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House Armed Services Committee Hearing
On DoD Management and the "Fourth Estate"

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Mr. Chairman, Members of the Committee, thank you for inviting me here today to address defense management and DoD's "Fourth Estate" – the Office of the Secretary of Defense (OSD) and the Defense Agencies and Field Activities (DAFAs). The views I express are entirely my own, and should not be interpreted as reflecting any position of my employer, the Institute for Defense Analyses (IDA). IDA is a Federally Funded Research and Development Center (FFRDC), which means that it is considered to be a government contractor. However, I am testifying in my individual capacity as a former Deputy Chief Management Officer (DCMO) of the Department of Defense, and as such, I do not have any federal contracts or grants, or any contracts or payments from a foreign government, to report.

I understand that the current DoD management team, headed by CAPE Director Bob Daigle and Chief Management Officer Jay Gibson, has established the ambitious goal of saving tens of billions of dollars through internal reforms and efficiencies over the course of the Future Years Defense Program (FYDP). It is a worthy objective, but it won't be easy. Getting savings planned and programmed is just the first step; the hard work comes with driving through implementation and ensuring that meaningful changes are really made. Otherwise, the effort will just create a "wedge" in the budget, leaving essential work unfunded and unperformed.

When I served as DCMO, we established a more modest goal of saving $7 billion over the FYDP. We were able to achieve the goal through headquarters reductions, service contractor cuts, information technology (IT) efficiencies, and a new business model for the defense commissaries. We focused our efforts on the Fourth Estate, for the simple reason that the Services had their own DCMOs and already had their own efficiencies initiatives underway, attacking many of the same areas that we were looking at. For example, the contractor courts that we established for the defense agencies were modeled on service contract requirements review processes that were already under way in the Services.

There is still plenty of waste and inefficiency to go after, but it is hard work to attack it – especially after a decade of cuts that have brought "efficiencies fatigue" to many of the Department's senior civil servants. As former Secretary of Defense Robert Gates explained a few years ago, it is tempting to try to achieve savings through arbitrary, across-the-board cuts, but that isn't real reform. "True reform," he said, "requires making trades and choices and tough decisions, recognizing that some activities are more important than others. It is hard to do, but essential if you are to re-shape any organization into a more effective and efficient enterprise."

If you want to make DoD more efficient, you have to understand how the Department's organizations and processes work, so that you can figure out how things can be done better. For example, I tried to rationalize the OSD hiring process, expedite the system for approving congressional reports and correspondence, and eliminate bottlenecks in the approval of conference attendance for scientists and engineers. I brought in new managers for the Defense Human Resources Activity (DHRA) and the Defense Manpower Data Center (DMDC) to streamline their organizational structure and bring order to their chaotic information systems. Those kind of changes take time to bear fruit, but if successful, result in more lasting improvement than arbitrary cuts.

A couple of years ago, Secretary of the Navy Ray Mabus complained that the Fourth Estate had grown like a weed, to the point where it was consuming almost 20 percent of the defense budget. "Pure overhead," he called it. In fact, DoD spent about $120 billion for the Fourth Estate in FY 2017 – roughly 17 percent of the defense budget. These numbers can be misleading, however. One-third of the Fourth Estate budget goes to the Defense Health Program. More than a third goes to the defense intelligence agencies, the Missile Defense Agency, and U.S. Special Operations Command – hardly what we usually think of as "pure overhead." The $30 billion a year that is left is still a lot of money, but it's less than 5 percent of the total defense budget.

Large defense agencies like the Defense Logistics Agency (DLA), the Defense Finance and Accounting Service (DFAS), the Defense Contract Audit Agency (DCAA), and the Defense Contract Management Agency (DCMA) perform functions that are needed by all of the military Services. Before these agencies were established, the Department ran parallel activities in each of the

Services, multiplying the overhead and the number of people needed to perform the work. The consolidated agencies have the advantage that they are essentially businesses, so their leadership is able to focus full attention on management activities. The Secretaries of the military departments and the Service Chiefs care about efficiency, but they have to worry about a hundred other priorities, covering everything from the well-being of the troops to the vision for a future force.

DLA and DFAS – the two agencies that get the most complaints because of their size – are among the most efficient entities in the Department. DFAS took over more than 300 separate finance and accounting systems and 27,000 employees from the Services when it was established in the early 1990s. It now runs a much-improved finance and accounting operation with a handful of business systems and just 11,000 people. DLA absorbed functions from the Services over a longer period of time, but managed to go from 64,000 employees in 1992 to 23,000 in 2014, while dramatically reducing warehouse space and other overhead. That's an annual savings of about $6 billion a year in manpower reductions alone from the consolidation of the two agencies.

Unfortunately, not all DAFAs are run as well as DFAS and DLA. Three of the DAFAs that reported to me as Acting Under Secretary of Defense for Personnel and Readiness – the Defense Health Agency (DHA), the Defense Commissary Agency (DeCA), and the Defense Human Resources Activity (DHRA) – are probably more typical of the average defense agency. I found them to be heavy on bureaucracy and not good enough on performance. They are underfunded for what they do, but what they do is not efficient. DHA and DeCA have embraced congressionally-mandated reforms, while DHRA has a new leader who has initiated significant reforms himself. They're on the right track, but they still have a long way to go.

Other defense agencies were established to perform specific tasks that do not fall naturally into the purview of the military services. These include the Defense POW/MIA Accounting Agency (DPAA), the Defense Security Cooperation Agency (DSCA), the Defense Threat Reduction Agency (DTRA), the Joint Improvised-Threat Defeat Agency (JIDA), the Defense Technical Information Center (DTIC), the Defense Technology Security Administration (DTSA), and the Defense Test Resource Management Center (DTRMC). These are not business entities, so their leaders and the political appointees to whom they report in the Pentagon tend to be more interested in policy than management. I have no doubt that these agencies could benefit from close management oversight and review, but their budgets are small, so the potential savings are also small.

