Common Defense 2011

Remarks of Mr. Brett Lambert
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No discussion about our nation's defense can occur without addressing head-on the fiscal environment in which we find ourselves and the reality of how the budget affects us all in the defense sector, both in industry and in the government. The effect of our nation's fiscal environment on the future of defense is not an abstract or theoretical issue. It is simply a fact.

I would also like to discuss some of the macro trends we are seeing in the industrial base. More specifically, how we in the Department of Defense are trying to better understand that base to enable us to identify the critical capabilities so vital to our continued commitment while fielding the best systems possible for our war fighters at the most affordable price to the taxpayers. This effort is especially important given the anticipated changes in the department's spending profile over the coming decade.

The Current Fiscal Environment: Lessons from History

Changes in the defense budget profile are not uncommon in the DoD history or in the history of the firms that have traditionally comprised our industrial base. A little over a year ago, while recognizing the importance of learning and adapting from historical experiences, then–deputy secretary of defense William Lynn began referring to the new era we are all entering as the "fifth inflection point" in post–World War II defense spending. The first three inflection points arose immediately after major wars were fought: World War II, the Korean War, and the Vietnam War. The fourth inflection point was the result of the Gramm-Rudman Act of 1985, where deficit reduction was the central tenet. The collapse of the Berlin Wall and the end of the Cold War further accelerated the decline in defense spending during that time.

When one looks back at these inflection points, several common themes emerge. First, each inflection point resulted in significant loss of core capabilities by the department. Second, reconstitution was required in each instance, often at significant cost. Third, in different ways, the DoD managed each inflection transition poorly. So the bottom line is that we are 0-for-4 in our management of budgetary downturns.

Now, I believe it is important to acknowledge the former and current DoD leadership for recognizing our past missteps. Specifically, former secretary Robert Gates, former deputy secretary Lynn, Deputy Secretary Dr. Ashton Carter, and acting undersecretary Frank Kendall have been organizing and preparing for the new environment for a number of years. Although to many, the effort began with a speech by Secretary Gates in Abilene, Kansas, in 2010, the underpinnings were well under way long beforehand. In fact, five broad lessons that emerged from earlier inflection points have served as a road map for DoD planning for quite some time.

First, we must make difficult decisions early. The current fiscally constrained environment is not going to improve anytime soon. There will be less money than we anticipated in the future. And because even well-managed programs experience cost increases, the bottom line is that if we cannot afford it now, then we will certainly not be able to afford it in the future. It is irresponsible to embark on programs that we simply cannot afford. We need to make the hard decisions now to live within our expected resource levels. Affordability is, and will remain for the foreseeable future, at the forefront of our purchasing decisions.

Second, it is impossible to generate needed savings through pure efficiencies alone. By pure efficiencies, I am referring to the performance of the same function but doing so with less money. We can generate some savings through this method, but we are not going to find enough pure productivity gains to generate all of the necessary savings required. This means that we have to prioritize. We will eliminate programs that, while valuable, may not be valuable enough to sustain in the current budget environment. You have already seen several high-profile program terminations, not because we did not want these systems, but because we simply cannot afford them at this time.

Third, budget reductions must be evaluated in a balanced way. Reductions focusing on a single area raise costs later. For example, overly severe cuts in operational accounts hollow out the force by depriving it of essential training and maintenance. Similarly, reductions that single out investment accounts, while seemingly easy, effectively force a procurement holiday that might necessitate a future bulge in procurement to catch up the inventory.

This approach is often penny-wise and pound-foolish. Outdated equipment ultimately needs to be replaced at great expense a decade or so later. The bill that comes due is far greater than if careful consideration had been given during initial budget planning. To prevent such problems, we need to balance reductions today across force structure, O&M, and investment accounts.

Fourth, defense budgets should not be reduced too quickly or too drastically. We need to recognize that budget reductions have long-term effects. Rebuilding capabilities is both expensive and fraught with risks. We must protect our core missions, maintain our technical superiority and the quality of our force, and ensure that key elements of our industrial base which are essential to our current and future capabilities continue to remain available to our war fighters.

And fifth, we must be mindful of the state of our industrial base as we make these difficult decisions in the months and years ahead. It is important to remind ourselves that despite spending over $1 billion a day, we in the Pentagon do not actually make anything. Our industrial partners provide much of the innovation and almost all of the production and maintenance of the systems and services our war fighters rely upon to remain a fighting force unmatched in the annals of history. We must not take this base for granted—it is not a birthright.

Macro Trends in the Industrial Base

Now, I would like to turn to the second topic: macro trends in the industrial base. I firmly believe that we must maintain a financially robust and technologically advanced industrial base if we are to succeed in aligning our available resources to our current and future requirements. Without a robust and vibrant base, all of our policies would be to no avail. At the end of the day, we must recognize a simple truth: we in the DoD do not actually make anything. We rely on our industrial partners to develop, build, manufacture, integrate, and maintain the products and services upon which our war fighters' lives depend, along with the lives of the citizens whom they defend.

I see three current trends changing our industrial base. Simply put, our base is more global, more commercial, and more financially complex. This reality is truer today than it was yesterday and will be even truer tomorrow than it is today. The defense industry and its suppliers are constantly changing and constantly adapting to the department's requirements and the conditions set forth by the marketplace. This evolution in the base generates new and difficult challenges that require our attention.

Outdated constructs of a static and stale industrial base must give way to the basic fact that our base is no longer a singular, monolithic entity. Any industrial-base policy must take this fact into consideration, developing a more sophisticated and nuanced view of our base. Overall, the goods and services the DoD relies upon reach far deeper into the overall US economy than most people appreciate. While there are unique items produced solely for the department, these items often rely on a complex and integrated supply chain of manufacturers that if restricted at the subtier levels would jeopardize our ability to support the war fighter.

