

**HOLD UNTIL RELEASED BY THE  
HOUSE COMMITTEE  
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**TESTIMONY OF**

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# **The Defense Industrial Base: The Role of the Department of Defense**

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Chairman Shuster, Congressman Larsen and Members of the Panel:

Thank you for the opportunity to submit this written testimony on the U.S. Department of Defense's (DoD) commitment to maintain the health and productivity of the defense industrial base.

I am Brett Lambert, the Deputy Assistant Secretary of Defense for Manufacturing and Industrial Base Policy (MIBP), and my office reports to the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (OUSD(AT&L)). Today, I will discuss some of the Department's activities to sustain the health, vibrancy, and efficiency of the U.S. defense industrial base as well as briefly describe the role the office plays within the Department.

Let me begin by defining what we mean by the term Defense Industrial Base. The defense industrial base is comprised of an extremely diverse set of companies that both provide products and services, directly and indirectly, to national security agencies, including the military. References to "the" defense industrial base that imply a monolithic entity are not analytically useful. The defense industrial base includes companies of all shapes and sizes resourced from around the globe, from some of the world's largest public companies to sole proprietorships to garage start-ups. Some companies deal directly with the federal government, while the vast majority act as

suppliers, subcontractors, and service-providers in a value chain that leads to those prime contractors. Companies at any tier, and of any size, may offer critical or hard-to-make products that ultimately lead to the systems used by our warfighters. Likewise, companies at various tiers have the ability to offer highly competitive products or services that could be substituted if the specific production art used by a legacy contractor or company were lost, thus offering the Department vital technology and process refreshment over time. Some products and services sold by companies in the defense industrial base are unique to defense applications, while most have substantial levels of non-defense demand or are even sold exclusively on commercial terms such that the supplier may not even know that the product is used in military systems; and likewise, the military may not know it depends upon a primarily commercial component. Finally, while the pace of innovation is extremely rapid in some segments across the defense industrial base, others segments are based on very mature technologies where dynamic innovation is less important to the Department. In short, there is not a single defense industrial base. There is a defense market serviced by a diverse selection of companies which span, and often reflect, the greater global economy for goods and services.

The U.S. military's superior operational capabilities are enabled by this diverse base. For decades, the U.S. has commanded a decisive lead in the quality of defense-related research and engineering conducted globally, and in the military capabilities of the products that flow from this work. However, the advantages that have enabled American preeminence in defense technology are not a birthright, and the key elements of that base are necessary to ensure U.S. dominance on future battlefields must be

sustained and nurtured. The U.S. defense industrial base is critical to equipping our military with superior capabilities; and a strong technologically vibrant and financially successful defense industry is therefore in the national interest.

### **The Industrial Base in a New Era**

The United States depends on a robust and capable defense industry to develop, field, and maintain high-quality equipment and services that provide our warfighters with unsurpassed technological advantage. Whenever possible and appropriate, the Department allows market forces to create, shape, and sustain industrial and technological capabilities, but we must recognize that the Government's programming and budget decisions have a major influence on key portions of the defense industrial base. Consequently, we must consider the effects of our decisions on competition, innovation, and essential capabilities in the industrial base.

For too long the defense industry has been viewed as a monolithic sector of the economy whose key players are made up of only a few companies. In reality, our base today is increasingly global, commercial, and financially complex. Although some unique items are produced solely for the Department by well known defense firms, these items themselves often rely on a vast, integrated supply chain of product providers that, if constrained at the lower tiers, would jeopardize the ability of the seemingly pure military industrial providers in their support of our forces.

Challenges to sustain a vibrant and robust base vary significantly across defense sectors. The business environment for companies that offer relatively mature platforms, like ships and tanks, differs substantially from the situation for companies in emerging

sectors like unmanned vehicles and cyber defense. The business environment differs at various tiers as well: at some levels, a key supplier may make a truly defense-unique product, while other suppliers at other tiers are primarily driven by their sales to commercial markets, offering innovative products to the defense supply chain as a sideline – a sideline for them, in terms of revenue, that may be vitally important for us, in terms of military capability or cost control. Adapting to this new complexity in the industrial base, the Department must increasingly turn away from one-size-fits-all approaches to tailor its relationships and policies.

The Department must emphasize several factors when considering actions that affect the industrial base. First, certain defense industrial activities rely on highly specific labor skills – high-skill jobs that depend on experience learning a craft, where new workers cannot readily be hired in the future to replace workers laid off today. Second, the Department has greater responsibility for maintaining defense-unique capabilities; the Department does not need to be as concerned to ensure the long-term health of capabilities that draw readily on the commercial marketplace. Third, the Department is most concerned with industrial capabilities that are most likely needed in the future, that are least likely to be superseded by innovation or changes in the strategic environment, and that are the most expensive to reconstitute if a capability had to be rebuilt later to replace one lost today for lack of demand.

