2007

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DOUGLAS A. BROOK and PHILIP J. CANDREVA

Business management reform efforts have been part of the U.S. Defense Department agenda for decades. Current reform efforts have explicitly established the goal of generating, harvesting, and reinvesting savings from business management reform to buy more capital items; that is, they have focused on a measurable reallocation from operating and support costs to investment within a given budget top line. Recent increases in the defense top line, largely related to the war on terrorism, are not likely to persist; in addition, an examination of the factors affecting the top line suggests that a decline in the near term is likely. An examination of current and past defense management reforms suggests that efficiency-seeking business management reforms are not likely to generate sufficient resources to cover a budget decline. Instead, management reform should be sustained for reasons of stewardship and accountability.

INTRODUCTION

After six years of increasing budgets and an active defense management reform agenda in the G. W. Bush administration, it now appears that defense budgets may be headed for a decline and the future role of management reform initiatives may be uncertain. Internal

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pressures from rising costs for manpower, health care, acquisition, and operations and maintenance are constraining discretionary spending inside the defense budget. Despite significant increases in defense spending, resource allocation decisions have favored operating expenses over capital investments. External pressures from the budget deficit, rising costs for entitlement programs, pressure from other discretionary programs in the federal budget, and public opinion regarding defense activities suggest that the total resources allocated for defense will be further constrained in the foreseeable future. Meanwhile, the Department of Defense (DoD) and the individual service components have been looking toward major management reform initiatives as a means to save and reinvest budgetary resources.

This paper addresses both sides of the issue raised in the title: is the defense budget expected to decline and, if so, what are the implications for defense management reforms? What are the prospects for sustaining management reform in a time of declining budgets?

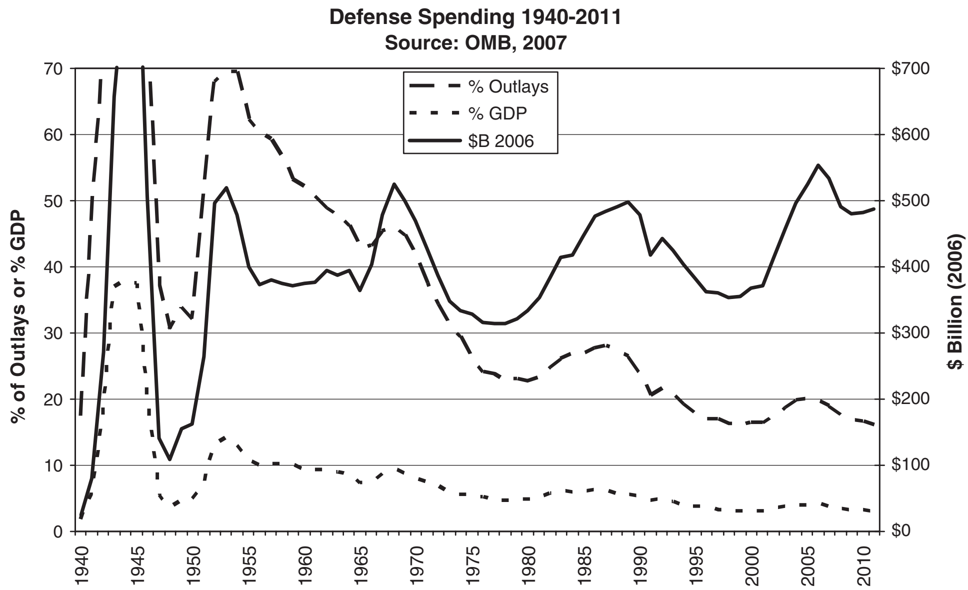
WILL THE DoD BUDGET TOP LINE DECLINE?

When one considers whether the DoD budget top line will rise or fall, there are historical patterns that should be considered and internal and external factors that affect those patterns. First, however, one must define the top line. If one defines the top line in absolute terms, budget authority and outlays are the common definitions. Both of these may also be defined temporally, as the request in the annual president's budget, or as the authority granted by congress in an appropriation, or as the final expended amount.

One may also define the defense top line in relative terms. One version of a relative measure is the percentage of Gross Domestic Product (%GDP) spent on defense. This is a widely used measure, but often a misused one. It is useful when comparing the defense spending of different countries as it normalizes the level of spending in terms relative to the size of the nations' economies. It is misused when the denominator effect is ignored—an economy that grows faster than defense spending suggests a decline in defense capability when, in fact, that capability may be rising. A second relative measure is the percentage of total federal outlays (%Outlays). This measure indicates the relative importance of defense spending in terms of spending for all the other activities of the federal government. If government is what government spends, then a decrease in %Outlays for defense indicates a shift in governmental priorities away from defense and toward other functions. This measure also suffers from a denominator effect. Defense spending could fall in %Outlays while still rising in absolute terms if the aggregate rate of growth in all other government programs is higher than in defense.

Figure 1 displays three measures of the defense top line over the period 1940–2011. Since World War II (WWII), in absolute terms, defense outlays appear as a cyclical pattern with a lower limit of about $350 billion and an upper limit of about $550 billion in constant FY2006 dollars. The cycles are fairly consistent, with a wavelength ranging

FIGURE 1



from 15 to 21 years and averaging 17 years. Fiscal Year 2007 is 18 years since the last peak in 1989, suggesting that *if the long-term pattern repeats*, defense will face declining absolute top lines beginning within the next few years and continuing for seven to 10 years.

