United States General Accounting Office

132188

GAO Testimony

For Release
on Delivery
Expected at
9:30 a.m.
Thursday
February 19, 1987

DEFENSE BUDGET AND
PROGRAM ISSUES
FISCAL YEARS 1988 and 1989

Statement of
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Before the
Committee on Armed Services
United States Senate

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GAO/T-NSIAD-87-3

Mr. Chairman, I appreciate the opportunity to discuss the allocation of resources devoted to implementing our defense strategy.

By any measure, the growth in the defense budget, begun in the final years of the Carter Administration and accelerated by the Reagan Administration, has been of historical peacetime proportions. Since 1980, through fiscal year 1986, the Nation has invested on the order of $1.6 trillion in defense, and by the close of this decade the amount invested will approach $2.5 trillion.

The question many are asking is whether the American people are receiving full value in increased security for the money they are investing. Has the gap between our declared military strategy and the resources to support that strategy narrowed? Or, are the critics, who point to revelations of procurement abuses and Pentagon mismanagement, more correct when they state that we have experienced a defense spend-up rather than a defense build-up.

It is not possible to precisely tally up the extent to which the Nation is more secure due to the money spent. It is clear to me, however, that our Nation's military forces are stronger, more capable, and more ready today than at the beginning of this decade. No where is this more evident than in the dramatically improved quality of people in the Armed Forces. At the beginning of the decade, for example, less than 65 percent of Army recruits were high school graduates. Today, that number for the Army

exceeds 90 percent, and the other services are doing as well or better. High school graduation is but one indicator of personnel quality. Other indicators of quality, such as aptitude test scores are also up significantly over what they were in the late 1970s and early 1980s.

Despite the improvements that have been made in our military capabilities over the past six years, serious gaps will continue to exist between military strategy, capabilities, and resources. For example, our military strategy since early 1980 has called for a very rapid response to a Soviet threat in the Persian Gulf region. The fact remains, however, we do not have all of the forces that the military believes are needed to respond to such a threat -- strategic airlift, fast sealift, prepositioned material and equipment, and dedicated forces. Even with the recently ordered C-5B aircraft, which are now entering the fleet, and the new C-17 aircraft, which have not yet begun to come off the production line, the military will still fall short of its strategic airlift requirement. Force mobilization and deployment from the U.S. for a major NATO war also remains a serious concern, as does our nation's ability to execute our nuclear strategy due to questions concerning the reliability and survivability of our command, control, communication, and intelligence (C^3I) gathering systems.

Of equal concern is whether our stores of ammunition, spare parts, and other material needed to fight over a prolonged period are

adequate. Budget allocations to improve sustainability have increased in absolute terms during the first half of the 1980s, although not at the same relative rate as have other components of the budget. Despite these increases, the chiefs of the warfighting commands continue to warn that because they are short of critical spare parts and ammunition, our forces would be hard pressed to fight intense combat for a prolonged period.

These gaps between strategy and resources must be viewed in the context of a series of questions and problems concerning the overall balance within the defense budget and the affordability and supportability of systems currently in the inventory and those coming on line. This then must be judged within the larger context which this Committee has been examining of whether our military strategy is correct.

CAN WE SUPPORT WHAT WE HAVE AND WHAT IS COMING ON LINE?

It seems clear that we are following the historical defense funding cycle, and are now moving from a period of relatively rapid defense budget growth to a period of more restrained budgets. This is evident in the reductions the Congress made to the President's budget requests for fiscal years 1986 and 1987, and is further evident when one looks at the President's request for fiscal year 1988 and finds that it is some $30 billion less than the Administration projected just one year ago for 1988. While DOD

will be unable to procure everything it wants, the major capital assets it has bought -- ships, aircraft, missiles, and tanks -- are very costly to maintain and will place a heavy burden on the defense budget as we enter the years of slower or no growth in the defense budget.

