising the Health Care Beneficiary Pool

Military health care coverage is another major part of compensation. This service is provided free for active-duty members, and there are no recommendations to change that. But this form of compensation continues long after a member has left the active-duty rolls, either by retiring or returning to inactivated Reserve Component status.

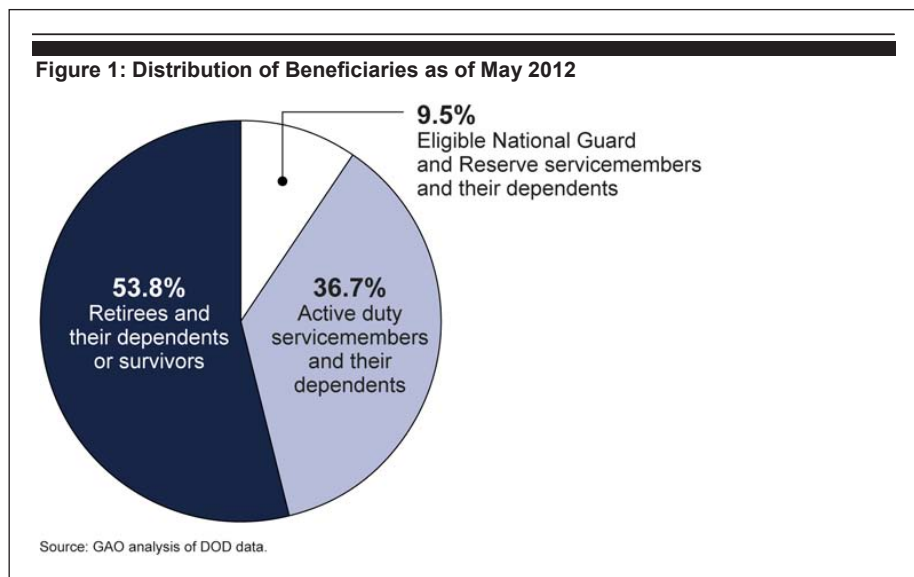


Figure 1: Distribution of Beneficiaries as of May 2012, “Additional Analysis of Costs and Benefits of Potential Governance Structure Is Needed, Government Accountability Office, September 2012, p. 6

The cost of a health care program depends foremost on how many people receive the benefit. That pool of non-active beneficiaries expanded for the military’s TRICARE program on several occasions during the last decade. “TRICARE for Life,” enacted as part of the fiscal year 2001 National Defense Authorization Act, introduced Medicare wrap-around coverage for seniors at no fee. “TRICARE Reserve Select” passed as part of the fiscal year 2005 authorization and expanded coverage to inactivated Reserve Com-

ponent members at premiums ranging from 28–85 percent of costs.<sup>21</sup> And “TRICARE Young Adult” was added in the fiscal year 2011 authorization to extend dependent eligibility through age 26 under some circumstances.

These expansions are one reason — precipitous health care inflation being another — that military health system costs grew from \$19 billion in 2001 to an estimated \$53 billion in 2013.<sup>22</sup> The relationship between health care benefits and military readiness also has been subject to question. The Center for Strategic and International Studies (CSIS) used TRICARE Reserve Select as an example. The Reserve Component “population knows they will get full coverage for free if they are called to active duty, a benefit that can, unfortunately, serve as a disincentive to enroll” in TRICARE Reserve Select. Another unanswered “question is whether [TRICARE Reserve Select] is a more cost-effective retention incentive for DOD than other options, such as increased direct compensation.”<sup>23</sup> That same issue may determine how effective benefits like Medicare wrap-around coverage are for recruiting and retaining young service members. The biggest and most direct health care savings might come from rolling back the extension of these benefits.

### Adjusting the Cost-sharing Ratio and Fee Structure

Within a set beneficiary pool, health care costs depend heavily on the respective share paid by the Pentagon and the inactive or retired beneficiary. Enrollment fees for working age (i.e., pre-Medicare-eligible) retirees on the TRICARE Prime rolls remained fixed at their 1996 values until fiscal year 2012. Those fees previously stood at \$230 per year for single beneficiaries and \$460 per year for those with families; they now cost \$270 and \$540 per year, respectively.<sup>24</sup> Meanwhile, CBO estimated that the fee would have had to more-than-double to keep pace with health care inflation.

**Table 9.**  
**Estimated Growth in TRICARE Prime’s Family Enrollment Fee Using Selected Measures, 1995 to 2008**

(Dollars)	Estimated Prime Fee <sup>a</sup>
Consumer Price Index (Medical)	760
Premiums for the Federal Employees Health Benefits Program	1,080
Gross Domestic Product Price Index	610
National Health Expenditures per Capita	960
<b>Memorandum:</b>	
Current TRICARE Prime Fee	460

Source: Congressional Budget Office based on the following: the medical portion of the consumer price index, from the Bureau of Labor Statistics; data on premiums (specifically, the average employee share) for the Federal Employees Health Benefits program, from the Office of Personnel Management; the gross domestic product price index, from the Bureau of Economic Analysis; and per capita data on national health expenditures, from the Centers for Medicare and Medicaid Services.


a. The estimated amount of the fee in 2008 if its growth had mirrored that in the measures noted. The original nominal value used for the calculations was \$460, the amount of the TRICARE Prime enrollment fee in 1995.

The Defense Advisory Commission on Military Compensation proposed asking working-age retirees participating in the most generous TRICARE plan to contribute at “levels commensurate with premiums and cost sharing in civilian employer plans.” After that reset, it would peg future increases to the annual military retirement cost-of-living adjustment.<sup>25</sup> The Tenth QRMC instead considered using Medicare Part B premiums as its benchmark for resetting the cost-sharing ratio and determining the annual increase. Under its plan, single working-age retirees would have paid 40 percent of the Part B premium and those with dependents would have paid 80 percent.<sup>26</sup>

Three years after the Tenth QRMC, in 2011, CBO reiterated the facts on this issue:

DoD has estimated that, in 2009, a typical military retiree and his or her family who enrolled in the [most generous] Prime plan incurred about \$860 in annual out-of-pocket costs (that is, TRICARE co-payments and the enrollment fee). By contrast,

Table 9. Estimated Growth in TRICARE Prime’s Family Enrollment Fee Using Selected Measures, 1995 to 2008, “The Effects of Proposals to Increase Cost Sharing in TRICARE,” Congressional Budget Office, June 2009, p. 21



again according to DoD's estimates, a similar retiree with family coverage who enrolled in an HMO through a civilian employment-based plan typically paid \$5,200 in premiums (not including the share paid by his or her employer) and copayments. TRICARE Prime beneficiaries also use the system more than do comparable civilian beneficiaries: DoD estimates that Prime enrollees use services at rates that are higher by 77 percent for inpatient services and 55 percent for outpatient services than the rates for civilian HMO enrollees.<sup>27</sup>

One CBO option in response to this situation projected the effects of raising the single working-age retiree fee from \$230 per year to \$550, and from \$460 per year to \$1,100 for beneficiaries with dependents. (Note these fees began growing with the retiree cost-of-living index in fiscal year 2012 and now stand at \$270 and \$540, respectively.) This would have approximately restored the cost sharing from when TRICARE was implemented in 1995, and future growth would have been indexed to health care inflation. CBO estimated that it could save \$29.7 billion from 2012-21.<sup>28</sup> The Rivlin-Domenici Task Force considered an option based on these terms, as well as introducing a small enrollment fee for Medicare-eligible retirees.<sup>29</sup>

Another CBO option considered excluding working-age retirees from TRICARE Prime, giving these beneficiaries a narrower choice of less generous plans. Some may find this appropriate because:

About three quarters of all retired military beneficiaries not yet eligible for Medicare have access to employer-sponsored insurance through civilian employment... In 1999, 55 percent of military retirees and their dependents had signed up for other health insurance, but by 2009 that figure had dropped to 29 percent.<sup>30</sup>

This option would have set the enrollment fee at 28 percent of costs for the less generous plans and raised the maximum out-of-pocket expense from \$3,000 to \$7,500. CBO estimated that this would save \$111 billion between 2012-21.<sup>31</sup>

