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COAST GUARD

Strategies for Procuring New Ships, Aircraft, and Other Assets

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Mr. Chairman and Members of the Subcommittee:

We are here today to discuss the Coast Guard's plans for modernizing its ships, aircraft, and other capital assets needed to carry out its missions, as well as the agency's plans and strategies to fund these needs. During the last 2 years, we have issued reports on the overall fiscal challenges facing the Coast Guard and the justification and the affordability associated with its multibillion-dollar Deepwater Replacement Project to modernize or replace many of its ships and aircraft.^{1,2} The project may cost as much as \$9.8 billion (in constant 1998 dollars) over the next 20 years, making it potentially the largest acquisition project in the agency's history. This project will put enormous pressure on the agency's budget for capital projects and heightens the need for effective capital planning and other strategies to meet the Coast Guard's needs in a constrained fiscal environment. For fiscal year 2000, the Coast Guard is requesting \$350 million to fund its capital needs. By 2002, the cost of the Deepwater Project alone could be substantially more than this.

My testimony today, which is based on our recently completed and ongoing work at the Coast Guard, addresses two topics: (1) the Coast Guard's progress in justifying the Deepwater Project and addressing our concerns about its affordability and (2) the Coast Guard's progress in developing strategies and plans for funding its capital needs within a constrained fiscal environment.

In summary, our work shows the following:

- The Coast Guard has not yet sufficiently justified the Deepwater Project, in that accurate and complete information is lacking on the performance shortcomings of its ships and aircraft and the resource hours needed to fulfill its missions. Proceeding without these key data increases the risk that contractors will develop alternatives that are not the most cost-effective to meet the needs of the project. The Coast Guard and its contractors are currently developing this information, but some of it will not be available until later this year. We also reported that if the cost of the Deepwater Project approaches the agency's initial estimate of \$500 million annually, it would consume more than the agency now spends for all capital projects and leave little funding for other critical capital needs. Coast Guard officials believe that competition among contractors will

¹ Coast Guard: Challenges for Addressing Budget Constraints (GAO/RCED 97-110, May 14, 1997).

² Coast Guard's Acquisition Management: Deepwater Project's Justification and Affordability Need to Be Addressed More Thoroughly (GAO/RCED 99-6, Oct. 26, 1998).

reduce the cost of the Deepwater Project and more closely align its potential cost with probable funding levels. However, until the Coast Guard develops its new justification for the project in early 2000 and contractors provide their cost estimates for various alternatives, the Coast Guard will not know whether the affordability issue has been adequately addressed.

- The costs of the Deepwater Project, together with funds needed to complete all other ongoing capital projects, may outstrip the Coast Guard's ability to pay for them. The Office of Management and Budget (OMB) proposes freezing the Coast Guard's budget for capital spending at \$485 million annually through fiscal year 2004. If the Deepwater Project requires annual funding levels of \$500 million, this cost, coupled with the costs of ongoing capital projects, would exceed the OMB target by about \$300 million in 2002. With good planning, renewed efforts to reduce costs, and better information on the useful life of its ships and aircraft, the Coast Guard may be able to prioritize its needs and minimize future capital needs. The Coast Guard is now developing a new plan and budget strategies for dealing with its capital funding needs in an environment of fiscal constraint, but putting these approaches in place may take several years and their effectiveness is uncertain.

The Justification and the Affordability of the Deepwater Replacement Project Have Not Been Fully Addressed

In October 1998, we issued a report that raised concerns about the justification and the affordability of the Deepwater Replacement Project. Our major findings included the following:

- The Coast Guard had understated the remaining useful life of its aircraft and, to a lesser extent, its ships. For example, the justification the Coast Guard prepared in late 1995 estimated that its aircraft would need to be phased out starting in 1998. However, last year, the Coast Guard issued a study showing that its aircraft, with appropriate maintenance and upgrades, would be capable of operating until at least 2010 and likely beyond.³ The study's findings suggest that in upgrading or replacing its deepwater ships and aircraft, the Coast Guard should give a relatively low priority to modernizing or replacing its aircraft. Since our report was issued, the Coast Guard has taken additional steps to assess the condition and the remaining useful life of its ships, including hiring naval architects to evaluate the condition of its deepwater ships and completing studies on two 378-foot cutters. According to a Deepwater Project official, contractors have also conducted their own evaluations of the condition of

³Aviation Near-Term Support Strategy, Office of Aeronautical Engineering, U.S. Coast Guard, Sept. 4, 1998.

deepwater ships and aircraft to validate their condition.

