Center for Strategic and International Studies (CSIS)

Preparing for the 2014 Quadrennial Defense Review

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CLARK MURDOCK: If people would take their seats, please. I think for the first round we've had sort of all the optimism we can stand for today – (laughter) – so we're going to turn to the dismal science and the fiscal environment that we're in. I can't think of four better people to address that issue.

I did not want to start this – maybe I just did – did not want to start this with another lie about the four best people. (Laughter.) But I do have a truth, and that is that once this panel is concluded, lunch will be served out there and people should go out and take it and bring it back in. I thought that would be sort of self-obvious, but the lunch is there and it will be provided.

Anyway, we'll start our second panel with Gordon Adams.

GORDON ADAMS: Thank you, Clark. Thank you all for coming. I used to go into meetings like this when I was working at the Office of Management and Budget and I'd say: I'm from OMB. I'm here to help you. So I'm here to help you but probably not to be optimistic.

I want to say several things, probably five or six things, and then step down from my position and have an extraordinary array of talented people here who will tell me every single way in which I'm wrong. And there's at least 50 people in the audience who will do the same. But I'm going to, if I can, try to start by setting this issue of what the QDR is going to have to deal with in context, in a fiscal context, then talk a little bit about the short term versus long term, give you at least a forecast of my view of what is likely to happen here and how it will happen, and then a couple of thoughts on what the QDR might be but probably won't. Based on the last panel I think I'm probably right.

The most important thing that I could leave – if I could leave you one thing today it would be only one thing, and that is, in the context of the policy process in Washington that we're looking at today, defense is a residual. It is a dependent variable. It is not the independent variable. And although you and I and everybody in this room probably spend most of their time thinking about how we do defense and how we plan defense and how we fund defense, in the universe that we're dealing with today, defense is a residual. It is a consequence of decisions that are being made elsewhere in a different framework.

And that's largely because we left Iraq; we're coming out of Afghanistan; the political system has shifted its attention to jobs, the economy, debts, the deficit. That's the political context within which the defense budget decision is going to be made. That is not particularly good news if what you want to do is hold the line or increase defense spending. In fact, I daresay the vector is mostly flat or down.

The second point I want to make is that, in my view at least, sequester is not the issue; that we will be dealing, and the press corps will be dealing, and there will be a tremendous amount of chatter, and everybody – you, me and everybody else included will get to write a lot of stuff because there will be enormous noise in the atmosphere. But the signal-to-noise ratio is very, very bad. The noise will be about sequester. The

noise will be about CR versus a fiscal 2013 bill. The noise will be about when the 2014 budget is going to be submitted.

And I hope to step past some of that noise today because, in my view, it's the long term that is really key, and the long term is that we are in a drawdown, fundamentally. Whether sequester happens or not, we are in a drawdown. And of course it's not the first time that we've been in a drawdown in American history. The drawdown is, in fact, already happening. If you go back and actually look at peak 2010 level of the defense budget and what has happened in '11, '12 and '13, we're already down from peak, including OCO, about 10 percent in constant dollars. And procurement dollars are down even sharper from peak to where we are today. So we're already in a drawdown. It's not like this might happen.

What's not particularly realistic is the 10-year forecast from now. That's not a realistic number. What I expect will happen – and I'm going to try to see if I can advance these – probably not. Can't advance these slides. There we go. That says we're in a drawdown, because you can see the top line OCO, bottom line base. That's where we're going. The out-year forecasts, regardless of what you're looking at here, right – whether you're talking about the House budget alternative, Ryan, from last year; the president's '13 request; the budget control act levels; the sequester level after year one – all of those lines go up. None of them are real but they all go up, right?

What is more likely is something like this: This compares the drawdowns from the peak year down, starting at a hundred and going below, where these different drawdowns look. Without going into the details of this chart because it's actually fairly complicated, there's two things that I'd like you to pull out of it. One is that the administration's plan looks kind of like the Cold War drawdown, only that flat line will be down. And the other is that compared to the past, given the high level of funding that we are starting at this will be probably the shallowest build-down that we've done, including Korea, Vietnam and the end of the Cold War, over time.

So that's where the resources are going, and the eventual – I think the second point that I want you to pull out of what I'm going to say is this thing is not and will not be strategy-driven. We just spent a whole panel on what strategy needs to look like, and I'm not saying that's not an important exercise. It's an important exercise, for reasons I'll come to at the end, but in all likelihood the drawdown will not be strategy driven, okay?

So how will it happen? Okay, so what do I think is likely to happen here? Point one. There will be no long-term budget deal that tells the Defense Department exactly what its resources are going to be over the next 10 years. Unfortunately I've been around long enough in this business and this town to know that everybody always searches for that Holy Grail: Tell me what my number is going to be. If only my budget were stable. I've heard Secretary Panetta say it. I've heard secretaries before him say it: If only I knew what my budget were going to be in the out-years I could plan coherently.

Get over it. It never has been. It never will be. There will not be a long-term budget deal. And oh, by the way, people are worried about Medicare and Social Security and domestic discretionary spending and so on. It's the same for them. There will not be a 10-year plan that guarantees people numbers. It will happen, a drawdown, year by year. It will be more ankle biting than it will be systematic planning, because that's the way these things happen.

Second, what's going to happen? The line, as I've suggested already, will be deeper than the line that is forecast. It will be down considerably below. If you look at these things as wedges, in the Cold War, when you see that drawdown line year 1 to year 10, the size of the wedge if you took peak 1985 and ran it across and gave it inflation and the line that actually happened, when we turned around and looked back at 1997, the difference between the size of that wedge was $1.6 trillion. So if you'd simply inflated from peak and then compared it to what actually happened, "magical mystery tour" here, $1.6 trillion suddenly disappeared, when bye-bye. I predict something like that – and I'll come back to that.

The next thing that is likely to happen – I'm not going to use all these slides but this one I think as the '90s drawdown is illustrative, is – and this is typical with Vietnam, it's typical with Korea – is procurement is the hardest hit. So who's here in the industry? Who's here from the industry? Prepare thyselves, right, because procurement, acquisition is the thing that takes the hammer, right? It is already taking the hammer. Acquisition dollars are already down peak '10 to the current year, right? That is already happening and it typically happens.

The second thing that will happen is end strength will go deeper down than currently projected. It just will. Marine Corps won't hold 182(,000). Army won't hold in the 490s (thousand). It will not happen. They will get smaller.

The next thing that's going to happen is that pay and benefits will scarcely be touched. The third rail of budget planning in the Department of Defense is doing anything about the pay table. It's doing anything about the benefits level. It's doing anything about bringing people onboard for higher enrollment fees, deductibles, co-pays or what have you. It's having anybody decide you're going to either bring the retirement age forward, invest people early, or delay the date of retirement until 57, like the Civil Service. Not going to happen. I'm making predictions here.

The next thing that's going to happen is operations and maintenance funding will be cut. This tells you it's usually a shallower reduction than the reduction in procurement. It will probably be done typically top-down. The dollars will go away. The desperate search for efficiencies that allow you to pull that down in a sensible way probably won't happen. There will be some efforts at that, but what will probably happen is the dollars will go down and the efficiencies will emerge on the way.

The next thing that's going to happen is that won't change very much. This is a chart that shows you service shares defense-wide – Air Force, Navy, Army. It goes back

to '72. You go back earlier, it's not a dissimilar pattern. This will not follow a rational planning model; this will follow a bureaucratic politics model, to quote Graham Allison. And that's pretty much where we're likely to end up in the long-term future, in my judgment.

Those are the things that are likely to happen. Let me come back and say something about the short term. I've said the drawdown is already underway. I think sequester is more likely in the wake of the debt ceiling agreement than less likely, although I don't consider it more than 50 percent likely. Nonetheless it could happen. And likely to be fixed later in the context of the debate over the fiscal '13 budget. We're going to exercise a lot of turmoil about that month as we go through those negotiations.

