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Defense Budget and Program Issues
in the Fiscal Year 1991 Budget

Statement of
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of the United States

Before the
Committee on Armed Services
United States Senate



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Mr. Chairman and Members of the Committee:

I appreciate the opportunity to testify today before this Committee to present GAO's views on the defense budget. The rapidly changing events in the world, particularly in Eastern Europe, are creating new challenges; and the Department of Defense (DOD) and the Congress are striving to cut defense spending while maintaining national security.

In this type of environment, hard decisions are even more difficult to make, but this environment also affords opportunities to reassess strategies and priorities. My statement today will focus on the following areas:

- the prospects for deficit reductions in fiscal year 1991 and beyond;
- the relationship between the most recent Five Year Defense Plan and the 5-year budget projections for defense spending in the President's fiscal year 1991 budget submission;
- our observations on the management of defense activities and programs and a possible means to improve the management of these activities and programs;
- our views on the prospects for achieving the anticipated savings identified in the recently issued Defense Management Report;
- the results of our recently completed financial review of the Air Force;

- the vulnerability of certain DOD program activities to fraud, waste, and abuse and what we believe needs to be done to reduce these risks; and
- other program areas in which we have refocused our defense work to better respond to the rapidly changing political, military, and economic picture throughout the world.

PROSPECTS FOR DEFICIT REDUCTION
IN FISCAL YEAR 1991 AND BEYOND

The President's budget for fiscal year 1991 projects a deficit of \$63.1 billion and a budget surplus by 1993. In my view, these projections are the result of creative bookkeeping; they do not portray the real situation. Using the Congressional Budget Office's numbers, I believe that the deficit will exceed \$270 billion in fiscal year 1990 and will increase to over \$300 billion by fiscal year 1995 if you exclude the surplus in trust funds from the deficit calculation.

The true deficit situation is masked because we are using surpluses in the federal trust funds (for Social Security, highways and other areas) to pay current operating expenses. By doing this, the government creates the illusion that the deficit problem is being solved when in actuality it is getting worse. For example, in fiscal year 1990, the government used \$132 billion of the Social Security and other government trust funds to pay current operating expenses and cloud the true deficit situation. In fiscal year 1991, it is estimated that the government will use about \$136 billion of trust funds to reduce the actual deficit.

If we continue along this same path, we can expect the national debt to increase to \$4.5 trillion by fiscal year 1995. A debt of this magnitude would require annual interest payments of over

\$335 billion and would represent the largest single item in the federal budget.

RELATIONSHIP BETWEEN THE FIVE YEAR
DEFENSE PROGRAM AND THE PRESIDENT'S BUDGET

The President's fiscal year 1991 budget request reflects a fiscal year 1990 to 1994 defense budget projection of \$1.5 trillion. This is \$212 billion less than the most recent Five Year Defense Program (FYDP) which was prepared in 1989.

To date, DOD has decided on reductions of \$74.1 billion from the 1989 FYDP: \$4.2 billion in fiscal year 1990, \$22.4 billion in fiscal year 1991, \$22.8 billion in the outyears, and \$24.7 billion in anticipated savings related to the Defense Management Report. Even so, DOD is still faced with decisions on how and where to make reductions of another \$137.9 billion (\$212 billion minus \$74.1 billion) between fiscal years 1992 and 1994.

DOD officials explained that rapidly changing events make it difficult, if not impossible, to make the decisions at this time on where and how these reductions will be made. For these reasons, a new FYDP has not been prepared. While we do not think that DOD should make hasty and premature decisions, it is important that these decisions be made soon. Until these decisions are made, program managers may be making decisions based on erroneous information. Resources that are now allotted to them in the FYDP may not be available. Furthermore, the Congress is faced with budget decisions that will have long-term implications, but without an updated FYDP, it does not have the information necessary to fully assess alternatives.

THE NEED TO REASSESS MAJOR
WEAPONS ACQUISITIONS

The Congress will need accurate and timely information to use in scaling down the types and quantities of major weapon systems that enter DOD's inventory. In the President's budget for fiscal year 1991, 20 programs are scheduled for termination in fiscal year 1991. These programs account for about \$3 billion of reductions in fiscal year 1991 and a total of \$28.3 billion in reductions between fiscal years 1991 and 1994.

