

America's Imprudent and Unsustainable Fiscal Path

Fiscal Challenges Confronting DoD Will Necessitate Better Acquisition Outcomes

David M. Walker

A fiscal and financial crunch is coming. It's not a matter of if, but to what extent and at what time. The government is on a "burning platform," and the status quo way of doing business is unacceptable.

This article provides *Defense AT&L* readers my broad perspective of where the country is and where we are headed from a financial and fiscal standpoint. I also outline some of the other challenges that the nation faces because our fiscal and financial crunch overarches everything. There will ultimately be a ripple effect on every department, agency, program, and policy in the federal government.



High-Risk Areas

We have large and growing structural deficits in the out-years. We have rising public expectations for results. We also have a number of trends and challenges that face us as a nation and our position in the world that don't have geopolitical boundaries—whether you're combating terrorism, whether you're fighting infectious diseases, whether you're promoting clean air and water, or whether you're trying to assure stable capital markets. We have to be able to partner more internationally as well as domestically—partner for progress between governments, between the public sector, private sector, and not-for-profit sector.

We have additional resource demands due to Iraq, Afghanistan, incremental homeland security costs, and recent natural disasters. We also have a range of government performance, accountability, and high-risk areas. Figure 1 shows the Government Accountability Office's latest high-risk list. These programs represent areas at

greater risk of fraud, waste, abuse, and mismanagement; and others at risk of not achieving their mission. DoD is prominently represented—14 of 25 areas. DoD has some of the best people, both in uniform as well as civilians. The total force of civilian, military, and contractor communities is very capable—an absolutely awesome power. DoD is No. 1 in the world in fighting and winning armed conflicts—it's an A + . But in my opinion, DoD is a D (rated on a curve and giving the benefit of the doubt) on economy, efficiency, transparency, and accountability.

Wants vs. Needs

Business transformation within DoD has been a challenge since 1947, and a number of things are going to have to be done fundamentally differently in order to get DoD to where it needs to be. For every dollar that DoD spends today on a want is a dollar it will not have for a need tomorrow—because the crunch is coming.

Let me give you a little bit of a financial perspective so you can put this in context. In 1964, almost half the federal budget was for defense. If you fast forward 40 years to 2004, it was down to 20 percent. The 2005 numbers haven't been released yet. Where did the money go? It went from defense to Social Security, Medicare, and Medicaid. That trend cannot continue.

In 1964, 7 percent of the federal budget was for interest. The same was true in 2004. Today, however, the interest portion of the budget is escalating rapidly because we're adding debt at or near record rates and interest rates will go up. We are very fortunate that the Chinese, the Japanese, and other countries save a lot, because we don't. Right now, what they're doing is loaning us their excess savings, which means that they end up holding an increasing piece of our nation's mortgage—and that could have serious implications for our future economic and national security.

Walker is the comptroller general of the United States, the nation's chief accountability officer, and head of the U.S. Government Accountability Office. As the head of GAO, he oversees a legislative branch agency whose mission is to help improve the performance and assure the accountability of the federal government for the benefit of the American people.

FIGURE 1. GAO's High-risk List

High-Risk (HR) Areas	Designated HR
Addressing Challenges in Broad-based Transformations	
Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures	1997
Strategic Human Capital Management ^a	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook ^a	2001
Managing Federal Real Property ^a	2003
Implementing and Transforming the Department of Homeland Security	2003
Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security	2005
DOD Approach to Business Transformation ^a	2005
DOD Supply Chain Management (formerly Inventory Management)	1990
DOD Weapon Systems Acquisition	1990
DOD Business Systems Modernization	1995
DOD Financial Management	1995
DOD Support Infrastructure Management	1997
DOD Personnel Security Clearance Program	2005
Managing Federal Contracting More Effectively	
DOE Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992
Management of Interagency Contracting	2005
Assessing the Efficiency and Effectiveness of Tax Law Administration	
Enforcement of Tax Laws ^{a,b}	1990
IRS Business Systems Modernization ^c	1995
Modernizing and Safeguarding Insurance and Benefit Programs	
Medicare Program ^a	1990
HUD Single-Family Mortgage Insurance and Rental Housing Assistance Programs	1994
Medicaid Program ^a	2003
Modernizing Federal Disability Programs ^a	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program ^a	2003
Other	
FAA Air Traffic Control Modernization	1995

^a Legislation is likely to be necessary, as a supplement to actions by the executive branch, in order to effectively address this high-risk area.

