

A Special Report

U.S. Defense Acquisition: An Agenda for Positive Reform

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There has been substantial expansion of acquisition-related legislation in the national defense authorization acts passed during the past 10 years. Since the late 1990s, the number of acquisition provisions put in place by Congress has increased by three-to-four fold. In the past two years alone, the number has approached 100.

At the same time, there has been growth in the defense budget along with a dramatic reduction in the acquisition workforce-making it almost impossible for acquisition officials to perform their jobs efficiently and in compliance with all rules and laws. Moreover, there is a commensurate cost of compliance on the part of the defense industry included in the prices of goods and services.

The Aerospace Industries Association believes that now is the time to recalculate the imbalances in the defense acquisition system and take action for positive reform to ensure that the policies and processes that govern it are fair, reasonable and flexible.

The detailed AIA paper herein provides an overview of the acquisition system and offers recommendations for improvement. We welcome your comments and suggestions on this positive agenda.

Sincerely,

A handwritten signature in black ink that reads 'Marion C. Blakey'. The signature is written in a cursive, flowing style.

Marion C. Blakey
President and Chief Executive Officer

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U.S. Defense Acquisition: An Agenda for Positive Reform

Introduction: Understanding the Aerospace and Defense Industry and the Factors That Drive Industry Decisions

Supplying the systems and services that support America's men and women in uniform is one of the most important functions of the aerospace and defense industry.

The defense acquisition system — when properly used — is a powerful tool for ensuring that systems, platforms and services are provided at fair and reasonable prices in compliance with the cost, schedule and technical parameters of government contracts.

Although most defense programs deliver products and services on schedule and on budget, recent studies and reports by the Government Accountability Office indicate that cost growth, schedule delays and performance challenges that impact some programs — especially major system development programs — have left some observers with the false impression that the U.S. defense acquisition process is in disarray.

For the acquisition process to function more smoothly and efficiently, the incoming administration and Congress must strive to ensure that taxpayers' dollars are spent wisely while integrating the industry into the process in a way that provides an opportunity for both government and industry to achieve their objectives.

Key to positive acquisition reform is an in-depth understanding of the aerospace and defense industry and the factors that drive industry decisions.

The ability of the defense acquisition process to produce the best military equipment at the best value for taxpayers is dependent on several important factors — a strong industrial base, a rational and flexible acquisition process, well-defined requirements, budget realism, stable procurement plans, and a well-trained and experienced acquisition workforce and support from Congress.

All are interdependent and all operate in a dynamic environment that faces continuing challenges. Legislation, regulations, rules, processes, procedures and practices that comprise the defense acquisition process must be designed to foster a responsive industrial base and provide the tools and predictable approaches necessary to meet the difficult task of inventing, developing, producing and maintaining the most complex of defense products.

Background

Over the past half-century hundreds of studies have been done on the defense acquisition system and its challenges. Several serious examinations have produced comparable observations regarding systemic shortcomings and recommended fixes.

For example, the Packard Commission report of the mid-1980s provided this insight:

“No matter how DoD improves its organization or procedures, the defense acquisition system is unlikely to manufacture products as cost effectively or cheaply as the commercial marketplace. DoD cannot duplicate the economies of scale possible in products serving the mass market, nor the power of the free market system to select and perpetuate the most innovative and efficient producers.”

In 2005 the deputy defense secretary authorized an integrated assessment of the defense acquisition process through the Defense Acquisition Performance Assessment (DAPA) project. The DAPA panel found that the defense acquisition system's problems “are deeply embedded in many of the acquisition management processes that we use in the Department of Defense and not just the traditional procurement system.” It

proposed an integrated transformation of acquisition to “reduce costs and enhance overall acquisition performance.” This assessment found that the defense acquisition process is in need of fundamental reform to more clearly align responsibility, authority and accountability within six major categories — workforce, acquisition, requirements, budget, industry and organization.

There is merit to a number of the reforms advanced in the DAPA Panel Report and the follow-on Defense Acquisition Transformation Report to Congress. AIA is particularly supportive of major acquisition reform initiatives that advance the stability of programs and requirements, expand workforce skills and experience, and provide better contract incentives to reward good performance and enable firms to attract capital and earn fair returns on contracts. By institutionalizing such changes and obtaining more affordable and predictable acquisition outcomes, the acquisition system will become more transparent, predictable and cost-effective.

AIA recommends that the new administration and Congress consider rational reform of the current acquisition system to streamline burdensome processes and adopt and implement appropriate DAPA study findings and recommendations.

The association supports maintaining a strong, well-trained federal acquisition workforce and opposes any further reductions in its size. In fact, the workforce is facing new issues: workforce demographics, the imminent retirement of baby boomers, retention of core competencies and the need to perform inherently governmental functions organically.

AIA also believes that additional improvements are necessary in the areas of organizational collaboration, realistic cost estimating, budget realism and stability, requirements definition and control, and broader access to commercial items in the defense market. A dedicated effort should encourage more, not less, dialogue between DoD and industry on these acquisition matters. Rather than regressing to more complex and unique government acquisition procedures that will require more reporting, more oversight and more acquisition personnel, AIA believes the government should aggressively defend the reasoned reforms of the past and strive for more flexible rules that preserve program integrity while allowing for the ingenuity of a well-trained and experienced acquisition workforce to be applied in the best possible manner to each new situation.

Reform Focus for the Future

Although there are multiple areas in which defense acquisition should be improved in coming years, AIA recommends that the new administration and Congress focus primarily on these three overarching themes in 2009.

1. Promote Stability and Fairness in Contracting and Financial Policies. In order to maintain a competitive industrial base that effectively supports the warfighter and the nation, AIA urges the government to promote balanced, stable and fair contracting and financial policies that offer the opportunity for reasonable returns and cash flow in the industry’s performance of government contracts. Industry acknowledges that such reforms should be based on good performance. Contracting and financial policies that offer the opportunities for reasonable returns for good performance would

- Make companies more likely to invest in independent research and development and make capital expenditures.
- Provide for reasonable base fees and higher available award/incentive fees, giving industry a reasonable chance of earning a fair return.
- Permit award fee rollover when appropriate.
- Prohibit fixed-price options before design reaches an acceptable level of maturity and stability.

AIA proposes a series of reforms to promote the goal of stability and fairness in contracting and financial policies in such areas as competitive sourcing; streamlined acquisition of commercial items; and financial

and contractual reforms (e.g., contract types, award/incentive fee policy, and budget and cost realism). In addition, the government requires a highly capable workforce with a clear definition of inherently governmental functions so that there is a proper understanding of the role of contractors in supporting the DoD workforce.

