Carter Briefing On Acquisition Efficiency

June 28, 2010

SEC. GATES: I'm the warm-up act today. (Laughter.)

I want to say a few words regarding a major initiative we're undertaking to address one of my highest priorities, reforming the way the Pentagon does business. Over the past month, I've directed the Pentagon to take a hard, unsparing look at how the department is staffed, organized and operated. The purpose is to significantly reduce our overhead costs in order to free up the resources needed to sustain our force structure, to modernize, and to create future combat capabilities.

The department has set a goal of finding more than $100 billion in overhead savings over the next five fiscal years, starting in FY '12. As a matter of principle and political reality, we must do everything possible to make every taxpayer dollar count.

Some of these savings can be found by eliminating unneeded programs and activities. The department's leadership has already taken strong action in this area, and needs to do more. But other savings can be found within programs and activities we do need, by conducting them more efficiently.

A large part of our activity is done through contracts, some $400 billion across the department. In a spirit of innovation and fiscal responsibility, Ash Carter, the undersecretary of Defense for Acquisition, Technology and Logistics, will be leading a major effort to improve the efficiency and cost-effectiveness of the way we buy goods and services. In a couple of minutes, Dr. Carter will explain the elements of this initiative in more detail.

Clearly, an important part of achieving that goal is working closely with our industry partners and departmental contracting professionals. Earlier today, Dr. Carter met with hundreds of CEOs and military acquisition leaders to discuss the way ahead for this project. Like all important and necessary institutional changes, this process will take time. But I'm confident we'll succeed.

Ultimately, we as leaders in government owe it to the men and women of our armed forces to do all we can to provide them with the very best support possible.

Ash?

MR. CARTER: Thank you, Mr. Secretary.

Good afternoon, everyone. What I'm going to describe is part of the efficiency initiative that Secretary Gates launched at his Abilene Eisenhower Library speech some weeks ago, and which Deputy Secretary of Defense Lynn has also discussed with you here in the press room. The motivation is and the bottom line is that the secretary and the deputy secretary and I and the senior leadership of the department have concluded that we can't support our troops with the capability they need unless we achieve greater efficiency. And I am going to describe today the framework for a process to obtain 2 to 3 percent net annual growth in war fighting capabilities -- growth in war fighting capabilities -- without commensurate budget increase, by identifying and eliminating unproductive or low-value-added overhead and transferring the savings obtained to war fighting capabilities.

In effect, doing more without more.

As the secretary indicated, today I spoke to our acquisition leadership. The other senior leaders of the acquisition core are present here in the press room with me. We spoke to the department's acquisition logistics leadership from around the country. I also had the opportunity with them to meet with industry leaders this morning, and now to speak with you.

So let me describe how this will work and how it will unfold, and then a few ways you might be able to think about it. You have in front of you the letter that I issued today at 11:00 in the morning to the acquisition core of the department, and then three charts, which describe this specific initiative.

So let me begin at the beginning. The focus of this is on the $400 billion out of our $700 billion budget that is contracted out for goods and services.

About equally between goods and services, by the way.
The charts are a framework for the steps we're taking. The first chart is about incentives to industry to increase its productivity, and the second is about how DOD can adapt its management practices to encourage efficiency. The point here is what -- I use the phrase "more without more." This is what economists call productivity growth. That's what we're looking for. In the rest of the economy, we expect this. You get a better computer every year, and cheaper. But we haven't seen productivity growth in the defense economy. More has been costing more. And we need to reverse that trend and restore affordability to our programs.

For example, if you look on chart two, it suggests that I'll be issuing guidance to make sure that contracting officers are using the proper contract type to give the taxpayer buying power. An example would be using a fixed-priced contract for development of the KC-X tanker, which we're doing. This stabilizes design and enhances the value of competition.

Another example you see on the charts is the phasing out of time and material contracts for services, which tend to lead to unnecessary cost growth over time. Note that I use the phrase "phasing out," because like many items in this initiative, it will take some time to work out inefficiencies that have crept into our practices in a decade of generous budget growth. That's why we're setting an annual goal of 2 to 3 percent which accumulates over the coming years. But there will be specific targets for going down and getting leaner in these different categories.