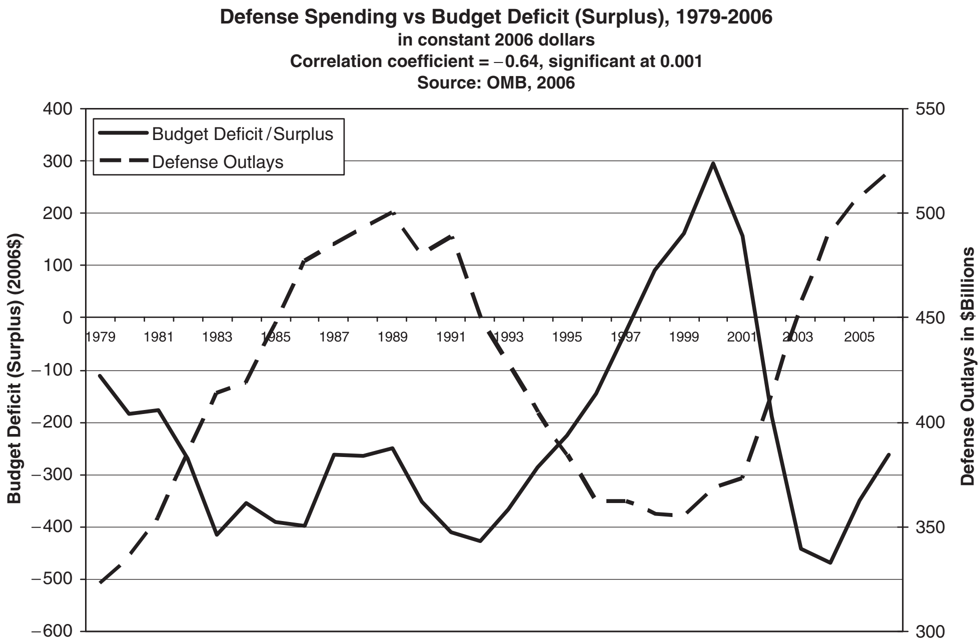
If one instead uses relative terms for defense spending, since WWII, defense spending as a %GDP has fallen rather steadily from a peak of 14.2 percent in 1952 to a low of 3 percent in 1999–2000. In 2006, defense spending stood at about 4.1 percent of GDP, which was one-third more than just a few years back, but one-fourth of what was spent in the 1950s. Defense spending as a percentage of federal outlays has also declined significantly, from a peak of 69.5 percent in 1954 (the last year of the Korean War) to a low of 16.1 percent in 1999. In 2006, defense was 19.8 percent of federal outlays.[1]

Today, approximately one-fifth of federal government spending is for national defense, and four-fifths are for other functions of government. In the 1950s, two-thirds of government spending was defense. *Should the long-term trends continue*, defense can expect declining relative top lines.

Simply identifying the trends of the last 50 years does not mean that those trends will apply to the next three to five years. We do not have the knowledge to make a point prediction. More than a long-term average is needed and there are other factors that may

1. Office of Management and Budget, *Historical Tables, Budget of the United States Government for Fiscal Year 2008* (Washington, DC: Office of Management and Budget, 2007).

FIGURE 2



affect the top line—factors both external and internal to the department. External factors are associated with federal fiscal policy and political dynamics.

External Factors

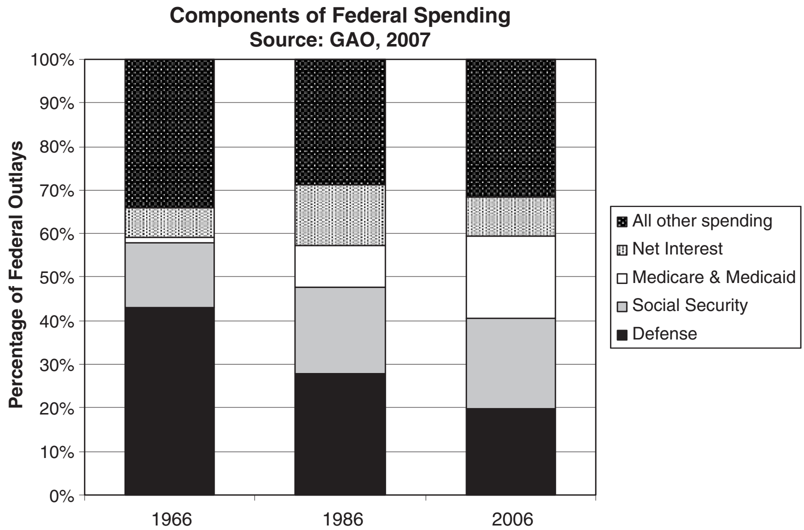
Deficits. As of 2006, the United States had experienced four consecutive years of budget deficits following four consecutive years of budget surpluses. The Bush administration's position is that it will eliminate the deficit by 2012.[2] When an administration or Congress wishes to reduce a deficit, generally it requires a combination of increasing revenues and decreasing outlays. If defense maintains even a steady proportion of federal spending during an overall decline, it will lose top line.[3] But the correlation between defense spending and deficits may be even more closely linked.

Figure 2 plots budget deficits against defense spending from 1979 to 2006. It is readily apparent that as defense spending increased, deficits increased; as spending on defense declined, deficits fell to the point of achieving surpluses. Statistically, the correlation is a rather strong -0.64. Of course, correlation is not the same as causality. Defense spending

2. George W. Bush, *The Budget Message of the President, Budget of the United States Government for Fiscal Year 2008* (Washington, DC: Government Printing Office, 2007.)

3. Of course, if growth is kept below the rate of inflation, there could be deficit reduction with a nominal increase in the top line.

FIGURE 3



does not necessarily cause deficits; rather, each could be affected by a third factor such as an unstable international situation. Levels of defense spending, as the figure suggests, are not necessarily driven by macroeconomic conditions. A larger military does not result because it is affordable; a larger military results because it is deemed necessary for the security of the state. In fact, the cause–effect relationship is often in the other direction. Financing of military expansion has historically been carried out in a manner that requires consideration of its effect on the economy.[4] However, the apparent relationship between defense spending and deficits suggests that balanced budget policies may exert pressure on the defense top line.

Mandatory Programs. Defense spending has declined from two-fifths of federal spending to one-fifth in the past 40 years, supplanted by mandatory spending; see Figure 3. From 1966 to 2006, interest on the debt and ''all other spending'' accounted for roughly the same proportion of federal spending: about 41 percent. The remaining 59 percent was largely defense spending in 1966; at the time, defense spending was three times more than Social Security spending. In the intervening 40 years, the proportion of federal spending on defense was reduced more than 50 percent while Social Security increased by 40 percent. Health programs, new in 1966, represent nearly as much as defense in 2006.[5]

4. Robert D. Hormats, *The Price of Liberty: Paying for America's Wars* (New York: Henry Holt, 2007).

5. Government Accountability Office, *Saving Our Future Requires Tough Choices Today: Fiscal Wake Up Tour* (GAO-527CG) (Washington, DC: GAO, 2007). Concerning health care, if one allocates the health-related programs from defense and ''all other spending'' and adds them to the Medicare and Medicaid wedge, the total health-care portion grows to about 25 percent and defense declines to about 19 percent. See Table 16.1 of the Historical Tables that accompany the federal budget for fiscal year 2008.