2. Promote Reform of the Major Elements of the Defense Acquisition System. Government and industry agree that there is a major disconnect in the defense acquisition process between requirements, programs and budgets. This critical element of the defense acquisition process must be repaired.

The results of the deficiency are self-evident: major procurement contracts have been delayed year after year, impairing both military and defense industrial planning; unit costs keep growing, deterring economic production runs and slowing force modernization and recapitalization; industry protests, inspector general investigations and Government Accountability Office criticisms of the acquisition system are on the rise, fueling the perception that the system itself is dysfunctional. The inability to correct these enduring problems has led to the judgment that there is a lack of accountability in the system in general and has reflected negatively on aerospace and defense contractors.

AIA recommends that the next administration and Congress address this problem in an effort to restore system-level accountability across the board.

Reforms are proposed in

- Program/budget/requirements stability and logistics reform.
- Multiyear procurement authority.
- Nunn-McCurdy reporting.

Undergirding the reforms proposed by AIA is industry openness for additional dialogue and communications with both the executive and legislative branches of government.

3. Promote the Competitiveness and Efficiency of the Aerospace and Defense Industry. The defense business is increasingly taking on a global character. Competitiveness and efficiency should be promoted within this market by ensuring access to the best sources in the global supplier base. U.S. government policies should seek to strengthen the U.S. aerospace and defense industrial base while ensuring that U.S. suppliers have access to international markets.

Government policies designed to correct perceived deficiencies in the contracting process or protect specific U.S. sources could result, however, in the erosion of U.S. competitiveness and in critical U.S. suppliers being unwilling to participate in government contracts in the future. AIA concerns include:

- Punitive tax rates that discourage corporate investment and discourage research and development.
- Requirements for domestic specialty metals in commercial items whose manufacturers and distributors do not track sources of metal.
- Demands for detailed cost data from commercial item suppliers.

The goal of U.S. policy should be to enable greater openness in the global defense market, expanded international collaboration and more, not less, competition for defense goods and services. AIA has long promoted the modernization of the U.S. export control system to help achieve this goal; it also recommends specific reforms in the tax, financial and industrial base areas that would support the goal of greater openness in the global defense market.

Recommendations

Specifically, AIA urges the new administration to work with Congress and DoD to take the following actions:

- Stabilize program requirements, procurement plans, budgets and configurations.**
- Realistically estimate and budget programs, including variable costs such as inflation and escalation.**
- Promote U.S. government policies that address concerns about the role of contractors that are required for agencies to ensure the continuity and performance of key missions and functions.**
- Promote contractor responsibility and self-governance.**
- Encourage contract incentives that reward good performance and permit reasonable returns for positive outcomes, especially research and development contracts.**
- Provide adequate funding to hire and train a cadre of new government scientific, technical, engineering and acquisition professionals to recapitalize the acquisition workforce.**
- Resist restrictive legislation that could limit warfighter access to the best technologies available in the global marketplace.**
- Reaffirm the government's commitment to the use of commercial products and services for DoD and other agencies.**
- Rationalize oversight to eliminate duplicative and overlapping auditing and reviews.**
- Strongly resist creating further roadblocks to companies offering commercial items that can meet government acquisition needs.**
- Reverse legislation that uses the acquisition process to enforce unrelated civil and criminal statutes.**
- Support legislation that will promote U.S. defense industry competitiveness in the global aerospace and defense market.**
- Reverse legislation and policies that adversely impact the U.S. defense industry's ability to team with foreign entities and possibly precipitate retaliatory policies from foreign governments.**
- Support appropriate treatment of costs resulting from legislative mandates such as payments into pension plans required by harmonization of the Pension Protection Act of 2006 with Cost Accounting Standards.**

Goals

The goals that follow reflect topics of growing concern to the aerospace and defense industry.

Goal: Promote Stability and Fairness in Contracting and Financial Policy

- **Commercial Item Reform.**
- **Financial and Contractual Policy Reforms.**

- **Workforce Stability and the Role of Federal Contractors.**
- **Inherently Governmental Functions and Competitive Sourcing.**

Goal: Promote Reform of Major Elements of the Acquisition System

- **Budget/Program/ Requirements Stability and Logistics Reform.**
- **Expansion of Multiyear Procurement Authority.**
- **Nunn-McCurdy Reform.**

Goal: Promote the Competitiveness and Efficiency of the Aerospace and Defense Industry

- **Tax Reforms That Strengthen America’s Economy and Global Competitiveness.**
- **Specialty Metals Reform.**

In-depth analysis of each of the above goals is found in the sections that follow.

GOAL: PROMOTE STABILITY AND FAIRNESS IN CONTRACTING AND FINANCIAL POLICY

Fair acquisition policies are needed to maintain a competitive defense acquisition environment for the government and a healthy defense and aerospace industrial base. In order to maintain a competitive industrial base that effectively supports the warfighter and the nation, the government should develop policies that reinforce the supportive role that contractors provide the government as well as promote contracting and financial policies that encourage and reward good performance, promote fairness and stability, and establish balanced and equitable risk-management relationships.

To achieve this goal, AIA proposes a series of reforms related to 1) commercial item reform, 2) financial and contractual policy reforms, 3) workforce stability and fairness in contracting and financial policy and 4) inherently governmental functions and competitive sourcing.

Commercial Item Reform

The U.S. government acquires goods and services to support the enormous variety of missions of agencies ranging from the departments of Defense and Homeland Security, the Veterans Administration, the Federal Aviation Administration and the General Services Administration. Most of these goods and services are not unique to government needs but can meet government requirements with only minor modifications. They are readily available from commercial companies, and buying them commercially provides significant savings of time and money and often the very best available capability.

Congress recognized the opportunities commercial items provided to the government and that procurement statutes were not well-suited to acquiring these items from commercial companies. As a result, it enacted several statutes beginning in 1994 to help the federal acquisition system more readily incorporate commercial items whenever and wherever practicable to meet the government’s needs:

- The Federal Acquisition Streamlining Act (FASA) (P. L. 355, 103rd Congress, 2nd Session, 1994).
- The Federal Acquisition Reform Act (FARA) of 1996, Division D; National Defense Authorization Act for FY 1996, (P. L. 106, 104th Congress, 2nd Session, 1996).
- The Services Acquisition Reform Act of 2003 (SARA) (P. L. 136, 108th Congress, 2nd Session, 2004).

