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DOD Efficiency: Charting A Course to Savings**

Good morning, everyone. I'm extremely pleased to be with you today. I want to thank the Air Force Association for the opportunity to discuss an issue of importance to us all.

Of course, this event coincides with National Aerospace Week, which has now been officially designated by Congress as the third week in September. AIA kicked this off last year, and we're gratified by the response we've had, especially by AFA and organizations both inside and outside the Beltway. This week is a great opportunity for us to reinforce the role the aerospace and defense industry plays in the American economy, our national security and our technological superiority.

We also want to salute the significant and unique contributions of the more than 819,000 Americans in every state of the union that bring a diverse set of skills and capabilities to their jobs --engineers on the cutting edge of advanced materials; structures and information technology; machinists fabricating complex shapes and structures; and technicians from almost every degree field, testing, applying and integrating the latest technologies. This blend of skills gives our aerospace industry the strength to lift America.

It's also appropriate during National Aerospace Week that we're joining with the Air Force Association to recognize our men and women in uniform who, along with the civilian workforce,

both government employees and contractors, provide the strength to defend America in a sometimes hostile world. I want to add my voice and the voices of all who are represented by the Aerospace Industries Association to say “thank you” to so many of you here – to you and to your families for the job you do, the hardships you endure and the obstacles that you overcome every day.

This commemoration of our industry coincides with the unveiling of DOD’s “efficiency initiative” or, as it is known affectionately around our shop – “Carter’s Crusade.” Seriously, though, we are eagerly addressing our responsibility to be an active partner in these discussions. We’ve already had a series of excellent meetings of our CEOs with DOD leadership and we expect this interaction to continue.

In fact, we want to reinforce Under Secretary Carter’s statement yesterday that we are “managing together to a new era.” These are encouraging words. He unveiled a list of 23 directives to DOD’s acquisition workforce designed to achieve real savings efficiencies, and we’re pleased that a number of these align with the recommendations of our own CEOs that I’ll discuss in a few minutes. And, no surprise, he listed other steps that raise some concern and on which we’ll seek further clarification. But, is this a step forward? You bet it is. And industry has the incentive to help keep things going in the right direction.

In this spirit, I’d like to take you back in history a bit to the advent of the first military aircraft. The specs called for a flying machine that could carry two persons having a combined weight of 350 pounds -- that could hit a speed of at least 40 miles per hour -- and which could be taken apart and carried on a wagon. There was an open bidding process, but only the Wright Brothers could meet the specs, including a price of \$25,000.

The proposal was contained on one page. The single sheet of paper, that’s been called the birth certificate of the U.S. Air Force – Requisition Order 3619 – was issued on February 10, 1908.

Now, let's fast forward a bit. There's been a slight expansion in thinking about requirements, one might say, and so proposals have increased in length. I asked Lockheed Martin about the size of their proposal for the F-22. The answer? A mere 36,000 pages.

Now the F-22 is a tad more complicated an aircraft than the Wright Military Flyer, but I mention this comparison to make a point. Even though more complicated, the requirements, the hoops if you will, have exploded and so have costs. Part of the change is, of course, a result of the increased technological capability of fourth generation fighters. But, the size of the contract is also a testament to the growth in government contract requirements that drive cost.

So, our industry was actually delighted when Secretary of Defense Gates announced in his speech at the Eisenhower Library on May 8 that he intended to embark on a campaign to reduce costs and turn those cost savings into sustainable operational capability. We were even more enthusiastic when Under Secretary Ash Carter asked industry to contribute our ideas and energy to identifying real cost reductions while maintaining a reasonable return on industry's investment.

We truly believe that finding and eliminating serious cost deficiencies will require a joint DOD-industry effort. We see this as a partnership and we intend to keep our part of the bargain.

But let me be clear: We at AIA view this effort as vital to the entire aerospace industry, and not only defense. Our very large enterprise includes civil aviation and space, as well as national security and they are all joined at the hip. We have seen the effects of a downturn in commercial aviation, which thankfully is on the rebound. When one piece is diminished, the whole is affected. So a potential softening in the defense budget may drag down the entire aerospace industry. And if we want to prevent that, then it certainly behooves us to help find the efficiencies the Pentagon is seeking. The stakes are high – a robust industrial base, a strong workforce and cutting-edge products for our nation.

In response to DOD's request for our initial input, our companies generated a list of 97 initiatives ranging from big endeavors like reforming the export control process to more modest

improvements such as reviving the use of integrated product teams to improve communication. Then we took a more focused look and refined these ideas into a list of 10 things that DOD could undertake immediately -- within its own authority -- to save money.

Our entire list is available on AIA's website. But let me talk about just three of the proposals in our top 10 list. Maybe David Letterman will invite me on his show to read them all!

- First is the need for more multi-year procurements. Multi-year procurements save money both by stabilizing production and allowing companies to make more economically efficient buys of components and parts. We recognize that not all programs can be procured in this fashion, but most of our aircraft programs, like the F-35, are intended to be produced in quantities that, once the design is stable, would be good multi-year candidates.

We were gratified yesterday when the DOD leadership pointed to recently concluded negotiations for multi-year procurements of 124 F/A-18 strike fighters and E/A-18 electronic attack aircraft which, according to Ash Carter, will “yield over \$600 million in savings to the Department.” Multi-year contracting is a proven means of attaining considerable cost savings.