- The Coast Guard had not conducted a rigorous analysis comparing the current capabilities of its aircraft and ships with current and future requirements, as required by DOT's and the Coast Guard's own guidance. Although the Coast Guard asserted that its current deepwater ships and aircraft were incapable of effectively performing future missions or meeting the future demand for its services, we were unable to validate these assertions. The Coast Guard had originally planned to complete a comparative assessment of the current capabilities and the functional needs of the future deepwater system by November 1998, but work on that assessment has slipped. The Coast Guard completed a baseline study of the capabilities of its existing fleet of ships and aircraft last month; a comparative assessment is planned for completion in April 1999.
- The Coast Guard lacked support for its estimates of the resource hours needed for its deepwater ships and aircraft to perform required missions. We attempted to verify the Coast Guard's estimates of surface and aviation hours needed for deepwater law enforcement missions, which constitute over 95 percent of the total estimated mission-related hours for its ships and about 90 percent of the total estimated mission-related hours for its aircraft. We could not verify the reasonableness of these estimates because the sources for the data were not documented or available. An independent group—the Presidential Roles and Missions Commission—will study the Coast Guard's roles and missions and report on its findings by October 1999. The Coast Guard plans to use this study to recalculate the operating levels needed to meet the requirements of its missions for its revised mission analysis, which is scheduled for completion in January 2000.

We agree that the Coast Guard should start now to explore alternative ways to modernize its deepwater ships and aircraft. However, proceeding with the project without a clear understanding of the current condition of its ships and aircraft and whether they are deficient in their capabilities and service demands increases the risk that the contractors, now developing proposals for the project, could develop alternatives or designs that would not be the most cost-effective to meet the Coast Guard's needs for the Deepwater Project. We recommended that the Coast Guard expedite the development and issuance of updated information from internal studies to the contractors. The Coast Guard agreed with our recommendation and has made progress in developing data on the condition of its ships and aircraft; however, other data on its roles and

missions and any shortfalls in its performance capabilities will not be available until later this year or early next year.⁴ Contractors, however, are scheduled to provide the Coast Guard with an analysis of alternatives for the Deepwater Project later this month and conceptual designs for the system in December 1999.

The Coast Guard agreed with the importance of providing contractors with accurate and complete data as soon as possible; however, it also noted the importance of starting now because of the long lead times associated with a project of this magnitude. The agency plans to provide the contractors with data on its roles and missions and performance shortfalls as soon as the information becomes available. Coast Guard officials believe that they will have data in enough time so as not to adversely affect the contractors' proposals. We plan to continue monitoring the project to ensure that contractors receive timely and accurate data to include in their proposals.

Our report also raised concerns about the project's affordability. The estimated cost of the Deepwater Project could consume nearly all of the agency's projected spending for its capital projects. Unless the Congress grants additional funds, which under current budget laws could mean reducing funding for other agencies or programs, the Coast Guard's other capital projects could be severely affected.