The questions of whether we can support the capital assets we have acquired, and whether adequate funds will be available to maintain readiness and improve sustainability will be paramount as we proceed into the last half of the 1980s and look forward to the 1990s. While money for readiness and sustainability clearly increased in absolute terms over the first half of this decade, the defense buildup was front loaded in favor of major weapons systems and force structure expansion. In the future we will be faced with such budgetary demands as:

--operating and supporting a 600 ship Navy, that according to Navy projections will require some real budgetary growth over the next decade,

--maintaining and operating a fleet of B-1B bombers while at the same time developing and acquiring a Stealth bomber,

--continuing to modernize the Army, though at a slower pace than desired, which the Army believes will require about 3 percent real growth in its budget, and

--continuing the development of the Strategic Defense Initiative (SDI), the Small Intercontinental Ballistic Missile (the Midgetman), the Trident II (D-5) missile, and the deployment of MX.

Historically, too many weapon systems have been started or proposed for the limited funding available, and often the cost estimates for the systems have been overly optimistic. This combination -- too many programs and optimistic cost-estimating -- has produced the much discussed "bow wave" phenomena where future funding requirements out-strip funding availability.

Procurement stretchouts, rather than program cancelations or postponements, have been the time honored way of reducing current year budgets and changing the shape of the "bow-wave." Such a policy results in increased total program costs and unit prices. The unit cost of the M-1 tank, the F/A-18 aircraft, the Blackhawk helicopter, and several other weapon systems proposed for quantity reductions in the fiscal years 1988 and 1989 budget will increase due to the policy of procurement stretchout. Some believe that other areas of the defense budget, such as sustainability, have also suffered in order to meet the budgetary demands of the new and more modern weapon systems.

In 1981, DOD implemented its Acquisition Improvement Program, better known as the "Carlucci Initiatives." Of the 32 management initiatives undertaken, DOD focused special management attention on

the initiatives involving (1) program stability, (2) multiyear procurement, (3) economic production rates, (4) readiness and support, and (5) competition.

Both the Packard Commission and GAO have seen improvements in the acquisition process. However, the initiatives have not fully achieved their intended results. Little progress has been made in stabilizing weapons acquisition programs. The Department still needs to budget more realistically, limit the number of new programs, and eliminate marginal programs.

THE ARMY'S LHX PROGRAMS

During this upcoming biennial budget period, a number of very expensive weapon systems are scheduled to transition to full scale development or to full rate production. The Committee has asked for GAO's assessment of 27 of these systems, and we will be providing this assessment to you in the near future. However, I would like to mention briefly one Army system that the Committee may wish to examine more closely as you consider the next two year's budget priorities. This is the LHX helicopter program, one of the Army's largest new acquisition programs.

We agree with the Army that the goals of the LHX helicopter program are worthy -- to replace the Army's aging helicopter fleet with aircraft which, among other things, would out perform the older

aircraft and yet be less expensive to operate and maintain. But, is the system affordable given rising costs which reflect efforts to achieve its challenging performance requirements? Or do modified and upgraded existing systems offer an acceptable and less costly alternative?

Current program estimates indicate that several of the LHX's original goals will not be met. This underscores the difficulty of filling the LHX's requirements while trying to hold costs down. The flyaway cost goal for the LHX fleet was $5.3 million (in fiscal year 1984 dollars) per aircraft; this has now escalated to $6.1 million per aircraft. Hoped for savings in operation and support costs, originally put at 40 to 50 percent, are currently estimated at about 20 percent. While the Army is still striving to make the LHX a single pilot aircraft, early development has indicated that enough risks remain that it was prudent to add a dual pilot version to the LHX's development effort. Last year, the cost to develop and produce 5,000 LHXs was estimated at $61 billion (in escalated dollars). Now, the Army estimates that it will cost $66 billion to develop and produce 4,500 aircraft. At the same time, performance expectations of the LHX have been lowered somewhat.

The magnitude of the LHX program alone makes affordability a key issue, independent of technical uncertainties which may lie ahead. Last year, Army data projected a shortfall of funds in several peak years of LHX production. This year, LHX cost estimates are even

higher, but estimates of available funds are lower.

