

BACKGROUND

No. 3272 | APRIL 16, 2018

Congress Should Pursue Pentagon Business Reforms

Frederico Bartels

Abstract

In periods of budget increases, reforms and efficiencies tend to fall by the wayside. That should not be the case. The budget increases should be a chance to reflect and to re-assess efficiencies and reforms, especially those that require up-front investments to be executed. The Department of Defense needs to be a good steward of taxpayers' dollars, regardless of future levels of the defense budget. Good stewardship includes being able to extract the maximum amount of value from every dollar spent, independent of the department's budget. The Pentagon should take advantage of its increased budget to make sure that there is room to invest in creating efficiencies and reforming outdated systems.

The passage of the Bipartisan Budget Act of 2018 represented a substantial increase for the defense budget in both 2018 and 2019.¹ Providing critically needed funding to rebuild the military, the legislation sets a new cap for 2019 that is unlikely to change during congressional deliberations. This means that there will be less deliberation about the topline defense budget, allowing lawmakers in the 2nd Session of the 115th Congress to focus on more complex issues below the surface.

This influx of resources will help the Department of Defense (DOD) rebuild the military's capability, capacity, and readiness. The military's problems in these areas have been well documented over the years in The Heritage Foundation's *Index of U.S. Military Strength*.² The military did not end up in this situation in one year, and getting out of this state will also take more than one year.

Nonetheless, the future of defense budgets is neither guaranteed nor well-defined by either the DOD or the White House.³ The pro-

KEY POINTS

- The influx of resources from the Bipartisan Budget Act of 2018 will help the Department of Defense rebuild the military's capability, capacity, and readiness. It also creates stability in the funding expectation for 2019.
- The military's problems in these areas have been well documented over the years in The Heritage Foundation's *Index of U.S. Military Strength*.
- The Pentagon should take advantage of its budget increase to enact business reforms that will lead to a more efficient and effective Defense Department.
- From closing and realigning bases to properly auditing the DOD, there are many opportunities for the Pentagon to improve its operations.
- The Department of Defense will need congressional support to enact meaningful business reforms, and should seek and build Congress's cooperation now.

This paper, in its entirety, can be found at <http://report.heritage.org/bg3272>

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

jections for future defense spending are consistently unclear and heavily dependent on changing the caps set by the Budget Control Act of 2011.⁴

The budget increases should be a chance to reflect and to re-assess efficiencies and reforms that require up-front investments to be executed. The DOD needs to be a good steward of taxpayers' dollars, regardless of future levels of the defense budget. Good stewardship includes being able to extract the maximum amount of value from every dollar spent, independent of the department's budget.

Heritage Foundation analysts have made multiple proposals for how Congress and the DOD can pursue reforms and improvements to defense systems. As such, there are multiple reforms that Congress and the DOD can work on together. Many of these reforms have been featured in previous Heritage Foundation research.⁵

Reform Management Groups (RMGs)

When James Mattis took over as Secretary of Defense, one of his three lines of emphasis was to bring business reform to the Pentagon.⁶ This effort is currently being conducted under nine RMGs, one for each of nine areas of reform, established by Deputy Secretary of Defense Patrick Shanahan. According to the 2019 budget request, "The RMGs' central goal is to leverage best practices, centers of excellence, and private sector sources to benchmark and best align business operations."⁷

The nine identified areas of reform are (1) information and technology, (2) health care, (3) real property, (4) human resources, (5) financial management, (6) contracted services and goods, (7) logistics and supply chain, (8) military community services, and (9) testing

and evaluation. Each of these areas represents a great opportunity for the DOD to improve and rationalize the way it conducts its business operations. Many of them are back-office functions that have the potential to save resources. The first step, and often the most difficult, is to establish what the DOD spends on these various functions. This is harder than it appears. The Services have different definitions and methods of capturing costs. Labor costs are attributed in different manners among the Services. Therefore Congress should expect the Pentagon over time to be able to describe the burdened costs in each category.