The DBB in its 2005 study sought to place more of the cost burden on employers by recommending that TRICARE become a “secondary provider to ‘fill the gap’ for retirees for access to corporate health care.” TRICARE already is used as wrap-around coverage to their employer-provided insurance for Medicare-eligible retirees; this plan would have done the same for working-age retirees. Erosion in the cost-sharing ratio would have been managed by indexing fees to industry deductibles, co-payments, and premiums.<sup>32</sup>

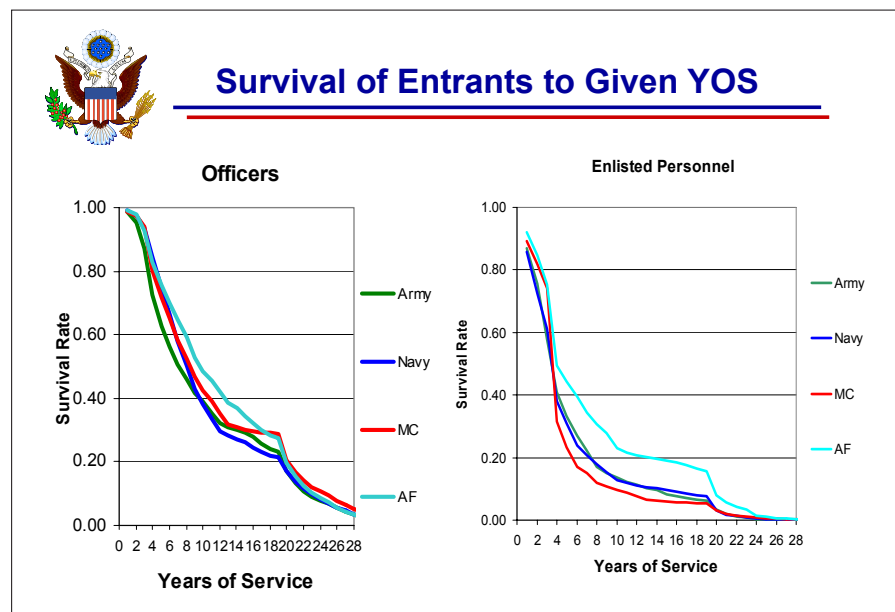
Cost sharing applies to co-payments for prescribed drugs as well. The Tenth QRMC reported that “the pharmacy benefit has been the fastest growing component of military health care since 2000” and consequently proposed setting prescription co-payments at roughly two-thirds of that paid by civilians. Importantly, the Tenth QRMC emphasized that, “prescriptions filled at military treatment facilities should continue to be dispensed at no cost.”<sup>33</sup> CBO likewise considered an option that would extend co-payments to military treatment facilities for beneficiaries not on active duty, finding \$13 billion in possible savings from 2012-21.<sup>34</sup>

Congress did allow annual enrollment fees to increase in fiscal year 2012 as well as to rise each year, but at a rate no quicker than the retirement cost-of-living index.<sup>35</sup> It took similar steps with respect to the pharmacy co-payment beginning in fiscal year 2013.<sup>36</sup> Still, the retirement cost-of-living index grows significantly slower than health care costs, meaning that the Department's health care costs will continue to increase. Now as part of its fiscal year 2014 request, the Obama administration has submitted, and Congress is considering, several more significant reforms of this type. The proposal would require greater cost sharing from all working-age military retirees. After a four-year phased increase, fees for the most generous plan would be bounded by a newly-created floor and ceiling within which they would be pegged to 4 percent of retirement pension income. These increases are substantial and would bring the cost-sharing ratio closer to its balance when TRICARE was created in 1995. Meanwhile, the Pentagon's request also would introduce enrollment fees and deductibles for its less generous plans.<sup>37</sup>

In addition to changes for working-age retirees, the Pentagon included similar proposals for Medicare-eligible retirees in its 2014 budget proposal. Specifically, it asked to introduce enrollment fees for the Medicare wrap-around plan and for those fees to be pegged to 2 percent of retirement pension income, also subject to a ceiling. Pharmacy co-payments "to fully incentivize the use of mail order and generic drugs" are considered for increases as well. Lastly, the \$3,000 catastrophic cap also would be indexed to retirement income.<sup>38</sup>

### Modernizing the Retirement Plan

The most unique part of military compensation is the retirement package. Vesting for the retirement plan operates on a "cliff" schedule. Personnel that separate prior to 20 years of service are not eligible for any benefits, and those retiring at or after 20 years of service receive a full and defined benefit. There is no gradual vesting; it is all-or-nothing, motivating personnel nearing eligibility to hang on until achieving it and then to separate immediately thereafter. Reciprocally, it provides no benefit to those who get out before then.




Survival of Entrants to Given YOS, "Military Retirement Committee Report," Defense Advisory Committee on Military Compensation, July 20, 2005, p. 7

According to a 2011 DBB study, constructing the benefit in this way has several adverse implications:

- First, the current military retirement system is unfair. For example, 83 percent of those serving in the military will receive no retirement benefit... This cohort includes the majority of troops who have engaged and will engage in combat... The distribution varies between officer and enlisted personnel; 43 percent of officers and 13 percent of enlisted personnel have historically received a pension.
- Second, the current military retirement system is inflexible and has disadvantages with regard to force shaping...
- Third, in light of the budget challenges DoD is currently facing, the military retirement system appears increasingly unaffordable. In FY11, the retirement plan will accrue 33 cents for each dollar of current pay, for a total of \$24 billion.<sup>39</sup>

Like the cash compensation system and the health care benefit, a number of components factor into the military retirement formula, and each can be revised in order to affect costs. Unlike cash compensation and health care, however, retirement components are especially interdependent. Savings options tend to come as package deals rather than as a menu from which decision-makers can choose. Often these pension packages will collectively consider age eligibility, vesting schedule, calculation of benefit, role of retention bonuses and gate pays, need for a “defined contribution” corollary / substitute, and grandfathering provisions.




### Previous groups have recommended overhaul

- **Defense Manpower Commission (1976):**
  - vest personnel in an old-age annuity after YOS 10
  - pay immediate annuity to Combat Arms personnel after YOS 20 & all others after YOS 30
- **President’s Commission on Military Compensation (1978):**
  - vest personnel in an old-age annuity after YOS 10
  - provide a cash transition fund financed by annual DOD contributions into a TSP-like account
- **President’s Private Sector Commission on Government Cost Control (1985):**
  - vest personnel in an old-age annuity after YOS 5
  - eliminate the second-career annuity
- **Three recent DOD study groups recommended systems similar to Federal Employee Retirement System (FERS)**
  - FERS vests early
  - provides combination of old-age annuity & TSP contributions

Previous Groups Have Recommended Overhaul, “Military Retirement Committee Report,” Defense Advisory Committee on Military Compensation, July 20, 2005, p. 5

The Defense Advisory Commission on Military Compensation suggested a gradual phase-in of its recommendations. All currently serving military personnel would have been grandfathered to remain in the current system but also could have chosen to accept voluntary buy-outs after 10 years in selected occupations or to opt into DACMC’s new system. Savings would have accumulated more slowly than if some members were not grandfathered, but more quickly than if some service members didn’t have the buy-out or opt-in choices.



New members entering the service would have been enrolled automatically in a new retirement system that distributed the benefit between working-age and full retirement. It would have introduced a defined contribution equaling approximately 5 percent of base pay into a thrift savings or 401(k)-styled plan. Members would have begun saving immediately and the government contributions would have vested between five and 10 years of service. Standard rules would have allowed members to benefit from these types of plans while still of a working age. For full retirement, the Pentagon would have continued offering a defined benefit annuity. Cliff vesting would have been replaced by a graduated schedule from 10 to 40 years of service, with those reaching 40 years receiving 100 percent of their average pay from their highest earning three years. Payout would have been postponed to age 60, though retirees would have remained eligible for health benefits after 20 years of service. “Gate pays” at major career benchmarks would have helped retain personnel with high-demand skills while “transition pay” would have helped ease a member’s return to civilian life if the demand for their skills lessens.<sup>40</sup>

The Tenth QRMC’s retirement plan shared many of the same reforms as DACMC’s but handled them somewhat differently. It also would have introduced a defined contribution plan alongside the defined benefit, but would have pushed payout eligibility later for both of them. The defined contribution element would have offered up to 5 percent of base pay, depending on years of service, and would have vested at 10 years, but it would not have begun paying out until age 60. Meanwhile, the defined benefit plan would have kept its calculation formula (i.e., High-3 pay x 0.025 x YOS) and also would have vested at 10 years. Payout would have been delayed, however, to age 57 for those that serve 20 or more years, and to age 60 for those that serve between 10 and 20 years. Like DACMC, the Tenth QRMC also incorporated gate and transition pays to help manage retention more precisely.