^b Two high-risk areas—Collection of Unpaid Taxes and Earned Income Credit Noncompliance—have been consolidated to make this area.

^c The IRS Financial Management high-risk area has been incorporated into this high-risk area.

In 1964, two thirds of the budget was discretionary spending decided by Congress each year. In 2004, discretionary spending went down to 39 percent. Stated differently, 61 percent of the federal budget was on autopilot in 2004, and that percentage is growing every year. It should come as no surprise that defense is in discretionary programs such as homeland security, the judicial system, education, transportation, the environment, and the GAO. These

are all important expenditures, some of which are in the Constitution of the United States. Yet, these items that are deemed to be mandatory spending are squeezing out discretionary spending. The past cannot be a prologue.

Figure 2 shows the bottom line numbers in 2004/2005. You need to add 9 zeros to each of these numbers to get a sense for what they really look like. In 2004 we ran a \$412,000,000,000 unified budget deficit. But that's really misleading because we spent every dime of the Social Security and Medicare surplus on other government operating expenses. We ran an operating deficit of \$567 billion. Now of that \$567 billion, only a little over a \$100 billion had anything to do with Iraq, Afghanistan, and incremental Homeland Security costs. (By incremental I mean post-9/11 costs. Before 9/11, we had the Coast Guard, the Border Patrol, Customs Service, and the Secret Service.)

We haven't been in a recession since November of 2001. We had the strongest economic growth rate of any industrialized nation in 2004/2005. How to justify deficits of that size? The answer is you can't. It's fundamentally imprudent. We are mortgaging our kids' and our grandkids' future. They're going to pay a big price unless somebody starts doing something different—and soon.

Demographic Tsunami

In 2008, the first baby boomer reaches 62 and therefore is eligible for Social Security. In 2011, the first baby boomer reaches 65 and is therefore eligible for Medicare. At that point in time, we are at the beginning of a "demographic tsunami" that, unlike most tsunamis, will never recede. It will put incredible pressure on the budget, the economy, workforce factors, and a variety of other areas.

We are not well prepared. Our nation's budget works largely on a cash basis—cash in, cash out. We don't have a capital budget. There are a number of other challenges associated with our budgeting process. Most of the money is one-year money; there is some multiyear money and some no-year money, but it's mostly one-year money.

In 2000, if you added up the total liabilities of the United States and the unfunded promises attributable to Social Security and Medicare, it was \$20 trillion—that's 20 followed by 12 zeros. In four years it went from \$20 trillion

FIGURE 2. Fiscal Year 2004 and 2005

	Fiscal Year 2004		Fiscal Year 2005	
	\$ Billion	% of GDP	\$ Billion	% of GDP
On-Budget Deficit	(567)	(4.9)	(494)	(4.0)
Off-Budget Surplus*	155	1.3	175	1.4
Unified Deficit	(412)	(3.6)	(319)	(2.6)

* Includes \$151 billion in fiscal year 2004 and \$173 billion in fiscal year 2005 in Social Security surpluses and \$4 billion in fiscal year 2004 and \$2 billion in fiscal year 2005 in Postal Service surpluses.

to \$43 trillion. I expect the number for 2005 will be at least \$46 trillion. That number is going up every minute of every day for three reasons: continued deficits; demographic destiny; and compounding interest costs.