Also on chart two is an important item: leveraging real competition. An example is the littoral combat ship where the approach we had been taking was leading to a pattern of directed buys rather than real competition. Our new approach ignites real competition. One of the reasons the department is opposed to an extra engine for the Joint Strike Fighter is that we do not think it will lead to real competition but to directed buys.

Another item to note on chart two, a preferred supplier program, sort of like a frequent flyer program -- where consistently excellent performance by a contractor will be reflected in special benefits that enhance profit.

On chart three, we're pointing to steps that government can take as part of this initiative, essentially to make sure that our practices permit and indeed encourage leanness and productivity growth in the defense sector. For example, the first bullet on chart three emphasizes that we're -- while we will be using independent cost estimates as forecasts for how much our programs will cost if we keep managing it inefficiently, we want our managers to acquire our weapons for what they should cost.

Chart three also emphasizes that as we start the new ballistic missile submarine, the Ohio class replacement, the Army's new ground combat vehicle, the family of systems for long-range strike and electronic attack that will replace the cancelled Next-Generation Bomber, the presidential helicopter, that we need to make sure affordability and not just appetite are designed in from the start.

So these are some examples. Each of those items on the chart will be ones that we'll be pursuing, and in the pursuit of this 2 to 3 percent net increase in war-fighting capability by removing inefficiencies that have crept into our acquisition of goods and services. Over the next several weeks, I will be conferring with our acquisition executives and with industry about specific ways we can do that, identifying specific targets along the -- within the framework provided to you today. And at the end of that period, I will issue guidance to our acquisition cadre implementing what we have ascertained during that time.

Let me give you a few additional ways you might think about this initiative as you try to understand where we're going. You might -- first is, why now? And the first reason for that is the imperative that the secretary gave. We're entering an era where the Defense budget will not be growing as rapidly as it was growing in the last decade. We do not expect it to decline. We expect it to grow slowly.

And therefore, if we're going to provide, in the war-fighting accounts, the 2 to 3 percent annual real growth that is necessary to execute the program in front of us, to avoid broken programs and instability, we need to achieve efficiencies.

This is different from acquisition reform. And you may have heard that phrase in the past. This is different in the sense that it's focused on specific outcomes, not on our bureaucratic processes, and focused on the execution of programs rather than budgeting for programs. So this is a different approach; I think will be a more effective approach.

Third, it's entirely plausible that after a decade of growth in the Defense budget as we have enjoyed, that inefficiencies have crept into our processes and so that we can find 2 to 3 percent savings per year over the next five years.

And finally, we're at an inflection point in history of the Defense budget. The Defense budget is not going down, but it's not going up at the rate it was in the last decade either. And so we need to adapt to change, play the game that's on the field. And the earlier we do that and take on this challenge, the greater will be our chance of success. So that's why now.

This morning former Secretary of Defense Perry made comments at the Center for Strategic & International Studies where I was meeting with industry CEOs, and he remembered the last supper of the 1990s, which I attended. And he was careful to say that this is different, because that was an era of budget decline.

Then there is the first decade of this century, which was an era of budget growth. This is neither the '90s nor the last decade. It's different. It's an environment in which we're going to have slow real growth. And our senior managers and our partners in industry need to manage accordingly.

So one way to think about this is in contrast to the 1990s and to the decade just past. Another way is to think about last year and this year. Last year, first of all, we focused a great deal in the department on eliminating unneeded programs. Secretary Gates just said that. More of that can be done. But this initiative focuses on the capabilities we do need and providing them more affordably. That's different.

Second, last year we were heavily focused on the Weapon System Acquisition Reform Act and the implementation of that, which largely had to do with our bureaucratic processes, and rightly so. And we've done a lot to implement the Weapon System Acquisition Reform Act. This is different. This is focused on execution and outcomes.

I would say to anyone who's hesitant about embarking on this path that they need to consider the alternative. And the alternative is broken programs, turbulence of canceled programs, unpredictability and uncertainty for industry, erosion of the taxpayers' confidence that they are getting value for their money, and, above all, lost capability for the war fighter that we can get if we're successful in inducing productivity growth, leanness, and restoring affordability in Defense.

So that is the purpose. That is the process.