I do not envy the new secretary of defense coming into his job because he's got sequester, CR levels, submitting the '14 budget and the beginning of the QDR on his plate. And this somebody who didn't serve on the Senate Armed Services Committee, so the learning curve is very steep and the need for help is going to be great. You know, congratulations to all of those of you who were in the process of helping him. I'm doing what I can.

What is interesting, though, about the sequester argument is the memo that Deputy Secretary Carter sent out and the services have sent out. While filled with a certain amount of hyperventilation, as these memos always are, it actually contains some germs of truth. In sequester, the area of accounting at the Defense Department that is most seriously touched is operations and maintenance. It's not procurement. Mil pay, personnel, well, that's off the table. It is not procurement because contractors are working on existing obligated dollars and not out of future dollars. It will mean business forecasts are down but it doesn't mean you shutter doors and lay off employees tomorrow.

But what really gets to it is operations and maintenance. And what's interesting about the Carter memos and the service memos is that they say, better set some priorities here. And the priorities they set were of no surprise to me at all, I have to say. Term hires, stop them. New term hires, forget about it. We've got, Mike Bayer estimates, 750(,000), 800,000 people in the Pentagon who don't actually work for the Pentagon. They work for a contractor. And that's going to winnow down. That's going to be whittled down if we have a sequester. It's going to be whittled down anyway.

And civil servants – how many people here are civil servants in the Department of Defense? Beware. (Laughter.) Beware: Take Friday no pay; thank you. There will be furloughs if sequester happens. But it's not a surprising task. It's not a surprising outcome. And it's the kind of thing that I thoroughly expect to happen. Rather than furloughs it will be attrition. And as the civilian workforce ages there will be an acceptance of the attrition in the civilian workforce in the Department of Defense. It's very likely to be the trend here.

So I found those memos actually quite interesting, and mostly very much on target. The focused on sequester, but for the long term there are some signals there about where the focus is I think likely to be.

Now, let me just close with this: What should the QDR be, as opposed to what we think it may actually be? I was listening to General McKittrick the other day talking about the Marine Corps and the coming QDR, and suggested the following: What if the secretary came in with a design for the QDR that said, I'm going to have resource options at this level, at this level, and at this level; give me your best shot about what you do in end strength, force structure, acquisition plans, R&D, operations at each of these budgetary levels. And, oh, by the way, don't "Washington Monument" me. Don't tell me how Western civilization ends at lower levels. We start from a very high level. We've got some severe problems that need to be dealt with I think in the context of the QDR, but give me your options.

Defense planning is resource driven. It's not accidental. QDRs, if they're only strategy driven, are, as somebody suggested in the earlier panel, worth reading, probably overseas more than here, but they are in fact – what actually happens in the Defense Department, as my earlier intervention suggested, is resource driven. We would not have had the January 2012 Interim Strategy Review had it not been for the fact that the budget was going south. And while $487 billion was actually not a cut, it was a reduction in projected growth in the defense budget, I think we're looking at real cuts.

So resource driven, let's accept that reality and let's say, what are our options for serious management of a drawdown rather than sort of annual ankle biting at different resource levels? And mind you, I don't expect this to happen, but I'm saying it's probably the most sensible way, especially in this moment when we're in a drawdown, for the secretary to do that, which means realistic resource forecasting and developing options at different levels.

And then in the QDR I would have the secretary focus at least on several critical issues like, how do we get control of the fact that mil purse dollars per troop are rising exponentially in the early decade of this century; like what do we do about the health care system costs and the integration of health care alternatives, the benefits level, the integration of structural systems in the different services to harmonize and consolidate; what do we about operations and maintenance, you know, per troop relative to end strength that is growing exponentially, especially in the last decade; how do we get the real forces that are eating defense capabilities under control? Those would be useful exercises once you start from a resource-driven base.

So I will close there. There are a lot more pictures but they're just pretty. They're not necessarily going to help you much. But saying that in my judgment what is going to drive this exercise over the next 10 years is resources; that it will be, bar the "black swan," a down slope, consistent probably with the down slope of the 1990s at the end of the Cold War. And the QDR ought to be planned with that perspective in mind. Thank you.

MR. MURDOCK: Thank you.

Todd?

TODD HARRISON: If I can make it through. All right, here are my slides here.

So I want to start making a couple of points basically picking up where Gordon left off. The first slide here just shows the base defense budget in the solid blue line there, going back from the late '70s through the '80s buildup down in the '90s and then back up again over the past decade. This is in constant FY '13 dollars. The dashed purple line is active duty military end strength over that same time period.

So the first thing that should stand out to you here is this drawdown will be different because the buildup was different. As we came out of the '80s buildup – and the drawdown that started in Reagan's second term lasted throughout the 1990s – you see as the budget went down, end strength went down, roughly in proportion. But in the recent buildup in the 2000s, end strength remained relatively flat.

We did see an increase in Army and Marine Corps end strength, but we saw reductions actually in the Navy and the Air Force end strength. So it kind of balances out. And the reductions that were forecasted in the FY '13 budget request, roughly 100,000 troops coming out of the Army and Marine Corps over the next five years, you know, that just takes us from 1.5 million active end strength to 1.4 million. It's a relatively small reduction in end strength that's planned.

So why did the base budget – this is not including war funding – why did the base budget grow so much over the past decade when the size of our force didn't grow, our end strength didn't grow? So that's the first reason I think this downturn will be different. I'll get to that in my later slides.

The other thing I want to point out is let's look at those long-term budget forecasts. I completely agree with Gordon. They're made-up numbers in the future. This is not how things will actually play out in the future, but it is a baseline we can use for a comparison at this point. The green line you see there is in the president's FY '13 budget request last year, just the base budget again. The red line is what would happen if all of the cuts under sequestration go into effect and stay in effect for the rest of the budget cap period. These go out to FY '21.

So keep in mind that the green line there where that puts you in FY '21, slightly higher than we are today when you adjust for inflation, and the red line, it's about a 10 percent reduction from the green line. So just keep in mind where that will put you in the future if for some reason those predictions were to come true. That's the relative magnitude that we're talking about.

So why did we have this growth in the cost of the base budget when we did not have a growth in the size of the force over the last decade? Well, I look at the data and there are two real underlying factors here. The first is military personnel costs. So this graph shows the blue is the overall DOD base budget over time. The red is the military personnel-related part of it.

Now, for budget geeks in the room, I'm using something more than mil purse. I'm taking mil purse plus the Defense Health Program, which is actually under O&M. The Defense Health Program funds things like TRICARE, so it really is a personnel-related cost. So that footnote there. I am putting Defense Health Program in here.

You see that in the '80s, in that buildup, it was actually primarily an acquisition buildup. We started buying a lot more equipment. And, you know, our force increased slightly and our personnel costs increased slightly but our total budget increased by much more, so the share of the budget that went to personnel-related costs actually feel from 34 percent to 24 percent in the mid-'80s. So only, you know, a quarter of our budget was going to personnel-related costs.

Well, as the budget came down, force levels came down, it leveled off a bit and then we returned to more of a normal level of about 30 percent of our budget going to military personnel costs. But then over the past decade, as the overall defense budget grew, military personnel-related costs grew, and they grew faster than the overall budget so their share of the budget increased to 34 percent. That's where we are right now. In FY '12 we're at 34 percent and we're on a CR right now at that same level.

So now military personnel-related costs are consuming 34 percent of the base defense budget, but as I said before, we don't have more people in the force. Those people are just costing more. So this is the cost per active duty service member. This is the mil purse plus Defense Health Program divided by the number of active duty service members. I'm taking out here the cost of the Guard and Reserve personnel, just looking at active duty. And you can see that growth really accelerated over the past decade.