AFFORDABILITY OF NAVY PROGRAMS

In 1981 the Navy changed its maritime strategy from a defensive posture during hostilities to one of forward deployment. This change in the maritime strategy is the "linchpin" and underlying reason for the Navy's fleet expansion initiative -- commonly referred to as building to a "600-ship Navy," including 15 deployable carrier battle groups. Between 1981 and 1986, the Congress appropriated about $74 billion (in fiscal year 1986 constant dollars) for the Navy's shipbuilding and conversion programs. This does not include cost of aircraft for the carriers or operation and support costs. During this period, the Navy increased the size of its fleet from 13 deployable aircraft carriers and 466 ships to 14 deployable carriers and 542 ships.

The Navy, however, still has some way to go before it will achieve the "minimum force" it says it needs to execute the maritime strategy. By 1989, the Navy will have 600 ships in the fleet, including 15 deployable aircraft carriers and an additional one undergoing service life extension. But, based on current projections the Navy will not have the mix of ships that the strategy requires. Our analysis of the Navy's shipbuilding plans through fiscal year 1996 shows that even if current plans are executed, the Navy will not achieve its "minimum force" requirement

before the year 2000. Shortages in the Navy's "minimum force" will continue to exist in surface combatants, amphibious ships, attack submarines, and support ships.

Expanding the fleet is expensive, but the capital investment is only a portion of the costs associated with a larger fleet. Operations and support costs will also grow substantially. As new classes of ships and their attendant systems are introduced into the fleet, our calculations show that operating and support costs of $47 billion in fiscal year 1986 will nearly double in constant dollars by fiscal year 2000.

It seems to me that this raises a fundamental question about whether this country can over the long haul, spend what the Navy says is required to carry out its current forward deployment maritime strategy. The Navy's current budget request of $1.4 billion for a down payment on two new replacement nuclear aircraft carriers brings to the forefront the need to address this fundamental question.

The Navy's plans originally called for requesting authorization for these carriers in 1994 and 1996, but it was decided to accelerate the schedule by four years. The Navy told us that there are two primary reasons for this 4-year acceleration. The first is to maintain the shipbuilding industrial base at the Newport News shipyard. The second is that the Navy believes it is better to go

for new construction rather than to pay the costs of extending the life of an existing ship. Service life extension for an aircraft carrier now costs over $1 billion and takes about three years to complete. To control the cost of the service life extension program, the Navy is reducing the scope of work to be performed.

Funding for the $1.4 billion down payment reportedly came from all Navy accounts, but primarily from reducing the scope of work for extending the life of aircraft carriers and by eliminating the planned service life extension program for the LPD-4 class amphibious ship. The Navy has stated that the early procurement of these two carriers will save from $1.5 billion to $3 billion in acquisition costs. We are currently evaluating the basis for these anticipated savings.

Maintaining the Nations's industrial base is an extremely important issue, and goes well beyond the Navy's immediate concern regarding the Newport News shipyard. For example, what are the minimal industrial base requirements for a wartime surge capability in those industrial sectors upon which the military relies, such as shipbuilding, and aircraft manufacturing? And, what are the long-term budgetary implications of sustaining the necessary industrial base? There are no easy answers to these questions. But, I believe that this issue bears directly on the decision the Congress makes regarding the Navy's request. As part of our inquiry into the Navy's savings estimates, we will also obtain

information on the reasonableness of the Navy's argument that this early procurement is needed to maintain our shipbuilding industrial base.

STRATEGIC BOMBER PROGRAMS

As the Committee examines the Administration's budget requests for future spending, particularly for new programs, it is useful to look at how money authorized and appropriated in earlier years was spent.

Our examination of the Air Force's management approach for the B-1B bomber program offers some instructive insights as you consider the Pentagon's requests for money to proceed with other programs, such as the Stealth Bomber, the Advanced Technology Fighter (ATF), the Advanced Cruise Missile, and other programs that are on the cutting edge of technological development.