The Congressional Budget Office estimates that this shift will continue. They estimate that in 2016, the mandatory programs will cost $1,274 billion more than in 2006, a total of $2,793 billion.[6] This is more than all the projected federal outlays, mandatory and discretionary, in 2007. The CBO projects that in the period from 2008 to 2017, discretionary budget authority will increase at 2.0 percent per annum, relative to GDP growth of 4.5 percent, while mandatory spending will grow at 5.9 percent.[7]

Nondefense Discretionary Spending. Defense top lines not only feel pressure from growing entitlement programs, but may also face pressure from other discretionary programs. From 1985 to 2006, total discretionary outlays as a percentage of GDP declined from 10.0 to 7.8 percent. Of those 2.2 percentage points, defense spending accounted for 2.1 and other discretionary spending accounted for 0.1.[8] Nearly, the entire reduction in discretionary spending was absorbed by defense. The last few years of that history tell a different story, however. From 2001 to 2006, total discretionary outlays as a percentage of GDP increased from 6.3 to 7.8 percent. Of that 1.5 percentage point increase, defense accounted for 1.0 point and nondefense accounted for 0.5.[9]

Democratization of Defense Spending. How responsive are Washington decision makers to the demands of the public? The evidence strongly suggests that if the general public believes that defense spending is too high, defense spending declines and vice versa. Studies conducted at the end of the Cold War demonstrated empirically that the desires of the public are reflected in future spending decisions.[10]

Updating that research, Figure 4 displays the relationship between the direction and strength of public opinion about defense spending and subsequent changes in the proportion of federal outlays on defense. In a series of public opinion polls in which respondents were asked whether they thought that the United States spent too much, about the right amount, or too little on defense, the bars in the figure represent the difference between those who responded "too much" and those who responded "too little."[11] A downward-oriented bar represents more support for a declining defense budget than a rising one; the height of the bar represents the strength of that opinion. The line in the figure represents the percentage change in the subsequent year's defense spending (%Outlays) compared with the year during which the polling occurred. Statistically, the change in defense spending correlates strongly with the direction and strength of public opinion. When public opinion favors increased defense spending, spending has tended to go up the following year; when the public favors a decrease, spending tends to decline the

6. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007–2016* (Washington, DC: Congressional Budget Office, 2006).

7. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2008–2017* (Washington, DC: Congressional Budget Office, 2007).

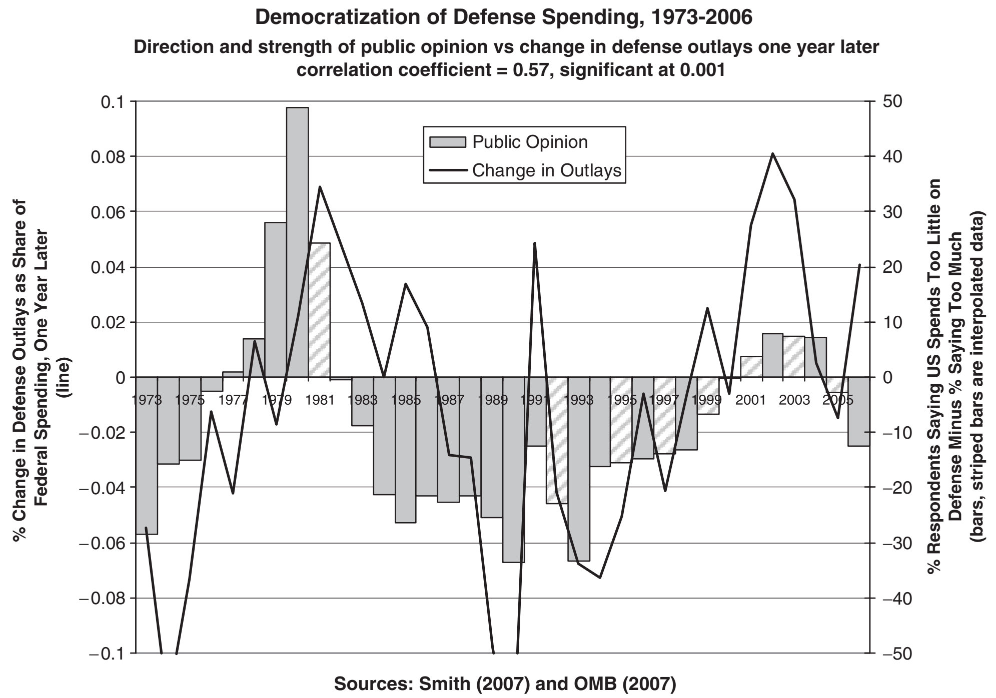
8. Ibid.

9. Ibid.

10. Thomas Hartley and Bruce Russett, "Public Opinion and the Common Defense: Who Governs Military Spending in the United States?", *The American Political Science Review* 86, no. 4 (1992): 905–915; and Robert Higgs and Anthony Kilduff, "Public Opinion: A Powerful Predictor of U.S. Defense Spending," *Defense Economics* 4 (1993): 227–238.

11. Tom W. Smith, *Trends in National Spending Priorities, 1973—2006* (Chicago: National Opinion Research Center, 2007).

FIGURE 4



following year. In combination with the data in Figure 1, one might conclude that the public has a "comfort zone" of appropriate defense spending that ranges between $350 billion and $550 billion (FY2006 dollars). One should note that defense spending for FY08 is projected to be above that zone at $593 billion (FY2006 dollars).

What does the public currently believe about defense spending? The polling data used in Figure 4 indicate that in 2006, 39.4 percent of Americans favored reduced defense spending compared with 26.8 percent who favored an increase.[12] An extensive survey conducted in 2005 by the Program on International Policy Attitudes (PIPA) at the University of Maryland corroborates Smith's findings.[13]

National Politics. Defense-spending levels do not correlate to the political party of the president or the congressional majority. However, the return to divided government after the 2006 midterm elections, the debate over the fiscal year 2007 Iraq war supplemental appropriation, and the dynamics of the 2008 presidential campaign to date indicate higher levels of scrutiny and debate over defense spending options. Since the 2006 election, the new Democratic majority in Congress has focused on using the power of the purse to force

12. Ibid.

13. PIPA, The Federal Budget: The Public's Priorities. The PIPA/Knowledge Networks Poll, 2005. Report online; available from: *http://www.pipa.org/OnlineReports/DefenseSpending/FedBudget_Mar05/FedBudget_Mar05_rpt.pdf*: accessed 6 April 2007.

policy changes and reduce involvement in Iraq. They appear, however, to distinguish between the war in Iraq and the overall effort to combat terrorism. While seeking to reduce funding for operations in Iraq, the Democrats have shown less inclination to reduce overall defense spending. Looking toward the 2008 elections, notwithstanding a difference on war funding, neither party seems to be advocating large-scale defense budget cuts in the near term. Both undoubtedly recognize the looming costs of reconstituting the force after Iraq and neither may wish to be portrayed as stingy on defense. However, there is a range of thought on these issues among the candidates in both parties. It is certainly possible that different candidates, if elected, might approach shaping the defense budget in different ways, to support their view of current and future defense strategies and in consideration of defense domestic-spending priorities.