Now, over about three decades our historical average rate of growth: 2.6 percent. That's above inflation, 2.6 percent real annual growth. Over the past decade or so it was 4.2 percent. Now, why was that? You see there's some sharp growths in there around 2001 and then a few years later as well. Well, that's because Congress went in and added a number of new benefits, expanded a number of benefits. So you've got things like TRICARE for Life, that Medicare – I forget the whole name – Medicare Eligible Health Care Reimbursement Program. That is costing about 11 billion (dollars) a year in the budget right now. So that added significantly to the cost per person.

But, you know, I give this – and I will give the warning in advance that this won't actually happen, for reasons I'll go into next, but if we continued allowing our personnel costs to grow at that same rate, 4.2 percent, like they did over the past decade, by the year 2039 those personnel costs would consume the entire defense budget. Now, that won't

happen, right? Obviously it won't happen. So what will happen? You've got a number of options.

Before I go on, though, the FY '13 budget request, which proposed a number of reforms in pay and benefits, things like reducing the amount of pay raises in future years, things like adding fees for TRICARE, increasing co-pays, things like that, if all of those things had been enacted that would have reduced the growth in the cost per person to just .3 percent. But most of that died in Congress. That's not going to be enacted. So we are looking at a higher growth rate than that.

Now, what are your options with your military personnel costs? Well, one option of course is you reduce – oh, it got thrown off the bottom of the slide here. (Chuckles.) One option is you reduce your end strength. And so, you know, if you hold the president's request level that I showed you before, the green line on that graph, out to FY '21, the budget would be about 618 billion (dollars). That's in then-year dollars. If you hold the military personnel's share of the budget at 34 percent, like it is now, and you stay at your historically normal growth rate of 2.6 percent, you'll have to reduce your end strength by about 82,000 from the currently planned level. That's an additional reduction on top of what's already been planned.

Your other option is you can reduce the rate of growth in your costs. So again, if you hold everything else constant, the share of the budget constant; if you hold your end strength level constant and you just try to reduce the rate of growth, you only have to reduce the rate of growth to 1.9 percent. So all the reforms that were in the last budget request would have reduced the growth rate much lower than this. So this can be done.

And of course the other option is you don't try to reduce the rate of growth. You don't try to reduce end strength. You just let your personnel costs consume a greater share of the budget. Then you end up with 36 percent of your budget will be going to military personnel-related costs.

Now – and sorry it doesn't show up here on the bottom – if you have to cut the budget more deeply, if you're looking at sequestration-level cuts – that's what the bottom section here shows, that red line that I showed you in the original graph, which is still higher than we have seen in previous drawdowns; it's still a higher level of funding – but that would give you about 563 billion (dollars) for defense in FY '21. So again, if you focus on reducing end strength – you can't see it here, but you would have to reduce your end strength by about 200,000 down to 1.2 million if that's how you're going to control your personnel costs.

If you want to slow the rate of growth but keep your personnel – your end strength level constant, you would have to slow your rate of growth to .9 percent, which, again, is doable. We know the reforms that would do that. Or you could just let the costs grow at the historically normal level. You could keep your end strength steady and your military personnel costs will consume 40 percent of your budget. And this is just eight years in the future it would grow to consuming 40 percent of your budget.

Well, what's the other big driver within the budget that made costs grow so much over the past decade even though our force structure didn't grow? O&M costs is the other big portion of that. Now, it's a little different story here. O&M costs, again in the '80s, you know, as the overall budget grew it was primarily growth and acquisition accounts that we saw in the '80s, so O&M fell as a share of the budget to 27 percent of the budget, but things came back to more normal levels.

Around 2001 we were at 32 percent of the budget going to O&M. And over the past decade, O&M as a share of the budget has stayed relatively constant. It's dropped just slightly to 31 percent. But that means the O&M costs, as you can see, have grown over the past decade but the size of the force hasn't grown. So, again, you look at it on a per-person basis, O&M costs per person, they've actually grown pretty steady.

If you go back, you know, four decades or so, they've grown at a real annual rate of 2.5 percent above inflation. Over the past decade they grew a little faster, 2.7 percent, but not much of a change. If you look at the last budget request, it projected a growth rate of 1.9 percent, so slowing the growth in O&M costs, although there's kind of a spike there in FY '13 as some of these O&M costs come back into the base budget that have been subsidized, if you will, by the OCO budget.

So what are your options here? Again, you could reduce the size of your force. That would reduce your O&M costs. And you would have to reduce the size of your force, if you used that method, to 1 million-186,000, so significant reduction in force there. And that's just under the president's request, so kind of the most optimistic budget level. You could reduce the cost-growth of O&M but you have to reduce it to .6 percent. Going from 2.5 percent to .6 percent, that's going to be hard to do. Or you could just let it all grow and it would take up a larger share of the budget, 37 percent.

Again, if you have sequestration-level cuts, what do you have to do? You have to drop your end strength to 1.1 million. We're talking, like, almost a 300,000 reduction in end strength here. Or you could reduce your cost growth, but here you actually have to get down into negative numbers. You have to reduce the rate of growth to -.4 percent. Or you just let it eat up a larger share of the budget, 40 percent of the budget. And this is only eight years in the future this would be happening.

So what's the bottom line here? Here are the hard choices: If DOD wants to maintain end strength at the current level, maintain our current force structure, but it's not able to reduce the rate of growth in personnel costs and in operations and maintenance costs either because DOD doesn't want to propose those reforms or Congress won't let them enact those reforms, if those areas of the budget keep growing at their historical norms, then personnel and O&M costs are going to consume up to 80 percent of the budget by FY '21 – 80 percent, assuming we have something like the sequestration level of budget by the end of the decade, personnel and O&M, 80 percent of the budget.

So the other 20 percent, that's all you would have for research and development, for procurement, for military construction, for family housing, all of those other things. That's all you would have left. And quite frankly I think that puts our budget out of whack. And, you know, all of the discussions that we have in the QDR about what capabilities do we need for the future, you're not going to be able to buy any of that. That doesn't matter. If you let your personnel and your O&M costs eat up that much of your budget, you will not have strategic choices in those other areas that you can make. You will simply be treading water in a lot of these other areas.

So, you know, if it were up to me, number one job in this QDR and in defense planning right now has got to be to figure out, how are we going to handle this cost growth within the defense budget? Are we going to get smaller? Are we going to get leaner, more efficient? Are we going to implement some really tough reforms? Are we just going to let these costs grow and suffer the consequences? That's all I have.

MR. MURDOCK: We've done that for the last 20 years. Why –

(Cross talk.)

MR. MURDOCK: I'd like to thank both Gordon and Todd for bringing new meaning to the word "dismal science." (Laughter.) I think, David, you're going to rescue it all now. David Berteau.

DAVID BERTEAU: Yes, thank you, Clark. I will bring some positive focus to this. You know, what you've just heard from Gordon Adams and Todd Harrison is that things are bad and they're going to get worse. And I'm here to tell you that I'm positive things are bad and they're going to get worse. (Laughter.)

The beauty of following Todd and Gordon, first of all, is you don't need any additional charts because they've actually laid this out pretty thoroughly. And I checked their arithmetic as they were doing it and it checks out pretty good. I'm really struck by a couple of things, though, and I have a few lists of comments to make. I don't have any charts, so hard choices – let's leave the hard choices up there.

You know, the strength of DOD over essentially the last 50 years or more, really since McNamara brought the PPBS into the Defense Department, is its ability to do fiscally disciplined, long-term programming, and to actually have that bear some relationship to what ultimately DOD invests money in.

Gordon may be right that we can't actually nail down how much money we're going to have in the future, but in fact DOD has a better baseline to start from to deal with a changing reality than any other agency. Just look at the dynamic of sequestration. Look at the difference in the guidance documents and the reactions to the guidance documents internally to DOD in terms of preparation for sequestration compared to the rest of the federal government. DOD is the only agency that even has a baseline from which to calculate what its impact might be.