The pace of any savings generated by the Tenth QRMC plan was unspecified. Rather than considering a specific implementation plan, the Tenth QRMC suggested a gradual transition beginning with a multi-year demonstration project. Final terms of the plan, including the schedule and the savings estimate, would have been determined after that test.<sup>41</sup>

The Rivlin-Domenici Task Force considered a third package based largely on updates to RAND’s 1998 study, “Reforming the Military Retirement System.” Writing eight years before the DACMC and 10 years before the Tenth QRMC, RAND tackled the same retirement concerns. “The military retirement system has been subject to numerous criticisms, including that it is unfair to pre-20 years of service separatees, excessively costly, inefficient, and inhibits force management flexibility.” The alternative developed in that study had three parts:

The first is a retirement plan that is very similar to FERS, the retirement plan for civil service employees, which we call the Military Federal Employees Retirement System, or MFERS. The second part is a 7 percent across-the-board pay increase to compensate members for mandatory contributions to the retirement plan, and the third part is a set of retention bonuses targeted to specific groups (such as occupations) to address any retention problems. MFERS would also consist of three parts: Social Security benefits, a defined benefit plan (called the

basic plan) that vests employees at five years of service in an old-age annuity, and a defined contribution plan (called the thrift savings plan) that vests employees at three years of service and that matches employee contribution up to five percent of basic pay.<sup>42</sup>

This plan might have saved \$3 billion from 2012-20, according to the Rivlin-Domenici Task Force's updates to RAND's calculations. That projection assumed that personnel with more than 15 years of service would have been grandfathered to remain in the current system and that benefits would have paid out at age 57.<sup>43</sup>

The DBB's October 2011 assessment is the most current and aggressive retirement reform package. Several findings were especially emphasized in the DBB's study and may have motivated this appetite for reform. "The military retirement system has not materially changed for over 100 years," the Board noted. Today, "retirement funds accrued for personnel serving less than 20 years are effectively applied to the benefits of those serving more than 20 years. For those serving more than 20 years, the retirement contribution is 10 times greater than the private sector."<sup>44</sup>

The DBB responded to this analysis by proposing a wholesale replacement of today's defined benefit system with a new defined contribution plan based on the Uniformed Military Thrift Savings Plan currently in place. Government contributions would have varied based on force management needs to include increasing the benefit for combat service, but generally would have been "comparable to the highest end of a private sector pension plan."<sup>45</sup> Vesting could begin as early as after the first recruitment period, and payout would have started between the ages of 60 and 65. Some partial withdrawals prior to age 60 would have been permitted, including to facilitate transition to a second career or to cover costs associated with education, health care, and emergencies. All current retirees would have been grandfathered to remain in the current system. The pace of potential savings would have depended on how far into the current force that grandfathering provision was extended. The DBB considered options at either end of that spectrum, either no grandfathering for the current force or full grandfathering for the current force.

*Bloomberg Government (BGov)* estimated the savings should the DBB plan be implemented. It assumed that the entire current force gets grandfathered to remain in the current system, and that recruits in 2013 – the first service members to enter into the new system – would have arrived in the same numbers as 2009. Savings came from the difference in the percentage of average salary that the Pentagon has to accrue to cover retirement obligations. Thirty-three percent of military pay presently is required, but BGov projected that only 16.5 percent would be needed under the DBB plan. On the basis of those accrual rates and BGov's assumptions, savings would have been \$37 billion between 2013-21.<sup>46</sup>

### Parameters for Possible Savings

Our service members are the military's most important asset, and their compensation is only part of what the country owes them. But the specific policies are not sacred in and of themselves. There may be ways to achieve savings even while better caring for our service members. Nevertheless, these are politically-fraught questions and their answers cannot be assumed. The table below displays possible savings for the options presented above.



**APPROXIMATE POSSIBLE SAVINGS IN BILLIONS OF DOLLARS OVER 10 YEARS**

Adjusting the formulas for cash compensation growth	\$20-\$30
Pegging pay to specialization in high-demand areas	\$10
Transfer non-cash compensation into cash compensation	\$10
Curtail pool of health care beneficiaries	\$90-\$100
Increase health care fees and cost sharing	\$40-\$110
Modernize military retirement	\$5-\$40
<b>Total Possible Savings</b>	<b>\$155-\$300</b>





## MORE EFFICIENT UTILIZATION OF MANPOWER

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The United States depends on a professional force of volunteers to provide the best military in the world. Volunteers that step forward to serve our country are the U.S. military's most important asset, and the U.S. must be committed to using them as deliberately and efficiently as possible. That could include: streamlining duplication and redundancy, reducing infrastructure billets, concentrating service members on inherently military functions, trimming civilian manpower and contractor support, and better balancing between the active and reserve components.

### Streamlining Duplication and Redundancy

Streamlining duplication is a common way to cut overhead. Duplication in the military can be most visible between the three separately-organized military departments – Army, Navy, and Air Force. Then-General Colin Powell's 1993 "Roles, Missions, and Functions" study, prepared in his capacity as Chairman of the Joint Chiefs of Staff, is seminal in this regard. Acknowledging that not all redundancy is bad, Powell focused on locating "unnecessary" duplication, selecting for review those areas in which "two or more Services perform similar tasks, where restructuring might generate significant cost savings, and where changes in our strategy and force structure made a comprehensive review appropriate."<sup>47</sup> That principle is one that might be applied to the following examples:

- **SATELLITES:** Responsibilities for acquiring space systems are diffused across various DOD organizations—including the military services and the Missile Defense Agency—as well as the intelligence community and [NASA]... Each military service or agency that acquires space systems has its own lines of acquisition authority... A single authority responsible for ensuring coordination and setting priorities... would be in a better position than any one department or agency to determine the best use of limited funds and resources by more effectively prioritizing the most highly-needed space programs, and would have the authority to reduce duplication across programs.<sup>48</sup>
- **DEPOTS:** The organic depot maintenance enterprise is large, incorporating 17 major facilities, 77,000 civilian employees, and annual operating expenses in excess of \$16 billion... There is a persistent question as to whether the overall organizational management structure of these activities is sufficiently flexible, responsive, and cost effective... By law and mission, the military services have the responsibility for planning and executing maintenance programs to meet their operational needs, and to provide the resources to satisfy those requirements... The current structure further hinders performance by the total depot enterprise, effective resource allocation for the full depot workload, and timely accomplishment of major innovations across organizational and functional lines.... A full and comprehensive reassessment of the current depot management organizational structure is overdue.<sup>49</sup>
- **INFORMATION SYSTEMS:** DOD reports that its business systems environment [e.g., civilian personnel, finance, health, logistics, military personnel, procurement, and transportation] includes about 2,300 investments... DOD's business systems environment has been characterized by (1) little standardization, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, and (4) manual data entry into multiple systems... Because DOD spends over \$10 billion each year on its business systems and related information technology infrastructure, the potential

identifying and avoiding the costs associated with duplicative functionality across its business system investments is significant.<sup>50</sup>

- **FACILITIES MANAGEMENT:** The services have not reduced spending in concert with the decrease in square footage resulting from the completion of base closures in the past 10 years. While square footage fell by 21 percent, spending increased by 18 percent in real terms. Spending for facilities maintenance is now at close to 100 percent of requirements, and the services have also benefited from additional funding provided in base closure funds for consolidations.... [The Simpson-Bowles Fiscal Commission] option would reduce facilities maintenance spending on buildings by \$1.4 billion or 18 percent below the \$7.7 billion estimated for 2015.<sup>51</sup>

- **HEALTH SERVICES:** Under the current structure of DOD's Military Health System, the responsibilities and authorities for its management are distributed among several organizations—including the Assistant Secretary of Defense for Health Affairs and the military services. Health Affairs is responsible for creating and submitting a unified medical budget and allocating funds to the military services for their respective medical systems; however, Health Affairs lacks direct command and control of the services' military treatment facilities. Additionally, the three departments each have Surgeons General to oversee their deployable medical forces and operate their own health care systems, including training for medical personnel... [Per GAO's 2011 "Duplication" Report,] realigning DOD's military medical command structures and common functions could increase efficiency and result in projected savings ranging from \$281 million to \$460 million annually.<sup>52</sup>

Unnecessary duplication may not be limited to just these cases. Others could include chaplains, judge advocate generals, meteorologists, linguists / translators and possibly more.