The charts in front of you and the letter that I gave this morning to our acquisition corps describes in some detail this initiative. And the final guidance will be issued by me in some week's time.

With that, let me take your questions. Let's focus the questions initially on this initiative, although we can go to other questions later.

Q Mr. Secretary, what impact, if any, do you expect this initiative to have on arms makers' profit margins? And what do you think is a reasonable profit margin for the industry to expect in order to maintain the defense industrial base?

MR. CARTER: Well, the first thing to say about that is this is about costs, not profits. It's about eliminating unnecessary cost. And in the commercial world, the way you pursue profit is by -- one of the important ways is way eliminating cost. And we want to give the same incentives to the defense industry.

The second thing is that if you use profit as an incentive for productivity in the defense industry -- we want to do that.

Second -- so it's backwards to say it's about reducing profit. It's not at all about that. It's about reducing cost.

The second thing to say is that a healthy, vibrant and financially viable defense industry is in the national interest because we don't, as my letter indicates today, we don't build our own weapons systems in the government in this country. We contract with private industry for them.

So it's important for us to have a healthy industry. So the objective here is productivity and the reduction of unproductive cost.

Q But as you shift to a greater use of fixed-price contracts and away from cost-plus and time and material contracts, is it not reasonable to expect that that's going to put pressure on profit margin?

MR. CARTER: Fixed-price contracts are ones in which the business arrangement between government and industry is on a different basis from a cost-plus contract. That doesn't distinguish the profitability to the industry. If industry gives us a fixed-price that is advantageous to us and gives us a weapons system that is affordable to us and that exceeds our expectations for how low the price can be, and then goes on to execute to an even lower cost and increase their profit, that's fine. That's a good deal for us. That's productivity growth.

At the same time, if you're in a cost-plus environment, which is appropriate to exploratory development -- but if you're in a cost-plus environment in production, there is no incentive to contain cost because all the costs are simply passed onto the taxpayer. So it's all a matter of what's an appropriate vehicle for the environment you're trying to work in and that gives incentives to reduce cost to the taxpayer and war fighter so that the price we pay is lower. And that doesn't really distinguish fixed-price versus cost-plus. The circumstances do.

And profits can be made in both environments, certainly, in fixed-price, but by performing well.

Q Could you offer some examples of what you mean by unnecessary costs that you're trying to eliminate?

MR. CARTER: Yes. Let's take, for example, in a weapons system production, if you're looking at the production process, are all the people who are part of the production process being used with optimal efficiency? Are all the subcontractors being incentivized to control the costs of parts? Is the government controlling its requirements and not changing them so that the production process is not disruptive which is uneconomical?

Those are three examples.

Q You have enough of all the systems and ways of tracking this, not only being able to say, here are the number of people working on this versus work on something else?

MR. CARTER: Yes, we do. In general, we get a lot of that data. We depend for industry -- on industry for some of that data. They obviously collect it. Everybody scrutinizes their own business practices and production practices. And we do the same, and we're going to do it more so that we understand each and every cost that we're incurring and paying for something for the taxpayer, and making sure that we are scrutinizing and controlling all those costs, trying to minimize them.

Q But implicit in that assumption, though, is that, like you said, in the last 10 years, when the budgets have grown, there are some inefficiencies that have crept in. But the other way of saying that is some of the cost that is being billed now to the Pentagon is not necessary, and so therefore that cost that is being now billed to the Pentagon actually affects the profits of companies, so if you take them away, these companies have to somehow find a way to --

MR. CARTER: No, unnecessary -- unnecessary cost is not necessarily profit. If there -- if a given production process could be leaned out by, for example, having fewer people or using less materials, then that is just more economical. Those people are being paid now -- who, if they're not necessary, those costs will not be incurred. So inefficiency doesn't translate into the bottom line.

Q But would it be fair to assume that there would be some kind of layoff and job reductions as a result of this focus?

MR. CARTER: No, because defense spending is not decreasing. Defense spending is not decreasing. We're talking about deploying people in the optimally efficient economic way, so that there's the most output for the taxpayer and the warfighter. But there's the same number of dollars, and therefore the same amount of employment.