In January 1999, Coast Guard officials told us that they plan to address the Deepwater Project's affordability issue in two ways. First, they believe that competition among three teams of contractors to develop alternative deepwater systems will help minimize the project's life-cycle costs because the proposed costs will be one key factor in selecting the winning proposal. Second, they said that the agency's independent evaluation group would analyze various funding alternatives to determine their impact on the project. The group will examine the most cost-effective funding amounts for the project as well as the minimum amount that is needed each year. However, until the Coast Guard develops its revised mission analysis in early 2000 and the contractors provide their cost estimates for various alternatives, it will not be known whether the affordability issue has been adequately addressed. Furthermore, the Coast Guard will have additional time to demonstrate that it has put in place a prudent strategy for dealing with the cost of the project within probable

⁴In response to GAO's review of the Deepwater Project, the Director of Resources stated that the Coast Guard will revise its System Acquisition Manual to require that all future proposals for new projects develop estimates of total ownership costs as part of the justification.

funding levels—a practice that becomes highly critical during this time of fiscal constraint.

Coast Guard Faces Potential Funding Shortages for Capital Projects Unless It Develops Better Plans and Strategies

The ability of the Coast Guard to meet its future capital needs depends largely on the funding requirements for the Deepwater Project. The agency faces potential funding shortages of as much as \$300 million by 2002 to complete ongoing and future projects. To deal with this, the Coast Guard must improve its capital planning process to prioritize and manage its capital projects more effectively, renew cost-saving efforts, and/or secure additional funds.

Future Capital Needs May Exceed Current Budget Targets

In our May 1997 report, we discussed the challenges that the Coast Guard faces in the future as it buys ships, aircraft, and other equipment in a constrained budget environment.⁵ We reported that balanced budget agreements would create substantial pressure on the Coast Guard's budget for capital spending in the coming years.⁶ Even with the current projections for surpluses in the federal budget, agencies such as the Coast Guard are still subject to spending limits and must continue to operate in a constrained budget environment. In an effort to balance the budget, caps on discretionary spending have been set. OMB develops budget marks, or targets, for agencies such as the Coast Guard so that they can develop budget plans and requests that are aligned with the marks. For fiscal years 2001 through 2004, OMB has set a mark of \$485 million a year for the Coast Guard's budget for capital spending.

As figure 1 shows, the extent to which capital funding requirements are less than or greater than OMB's target for fiscal years 2001 through 2004 depends largely on the amount needed for the Deepwater Project.⁷ Funding needs for ongoing acquisition projects decline steadily through

⁵See footnote 1.

⁶Accompanying the effort to balance the budget are statutory limits on total discretionary spending that have been in effect since fiscal year 1991. The Balanced Budget and Emergency Deficit Control Act of 1985 (the "Deficit Control Act"), as amended by the Budget Enforcement Act of 1990, the Omnibus Budget Reconciliation Act of 1993, and the Budget Enforcement Act of 1997, established statutory limits on the federal government's discretionary spending for fiscal years 1991 through 2002. Under these limits, outlays for discretionary spending will remain almost constant in dollar terms from fiscal year 1998 through fiscal 2002.