I will start with the first reality of our industrial base: our base is more global, and we must recognize the implications of the global marketplace in which we operate. We are finding that increasingly the advanced goods and services upon which we rely are produced by firms that were not found in the United States. Additionally, we are finding that many lower-tier and information technology companies in our supply chain are located in countries that are not our closest allies.

Buying from a global environment does offer many advantages. First, it increases competition and reduces costs. Second, it facilitates the introduction of new technologies and concepts. Third, it often supports coalition war-fighting efforts; at a minimum, it lessens the challenges of operating across coalition partners. Fourth, it allows us to benefit from the lessons learned and efficiencies gained in other nations that have faced difficult financial circumstances and were forced to implement their own "Better Buying Power" initiatives.

However, there are also associated risks with our increasingly global environment. These include, but are not limited to, the threat of counterfeit or inferior parts entering the supply chain, the potential for undue reliance on components whose origins or actual configurations might not be fully understood, and the risk of leaking intellectual property to foreign businesses and governments. We in the department are acutely aware of these risks and are aggressively working across our enterprise to address them.

The second reality of our industrial base, closely linked to what I just described, is that increasingly, many of the industrial segments vital to defense are commercial in nature or rely on commercially designed parts.

This is a trend that the department has been more willing to recognize in policy than in practice. I estimate that 25 years ago, nearly 70 percent of the goods and services the DoD procured were developed and produced exclusively for the military. Today, I estimate that the ratio has reversed, with approximately 70 percent of the goods and services procured either having been made for commercial consumption or originally developed with commercial applications in mind.

This is a difficult reality to embrace. Yet, we must adjust to this new reality if we are to successfully navigate this new industrial terrain. The DoD cannot afford to dominate or sustain every important domestic industry upon which it relies. It is simply not economically feasible or strategically desirable. The department will continue to support niche elements of the industrial base that are critical to our nation's security, but we must first improve our understanding of precisely what these critical elements are and how their absence might disrupt the supply chain. Buying from commercial firms, when warranted and prudent, allows us to save money to support the defense-unique segments.

Introducing commercial products into the defense arsenal is not without its own set of challenges. Incorporating more commercial firms will require eliminating many of the bureaucratic barriers to entry that currently exist within the defense marketplace. Top managers of commercial companies might find the complexities of working with the DoD as both a regulator and a buyer confusing and challenging. I am aware of these difficulties, and the department is working with our industry partners to explain the processes and to make the rules of market entry more transparent.

We in the department recognize the dichotomy of our approach and the hazards associated with it. On one side, the key attribute that allows for a steady, long-term supply base is the high barrier to entry that our market imposes. But at the same time, we want to lower these barriers to facilitate ease of entry and exit, provide access to the most advanced technology, and increase competition for our commercial partners. By reducing barriers to entry, we are opening ourselves up to companies that might respond to short-term pressures that are in direct conflict with the department's longer-term interests. We are taking measures to mitigate these risks while opening up the market to more commercial enterprises.

The third reality of our industrial base is the growing complexity and importance of the financial sector. The financial community has a vital, and often overlooked, role in ensuring the health and viability of our industrial base. From small technology start-ups that seek venture funding to pursue transformational products and applications, to the debt markets that support our base through access to capital as programs mature and evolve, the industrial base simply cannot survive without access to capital on a competitive basis. And, as is the case with our supply chain, the financial sector is becoming more complex and more global each day. The DoD is considering how the new sources of finance affect investment opportunities in the defense industry—and whether we need to adapt our own financing policies to ensure that investment money reaches our critical suppliers.

Sector-by-Sector, Tier-by-Tier Evaluation of the Defense Industrial Base

The common theme of these three realities is that our base is becoming increasingly complex. Consider an analogy to the Mall of America: anchor stores are the major companies in defense and aerospace, the national chains are the niche suppliers, and the hundreds of other shops and stores are the multitude of lower-tier manufacturers, suppliers, and service providers in the supply chain. When you are used to buying everything from the anchor stores, it is easier to track your spending and to know where to buy the things you needed. But in the Mall of America, you might actually spend a bit at many different stores, whose names you do not really recognize—and you might wonder as you walk past other stores, who would buy anything there? The answer is probably that the Pentagon buys something from the analogous companies in the US economy, even though the department does not know much about the companies or their long-term viability.

We in the DoD lack a systematic understanding of the companies that comprise the lower tiers of the defense supply chain. These companies often contribute some of our best innovation and critical subcomponents to our vital programs and systems, yet we have had little visibility and insight into their technological and industrial capabilities and the unique challenges they face as subcontractors and lower-tier suppliers.

For this reason, my office is spearheading multiple, concurrent efforts to map and better understand the gross anatomy of the defense industrial base. The holistic, systematic character of this effort contrasts with previous program- and product-focused assessments.

The initial phase of the sector-by-sector, tier-by-tier (S2T2) review will develop a baseline of data across a wide swath of industry (including aircraft, shipbuilding, space, ground vehicles, missiles, missile defense, services, and information and communication technology). Sustained efforts will maintain and strengthen the data over time, and in the future, the database and methodology will serve as a starting point for the department's wide variety of industrial assessments. The reservoir of knowledge will contribute to acquisition decisions, help ensure realistic program objectives, and reduce programming swings that disrupt industrial base investment. It will also contribute to the department's merger, acquisition, and divestiture reviews and other industrial base policies.

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