Congress and the DOD should be partners in this endeavor. Undoubtedly many of the likely proposals in each of these areas will require changes in the law in order to be effective. The department should be transparent with Congress and the American public about how these groups are organized and what their goals are. Neither should there be any illusions about the source of the cost savings: Efficiencies in "back-office" functions come from labor savings—that is, fewer people, usually government civilians.

Because there will always be incumbent forces unwilling to change, business-processes transformation could be more challenging than expected. The dispersed nature of the benefits created by business reform make it necessary to engage with congressional stakeholders early and often to guarantee that they will not prevent or slow down necessary changes.

A New Round of Base Realignment and Closures (BRAC)

For the first time in the past six years, the DOD did not request Congress to authorize a new round of BRAC. The need has not gone away; if anything, the

-
1. Bipartisan Budget Act of 2018, Public Law 115-123.
 2. Dakota L. Wood, ed., *2018 Index of U.S. Military Strength* (Washington, DC: The Heritage Foundation, 2017), <http://www.heritage.org/military-strength>.
 3. Frederico Bartels, ed., "How Congress Can Improve the 2019 President's Budget Request for Defense," Heritage Foundation *Backgrounder* No. 3303, March 30, 2018, <https://www.heritage.org/defense/report/how-congress-can-improve-the-2019-presidents-budget-request-defense>.
 4. Budget Control Act of 2011, Public Law 112-25.
 5. See, for instance, Frederico Bartels, ed., "The 2019 NDAA Must Continue to Rebuild the Military and Make It More Efficient," Heritage Foundation *Special Report* No. 198, February 9, 2018, <https://www.heritage.org/defense/report/the-2019-ndaa-must-continue-rebuild-the-military-and-make-it-more-efficient>, and The Heritage Foundation, *Blueprint for Balance: A Federal Budget for Fiscal Year 2018*, March 28, 2017, <https://www.heritage.org/budgetand-spending/report/blueprint-balance-federal-budget-fiscal-year-2018>.
 6. Cheryl Pellerin, "Mattis Details Three Lines of Effort in Memo to DoD Personnel," *DoD News*, Defense Media Activity, October 11, 2017, <https://www.defense.gov/News/Article/Article/1339147/mattis-details-three-lines-of-effort-in-memo-to-dod-personnel/> (accessed March 21, 2018).
 7. U.S. Department of Defense, "Defense Budget Overview: United States Department of Defense Fiscal Year 2019 Budget Request," p. 7-1.

need has become more pronounced. The Infrastructure Capacity study indicating a 19 percent in excess infrastructure is still the most current assessment of the Pentagon's real estate usage.⁸

A new round of BRAC could save over \$2 billion annually in reduced fixed costs.⁹ Additionally, the new National Defense Strategy clearly states that the "Department will also work to reduce excess property and infrastructure, providing Congress with options for a Base Realignment and Closure."¹⁰

Delivering options to Congress on BRAC is a fairly modest responsibility established by the National Defense Strategy, but the DOD failed to fulfill it. While the RMG on real property develops its proposals, Congress should start empowering the DOD to conduct robust infrastructure assessments by loosening the current reporting requirements that exist whenever there is any proposed real estate change.¹¹

These measures are short of authorizing a new round of BRAC, but would represent a step forward in the DOD's current real estate management. Congress needs to take the lead in changing how the Pentagon manages domestic military bases.

Auditing the Pentagon

There is a widespread belief in Congress that the DOD financial audit will identify large areas of waste or fraud, yet the audit experiences of other federal agencies and private corporations largely do not support that expectation. In the private sector, financial audits are primarily used to fulfill legal requirements and to increase investor confidence in financial statements, leading to a reduced cost to raise capital. There is no corresponding need for the DOD audit.

Audit results that lead to actual reduced waste or inefficiency are rare, and many companies that can legally escape undergoing financial audit choose to do so.¹² Pentagon Comptroller David Norquist estimates that the 2018 audit of the DOD will require at least \$870 million to complete, which includes remediation actions.¹³ That is the equivalent of at least eight F-35A fighter aircraft, which U.S. forces desperately need.