Over the past several months, particularly since the B-1B attained what the Air Force has defined as initial operational capability, there has been a great deal of media attention to the substantial shortcomings of this aircraft. While the B-1B clearly adds to this Nation's strategic capability, our work substantiates that serious deficiencies exist. The defensive avionics system, critical to the aircraft's survivability has experienced serious developmental problems and changes during production. The details regarding

these deficiencies are classified; however, it is clear that the current deficiencies reduce the bomber's capabilities and limit the strategic planner's flexibility in deploying the aircraft on the full range of missions initially envisioned. Some of the problems are not amenable to quick or easy solutions while others can be more easily fixed.

But, there are lessons to be learned from the B-1B procurement; the primary one being the need to provide sufficient time for more thorough operational testing and evaluation of systems prior to production. In this instance, flight testing of the aircraft was severely limited due to the unavailability of test equipment and the short amount of time allotted for conducting tests prior to the date mandated for initial operational capability. GAO has long been concerned about concurrent development and production of major weapons systems, and we have recommended in the past that results critical to assessing mission performance be available before full-scale production begins.

MANNING THE FORCE OF THE FUTURE

I would like to turn briefly to a topic of great interest to you and this committee, an issue that will not only have important budgetary implications for the future, but could also influence the development of military objectives, strategy and doctrine. The issue I am referring to is the question of how this Nation should

man the force of the 1990's and beyond. Should we continue to rely on the all-volunteer force? Or, should we return to conscription because of the declining pool of eligible youth, for budgetary reasons, to recognize civic obligation, and/or to increase our mobilization capability?

GAO is currently evaluating numerous studies that touch on this issue, and we are gathering information on how our allies and principal adversary have addressed it. Based on these studies, the information collected, and preliminary costing work we have done, it appears that returning to conscription could save money only if certain assumptions are adopted in making this analysis. These assumptions would include the extent to which first-term pay could be reduced, whether the force size would remain at about the same level as it is today, and whether a significant shift in favor of having more first-term personnel as compared to career personnel in the Armed Forces is feasible. I would quickly add, however, that force manning changes, such as modifying the force mix in favor of a higher ratio of first-term personnel or changes in manning levels, could also reduce the cost of the all-volunteer force.

Aside from questions of cost, however, it is not clear how conscription would affect force quality or military effectiveness, nor are the studies clear on how several other questions should be resolved. For example, if we were to return to a 2-year draft with low wages for conscripts, how should the question of equity be

addressed in view of the fact that less than half of the eligible youth population would be asked to serve in the military? What should be the proper trade-off between the need for an experienced force and the fact that more young people that would receive military training under a draft and would thus be potential mobilization assets? The resolution of this question would be of particular importance in light of the more sophisticated weapons systems now in the inventory.

We hope that the results of our work will help the Congress address this issue.

MANAGING DEFENSE RESOURCES

The growth during the 1980s of the defense budget has been and continues to be substantial. It has clearly been the intention of the Administration, supported by the Congress, to increase the buying power of the defense budget. This was needed to rebuild our forces and increase their sustainability and readiness. It is clear that progress has been made in achieving those objectives.

However, with the growth of the defense budget a number of issues surface that directly relate to these budgets. Money was included in the DOD budget request and the defense appropriations, each year, to pay for future inflation. However, since inflation was less than projected, DOD received an estimated $55.8 billion more

than was needed over the past six years to pay for actual inflation. Some of the "extra" inflation funds were used to buy more defense programs, some were reprogrammed into other programs, some simply lapsed, and according to DOD calculations, $17.2 billion was eliminated by congressional cuts.

Prior to the early 1960s neither DOD nor any other federal department budgeted for inflation. The low inflation rates of that period presented little threat to real purchasing power. That all changed during the 1970s when unexpectedly high inflation rates seriously eroded the purchasing power of money appropriated for defense. The situation again changed during the 1980s when lower than expected inflation rates produced an unintended dividend. At the direction of the Congress we are currently examining alternative methods to budget for inflation and to report the effect of inflation budgeting to the appropriate committees. We will be reporting on this study in the near future.

Each year we examine the individual service budgets and identify amounts that we believe the Congress should consider for reduction. Last year we told Congress about $14.8 billion in possible reductions for reasons such as production schedule shippages or contracts that were for lower amounts than expected. Significant reductions were made. As the service budget justification books become available, we will again be examining them for similar types of reductions.