To summarize, there has been fiscal pressure on the defense top line from growth in mandatory spending accounts and nondefense discretionary accounts. The United States is again at a time when deficits are a point of concern. Politically, the administration faces increased congressional scrutiny over and opposition to military policies, and public support of defense spending is waning. Time will tell how that manifests in spending decisions. Such external factors are vital when considering current defense management reform but internal factors may be more important.

Internal Factors

Internal factors affecting defense spending are those which defense leaders are more able to directly control and include budgeting and spending for acquisition, personnel, and operation and maintenance. The policy of budgeting for the war separately also confounds analysis of defense spending. Before looking at specific factors, let us adopt a broad view. From the low point of the 1990s "procurement holiday" to today, the Department of the Navy's budget increased 46 percent in real terms, but the size of the fleet declined from 354 battleforce ships to 280; aircraft inventory declined from 2,559 to 2,330; and the number of personnel (uniformed and civilian) declined from 929,358 to 829,531.[14] While spending increased by half, the naval forces are 15 percent smaller. The last time defense experienced 12 continuous years of budget growth was 1979–1990 during which time the fleet grew from 530 to 587 ships.

To sustain the Navy's current goal of a 313 ship navy, there needs to be sufficient shipbuilding budget authority to consistently build an average of 11 ships a year. Since 1998, navy five-year budgets have planned to build eight ships per year but have succeeded in building only six ships per year. To get to 12 will require nearly doubling the annual shipbuilding budget, currently at $11 billion.[15] Can management reform efforts generate approximately $10 billion from the other accounts?

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14. Department of the Navy, Budget Highlights, Editions for Fiscal Years 1998–2008, Washington, DC, 2007; available from: *http://www.finance.hq.navy.mil/fmb/08pres/books.htm*: accessed 13 February 2007.

15. Congressional Research Service, *Navy Force Structure and Shipbuilding Plans: Background and Issues for Congress* (Report RL32665) (Washington, DC: Congressional Research Service, 2006).

- *Acquisition costs*. The department's appetite for major acquisition programs and the cost performance of those programs continue to be important issues. The Joint Strike Fighter, F-22, the Army Future Combat System, the Air Force's Transformational Satellite System, the Navy's DD-1000, and Virginia-class submarine programs have all experienced significant cost growth, quantity reductions, and schedule slips.[16] In early 2007, the Navy acquisition executive issued a stop work order for the Littoral Combat ship when the first ship in the class experienced costs 50 percent over budget. Two decades of acquisition management reform have not significantly improved program management practices. Annual budgeting horizons favor short-term decisions at the expense of long-term planning horizons. Costs rise and schedules slow, pushing up against the top line without resulting in more capability.[17]
- *Personnel costs*. Pay and benefits for personnel have increased in recent years at the same time accrual accounting changes have illuminated costs, such as the accrued costs of retiree heath care, which have always been there, but were not explicitly recognized. The activation of tens of thousands of reservists and guardsmen for the Iraq war resulted in increased long-term liabilities because their benefits packages have been expanded. Figure 5 plots Department of the Navy spending from 1997 to 2008 on pay, allowances, and family housing against the total number of active and reserve navy and marines. In constant dollars, the cost per troop has increased 47 percent. In an effort to hold outlays constant, the policy has been to reduce the size of the force.
- *Operations and maintenance costs*. Operations and maintenance costs have increased significantly due to the Global War on Terrorism. The war's toll on equipment will further drive up O&M requirements for the next few years, particularly in depot maintenance.[18] These numbers, however, are not clearly reflected in the budget. The FY2008/2009 defense budget, like all defense budgets since 9/11, was tallied and submitted separately from the wartime supplemental budget. Because of this practice, for example, the baseline budget for Marine Corps depot maintenance[19] shows a decrease in activity from $372 million in 2006 to $71 million in 2008.[20] Separately, the Marine Corps requested an FY2008 supplemental appropriation of $490.6 million for this account. If one has the

16. Congressional Research Service, *Defense Budget: Long-Term Challenges for FY2006 and Beyond* (Report RL32877) (Washington, DC: Congressional Research Service, 2005).

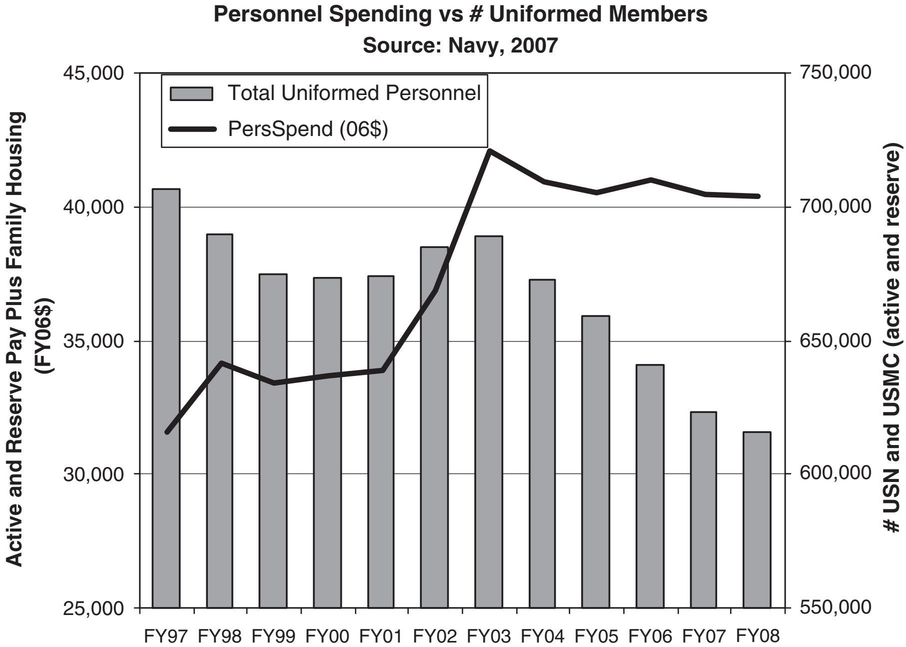
17. Ronald Kadish et al., *Defense Acquisition Performance Assessment Report for the Deputy Secretary of Defense* (Washington, DC: Department of Defense, 2006).

