

**The Honorable Ashton B. Carter**  
**Remarks at Aviation Week's R&D Technology & Requirements Conference**  
**Washington, DC – February 16, 2011**

Secretary of Defense Gates presented President Obama's Fiscal Year (FY) 2012 defense budget on Monday. Before recapping the main features of the FY12 budget, I'd like to make two important points about the challenges we are facing with the fiscal year we are in.

As you know, it is February 16<sup>th</sup>, and we still do not have an appropriations bill for FY11, and we are managing the Department's affairs under a Continuing Resolution (CR) until at least March 4, 2011. Each and every program manager in the Department is having to upset carefully calibrated plans, stop or slow activities only to restart them later, defer the commencement of important new programs, and so on. The result is not only delay; it is inefficient and uneconomical to proceed in herky-jerky fashion with our programs and procurements. It is not only inefficient, it is anti-efficient. It adds a dollop of cost overhead to everything we do, like a hidden tax. Secretary Gates has called it a "crisis on our doorstep," and I think every program manager in the Department experiences that crisis in his or her program. We can only hope that we get an appropriation soon, and that it meets the minimum level of \$540 billion for the base, as stated by Secretary Gates.

A second point about the fiscal year we are in has to do with the constant need to respond to urgent operational needs growing out of the new effort in Afghanistan. Due to a true miracle of logistics, we got all the new forces and enablers associated with the uplift into Afghanistan by the end of August, as President Obama required us to do. Those forces and their commanders have now been there for some months, and they understand what is working, what they need more of, and what new capabilities they need. As I have said many times, filling those urgent operational needs is job number one for me and the Acquisition, Technology & Logistics (AT&L) leadership. When we have these urgent requirements, we need to reprogram funds, then quickly acquire and field them. Three steps.

The first step is to obtain the funds, and I mention it because it is another matter on which we are working with the Congress in these months, even as the FY12 budget will be debated. I am sure you all know the main outlines of the FY12 defense budget. As the war in Iraq winds down, overall defense spending will decline from FY11 to FY12. The base budget, which excludes the marginal costs of the wars as included in the Overseas Contingency Operations (OCO) budget, grows modestly this year and indeed over the next five years. But a modest rate of growth will feel very different from the double-digit year-on-year growth of the decade after 9/11.

Beginning in May of last year at his speech at the Eisenhower Library, Secretary Gates has been signaling loudly and clearly that we are entering a new era in defense. In Deputy Secretary of Defense Lynn's words, we are at an historical inflection point but one that can be different if managed proactively.

Secretary Gates launched a many-pronged Efficiency Initiative to ensure the Department is managing the budget in a manner that is, as he put it, "respectful of the taxpayer at a time of economic and fiscal distress." Under this initiative, we were able to identify low-value-added

activities and overhead -- \$178 billion worth overall – and allocate the savings to new programs like a new bomber, more naval vessels, a new ground combat vehicle, and other military capabilities for the near and far terms. One hundred billion was reallocated in this way, and \$78 billion was allocated to top-line reductions so we would not need to ask for as much money from the taxpayer in future years.

As one of the prongs of that overall Efficiency Initiative, Secretary Gates tasked me, as the Acquisition Executive, to devise a plan to find efficiencies in the \$400 billion out of the approximately \$700 billion base-plus-wartime budget that is contracted out. This led to BETTER BUYING POWER, introduced by Secretary Gates and me on September 14, 2010. It is guidance from me to the acquisition workforce in the Defense Department on how we can get “MORE WITHOUT MORE.”

In the past two years, we have cancelled many programs that were not performing, whose time had passed, or where we had already bought enough (more than \$300 billion worth). But most of the programs we now have underway or which are getting underway are military capabilities we do need and do want. We need to get them for the money the country can afford to give us.

BETTER BUYING POWER is summarized in the chart that you have before you. Its twenty-three points were devised with input from the Department’s acquisition workforce and from our partners in industry and are mindful of the WSARA. We are now implementing each and every one of them. The twenty-three points in the chart cover ways the government can improve its own performance and incentivize better performance in our industry.

I’m happy to take questions on any one of the twenty-three points. They are part of the fundamental adjustments we have to make in the Department to the new era we are in. But for my remarks, let me turn to a different but closely related subject, which is how the industry that supports the warfighter will also need to make adjustments.

I gave a speech last week in New York City Cowen Group conference, where I set forth the logic that will guide the Department’s thinking on the defense industry. Secretary Gates, Deputy Secretary Lynn, and I have made it our practice to meet frequently with defense industry leaders, reversing an unfortunate trend in recent years.

The fundamental starting point is the understanding that we do not make weapons in the Pentagon. They come from our defense industry. And these weapons systems are, second only to our superb men and women in uniform, what makes our military power unrivaled and what provides the buttress of national and international security. A strong, technologically vibrant, and financially successful defense industry is therefore in the national interest. In this respect, the warfighter’s and taxpayer’s interests are aligned with the long-term interests of the defense industry. We will promote policies and actions that provide for the long-term innovation, efficiency, profitability, and productivity growth. The emphasis here, as I will note again shortly, is long-term.

