WRITTEN STATEMENT

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(PERSONNEL & READINESS)

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Mr. Chairman and members of this distinguished Subcommittee, thank you for the opportunity to be here today.

The Secretary of Defense is firmly committed to safeguarding the quality of life of our military and their families. The war effort accentuates the demands on the military community and the importance of the Department's commitment to support troops and their families and to meet the changing expectations of a new generation of military service members. The commissary, exchange, and morale, welfare and recreation (MWR) programs are essential to honoring those commitments.

I commend the Subcommittee for inviting combat veterans and military family members to testify today. They provide important perspective on the meaning of these benefits to the military community.

The FY 2006 budget and the FY 2006 – 2011 Future Years Defense Program (FYDP) support priorities set by Secretary Rumsfeld to fulfill the President's pledge to take good care of our forces. The budget requests nearly $3.2 billion for commissary, exchange, and MWR programs. While our overriding priority will be to continue supporting our troops prosecuting the global war on terrorism and their families at home, President Bush continues to set an ambitious course to prepare for the future. The resale and MWR programs are fully participating in the transformation efforts.

- We are developing new approaches that we plan to implement over the coming years with the help of the Congress.

- We are redefining and refining our programs to improve our support of our military and their families.

- We continue the reforms needed to eliminate redundancy and waste in the way we do business.

- We are taking advantage of the information age and best business practices.

- We are engaging partners from the private sector, philanthropic organizations, other federal agencies, and state and local governments.

Success depends on unwavering commitment to make the changes that guarantee these benefits continue to be relevant to the retention and readiness of our members of the Armed Forces. We can and we will get the job done.

COMMISSARY OVERSIGHT

To guarantee a viable commissary benefit well into the future, the Under Secretary of Defense for Personnel and Readiness, USD(P&R), commissioned the Commissary Operating Board (COB) and DeCA to set rigorous objectives to:

- Provide groceries at a 30% savings to active duty members.

- Operate efficiently to reduce the taxpayer subsidy.

- Maintain customer service that compares favorably to the grocery industry.

The Commissary Operating Board (COB), chaired by Vice Admiral Justin D. McCarthy, is providing valuable advice on the commissary benefit and opportunities to improve DeCA's performance.

DeCA Performance. DeCA's progress to date is proving that the taxpayer subsidy can be controlled, while customer savings are sustained and customer service is improved. In Fiscal Year 2004, the commissaries sold $5,235.1 million in groceries, a 3.9% increase over the previous year, while U.S. grocers experienced a 3.3% increase. Customer savings held at 32.1% under a more stringent comparison to commercial prices. Remarkably, in less than 5 years DeCA's internal customer satisfaction score surpassed the long-term goal of 4.50. Commissary customer satisfaction is in line with the grocery industry average, according to the American Customer Satisfaction Index (ACSI). Since 2001, the commissary surcharge has consistently supported over $260 million of recapitalization and information technology investments. Now averaging 8 major construction projects a year, the overall condition of commissary stores is rated 74.5 on a scale of 0 (lowest) to 100 (new store). Congress has championed the benefit and provided much needed legislative relief to enable these improvements. Thank you.

Commissary Funding. DeCA's FY 2006 budget fully funds operations at $1,181.8 million, including a direct appropriation of $1,154.9 million. The 1% growth in the budget is primarily due to civilian pay and utilities. The budget supports new programs to modernize information technology and two store openings. To control budget growth, DeCA finances new programs from operational efficiencies. Sales of $5,265 million will sustain $268.5 million of surcharge obligations for commissary recapitalization.

Business Initiatives. To enrich the commissary benefit within budget constraints, DeCA routinely identifies business initiatives for study, adopting those that will work and modifying or discarding those that don't fit the current business model. In Fiscal Year 2004, DeCA began re-engineering and realigning of business areas and offices at Headquarters and regions. The Department accepted an independent study recommendation that DeCA should not implement variable pricing. Work continues on other opportunities, including case ready meat, information system migration, and personnel management.