Have you heard anywhere about the cries of devastation that will affect the rest of the federal government from essentially the same level of cuts as DOD? No. They don't have any ability to actually project that. I mean, I see a scenario in which, you know, it takes you four hours to get through a TSA line at the airport post-sequestration because they've only got one station open, but it won't really matter because FAA won't have enough air traffic controllers that any airplanes will be taking off anyway. But they're not projecting that kind of level out there. That strength, though, of DOD is in fact also a constraining factor.

There are many ways to look at defense and national security. One of the most pedestrian ways is in fact, what does DOD really do? What they really do is they give money to three different groups of people. And that's all they do, right? You know, Article 1, Section 9 of the Constitution says, "No money shall be disbursed from the Treasury except under appropriation by law." And that's what the Defense Department does. It gives money to military personnel. And that, as Todd points out, will grow absent any changes to 40 percent of the defense budget by 2021. It gives money to civilian personnel, which is buried mostly inside the O&M accounts. And it pays money in response to invoices – in other words, contractors.

That's about 98, 99 percent of what DOD does with its money. Now, that's not the way DOD sees itself. Why? Because it consumes the results of all that money being spent, which is very different than other federal agencies who mostly have customers outside. In DOD's case the customers are internal, all right?

If we follow Todd's logic, 40 percent of the defense budget going to military pay and benefits, including the Defense Health Program, 40 percent of the military budget going to the rest of O&M, that leaves 20 percent for investment, for R&D and for procurement. If we look out across the globe and look at sophisticated professional militaries which use high-tech equipment and capabilities, there is one country who that resembles very, very carefully, and that's Japan, who in fact has essentially about a 20 percent investment level for its military.

That probably works as long as your mission is self-defense of your own homeland, all right? That however is not the mission that DOD sees itself occupying in 2021. So the real result of Todd's budget numbers and of Gordon's constraints here is a military in 2020 that in fact is capable of self-defense and not much else. That I would submit is not consistent with the Strategic Guidance from January 5th and probably not what's going to go into the political guidance of the 2014 QDR. But that's the path that we're on, if you will.

From the point of view of sequestration, all of that's being ignored. In fact, if you look at all of the internal guidance documents that have been circulated around, they focus on 2013. There's almost no focus on 2014 and beyond. And the real impact of the budget control act is not the 45 billion (dollars) that's going to come out of DOD the remaining of this fiscal year, although that's serious enough, you know?

My numbers say the Army is going to have to take 30 percent of base budget O&M out in order to protect their share of OCO, and that 30 percent has got to come out in the last essentially four months of the fiscal year, because by the time you lay out furlough notices and defer contracts, you don't really see any fiscal impact until about May or so – May, June, July, August, September, so it's five months, if you will. But we're ignoring the FY '14 and beyond, if you will, at our peril, in a sense.

We also – and really, the focus of this day's conference is we're in this critical time where we're trying to figure out how to align strategy and programs and resources. We've got presumably – because every president does it at the beginning of the second term – a new National Security Strategy. I would assume it would form off the baseline of the Strategic Guidance from last January. We'll have a QDR, delayed or not. It will come forward.

We will eventually have another FDYP that makes sense. I mean, the FY '14 to '19 FDYP is essentially not going to be redone because we won't have time to redo it. We'll redo '14 as needed. We'll redo '15 when it comes to '15. But we won't really go back and rebaseline a Future Year Defense Program until the FY '16 to '21. The guidance for that FY '16 to '21 program is about 15 months away, roughly April of 2014. That will be our first post-Iraq and Afghanistan, post-QDR, post whatever budget agreement deal we get to, and whatever shape that may have. It will be the FYDP that actually matters.

It also happens to be the FYDP that will deliver not the 2020 force but the 2030 force. It will be the future of national security in DOD. We've got about 15 months to get this right, to not be – and I don't mean to decry this, but to not be essentially trapped into a self-defense force as our future.

You may recall, some of you, Norm Augustine's famous chart projecting the cost of military aircraft outright. And he keeps refining this. He's getting better and better. I think he's got it down to a specific date in March, around 2051 now, right, where the entire DOD budget will buy one airplane. Well, Todd's chart says that's okay because we're only going to be able to afford one pilot. (Laughter.) And so, you know, we're on a path where it better be a damn good airplane, and of course right now nobody's designing it.

It's also true, I think, that – and that airplane example is not a bad one. There's an industrial base impact here that's hard to look at. From the point of view of the major primes, they're fairly well positioned to survive all of this over the near term. They've got a pretty good cash position. Their backlog's not bad, although they're eating into it a little bit. I think as you see the earnings statements come out over the next few weeks you're going to see the beginning of a trend – in fact, you saw it yesterday with one major defense prime – where we're now not going to be reporting record profits and record margins and record levels of cash and backlog and you're going to start seeing eating into that.

But that's not the real visible set of the problem. The second and third tiers have much less robustness in being able to sustain and survive this time period. DOD has developed, through the sector-by-sector, tier-by-tier analysis, a pretty good mechanism for detecting companies that all off the cliff and deploying parachutes to them before they hit the ground, but that is not an industrial-based policy that's sustainable over the long run for the kind of support that DOD is needing.

And where you're particularly going to see the impact is in services contracts because the deferral of contracts that comes from sequestration and beyond doesn't have an immediate impact on the hardware side but will have a very immediate and near-term impact on the services side. And I think that that part of it is tough to ignore.

Finally, we are nonetheless still managing to employ lots of lawyers. I have here a prop. Some of you may know that in the FY '13 budget, as part of the $487 billion reduction from the first tranche of the budget control act, Army force structure is projected to go down out to 2017. That budget was in fact approved by the president, submitted to the Congress. It is consistent with the FY '13 authorization act, the National Defense Authorization Act. It is consistent with the continuing resolution and whatever appropriations we might eventually get for FY '13 or at least the baseline there.

Nonetheless, what the Army has decided it has to do is they have to do an environmental impact statement on the force structure drawdown. I have here the first trance of the background material – it's hundreds of pages – justifying a force structure decision which has been made, authorized by Congress, budgeted for, and scheduled.

Now, not surprisingly there's a finding of "no significant impact." (Laughter.) Now, why is that not surprising? It's not because there's no impact from drawing down 100,000 troops. It's because that's the only acceptable outcome of an environmental impact statement is to have a finding of "no significant impact." Otherwise you have to mitigate the impact.

Now, the beauty of an EIS process is you also have to compare it to an alternative. The alternative is to do nothing, meaning don't draw the force structure down, an alterative which is not only unrealistic but isn't even funded. This, folks, is a lawyer's employment act manifestation for the foreseeable future, but it illustrates, if you will, the strategic disconnect that we operate in.

The reality that we have to operate in is, at the strategic level, tough enough. At the execution and implementation level it's way tougher. And that part we're not paying much attention to at all. And I would think if there's one thing we ought to give as guidance to the end, Clark, when you come back and talk about 2014, it is the importance of looking at the execution and implementation element of this as well, as we go forward. Strategy is fine, but until you can implement it and execute it, it's really just a bunch of words.

So with that I'll terminate my optimistic outlook and turn it over to the next – (audio break).

MICHAEL O'HANLON: Thank you. Okay, this one has to be on the record so I'm glad the mike's on just in time. (Laughter.)

Bob told this joke of a gentleman who needed a heart transplant, and this doctor came and said, I have some bad news: If you don't get a heart transplant you're going to die, but the good news is that I've got three candidates for you. And, you know, it's a pretty interesting spectrum of possibilities. One is a 20-year-old woman who was a tri-athlete and just tragically ran into a truck on her last training mission. You could have her heart if you want it. The other is a 30-year-old baseball player. He's in reasonably good shape and a professional-caliber athlete. And the last option is an 80-year-old former DOD comptroller. And so which one do you want?