With this as background, I set forth seven guideposts the Department will follow in considering our industrial structure in the era we are entering:

- First, in the main we will rely on normal market forces to make the most efficient adjustments to the defense industrial base. This is not only in accordance with sound economic theory, but necessary to prevent the defense industry from becoming further distanced from the main currents of 21<sup>st</sup> century technology, creativity, and capital markets. These market forces will doubtless lead to an uptick in the volume of M&A and other industry adjustments in the coming period, and this is normal. For our part, the Defense Department welcomes needed adjustments that lead to greater overall efficiency but will require transparency with respect to all contemplated transactions. We will examine these transactions to ensure that the Department's long-term interests in a robust and competitive industrial base dominate any near-term or one-time proposed savings, that potential organizational conflicts of interest are avoided or carefully mitigated, and that we have full visibility into restructuring costs and the potential for continuing capital investment and R&D. The interests of the taxpayer and the warfighter will be forefront in our minds as we review proposals that may result in the creation of weaker stand-alone firms less likely to thrive without the necessary capital structure that their larger parent company is able to provide. The Defense Department would not want to see its industrial base experience what has happened in some other sectors of the economy: poor risk management and an excessively short-term behavior at the expense of long-term health. Transparency allows all these things to be addressed early in the process, which is in the interest of all involved.
- Second, as President Obama made clear to all Federal departments and agencies when he took office and most recently last month in Schenectady, NY, competition is one of the key drivers of productivity and value in all sectors of the economy, including defense. Accordingly, the Department is not likely to support further consolidation of our principal weapons systems prime contractors. A number of our specific Better Buying Power initiatives are aimed at increasing competition among all our suppliers and throughout our procurement of goods and services. Sometimes competition is provided by having two or more providers of the same thing go head-to-head, but where this is not possible we can still harness this power through a wide variety of other competitive strategies that provide real incentives for increased productivity.
- Third, we will be looking at our industry sector by sector – from shipbuilding to professional services, and from stealth to space. While we cannot sustain the base in a given sector if it has the wrong size and shape for the new era, once it is right-sized and right-shaped, the government will take an interest in keeping it that way.
- Fourth, our interest in the defense industrial base extends throughout its entire spectrum. Far too often, people view our industrial base as being made up of those who receive prime awards. The truth is that perhaps two-thirds to three-quarters of every dollar we award at the prime level is spent for subcontracted goods and services at the so-called “lower tier” of the industry. But while these companies might be “lower tier” in this sense, they are not of lower importance – they are centrally important to a healthy industrial base. They are frequently rich in technology and dynamism. They are a conveyer belt of new faces, new ideas, new technology, and young engineers into the

defense sector. They also bring new competitors into the landscape. Defense can also provide opportunities for small businesses.

- Fifth, the Better Buying Power guidelines give heightened attention to the increasing importance of the “services” component of the “goods and services” we require – again provided by firms not often considered “defense companies.” These services are as essential as weapons systems to mission accomplishment, and Better Buying Power directs a number of steps to better understand and manage this part of the Department’s spend. Currently about half of our prime contract spending is in the services sector – and this does not take into account the portion of services required by traditional procurement program
- Sixth, a key part of our defense industrial strategy is to encourage new entrants. These offer competition, renew and refresh the technology base, and ensure that defense is benefitting from the main currents of emerging technology. We must accordingly work constantly to lower the barriers to entry. We are addressing many of these barriers – such as needless or time-consuming paperwork – as part of the Better Buying Power initiative because they impose unnecessary costs.
- Seventh and finally, globalization is affecting security and commerce in profound ways, and this trend has implications for our industry. In Afghanistan our troops fight alongside forces from a wide coalition of other friendly nations, and we anticipate that in the future it will be rare indeed that we fight alone. In the industry that supports these international security efforts, we likewise simply cannot avoid or wall ourselves off from globalization. Depending on the program, from a few percent to much more of the value-added in defense goods and services is sourced overseas – mostly to companies that serve as subcontractors to U.S. primes and that provide, for example, a particular specialized part. Sometimes that is where the best technology or best value can be found, and when it is, we owe it to the warfighter to do so. Globalization of our market is not an option – it is a reality. Our utilization of, for lack of a better term, “non-heritage” firms is essential for nearly all of the systems upon which we rely. We are committed to continue opening our markets while at the same time striking the appropriate balance with security concerns. Just as we have opened our markets to the leading firms from around the world, we urge our partner nations to do likewise. Exports obviously strengthen our industry's competitiveness, but they also enhance our security – and international security – when they build the capacities of international partners. We are doing our part by implementing President Obama's reforms of our antiquated export control regulations and procedures, and we expect our efforts will result in increasingly open and fair competitions around the globe.

These, then, are our guideposts as the Department enters a new era, and of necessity so also does the defense industry. Each case of adjustment or transaction will be different, and we will approach them case-by-case. But these will be our guideposts as we look after the long-term interests of the warfighter and taxpayer in a vibrant defense industry.

So the world is changing, the budget landscape is changing, we in DoD under Secretary Gates are changing the way we do business to get MORE WITHOUT MORE. We know the industry leaders in this room must change also. What is not changing is the dedication and quality of our men and women in uniform.