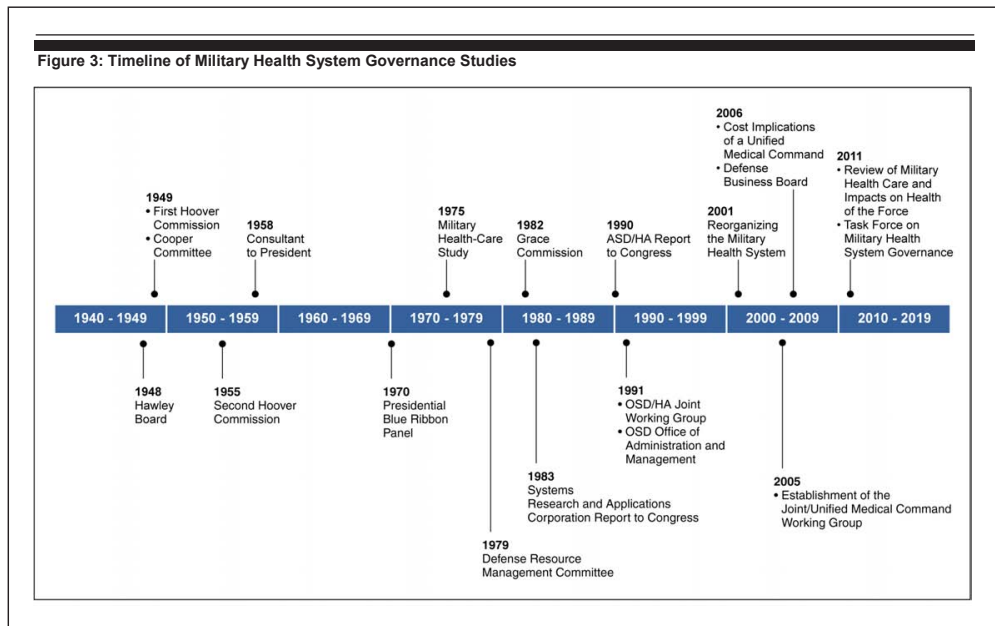


Figure 3: Timeline of Military Health System Governance Studies, "Additional Analysis of Costs and Benefits of Potential Governance Structure Is Needed," Government Accountability Office, September 2012, p. 9



### Reducing Infrastructure Billets

The relationship of our military's combat "tooth" to the overhead "tail" that supports it is another well-established measure of personnel efficiency. In 2010, the McKinsey Corporation compared 30 industrialized states, including many NATO Allies and potential rivals like China and Russia, and found that only Switzerland has a ratio of combat-to-noncombat forces smaller than the U.S.<sup>53</sup>

Maximizing productivity in the tail could potentially save money by reducing the size of the force. The Defense Manpower Requirements Report noted in 2011 that 35 percent of the active-duty force is in an infrastructure billet. Three-quarters of those infrastructure positions belong either to central training, defense health, central personnel administration, or departmental management.<sup>54</sup> The Rivlin-Domenici Debt Reduction Task Force, convened by the Bipartisan Policy Center, argued that military end-strength could be lowered by 100,000 to control infrastructure positions.<sup>55</sup>

### Concentrating Service Members on Inherently Military Functions

Defining activities that are inherently governmental, and further, those that are inherently military, is essential to managing which duties are performed by service members, which by civil servants, and which by contractors. The DBB determined in 2010 that 340,000 service members are performing commercial duties that do not need to be performed by service members. Its recommendation was direct: Eliminate 10 percent of the military's commercial activity positions. It projected saving \$5.4 billion annually as a result, based on a \$160,000 troop per year estimate.<sup>56</sup>

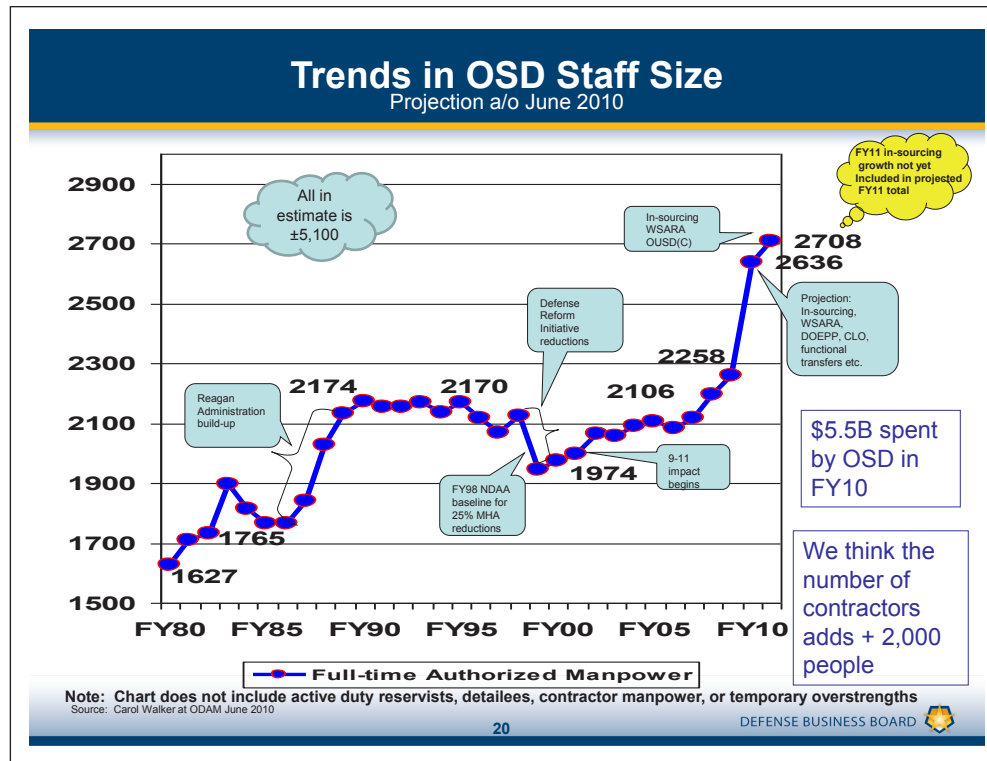
The Simpson-Bowles Fiscal Commission's staff-built illustrative savings also reiterated the DBB's conclusion and matched its savings, but by converting contractors to civil servants:

This option eliminates 88,000 military personnel who are performing clearly commercial types of activities and replaces them with 62,000 civilians, at considerable per-employee savings. One-third of the military positions can be eliminated during the conversion because civilians are not required to carry out military-specific duties on top of their commercial duties... this option standardizes the share of military performing these commercial types of work, adopting the lowest rate of military participation among the services, and converting the number of positions above that level to cheaper civilian slots.<sup>57</sup>

Converting military billets to civil service positions, as the Fiscal Commission considered, would have generated savings in part because health care cost sharing, retirement benefits, allowances, and in-kind compensation cost the federal government substantially less for civilians.

### Reduce Civil Service and Contract Personnel

It may be possible to simply reduce the number of civilian personnel as well; 791,000 civil servants work for the Pentagon, in addition to the 1,478,000 uniformed personnel.<sup>58</sup> The DBB highlighted growth among civil servants just in the Office of the Secretary of Defense (OSD). Using those figures, OSD has grown by 37 percent since the September 11th attacks. The DBB suggested cutting civil servant employment across the Pentagon back to its fiscal year 2003 level of 650,000 personnel, or by 15 percent, whichever is greater.<sup>59</sup>



Trends in OSD Staff Size Projection a/o June 2010, "Reducing Overhead and Improving Business Operations: Initial Operations," Defense Business Board, July 22, 2010, p. 20


The Defense Department also relies heavily on contractors to perform many duties. Pentagon Comptroller Robert Hale estimated the contractor workforce at 300,000 full-time equivalents in February 2012 testimony before the Senate Budget Committee.<sup>60</sup> As with its recommendation on civil servants, the DBB recommended returning contractor spending across the Pentagon to fiscal year 2003 levels.<sup>61</sup>

Congress turned to these issues in the fiscal year 2013 National Defense Authorization Act. That legislation requires the Pentagon to reduce civilian personnel and service contractor costs in proportion to "the savings in funding for basic military personnel pay achieved from reductions in military end strengths."<sup>62</sup>

Past debates focused on whether outsourcing work to contractors was cheaper than relying on civil servants, but the most recent decade has been characterized more simply by growth. While these approaches to finding efficiencies were blunt, they addressed those recent increases rather than the previous, finer debates about whether civil servants or contractors are cheaper.