Passage of this legislation was a recognition that policies were written to address the government’s unique needs and that more streamlined policies were necessary to draw commercial companies into the

government supply base and to take full advantage of the commercial marketplace. Commercial companies that do a relatively small percentage of their business with the federal government find it very difficult to meet government-unique procurement policies and practices while still competing globally and responding to competitive pressures.

The benefits of employing commercial item acquisition processes are many and widely recognized. The DoD inspector general's office identified the benefits of commercial acquisition in its audit report D-2006-115, Commercial Contracting for the Acquisition of Defense Systems, September 29, 2006. The report lists the importance and benefits of commercial item acquisition to DoD, including:

- Access to state-of-the-art technology and products.
- Savings on limited financial resources for research and development.
- Establishment of a market price as a price analysis tool.
- Integration of the defense and commercial industrial bases to benefit the nation's security and economy.
- Reduced economic risk associated with developing new items.
- More rapid deployment of state-of-the-art technologies and terms.
- Access to proven technological capabilities.
- Increased competition.

While complex products, such as weapon systems, frequently take a decade or more to field, technologies from the commercial marketplace can be rapidly applied and fielded. This is particularly the case in the electronics industry whereupon much of the defense and aerospace industry depends. Acquiring existing commercial technologies enables DoD to maintain the technological superiority necessary to address new challenges. Because the United States needs rapid, unimpeded access to these commercial technologies, it must be able to quickly and simply purchase commercial and other state-of-the-art products and technology from commercial suppliers.

Considerable progress in adapting the acquisition process to the commercial marketplace was made in the first decade after these statutes were enacted and implemented. In more recent years, however, there has been a disturbing retreat when acquiring commercial items toward the use of government-unique procedures and intrusive government oversight more appropriate to products where the U.S. government is the only buyer. Commercial companies have become concerned that excessively unique, costly and burdensome requirements will reemerge and lead to the government's inability to access the best commercial technology.

The availability of commercial, item-appropriate acquisition procedures in Federal Acquisition Regulation (FAR) Part 12 has enabled the government to obtain high-technology products. When using FAR Part 12, the government receives state-of-the-art technology without the delays attendant to its own development process and at a market-tested price that compensates producers for their own investments, the costs of which are spread over a considerably larger customer base.

Commercial acquisition policies have attracted commercial companies and given DoD and other agencies the benefit of shorter time spans to field capabilities and logistics support using commercial distribution systems and increased competition. Recent changes in policies and legislation, however, require commercial item suppliers and manufacturers to establish a government-unique business infrastructure with increased requirements for cost and pricing data and disclosure of business-sensitive information — constraints unparalleled in the commercial marketplace and exposing commercial companies to increased risk.

Should current trends continue, we risk significantly limiting the ability of the government to access cutting-edge commercial technologies. If manufacturers are forced to segregate production of commercial and government items — where a single commercial production line is now in use — and establish a

government-unique cost accounting system, the costs could be prohibitive for the government. Commercial companies cannot afford to jeopardize their survival in intense, globally competitive marketplaces by taking on the burden of compliance with procurement policies more appropriate to government-unique procurements. Like “requirements creep” in a development program, “regulatory creep” in the form of a growing list of government-unique clauses that can be imposed on FAR Part 12 procurements has a negative effect on the desired outcome. Too many government-unique requirements that are being added to commercial item acquisitions will again chase commercial companies from the government marketplace.

AIA is concerned that there has been a steady erosion of the streamlined approach to commercial item acquisition — an approach that adopted an appropriate and carefully crafted balance between commercial item acquisition and more detailed procedures for acquiring government-unique goods and services. These unique requirements will force commercial companies to decide whether their business with the U.S. government has become too difficult, risky and costly to continue. This will hurt the U.S. government both by increasing costs enormously and by depriving it of what in many cases is the latest technology. Therefore, AIA supports industrywide efforts to preserve the flexibility needed for commercial item acquisition.

Recommendations

- AIA strongly encourages retention of FAR Part 12 authorities.**

- DoD should carefully consider the above observations when developing and implementing its plan for restricting government-unique contract clauses in commercial contracts as mandated by Section 821 of the fiscal 2008 National Defense Authorization Act.**

- Congress should streamline the following legal and regulatory burdens on commercial item acquisition:**
 - **Application of new procurement laws to commercial items without very carefully considering the potential impact on the government’s access to companies that sell commercial items.**
 - **Policies that would allow contracting officers to require commercial companies to provide detailed cost data more appropriate to government-unique procurements.**
 - **Written documentation of commercial item determinations over \$1 million.**
 - **Public disclosure of justification and approval documents for noncompetitive contracts.**
 - **Disclosure of government contractor/audit findings not related to commercial item reform.**

- Statutory changes considered necessary to resolve perceived problems should not be undertaken in a piecemeal manner or without specific regard to the impact on commercial item acquisition.**

Financial and Contractual Policy Reform

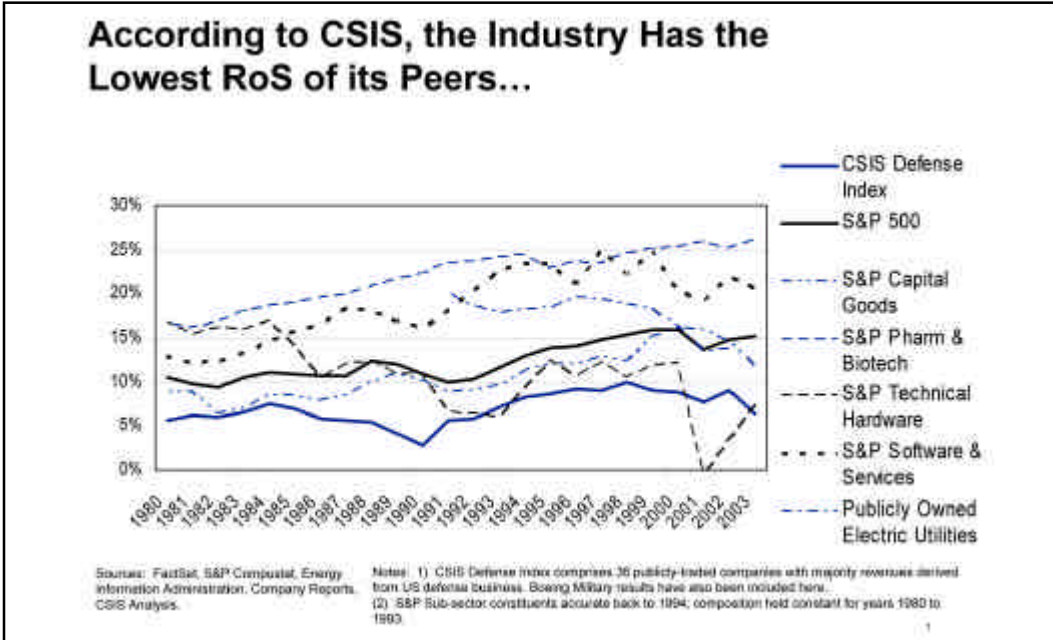
The U.S. aerospace and defense industry must be able to earn a fair and reasonable profit in the defense marketplace in order to attract capital and skilled employees and provide competitive returns to investors. Government policies should reward good industry performance and offer industry the opportunity for fair and reasonable margins and cash flow in the performance of government contracts.