Certainly some aspects of the DOD audit are necessary. Reconciliation of DOD accounts with the Treasury is one area that needs attention. Other areas do not require similar attention, whether because there are other systems that check for accuracy or because there is no potential for savings or efficiency. For instance, verification of real property accounts or equipment is not an area that needs to be examined in the financial audit, yet consumes a vast amount of time.

In general, there are better methods for reducing waste or inefficiency, such as "waste audits" or zero-based budgeting techniques. Costs may go down slightly in subsequent years, but Congress should nevertheless take the examination of the 2019 budget as an opportunity to push for ways to accomplish the most essential aspects of an audit at a lower cost in future years.

Replacing Military Personnel in Commercial Positions with Civilian Employees

According to the Congressional Budget Office (CBO), the DOD currently employs around 340,000 active-duty military personnel to perform support functions in commercial positions.¹⁴ These com-

8. U.S. Department of Defense, "Department of Defense Infrastructure Capacity," October 2017, https://1yxsm73j7aop3quc9y5ifaw3-wpengine.netdna-ssl.com/wp-content/uploads/2017/10/101717_DoD_BRAC_Analysis.pdf (accessed March 20, 2018).

9. James Mattis, "Written State for the Record," testimony before the Committee on Armed Services, U.S. House of Representatives, June 12, 2017, <http://docs.house.gov/meetings/AS/AS00/20170612/106090/HHRG-115-AS00-Bio-MattisJ-20170612.pdf> (accessed March 20, 2018).

10. U.S. Department of Defense, *Summary of the 2018 National Defense Strategy of the United States of America: Sharpening the American Military's Competitive Edge*, January 2018, p. 10, <https://www.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf> (accessed March 20, 2018).

11. Frederico Bartels, "Guidelines for a Better—and Necessary—Round of BRAC," Heritage Foundation *Backgrounder* No. 3257, October 19, 2017, <https://www.heritage.org/defense/report/guidelines-better-and-necessary-round-brac>.

12. Arthur J. Radin and Miriam E. Katowitz, "Have Audits Become Too Inefficient and Expensive?" *The CPA Journal*, February 2016, <https://www.cpajournal.com/2016/02/01/audits-become-inefficient-expensive/> (accessed March 20, 2018).

13. Tony Bertuca, "Pentagon Comptroller: Massive DOD Audit Effort to Drive Reform," *Inside Defense*, October 30, 2017, <https://insidedefense.com/daily-news/pentagon-comptroller-massive-dod-audit-effort-drive-reform> (accessed March 22, 2018).

14. Congressional Budget Office, "Replacing Military Personnel in Support Positions with Civilian Employees," December 2, 2015, <https://www.cbo.gov/publication/51012> (accessed March 20, 2018).

mercial positions are defined by two criteria: (1) being available in the private sector and (2) not dealing with the discrete exercise of government power or obligation of government funds.¹⁵ Some of these positions can be transformed into civilian positions, without losing the possibility of allocating military to commercial positions to enable them to rotate away from combat positions. The CBO analyzed the possibility of transforming a quarter of these positions—80,000.¹⁶

The savings vary depending on the replacement rate that the DOD achieves. In similar earlier initiatives, the DOD was able to average a ratio of 1:1.5, with two civilians replacing three military personnel. At a ratio of 1:1.5, the amount would reach \$5.7 billion. Even if the DOD can only achieve a replacement ratio of 1:1, it would save \$3.1 billion annually.

Military personnel are inherently more expensive than civilians due to the required training and rotations that are shorter than the time that a civilian usually spends on a job. According to the CBO, the savings would be generated because of two factors: (1) Civilians are on average 30 percent less expensive, and (2) one can use fewer civilians than the number of military personnel employed in the same positions, as the DOD was able to do in past conversions.¹⁷

Reducing Commissary Subsidies and Combining Commissary and Exchange Systems

The DOD operates two parallel, and similar, organizations for providing Service members and their families with access to goods and groceries. The commissaries provide groceries at cost plus 5 percent, which is only sustainable through an annual

subsidy. In fiscal year (FY) 2018, Congress subsidized the commissaries with \$1.4 billion.¹⁸

On the other hand, the military exchanges for non-grocery goods operate largely without subsidies by passing appropriate costs on to the consumers. Maintaining access to affordable groceries and goods is important for Service members, particularly those stationed overseas or in remote locations. In the debates for the 2018 National Defense Authorization Act (NDAA), Congress had a reporting requirement that would provide a cost-benefit analysis and aim at reducing the operational costs of commissaries and exchanges by \$2 billion.