### **A Healthy Industrial Base**

As the era of sustained growth in the defense budget comes to an end, the Pentagon's stewardship responsibility to ensure access to a robust industrial base

becomes more challenging. The Department needs to adapt its industrial base considerations and actions to the emerging fiscal realities. In the past two years, the Department has significantly increased its efforts to address the implications of the changes in both budgets and the nature of our defense industry. We understand that America relies on a defense industry that is healthy, robust, and innovative. A healthy industry is one that on the whole makes a competitive profit. Companies exist to make money, and without that potential no one would be competing to win defense contracts. As a whole, most corporations in our base fare well, particularly in comparison with other relatively mature industrial sectors. In addition, our primes typically have the advantage of strong backlogs and visibility into plans and programs in the markets they serve.

The Department of Defense also appreciates that businesses must be motivated by the opportunity to make a reasonable profit. Indeed, leveraging the inherent motivations to allow companies that perform well to increase profit levels above a mean is in the Department's interest. Likewise, individual companies that do not provide the government with quality products that meet the Department's requirements on time and at reasonable cost, should expect to make reduced or no profits. In the high budget environments of the past, many companies have grown to expect high margins independent of the quality of their performance. As budgets shrink, this practice must end.

A healthy industrial base is not just profitable. Being healthy also includes being fit, or if you will, lean. Competition, disciplined cost negotiations, and well structured contract incentives are the key motivators the government can employ to ensure that our

industrial base is lean. Competition is one of the key drivers of productivity and value in all sectors of the economy, including defense. Sometimes, competition is provided by having two or more providers of the same thing go head-to-head, but where this is not possible, we can still harness this power through a wide variety of other strategies that create a competitive environment where companies are not complacent about the work they will receive.

As the budget environment changes, we do expect some niche firms to face difficulty due to decreased demand. In such cases, we attempt to identify early warning signs through a variety of means, to isolate and if necessary mitigate these issues, particularly if a firm offers truly critical, unique, and necessary capabilities. While to date these cases have been isolated, we must nonetheless be prepared on occasion to tailor our investment policies to preserve essential capabilities. We need sufficient insight to make these strategic investment choices.

Toward that end, we have undertaken an aggressive effort to map and assess the industrial base sector-by-sector, tier-by-tier. The goal is to understand the gross anatomy of the industrial base. Just as doctors do not seek to understand the functioning of every individual neuron in the central nervous systems, the Department does not seek to know the exact details and reasoning behind every supplier relationship. But we do need to better understand the industrial base's nervous system, circulatory system, and bone structure.

The new Sector-by-Sector, Tier-by-Tier repository of industrial base data, known as S2T2, will also serve as a jumping off point for future assessments by all Defense Components, ensuring that data collection and analysis cumulates, thereby increasing the value of all industrial base assessment efforts. Having one office in the Department leading this effort will prevent duplication that wastes the Department's resources and harasses overworked program offices and contractors with multiple, redundant requests. Sustaining and strengthening the data over time will also contribute required insight to the Department's merger, acquisition, and divestiture reviews and other industrial base policies. This information will also be used to manage our investments more effectively to ensure a healthy industrial base for those key sectors critical to future capabilities.

Finally, the Department relies on a variety of investment tools to directly sustain and improve discrete, critical industrial capabilities. Program offices routinely manage industrial base issues as part of keeping their programs on track, and OSD coordinates those efforts when their relevance extends across multiple programs. One key mechanism is Manufacturing Technology (ManTech) applied research that the Department manages to direct investments for enhancing manufacturing productivity in concert with program offices. The Department also preserves critical capabilities through R&D investments, life-of-type purchases of materials and components, and acquisition strategy choices that sometimes give roles to multiple companies rather than relying on a single supplier. Another example of industrial base investment is the Department's partnership with eighteen civil acquisition Departments and agencies on initiatives to

preserve and create essential domestic capabilities through forums such as the Defense Production Act Committee (DPAC).

Our commitment to working with industry, however, does not mean the Department of Defense should underwrite sunset industries or prop up poor business models. It does mean that the Department will create an environment in which our vital industrial capabilities, a foundation of our nation's strength, can thrive and continue to provide our warfighters with the best systems available at a reasonable cost to the taxpayer.

## **Conclusion**

The Department has a responsibility to invest taxpayers' money wisely, creating an environment that promotes financially sound and technologically superior supplies. Leaders in both the DoD and the defense industry widely recognize our collective long-term interest in supporting the warfighter and protecting American national security, and are therefore working aggressively to identify and mitigate activities or decisions that could unintentionally destabilize the base upon which we depend.

Congress has been actively involved in shaping and supporting many of the Department's initiatives on this front, and that support has been both welcomed and appreciated. Congress has also supported the Department's engagement with industry, affording the Department the flexibility necessary to maintain a healthy industrial base. On behalf of the Department of Defense, we appreciate this support and look forward to continued partnership to best serve our warfighters and our taxpayers while maintaining a financially healthy and technologically superior industrial base.