In view of the lessening tensions with the Soviets, the change in the types of conflicts we are likely to face in the future, and the increase in warning time that appears to have come about as a result of the reduced tensions, now is the time to rethink our entire weapon system acquisition strategy.

During the 1980s, numerous systems were approved for production before adequate testing had been done to ensure that the weapons did what they were supposed to do. This strategy of concurrent production and testing was designed to get systems in the field more quickly, but it often resulted in making extensive--and expensive--changes after the systems were fielded. In some cases, it resulted in systems that did not perform their mission. Several major systems acquisitions, such as the following, are now following this same path:

The B-2 Bomber Program: The B-2 acquisition strategy includes cost and schedule projections that rely on very high annual funding levels (\$7.5 to \$8.0 billion) and on ordering a large number of planes before the necessary testing is completed to demonstrate that the B-2 can perform its mission.

From 1986 to 1989, the B-2 cost estimate increased by a net \$12 billion: cost increases are estimated at \$18 billion, and projected future savings are projected at \$6 billion. The final B-2 delivery was extended 3 years to 1999. Future schedule changes and cost increases will occur if projected annual funding requirements are not appropriated or if planned program savings are not achieved.

The flight test program has just begun. If current schedules are met, it will be at least 3 years before critical performance requirements have been fully tested. At that point in testing, problems are typically discovered, and under the current schedule, over \$48 billion will have been appropriated, and 31 aircraft will have been ordered.

Major design changes early in the B-2's development caused manufacturing difficulties that have contributed to a slower production schedule and labor cost increases. Contractors have reported improvements in productivity and reductions in manufacturing defects, but these improvements are less than anticipated. Also, continuing design changes may further hinder manufacturing improvements.

In view of all of these uncertainties, as well as changing world conditions, we believe that it would be prudent to reduce the pace of the funding and production of the B-2 in order to limit up-front investment until the critical performance elements of the aircraft have been adequately evaluated.

Rail Garrison: Initial operational capability for the rebased Peacekeeper missiles is planned for 1992, and the full operational capability of all 50 missiles is planned to be achieved in 1994. To meet these milestones, an initial low-rate production decision for the missile launch cars is scheduled for February 1991.

At the time the initial production decision is scheduled to be made, no operational test and evaluation of the complete weapon system (including the missiles and rail launch cars) will have been conducted. Additionally, the Air Force plans to purchase about 73 percent of the launch cars after the initial production decision. Such a large purchase would, in effect, amount to full-rate production without any operational test or evaluation of the complete weapon system.

The Air Force considers the Rail Garrison to be a low technical risk because it views the program as basically an engineering effort to integrate proven missile systems into the existing rail industry. However, the Rail Garrison Test and Evaluation Master Plan identifies unique characteristics of the program that require testing. These include (1) the capability of the train to withstand missile launch, (2) the launch effects on commercial railroad trackbeds and the ability of the train to resume mobile operation after launch, (3) the capability of the guidance and control system to recover specified levels of accuracy following rail transit, and (4) the effects of horizontal basing and rail movement on Peacekeeper missile performance and reliability.

We have recommended that the initial production decision be deferred until the Air Force has conducted some operational test and evaluation of the complete weapon system. While the Air Force has delayed the initial production decision from April 1990 to February 1991, the first flight test of the complete weapon system is not scheduled until the third quarter of fiscal year 1992. Therefore, we believe that the \$1.62 billion in the fiscal year 1991 budget for the procurement of the rail launch cars (\$1.35 billion) and construction of the garrisons (\$269 million) should be deferred pending completion of operational tests and evaluation of the test results. We also believe that the \$102.6 million in advanced procurement funding and the \$104.8 million in military

construction funding, which was appropriated in fiscal year 1990, should be rescinded.