- Second would be the increased use of performance-based logistics contracts. PBLs offer a cost-effective means for sustaining equipment and facilities. The benefits of PBL partnerships for the warfighter are numerous and well-documented, but here are a few examples. Performance-based logistics improve readiness of systems vital to our nation's defense, which in turn, lowers procurement and maintenance costs throughout the lifecycle. Partnering also ensures tasks are conducted by those most qualified to do them, while critical skills are maintained for the long term in the industrial base and government. Finally, PBLs offer transparency and accountability through fixed-price contracts with clear data reporting, performance metrics and incentives to drive positive performance. One example was the contract for the C-17, where the cost in dollars per flight hour was reduced by 28 percent over a five-year period ending in fiscal 2009.

- Third is a need for a reduced volume of cost or pricing data. Contracting officers have an obligation to the taxpayer to determine whether a proposed price is fair and reasonable. Industry supports that requirement. However, the excessive requirement for such data -- when it is not needed to establish a fair and reasonable price -- is costly to both industry and the government. For example, for lot eight of the C-17 program, after 180 planes had been procured, Boeing was still required to deliver 63,000 pages of data. We believe that in the case of systems in the later lots of production, where there have been no major engineering changes, a fair and reasonable cost can be established through price analysis.

Now, each of the 10 initiatives we have shared with DOD will save money, avoid costs or reduce unnecessary effort. Consider this: even a two percent savings in the fiscal 2010 investment budget of \$207 billion -- which includes procurement -- would save some \$4 billion that could be kept in R&D that helps protect our men and women in uniform.

However, now is the time -- and Secretary Gates has given all of us the opportunity -- to think more boldly about new efficiencies.

Ingenuity and boldness are hallmarks of the aerospace community and one of the things we celebrate during National Aerospace Week. A number of our CEOs recently met with Secretary Gates, Deputy Secretary Lynn, and Under Secretary Carter to discuss ideas in four areas where significant savings can be generated.

The first area is export control modernization. The administration has already completed a draft "scrub" of military vehicles on the U.S. Munitions List. They've concluded that approximately three-quarters of the 12,000 transactions requiring an ITAR license last year -- about 9,000 items -- could have either been safely reviewed or licensed under the less stringent Commerce Department regime for dual-use technology or not require a license at all. This process should be promptly applied to the approximately 19 remaining USML categories. If we multiply by 19 what was accomplished by scrubbing just one category we'll see some real efficiencies!

The second area which we have recommended to DOD lies in promoting the efficient use of government and contractor resources. DOD already recognizes the need to improve the defense acquisition workforce, yet adding people is necessary but not a totally sufficient answer. The workforce needs the skills and training so that it can make the right kinds of decisions in a complex environment. A skilled acquisition workforce helps both government and industry by making timely decisions and reducing the risk of protests.

Secretary Gates recognized the need to reduce infrastructure in his recent decisions about the Office of the Secretary and the Combatant Commands. Our companies have also made some tough decisions. Lockheed Martin is significantly reducing its senior corporate staff. Northrop Grumman announced its intent to sell part of its shipyard business. BAE Systems announced a cut of 300 additional positions after earlier reductions totaling more than 600 jobs. More needs to be done in this area, and it will be increasingly difficult to do unless the Pentagon and Congress incentivize industry to reduce unnecessary and redundant infrastructure.

The third area is improving stability for requirements and programs. Instability adds time and cost, while predictability allows for planning and financially sound decision making. DOD recognizes the need for consistency in its acquisition guidance, but these processes need to be the norm. Programs like the F-16 and Virginia class submarine have proven that the use of block upgrades – which reduce risk -- promotes cost efficiencies. The Navy claims savings on the submarine of \$4 billion using this process.

But again, more needs to be done. Requirements must be limited to performance-based key parameters. Certainly, DOD's decision to make production rates economical and stable – announced yesterday -- will go a long way. Greater stability can be found through shorter program timelines and managing to them – and, the keystone of DOD's effort – managing affordability as a requirement.

The fourth and final area is eliminating government-unique processes and procedures. A 1994 Coopers & Lybrand study revealed that the cost then of unique requirements was a premium of

18 percent. Since that time, numerous new requirements have been layered onto the acquisition system.

We believe it's time to do another Coopers & Lybrand study to determine the current cost premium and identify areas where that premium can be reduced. But we don't have to wait for such a study to be completed. DOD can establish a process today with regulatory waivers that allow development and production to track to operational cadence. Then periodically assessing these waivers will provide a good indication of where permanent regulatory pruning can be done.

Secretary Carter's decision to target oversight processes, reviews, and other overhead-related procedures will assist in alleviating many of the costs associated with these burdens.

This list is not exhaustive, but we believe represents the innovative thinking in industry. We're in the process of developing a set of recommendations to give DOD in the areas I've described.

Let me conclude with a note about the process of acquisition reform. Since the end of World War II, there have been literally hundreds of attempts to change the way DOD buys things, some on a large scale and some small. The ship that is DOD procurement tacks slightly with each change, but rarely changes course.

At root of this intractability is a simple thing called democracy. While the public wants defense acquisition to be as efficient as a private-sector business enterprise, our system tends toward inefficiency. The public wants to pay the lowest prices for the best quality equipment, but they also want to ensure that every business has the same opportunity to compete for each contract. They may fail to recognize that there is only one customer for the products being produced according to that customer's precise specifications. They want to fix costs for work being done on a program over several years, but also want to change the amount of money available to pay for that program each year.

Reform of the defense acquisition system is possible and desirable, yet it will take some fundamental restructuring of how industry and the government work together, acceptance by all

parties that each participant in the process has a stake in a successful outcome and a willingness to make difficult decisions.

I don't expect that the efficiency initiative will take us back to the days of the Wright Military Flyer and one-page proposals. I do expect that at the end of this process – with industry working constructively with government – we will have a more rational system. Our men and women in uniform and the citizens they serve deserve nothing less.

Thank you for your kind attention.