When you're an investor, compounding works for you; however, when you're a debtor, it works against you. To put these numbers in perspective, the 2005 number is likely to be \$46 to \$50 trillion, but probably closer to \$46 trillion. The estimated net worth of every American in the United States was estimated in 2005 at \$48.5 trillion. Under the status quo, we would have to confiscate nearly the entire net worth of every American and invest it at Treasury rates in order to deliver on our current promises. Obviously, that is not going to happen. We need to recognize the reality that we are on an imprudent and unsustainable path—and we need to change course.

Figure 3 is based upon four assumptions that the Congressional Budget Office is required to make by law:

- No new laws will be passed in the next 35 years.
- Discretionary spending, which includes national defense and homeland security, etc., will only grow by the rate of inflation in the long term.
- All cuts in 2001 and 2003 will sunset—none will be extended in whole or in part, and none will be made permanent.
- The alternative minimum tax (that bait and switch surtax that I have had the opportunity to pay in two of the last three years) will not be “fixed.”

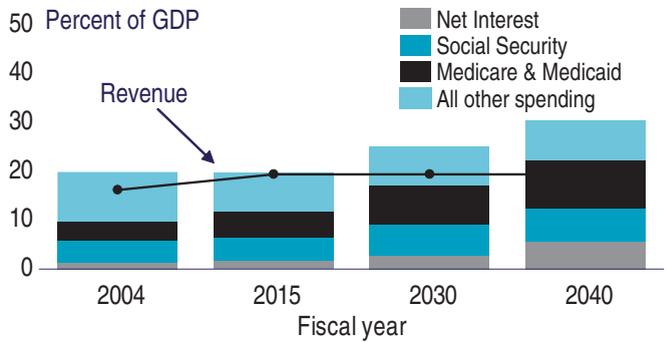
The line in Figure 3 represents spending as a percentage of the economy with inflation taken out. If the bar is above the line, that's a deficit. Congress is now using this simulation to make its annual budget and appropriations decisions. Clearly, there is a large and growing deficit starting after 2015. Many say that's a way off. Maybe we'll grow our way out of the problem and maybe not. Maybe the assumptions are too pessimistic and maybe not. How many people would believe these assumptions? I would venture to say no one reading this article. Yet, all four of these are behind the simulation in Figure 3.

Imprudent, Unsustainable Path

Clearly, we are on an imprudent and unsustainable path. The status quo is not an option. Faster economic growth can help, but there's no way we're going to grow our way out of this problem. If you're a student of economic history or have passed basic math, the numbers just don't work. What are we going to have to do?

- We are going to have to re-impose budget controls on both the tax and spending side of the ledger.
- We're going to have to make sure that we're considering the long-term affordability and sustainability of tax cuts and spending proposals before they're enacted into law.

FIGURE 3. Spending as a Share of Gross Domestic Product (GDP) (Under Baseline Extended)



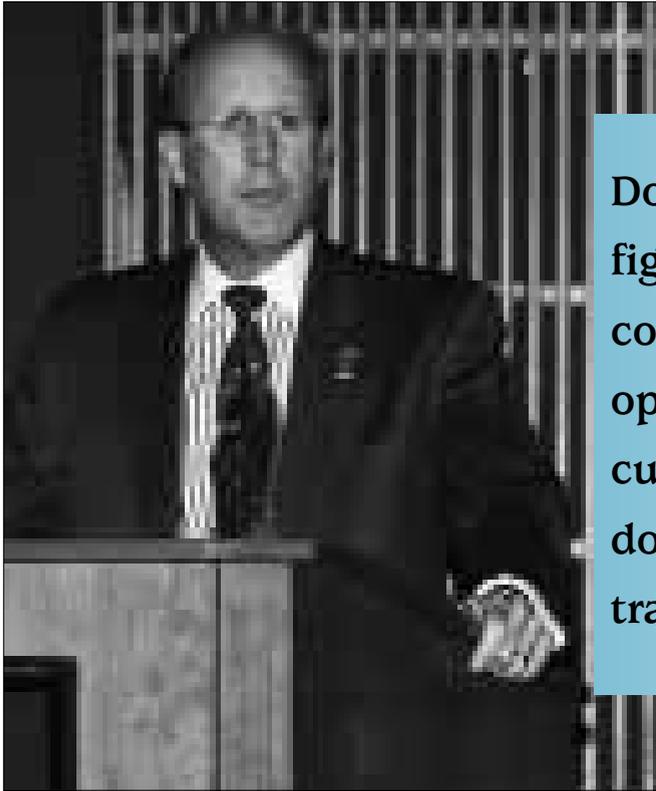
- We're going to have to revise our financial statement presentation to be able to show the large and growing financial burdens and the intergenerational consequences of those burdens if we don't start doing something about them.
- And we're going to have to develop a set of key national outcome-based indicators—safety, security, economic, social, environmental—to help understand where we are, where we're making progress, where we're not, and how we compare to other nations.