And the guy thought for a while and he said, I'll take the 80-year-old comptroller's heart. And they guy said, why would you choose that? And he said, because I decided I wanted the heart that had been used least. (Laughter.) And so we're in the right mood here. And comptrollers apparently can be funny too, so I recommend you listen to Bob whenever you get a chance. I guess we all are these days.

And let me just say a couple of things. I basically agree with most of the tenor of the panel, but I want to give a couple of slightly countervailing broad perspectives, and then maybe as a beginning of a segue to the afternoon, talk a little bit about some of the ways I think we can programmatically handle some of these challenge, not necessarily the most dire things you've heard so far from my fellow panelists but at least in the spirit, and also in the spirit of what Shawn said in the first panel.

Try to keep the president's guidance, a basic view of the world, which is not just his really but most of post-Cold War America and strategic thinking, and the broader political community, and see how far we can push doing some things that are uncomfortable that are somewhat risky that are lower priority but nonetheless allow us to keep what I would consider the basic tenets of our defense strategy, with a focus on the Middle East and the Western Pacific, with some kind of a two-contingency capability, even though we can debate a lot what that should be, with an effort to make sure the all-volunteer force remains very robust and treated well by a political system and a country that's asked it to do a lot, by an industrial base that produces the best stuff in the world for all the bad press and difficult issues that it sometimes has to contend with as well.

So if you consider those irreducible minima but you're willing to push and take some chances on a few of the ways you try to sustain that, then I think there's actually room for some substantial additional cuts, and I'll try to speak in that spirit. But just one partial counter, not to disagree at all with the way Gordon laid out the 10-year typical political trajectories of how we think about defense planning after peak levels of activity or intensity or war, but I will say – and this is not really meant to be good news, but it's a

different kind of bad news – that we could wind up with two things that disrupt a little bit the narrative.

One is war with Iran, which is a 50-50 proposition as we speak here today, I think. Different people would calculate that figure somewhat differently, but the president said that an Iranian nuclear weapon is unacceptable. The secretary of state designate said yesterday that prevention remains our policy. And even if an incoming potential secretary of defense has voiced different views at other times, there's only one commander in chief and he's been pretty emphatic on this point. So we've got a potential. I don't know how that will change the long-term, and we could have a discussion about that as well. But one thing we know about war is once it starts, we don't get to decide here in Washington when it ends, by ourselves. And so that's just one little caveat.

Second, we haven't really, in all the kinds of charts we've been showing, that I show as well, for the last 20 years we haven't usually had another country on the chart. Since the Cold War ended we haven't really had another country. Over the next decade, the 10-year time horizon that we're talking about, we will start to have another country on the chart, because China's defense spending level is going to start to get "interesting," to use the old saw, compared with our own, especially if you think of China's defense budget burden as focused primarily on the East Asian littoral and our essentially divvied up between the broader Middle East and the Western Pacific. And if you start to divide our defense budget by two and compare it to China's, it's going to get interesting. So that may or may not have an effect on the broader political debate.

I think Gordon is largely right to say that defense is no longer the central driving issue, the first thing people think about when they think about budgets, but I wouldn't go quite so far as to say that it's a residual. I think that we'll have to see. That debate is wide open. But the central point is budgets will keep coming down. There will continue to be pressure. And 10-year plans don't mean much. So on 90 percent of what Gordon and Todd and others have said, I agree.

Okay, so in that vein let me now try to lay out a few thoughts of how I think we can perhaps save another couple of hundred billion (dollars) in 10-year defense plans, with one big caveat. And I would encourage everyone in this room who agrees with this point – and I think it's historically pretty well documented – to start saying this more so that the rest of the policy debate hears it as well. Right now we're going to need additional programmatic cuts just to comply with the $487 billion in reductions that have happened so far, because we still have a plan, a program and a force structure that's too expensive for the budget control act levels. We always do.

There's nothing wrong with what the Pentagon's doing today, nothing wrong with what any of you are doing compared to your predecessors. We always have a mismatch between what's in our program and our plan and what we can afford based on our projections. Or to put it differently, stuff always costs more than we think. And

therefore, some of these cuts I'm about to lay out are going to be needed just to satisfy the existing ceilings.

So I don't want to create a lot of expectation that this is going to get anywhere near the kinds of reductions that Gordon thinks will be necessary, that others in this room may think necessary or prudent, but I will at least put out a couple hundred billion dollars worth of additional programmatic cuts. Let me just quickly tick through a couple. I know Clark wants some time for discussion as well, so let me be brief.

On the ground forces – other people have already mentioned this today – I think it's going to be very hard to argue that steady-state U.S. ground forces after Afghanistan should be higher than they were in the 1990s. We can all have a debate about whether 1990s levels were inadequate for the time or not, whether they, you know, didn't see what was coming and should have been a little bit bigger, but it's going to be just a simply difficult proposition to say that after Afghanistan, with Iraq still a challenge but not the kind of over-land invasion threat that it was in the '90s, presumably, that we need ground forces bigger than they were in that previous era.

So I think ground forces will come down. My own comfort level would be fine with something like 450,000 active duty Army and 160,000 active duty Marines. It's not comfortable. I didn't say this was going to be fun. But these are the kinds of things that I think are consistent with presidential guidance. And I'm not predicting that President Obama will agree with each of these, but I think they're consistent with his view of the world and with what I think we need to do as a matter of national security policy.

Turning quickly to the Navy, an idea that CNA and other parts of the Navy broader community have often talked about, so it's not just some wooly-headed Brookings guy putting this out there, but the idea of Sea Swap, the idea of having crews share ships. I think this is an idea that's way overdue. We do it already with mine sweepers. We do it with ballistic missile subs. But the Navy is extremely resistant to doing it with anything that floats on top of the water and costs more than a few hundred million dollars.

There's no company in this earth – on this earth that could have a billion-and-a-half-dollar asset and only use it 15 percent of the time, and that's what the Navy is basically doing today. Ships are on station about one-sixth of the time. The Navy cycle is inefficient. I know it's easy for me to say as a civilian, and I know the logistical challenges of doing Sea Swap are enormous, but the Navy has already proven it's doable.

And I'm not suggesting you do it for aircraft carriers in the next three or four years. I am suggesting you do it for surface combatants with crews of 200 to 300 of a common class where people can train on one ship in that class in U.S. waters and fly to relieve another crew overseas instead of wasting all that time in transit. You've got 30, 40 percent more efficiency this way. The fleet can do down from 286 to 270 instead of having to go up from 286 to 313, and maintain current deployments. That's another kind of idea I think we'll have to consider.

Nuclear weapons. My basic premise on nukes is we should stay at 1,550 strategic, long-term, safe, reliable warheads until we get another treaty with Russia, which I would favor, which I think can bring forces down. But in the short term we're going to have to stay at 1,550. But the details don't matter. Let's expunge the word SIOP from any of our thinking. There is no merit to the SIOP anymore, period.

It doesn't matter how much hard target kill capability we have against Russian ICBM silos. I'm being blunt in the interest of trying to be quick and I'm maybe slightly overstating the point on certain specifics. You need some flexibility in how you would use that first 10 or 20 or 30 or 40 nuclear weapons. Anything else is fantasy world, in my opinion, and not necessary in terms of what we need to do with future nuclear capability.

So I think you've got to keep those 1,550 warheads safe, survivable, redundant at some level, on parity with Russia. Beyond that we have a lot of flexibility in how we maintain them. I would cut the ICBM force in half. I'd still like to keep some ICBMs but I would cut it in half, use the bomber force, which we have anyway, for conventional missions more as a way of sort of populating or representing a higher fraction of the 1,550. It doesn't really matter if we can actually deliver them all quickly. Again, we've got to get the SIOP concept out of our heads. We don't need it anymore, if we ever did.