The M-1 Block II Program: The Army requested \$166 million in fiscal year 1990 for advanced procurement to produce a costly and significantly modified Abrams M1A1 tank. The Army believed that the modified tank, called the "M1A2," was needed as an interim response to future Soviet threats. The Secretary of Defense has also requested funding in the fiscal year 1991 budget to produce 62 M1A2 tanks. With completion of these tanks in March 1993, production of the Abrams tank is planned to be terminated.

In December 1988, the Defense Acquisition Board conditionally approved the Block II program (the third in a series of block modifications to the Abrams tank) for development but placed a \$300 thousand per-tank limit on the modifications. As currently designed, the modification package will cost about \$532 thousand per tank with total program production costs of over \$1.5 billion.

The Block II modifications are intended to improve the tank's survivability, fightability, and firepower, as well as to provide a linkage to the next generation of main battle tanks. However, the current package design does not include all the survivability, fightability, and firepower enhancements envisioned when the Army performed its cost and operational effectiveness analysis.

In an attempt to field an upgraded tank within the prescribed time frame, the Army adopted a compressed acquisition strategy, which is risky because key components of the modification package are in the early stages of development, and testing and evaluation will not be completed when certain production decisions are made. Thus, under the current plans, the Army will commit advanced procurement funds before test results are available.

We agree with the Secretary of Defense's decision to terminate the program.

The DDG-51: The DDG-51's contractor has experienced problems in designing and constructing the lead ship. Because of these problems and because the Navy has changed the contract's requirements, costs have increased substantially, and the expected delivery schedule has slipped about 17 months from the original estimate.

The target costs for the lead ship were initially established at \$111 million for design and \$157 million for construction. Target costs are now estimated at \$247 million for design and \$253 million for construction. These costs do not include government-furnished equipment, such as the AEGIS combat system.

Although the contractor estimates that about 50 percent of the lead ship is complete, the major job of outfitting the ship remains to be done. The combat system and other technical components have to be installed and integrated within the ship. Often, in the development of new systems, it is during the systems integration phase and subsequent testing that problems surface. The schedule and costs of follow-on ships are often affected.

Although the first follow-on ship is only 1 percent complete, the estimated cost to complete it is already over the ceiling price by 11 percent, according to the contractor, and by 22 percent, according to the Navy. In January 1990, we issued a report on the DDG-51 program in which we recommended that the Secretary of Defense delay the contract award for follow-on ships until he could provide assurance as to the development and affordability of the program.

Last week, the Navy awarded contracts for 5 follow-on ships and now has a total of 12 follow-on ships under contract. Furthermore, the

Navy could have as many as 17 follow-on ships under construction or awarded before the lead ship has finished testing and has been delivered in February 1991. We believe that the DDG-51 program should be reexamined.

The Advanced Combat Systems for Submarines: To meet new Soviet threats and to ensure continued U.S. submarine superiority, the Navy has initiated the development of two new advanced combat systems. The AN/BSY-1 is to be installed in the improved SSN-688 class nuclear attack submarine, and the AN/BSY-2 is to be installed in the SSN-21. The life-cycle cost for the two systems is estimated at over \$26 billion.

These two systems are experiencing problems. Problems with the AN/BSY-1 raise questions about when the improved SSN-688 will be fully mission capable. In its overly ambitious development objectives and schedules for the combat development program, the Navy allowed insufficient time to resolve technical problems. While the AN/BSY-1 system will provide the SSN-688 with improved acoustics and weapons launch capabilities, the system will be less capable in other areas. Also, these improved capabilities will be delivered later and will cost more than originally planned.

Potential problems with the AN/BSY-2 are similar to problems the Navy has experienced in developing other advanced submarine combat systems, including the AN/BSY-1. In order to meet the SSN-21's construction schedule, the Navy also established overly ambitious objectives and schedules for the AN/BSY-2 program. As a result, the first combat systems will not have full capabilities when they are delivered to the shipbuilder. The contractor will not be able to deliver the first combat system with full capability to the Navy until November 1994, 1 year later than necessary to meet the scheduled delivery of the first SSN-21 in May 1995.