The Crunch is Coming

The United States spends \$2½ trillion a year and foregoes \$800 billion plus in some years in revenues because of tax preferences; yet in most cases, we have no idea whether our programs and policies are working or not because we don't have outcome-based indicators to be able to assess whether we're doing well or not. The United States is No. 1 in the world in many things including our military, but we are not No. 1 in the world in everything. In fact, we are laggards in a number of very important areas.

For example, we're No. 25 in the world in K-12 education. In a knowledge-based economy, that is a flashing red light. We spend 50 percent more of our economy on healthcare than any nation on earth, yet our life expectancy is less than most industrialized nations. Our infant mortality rate is higher than most industrialized nations, and our medical error rate is much higher than most other industrialized nations. We need to recognize and understand how we're doing because, ultimately, we're going to have to restructure entitlement programs; reexamine the base of discretionary and other spending; review and revise tax policy, including tax preferences; and determine what level of revenues will be necessary in order to pay our nation's current bills and deliver on our future promises.

The Defense Department and Homeland Security have largely been given a pass from budget pressures to date, but the crunch is coming.



DoD is No. 1 in the world in fighting and winning armed conflicts—it's an A + . But in my opinion, DoD is a D (rated on a curve and given the benefit of the doubt) on economy, efficiency, transparency, and accountability.

21st Century Challenges

The Government Accountability Office has published a report, *21st Century Challenges: Reexamining the Base of the Federal Government*, <<http://www.gao.gov>>. The document raises 200+ illustrative questions about government that need to be asked and answered. It also contains a hypothesis I believe is true: that a vast majority of the federal government's policies, programs, functions, and activities are based upon conditions that existed in the United States and in the world in the 1950s and the 1960s.

Let me give you two examples. The definition of *disability* that is used for most disability programs in the United States was determined in 1947. The organizational model, along with the classification system and compensation practices for the federal government, were determined in the 1950s.

DoD Transformation

Let's transition to a topic everyone's talking about—transformation. What is transformation? One possible definition for DoD is:

Creating the future of warfare and protecting our national security while improving how the department, including all of its various component parts, does business in order to support and sustain our position as the world's preeminent military power within current and expected resource levels.

What are we trying to accomplish with transformation? We're trying to create a more positive future by maxi-

mizing value and mitigating risk within current and expected resource levels. I picked these words intentionally. We're trying to create a more positive future. We're not just trying to build upon the past.