Commissary Openings and Closures. In Fiscal Year 2006, commissary stores are opening at Willow Grove, Pennsylvania and Richards-Gebaur, Missouri. While the Military Departments determine the future requirements for commissary and exchange support at Homestead Air Review Base (ARB), Florida, the AAFES-operated combined store remains open. The COB annually reviews each commissary to ensure that criteria are met for continued operation. Based on the review, the COB is monitoring nine stores in FY 2005; but there are no plans to close those commissaries.

It is likely that the Global Posture Initiative and BRAC 2005 will alter the commissary system. Existing stores may expand, close or scale back, while new stores may be needed at some locations. As the basing information becomes available, DeCA is adjusting plans to respond appropriately. Early in Fiscal Year 2005, we reported the closures of the commissaries at Camp Howze and Camp Page, Korea. The Rhein Main, Germany commissary is scheduled close when the installation closes at the end of FY 2005. The Korea stationing plan may result in the closure of the Camp Hialeah, Korea commissary near the end of Fiscal Year 2006. Actions are underway to review the remaining commissaries in Korea to adequately support customers.

As required by the Fiscal Year 2005 National Defense Authorization Act, we will evaluate the effect of commissary closures on the quality of life of the military community members who utilize the store, with special consideration for the welfare of active duty and their families. The Congress will be notified of closures, other than by BRAC action, 90 days in advance.

EXCHANGE OVERSIGHT

The Army and Air Force Exchange Service, the Navy Exchange Service Command, and the Marine Corps Exchange continue to operate independently. The Armed Services oversee their respective exchange through three distinct boards of directors.

Exchange Consolidation

As you are aware, over the last 30 years, the Department of Defense has studied ways to optimize the military exchange system whether through integration, cooperative efforts, or privatization. Through all of the studies, a common theme appeared – changes must be made in order to continue to provide this important benefit.

The time for these changes is now.

Since Deputy Secretary of Defense Paul Wolfowitz' May 2003 directive to optimize the Exchanges, the Unified Exchange Task Force and the three Exchanges have made considerable progress toward developing a plan that will sustain and enhance the exchange benefit for all patrons. However, the Task Force effort to date has been met by staff resistance that directly impacts my office's ability to meet the Secretary's expectations.

Trends within the retail environment and the repositioning of the U.S. military force are putting increased pressure on the exchanges. Going forward, the exchanges cannot employ the same business-building tactics as typical commercial retailers, such as seeking a new customer base or building new stores closer to existing customers. The exchange system must look internally to change their current cost structure.

As you know, the President has announced that up to 70,000 troops and some 100,000 family members and civilian employees will soon be transferred home to American soil. The exchanges may need to shift capital resources to build and expand facilities both here and abroad, placing further pressure on the system.

Over half of all exchange profits are generated overseas. As more and more troops and family members are transitioned back to the United States, this profit profile will shift. Increased support of expeditionary forces may also reduce overseas profits.

These issues are not AAFES issues or MCX issues or NEXCOM issues. Take a look at the military resale system today and you will see an interdependent enterprise. The customers are the same, whether they walk into a PX, a BX, an MCX or an NEX. The Military Star Card, Exchange Select and catalog operations serve all beneficiaries. A large number of the vendors are the same. The pair of

Dockers is the same at AAFES as the one sold at NEXCOM, regardless of the name on the exchange door. If we face challenges, we face them together as one Department of Defense retail enterprise.

We plan to confront these changes by developing a back office shared services approach for five functional areas: Finance, Information Technology, Human Resources, Logistics, and Non-Resale Procurement. The Unified Exchange Task Force is currently conducting a Modified Business Case Analysis to identify the shared services model that will yield the most benefit for the exchange system. This strategy presents an executable alternative with the potential to generate annual cost savings in the range of 15% to 40% while improving efficiency, increasing the dividends that the exchanges provide the Services, and reducing the cost for our authorized patrons. The objective is to identify and cost out the various ways exchanges can streamline operations. An example from logistics exhibits obvious benefits: the AAFES warehouse in Atlanta supplies Eglin Air Force Base; clearly the Navy Exchange warehouse in Pensacola could do the job just as easily. Another example comes from information technology; the three exchanges are currently operating three distinct email systems when one integrated system would allow for improved communication and lower costs.