18. Government Accountability Office, *Global War on Terrorism: Observations on Funding, Costs and Future Commitments*, Report GAO-06-885T (Washington, DC: GAO, 2006).

19. Operation & Maintenance, Marine Corps, Budget Activity 1A3A.

20. Department of the Navy, Fiscal Year 2008/2009 Budget Estimates, Justification of Estimates, Operation & Maintenance, Marine Corps, 2007; available from: *http://www.finance.hq.navy.mil/fmb/08pres/ops/OMMC_Book.pdf*: accessed 13 February 2007.

FIGURE 5



Personnel spend per service member (constant FY06 dollars)
FY97: $44.7 K FY08: $65.6 K

wherewithal to marry the two, they will see that depot maintenance is actually projected to increase from $372 million to $562 million, not decrease. Program and budget analysts, in an attempt to separate a ‘‘peacetime'' baseline budget from the cost of war, now produce twice the number of documents (leading to twice the legislation and twice the number of accounts to manage), none of which individually accurately portrays the true level of activity.

- *Other supplemental appropriation issues*. The wartime supplemental appropriations confound analysis of defense spending further. When the Navy submitted its FY2008 budget, it announced cuts in the acquisition of aircraft,[21] but replaced a large number of those aircraft in the supplemental request. For example, nine H-1 helicopters were cut from the base, but requested in the supplemental, eight H-60 helicopters were cut from the base, but nine were requested in the supplemental, four V-22 tilt-rotor aircraft were cut from the base, and three were requested in the supplemental (despite the fact the V-22 has not been used in the war).[22] These practices will cause distortions in future baseline budgets that may negatively

21. Christopher J. Castelli, Navy Cuts Aviation Accounts, Budgets for Seven Ships in 2008; available from: *InsideDefense.com*: accessed 5 February 2007.

22. Navy, Budget Highlights.

affect future DoD budgets after the use of supplemental appropriations ceases unless some type of "recapture" takes place.

Summary

Will the defense top line rise or fall over the next few years? Long-term historical trends suggest that by all measures (%GDP, %Outlays, and constant dollars), defense spending is likely to fall. If one takes into consideration both external and internal factors in the near term, we also see evidence of downward pressure. External factors related to fiscal policy such as deficits, growing entitlement programs, and growing discretionary programs all restrict the room for growth in the defense budget. The Democratic leadership in Congress and the direction and strength of public opinion push down on (or at least more closely scrutinize) defense spending. Internal factors push for a higher topline, but include significant inflationary effects and so top line increases will buy relatively less capability. Supplemental appropriations for the war are likely to continue and provide an opportunity for the defense department to seek relief from budget pressures in other ways; however, their use distorts data used in budgeting for the future. The administration requested a significant defense budget increase in FY2008, 11 percent more than in FY2007, but the DoD is already exhibiting signs of fiscal stress. No one can say for certain what will happen in the future, but it appears that the defense budget is under increased pressure from many sources and is under increased scrutiny.

DEFENSE BUSINESS MANAGEMENT REFORM

How does this budget situation relate to business management reform within the DoD? At best, business management reform in DoD can only address the internal factors pushing against the budgetary top line. A review of the recent history of defense business management reform and an examination of the current management reform agenda suggest some implications for managing in a time of budget reductions.

Recent History of Defense Business Management Reform

The idea of reforming the business practices of defense to achieve savings is not new. The current era of defense management reform has its origins in the Blue Ribbon Commission on Defense Management (the "Packard Commission") established in 1985 by President Reagan to examine certain defense management policies and procedures. Defense Secretary Frank Carlucci prepared the Defense Management Report (DMR) for the president based on the management reforms recommended by the Packard Commission and the DMR formed the basis for the management reform agenda of Defense Secretary Cheney in the Bush (41) administration. Differing from short-term budget reductions, the purpose of these reforms was to save money long term through streamlined management practices and efficiency measures. The imperative for these reforms came from competing national priorities and the decline of financial resources available for national defense.[23] DMR sought savings through consolidation of like functions and improved cost management. For instance, finance and accounting were centralized in the new Defense Finance and Accounting Service (DFAS), civilian personnel management was centralized in the Civilian Personnel Management Service (CPMS), and a consolidated revolving fund, the Defense Business Operating Fund (DBOF), was created. Cheney reported that DMR efficiencies would result in savings totaling $70 billion by FY 1997.[24]

The management reform agenda of the Clinton administration was derived from the National Performance Review (NPR). Its goal was "to make the entire federal government less expensive and more efficient . . . ."[25] The characteristics of reinvention included information technology integration, cutting costs, streamlining processes, improving customer service, and experimentation. During Secretary Aspin's short tenure as Secretary of Defense, there was a focus on cost reduction through dual-use technology.[26] During William Perry's term as Secretary of Defense, themes of cost reduction and "enhancing defense reform" were continued.[27]

In 1998, Defense Secretary William Cohen introduced a new approach to defense management reform—"Transformation for the 21st Century." Cohen argued that DoD management practices were far behind those found in the private sector. Cohen proposed the Defense Reform Initiative, a "strategic blueprint," to make the DoD "leaner and more flexible in order to remain competitive."[28] This plan proposed four major initiatives:

- *Re-engineer*: Adopt modern business practices to achieve world-class standards of performance.
- *Consolidate*: Streamline organizations to remove redundancy and maximize synergy.
- *Compete*: Apply market mechanisms to improve quality, reduce costs, and respond to customer needs.

23. Richard B. Cheney, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 1990).

24. Richard B. Cheney, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 1993).

25. William J. Clinton, Remarks by President Clinton Announcing Initiative to Streamline Government; available from: *http://govinfo.library.unt.edu/npr/library/speeches/030393.html*: accessed 9 August 2006.