Congress should revisit the question and continue with reforms to how it provides access to groceries and goods. This is especially important at a time that the Government Accountability Office has found that the DOD does not properly measure the benefits delivered by its system of personnel benefits.¹⁹ Furthermore, the RMG reviewing military community services has started to examine the possibility of merging the different services.²⁰ Congress should collaborate with the DOD on modernizing this benefit.

Lifting the Moratorium on Private–Public Competitions

Under pressure from federal employee unions since 2008, Congress has prohibited competition between public and private organizations to determine which could provide more cost-effective services for the U.S. government. This moratorium leads to situations wherein the local organizations near a base are not allowed to offer its services to that base. DOD-specific competitions remain prohibited per section 325 of the 2010 NDAA.²¹ Yet even critics will admit that “competition is the

15. Office of Management and Budget, “Publication of the Office of Federal Procurement Policy (OFPP) Policy Letter 11-01, Performance of Inherently Governmental and Critical Functions,” *Federal Register*, Vol. 76, No. 176 (September 12, 2011), p. 56236.

16. Congressional Budget Office, “Replacing Military Personnel in Support Position with Civilian Employees.”

17. *Ibid.*, p. 3.

18. U.S. House of Representatives, “Conference Report to Accompany H.R. 2810–National Defense Authorization Act for Fiscal Year 2018,” November 2017, <http://docs.house.gov/billsthisweek/20171113/HRPT-115-HR2810.pdf> (accessed March 22, 2018).

19. U.S. Government Accountability Office, “DOD Needs to Improve Business Processes to Ensure Patron Benefits and Achieve Operational Efficiencies,” *GAO Report to Congressional Committees*, GAO-17-80, March 23, 2017, <https://www.gao.gov/products/GAO-17-80> (accessed March 22, 2018).

20. Tom Philpott, “New DOD Task Force Eyed for Merging Exchange Services, DECA,” *Military.com*, March 15, 2018, <https://www.military.com/militaryadvantage/2018/03/15/new-dod-task-force-eyed-merging-exchange-services-deca.html> (accessed March 22, 2018).

21. National Defense Authorization Act for Fiscal Year 2010, Public Law 111-288.

greatest single driver of performance and cost improvement.”²²

The RAND Corporation has estimated that opening support services for the military to private competition could result in savings of between 30 percent and 60 percent.²³ The common criticism levied against such competition is that the process has not been updated and has created problems for both government and the private sector.²⁴ This is more reason for Congress to revisit the guidance that enables private–public competitions, and lift its moratorium.

Increasing Use of Performance-Based Logistics

Congress should incentivize and enable the broader use of performance-based logistics (PBL) throughout the acquisition enterprise at a system level. PBL is an arrangement in which the contractor is responsible for a larger portion of the support throughout the life cycle of the product. Thus, instead of a contract that is associated with the delivery of a platform, the contract is associated with the proper functioning of said platform.²⁵ Along these lines, “PBL has been implemented to deliver needed reliability and availability, reduce total cost, and encourage and reward innovative cost reduction initiatives.”²⁶

PBL serves to align the contractors’ interests with the DOD in maintaining the readiness of platforms.

PBL is both DOD policy and a priority for product support solutions, and it saves an estimated 5 percent to 20 percent of contract costs.²⁷ It is an arrangement that is not universal, and depends on the system being assessed. In October 2014, PBL accounted for between 5 percent and 10 percent of all Pentagon maintenance contracts.²⁸ Nonetheless, it is a great method for aligning the interests of government and contractors. Congress needs to push the DOD to increase the use of PBL in weapon-systems sustainment, especially at the system level.