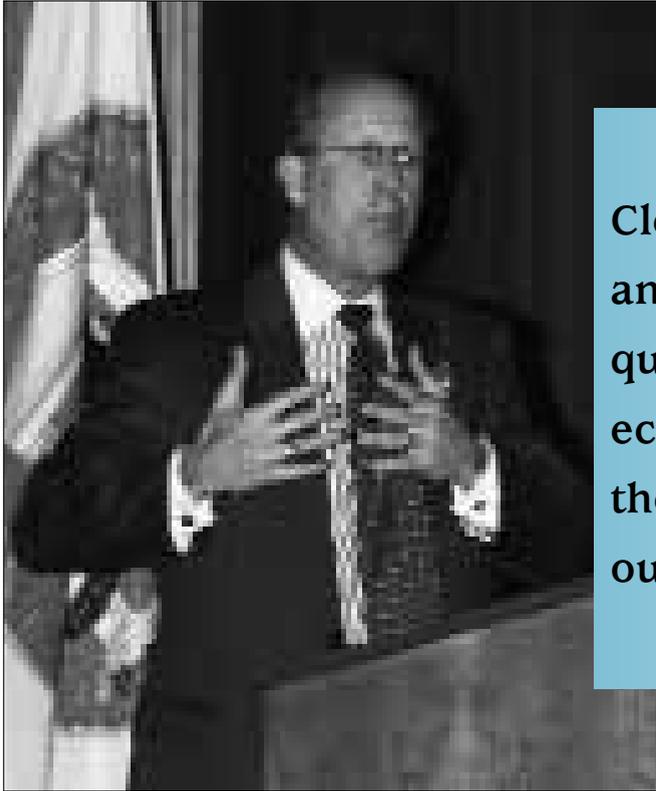
Incrementalism

Part of the problem with government is incrementalism. You assume the base of government is okay and therefore the big debate is whether we are going to plus-up or reduce the base. The base is unaffordable, unsustainable, and unacceptable. We have to think outside the box, to create a more positive future learning from lessons from the past, to maximize value, and to mitigate risk. Notice I didn't use the word minimize. As with investments, you cannot maximize value if you minimize risk. You need to manage risk. You have to take prudent risk, but you need to understand what you're doing, do it conscientiously, and try to take steps to mitigate risk—this is very important for DoD, where risk management has not been done with an eye to current and expected resource levels.

The Big A

For acquisitions—the so-called “Big A”—the difference between wants, needs, affordability, and sustainability is large and growing. DoD must reconcile the Big A because the longer we wait, the more money we're *not* going to have to meet our needs in the future. The irony is that in reconciling that Big A within the Services, among the Services, or enterprise-wide—whether for weapon systems or information systems—we must understand that we need to go about the process of determining what we're

investing in, but in a fundamentally different way. We need to understand what the credible and probable threats are for today and tomorrow. We need to make sure that we're allocating our resources to address the most likely current and future threats. We're not doing that adequately right now. After all, given current and projected budget deficits, every dollar we waste on unneeded wants today is a dollar we won't have for needs tomorrow.



Changing the Culture

One of the things that has to happen is that we've got to change the culture in government. Consider AT&T before divestiture: it was very much like the government in its culture because it didn't have a lot of competition. It was too hierarchical, too process-oriented, too stovepiped, and too inwardly focused. The company was comfortable with the way things were and didn't try to think outside the box to determine how things *should* be.

Commitment from the Top

In order to make transformation a reality, a lot of things are going to have to happen, one of which is commitment from the very top, meaning the president of the United States, the secretary of defense, and other top-level leaders. For DoD that means the SES and flag officer levels—it's got to be the total force, including the military, civilian, and contractor communities. We have a shared responsibility. We all have a shared stake in the outcome. The irony is that with the consolidation of the defense industry, many of the reconciliations that are going to have to take place involve the same contractors. It's not a matter of whether or not the contractor's going

to get work—it's a matter of what they're going to work on. We have not recognized that reality. We have not begun to reconcile the Big A, and I believe we're going to be hurting if we don't do it soon.

Fundamental Truths of Change Management

Part of the problem with committed and sustained leadership is that the top people within government tend to change jobs. But when you're making fundamental and dramatic changes that involve cultural change, even in the private sector it's a seven-plus year effort from when

Clearly, we are on an imprudent and unsustainable path. The status quo is not an option. Faster economic growth can help, but there's no way we're going to grow our way out of this problem.

you really get started. Now who's around for seven-plus years? The answer is very few other than dedicated civil servants. I would say, therefore, that civil servants will have to bear a disproportionate part of the burden to try to get us on the right path. All of you have a stake and you're likely to be around to either enjoy the benefits or suffer the consequences if things aren't changed. We need to recognize some of the fundamental truths of change management.