As the three exchange commanders have advised that this planning effort has impacted them at the store operations level, I have directed the Unified

Exchange Task Force to conduct the analysis and development of the Shared Services Business Unit to the maximum extent possible without burdening the exchanges. Accordingly, the UETF will provide the commanders information and seek their feedback as their work progresses, but the UETF will do its best to limit further burdens on our Exchange professionals.

It is critical that this effort secures and retains your support as work continues. If we don't act now, short-term victory by today's naysayers may simply mean they have doomed the exchanges to further erosion of the service member's benefit.

Exchange Performance

Exchange Funding**.** Each exchange system's independent auditor reported sound financial condition for Fiscal Year 2003. The exchanges have current A+ Standard and Poors ratings. Sales continue to rise – almost reaching $11 billion in Fiscal Year 2004. Even so, exchange sales growth lags behind the industry and rising fuel prices account for half the exchange sales growth. Profits and dividends have not recovered to pre-2001 levels. Extraordinary income and pension adjustments totaling $124 million represent a significant portion of the $585 million in exchange profits for Fiscal Year 2004. The reduced appropriated funding of MWR programs is putting greater pressure on the exchanges to increase dividends, especially in the Navy and Army. The exchanges plan to distribute a larger percentage of profits as dividends to MWR: $318.7 (53.5%) of

2003 profits, $337.7 million (57.8%) of 2004 profits, and $336.8 (61.6%) in FY 2005. Although this action provides a steady stream of funding for MWR, it reduces funding available for future exchange capital requirements**.**

Appropriated Funding of Exchanges. The Fiscal Year 2006 budget includes $139 million of appropriated fund support for exchanges, primarily for overseas utilities and transportation. This is a 29% decline from Fiscal Year 2005. The Army has reduced second destination transportation funding for AAFES from $125 million in FY 2005 to $67 million in FY 2006. The reductions are based on Army estimates of potential savings from global rebasing and AAFES inventory optimization. We expect the Army to restore the funding if the savings do not materialize.

Exchange Benefits**.** The exchange benefit encompasses two forms of non-pay compensation: selling goods and services at low prices and distributing earnings as dividends to support MWR programs. In forward deployed locations, the exchange mission is to provide merchandise and services that commanders consider essential to the readiness and morale of the troops. The Social Compact pledged to measure the exchange benefit consistently and communicate those measures to our beneficiaries.

The Department measures exchange customer satisfaction using the American Customer Satisfaction Index (ACSI), a nationally recognized index that is widely used by leading retailers. For the third year, the three exchanges ACSI scores fall short of the department and discount industry average for customer satisfaction. Customer satisfaction varies from one exchange to the next, but the ACSI results consistently denote a need to improve customer loyalty and customer retention. The exchanges also use a standard internal customer satisfaction index (CSI) that is part of a broader survey tailored by each exchange to meet their specific survey requirements. These are invaluable management and oversight tools.

Customer perceptions about the value of the exchange benefit, including savings, are important. The resale activities conduct market-basket price surveys to measure customer savings by comparing the costs of like products in the commercial industry in the United States. Through a cooperative effort, the Military Exchanges are developing a uniform survey to ensure that consistent information is provided to customers.

Exchange benefits also include distribution of dividends to support MWR programs. The Armed Services determine the amounts of dividends that are declared each year from exchange profits. Through cooperative efforts, the exchanges continue work to disclose more consistently dividends to MWR. Preliminary Fiscal Year 2004 data indicates that per capita profits declared as MWR dividends are $173.14 for Navy MWR, $230.17 for Air Force MWR, $246.86 for Marine Corps MWR, to $267.53 for Army MWR.

MORALE, WELFARE AND RECREATION OVERSIGHT

MWR Funding. The continued vitality of the MWR program depends on sound management, a predictable stream of nonappropriated fund revenues, and also solid APF support of Category A and B activities. Each of the Service MWR programs is in sound financial condition. Overall, nonappropriated fund net profits increased this year. While deployment and currency fluctuation still affect operations, the MWR system-wide improved performance is attributed to an increase in self-generated income and to dividends while operating expenses remained stable.