And if you carry this logic through, you go down to eight Trident submarines and you also fill them up with the number of warheads they were originally intended to cancel (sic). You actually cancel the Trident replacement program because the Trident sub never needs to be replaced. We just need to build more of the same type because they're perfectly good enough for the strategic challenges we face.

My overall view on nuclear weapons would save us somewhere around 3 billion (dollars) a year. Most of these ideas I'm putting forth are going to save you, you know, 3 billion (dollars), 5 billion (dollars), 8 billion (dollars), 10 billion (dollars) a year. You add them all up, you get closer to 200 billion (dollars). It's not going to do sequestration or Simpson-Bowles levels of savings, but it's the kind of stuff we can do that I think is still consistent with presidential guidance.

Just a couple more ideas and I'll be done.

On the F-35 program – again, I'm a supporter of this plane and I think it's an impressive plane in many ways. We can debate whether it's been rushed through acquisition, but I don't think sizing it to replace force structure more or less one for one is the right way to think of the F-35. The F-35 is a high-end plane for high-end missions, primarily deterrence of China in the Western Pacific, and we should size it based on contingency requirements, not based on force structure requirements.

So if you have a certain amount of Navy, Air Force and Marine Corps force structure you've got to replace, don't think of the F-35 as a way to replace fourth-generation aircraft. Think of it as your high-end capability and otherwise refurbish

existing stuff, buy more fourth-generation capability, and use more unmanned systems. I wind up recommending the F-35 program be roughly half the size that it is today.

Compensation reform, I hear the points argued earlier by Gordon and others, and Todd. I understand the congressional resistance here, but we've still got to keep at it. I think both military health care reform and pension reform are needed. And I would like to protect base pay if possible and keep it going up with inflation.

I would like to do retirement reform with an interest and a focus on equity not just on savings. So I want to give 401(k)s to the younger forces and younger troops who don't stay in for 20 years, but I still think we've got to reduce military pension spending and ask for more cost-sharing in the TRICARE and other health care programs. And you can save 5 (billion dollars), 6 billion (dollars) a year in each of these once you've implemented this.

And then finally, one last option I want to put on the table – this sort of reinforces my Navy proposal from earlier but it might actually allow for a cut in the aircraft carrier fleet, on top of what I've already said, at least one or two carriers. And here's the idea: Right now we're trying to keep almost all the time, or most of the time, two carriers near the Persian Gulf. We're seeing that as our primary attack aircraft capability vis-à-vis Iran. But a basic law of defense economics, as I understand it anyway, is when you know where the threat is and you have allies nearby, you're much better off putting some of the capability on land.

Now, we obviously have constraints. If we depend on the Saudis or the Kuwaitis or the Qataris or the UAE to give us permission to attack Iran, they're probably going to say no. So you need a surge capability with aircraft carriers to be able to have a strike force in place. But if you're concerned about maintaining constant capability in the region, it would be nice to have some of that on land.

Right now we really don't. This is partly a residual of what happened after Operation Southern Watch, but it's time to start asking Qatar, Kuwait, UAE, maybe even Saudi, Oman, if we can put a couple of squadrons of land-based fighters on their territories as a permanent capability in the region.

This is actually much more economical than doing it through carriers, because when you do it through carriers, you need five in the force structure to keep one on station. That's the fundamental reason why the carrier option is less efficient. The TAC AIR, the ground-based TAC AIR, can be done of course in a less expensive way.

You add all this stuff up, I find something in the range of $200 billion in 10 years savings. None of these ideas except military health care reform, are in the existing Pentagon plan. So this is additional savings above and beyond what we've got today. It doesn't get me all the way towards the dire scenarios and the lower budget numbers of some of my co-panelists, but at least it's a start.

And I think it makes the debate be a little bit more of one that we in the defense world can, you know, try to view also as an opportunity to educate those on the outside so we don't just have defense be a dependent variable but it becomes one of the active parts of the discussion as well as we think through these big budget decisions. I agree with Gordon and Dave and Todd; whatever happens in the next five weeks, this is not the end of the debate. So let's start informing the broader community, the broader political system, about what's required to get to some of these numbers. Thanks.

MR. MURDOCK: Oh, I'm sorry. I just can't get anything right today.

The Gates efficiency initiatives resulted in about 150 billion (dollars) in claimed savings. In January of 2012 Panetta added another 60 billion (dollars) in claimed savings. How much of this do you think will actually be realized as bankable savings? Is it realistic – the second part of the question – is it realistic to believe that even more is possible, as you can see in the recent Stimson Center report, which will be discussed this afternoon. I think Brookings is doing a conference on all of the dollars to be saved by reform within the Pentagon. Do we really think these things are going to happen?

MR. ADAMS: Good question. The answer is no. And I could stop there except there's two things, in my experience, that lead to savings in this area. And as a budget type, I put these in the O&M basket. That's basically where you would reap the savings. You get consequential savings two ways.

One is you take the money and the savings come. In other words, the approach of saying program by program, office by office, redundancy by redundancy I'm going to find ways to scratch my way to $150 billion worth of savings usually doesn't produce $150 billion worth of bankable savings. What, in my experience, happens is that the O&M account level is driven down and the service architectures have to accommodate a lower level of funding. You find the savings first. You pocket the savings. And then you find the efficiencies.

The other is if you want to drive it efficiency by efficiency or program by program, is you really need to have a deputy secretary and a secretary who focus on it. That's absolutely critical. There's no way to reap these savings without leadership, and the leadership has to come from the top. And I can remember Secretary Perry in the 1990s picking two or three issues and saying, I want people in my office every week telling me how they're doing on this particular thing. I want to see the results and I want to see them regularly, because the building really responds if they think the deputy – if the deputy cares that he's focused on it and the secretary has the deputy's back in that focus.

Those two things are critical. I think the jury is out on whether the next leadership in the Department of Defense is going to have that focus, which is kind of a concern to me because we're in a drawdown, and having a leadership that takes that kind of focus is going to be critically important to their success. It's what's going to make this something other than the mayhem that Todd Harrison's charts point to if you don't get

O&M per troop and military purse and benefit per troop down and leave yourself enough budgetary space.

O&M accounts, in my judgment, are the refuge of scoundrels. They're highly fungible dollars. There's a reason why they have a different treatment in sequester than procurement or research and development. It's because it's very hard to do this at a program level in the operations and maintenance accounts. It's very hard to get your arms around what the tradeoffs are. And therefore, in defense budgeting and planning over time, they have been the place where a lot of stuff gets hidden and a lot of stuff doesn't get worked out.

So while I expect sequester, if it happens, to focus attention on services contractors – and I think it may have been Todd who said that, or Dave – it's absolutely right. And I expect it to focus on furloughs of civilian personnel. Getting those real savings I think is going to depend significantly on top-down management attentions and bringing the dollars down, pocketing the savings, and then enforcing the process of efficiencies.

MR. HARRISON: I'd just like to add a couple points.

So I don't think we'll achieve all the projected efficiencies, because if you look at the details of them, some of those efficiency initiatives are classified as low risk. They're things where we're pretty confident we can actually achieve those savings.

A good example is the Air Force changing the way they operate their C-17s. It turns out if you fly them in formation, like you see geese flying in a V formation, if you fly within the wingtip vortices of the other plane in front of you it reduces drag, reduces fuel consumption, we know we can save money by doing that. So the Air Force has started doing that. That's a low-risk efficiency saving. I'm not sure why we weren't already doing that.

But then you look at other things like, well, let's combine email systems and that will save us a bunch of money in the future. Well, that's a high-risk type of savings where, you know, you don't know how much it's going to cost up front to combine all those email systems. You start a program like that, you get into it, you realize it costs two or three or four times as much as you thought, and then you don't know how much you'll actually end up saving and when that break-even point is. So savings like that may not actually materialize.