### Balance between Active and Reserve Components

Many tasks are inherently military and cannot be considered for shifting to either civil or contracted personnel. But not all service members carry the same cost burden, and some believe that savings



can be reaped by re-examining how different types of military manpower are used. Reservists and National Guardsmen are a much more scalable labor force, for instance, able to surge specifically when needed and require less cost when not needed. The Reserve Forces Policy Board determined in a January 2013 report that Reserve Component personnel have a fully-burdened cost to the Pentagon that is less than a third that of Active Component personnel –\$34,272 relative to \$108,307. These figures include health care, dependent education, family housing and commissary benefits, in addition to salaries.<sup>63</sup>

The Reserve Component is and will continue to be a way to maintain the capability to conduct less probable missions without bearing as much of the cost. In its latest budget priorities statement, the Pentagon similarly said it “will maintain key combat support capabilities such as sustainment as well as combat service support capabilities such as civil affairs maintained at a high readiness level in the Reserve Component.”<sup>64</sup> It may be possible to save money by locating additional capabilities in the Reserve Components.

Rebalancing between the traditional Active and Reserve Components also could be a way to increase manpower flexibility and potentially save money. Easing service members’ ability to flow from one type of commitment to another is a more direct, but also more unusual, approach. The division between the Active and Reserve Components is stark at present. CSIS envisioned this polarized model being replaced by a “continuum” model:

The 39-days-a-year ‘one size fits all’ [Reserve Component] model is no longer adequate. In some cases... it unduly constrains DoD’s ability to develop units in high demand specialty areas comprised of individuals who are willing to put in more than 39 days a year. Conversely, it may also complicate DoD’s efforts to develop nontraditional contracts for reservists who can perform critical functions without needing to drill one weekend a month plus two weeks of training a year. Manning and maintaining the operational reserve could be greatly facilitated by fully implementing what the Department of Defense calls a ‘continuum of service’ approach, in which individual reservists can seamlessly transition in and out of active service to meet various mission requirements over a lifetime of service. At the core of this concept is the notion of creating many more ‘on ramps’ and ‘off ramps’ between active duty and reserve duty in the US military.<sup>65</sup>

Such an approach might have optimized savings by allowing service members to transition between active and inactive statuses as rapidly as the demand for their skills changes. Reserve Component professionals in specializations like medicine, law, finance, and public affairs – as well as potentially those in fields like logistics and civil affairs – often have very similar civilian jobs, benefit from training and education in those jobs, and face irregular peaks and valleys in the military’s demand for their skills. They may have the ability to flow seamlessly into and out of service. Building a framework that allows them to do so may better match labor supply and demand. Savings could flow from permitting more missions to be located in a “less-than-active” force and by minimizing the time needed for mobilization when required.



### Parameters for Possible Savings

The ideas presented above represent some of the ways that utilizing manpower more efficiently may make it possible to save money. Most of these ideas have been discussed many times. Some have been implemented at least partially, while others still seem unadvisable to most. Together, they provide a range of possible savings, as described in the table below. What savings can actually be achieved is a question of political judgment rather than simply analysis.

#### *APPROXIMATE POSSIBLE SAVINGS IN BILLIONS OF DOLLARS OVER 10 YEARS*

Streamlining redundancy and duplication	\$25
Reducing infrastructure billets	\$100
Concentrating service members on inherently military functions	\$50
Reducing civilian manpower	\$200
Relying less on contractor support	\$110
Better balancing between the active and reserve components	\$35
<b>Total Possible Savings</b>	<b>\$520</b>



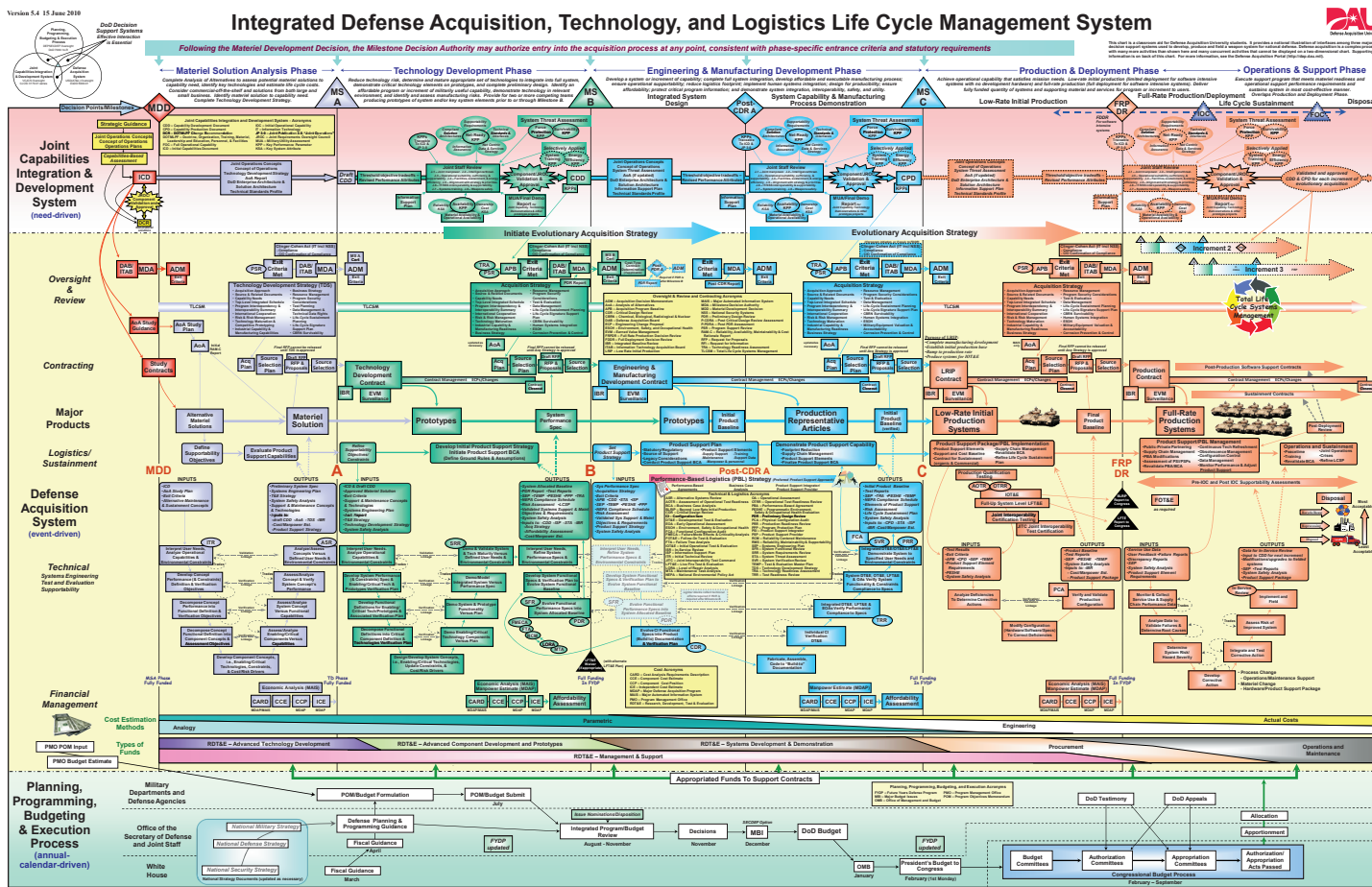





# BETTER ACQUISITION PRACTICES

The Pentagon has spent more than \$360 billion on contracts in each of the last three years, and more than \$200 billion of that through its procurement and research and development appropriation titles.<sup>66</sup> Weapon programs tend to be the most visible acquisitions, but contracting also includes very sizeable sums spent on services, information technology, and commercially-available goods. Many believe these sums are not spent as efficiently as they could be. The Government Accountability Office's "high risk list" has included defense weapons system acquisition since 1990. It likewise has included defense contract management since 1992.