For the first time, all of the Services met minimum percentages of APF support for Categories A and B in Fiscal Year 2004. In the past decade, the Military Departments made tremendous strides improving the funding profiles for MWR activities. Category A activities (fitness, libraries, recreation centers, single Service member programs, intramural sports, and unit activities) should be entirely funded with appropriations. The Department sets a minimum standard requiring at least 85% of total expenses being supported with APF. From 1995 to 2004, DoD improved annual APF support to Category A by $240.3 million – raising the level of support from 83% to 91%. Category B activities (child care, youth programs, outdoor recreation, crafts and hobby shops, and small bowling centers) should be supported with a minimum APF of 65% of total expense. Since

1995, DoD has increased APF support by $400.2 million to Category B from 57% to 68%, of which $157.9 million went to the child care program.

Unfortunately, this progress is in peril due to sustained reductions of appropriated funding, especially in the Army and Navy. In Fiscal Year 2005, the Armed Services requested $1,668 million to support MWR programs compared to the $1,746 million provided in Fiscal Year 2004, which excludes $118 million of supplemental expenditures. The FY 2006 budget requests $1,779 million. All the Services increased funding between FY 2005 and FY 2006, but the Army and particularly the Navy plan to continue to fund their MWR programs below Fiscal Year 2003 levels. We are very concerned about the potential unfavorable impact on the MWR services provided to troops and their families.

Fitness. Fitness is vital to force readiness. However, sixty percent of DoD fitness centers currently do not meet DoD fitness center standards for facilities, programs, equipment or staffing. In addition to being a vital component of force readiness, fitness programs are consistently identified by Service members as their top off-duty activity. In an effort to improve DoD fitness program delivery, the Department has a fitness business initiative to seek public-private partnerships. We have accomplished contracted site surveys at six installations. These site visits will produce business case analyses and identify public-private venture strategies. Our goal is to test promising strategies at these four installations starting fiscal year 2005. Public-private venture strategies that prove successful will be conveyed to the Services for their consideration to implement at other installations having a need to improve their fitness programs.

Child and Youth Development Programs

The Department of Defense is the model for the nation for employer supported child care. DoD child care serves over 200,000 children daily through a “single point of entry system” which includes child development centers, family child care homes both on and off the installation, school-age programs, and registration and referral services.

Even with a major expansion push, there is still an estimated unmet demand of approximately 38,000. This has intensified dramatically with the increased deployments and the activation and deployment of National Guard and Reserves. As a result, in addition to further construction, the military is reaching out to purchase community-based child care to augment the current structure on the installations. As we are able to identify other spaces, we will be more ready to support those who live and work far from military installations.

We are developing a strategy to eliminate child care deficiencies and sustain reasonable recapitalization. In formulating the approach, we are working with the Department’s installation and housing experts. We plan to focus on child care requirements that are essential to readiness and to sustain appropriated funding of facilities and operations. Our first priority is to meet the needs of families living in high personnel tempo and high deployment locations. The Services identified 4,403 spaces at 14 locations in need of an emergency intervention strategy. The plan is to use temporary facilities, contracting and leasing as a stopgap measure. To support families impacted by rebasing and to reduce the total child care shortfall, the Department is reviewing public private partnerships with civilian child care providers and providing incentives for in-home care providers on and off the installation. This approach has a potential to yield as many as 9,000 spaces by FY 2011. We appreciate your support of initiatives that will help to reduce the waiting lists and guarantee dependable, affordable, quality child care for our active and reserve forces.

Thanks to supplemental funding, Services are expanding programs for families including extended hours, care for mildly ill children and increased opportunities for temporary care. Each Service provides additional care through reduced fees, targeted counseling services, group homes that are available 24/7 and free care for those returning from deployment. *"Operation: Military Child Care"* is an initiative to support temporary child care needs of deployed parents through helping eligible families locate affordable care options and reduce fees in locations near their homes.