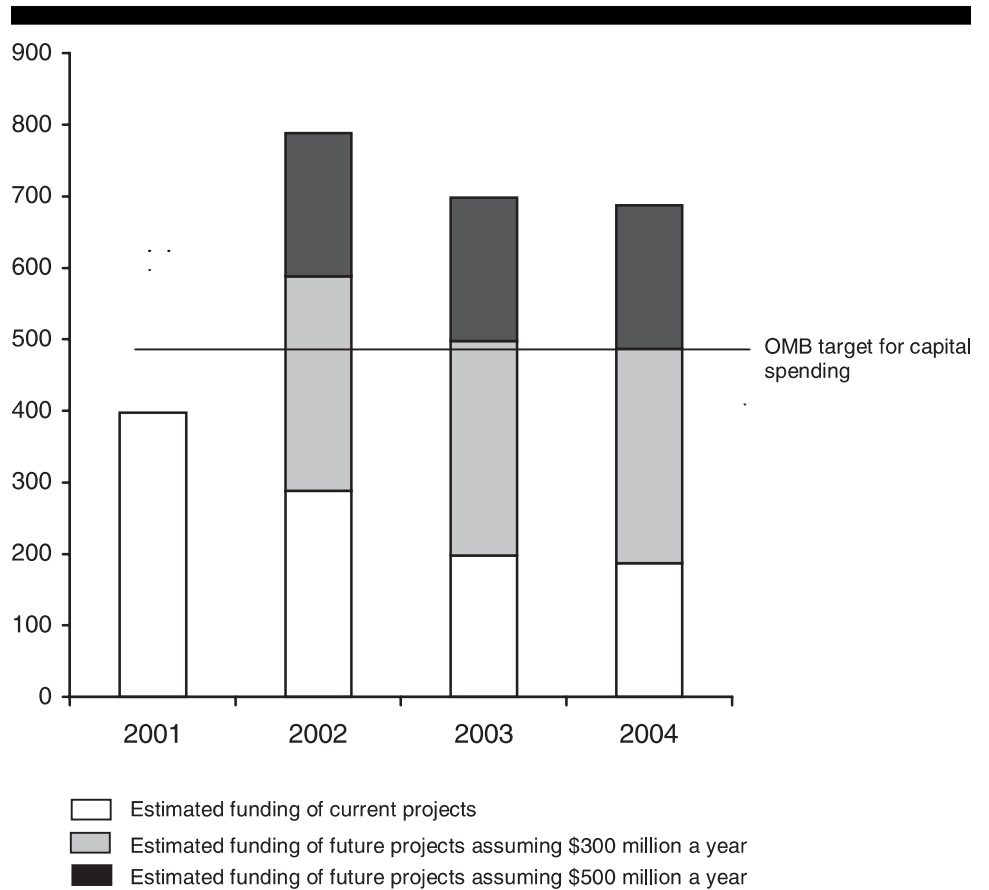
⁷The estimate in figure 1 does not include the funding requirements for three projects—the Human Resources Information System, the Loran-C Continuation Project, and the Great Lakes Capability Replacement Project. The future funding needs of these three projects have not yet been determined. In addition, other funding requirements may arise for projects begun with the emergency funds the Coast Guard received in fiscal year 1999.

fiscal year 2004 as projects such as the buoy tenders are completed. The funding needs for fiscal year 2001 are well within the budget mark set by OMB, mainly because the projected cost for the Deepwater Project is still relatively low, at \$42.3 million. In later years, however, the ability of the Coast Guard to stay within the OMB mark for its budget for capital spending is more uncertain. For example, if the Coast Guard's funding needs for the Deepwater Project and other new projects amount to \$300 million annually beginning in 2002,⁸ the Coast Guard will experience a funding gap of about \$100 million in fiscal year 2002 but little or no gap in fiscal years 2003 and 2004. If, on the other hand, funding requirements for the Deepwater Project approach its initial estimate of \$500 million annually beginning in 2002, then the Coast Guard will face a substantial funding gap—exceeding \$200 million in 2002 and beyond.⁹

⁸Coast Guard planning documents submitted to OMB in late 1998 show a funding stream for the Deepwater Project of \$300 million a year for fiscal years 2002 and 2003.

⁹The Coast Guard may also have to fund new projects, such as river buoy tenders and large utility boats. The Coast Guard has yet to determine the funding requirements and schedule for any new projects.

Figure 1: Comparison of OMB's Budget Target and Projected Coast Guard Capital Funding Requirements



Status of the Coast Guard's Capital Planning Efforts

The Coast Guard is developing a new capital planning process that, when implemented, could improve its ability to set priorities and manage its capital projects and ultimately provide a workable approach for acquiring the ships and aircraft it needs within its approved budget.¹⁰ Begun in 1997, this effort is directed at aligning capital needs with probable levels of funding. The Coast Guard's previous capital plans simply identified various funding needs regardless of probable funding. The Coast Guard acknowledged that this approach no longer reflected the budget climate and needed revision.

¹⁰Our October 1998 report highlighted the importance of planning major acquisitions within available funding budgets. Also, OMB's 1997 Capital Programming Guide emphasizes the need to plan within available budget levels.