The aerospace and defense industry is considered a relatively volatile market with comparatively low returns, given the high levels of risk. Returns are sometimes lower than the cost of capital, with the lowest returns historically on large development contracts. Additionally, most, but not all, major aerospace and defense contractors are largely dependent on U.S. government sales and foreign military sales for sustaining and expanding their business bases.

Hence, the government must recognize its responsibilities as a monopsonist procurer because there simply is no alternative domestic market for most of the aerospace and defense systems it buys. And, because many of today’s large development programs are not followed by long, predictable and profitable production runs, development contracts must be capable of generating reasonable returns, independent of any projected production.

The following 20-year review of the defense and aerospace industry’s margins, developed by the Center for Strategic and International Studies (CSIS) (Figure1), indicates that the industry historically has been among the lowest sectors in return on sales (ROS).

FIGURE 1



DoD incentive policies must reward good performance and enable contractors to earn a fair return on research and development contracts. With fair returns for good performance, companies are more likely to invest in independent R&D and make capital expenditures. Unstable government financial policies will impede industry’s ability to earn fair returns.

Some recent government policy changes impacting industry’s ability to earn fair returns include:

1. Reducing contract incentives and award fees.
2. Renegotiating prices to adjust for excessive pass-through charges consisting of normal overhead.
3. Preventing the net cost impact of simultaneous contractor cost accounting changes.
4. Disallowing costs for pension contributions required by law.

DoD Financial Policies and Cost Growth

The following actions would assist in stabilizing DoD financial policies and controlling cost growth:

1. **Contract Type.** Past experience has demonstrated that the very nature of advanced development is risky. Selection of the appropriate contract type in development can also do much to limit delays to the warfighter and cost growth on major weapons systems programs.
 - Misalignment of contract type and performance risk often results not only in delays but also leads to

- disputes, cost overruns and failures that further damage the credibility of the procurement process.
- Fixed-price contracts are suitable for acquiring supplies when there is a stable design based on validated requirements and specifications so that the government and the contractor can establish reasonable prices early on. A fixed-price contract, however, is generally not suitable for high risk, such as the development of major weapon systems with ambitious performance requirements. Cost-reimbursable contracts are more appropriate in those instances.
 - AIA urges caution in the application of fixed-price contracting for development contracts unless this contract type can be closely tied to what could reasonably be considered a low level of technological risk in the proposed development program.
 - Fixed-price contracting is most appropriate in the context of mature production programs. This most likely would be the case with those programs being considered for multiyear contracts.

AIA urges the new administration and Congress to encourage the use of contract types that are appropriate to the circumstances of the acquisition. In particular, the initial development phase of a program should be accomplished on a cost-type contract and only when risk has been appropriately reduced if the program transitions to a fixed-price contract.

2. Incentive Fee Reforms. Important reforms in the area of incentive fees include:

- Provide fair opportunities to secure reasonable returns by moving toward objective incentives.
- Permit rollover of the unearned incentive fee-pool into subsequent opportunities to earn the incentive.
- Fund and award cost-reimbursable development contracts at the government's estimate.
- Increase the emphasis on cost realism in source selections.

3. Award Fees. Where award fees are still appropriate:

- Promote reasonable and flexible implementation of the April 24, 2007, memorandum *Proper Use of Award Fee Contracts and Award Fee Provisions* from the director of Defense Procurement and Acquisition Policy (DPAP). Industry will assist in the dialogue with DPAP on implementation issues, including implications for industry pricing policies.
- Provide base fees and higher available award fees.
- Permit award fee rollover in appropriate circumstances.
- Prohibit fixed-price options before design completion.
- Encourage use of provisional award fee payments to enhance cash flow.
- Encourage alignment of award fee pool payments with overall program expenditure levels.

4. Costing/Budgeting.

- Require the Defense Department to budget programs at no lower than an 80 percent probability of success.
- Increase emphasis on cost realism in source selections.
- Fund and fence management reserves where justifiable.
- Provide appropriate treatment of costs resulting from mandatory accounting changes and legislative mandates for payments into pension plans.
- Take full advantage of current DFARS guidelines that allow added profit for cost efficiency and technology/manufacturing incentives.

Other Industry Concerns

1. Ethics/Disclosure. Consider industry comments on proposed changes to the Contractor Code of Business Ethics and Conduct rule regarding mandatory reporting of ethics violations of federal law to the inspector general rather than voluntary disclosure.

- Consideration should be given to the negative effect of mandatory reporting and the positive benefit of voluntary reporting. The development of new ethics rules should include consideration of investigative time and probable cause.
- Company management should have opportunities to remedy contracting problems or negotiate rectification with contracting officers, thus avoiding immediate, mandatory disclosures to the DoD inspector general of any violation of government rules.

2. Protecting rights to privately developed intellectual property. New government rules designed to aid sustainment of government systems could discourage private investment in technology innovation and create a barrier to commercial technologies by requiring commercial contractors to justify proprietary data rights to privately developed intellectual property as a condition of doing business.

Obtaining greater rights in data alone will not solve most logistics support problems. Excessive government demands for data in requests for proposal are counterproductive. A policy priority should protect the private sector's intellectual property rights, especially those necessary to encourage private investment and innovation.

3. Ensuring a workable approach to preventing inappropriate access to sensitive but unclassified information on contractor computer networks. The next administration should work to ensure a workable approach to preventing inappropriate access to unclassified sensitive information. In particular, draft government rules on protecting unclassified information on contractor networks do not define clearly the information to be protected, threaten to disseminate network vulnerabilities, do not consider the costs of developing systems to protect such information and are unclear in the penalties for failure to protect such information.

The government information assurance implementation group should take account of the industry position on protecting sensitive unclassified information and work toward a single memorandum of understanding for companies to sign on voluntary disclosure of inappropriate network incursions.