- Commitment and sustained leadership
- Demonstrated need for change (i.e., burning platform)
- Start at the top and with the new people (transformation takes seven-plus years)
- Process matters (e.g., employee involvement—don't fight a two-front war)
- Identifiable and measurable progress over time
- Communication, communication, communication
- Figuring out what's right versus what's popular
- Going from patience, persistence, perseverance to pain before you prevail.

Strategic Plan

In addition, we need to have a plan. The United States doesn't have a strategic plan. No administration has ever had a government-wide strategic plan. I don't know that the Defense Department has a strategic plan. We need

FIGURE 4. The Way Forward: Selected Potential DoD-Related Actions

- Revise the current approach to developing national military strategy (e.g., order, integration)
- Take a longer range approach to program planning and budget integration (e.g., life cycles, opportunity costs)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)
- Revise the process for developing and communicating key changes (e.g., DoD transformation, NSPS legislative proposal)
- Reduce the number of layers, silos, and footprints
- Strengthen emphasis on horizontal and external activities (e.g., partnerships)
- Differentiate between warfighting and business systems development, implementation, and maintenance (e.g., resource control, project approval)
- Make it okay to pull the plug or reduce quantities of weapon systems and information systems projects when the facts and circumstances warrant it
- Recognize the difference between approving and informing
- Create a Chief Management Officer to drive the business transformation process
- Get the design and implementation of the NSPS right, including modernizing and integrating the DoD, Service, domain, unit, and individual performance measurement and reward systems
- Employ a more targeted and market-based approach to compensation and other key human capital strategies
- Streamline yet strengthen current commercial contracts (e.g., incentives, transparency, and accountability mechanisms)
- Provide for longer tours of duty in connection with key acquisitions and operations positions (e.g., responsibility and accountability)
- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance, and opinions)
- Employ a more reasonable, strategic, and integrated approach to business information system efforts and financial audit initiatives.

to determine what force structures we need, what platforms we need, what footprints we need, and what technologies we need. We need to do that within the construct of current and future threats, keeping in mind the current and likely resource levels. We've not done that in the past.

The Government Accountability Office now has a strategic plan. We didn't have one until 2000, but it's made all the difference in being able to maximize value and mit-

igate risks within current and future resource levels. Its concepts are simple:

- Strategic plan
- Core values
- Organizational alignment
- Recruiting, development, and succession planning strategies
- Modernizing and integrating institutional, unit, and individualized performance measurement and reward systems
- Employee empowerment and effective communications.

Where there's no plan, all you can rely on is prayer. Prayer is important, but you need to have a plan too.

Organizational Alignment

You need to realign your organization to support the plan. There are way too many layers, way too many players, and way too many hardened silos in the Pentagon. For example, when I participated in Capstone several years ago, I found out that over 20 units within the Pentagon had to approve the activation and deployment of 10 people! DoD's got to de-layer and de-silo.

Think About Tomorrow

We need to move from past to future threats. We need to move from today and think about tomorrow's budgets, including the life cycle cost and the long-term affordability and sustainability of some of the things we're doing now. We need to move away from "get the money and spend the money." We need to move away from "plug-and-pray" approaches to weapon systems. What do I mean by plug and pray? Well, you determine how much money Congress is giving us. You then divide by the cost per copy and that tells you how many you can buy. So you plug into the budget how many you can buy and pray you'll get more money. The plug-and-pray approach is not strategic, it's not prudent, and it's part of the problem.

Systems—Needs vs. Wants

DoD needs to move away from the thousands of outdated and non-integrated information systems. It needs to recognize the difference between warfighting systems and business systems—those that are business-essential versus those that are wants—because we're throwing a lot of money at systems that are wants, not needs, systems that are not critical. That's money that is therefore not available to create a more positive future for the Defense Department and for the country. We need to look more from the standpoint of "we," rather than "me."