26. Les Aspin, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 1994).

27. William Perry, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 1995).

28. William Cohen, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 1998).

- *Eliminate*: Reduce excess support structures to free resources and focus on core competencies.[29]

Cohen's Management Reform Memoranda proposed 17 reform measures to streamline the infrastructure and "re-engineer" business processes in acquisition, education, information sharing, transportation, travel, and facilities and property management.[30]

Defense Management Reform in the Current Era

The George W. Bush administration also came to office with a management focus. The President's Management Agenda (PMA) addresses five areas targeted for management reform throughout the federal government: human capital, improved financial management, competitive sourcing, electronic government, and budget and performance integration.[31]

In the DoD, an initial management objective was to "increase effectiveness through increased accountability and efficiency"[32] with emphasis on cost reduction, improving quality, reducing redundancies, and adopting best business practices. Secretary Rumsfeld emphasized the creation and use of metrics to quantify performance improvements and he sought to focus the Department's resources on core functions.[33] To improve its efficiency, the DoD is tackling several significant challenges: cost reduction, organizational realignment, and cultural issues.[34]

The DoD has identified six major, strategic, high-leverage initiatives, called Business Enterprise Priorities (BEPs). These BEPs address personnel, acquisitions, material, finance, common supplier engagement, and real property accountability. Each BEP "details measurable program and business capability milestones over the next several years. They provide enduring improvements to the department's business infrastructure [. . .] through integration of enterprise business processes, reducing systems redundancies, and continuously improving financial transparency."[35] The Business Enterprise Architecture (BEA) "is the enterprise architecture for the Department of Defense's

29. Ibid.

30. Ibid.

31. Donald Rumsfeld, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 2003).

32. Donald Rumsfeld, *Annual Report to the President and Congress* (Washington, DC: U.S. Department of Defense, 2002).

33. Daniel B. Francis and Robin J. Walther, *A Comparative History of Department of Defense Management Reform from 1947 to 2005* (Monterey, CA: Center for Defense Management Reform Report NPS-CDMR-GM-06-009, 2006).

34. David M. Walker, Fiscal Year 2004 Transitions and Transformations in the Federal Government, 2004; available from: *http://www.gao.gov/cghome/dia/fy2004tt-dia.pdf*: accessed 12 March 2007.

35. Defense Business Transformation Agency, Business Enterprise Priorities; available from: *http://www.defenselink.mil/dbt/priorities_beps.html*: accessed 22 May 2007.

business information infrastructure processes, data, standards, business rules, operating requirements, and information exchanges.''[36] The BEA seeks to add uniformity to DoD processes to ''ensure accurate, reliable, timely and compliant information'' and also to streamline activities. DoD is using budget and performance indicators to support performance-based budgeting and has used the balanced scorecard approach to measure performance with resource management.[37] The Enterprise Transition Plan (ETP) is to be used by DoD components to ''design and implement their own business transformation solutions within a framework of transformational DoD business rules and standards.''[38] DoD has sought to institutionalize the oversight and management of its current reform agenda. Oversight of defense business transformation is conducted by the Defense Business Board, an advisory panel consisting of private-sector executives chartered to provide ''independent advice and recommendations on effective strategies for the implementation of best business practices of interest to the Department of Defense.''[39] The Department's Business Management Modernization Program (BMMP) and Defense Business Transformation Agency (DBTA) were created to institutionalize parts of the DoD change program. DBTA's strategic objectives include improving financial stewardship, enabling rapid access to information, and reducing the costs of defense business operations.[40] The future of this governance structure for business management transformation is uncertain, of course. Much of it is associated with the administration of Donald Rumsfeld and may change as leadership in the department changes. Thus far, Rumsfeld's successor, Secretary Robert M. Gates, has had little to say publicly about management, but Deputy Secretary Gordon England appears to be continuing his active leadership of the department's management reform agenda, as have the service secretaries.

The Army, Navy, and Air Force have developed service-specific management reform agendas as well.

- The Army's goal is to instill a culture of continuous process improvement to increase responsiveness, decrease cycle time, decrease inventories, and provide enhanced support. Lean Six Sigma is the Army's tool of choice to drive across-the-board elimination of unnecessary or wasteful processes, the reduction of process variability, and the improvement of quality.[41] The tool is viewed as a supplement to the Army's ongoing efforts to transform its business operations through

36. Defense Business Transformation Agency, FAQ: BEA; available from: *http://www.dod.mil/dbt/faq_bea.html*: accessed 12 March 2007.

37. Francis and Walther, p. 110.

38. Carlos Pair, ''Department of Defense Business Transformation: It's on A Roll,'' *Armed Force Comptroller* 52, no. 1 (2007): 17–19.

39. Defense Business Board, Mission Statement; available from: *http://www.dod.mil/dbb/mission.html*: accessed 28 February 2007.

40. Pair (2007).

41. Department of the Army, About Continuous Process Improvement; available from: *http://www.army.mil/ArmyBTKC/focus/cpi/index.htm*: accessed 31 July 2006.

initiatives such as Personnel Transformation, BMMP, Portfolio Management of Business Information Systems, Balanced Scorecard, Logistics Transformation, and Institutional Army Adaptation.[42]

- The Air Force intends to create new processes through its Smart Ops 21 program, the implementation of which was catalyzed by the Air Force's mandate to reduce its force by approximately 40,000 active duty personnel. Smart Ops 21 encompasses the tools of Lean, Six Sigma, and Theory of Constraints.[43]
- The goal of the Navy's Sea Enterprise initiative is to reduce costs in order to provide internally generated resources for reinvestment and recapitalization.[44] Sea Enterprise has identified three imperatives: change the culture, improve processes and structures, and harvest savings.[45] The Navy is also undertaking a challenging enterprise realignment to create a more matrixed organization and to create a culture of enterprise-wide thinking.

Thus, current management initiatives are part of a continuum of change, albeit influenced by the shape of current forces acting upon it. This continuous change model has recurring themes of process improvement, cost management, cost reduction, organizational streamlining, culture change, and adoption of best practices from the private sector.[46]

The current management reform agenda does have one possible defining distinction, however, which is its explicit focus on generating internal savings, through effective cost management, to support investment and recapitalization for the operating forces. This idea of cost savings to fund departmental needs is not new of course. But the explicit nature of the rhetoric of current reform initiatives—suggesting that the principal reason for seeking savings is for recapitalization and that savings *will* be applied to reinvestment and recapitalization—stands out. This vision has been much more explicit than in past reform efforts. It provides a measurable objective, and it aligns with the core values and mission of the organization. If defense budgets are poised to decline, then what has been learned in prior periods of budget retrenchment that could inform the current management agenda?

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42. Secretary of the Army, Memorandum: Management Oversight of the Army's Business Transformation Initiatives; available from: *https://acc.dau.mil/CommunityBrowser.aspx?id=32338*: accessed 31 July 2006.

43. T.C. Lopez, "Smart Operations Office Formed at Pentagon," *Air Force Print News*, 11 May 2005.

44. Vernon Clark, "Sea Power 21: Projecting Decisive Joint Capabilities," *Naval Institute Proceedings* 12, no. 10 (2002): 32–41.