Recommendations

To enhance the stability and predictability of defense procurement, AIA recommends that the following financial and contractual reforms be introduced into the acquisition system:

- Create simple procedures for use of advance payments on major acquisition programs to improve cash flow and strengthen the defense industrial base without increasing the DoD budget.**
- Award competitive cost-type development contracts at no lower than an 80 percent probability of success, based on the Cost Analysis Improvement Group estimate to decrease the probability of cost growth.**
- Reduce the time and expense in awarding new contracts by allowing the waiver of the Truth in Negotiations Act requirements when adequate data for pricing exists.**
- Establish an acquisition management reserve capital fund for each military service at 5 percent of the service's acquisition topline with management and control of the fund under the cognizance of the respective service acquisition executive.**
- Provide and fence management reserves on development programs to mitigate disruptions from cost growth.**
- Prohibit requirements changes without additional funding on development contracts.**

- Provide adequate base and award fees on high-risk development contracts where returns on sales are unusually low in order to sustain the high-technology industrial base.**
- Don't encourage or require contractor investment to supplement appropriations for R&D because companies cannot rely on production to recover that investment.**
- Expand multiyear and block-buy procurements to reduce costs, promote a stable supplier base and encourage contractor investment in production efficiencies.**
- Prohibit fixed-price options prior to design stabilization on a major system acquisition due to cost risk.**
- Increase budget reprogramming authority to provide greater flexibility to address emergent requirements.**
- Resist using the acquisition system as a mechanism for enforcing unrelated goals and objectives, such as those in immigration and employment laws.**

Workforce Stability and the Role of Federal Contractors

A significant challenge for the next administration will be addressing the loss of talent and expertise in its defense acquisition workforce. This decade-long development has led to an increasing dependence on contractors for key acquisition functions. A smaller and much weaker defense acquisition workforce can ultimately impair both necessary government oversight and the timely acquisition of military capabilities by DoD.¹

Successful defense program management requires a professional federal workforce with expertise in the subject area. Since the early 1990s there has been a conscious national effort to reduce the size of the federal workforce, and the 2006 DAPA report determined that the reduction brought with it a corresponding reduction in the size of the government acquisition workforce. Personnel losses have been significant and the workforce is understaffed and overworked. As a result, the government workforce has become “increasingly overburdened as the demands have increased with the nature and complexity of the acquisition system.”

As DAPA noted:

1. No single organization is accountable for acquisition workforce career development; gaps in leadership and management continuity contribute to a lack of direction and leadership in the acquisition workforce.
2. DoD acquisition personnel responsible for requirements, budget and acquisition do not have sufficient experience, tenure and training to meet current challenges; personnel stability is not sufficient to maintain adequate understanding of programs and program issues.
3. Importantly, system engineering capability within DoD is insufficient in many areas, such as development of joint architectures and interfaces, definition of interdependencies of program activities and management of large scale integration efforts. Core competencies gravitate to the private sector as the government is deemed less a desirable employer.

Rebuilding the government acquisition workforce and stabilizing its leadership will take time. This should be measured in years, not months. Legislation mandating transition of functions outsourced to the private

sector back to the government with a specific time period might not only be unrealistic but also counterproductive to the government's current set of needs and requirements. Against this backdrop of workforce challenges, the government is at severe risk of losing additional technical expertise if acquisition and systems engineering expertise is mandated to be brought back "in-house."

Recommendations

□ AIA supports DoD's efforts to realign responsibility, authority and accountability at the lowest practical level of authority by reintegrating the services into the acquisition management structure.

These workforce goals should be pursued by the next administration:

- Seek to rebuild the federal acquisition workforce with an emphasis on the Defense Department. Provide the fiscal resources to grow that workforce in-house where needed, especially in the areas of program management, systems engineering and contracting. Permit the government to outsource to the private sector those functions that are not inherently governmental.
- Establish and direct standardized and consistent training, education, and certification and qualification standards for the entire acquisition workforce.
- Within DoD, follow-up on the DAPA recommendations to
 1. Establish service acquisition executives as term presidential appointments which would transcend change in administration in order to add leadership continuity and stability to the acquisition process.
 2. Seek legislation to retain high-performance military personnel in the acquisition workforce to include allowing military personnel to remain in uniform past the limitations imposed by the Defense Officer Personnel Management Act.
 3. Create a pool of acquisition-qualified, White House precleared, noncareer senior executives and political appointees to fill executive positions and provide leadership stability in the acquisition process.

□ AIA has also been at the forefront of aerospace industry efforts to highlight the need for a national effort to improve science, technology, engineering and mathematics (STEM) education for the U.S. workforce of the future.² As a part of a renewed national emphasis on education, industry supports government initiatives to develop innovative educational and workforce programs for the federal engineering and acquisition workforce, including cooperative training and education.

The association supports the provision of a governmentwide fund that could be used to recruit, train and hire professionals in these key fields. Other potential options that should be explored include joint government-industry training activities and rotational service programs between government and industry.

□ AIA also strongly supports a well-trained and experienced workforce that is experienced in various disciplines in acquisition and contract management. This is essential to best satisfy the ever-changing needs and requirements of the federal government. These disciplines include program management, systems engineering, production, logistics support and contract management.

Inherently Governmental Functions and Competitive Sourcing

The next administration, AIA believes, should promote policies that address concerns about the roles of contractors while ensuring that the U.S. government has flexibility in meeting mission requirements. This is increasingly significant for DoD because it now acquires more services than products, and defense acquisition policies must begin to adapt to this reality. Two key issues in service contracting involve inherently governmental functions and competitive sourcing.

With the growth in federal contracting over the past 20 years, concerns have been raised in Congress about

the extent that the increasing reliance on contract support impinges on the government's ability to perform agency functions. A recent GAO report observed that, although the private sector often has the expertise the government needs, agencies face challenges with their increased reliance on contractors.³

Federal law requires government employees to occupy positions that perform inherently governmental functions. There are multiple definitions and uses, however, of the term *inherently governmental function* in the U.S. Code. The government's guidance on the roles that contractors can and cannot perform and on the roles that ought to be performed by federal employees has been ambiguous.

This ambiguity poses significant problems for both government and industry. The lack of a common definition complicates issues related to the definition of organizational and personal conflicts of interest, subjects that are currently of keen interest on Capitol Hill. It has also led to congressional expansion of the concept into other areas. Congress, in Section 804 of the Ronald Reagan National Defense Authorization Act for fiscal 2005 (codified in 10 U.S.C. §2383), created another category of functions applicable only to the Defense Department — “acquisition functions closely associated with inherently governmental functions.”

Congress defined the “acquisition functions closely associated with inherently governmental functions” in reference to those listed in 7.503(d) of the Federal Acquisition Regulations. Section 807 of the fiscal 2008 National Defense Authorization Act then required defense agencies — to the maximum extent practicable — to bring in house positions performing those functions.