In January 1999, the agency produced a draft of a new capital plan that identifies strategies for dealing with the affordability of projects such as Deepwater. These strategies include the following:

- Implementing a number of techniques to control capital costs, such as extending the service life of the Coast Guard's ships and aircraft and replacing equipment with fewer, more capable assets. As an example, extending the service life of aircraft rather than replacing them could result in significant cost savings. A Coast Guard study¹¹ estimates that between \$257 million and \$297 million in upgrades and maintenance could extend the service lives of current deepwater aircraft by 11 to 28 years longer than the Coast Guard's initial estimate of when it would have to phase out these aircraft.¹² The Coast Guard estimates that a one-for-one replacement would cost \$3.8 billion to replace the same aircraft, or about \$3.5 billion more than the option to extend the aircraft's service life.
- Establishing an "Investment Board" composed of senior agency managers, such as Assistant Commandants for Operations and Marine Safety, the Director of Resources, and the Chief Financial Officer. The board will examine the agency's portfolio of assets and assign priorities to projects, including shore facilities, and build a range of budget scenarios over a 5-year period as a means of meeting the budget target given to the Coast Guard by OMB. This strategy would involve making trade-offs between projects. For example, the Coast Guard could concentrate its resources on buying more ships over 2 to 3 years and buying fewer aircraft or other equipment. After the ships have been bought, the agency could then focus its resources on buying the aircraft or other equipment and reducing the amount of resources used to buy ships. The Coast Guard believes that this approach can help it deal with "spikes" in the agency's capital needs during a period of fiscal constraint.

The Coast Guard is also striving to better link the capital planning process to its budgeting process. Linking capital planning to the budget process translates cost control strategies into action. As an example, the Department of Defense (DOD) links its capital planning process to its budget through its Future Years' Defense Plan, which is updated each year to reflect changing conditions. This plan is linked to OMB budget targets and used to make programming and budgeting decisions over a 5-year budget cycle. It identifies strategies for meeting budget targets, such as

¹¹See footnote 3.

¹²However, the estimated cost to upgrade does not include the increased cost of operating older aircraft.

cost-savings in operations that could be used to help fund capital requirements. In addition, according to an OMB official, the plan identifies the funds needed to complete projects and provides greater assurance that these funds will be available, which can ultimately lead to better-managed capital projects. The plan also allows the Congress to see where DOD is heading with its capital projects. Such a plan may be useful to the Coast Guard in developing plans and strategies for meeting its capital needs.

The Coast Guard's new capital planning process is still a work in process and the linkage between capital plans and the budgeting process may not be fully in place for several years, according to agency officials. While the plans, if implemented, will help the Coast Guard deal with affordability issues, it is still uncertain whether they will fully address the funding issues raised by the Deepwater Project.

Other Strategies for Addressing Potential Capital Funding Gaps

Better planning is not the only strategy the Coast Guard can follow to address potential capital funding gaps. Another option involves achieving cost savings from operations and using the savings to pay for new equipment in future years. Shifting funding amounts between the operations account and the capital account can be achieved in several ways. For example, as part of formulating the Coast Guard's budget requests, OMB and the Coast Guard could engage in an informal process in which OMB would allow the Coast Guard to add to its capital account an amount equal to identified cost savings from operations (with a corresponding decrease in its operations account). DOD and OMB have agreed on such an approach, and DOD is pursuing a number of cost-saving initiatives in operations as a means of supplementing its budget for capital spending.

A more formal mechanism for directing cost savings from operations to help fund capital needs would be to seek congressional authorization for a special budget account as a repository for such savings. As an example, DOD has received authorization to shift savings from its operations and maintenance account to help pay for capital acquisitions. Such an approach could provide incentives to Coast Guard managers to achieve greater cost savings if they had greater flexibility in deciding how to use the savings.