Related to, but broader than, acquisition practices is the issue of financial management. Transparency and accountability are keys to efficiently administering any account at any government agency. Since defense investment is so sizeable, the topic comes up especially frequently for the Pentagon with respect to its acquisition programs. Defense financial management likewise has been on GAO's high-risk list since 1995.



Integrated Defense Acquisition, Technology, and Logistics Life Cycle Management System, Version 5.4, Defense Acquisition University, June 15, 2010.



Many studies and commissions over the years have offered recommendations of how to reap efficiencies and savings from the acquisition process. These recommendations can be binned into the following categories: constructing contracts, managing the acquisition workforce, committing to best practices, and generating requirements.

### **Constructing Contracts**

Government contracts come in many different types. Contract vehicles can set an up-front price when the government and the provider are especially clear about what is to be delivered or, when what is desired is less clear, the contract can provide for regular invoicing with a profit margin on top. The contract award can be determined based on the lowest price to minimize the government's total cost or based on best value to maximize the government's return on each dollar spent. Acquisitions can be made on a year-by-year basis to hedge the government's commitment or on a multi-year basis to reap the efficiency advantage from economies of scale.<sup>67</sup>

All these choices have cost ramifications. They can be subdivided into contractor selection, comparisons between different contract types, and the interaction between government and contractor.

In its Better Buying Power Initiative, begun in September 2010 ("Version 1.0") and updated in November 2012 ("Version 2.0"), the Pentagon emphasized a need to clarify different standards for selecting among contractors proposals. "Best value" evaluates how well the contractor can do what it claims even if its bid is not the lowest. But the Pentagon argues that "industry tends to default to threshold performance levels because they are less costly and source selections seldom give predictable credit for performance above threshold." An insufficient understanding of how "value" is judged may mean that contractors are not defending higher costs on the grounds that their value warrants it. "Lowest Price – Technically Acceptable" is another structure for making a selection, but the Pentagon similarly noted that these competitions "essentially default to the lowest bidder, independent of quality." Better evaluations of benefits relative to costs underpin the Better Buying Power emphasis on defining both "best value" and "technically acceptable."<sup>68</sup>

Comparisons between contract types also have been recurring parts of the debate. DBB has been clear that contract type is not the defining problem for cost overruns. Still, in a January 2010 report it did determine that the "preferred choice is fixed-price, then cost-plus, then time and materiel contracts." It also counseled using incentives in both cost-type and fixed-price vehicles as a way to balance risk and motivate superior performance.<sup>69</sup>

The 2005 Defense Acquisition Performance Assessment (DAPA) took a wholly different approach and challenged how government fundamentally interacts with contractors. Rather than the current solicit-and-respond structure that governs contract types generally, it suggested that the Pentagon propose regulatory changes that would "formalize a risk-based source selection process in which cost proposals are replaced by industry and government agreements on most probable cost. An affordability determination is then made to determine when proposals are within the competitive range ..."<sup>70</sup> Under this model, costs would have been determined in a more collaborative and iterative interaction with



industry, compared to a current approach that hinges more heavily on either accepting or rejecting a contractor's cost proposal.

In each of these issues – selecting a contractor, alternatives between contract types, and the interaction between government and contractors – more informed choices may lead to more efficiency.

### **Managing the Contracting Workforce**


All acquisition reforms depend on the judgment of the government acquisition professional that oversees the contract. The way that the Pentagon constructs and manages this workforce greatly influences how well the acquisition system functions. Concern about civil servants' acquisition career paths date back at least to the 1986 Packard Commission, a Presidential-level task force led by former Deputy Defense Secretary David Packard. It found that:

The existing civilian personnel management system has not, however, allowed similar improvements in career paths and education for civilian acquisition personnel [relative to the military workforce]. To attract and retain a good work force requires a more flexible system for management of contracting officers... Major innovations in personnel management and regulations are needed.<sup>71</sup>

Writing in January 2010 and again in April 2012, DBB underscored the need to make defense acquisition an attractive career prospect, especially by defining the key elements of a career path.<sup>72</sup> Those elements included “a tour with industry ... prior to being a program manager,” “expanding programs like the Defense Fellows Program with industry,” and considering ways to create incentives for military personnel to pursue acquisition careers.<sup>73</sup>

A House Armed Services' Committee panel co-chaired by Rep. Rob Andrews (D-NJ) and Rep. Mike Conaway (R-TX) also reiterated needs similar to those identified by the Packard Commission. This panel, charged by the committee with a full review of defense acquisition, recommended that the Pentagon improve this career path by taking full advantage of authorized pay incentives and by institutionalizing standards, including for recertification.<sup>74</sup> Business Executives for National Security (BENS), a nonprofit organization that channels private sector executive expertise into national security issues, also tackled the issue. It raised the options of streamlined hiring and dismissal and a review of ethics regulations for the benefit they offer relative to the barriers to entry they impose.<sup>75</sup>

The Pentagon's approaches to improving the contracting workforce have addressed the total staff cadre generally and acquisition leaders specifically. One workforce-wide initiative has concentrated on size. Then-Secretary Gates decided as part of the 2010 budget request to insource 11,000 contract acquisitions professionals and to add an additional 9,000 positions in order to better oversee requirements creep.<sup>76</sup> The Pentagon's 2014 budget overview reported that 7,700 of those new positions have been filled to date, though it also noted that the Department will “shift in focus from primarily recruiting and hiring, to training and continuous improvement in the qualifications and experience set of the acquisition workforce.”<sup>77</sup>



Should all of these 20,000 new personnel be added to the civil service, it would take the total acquisition workforce from 127,000 to 147,000 people, according to another January 2010 DBB report.<sup>78</sup> This 16 percent increase raised concern about “chasing the numbers” rather than focusing on quality. The DBB report responded emphatically: “Bigger isn’t better; better is better.”<sup>79</sup> Its primary recommendations for Services and Components to focus foremost on quality and skill-based hires followed closely on that finding. Engineers involved in acquisition oversight and decision-making received particular attention when DBB returned to this topic in April 2012.<sup>80</sup>

Leadership of the acquisition workforce also is a point of emphasis for the Pentagon. Its Better Buying Power 2.0 Initiative was direct about the goal to “establish higher standards for key leadership positions.” Qualifications, not just certifications, were the standards on which it focused, including experience, education, and training.<sup>81</sup>

Meanwhile, DAPA considered the structure of acquisition management. One part would have included an elevated role for Service Acquisition Executives to “ensure that clear lines of responsibility, accountability, and authority for program execution are established and maintained.” It similarly would have:

...establish[ed] Four-Star Service Systems Commands that... will be responsible for aligning the acquisition workforce to include requirements and acquisition budget personnel, by establishing appropriate certification requirements based on formal training, education and practical experience. This organization provides advocacy for the acquisition workforce and will institute formal and informal mentoring of program managers.<sup>82</sup>


DBB shared this focus on management. Rather than creating new institutions, however, it focused on the service chiefs’ existing responsibilities. In its own words, “the Service Chiefs, in collaboration with senior acquisition leaders, should be accountable for the career path management, training, education, and particularly promotions and equal promotion rates of military acquisition personnel, as required by law.”<sup>83</sup>

Whether it’s the leadership, the full cadre of the acquisition workforce, or the management structure that guides how the two interact, better oversight and implementation may equate to an across-the-board improvement in acquisition efficiency.

### **Coming to Best Practices**

Contracts’ terms and the workforce that manages them are key parts of the structure for defense acquisition. Within that structure, acquisition practice also is a significant indicator of efficiency. This section now turns to techniques that may qualify as best practices.