DoD has also responded to support youth by recently publishing an instruction for youth programs. This will help create continuity across installations with focus on character and leadership, education and career development, health and life skills, arts and sports and fitness. A recent re-emphasis on youth sponsorship will provide a network to assist youth as they relocate to new areas and environments. Partnerships and collaborations with youth serving agencies, such as Boys & Girls Clubs of America and 4-H Extension Services, expand the availability and consistency of activities and enhance the technology to support learning as well as connect with important websites such as Military Teens on the Move and militarystudent.org.

TRANSFORMATION

The FY 2006 budget and FYDP reflect President Bush's plans to restructure America's global defense posture, streamline DoD bases, and make optimum use of funding for facilities and infrastructure. The quality of life of military members and their families is considered a priority as the Department moves forward with rebasing and BRAC 2005. The Department's goal is to ensure that quality of life for Service members and families is not diminished during transformation efforts. The Department's planning approach for quality of life is based on two principles: first, adequate funding will be reprogrammed from the losing to the gaining installations; and second, since two-thirds of families live off-base, the military will look to civilian communities in the U.S. to augment programs and services.

Global Posture Initiative

The military mission presents special challenges to military families. Overseas tours away from support networks, frequent moves that disrupt a spouse's career or a child's school routine, and long separations from family members test the strength of our military families. Because of the U.S. global force posture changes, some 70,000 troops and 100,000 family members and civilian employees will be leaving overseas bases and returning to the United States. With shorter overseas deployments and longer assignments at home bases, military families will experience considerably less disruption in their lives, substantial savings from fewer permanent changes of station, and greater stability.

Military Departments' plans are to realign quality of life support to coincide with the movement of troops and families, with special consideration of how best to maintain working and living conditions. These considerations will include schools, housing, MWR, child care, commissaries, exchanges, and other community support programs. The Under Secretary of Defense for Personnel and Readiness will approve each gaining installation's strategy. The Service plans will be evaluated using a model we are developing that takes into account program specific operational and funding requirements. The model is being designed to evaluate different basing strategies, including forward operating sites, cooperative security locations, and permanent CONUS and OCONUS locations.

Base Realignment and Closure (BRAC)

The new global security environment drives the Department's approach to our domestic closures and realignment. As we evaluate specific locations, our primary consideration is the impact of closure and realignment on active duty personnel and their families who use the commissary, exchange, and MWR activities. Generally, resale and MWR activities cease operations when a base closes. Continued operation of MWR and resale activities is considered when a significant active duty population remains in the area and would otherwise not be supported. These are highly unusual circumstances. Where separate commissary and exchange operations cannot be supported, a combined store is considered.

The exchanges operate two combined commissary and exchange stores at closed and realigned locations. As required by statute, edible groceries are sold at cost plus five percent and the operations may receive appropriated funding up to 25% of the amount used by DeCA in the last year it operated the commissary. This concept has not been successful as a mechanism to continue commissary support at closed installations. The concept may fit locations with significant reserve and retired populations, who actively use the commissary and exchange, such as NAS, Fort Worth.

We appreciate your concern about retaining and redirecting funding made available during closures. If we divest resale and MWR operations that are no longer required to support active duty missions, then BRAC could provide substantial savings. Those resources will be needed at installations with new missions to sustain and improve quality of life for our men and women in uniform and their families. Thank you for the legislation that released funds in the reserve accounts from the previous BRAC rounds. The authorized Fiscal Year 2004 and 2005 funding has been disbursed and will be used by the resale and MWR programs to construct or improve facilities.

Capitalization

Overall, capital investment in support of commissary, exchange, MWR and lodging programs is maintained at about $1.2 billion each year for facilities, equipment, and information systems. For FY 2006, commissary, exchange, Air Force MWR, and all the lodging programs plan healthy capital investment programs. Exchanges plan to reduce capital investment about 30%, largely due to the conclusion of three years of aggressive investment in information systems by AAFES. The Army and Navy plan to reduce MWR capital investment.