45. For a more thorough description of current reform efforts, see Richard L. Dawe and L. R. Jones, "Transformation of National Defense Business Management: Current Initiatives and Future Challenges," *International Public Management Review* 6, no. 2: 9–70; and Department of Defense, *Status of the Department of Defense's Business Transformation Efforts: Annual Report to the Congressional Defense Committees* (Washington, DC: Department of Defense, 2006).

46. Richard L. Dawe and L. R. Jones, "Transformation of National Defense Business Management: Current Initiatives and Future Challenges," *International Public Management Review* 6, no. 2 (2005): 9–70.

Management during Retrenchment

Charles Levine framed the decline of government organizations as a symptom of resource scarcity, a problem for managers who must maintain organizational capacity, and a contingency for employees and stakeholder groups.[47] He focused on the managers' problem by first acknowledging that most managers, accustomed to growth and believing that growth is essential, initially confront cutbacks as minor decrements, and do not take them seriously. These same managers were effective in growth periods because the presence of slack resources permitted (a) deliberative planning and decision-making tasks (which, at the time, are largely unused luxuries because resources are relatively abundant), (b) consensus building among conflicting stakeholders, and (c) insurance against the risks of innovation by the agency. When the slack was gone, planning became more essential but was often reduced in the cutback, pluralism among stakeholders increased along with conflict between them, and innovations were forsaken as extravagances. Decrement management reduced the likelihood of innovation and reinforced the status quo.[48]

In periods of decline, because there are winners and losers, and more of the latter, resistance is expected from both internal and external stakeholder groups. Managing during a period of decline is difficult, and problems are common. In a comprehensive study of the organizational decline literature, the attributes of dysfunctional decline include those noted above plus:

- the intensification of conflict over increasingly constrained resources leads to suboptimal across-the-board cuts in lieu of prioritized ones in an effort to ameliorate that conflict,
- morale among organizational members fell in the face of tighter resources and increased conflict,
- organizational flexibility declined as decision-making was centralized,
- organizational leaders were marked as scapegoats for the frustration felt by organization members, resulting in the loss of leaders' credibility and increased turnover, and
- disproportionate attention was paid to short-term crisis response supplanting long-term planning.[49]

DoD is not immune from these risk factors. Sustaining defense business management reform may therefore be at risk during a time of budget constraint.

47. Charles H. Levine, "Organizational Decline and Cutback Management," *Public Administration Review* 38, no. 4 (1978): 316–325.

48. Andrew Glassberg, "Organizational Responses to Municipal Budget Decreases," *Public Administration Review* 38, no. 4 (1978): 325–332.

49. Kim S. Cameron, David A. Whetten, and Myung U. Kim, "Organizational Dysfunctions of Decline," *The Academy of Management Journal* 30, no. 1 (1987): 126–138.

Management Reform at Risk?

The current defense management reform agenda is driven by three factors: (a) to align changed business practices with force transformation characterized by agility and speed; (b) to generate resources internally to support recapitalization and investment in future combat systems; and (c) to reduce internal pressures on the defense budget and respond to external pressures on the defense budget. If these imperatives are as strong as they appear, what then could undermine the current reform effort and make it unsustainable? There are four clear possibilities.

(1) *War costs*. If operations in Iraq and Afghanistan persist, costs associated with the base defense budget and the war effort will continue to diverge, particularly if war funding continues to be carried out through nontradition budget "bridges" and supplemental appropriations, a pattern unseen in the budgeting for past wars.[50] In this case, management associated with the base budget will operate in an increasingly constrained environment, while unconstrained spending will continue to be associated with the war. This is hardly an environment that will drive culture change and cost management throughout the organization. Moreover, these conditions invite the migration of base budget functions to the less constrained, and less cost managed, war budget, resulting in distortions in the base budget that will affect future budget decisions. As noted in the fiscal year 2008 aircraft procurement budgets, this process has already begun.

(2) *Losing the vision*. Alternatively, Congress could demand that appropriations for the war efforts migrate to the base budget. In that case, it is likely that total defense resources will erode as they are combined and become more transparent. Thus follows the second possibility: losing the reform vision to current-year "budget drills" to meet unfunded needs or budget "wedges" in the execution year. Successful reforms may depend on demonstrating that the cost reductions and management reforms have generated the desired savings a*nd that the savings have been applied to the stated objective*. Failure to sustain or account for the results can lead to a loss of credibility for senior leaders.[51] If budget reductions cause the recapitalization goals to disappear in favor of simply meeting reduced budget targets, much of the motivation for reform could be lost to "business as usual" and even supportive middle managers will likely retreat to traditional use-or-lose resource hoarding tactics.

(3) *Change fatigue*. "Repetitive Change Syndrome" is experienced when organizations adopt change initiatives too frequently. Such frequency generates chaos,

50. Congressional Research Service, *Military Operations: Precedents for Funding Contingency Operations in Regular or in Supplemental Appropriations Bills* (Report RS22455) (Washington, DC, 2006).

51. Michael A. Roberto and Lynne C. Levesque, "The Art of Making Change Initiatives Stick," *Sloan Management Review* 46, no. 4 (2005): 53–60.

burnout, and incapacity to make further change, thus, harming daily operations.[52] Observers warn against adopting change initiatives too frequently.[53] The short history above shows that defense management reform has been a continuous theme for over 20 years. Sustaining transformation could now depend on learning more about how the organization perceives the change agenda through analysis of communications and feedback and by examining the knowledge, attitudes, and actions of the receptors of communications about transformation.

(4) *Leadership change*. Leaders change frequently in the DoD among both the uniformed and senior civilian ranks. It often appears that management reform initiatives do not survive leadership transitions, notwithstanding the success or failure of any particular reform initiative. Former Defense Secretary Rumsfeld's reforms to the budgeting system explicitly acknowledge political leadership cycles.[54] The current administration is in its final two years; sustaining its management agenda beyond the election horizons may not be a high priority. A new management agenda will replace the current "transformation" agenda, although the new administration will almost certainly face the same challenges to find more efficient defense business management practices and seek reinvestable cost savings from these efficiencies. Will new leaders reinvent management reform to conform to their views of defense management? How much priority will be given to management, especially if budgets decline and management reform requires investing in the short run to achieve longer-term savings. Learning to institutionalize the principles and processes of management reform will be important to future leadership transitions. For instance, Comptroller General David Walker has proposed the creation of a chief management officer position for DoD.[55] Presumably, such an office could serve to perpetuate management improvement initiatives through transitions. Another possibility might be to combine the current governance structure into an organization that could both manage current reform and explore potential future reforms. We recommend a research and education project to facilitate the continuation of improvements in defense business management practices through the expected leadership transition of 2008–2009.