The Way Forward and Potential DoD-Related Actions

I serve as an ex-officio member of the Defense Business Board, which advises the secretary of defense on busi-

ness transformation. I've made some observations over the years, and I would encourage you to take a look at Figure 4 and consider implementing some of these potential DoD-related actions.

Better Acquisition Outcomes

The fiscal challenges confronting DoD will necessitate better acquisition outcomes. Over the last four years, DoD has been moving more toward mega-complex and integrated systems. In 2001, the top five systems in the Defense Department represented \$281 billion. Now it's \$521 billion. Some of the unwanted outcomes of the current acquisition process involve 12 to 15 years' development cycle times. Requirements-creep results from not nailing down requirements at the beginning. The result is cost overruns, schedule delays, and performance compromises—and building systems that we want versus what we need.

People and Tenure

Another issue I think DoD has to look at is how long do people—in this case program managers—stay in critical jobs? It's important to think about whether or not people should stay in their jobs longer. Currently, people are trying to do what they can to make sure everything goes okay in the program during their two- to three-year tour. In my view, that's not a long enough or broad enough perspective in order to do what's right overall.

Expectations

In program management, some of the challenges we've seen at GAO are that many times promises are high while cost estimates are low, which creates a double whammy. There's a huge expectation gap in that the program manager believes, "I'm going to get a lot for the taxpayer's dollar and it isn't going to cost very much." Then when variances occur, it's a triple whammy. The program manager gets less for more cost, and it takes longer. One of the reasons is failure to make sure that technology has matured to an appropriate level before moving to the next stage. If you don't have confidence in the maturity of your technology, you're just asking for problems.

Best Practices

We need to take a more disciplined approach to defining and to sticking to realistic requirements based on needs rather than wants, and based on likely current and future threats. We need to be able to make sure that we have clear and more performance-based contracting approaches. I recently read a GAO Report that noted DoD payment of 50 percent or more of potential performance bonuses to contractors who had significant delays and cost overruns. That's not performance-based.

DoD needs to use commercial best practices in design, development, and production decision making. More transparency is needed over waivers from established ac-

quisition policies and practices. DoD needs more continuity in key positions and more staffing for contractor oversight. When there's a problem in contracting, everybody looks bad. It's a shared responsibility: the government has part of the responsibility and the contractor has part of the responsibility. But when things go wrong, everybody's a loser, including the taxpayers.

Strengthen Services Acquisition

DoD also needs to strengthen services acquisition manuals and processes. A lot has been done with regard to platforms, but more needs to be done in the area of services, which is growing dramatically in the federal government in terms of contracting. It's fine to contract out certain things that aren't core to government. However, you must have an adequate number of people with the skills and knowledge to manage cost, quality, and performance. If you don't, you're headed for trouble. DoD, however, is not the only agency where services acquisition has become an area of concern; NASA, the IRS, and the Department of Energy, among others, are also struggling with the issue.

Today's acquisition workforce is stressed and strained. A significant element of the workforce is eligible for retirement. We need to do something about that—to restructure the workforce.

Leaders

We live in the greatest country on earth. We're No. 1 in many things but not everything, and we're on an imprudent and unsustainable fiscal path. We're going to have to make some dramatic and fundamental changes. We need leaders in the government—that means elected, appointed, and career civil servants—in the private sector, in the not-for-profit sector, and the media, who have three attributes:

- **Courage** to state the facts, to speak the truth, and to do the right thing even though it may not be popular and it may be counter-cultural
- **Integrity** to lead by example and practice what they preach
- **Innovation** to look for new ways to solve old problems and help others see the way forward.

We don't have enough leaders with the attributes of courage, integrity, and innovation. These qualities are going to be critical for us to make sure that we remain a superpower in the 21st century, to continue our economic growth, to improve our standard of living, and to help avoid unduly mortgaging the future of our children and our grandchildren.

Please join me in helping to address our current challenges, capitalize on our opportunities, and create a more positive future for our country and for future generations of Americans.