Quite aside from questions of how the Defense Department budgets for anticipated inflation, or whether specific budget lines can be reduced, is the broader issue of whether the Department's financial management systems facilitate or impede the decisionmaking process and whether adequate controls are maintained. As the Congress and the Administration grapple with the budget deficit and make the difficult decisions on controlling government expenditures, it is vital that ongoing operations be as efficient as possible. This can only be accomplished if we have adequate management systems.

Although DOD has an elaborate planning, programming and budgeting system, the financial management system used to tract the execution of the budget is in need of reform. A major difficulty is that the accounting systems that track how funds are actually being used are not directly linked to the budgeting process. A case in point is the Selected Acquisition Report (SAR) system. Though useful, the SARs have several limitations. First, the SAR generally rely on a contractor and other information not necessarily tied to DOD's accounting systems. Second, information on the same weapon system may be reported differently from one year to the next. Third, information in the SARs is not consistent with that in other budget documents provided to the Congress.

Another issue that bears on how defense resources are managed centers on DOD's profit policy. The most visible evidence that such improvements are needed is the current debate over whether

profit policy objectives are being achieved, and whether contractors are earning higher rates of return on their defense work than is earned by producing durable goods for general consumption. There is presently no legislatively mandated requirement to make such determinations, and past attempts to do so have been challenged because of their limited scope and differing analytical methodology.

The history of efforts to deal with the issue of government contractor profits is important because it emphasizes the need for periodic studies of profitability based on a mandatory profit reporting system. Under-pinning our economic system is the concept of a free market that established a fair price to the buyer and an equitable profit to the seller. However, because of aberrations in the marketplace, such as an escalating demand for war materials or the inability to obtain competition for many of the unique items which the government buys, the Congress, over the years, has found it necessary to address allegations of excess contractor profits. Congressional actions have included legislation which set prices, limited profits, and taxed excessive profits or authorized the government to recover profits deemed excessive. These measures were generally taken without adequate information because it was simply not available.

In November 1986 we released an exposure draft report entitled "Government Contracting: A Proposal for a Program to Study the

Profitability of Government Contractors." This exposure draft examined in some depth the need for government to develop a systematic method of measuring the performance of its profit policy, and explained why a structured and consistent profit reporting program is needed. As part of our study we offered draft legislation for the Congress to consider if a decision is made to establish such a program.

We are currently evaluating comments received from a wide range of defense contractors, industry associations, federal agencies, public accounting firms, and consultants. Not surprisingly, there is little enthusiasm on the part of industry and the Pentagon for our proposal. Despite this, we believe that dissatisfaction with the government's profit policy will continue without a consistent and appropriate analytical methodology to evaluate profitability, a means to verify contractor-furnished data, and mandating contractor participation.

SUMMARY

Mr. Chairman, today I have touched on some of the issues facing the Congress as you consider the President's fiscal year 1988/1989 budget request. In sum, the Department is continuing with the program begun in 1981. The budget continues to be front-loaded with major weapons programs, though at a slightly lower rate. This can be seen by observing that DOD's procurement and research,

development, test, and evaluation accounts have grown from about 34 percent of the defense budget in fiscal year 1980 to nearly 45 percent in fiscal year 1986. This ratio has declined to about 42 percent in fiscal year 1988, and remains relatively constant at that level over the 5-year planning period. Budgetary allocations for other accounts, primarily those that support readiness and sustainability, did not grow proportionately.

If defense budgets were to continue growing at the same rate as during the first half of this decade, such a policy may pose fewer problems. However, this will probably not be feasible. DOD is continuing to start programs that will be difficult to complete and support under anticipated budgets.

Mr. Chairman, I recognize that you and other members have urged the Department to share with the Congress its hierarchy of defense spending priorities. However, the Department has not been willing to do this. In my opinion, as budgets tighten, it would seem more important than ever for the Department to share its priorities with the Congress.

This concludes my prepared remarks. I would be pleased to respond to any questions you may have.