The Path Forward

As the Secretary of the Army Mark Esper stated at The Heritage Foundation, “[Y]ou fix a roof when it is sunny out.”²⁹ In that same vein, the DOD needs to take advantage to its budget increase to enact reforms that will yield future savings. Congress needs to be a partner in that task. As such, the DOD should:

- **Engage with Congress on reform.** Congress has been a willing partner when it comes to funding the military and is also willing to adopt reforms. Nonetheless, there are more areas in which the DOD needs to work together with Congress.
- **Embrace the opportunity to reform.** From now until the end of FY 2019, the DOD will experience relative calm in the topline. It is a great

22. Stan Soloway, “It’s Time to Bury A-76—It Worked Once, But Its Day Is Past,” *Government Executive*, January 4, 2017, <http://www.govexec.com/excellence/promising-practices/2017/01/its-time-bury-76it-worked-once-its-day-past/134305/> (accessed November 13, 2017).

23. Susan M. Gates and Albert A. Robbert, *Personnel Savings in Competitively Sourced DoD Activities*, RAND Corporation Monograph, 2000, https://www.rand.org/pubs/monograph_reports/MR1117.html (accessed November 13, 2017).

24. Valerie Ann Bailey Grasso, “Circular A-76 and the Moratorium on DOD Competitions: Background and Issues for Congress,” Congressional Research Service *Report for Congress*, January 13, 2013, <https://fas.org/sgp/crs/misc/R40854.pdf> (accessed November 13, 2017).

25. Daniel Gouré, “Performance-Based Logistics Contracts Continue to Prove Their Value,” Lexington Institute, January 17, 2014, <http://www.lexingtoninstitute.org/performance-based-logistics-contracts-continue-to-prove-their-value/> (accessed March 27, 2018).

26. U.S. Department of Defense, Assistant Secretary of Defense, Logistics & Materiel Readiness, *PBL Guidebook: A Guide to Developing Performance-Based Arrangements*, 2016, p. 12, <http://acqnotes.com/wp-content/uploads/2017/07/Performance-Based-Logistics-Guidebook-March-2016.pdf> (accessed March 27, 2018).

27. U.S. Department of Defense, Assistant Secretary of Defense, Logistics & Materiel Readiness, *PBL Guidebook: A Guide to Developing Performance-Based Arrangements*, 2016, <http://acqnotes.com/wp-content/uploads/2017/07/Performance-Based-Logistics-Guidebook-March-2016.pdf> (accessed March 27, 2018).

28. Michael O’Hanlon, “A Systematic Use of Performance Based Logistics Will Save DoD Money,” Brookings Institution, October 15, 2014, <https://www.brookings.edu/blog/up-front/2014/10/15/a-systematic-use-of-performance-based-logistics-will-save-dod-money/> (accessed March 27, 2018).

29. The Heritage Foundation, “A Conversation with the Secretary of the Army: Building a More Lethal Force in an Era of Renewed Great Power Competition,” April 5, 2018, event video, <https://www.heritage.org/defense/event/conversation-the-secretary-the-army-building-more-lethal-force-era-renewed-great>.

period to start reforming business processes in the department.

Congress, on the other hand, should:

- **Push the DOD to find business reform opportunities.** The DOD is developing options and concepts on business reform, but Congress plays a pivotal role in that task.
- **Take the initiative on business reform.** There are business reform opportunities to which the DOD is resistant, and which require congressional action to be implemented. Congress needs to use its power of the purse to push for these necessary reforms.

Conclusion

In times of budget increases, reforms and efficiencies tend to fall by the wayside. It should not be the case. The Pentagon should take advantage of its increased budget to make sure that there is room to invest in creating efficiencies and reforming outdated systems. From changing its installations to re-assessing how the commissaries benefit its population, there are many opportunities available for both Congress and the DOD.

—*Frederico Bartels is Policy Analyst for Defense Budgeting in the Center for National Defense, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy, at The Heritage Foundation.*