One of the major problems affecting the AN/BSY-2 system has to do with its computer software. The system involves the largest computer software development effort ever undertaken for a submarine. According to the contractor's software development plan, it will require 900 software personnel to develop and integrate 3.6 million lines of code written primarily in a computer language with which few experienced programmers are familiar. No consistent training program has yet been developed by the contractor. Also challenging will be (1) designing a system with sufficient reliability to ensure that mission needs are met; (2) developing, refining, and testing a model to accurately predict system performance; (3) ensuring that there is sufficient time for the government to witness software testing and to resolve identified problems; and (4) ensuring that independent verification and validation assessments are performed on the software.

DOD's Automated Information Systems

Computers are a problem not only with weapon systems but with automated information systems as well. Our work on eight automated information systems being developed by the Army, the Air Force, the Navy, and the Defense Logistics Agency showed a disturbing pattern of cost growth, schedule delays, and performance shortfalls. Furthermore, the cost estimates provided to the Congress in budget submissions were not always accurate, current, or complete, and the systems generally lacked internal oversight to identify problems, such as the following, that needed to be corrected during the development phase:

- All the systems have experienced significant cost growth, some in the hundreds of millions of dollars. As of September 1988, the estimated cost to develop and deploy the systems was about \$2 billion--about twice the originally estimated cost.

- Four of the systems have been in development for at least 8 years, and three of the eight systems' development efforts were abandoned after spending \$330 million.
- Budget submissions to the Congress have understated the total life-cycle costs for some of the systems because DOD components have not provided current, accurate, and complete cost information.
- The oversight body within the Office of the Secretary of Defense has not rigorously enforced established policies, procedures, and criteria for reviewing major systems to identify and resolve problems with system development and to curb cost growth and implementation delays.

DEFENSE MANAGEMENT REPORT SAVINGS
IN THE FISCAL YEAR 1991 BUDGET

The recently issued Defense Management Report projects savings totaling \$39 billion between fiscal years 1991 and 1995. Of this total, \$2.3 billion is related to the fiscal year 1991 budget. Savings are anticipated by reducing and consolidating various functions and activities, streamlining the operations of organizations, and reducing the numbers of civilian and military personnel associated with these activities.

We have recommended many of these proposed cost saving measures in previous reports. For example, we previously recommended consolidating depots and maintenance facilities, centralizing payroll functions, reducing supply system costs, establishing realistic aircraft spares requirements, and streamlining the acquisition process.

I would like to emphasize that the anticipated savings are merely projections. To a large extent, the initiatives to achieve these savings are proposed in broad terms; statements on these initiatives do not contain the detailed plans or milestones that will be required to successfully implement the initiatives. Therefore, the savings referred to in the report are merely targets.

The initiatives DOD proposes in its Defense Management Report are commendable in that they offer opportunities to achieve significant savings. However, it is too early to tell whether these projected savings will be achieved. Furthermore, achieving these savings will require a sustained effort on the part of DOD's management over several years. DOD's track record in carrying out such long-term initiatives is somewhat questionable.

FINANCIAL REVIEW OF THE AIR FORCE

I would now like to briefly discuss the results of our most recently completed audit of the Air Force's financial operations.

The Air Force does not have accurate cost data for almost all of its non-cash assets such as inventory, equipment, aircraft, and missiles. Over 70 percent of the accounts on its consolidated statement of financial position were unauditible, and therefore, we were unable to express an opinion on the financial statements for fiscal year 1988. Also, because of these weaknesses, the financial information reported to the Office of Management and Budget and the Department of Treasury is not reliable.

There are many reasons that the accounts were unauditible. The Air Force does not have financial systems that produce reliable financial data. A number of large-dollar items--aircraft and accounts payable, for example--are not included in its accounting systems. A double-entry set of books with a general ledger is not

maintained to establish full accountability over costs and assets. To balance its accounts, the Air Force has made a large number of adjustments--some over \$1 billion--but Air Force officials could not explain the bases for these adjustments. The inventory systems do not provide reliable data to support either the quantities or the values of inventories on hand. Also, there is no accounting of the full cost of its weapons systems.