Q Of the $400 billion that are spent on contracts, how much of that is overhead cost?

MR. CARTER: It's hard to give a general number for that because it varies, and appropriately so, from item to item. So some kinds of -- remember, overhead, there is legitimate overhead. Not all overhead is illegitimate. That is an appropriate part of the business transaction between us and a provider, an appropriate part of their providing the product to us. It depends whether it's goods or services, what kind of goods and so forth. And we just need to look at each case and make sure that we're appropriately incentivizing the reduction of unnecessary costs.

Q So under the new rule, would you say that maybe small businesses will benefit because they have lower overhead costs than large companies?

MR. CARTER: Small businesses are an important focus of this because the vitality of small business is a real asset to national defense. We want small businesses to be entering the defense sector, bringing their technology, their vitality, and yes, their efficiency and productivity. We want the companies that are now outside of the defense sector to enter the defense sector because they're lean and efficient, because the commercial economy makes them be so, and we want that influence within defense.

Q . . . sort of how are you going to evaluate whether things are efficient or inefficient, and some people have to create more positions through this evaluation, or?

MR. CARTER: Oh, I think the way that you'll see productivity growth in defense is when program costs stop growing or even come down, so that we're getting more value for the dollar. You've gotten used to seeing program costs grow inexorably. That's not something you see outside of the defense economy. Why is that the case? We would like to arrest and reverse that trend.

Q How are you going to get the defense industry to go after the productivity that you're seeking? Are there going to be regulations that require them --

MR. CARTER: Well, there are regulations already. The -- the --

Q New regulations that require them to --

MR. CARTER: Yeah, new regulations which incentivize the right -- the right thing, which is productivity growth.

Q So I mean, will they get a percentage of the increase as added profit, or?

MR. CARTER: Absolutely. We're prepared to use profit as an incentive for productivity and affordability. I can't make that point enough. That's the -- that's the principal leverage we have.

Q Can I just build on Rick's questions, sir? You spoke to the CEOs this morning. You also spoke to the contracting officials. What did they say to you? What was the feeling that you came away from those two meetings with?

MR. CARTER: Two things, I would say.

First of all, everybody knows that we're entering a new era, that we're at an inflection point, and that therefore we need to adapt our management practices to that reality, play the game that's on the field.

Secondly, they can do the math, which is that we're going to enjoy some real growth in defense spending, but not the kind that we've enjoyed over the last decade.

Therefore, if we want to continue to invest in war fighter capabilities, we're going to have to do that by finding efficiencies and being leaner.

So the logic, I think, is apparent to all, and they're looking for a path ahead. This is a mandate and a framework for that path ahead. It gives -- whatever there are on those charts -- 20 different items which cumulatively we're looking to deliver 2 to 3 percent in annual savings. That should be doable. That's an eminently achievable, practical goal.

So these are managers in government and industry that are looking for a managerial way ahead.

Q Mr. Secretary, beyond what's in the memo, do you have any specifics in mind or modalities that you could share with us in terms of how you plan to implement these overarching goals?

And also, I wonder, why should folks look at this effort as different from past efforts that have been unsuccessful to curb some of these costs?

MR. CARTER: Let's see. The measures we will take and prescribe will be continued in the guidance that I issue in several weeks' time which follow the format in front of you and which will be informed by the process of consultation and focusing that goes on over the next couple of months. And they will direct these activities, specific targets and a specific way of getting there.

Different from the past in two ways, as I described. Different in substance in the sense that this is not, as acquisition reform was, focused on our internal bureaucratic processes. That was necessary; we are still doing that. That's important.

This is different. And complementary, but different -- focused on outcomes and on the execution of programs, rather than on our processes in the budgeting for programs.

Number two, it's different because the era's different. It's not the '90s; it's not the first decade after 9/11. It's a different kind of period, so it requires a different managerial approach.

And I think the third thing is you see in Secretary Gates and in Deputy Secretary Lynn, Secretary Lynn clearly articulated the imperative. We are at war; our budget is not going to continue to grow at the rates it has been in the last decade. We have to deliver value. We have to get more without more in order to meet our commitment to the war fighter.

Q So does that mean the part you're going to tell acquisitions is that . . . within the Department would . . . out 2 (percent) to 3 percent of your . . .?