The other thing to note is in Gates' efficiency initiative, I think he came up – I think it was 178 billion (dollars) or 68 billion (dollars) in efficiencies. He gave 100 billion (dollars) of that back to the services. That money has already been spent. We didn't save it. The money was just spent. So if those efficiencies don't materialize, well then we've got a bill to pay because we've already spent the savings before we realized the savings.

So I think that is the real trap here for DOD is you build up a backlog of too many of these efficiencies and when they don't come true, and the full amount of the efficiency that you were projecting, well then, where do you pay for it? Where do you come up with that money if you've already spent it?

MR. BERTEAU: Clark, let me add one thing about O&M. You know, when you're cutting the budget and you take money out of investment accounts, you can put a cap and you pretty much know that you're going to be under that cap when it comes to spending it. If you put a cap on O&M expenditures because the nature of O&M expenditures if that they're bottom-up decisions that are made at the installation or the, you know, subcomponent level and they flow up.

You don't actually know you've exceeded the cap, in part because of the nature of O&M, in part because of the lack of real-time accounting systems inside DOD. You won't know you've busted the cap until about two months or so after you're through it. It's a little late to stop at that point, right, because now you've already had additional hours charged by government civilians, additional invoices incurred, and invoices becomes must-pay bills.

And so the reality, whether you take the money out or not, which is really, as Gordon and Todd point out, the only way to really save it here, is to take it out of the budget. The actual implementation mechanisms still need to be developed in order to actually achieve those objectives.

MR. O'HANLON: I'll just say one word briefly on base closures, which I think are going to have to be revived. And here we have a little bit – we as a community have a little bit of public education or re-education to do. And with apologies to anybody who worked on it in good faith, the 2005 base closure process was more complicated in terms of the way it was done, the effects it had, the potential budgetary savings or lack thereof.

And I think there's a general perception that base closures have run their course, or that we as a community have forgotten how to do them well, because the 2005 process – and I don't say this just because I live in Bethesda, although that's part of the reason I say it – doesn't appear to have been done as efficiently and with as much of a cost-savings mentality in mind as some other reviews of previous efforts.

I think we're going to have to show people that there actually are excessive numbers of bases still out there and not have some over-riding ideological concept like jointness be the driving rationale for the next round of base closures, which to some extent it was in 2005, because, you know, it's going to be hard to get any of these savings, and the things that we know work, we'd better make sure we do them and find the political support to do them, and base closures is where I'd begin.

Q: Good afternoon. I'm Lieutenant Colonel Carolyn Closs-Walford and I am with the Army National Guard Strategy Shop. And this question is in reference to the charts that were put up. How does this forecast or analysis consider both the fact that the

reserve component was an integral part of our nation's ability to participate in the war in Iraq and Afghanistan with 500,000 individual Army National Guard mobilization service members?

And a recent Reserve Forces Policy Board study suggests that one-third of the cost of an active – that the reserve component service members serves at one-third of the cost of an active component service member, that from that same study of the Reserve Forces Policy Board, 120,000 (dollars) a year for nondeployed reserve component service members as opposed to 330,000 (dollars) a year for nondeployed active component service members.

MR. HARRISON: Well, I will say that my charts I was focusing only on the active duty force structure. I did not look, cost per person, at Guard and Reserve service members, but I've seen the study the Reserve Forces Policy Board came out with recently. They make a lot of great points that the way that we account for personnel costs within the military is flawed in many ways.

One of the things I'd point out is the Defense Health Program, that's a defense-wide account. That's not in any one of the service's budgets and policy-wise the services can't affect that. And so, you know, we're talking about trying to reduce the growth and cost per person; a lot of that is outside of the control of the services. There's not much they can do about some of these benefits.

The other point I think that the Reserve Forces Policy Board gets to is some of these costs, like health care, you know, TRICARE for example, for active duty military, is much more than the cost per person of TRICARE for reservists, just because they're not full-time, so they don't get the same level of benefits. And that's something we've got to take into account, and we are facing a real strategic choice here in this next QDR, is what is the right mix of active and reserve component forces? Where does it make sense to put more capabilities into the Guard and Reserve, and where does it not make sense?

And that's not an easy question. Cost is one part of it, but the ability to deploy levels at which you anticipate you'll need to sustain forces, you know, doing active missions in the future, all of that plays into it. It is very sensitive – as the Air Force found out this past go-around, it's very sensitive to political factors, but it's also very sensitive to what the COCOMs are giving you in terms of steady state demand they're projecting for the future.

If the COCOMs are projecting demand on a budget-unconstrained basis, then they're going to be projecting something that we cannot necessarily afford, that will steer the analysis in favor of keeping more forces in the active component rather than the Guard and Reserve. So that's something we have watch out for in the future.

MR. ADAMS: Let me add one thought to that because I actually agree with what Todd has said. But let me just focus for a moment on history.

Historically, every time we end a major combat operation, the size of the ground force goes down. That's just an iron law. Eisenhower took it down after Vietnam. Nixon took it down at the end of the Cold War. Dick Cheney and Colin Powell took it down. But after every major series of combat operations we bring down the size of the active duty ground force.

That will happen again. We've seen various numbers up on the chart. I think Todd's numbers are very instructive. I actually expected to go down deeper than either what Todd said or what Michael said, that we're going down, I think, to a 1.1 (million) to 1.3 million-sized overall active duty force with the Army smaller than either that 450(,000) or 160(,000) number for the active duty Army and Marine Corps, as provided, which means we are, in cases of major combat operations – I don't think we'll have a stabilization operation soon, but in terms of major combat operations we are going to rely more on the Reserve and the Guard.

And I think the direction the secretary laid out a year ago is probably about the right direction. You want to park your reconstitution capability there. I think we're significantly empowered there in a way we aren't in some other areas because of Iraq and Afghanistan and the way in which the Guard and Reserve were used in Iraq and Afghanistan. It's not the same Guard and Reserve as the ones that we had before Iraq and Afghanistan.

So there's actually promise there, in my mind, of being able to create a reconstitutable Reserve with a serious combat capability and real training in the Guard and Reserve when you take that ground force piece down, which is what inevitably happens.

MR. MURDOCK: David.

MR. BERTEAU: Todd is right. It's an important strategic question: What is the role? Gordon is right. You've got capability and experience inside the reserve components today that are virtually unprecedented and that have great benefit in being sustained. What we do not have, though, is a common agreement on what the costing methodologies are so that we can, in fact, compare and contrast these things analytically, so that so much of the debate – and you actually see it inside the Reserve Forces Policy Board study.

If the debate is over whose numbers are right, you never get to the strategic question, you never get to the issue of how do you sustain and preserve the capacity and capability you have. So fundamentally we have got to get a common agreement on costing methodology before we can achieve any of those other objectives.

Q: Tom Kenwood (ph) with BAE Systems. As you look into your crystal ball and forecast where we're headed over the next five to 10 years, you've outlined a number of different scenarios and paths. Which path do you think we're going to end up with,

one that's more like the presidential request, where we have a smaller, more individually capable force, protect readiness, put additional assets to address new threats and likely put more downward pressure on ground to pay for it, or do we end up down a path where we make across-the-board cuts and use that as a mechanism to enforce the downturn?

MR. ADAMS: I actually think we've learned a lot from the last – from prior year build-downs. Although the secretaries love to say we've gotten it wrong every time, I actually disagree with the concept that we've gotten it wrong every time. We've gotten some things wrong virtually every time, but some things we've actually gotten pretty right.

The key here to me is focusing on management. I think you can manage this force down at even deeper levels than what are currently projected, and I think it's likely we will be there; that is to say, a wedge between 10 inflated and what we actually do. We'll get 10 years out and look back and say, gee, you know, that's about 1 (trillion dollars) to $1.5 trillion below what we thought it would be if we simply inflated 10. And we can do that with a well-managed drawdown. The key is "well managed."