Agencies must retain critical functional capabilities so that each can properly perform its mission and adequately administer its contracts. Whether or not a position should or must be occupied by a government employee is not limited to whether the function is inherently governmental. Agencies must also manage the contractors who will continue to provide the important support needed for agencies to operate and achieve their missions.

Recommendations

□ AIA supports the expeditious implementation of Section 321 of The Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 to help clarify the issue of the appropriate role of contractors in supporting agency missions. This provision requires the Office of Management and Budget to review the definitions of “inherently governmental functions” contained in 1) the Federal Activities Inventory Reform Act of 1998 (“FAIR Act”), 2) Office of Management and Budget Circular A-76, 3) Federal Acquisition Regulations and 4) any other federal law or regulation to determine whether a single definition can be proposed for such a term that would clearly identify the distinct role of government and industry and would

- Reasonably apply to all executive branch agencies.
- Ensure that each agency can identify each of its positions that are exercising an “inherently governmental” function.
- Ensure that each agency has the discretion to supplement its workforce in order to ensure the continuity and sustainment of core missions and functions.
- Ensure access to critically needed technologies.

□ The association also recommends that the U.S. government preserve its ability to implement competitive sourcing, addressed in OMB Circular A-76, as a resource management tool to meet its mission requirements. DoD should continue to make better use of competitive acquisition strategies to further enhance cost savings.⁴

GOAL: PROMOTE REFORM OF MAJOR ELEMENTS OF THE ACQUISITION SYSTEM

Defense acquisition reform has become an omnipresent issue — each new administration arriving in Washington works to propose reforms to streamline a system that is seen as too large, too bureaucratic, too cumbersome and too slow in getting needed goods and services to our warfighters. Government policies should foster the development and support of innovative and affordable products and services that continually adapt and remain relevant to an ever-changing global security environment.

AIA is prepared to work with the next administration in a positive way to address these challenges and make the acquisition system more transparent and accountable. But industry also knows that a key to achieving long-lasting reforms is an in-depth understanding of not only those reforms that the government must make but also the factors that drive industry decisionmaking. Integrating industry considerations into the process is critical to ensuring that both government and industry achieve their acquisition objectives.

An important element in this effort will be development of a cooperative and positive working relationship with the Defense Department. While the DoD-industry relationship has improved recently, we believe that this partnership can be strengthened further through increased personal contact with DoD leadership.

A sound government-industry relationship is vital to our nation's future — industry stands ready to serve and support in any way we can. Reestablishing regular meetings among the secretary or deputy secretary and aerospace and defense CEOs would do much to facilitate better communication and dialogue.

Budget/Program/Requirements Stability and Logistics Reform

AIA recommends that the government move to stabilize program requirements, budgets and system configuration — arguably the largest contributors to program cost growth, schedule delay and performance challenges. Many former high-level DoD acquisition officials have noted that the requirements and budget process “is broken,” and yet it is the most critical part of the acquisition process because validated requirements and baseline budgets are the foundation from which future growth and performance are measured.

Recommendations

□ Budget Stability. Multiyear budgeting and support for funding strategies, such as advance appropriations and capital investment funds, should be considered because they would introduce additional stability into the defense acquisition system.

- Unfunded mandates should not be levied on existing programs. Alternatively, unfunded mandates, such as recent statutory requirements regarding pension funding, should be legislated as allowable costs and considered as below-the-line adjustments that have no impact on a program's cost baseline.
- Annual inflation/escalation requirements should be appropriately estimated and fully funded.
- Program budgets should be based on realistic estimates that reflect no lower than an 80 percent probability for success.

□ Program Stability. Multiyear procurement contracts and block-buys should be used to the maximum extent practicable in order to enhance savings that could be achieved through economic quantity purchases and production learning.

- DoD should increase investment in maturing technologies in order to reduce program risk.
- Each service acquisition executive should have direct control of a capital fund (notionally several percent of the service's procurement topline) to address emergent and unanticipated program challenges.

□ Requirements Stability. Requirements need to be clearly defined and stabilized before the design and development of systems and platforms. Cost and schedule should be better integrated into the requirements process.

- Requirements changes after a program baseline is established should be fully funded by the respective military service before implementation by the acquisition agent as a configuration change to the system or platform.
- There also will be a greater need to think in terms of subsystems of systems and open architecture to accommodate the needs of multiservice and multinational customers.

□ Logistics Reform. In order to achieve additional savings, DoD should aggressively reform its logistics and sustainment function to improve readiness, enhance warfighter support and address the major force modernization and recapitalization needs that the United States faces today. Logistics reforms will ensure measurable improvements in systems performance and maximum efficiency in resource allocation to meet this national defense imperative. Performance improvements will be evidenced in enhanced availability, reliability and maintainability of DoD assets.

- To achieve improved performance and resource allocation efficiency, the department must
 1. Transform product support to a performance-based model across all DoD platforms.
 2. Rapidly expand commercial supply chains for commercial commodities.
 3. Right-size and modernize DoD mobility capabilities.
 4. Increase reliance on commercially provided in-theater logistics support.
 5. Implement modern logistics information systems through a managed service model.
 6. Modernize force training.
- An integrated logistics reform agenda from the new administration that addresses the six areas above will help strengthen the force modernization program our nation needs for the 21st century.

Expansion of Multiyear Procurement Authority

10 U.S.C. 2306b provides DoD the authority to enter into multiyear procurement contracts. Multiyear contracts are permitted whenever the agency head finds that each of the following applies:

- The use of such contracts will result in substantial savings of the total anticipated costs of carrying out the program through annual contracts.
- The minimum need for the property to be purchased is expected to remain substantially unchanged during the contemplated contract period in terms of production rate, procurement rate and total quantities.
- There is a reasonable expectation that throughout the contemplated period the head of the agency will request funding for the contract at the level required to avoid contract cancellation.
- There is a stable design for the property to be acquired and the technical risks associated with such property are not excessive.
- The estimates of both the cost of the contract and the anticipated cost avoidance through the use of a multiyear contract are realistic.
- In a purchase by DoD, the use of such a contract will promote the national security of the United States.

The Need for Change

At the national level, AIA has spoken to the need for increased resources for our country's defense modernization effort (see AIA's report, "U.S. Defense Modernization: Readiness Now and For the Future, April 2008"). It is becoming increasingly apparent in the aftermath of our extended presence in Iraq that the reset and recapitalization requirements are large and across-the-board and the list of unfunded service procurement requirements continues to grow every year.