The Air Force is aware of some of its problems and has taken a number of actions to correct them on a case-by-case basis. Its initiative to prepare financial statements and have them audited is an important step. The Defense Management Report identifies initiatives that will address several of the Air Force's financial management weaknesses. However, cost-effectiveness and efficiency need to become Air Force priorities if meaningful and lasting improvements are to be achieved.

DEFENSE PROGRAMS THAT ARE VULNERABLE
TO MISMANAGEMENT, FRAUD, AND ABUSE

Last summer, we launched a major effort to identify areas that are at risk to mismanagement, fraud, and abuse. Our objective in doing this was to identify troublesome programs and functions in hopes of preventing another scandal similar to the one that has ravaged the Department of Housing and Urban Development (HUD). Much of what happened at HUD could have been avoided if stronger internal controls and better financial management measures had been in place.

We have identified 14 "vulnerable" areas--2 in defense--and we have targeted them for special attention. The two areas in defense are DOD's inventory management systems and its major systems acquisition.

DOD's Inventory Management Systems

DOD's inventories exceed \$103 billion; about \$34 billion of this amount is for items that are not needed to meet current operating or war reserve requirements. DOD's inaccurate inventory records and its failure to cancel requisitions and planned procurement actions for unneeded items also reflect serious financial management problems.

Inventory management has focused on filling orders and obligating funds--not on reducing costs or controlling or securing stock. The situation has evolved to the point that the services often do not know what or how much they have in inventory or on order. In this type of environment, the system is vulnerable to mismanagement, fraud, and abuse. In addition, storing stock that may not be needed is expensive and contributes to inventory management inefficiencies. When inventory must be relocated to make room for additional incoming inventory, the potential for losing control over stock location is increased. This, in turn, can result in increased material denials and unnecessary procurements because the needed stock cannot be found.

With the current pressure to reduce DOD's budget, this area provides a great opportunity for DOD to make major improvements in its inventory systems.

DOD's Major Systems Acquisition

The total estimated cost of major systems currently being developed or produced exceeds \$900 billion. As I have said before, enforcing established management controls to deliver capable and supportable weapons to the user when and where they are needed and at reasonable cost has been the exception rather than the rule. As a result, DOD continually buys systems that cost substantially more than originally estimated, are delivered much later than

originally scheduled, and do not have the advertised capabilities. We plan to address the effectiveness of the initiatives being taken to solve these long-term problems and to achieve meaningful savings.

REFOCUSING GAO'S EFFORTS TO
MEET CHANGING NEEDS

The rapid changes that continue to sweep Eastern Europe pose enormous challenges for U.S. policymakers and legislators who must make difficult decisions in the face of uncertainty. DOD planners must restructure defense forces without a clear definition of future security threats. U.S. arms control negotiators find themselves rushing to conclude agreements that are complicated by major revisions in their own negotiation positions, announcements of unilateral force withdrawals by NATO allies, and calls for the removal of Soviet troops by Eastern European nations.

While uncertainties about the future abound, continuing domestic budgetary pressures make the direction of the adjustments clear. U.S. forces that are withdrawn from Europe will probably be removed from the force structure. These withdrawals will require adjustments to logistical support, defense facilities both here and abroad, and major items of defense equipment. How well the United States plans for and manages the required adjustments during this transitional period will, in large measure, determine the strength of U.S. defense posture and the U.S. standing in the world well into the next century.

In making these tough decisions, we should not forget the lessons we learned in the post-Vietnam era when we cut readiness and sustainability. In my view, the defense forces would be better served by ensuring that a smaller force is well trained and equipped than by trying to maintain a larger force with no muscle.

In order to be in a position to respond to the many anticipated requests from the Congress, we have refocused much of our work in the defense arena. In many cases, our refocusing has consisted of accelerating the type of work we had already planned to do. In other cases, we have reoriented the scope of our work to accommodate the changes that have already taken place or are in the process of taking place. I would like to discuss some of these.