Given the longstanding cost growth in acquisition programs, affordability is one of the most basic concerns. The Pentagon’s Better Buying Power 2.0 initiative favored affordability caps for programs. Specifically, it would have demanded long-term “investment planning to derive affordability caps;” used those



affordability caps to “force prioritization of requirements;” and urged senior acquisition officials to “halt programs that will not be within the established cap.” In other words, cancel programs that have lost control of costs. Better Buying Power 2.0 also sought to “implement ‘should-cost’ based management,” in which the cost a program should incur is used as an analytical and negotiating counterweight to what the program actually is costing.<sup>84</sup>

Timeliness also has drawn particular attention as programs tend not only to exceed their budgets but also to suffer schedule slips. DAPA sought to improve timely and reliable delivery by prioritizing time in developing a program. It would have:

...establish[ed] Time Certain Development as the preferred acquisition strategy for major weapon system development. These strategies will require delivery of the first unit to operational forces within approximately six years of the Milestone A decision. Through early fielding of a basic capability, operational users will gain a clearer understanding of requirements that should be incorporated during future block or spiral upgrades, and technologies will mature that will enable producers to satisfy those requirements. Time Certain Development differs from “evolutionary acquisition” in that a specific time frame is established in which useful military capability will be fielded... The time frame will not be adjusted to accommodate new requirements or capability enhancements prior to fielding the useful military capability.<sup>85</sup>

CSIS also explored acquisition timeliness in its “Beyond Goldwater-Nichols” analysis. It noted options for expediting an acquisition program and recommended increasing that authority for defense-wide rapid acquisition. Specifically, it proposed waiving and exempting the Joint Rapid Acquisition Cell from “regulations that impede responsive acquisition,” as well as endowing it with a billion-dollar capital fund pulled from unobligated balances.<sup>86</sup>

The Andrews-Conaway panel took yet another path. It concluded that:

...for the most urgent operational needs, special acquisition processes are clearly warranted. At the same time, the Panel believes the Department and Congress should not accept program development timelines routinely measured in the double digits for most of the Department’s needs as this approach will not be responsive to the Department’s operational requirements. The Panel believes that the Department must begin to actually apply its policies expressing a preference for evolutionary acquisition and open systems architecture in ways which result in different acquisition strategies and shorter development timelines.<sup>87</sup>

Tailoring the contract process based on the need being met was again a theme for the Andrews-Conaway panel as it considered information technology. In the words of a witness before the panel, the standard acquisition process is:

Ill-suited for information technology systems. Phase A is intended to mature technology; yet information technologies are now largely matured in the commercial sector. Phase B is intended to ready a program for production; yet information technologies are not produced in quantity.

Phase C is a production phase, which again is generally not relevant to information technology that is not produced in quantity.<sup>88</sup>

The consequences of this mismatch between the good being acquired and the process for acquiring it was clear to the panel:

The Department is unable to keep pace with the rate of IT innovation in the commercial market place, cannot fully capitalize on IT-based opportunities, and seldom delivers IT-based capabilities rapidly. By way of example, the private sector is able to deliver capabilities and incrementally improve on those initial deliveries on a 12 to 18 month cycle; defense IT systems typically take 48-60 months to deliver. In an environment where technology is obsolete after 18 months, defense IT systems are typically two to three generations out of date by the time they are delivered.<sup>89</sup>

The Andrews-Conaway panel responded to this assessment by recommending a separate acquisition process for information technology, including milestone decision points more aligned with how the private sector develops these tools. The Defense Science Board (DSB) also reached this conclusion in a 2009 acquisition study, and it offered even more detail: IT acquisition should occur in rapid increments driven by successful prototyping in order to keep up with the pace of IT change, according to DSB, and capabilities should be released as they become available even within increments.<sup>90</sup> In a larger frame, both of these positions were responses to a need for the acquisition process to adapt according to the type of goods or service being acquired.

Regulations affect how adaptable the acquisition process can be and defense acquisition is subject to a massive scale and fine detail of regulation. The Packard Commission found 26 years ago that “federal law governing procurement has become overwhelmingly complex.” Commissioners felt so strongly about this problem that they recommended a wholesale recodification of government-wide procurement into a single law.<sup>91</sup> Yet these regulations still continue to frustrate. From the Pentagon’s viewpoint, one example has been its Better Buying Power 1.0 announcement that it would “work with Congress to eliminate the requirement for the full suite of Nunn-McCurdy [cost breach] assessments and reporting activities in special circumstances where quantity-induced or other external reasons cause critical breaches to occur.”<sup>92</sup>

The business community also has its concerns about procedural rigidity and a corresponding perspective on regulatory flexibility. According to BENS:

A key to fundamental, systemic change lies with the Congress, which, through the body of Federal law and its oversight function, shapes the regulatory framework and influences the culture of defense acquisition. Any attempt to fix the system must first consider the antecedent of today’s dysfunctional acquisition system, the body of acquisition law. Fundamental reform of that body of law is clearly something neither the Pentagon, nor even the Executive Branch, can undertake alone. The Task Force believes the impetus for reform must originate with Congress.<sup>93</sup>



DBB likewise returned to the Packard Commission's position in its April 2012 report, urging the Executive and Legislative Branches to "zero base the entire system, including all directives and regulations."<sup>94</sup> Later it identified several regulations it would cut to help improve the relationship between industry and the Pentagon. Specifically, it favored Congress and the White House "minimizing financial disincentives, limiting recusals, allowing true blind trusts, providing tax incentives and longer divestures in adverse markets," as well as "reassessing the post-government prohibitions in order to shorten the time period and limit the scope of coverage to specific programs."<sup>95</sup>

Prototyping is another frequently mentioned best practice, one that is specific to the acquisition of goods. Extensive evaluation of prototype technologies, for instance, may provide firmer understandings of cost and capability, permitting better managerial decisions as the program moves into procurement. The Pentagon's Better Buying Power 2.0 initiative set the goal of being more stringent in how proof-of-concept demonstrations are conducted.<sup>96</sup> Prototyping was captured as well by the Packard Commission, which prioritized "building and testing prototype systems and subsystems before proceeding with full-scale development."<sup>97</sup> DSB in 2009 also emphasized prototyping as a way to achieve "more thorough analysis ... at the outset of system development and during key aspects of the development process."<sup>98</sup>

The risks of a development program can be avoided altogether if the needed system already exists. DSB argued that, when possible, the Department of Defense should purchase systems proven on the commercial market rather than a new development program. "Many advanced capabilities are available on the commercial market and offer an important option for supplying U.S. forces," DSB determined.<sup>99</sup> Part of acquisition best practice is knowing when to take advantage of these already available capabilities.

DSB concluded its report with a far-reaching observation on best practices: "you can and will only improve what you can measure." It did not find a particular shortcoming in the Pentagon on this count but rather reiterated that "the Secretary of Defense must personally insist on continuous improvement." It therefore recommended that:

The Secretary of Defense, with the Under Secretary of Defense for Acquisition, Technology, and Logistics at the lead, should develop acquisition performance metrics for monitoring the newly reengineered acquisition process – monitoring each program against performance metrics for cost, schedule, and quality, with quarterly reporting. The metrics should be visible to all.<sup>100</sup>

Measurement is the essence of a much more general discussion about defense financial management. The Pentagon is one of three federal agencies unable to meet the standards of financial audit and the only one that lacks even a qualified audit.<sup>101</sup> This is different than failing an audit. Rather, much of the Pentagon lacks the data fidelity to begin an audit. GAO includes defense financial management on its high-risk list out of concern over "DOD's ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; pre-

vent and detect fraud, waste, and abuse; address pressing management issues; and prepare auditable financial statements.”<sup>102</sup>

In response to these financial management challenges, the fiscal year 2010 defense authorization required the Pentagon to achieve audit readiness by September 2017. In October 2011 testimony before the House Armed Services Committee, then-Secretary Panetta accelerated the deadline for a core element of the audit package to 2014. Congress codified that sub-goal in the fiscal year 2013 defense authorization.<sup>103</sup> This partially fulfills one aspect of the HASC Andrews-Conaway Panel’s recommendation to comply with the audit standard well before 2017. That panel was firm in its belief that the full deadline should move forward, however, on the grounds that “failure to do so is fundamentally incompatible with the spirit of acquisition reform.” Consequently, it also recommended that Congress’ defense committees withhold funding or apply penalties in the absence of clear and quick progress.<sup>104</sup>

More rapid, flexible, accountable, and strategic acquisition – all elements of best practice – have clear connections to efficiency.