In our May 1997 report, we identified cost-cutting options for the Coast Guard that had been already identified by a number of studies conducted since 1981. Last week, we reported on other administrative and support

functions that have potential for cost savings.¹³ The agency has not implemented many of these options that we and others identified because they are controversial, require cultural changes within the Coast Guard, or are not popular with the public. Here are several examples of these options:

- Lengthen periods between assignment rotations for military personnel. Past studies by groups outside the Coast Guard have pointed out that this option could substantially reduce transfer costs, which now amount to more than \$60 million a year. The Coast Guard thinks its current rotation policies are best and does not plan to study the issue further. Coast Guard officials said that changing current practices would have several undesirable effects, including potential adverse effects on multi-mission capabilities, a reduced opportunity to command a variety of units or vessels, and lower morale among personnel assigned to undesirable locations for extended periods of time.
- Use civilian personnel rather than military personnel in administrative support positions. This option could achieve significant cost savings. Overall, the Coast Guard has estimated that it costs about \$15,000 more to compensate military personnel than comparable civilians.
- Consolidate functions or close facilities. Previous studies have identified this as another option to reduce expenditures. For example, several years ago, the Coast Guard identified a cost-cutting option involving the consolidation of its training facilities, a move that would have resulted in annual savings of \$9 million, by closing the facility at Petaluma, California. Fearing a public outcry by the local community, especially because of the numerous recent closures of military bases in California, the Coast Guard postponed taking this step. To address situations like this, we recommended that the Congress may wish to consider a facility closure approach for the Coast Guard that is similar to the one DOD has used to evaluate base closures. Under this approach, an independent commission would be established and given authority to recommend the closure of some of the Coast Guard's facilities. To date, such a commission has not been established.

Another option for addressing any funding gap would be for the Coast Guard to secure new sources of funding for its capital projects. However, obtaining additional funding through the normal appropriation process is uncertain, given existing limits on discretionary funding. While this may

¹³Coast Guard: Review of Administrative and Support Functions (GAO/RCED 99-62R, Mar. 10, 1999).

change as the administration and the Congress deliberate on how to use the existing surplus in the federal budget, no agreements have been reached. For fiscal year 1999, the Coast Guard received an emergency appropriation totaling \$230 million in addition to its regular appropriations to help buy new capital equipment. Most of these funds were for equipment to stem the flow of illegal drugs into the United States. The additional funds were used in part for ongoing capital projects, such as upgrades to C-130 aircraft engines and purchases of new sensors for Coast Guard ships and aircraft, potentially leaving more room in future years' budgets for the Deepwater Project and other needs. Additional emergency funding may be available in future years as well. In January 1999, legislation was introduced in the Senate to authorize additional funding for the Coast Guard in fiscal years 2000 and 2001 for anti-drug operations; however, there is no guarantee that these funds will be appropriated.

User fees are another potential source of revenue to supplement the Coast Guard's future budgets for capital spending, but the Coast Guard has been unsuccessful in getting congressional approval to impose such fees on services it performs. Last year, the House and the Senate turned down a Coast Guard request to levy \$165 million in user fees and stated its opposition to such fees. In its fiscal year 2000 budget request, the Coast Guard is again proposing a user fee on commercial cargo and cruise vessels for navigation services that the Coast Guard provides but does not charge for. This user fee, if approved, would add revenues of \$41 million in the last quarter of fiscal year 2000, and \$165 million a year when fully implemented. We are not taking a position on whether such fees, including the proposed fees on navigation services, should be established. This is a policy question that the Congress must ultimately decide after considering a number of issues and trade-offs.

In conclusion, the Coast Guard faces the daunting task of meeting its capital needs in a constrained budget environment. To be successful, the agency must first satisfactorily justify the need for modernizing or replacing its deepwater ships and aircraft. Then, the Coast Guard must identify approaches and strategies for prioritizing and better managing its capital projects while continuing to pursue cost savings and other ways to help meet funding requirements.

Mr. Chairman, this concludes my testimony. I will be happy to respond to any questions you or other Members of the Subcommittee may have.

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