In addition, the services are faced with extensive modernization and recapitalization bills caused by deferred post-Cold War investment spending. There currently is a growing requirement throughout the defense establishment for modernization and recapitalization of defense equipment — some have estimated the bill to be as high as \$100 billion.

In this emerging defense environment, multiyear contracting authority offers DoD and the defense industrial base an important tool for addressing broad and continuing defense acquisition requirements. As noted by the RAND Corporation, “such contracts afford contractors the opportunity to buy materials in more economical quantities, schedule workers and facilities efficiently, and reduce the burden of preparing multiple proposals. The U.S. government also benefits from a reduced workload.”⁵

There are also strong and compelling programmatic arguments for expanding multiyear and block-buy contracting authority. Multiyear procurement authority is an integral element of a broader defensewide effort to achieve greater program and funding stability. Expanded use of multiyear authority will enable the government to achieve maximum savings on individual programs and retain the flexibility it needs to reinvest the accrued savings intelligently on other defense activities, including defense procurement.

If planned and managed properly, multiyear procurements can be especially important tools in helping baseline and stabilize defense budgets and programs. In addition, properly structured multiyear contracts can provide increased incentives for design stability and technological maturity in our weapons procurement process. Multiyear contracts can also be of importance in such areas as energy, reduction of critical readiness shortfalls and performance-based logistics.

A House proposal considered during the fiscal 2008 National Defense Authorization Act would have provided new authority for the secretary of a military department to enter into a multiyear procurement provided the contract addressed a critical readiness requirement as designated by the new Defense Readiness Production Board (DRPB).

For example, the authority would have applied to procurements that had previous multiyear contracts, such as those that have been in full-rate production for three years or were nondevelopmental commercial items. DoD supported the House proposal, but in choosing to stand up the DRPB, Congress did not provide the multiyear authority for critical readiness items. This is an area AIA believes deserves reconsideration by the next administration and the next Congress.

One additional area in which multiyear authority should be considered for expansion is performance-based logistics (PBL) where DoD contracts for supplies or support over a period of time and not on a level of effort. Shorter-term contracts limit the contractor’s ability to make necessary trade-offs to meet or exceed PBL threshold performance outcomes. Yet, objective evidence has clearly established cost savings averaging 20 percent relative to organic support through longer-term PBL contracts.

Recommendations

□ AIA strongly endorses the use and expansion of multiyear procurement authority by the next administration.

The history of multiyear defense contracting has shown repeatedly that the government can achieve significant savings if it is permitted flexible implementation of the multiyear procurement statute. Multiyear contracting has been a key ingredient to stabilizing cost and budget estimates for a large number of acquisition programs during the last 25 years, including the B-1B, F-16, M-1 tank, H-60, F/A-18, F-22 and other major defense programs.

The new administration has an opportunity to innovate and expand the use of multiyear procurement authority into new areas beyond traditional major defense acquisition programs.

□ DoD should enforce a policy of making no engineering changes on contracts, multiyear or otherwise, without funding being provided to implement the changes.

In this regard, we encourage DoD to enforce configuration control requirements already established by DoD 5000, and generally support the establishment of SAE-level Configuration Steering Boards as a positive development if they can support the timely adjudication of configuration issues.

Nunn-McCurdy Reform

Section 802 of the fiscal 2006 National Defense Authorization Act significantly changed the Nunn-McCurdy Act (10 USC 2433) governing reporting of major defense acquisition program (MDAP) cost breaches. The new requirements replaced the two previous categories of cost growth with four new thresholds that would trigger congressional notifications.

MDAP cost-reporting requirements were extended to include reports on cost growth above both current and original program baselines with a subdivision of cost growth into “significant” and “critical” categories. This revision increased the number of thresholds for Nunn-McCurdy breaches from two to four. Significant breaches have an increase of 15 percent over a program’s current baseline or 30 percent over its original baseline. Critical breaches involve an increase of 25 percent over a program’s current baseline or 50 percent over its original baseline.

The fiscal 2006 update applied to MDAPs for which an original baseline estimate is established on or before the date of enactment. An exception was made, however, for MDAPs already having exceeded their original baseline by more than 50 percent. For these programs the current baseline for the program at the date of enactment was deemed its original baseline.

AIA questions whether or not these additional requirements will improve the efficiency and transparency of the acquisition system because 1) Nunn-McCurdy compliance requirements involve reporting, not cost management and growth; 2) new layers of MDAP reporting could shift the focus of program managers from performance and quality control standards to a preoccupation with cost; 3) Section 802 can generate multiple, serial, program cost breaches simply because of the “significant” and “critical” threshold redefinitions rather than any degradation of industry’s MDAP management; and 4) cost growth documented by the SAR process often occurs for several valid reasons aside from program performance, such as quantity, mission and scheduling adjustments.

AIA is concerned that expanded reporting might ultimately impact the incidences of variations negatively for the department and serve to move the management focus away from a holistic view based on performance, cost and schedule to one overwhelmingly driven by cost.

Recommendations

□ AIA urges the Defense Department to evaluate the public policy implications of the fiscal 2006 Nunn-McCurdy requirements and encourages the House and Senate Armed Services committees to hold hearings on the potential impact of the law on both government and industry acquisition management resources.

□ AIA recommends that both DoD and the Armed Services Committees re-evaluate the revisions to Nunn-McCurdy enacted in the fiscal 2006 NDAA.

□ AIA supports legislative proposals that would amend the Nunn-McCurdy law to

- Develop a more comprehensive definition of the original baseline of major defense acquisition programs.**
- Allow DoD to reset the baselines for programs that have exceeded their program acquisition unit costs/procurement unit costs by 50 percent and when MDAPs experience mid-program**

quantity reductions or budget cuts as directed by Congress or the department or fact-of-life increases (i.e., commodity prices, foreign currency fluctuations). This is currently permitted under 10 U.S.C. 2433(d)(2) with notification to Congress.

- **Permit an individual program's scope to expand in the development phase due to configuration changes to accommodate validated emergent mission requirements without that counting against the cost baseline of the original program.**

GOAL: PROMOTE THE COMPETITIVENESS AND EFFICIENCY OF THE AEROSPACE AND DEFENSE INDUSTRY

The benefits of globalization in the defense market are critical to both U.S. security and the U.S. aerospace and defense industry. Globalization helps the U.S. achieve its overarching national security strategy objectives while also enhancing the competitiveness and vitality of U.S. aerospace and defense exporters. AIA has been at the forefront of national efforts to support U.S. defense trade and modernize our nation's export control system. Technology trade and cooperation play a central role in support of the aerospace industry's 645,600 jobs. Aerospace companies posted a \$61 billion surplus in 2006 even while the U.S. trade deficit was nearly \$800 billion. Such efforts are essential to build greater interoperability and defense cooperation between the United States and its friends and allies.