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52. Eric Abrahamson, "Avoiding Repetitive Change Syndrome," *Sloan Management Review* 45, no.2 (2004): 93–95.

53. Ibid.

54. L. R. Jones and Jerry L. McCaffery, "Reform of the Planning, Programming, Budgeting System, and Management Control in the U.S. Department of Defense: Insights from Budget Theory," *Public Budgeting & Finance* 25, no. 3 (2005): 1–19.

55. Government Accountability Office, *Defense Business Transformation: A Comprehensive Plan, Integrated Efforts, and Sustained Leadership Are Needed to Assure Success*. Testimony by David Walker before the Subcommittee on Readiness and Management Support, Senate Committee on Armed Services (Washington, DC: GAO-07-208T, 2006).

Management Reform in a Declining Budget

How then should management reform be considered, if budgets are likely to decline and significant organizational risk factors threaten continuation of defense business management reform initiatives? We offer three propositions.

Efficiency-seeking management reforms will be insufficient to make up the budget shortfall. Claimed cost savings can be initially impressive. For instance, the Naval Air Systems Command claims FY 2007 savings to date amounting to $13.9 million composed of permanent cost reductions ($6.1 million) and potential cost reductions from improved practices ($7.8 million).[56] Overall, the Navy's business transformation advocate claims combined savings from Sea Enterprise initiatives of $27.7 billion from FY 2003 through 2005.[57] In both cases, some of the savings are realized in current-year operations and are more the result of projected cost reductions and revised future spending requirements. Nevertheless, these savings are not likely to close the type and magnitude of budget gap suggested by the foregoing analysis. As Barzelay and Thompson noted in an Air Force case study, "better cost management systems do not guarantee more effective cost management."[58] Even if efficiency-seeking savings reduce a significant portion of the internally generated fiscal stress, cost-reduction measures through management initiatives will not close the entire fiscal gap because they only address the internal sources of stress. The external sources are untouched by efficiency savings, except for those few stakeholders who define effectiveness in terms of achieving efficiency. Moreover, cost reductions are dispersed throughout the organization, are difficult to harvest, and are likely to be hoarded by middle managers in the face of tight resources. Savings in current year budgets are likely to be redirected to supposedly underfunded current requirements. Even if DoD's cost accounting systems could aggregate total savings, the amount of savings would not likely be sufficient to close a budget shortfall. Indeed, initiated solely, efficiency-seeking measures may aggravate the negative effects of retrenchment.

Good management does not attract resources. There is little evidence to suggest that good management is rewarded with larger budgets. Resource allocation decisions are policy choices among competing demands. Good management reduces the demand and may lead to reduced marginal future resource bases. Even the movement toward performance budgeting in the federal government leaves unclear the link between performance and resource allocation. Budgets simply do not grow because an agency gets a clean audit opinion or re-engineers business practices.

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56. Department of the Navy, Naval Air Systems Command AIRSPeed Home Page; available from: *http://www.navair.navy.mil/navairairspeed/Accessed*: accessed 28 February 2007.

57. Justin D. McCarthy, "The Case for Transformation." Presentation given to the Navy Corporate Business Course, Naval Postgraduate School, Monterey, California, 7 February 2006.

58. Michael Barzelay and Fred Thompson, "Responsibility Budgeting at the Air Force Materiel Command," *Public Administration Review* 66, no. 1 (2006): 135.

If efficiency-seeking business management reform cannot be viewed as a solution to declining defense budgets, how should DoD view the rationale for sustaining management reform initiatives? There are two strong imperatives for sustaining an effective management reform agenda.

Continuous efficiency-seeking management improvement in DoD should be understood as driven by stewardship concerns and the requirements of the operating forces. The DoD has the responsibility to the president, the Congress, and the public to be a good steward of the highly material portion of the federal budget it manages. There is a justified expectation that the DoD will manage its resources well. DoD also has a responsibility to support efficiently the varied requirements of the operating forces: people, systems, weapons, material. The policies and processes of management reform must align with operational requirements, especially as force transformation increases pressure on the business side of the department.

Large budget reductions can only be met by truly transformational responses. Despite the rhetoric of "transformation," the history of management reform in DoD has been a model of incremental continuous change. A large decline in the defense top line can only be met by transformational changes that take both functions and costs out of the department permanently. Major productivity improvements through consolidations, divestiture of both functions and assets, canceled programs, and sharply reduced personnel would have to be achieved.

The matter of sustaining management reform in a time of declining budgets can be approached as two questions, not one. What are the best budget policy decisions regarding resource levels and allocation considering the salient internal and external factors? And how much and what type of management reform is needed to meet the standards of stewardship and to support the requirements of the operating forces?

CONCLUSION

We have looked at business management reform in the DoD and see that it has been a continuous incremental process since at least the Reagan administration. Common themes have permeated each administration, although labels attached to the agendas have changed. Foremost among them is the efficient use of resources, whether they are capital, human, or financial assets, by increasing productivity and reducing costs.[59] No single initiative will clearly persist; likewise, changing conditions could interrupt the current management reform agenda. We have also examined the question of declining budgets. It is evident that pressure on the defense top line comes from external sources as well as internal factors, regardless of how one defines the top line. We have also investigated themes in managing downturns. From this analysis, we have argued that

59. Francis and Walther, p. 125.

efficiency-seeking management reforms can only address the internal pressures on the defense top line. We have identified specific threats to sustaining defense management reform in a time of declining budgets and have offered strategic propositions to consider when addressing management reform in a time of declining budgets. This paper contributes to the defense management reform literature by challenging the current reform emphasis of attempting to solve a looming budget problem through efficiency-seeking measures. We have concluded that management reform alone is insufficient to close the funding gap that exists and that may worsen from declining defense budgets. Budget reductions, if they come, must be met by large-scale change in the department. Better management, on the other hand, should instead be viewed by defense leaders as imperative for reasons of stewardship and support for the operating forces.

NOTES

The authors are grateful for the research support provided by their colleague Lt. Col. Bryan Hudgens, USAF; Nam Nguyen and Katherine Walsh, summer research associates from the Gerald R. Ford School of Public Policy at The University of Michigan; and Captain Dan Francis, USMC, and Captain Robin Walther, USMC, MBA students at the Naval Postgraduate School.