MR. CARTER: Absolutely. Yes. That's absolutely right. And here's how this can be done.

Look at your activities, look at your practices, look at your processes and see where you can find what is a very achievable degree of savings every year so that we can take those savings and plow them back into programs.

Q I just want to be sure I understand that. Then that's sort of across-the-board cut for all of the sub- assistance programs?

MR. CARTER: Well, cut's the wrong word when you're improving efficiency. If you can have 10 programs for the price of nine by making them all more efficient, you have more military capability for the same amount of money. That's good for everyone.

Q Hi. Your counterpart at the Air Force has recently criticized the Global Hawk program, and he said that they are going to undergo this should-cost review. Can you explain how that's going to happen? How is that going to work exactly?

MR. CARTER: Absolutely. And he's absolutely right, both as regards the need to take a look at Global Hawk. This is Mr. Van Buren, the very excellent Air Force acquisition executive who's actually here with us today. And he's describing the process which I think is the very first bullet on the third chart, which distinguishes will-cost from should-cost.

You're probably all familiar now with the process of independent cost estimates. They are an important tool because they represent a different look, an outside look from our programs and the contractors supporting them, at the cost of a program.

But they tend to tell us what something will cost if we keep managing the way we're managing. And I'm saying that we need to do something else, also, which is say, what should this cost?

In other words, let's look at the budget of a program piece by piece by piece and ask ourselves should we be paying -- is there inefficiency here? So will-cost and should-cost are are two different things. Both play a part, have a role, but what's new is should-cost. And we're going to do that for Global Hawk because it's been showing cost growth. Why? We need to find out why and see if we can address the why and bring that over. It would be a perfect example of what I'm talking about.

Q How is that review going to be, then, conducted? Can you give any more specific detail on what --

MR. CARTER: Yes. There are six or eight different applications of Global Hawk. They all have a roughly comparable airframe, different payloads. We have to look at the airframe part of the program, each of the payload pieces of the program and say what's going -- why are these things costing more every year and not less, like your computer costs less? Then there's the test program, also, and the lifecycle cost. And all of those things will be scrutinized with an eye to making it affordable, because it's on a path to being unaffordable.

Q I'm interested in your emphasis on fixed-price contracts for development programs as opposed to production programs, I assume. In development, isn't that when a company is figuring out how to meet requirements, what tools they need, how to build the structures, et cetera, of an aircraft, for instance? I mean, aren't they, at that point, trying to figure out how to do something they, by definition, don't know how to do yet since they're in development? And if I'm correct in describing that, then why does it make sense to have a fixed price if I don't yet know how I'm going to build that --

MR. CARTER: Well, a fixed price does not always make sense in a development program for just the reason you described. It depends on what kind of development program it is. It's not a matter of whether it's development or production.

The real issue is whether the government and the contractor can price risk. If you're doing something that requires invention then, by definition, neither you nor I can possibly know what it's going to cost. And therefore, when the government contracts for that kind of activity, it's appropriate that we say we will cover your costs; we want to know what they are; we want to audit them; we can't afford the moon, but we're going to reimburse you and then add a profit onto that. That's a cost-plus contract, perfectly appropriate for a situation where invention is required.

On the opposite end of the spectrum, where we know exactly what we want and don't change our mind -- that's where we require discipline and knowledge -- and where the contractor knows and has control of his processes and design and can, therefore, realistically give us a price, when those two conditions obtain, a fixed-price contract is a more appropriate vehicle because it incentivizes productivity gains, as I said, because when the contractor has a price and the better they do at controlling cost, the more they make, which is fine with us because we've gotten the price that we want.

So it's not a matter of whether it's development or not. It's a matter of what the circumstance is. So, for example, I used the KC-X tanker development.

Q Well, that's my question.

MR. CARTER: Okay. Well, that is not an invention. That's not an invention. That is a commercial aircraft in widespread use, hundreds of them are made every year, adapted in a relatively minor way to a longstanding military need and operated the way hundreds of tankers have been for decades. That doesn't sound like invention, does it?

So it's appropriate for us to know what we want and them to know what they supply in that circumstance, and that is a containable kind of development. And that's why a fixed price is appropriate there.