In addition to supporting reforms in the areas of defense trade and export control, AIA advocates reforms to America's tax, financial and industrial base policies. Reforms in these areas will strengthen the economy, ensure DoD access to the best sources in the global supplier base and make the United States more competitive in the global defense marketplace.

Advocate Tax and Financial Reforms to Strengthen America's Economy and Global Competitiveness

The U.S. national security posture is increasingly dependent on our nation's technological leadership and economic strength. Elements of the current U.S. tax code, however, pose immediate challenges to the long-term health of our technology base and economic well-being by

- Distorting business decisions because of the code's complexity.
- Deterring U.S.-based research and development investment due to lack of a robust, permanent R&D tax credit and other incentives comparable to those available in other countries.
- Hurting U.S. competitiveness by discouraging investment in the United States and imposing one of the world's highest tax burdens on U.S. corporations.

America's reputation for innovation was enhanced through the value of the research and development tax credit. The R&D tax credit is an important policy tool for directing U.S. investment into domestic R&D and preventing further migration of R&D activities overseas.

Two decades ago the United States led the world in reducing corporate tax rates and broadening the nation's tax base. Today, however, our nation is not keeping pace with other countries that have reduced their corporate tax rates. This inequity jeopardizes the competitiveness of American companies as well as potential future investment in the United States.

At nearly 40 percent (federal and state), today's corporate tax rate is the second highest among all major competitor countries. As the *Wall Street Journal* reported in August 2008, "For the first time the U.S. statutory rate is now 50 percent higher than the average of our international competitors, continuing a long-term trend as the rest of the world keeps reducing corporate tax rates." ⁵

Recommendations

AIA strongly recommends the following tax and financial reforms to strengthen America's economy and global competitiveness:

□ Retain America's reputation for innovation by enhancing the value of the R&D tax credit, extending its availability beyond its current 12/31/09 expiration date and increasing the Alternative Simplified Credit to 20 percent, an improvement over the rate of 14 percent for 2009.

These reforms will help direct U.S. investment into domestic R&D, thus preventing further migration of R&D activities overseas.

□ Promote long-term U.S. economic growth, higher wages and more business investment by lowering the corporate income tax rate.

The combined federal, state and local rate of close to 40 percent is among the highest of western industrialized countries and is hurting U.S. competitiveness.

□ Repeal the arbitrary 3 percent tax withholding on every government payment to contractors.

The new withholding penalizes tax-paying contractors, especially smaller companies whose financing costs are higher. Just to administer the law, DoD's costs will be \$17 billion, not considering the inevitable price increases that will result from contractors' recoupment of their costs.

□ Allow costs for pension contributions required by law.

Specialty Metals Reform

Over the past several years, few issues have absorbed more of the time and attention of the defense and aerospace industry than "Buy American" and specialty metals domestic source restrictions.

Title 10 U.S.C. §2533b, the specialty metals provision that used to be part of the Berry Amendment, requires DoD to procure items from the defense industrial base containing only domestically produced specialty metals (e.g., titanium, stainless steel and other alloys). Specifically, the specialty metals provision requires that any specialty metal delivered to DoD as an end product or a component of an aircraft, missile and space systems, ships, tank and automotive items, weapon systems or ammunition be either produced or "melted/smelted" in the United States.

Recommendations

□ Congress and the Pentagon should avoid additional legislation in specialty metals in 2009.

DoD and industry are generally in agreement that additional legislation would complicate an already torturous area of procurement law.

Because of the differences in specialty metals legislation in the fiscal 2007 and fiscal 2008 National Defense Authorization acts, government and industry over the past two years have seen contracts segregated into multiple categories — those requiring Domestic Nonavailability Determinations (DNADs), those rescinding them, those permitting waivers, those enabling exemptions and so forth. This has created a tremendous unproductive workload on both government contracting officers and contracting officials in industry for the sole purpose of rationalizing just one particular issue in the acquisition system.

Time should be given for recent legislation to be implemented, reviewed and assessed for its value. The multiplicity of rules governing specialty metals places a significant burden on defense contractors and procurement officers. Their time can be better utilized in other areas of acquisition policy and procurement law.

□ Conduct a comprehensive internal DoD review of the effectiveness of 10 USC 2533b.

AIA believes that within 12 months of the new administration taking office, DoD should assess 10 USC 2533b and report on the utility of the specialty metals provision of the U.S. Code. That public report should take into consideration the impact that 10 USC 2533b has had on U.S. economic competitiveness and the ability to acquire the best goods, services and technologies for warfighters at the best value for American taxpayers.

End Notes

1. "Creating an Effective National Security Industrial Base for the 21st Century: An Action Plan to Address the Coming Crisis," Report of the Defense Science Board Task Force on the Defense Industrial Structure for Transformation, July 2008, pp. 2, 21.
2. See: "Launch into Aerospace: Industry's Response to the Workforce Challenge," Aerospace Industries Association (Arlington, VA: September 2008)
3. Statement of David M. Walker, Comptroller General of the United States, "DoD Needs to Reexamine Its Extensive Reliance on Contractors and Continue to Improve Management and Oversight," Testimony Before the Subcommittee on Readiness, Committee on Armed Services, House of Representatives, GAO-08-572T, March 11, 2008.
4. The results of A-76 DoD cost competitions from 1978 to 1994 indicate an average savings of 31 percent totaling approximately \$1.5 billion on 2,138 competitions. See Defense Science Board Task Force Report, op.cit. p. 41, Figure 4.
5. Obaid Younossi, Mark V. Arena, Kevin Brancato, John C. Graser, Benjamin W. Goldsmith, Mark A. Lorell, Fred Timson, Jerry M. Sollinger, F-22A Multiyear Procurement Program: An Assessment of Cost Savings, (The RAND Corporation: Santa Monica, CA, 2007), p. xv.
6. "America the Uncompetitive," *Wall Street Journal*, August 15, 2008, p. A14.

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The Aerospace Industries Association of America

The Aerospace Industries Association of America (AIA) was founded in 1919, only a few years after the birth of flight.

Today, nearly 300 major aerospace and defense companies and suppliers are members of the association, embodying every high-technology manufacturing segment of the U.S. aerospace and defense industry from commercial aviation and avionics, to manned and unmanned defense systems, to space technologies and satellite communications.

AIA represents the nation's leading designers, manufacturers and providers of:

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