### Generating “Requirements”

Each of these acquisition process options has attracted the attention of experts and senior leaders. Many believe, however, that they have a common root. The Packard commission in 1986 found the acquisition systems’ problems “begin with the establishment of approved ‘military requirements’ for a new weapon, a step that occurs before development starts.”<sup>105</sup> Twenty-four years later, the Andrews-Conaway panel encountered the same sorts of problems. “The Panel heard at almost every hearing, regardless of the primary content focus of the hearing, that obtaining consistent, realistic requirements as a basis for the acquisition process is a critical problem in the defense acquisition system.”<sup>106</sup>

The Pentagon’s Better Buying Power 2.0 initiative included a specific determination: “More than anything, requirements drive cost.”<sup>107</sup> On that topic, it aimed to “improve requirements definition; prevent requirements creep,” especially by improving the quality of planning.<sup>108</sup> In its April 2012 report, DBB was equally frank: “Freeze requirements early after cost, schedule, and technical feasibility trade-offs.”<sup>109</sup> The centrality of requirements is a consensus point, and there is a litany of corresponding perspectives.

One possible response to this challenge would be to change how different organizations help create requirements. CSIS would have altered membership of the Joint Requirements Oversight Council, which formally approves requirements, to add the Office of Cost Assessment and Program Evaluation (CAPE) and to replace Service Vice Chiefs with Combatant Command Deputies. It also would have refocused the Office of the Under Secretary for Acquisition, Technology, and Logistics on research and engineering, dedicating this part of the institution to the long view, and would have returned management and execution authority to the military Services. These changes could foster service competition to meet COCOM requirements and permit the Office of the Under Secretary of

Defense for Acquisition, Technology, and Logistics (USD AT&L) to substantially reduce its staff.<sup>110</sup> Meanwhile, moving the services back into management and execution could “clarify issues of accountability and serve several Packard Commission design principles that remain valid today – to create clear, unambiguous command channels, limit reporting requirements, keep staffs small and establish close communication with the end user.”<sup>111</sup>

BENS also weighed in on the Joint Requirements Oversight Council membership. It shared CSIS’ concern with the balance between near- and long-term focus, but its recommendation was nearly opposite. BENS acknowledged that the COCOMS are leaders on immediate needs but found that the military Services are more likely to take the long view that should guide the requirements process.<sup>112</sup> Specifically it recommended that:

Sustaining needs should remain with the Service Chiefs (and Defense Agencies, as appropriate)... it should be the responsibility of the JROC to assure operational compatibility among the Services, working through the joint requirements organizations with special attention and rapid action for the near-term requirements.<sup>113</sup>

HASC’s Andrews-Conaway panel offered a bridge between the CSIS and BENS perspectives. It underscored the importance of COCOM, CAPE, and USD AT&L perspectives on the Joint Requirements Oversight Council and favored consideration of whether they should become voting members. It emphasized taking those positions into account, however, over an institutional change to the body’s composition, and made no suggestion that the Service Vice Chiefs should be replaced if the COCOM Deputies joined. Instead, it recommended designating “a COCOM as the end-user proponent” for all major defense acquisition programs as a means to include war fighter views in the process. Meanwhile, the panel expressed concern that “the divide established in the Goldwater-Nichols Act between acquisition and the military service chiefs has become so wide that it hinders both the acquisition and requirements process ... The service chiefs should also be given greater authority and responsibility to oversee contract quality assurance, especially for contracts that are highly operational in nature.”<sup>114</sup>

DBB addressed the role played by CAPE in this process. It determined that “CAPE cost estimates should be presented, when relevant, at Functional Capability Boards, Joint Capability Boards, and as part of JROC discussion.” Related to that, DBB also found that these cost estimates should influence the services as they build their Program Objective Memoranda and that they should be part of programming decisions made by USD/AT&L.<sup>115</sup>

DAPA targeted its recommendations more at the standards that underpin requirements than at Joint Requirements Oversight Council membership itself. The standards it proposed dovetail closely with its emphasis on Time Certain contracting. Specifically, it would have forgone schedule slips by releasing technology only when the COCOM determined that it was operationally acceptable and/or operationally usable, instead of when it fulfills criteria set out by the Director of Operational Test and Evaluation.<sup>116</sup> It likewise would have helped institutionalize these standards by:

...replacing the Joint Capabilities Integration and Development System by designating the Joint Chiefs of Staff/J-8 to lead the integration of the Combatant Commands' extended planning annexes into a Department wide, time-phased, fiscally-informed and prioritized Joint Capabilities Acquisition and Divestment plan.<sup>117</sup>

Since many identify requirements as the root cause of cost growth in acquisition, controlling requirements may have the biggest impact on achieving savings.

### Parameters for Possible Savings

The sheer scale and complexity of the acquisition system creates a perpetual risk of inefficiency that must be managed. Time after time, boards and commissions have found fault with the acquisition system.

The previous two sections have considered direct options to save money by compensating and utilizing our service members more efficiently. Reforming acquisition practices could yield comparable savings, in the eyes of some, by catalyzing better management. But these savings would be achieved indirectly. Instilling more discipline in the requirements process or choosing contract vehicles more deliberately, for instance, do not formulaically correspond to a savings figure, but rather allow the Pentagon to identify efficiencies on a case-by-case basis. Some cost growth would probably occur even if all these reforms were implemented. Consequently, the possible savings from these options should be considered in the aggregate instead of as an itemized list.

GAO has helped to quantify the risk of inefficiency just in weapons system acquisition, setting aside other programs for services or information technology. It reported that:

The total estimated cost of the Department of Defense's (DOD) 2011 portfolio of 96 major defense acquisition programs stands at \$1.58 trillion. In the past year, the total acquisition cost of these programs has grown by over \$74.4 billion or 5 percent, of which about \$31.1 billion can be attributed to factors such as inefficiencies in production, \$29.6 billion to quantity changes, and \$13.7 billion to research and development cost growth.<sup>118</sup>

That circumstance stabilized somewhat during 2012. In its 2013 update to that report, GAO wrote that:

The Department of Defense (DOD) 2012 portfolio of 86 major defense acquisition programs is estimated to cost a total of \$1.6 trillion, reflecting decreases in both size and cost from the 2011 portfolio. Those decreases are largely the result of more programs exiting than entering the portfolio, as well as reductions in procurement quantities due to program cancelations and restructurings. Notably a majority of programs in the portfolio gained buying power in the last year as their acquisition unit costs decreased. DOD's 10 costliest programs, excluding the Missile Defense Agency's Ballistic Missile Defense System, drive most of the portfolio's cost performance and funding needs.<sup>119</sup>

Saving money requires not only stabilizing this trend, though, but also reversing it. The proposed fiscal year 2014 defense plan would spend \$1.9 trillion on procurement and research and development over the 10 years from 2014-2023, which does not include many service contracts found in the operating and maintenance appropriations.<sup>120</sup> GAO found that major acquisition programs' costs grew by five percent in 2011 and stabilized in 2012. If acquisition reform proposals produced savings of only a few percentage points, it is possible that savings stemming from acquisition reforms and better practices could be on the order of a hundred billion dollars or even more over the next 10 years.

**APPROXIMATE POSSIBLE SAVINGS IN BILLIONS OF DOLLARS OVER 10 YEARS**

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Constructing Contracts	
Managing the Contracting Workforce	
Coming to Best Practices	
Generating "Requirements"	
<b>Total Possible Savings</b>	<b>\$100+</b>

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## CONCLUSION

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Although many disagree about what the Defense Department should do and how much it should cost, all agree that whatever it does should be done as efficiently as possible. This report has identified possible savings of \$300 billion over the next 10 years by reforming how personnel are compensated. It identified almost \$500 billion of possible savings through the more efficient use of manpower. And although it is difficult to estimate an exact savings figure from improved acquisition processes, it is possible that being more deliberate and disciplined could generate more than \$100 billion in savings. If all of these efficiencies were realized, they would represent close to \$1 trillion, or almost 20 percent of the planned defense budget over the next 10 years.

Few are likely to go that far. The options presented in this report have been proposed often, and for many years. Some reforms similar to these proposals have been made in the past and have achieved savings, but many more have not. Many of these options would require overcoming significant political opposition or would be difficult to implement, requiring sustained change over long periods of time. Offsetting effects might erode savings if some were implemented. The likelihood that these proposals might be taken and how well they might perform is a question of political judgment. Each observer will have a different take on each option and its likelihood.

Nevertheless, in the constrained budget environment the Defense Department faces, changes will be made and efficiencies will be enforced. This report has captured some of the possible ways that efficiencies can be gained. More importantly, efficiencies must be gained to ensure that U.S. defense dollars are spent as wisely as possible and that American citizens get the best and most effective defense possible, no matter what defense strategy the U.S. pursues.





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