The first change relates to restructuring the armed forces. In so doing, we believe that sound planning will be essential if readiness and force quality are to be preserved during this turbulent period. Last year, in a report we issued on the U.S. military presence in Europe, we stated that more than 723,000 servicemen and women, U.S. civilian employees, dependents, and foreign national employees were stationed in Europe. The information in our report should be useful to your Committee in addressing the President's proposal to reduce U.S. forces in Europe and concerns about the costs associated with maintaining U.S. overseas commitments.

DOD's planning is complicated by a still-evolving definition of the threat, ongoing conventional and strategic arms negotiations, and budgetary pressures that may force deeper-than-anticipated cuts in defense spending. Budgetary savings will accrue from troop reductions in Europe but only if forces are removed from the force structure. We plan to monitor DOD's evolving plans and to report as necessary on the reasonableness of the criteria used in making major force restructuring decisions as well as the efficiency and effectiveness of other planned changes.

Restructuring the forces will also have major impacts, such as the following, on logistics, facilities, weapons acquisition programs, the defense industrial base, and strategy and doctrine:

- The return of troops and equipment to the United States will alter deployment plans and require a reexamination of logistical support and strategic air and sealift requirements.

- Proposals for U.S. and overseas base closures will force difficult decisions affecting local economies and plans for military construction and land acquisition. Closing bases will result in long-term savings but will entail costs in the short term.

- Budgetary pressures will intensify debate over the future of key weapons acquisition programs and force modernization plans. These decisions could have major impacts on the U.S. defense industrial base.

- The anticipated conventional and strategic arms control agreements will require a reassessment of basic military strategies and doctrine. Major decisions on naval force structure will need to be made as land forces are withdrawn from Europe. Restructuring may significantly alter the way reserve forces are employed, trained, and equipped.

Other major areas that will be affected by the changing events in Eastern Europe are arms control and the changing U.S. role in NATO. The ongoing conventional and strategic arms control negotiations are expected to result in major accords this year. Once these agreements are concluded, the focus will shift to implementation and verification. Costs as well as benefits will accrue from these accords. As political restructuring proceeds in Europe, the role of NATO will be redefined, and there may be adjustments to the U.S. role and its security commitments. We have a series of ongoing and planned assignments to address these issues as well.

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Mr. Chairman, this concludes my prepared statement. I would be pleased to answer questions at this time.

GAO Masking the Federal Deficit With Trust Funds

Fiscal Year		1985	1986	1989	1990	1991	1993	1995
Dollars in Billions		(actual)	(actual)	(actual)	(estimate)	(estimate)	(estimate)	(estimate)
Revenue		\$734	\$769	\$991	\$1,067	\$1,137	\$1,277	\$1,438
Outlay		946	990	1,143	1,205	1,275	1,418	1,555
Total deficit		-\$212	-\$221	-\$152	-\$138	-\$138	-\$141	-\$118
Federal fund deficit		-267	-283	-275	-270	-273	-297	-303
Trust fund surplus		9	17	52	66	74	98	128
Social Security		45	45	71	66	62	59	57
Other trust funds		54	62	123	132	136	157	185
Subtotal, trust fund surplus		54	62	123	132	136	157	185
Total deficit		-\$212	-\$221	-\$152	-\$138	-\$138	-\$141	-\$118

Note: Totals may not add due to rounding.

Source: FY 1985 and 1986—OMB's Special Analysis for FY 1987 and 1988, FY 1989—OMB's Budget for FY 1991, Other Years—CBO's Economic and Budget Outlook, January 1990.

GAO Reductions in the Five Year Defense Program

Dollars in Billions	
April 1989 budget submission	\$1,665.9
April 1989 FYDP adjustments	45.0
Subtotal	\$1,710.9
Jan. 1990 budget submission	1498.9
Total FYDP reductions	\$212.0
Reductions made	
1990 Congressional reductions	\$4.2
1991 DOD budget reductions	22.4
1992-1994 Impact of 1991 reductions	22.8
1991-1994 DMR reduction goals	24.7
74.1	
Budget reduction decisions needed	\$137.9