If, on the other hand, you go to something that's more speculative or we're saying, you know, we really need a solution to a particular military problem but we don't know exactly what it looks like -- if you can't describe it, we can't describe it, they can't describe it, how can you possibly get a price to that?

So this is a place where the rule of reason applies. This isn't a religion.

It's a place where the rule of reason needs to apply, as in all choices of contract type. And we need to apply the appropriate tradecraft, and the one that reflects the reality of the situation at hand and that provides the right incentives to the performer of the work to reduce cost and to the government to contain its appetite and not change its mind.

Q Just to clarify . . . billion dollars did you spend annually on goods and services? You were targeting a savings of 2 to 3 percent off that? Okay.

And second, is there a list of -- or are you going to develop a list of programs where the --

MR. CARTER: Let me -- I want to turn it around the other way because what -- the 2 to 3 percent that we're looking for is a 2 to 3 percent increase in the war fighting, the meat. That's really the objective because that will allow us to continue -- that's the kind of real growth that historically keeps the investment part of the budget healthy. Since we're not going to enjoy that in the budget -- the defense budget as a whole, that rate of growth, we want that rate of growth within the investment account, and the way to finance that is to eliminate that which is unneeded, either unneeded programs or unnecessary costs within the programs we have.

Q . . . fixed window where you can find the 2 or 3 percent. I mean, if you do that for three years, you might find that there's no more gains to be had.

MR. CARTER: Well, the specific plan we have is 2 to 3 percent over five years. I would be delighted to get to a point where I couldn't possibly find another nickel and it was all meat.

Q One last question. So do you have a list of those programs where you find the inefficiencies are high, or would you develop a program --

MR. CARTER: I think you can just look at any issue of any of your publications and see programs that where cost has grown, and ask yourself, is that reflective of real unavoidable cost growth, or is this a case in which we should not be accepting this kind of cost growth but trying to contain it.

Q You said that . . . programs rather than the budgeting, but you want to get programs that . . . right from the start. . . for a creep over into requirements documents as they're coming to you, or --

MR. CARTER: Well, yeah, new programs are a special case. Obviously we're going to be looking in an ongoing and established programs for the most part because that's where most of the money is. But it's also true that as we start things, we want to look ahead to the years ahead and make sure that we're not creating something or imaging something or embarking on something that we're not going to be able to pay for. And now's the time to do the engineering trades in which you decide, well, maybe if I have 90 percent of the performance at 50 percent of the costs, that's a pretty good deal. Now's the time to make those trades.

Since we are embarking on some important new investments this year, I want to make sure that those kind of tradeoffs, that affordability is built in from the beginning. That won't save a whole lot of money in the near-term, but out there in the out years, it will, and it's an important part of the discipline.

Q At the far end, you mentioned the Last Supper that led to the consolidation of the industry. How will you urge industry to change, if at all now? Closing of units, closing of facilities, selling things off that -- how might industry --

MR. CARTER: Well, I want to hear their ideas. But what I asked today was look at your own processes for unnecessary cost, productivity gains, efficiencies. They know their operations very well. And where am I not giving you the right environment, the right regulation, the right incentive to realize that in the way that you would do if you were serving a commercial costumer.

Q So are you talking about . . . program?

Q Yeah, I want to ask them, you know, your -- you made an assertion early on that, you know, this is not the 1990s because --

MR. CARTER: It’s not an assertion. (Laughter.)

Q Well, because the growth in the budget is -- you know, that it'll remain pretty stable. But Congress has a vote and a big one -- Steny Hoyer said today, you know, deficit reduction is key and it's a national security matter, you know, imperative to kind of reduce the national debt and defense is a part of that. So how confident are you that Congress is going to go along with those?

MR. CARTER: Well, the president's -- the president's budget calls, as I said earlier, for modest but real growth in coming years that's different -- you're absolutely right -- from the last decade.

I think that people understand that we're at war and that a downturn is not appropriate. At the same time, the economic times are difficult, and so we're not going to enjoy the double-digit kind of growth that we had in the last decade. And I think the taxpayer wants to see us get by and do more with the amount of money we're going to have. And that's a perfectly reasonable expectation, and that's what this is all about.