So, is it possible to wring significant additional savings out of the Fourth Estate? Absolutely, but significant savings are likely to require some radical thinking. I would suggest two possible directions for the Committee and the Department to consider.

First, the Department may be able to achieve significant savings by increasing the transparency of its working capital funds. You all know the principle behind the working capital funds: a working capital-funded activity purchases supplies or performs work on behalf of operational customers, who then reimburse it for the cost out of appropriated funds. The idea is that the reimbursement process makes operational entities – the "buyers" – more aware of costs, so that they make better business decisions. Unfortunately, if prices do not appropriately reflect costs, they can incentivize bad business decisions instead of good ones. For example, it may appear less expensive for an operational command to use "free" military labor rather than paying the fees of a working capital fund, but the cost to the Department is likely to be much greater.

The DoD Comptroller establishes overhead rates for the working capital funds with one overriding objective in mind: to make sure that the working capital funds break even. As important as it is that the working capital funds do not overcharge or undercharge their customers, this system has not done enough encourage efficient operations, because the defense agency – the "seller" – is guaranteed to recover its overhead and stay in business whether or not its prices are reasonable. As a result, DoD customers often believe that they are paying too much. This problem could be addressed by establishing customer oversight councils which would require the working capital funded entities to justify their expenses to their customers and act like public utility commissions to balance customer cost concerns against long-term investment needs. Nobody has a greater incentive to eliminate wasteful spending than the person who is paying the bills.

Second, the Department may be able to achieve additional savings by increasing the responsibilities of the Defense business agencies and the working capital funds in a few key areas. If DFAS and DLA were able to save the Department billions of dollars a year through consolidation, we should be looking for other opportunities for similar economies. I would suggest a few areas for consideration.

First, administrative services. Washington Headquarters Services (WHS) was created to handle building and facilities, contracting and procurement, financial, human resources, and other support functions for the Pentagon – but even in the Pentagon, the military Services continue to perform many of these functions on their own. The Defense Media Activity has underutilized website hosting, television and audio studios, and other media support capabilities – yet the Services maintain their own media facilities and capabilities. Considerable efficiencies could be achieved by consolidating these activities in a single defense agency, which would be responsible for property management, building maintenance, purchasing and stocking of supplies, and other support activities – not only for the Pentagon, but for all defense installations.

Second, health care management. This Committee enacted important legislation a year ago to restructure the military health care system. You rightly recognized that a system developed to serve two incompatible goals – supporting the readiness of the military medical force and providing routine peacetime care to service members and their families – ends up doing neither one well. The DoD leadership is working hard to implement that legislation. However, it is hard to see how the military medical system can really be efficient as long as it has to support a 12,000-person headquarters in four separate medical hierarchies – one each for the Army, Navy and Air Force, plus one more in the Defense Health Agency. I believe that the Department should be as aggressive as possible in consolidating organizations and paring back bureaucracy as it implements the FY 2017 legislation.

Third, information technology and cyber activities. The DoD CIO is supposed to be in charge of the entire DoD information enterprise, including cybersecurity, communications, and information systems. However, most of the Department's communications and information systems are actually owned and operated by the individual components. As a result, the Services have continued to go their own way despite efforts by the CIO to institute defense-wide policies to achieve efficiencies through data center consolidation, enterprise licensing, and consolidated cloud contracts. The Department saved tens of millions of dollars by establishing the Joint Service Provider (JSP) as the single source of IT services to defense facilities throughout the National Capitol area. The savings from a nation-wide consolidation could be many times greater.

Finally, finance and accounting. DFAS was established 25 years ago to consolidate finance and accounting functions previously performed by the military services, and it has certainly made the functions that it performs far more efficient. However, the roles and capabilities on both sides have evolved considerably over the last quarter of a century. As a result, it may no longer make sense for the Services to ship transaction data to DFAS, so that DFAS can compile financial statements, to which the Services then have to certify. The Services now have modern Enterprise Resource Programs (ERPs), which they believe could perform some of the work currently provided by DFAS at no additional cost. I believe that a comprehensive reexamination of the relationship between DFAS and the military services could result in significant streamlining and improved finance and accounting operations.

I understand that the DoD leadership team has established a series of cross-functional teams to look at these and other areas. This is an important first step toward management reform and infrastructure savings, but only a first step. Intense leadership guidance and engagement is essential for a cross-functional team to produce useful results. I have no doubt that the mid-level military and civilian officials who make up these teams are incredibly hardworking public servants. Even so, they cannot be expected to sign off on disruptive changes that threaten to restructure organizations, unsettle existing relationships and reduce resources without strong and consistent encouragement and engagement from the Department's leadership.

Even if the cross-functional teams come up with solid recommendations for management reforms, it will be a huge challenge to implement them. In the absence of an all-out effort, a reform that looks good on paper may amount to nothing at all. In my time at the Department, it took me far more time to ensure that an initiative was actually implemented than it did to get the approval of the Secretary or the Deputy Secretary. Penciling in future budget cuts was not good enough: we had to work with the components and insist that they document what actions were taken, what contracts were cut, what positions were eliminated, and when.

Mr. Chairman, the new management team at the Pentagon has set incredibly ambitious objectives for themselves. If they can achieve even a small part of the efficiencies that they are after, it will be a tremendous victory for the Department and for the taxpayers. I look forward to the Committee's questions.