The FY 2006 budget requests $41 million to fund military construction of three fitness centers and one child care center. The Navy and Marine Corps have no MWR projects in FY 2006 military construction program. Last August, we submitted and you have approved a Fiscal Year 2005 surcharge and nonappropriated fund major construction program including 76 projects totaling

$626 million. As we expected, but could not estimate at the time we sought approval, there is significant materials cost escalation. In the coming weeks, we will seek out of cycle congressional approval for those projects with cost increases over 25%. The FY 2006 surcharge and nonappropriated fund major construction program, currently under development, is expected to go down about 20% from FY 2005. To mitigate risk of investing in specific projects, the resale and MWR capital programs consider projected overseas posture changes and will consider BRAC recommendations.

Global restationing, reduced exchange profits, and decreased MWR appropriations may have long-term consequences for capitalization programs. Overseas locations produce a significant portion of MWR revenues and exchange profits that support these programs. The nonappropriated fund capitalization program, for both exchanges and MWR, is largely dependent on exchange profits. With appropriated funding shortfalls, the MWR programs may become more reliant on nonappropriated funding.

SUPPORTING THE GLOBAL WAR ON TERROR

There are now approximately 204,000 military members deployed in support of Operations Enduring Freedom and Iraqi Freedom. Clearly, the Global War on Terror is extending the meaning and importance of quality of life programs.

In Theater. In theater, the exchange and MWR programs are fully supporting service members in austere conditions. Exchanges operate contingency stores, imprest funds, ship stores, name brand fast food, concessions and calling centers. MWR programs provide fitness equipment and recreation facilities complete with electronic game kits, movies, books, magazines, music CDs and Internet access where possible. Armed Forces Entertainment and the USO provide much welcomed celebrity and professional entertainment to our forces stationed or deployed overseas.

Telecommunications. Military members and their families must be prepared for a wide range of challenges that they will face during separation. One such challenge is the availability of direct communication between the service member and family and friends. The Department is committed to lowering the cost and improving the availability of telecommunications services. In support of the telecommunications benefit, the number and access to free telephone, email, and Internet services has improved. Service members and families are briefed before deployment on the best calling options. Costs for paid services have declined significantly. Donated commercial prepaid calling cards are distributed to Service members and their families, including those donations made through the exchange-sponsored "Help Our Troops Call Home" program.

Back Home. Support for the families back home is essential to the piece of mind of deployed service members. Military One source is an excellent information and referral service that is easily accessed by toll-free telephone, e-mail and web site. MWR child care centers provide increased hours, reduced fees, free services for returning members and assistance in locating affordable off base child care. Expanded youth programs, counseling and family assistance programs also support families. Each of the military departments has a highly responsive family support system to help families cope with the demands of military life. A worldwide network of 300 DoD family centers and 400 National Guard family assistance centers assure that a wide range of services are available to military members and families no matter where they live.

Resale and MWR activities have donated comfort items, gift bags and clothing for injured service members and sent recorded messages of support from families to the battlefront. AFRC hotels in Germany, Hawaii and Florida offer special rest and recreation rates and packages. Patrons and the general public show their support for military families by donating gift certificates through the exchange “Gifts from the Homefront” and commissary “Gift of Groceries” programs. Exchange special credit programs ease financial concerns for forward-deployed personnel. The Robert and Nina Rosenthal Foundation “Spirit of America Tour” supports celebrity entertainment at US military installations. Corporate America sponsors many programs to support the military and their families, including family reunions, special events, and nationwide donation campaigns.

Our Wounded. The American people's support for our troops, and in particular injured troops, is heartwarming. The Military Severely Injured Joint Support Operations Center complements the military services' efforts to reach out to their gravely wounded and give them long-term support. In addition to the support provided through the operations center, advocates will be assigned at or near major military and Veterans Affairs medical facilities to make sure there are no gaps in the transition process. The Fisher House Foundation generously provides the comforts of home to military families, allowing them to stay nearby their loved ones at medical facilities. Whether returning to military duty or civilian life, these combat veterans and their families will be supported as valued members of the military community.

CONCLUSION

Mr. Chairman, in conclusion, I want to thank you and the members of this Subcommittee for your advocacy on behalf of the men and women of the Department of Defense. The nation's gratitude for dedicated service is proved in the resale and MWR benefits. Through this transformation process, we must shepherd these benefits forward for the next generation of uniformed service members. We cannot protect these benefits without congressional support. I encourage our military resale community to rededicate to the important work that is underway.