Q You've spoken about unneeded programs. And Secretary Gates has frequently called into question whether there's a need for an amphibious landing capability. And Chairman Skelton says he expects the Defense Department to try to kill the EFV, excursionary -- expeditionary fighting vehicle.

Do you also expect the department to seek to kill the EFV?

MR. CARTER: Well, that's describing specific programs. Let me go back to how canceling unneeded programs complements the effort I'm talking about. There have been program cancellations over the last few years, and there will undoubtedly be some in the future. Again, I'm not addressing the specific case you alluded to.

And so -- and we will continue to look for and eliminate unneeded capabilities. But at the same time, we need to be trying to deliver the capabilities we do need more cheaply. That's what this is about. That's what I'm principally focused on in this effort. Both are important things to do.

A lot of the attention last year was, as I said, on getting rid of unneeded programs. Now we're moving on to another phase, which is reintroducing affordability to the programs that we have concluded we do need.

Q Sir, you said earlier that you need 2 to 3 percent growth each year. And then you also said that the budget -- that the president's budget request will have a real growth component to that. Does that 2 to 3 percent increase that you talk about needing include the real growth in the president's budget, or is that exclusive of that?

MR. CARTER: Yes, you can read the president's budget over the next five years. And it has in the neighborhood of a 1 percent real growth. In the investment accounts, I would like to see us attain a 2 to 3 percent growth. Since that's not going to come from the top line, we need to try to find it internally and pump those savings back into investment. That's the purpose of this process.

Q Sir, there's a review ongoing about the SSBN-X submarine, right, to try to cut the cost.

MR. CARTER: Yes.

Q Have you set specific targets for that review, or have you just said, "Do the best you can and come back to me with what you find"?

MR. CARTER: No, I'm not a participant in that review, so it's not a matter of standing back from it. But just to be specific, there are three or four major design drivers of the cost of the submarine. And for each of those, one has to look at what the tradeoff is for each of them between extra capability and cost and decide at which point in the design to -- that one has gotten most of the capability without paying most of the maximum cost.

And one needs to do that item by item, and then end up with a design that meets our military needs but might not have all the features that one can think of or one has thought of in the 30 years or so since we last designed a ballistic-missile submarine in the name of affordability, because we want an affordable submarine.

[. . .]

Q I wanted to ask about shipbuilding. That's one of the sectors that pretty much everyone agrees that has excess capacity, a lot of excess capacity. So cutting back on the capacity of shipbuilding, would that be an example of something you would --

MR. CARTER: Capitalization in general is very much an example where there is excess -- there are excess facilities and a larger plant for floor space or number of facilities is being used to conduct a given activity then, as necessary, to do it. And there are examples like that -- shipbuilding is one -- that's clearly an example where savings can be had and productivity can be increased.

Q What's going to be the penalty for a contractor to follow these guidelines to push to be more efficient?

MR. CARTER: Well, you're going to retain programs, win new programs, and be more profitable if you're leaner.

Q Can I ask you a question on the other side of incentives when you talked about the incentive for industry? One of the reasons that cost estimates have been so drastically wrong in many programs is because the requirements writers have, as you alluded to a little while ago, have shot for the moon often, and then there's requirements creep. What strictures or incentives are you thinking about to prevent requirements writers from going too far when they start programs? And how are you going to prevent requirements creep?

MR. CARTER: I described already the process we're using on the SSBN-X and our large programs to scrutinize. The key there is the engineering design trades, and that appetite is traded off against cost in the design at the beginning.

Requirements creep is -- there are many ways to prevent requirements creep, but one goes back to a question you asked earlier about contract type. One of the things that causes -- that will require us on the government side to make up our minds once and for all and not change requirements is a fixed-price contracting environment, because you pay dearly in that environment for changing your mind. So there's a premium on us in that environment to get the requirements straight upfront and not change our mind later, rather than lurching into something without having thought it through. So a fixed-price environment puts a burden on the government, an appropriate kind of disciplinary burden, even as it does on the contractor. And that's why it can be such a good incentivizer of productivity growth, which is the entire point of this.

And I thank you all very much, and I'd be happy to answer if there are any follow-ups.

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