I want to take a page from Dave Berteau's notebook here, which is to say execution is going to be everything here. The focus inside the building on the choices and the priorities are going to be critical to whether it's well managed and well executed. At the risk of being slightly self-serving, although I was at OMB and not at the building at the time, the drawdown that Dick Cheney and Colin Powell began and did a substantial part of and was completed in the Clinton administration was probably on balance about the best executed drawdown that we've done in American military history. It wasn't perfect but it was probably the best we've done.

And there are a lot of lessons to draw out of that in terms of choices made and where you focus and what – you know, what you put as your priorities, and that's why I suggest that the best exercise for the QDR would be, in fact, a resource-driven set of options, because it will tell you, we're going down lower and here's the kinds of management choices we need to make as we go down lower.

And I think everybody on the panel seems to agree. The big foci are not what's the threat, what's the challenge, what's the capability that we keep at the point of the spear; the big challenge is in the acquisition arena in terms of cost and performance in the O&M arena in terms of real efficiencies and real drawdowns and selective choices, and in pay and benefits and how we reprioritize in those systems. I'd love it if the QDR focused on those choices. But I think it is manageable and it will not be the president's budget.

MR. BERTEAU: Clark?

We ought to be able to defend America pretty well for $450 billion a year, which is kind of the floor or what everybody's talking about here. But the only way we can get there is through a combination of analysis, which we've talked about a lot today; policy, which is really – and it's the balance of policy and analysis that is the point of the QDR,

especially if you do a fiscally constrained QDR, which I think is essential here – management, as Gordon points out. But what we've not covered and what I don't think is on your agenda much at all, is the politics of this. And ultimately it's a combination of all four of those factors – analysis, policy, management and politics – that comes into play.

What Dick Cheney did at the time of the post-Cold War drawdown is the budget was coming down, and Cheney said, you know, Congress is going to look at this, and as long as we don't show real consequences and they don't feel real consequences, they'll keep cutting the budget. My nightmare scenario of sequestration is we actually execute on March 1st.

By March 26th when Congress is wrestling with what do you do with the CR, they look around and the execution, because it's kind of slow, they'll say, huh, we just took $45 billion out of DOD in FY '13. Nobody's dead, nobody's bleeding, nobody's been fired, nobody's been furloughed yet, nobody's been laid off yet; why don't we do it again? And that's your solution for the CR.

The politics of this have got to raise the level of visibility of what the consequences are. And I think that's a lot of why we're holding this whole discussion today is to help raise that level of visibility.

MR. HARRISON: I would just add to that, you've got to raise the level of visibility and it can't be hyperbole.

MR. BERTEAU: Right, it's got to be real.

MR. HARRISON: It can't be – the stuff that we had going on during the campaign about the WARN Act notices in industry. Come on. We've got to get past that. We've got to get serious about what the real impacts will be. It can't be, you know, the things that aren't actually going to happen, because you know what? Sequestration might really go into effect on March 1st, and when all of these dire predictions about all these major program cancellations, base closures, all this kind of stuff, when it doesn't happen you're going to lose credibility. So you've got to focus on what the real impacts are and the timeline for when we will actually start to see those real impacts.

MR. MURDOCK: All right, you can see what a failure I was as a chairman because we have a second round of panel comments but without a question intervening between them. (Laughter.) You had a question right back there?

Q: Hi. Steve Hedrick (sp), National Guard Bureau. I'd like to go back to one of the earlier comments about the Japanese defense force and their ability to simply act as a domestic defense force. I'm really trying to understand why that would be a function of those percentages rather than just that overall size. That's not very clear to me.

MR. BERTEAU: Since I was the one who pointed that out, it was – there's a limit to how far I can carry the analogy of where the U.S. is going to be when we have 40 percent of our budget funding military pay and benefits, 40 percent of our defense budget funding O&M, not including health care, which leaves 20 percent for procurement, R&D, MILCON and family housing.

That's arithmetically equivalent to the Japanese. If you look at the major highly integrated, professional, technically capable military forces around the world, the only one that has that ratio is the Japanese. I would submit – and I haven't done the analysis to support this – that there is a correlation between their mission and their ability to in fact sustain a military using that proportion of defense spending.

If you looked at the Chinese you would see that their – it's going to be a while before China spends 40 percent of its defense budget on military pay and benefits, all right? And they are actually not on a path that's going to put them there anytime soon. That doesn't mean that China has greater expeditionary capability than Japan does, because in fact they don't. They're not a technically sophisticated, professional force along the same lines, if you will.

So there's a limit to how far you can carry that comparison. But the fact of the matter is that there is no historical example of a nation able to sustain expeditionary global capability if it's only investing 20 percent of its resources in procurement R&D and its investment accounts. And if we're going to do that, we've got to have a very, very different model that we start from today, and that's where we're headed in the 2020s unless we change.

MR. MURDOCK: Harlan?

Q: I'm Harlan Ullman. Let me commend the panel for its unbridled optimism. Thank you for making the day brighter.

In the past we have always had the tendency of spending our way and not thinking our way clear of danger. And I'd like to call on the creativity of you guys who have really looked at this very carefully in terms of some really out-of-the-box and bolder thinking. Two ways.

First, if you take a look at cost-exchange ratios, we're getting killed. We spent between 70 (billion dollars) and $80 billion dollars on counter-IEDs. The bad guys spent peanuts. So the cost-exchange ratio is 5 (thousand dollars), 10,000 (dollars) to 1 (dollar) against us. It costs us half-a-million dollars, a million dollars a soldier and Marine to deploy. How do we break that cost-exchange ratio?

And second, how do we develop new ideas? For example, an air-sea battle, an air-sea campaign that's being put in place for the anti-access/area denial is really an offensive series of operations. It seems to me that if we're really worried about China,

we would want to bottle them up and possibly do it in a defensive way rather than an offensive way that's been more expensive.

So how do we deal with these new ideas and new concepts, first of all to take on the cost-exchange ratio which is hugely against us, and secondly coming up with new operational concepts that don't necessarily have to be based on very expensive offensive capability when there may be other alternatives?

MR. BERTEAU: I'll take a first crack at that, Harlan. Thank you.

I think the first panel actually mentioned one of the most critical pieces of this, which is a better way of thinking in an integrated manner about our use of allies and partners. And you're seeing some signs of that today in a number of areas. I think it's part of the pivot to Asia. It is part of the evolving dynamic in Africa and with AFRICOM. And there's a tendency in the QDR process to sort of have a baseline that says, if we have to go it alone, this is what we have to have. We may not be at the point where we can afford that luxury going forward, and that's going to be a critical element.

MR. HARRISON: I – oh, I'm sorry.

MR. O'HANLON: Go ahead.

MR. HARRISON: I just want to add, I think technology is not a cure-all but it can help change some of those cost-exchange ratios. A good example is missile defense. Right now we're on the losing end of the cost-exchange ratio in missile defense. It's always going to cost more to build a kinetic interceptor than it is to build the incoming missile. And so, you know, a potential adversary could spend us into the ground just by building more missiles than we can afford to build interceptors, not to mention the operational and logistics challenges of actually shooting down every one of the incoming missiles and having enough inventory on hand to do that.

So things like directed energy. It's not there yet but it could be. I don't know that it will really mature into what we need it to be. But directed energy weapons have the potential, if we invest in that technology, to flip the cost curve so that the cost per shot to hit each incoming missile is much lower. It's actually less than the cost of each incoming missile.

So I think technology can help us to do that but, you know, then you look at the budget situation and you say, well, can we really afford to be investing in these high, you know, technology type, you know, research and development projects? And I think we can, even in a budget downturn.

If you look at the drawdown in the '70s at the end of the Vietnam War, people call it a hollow force, they call it a lot of bad things, but what did we get right? We continued some important investments in technology at that time. That's where we had the origins of Stealth. Our Stealth aircraft was in the late '70s. Things like GPS, our

whole precision-guided weapons regime, all has its origins in that time. And that technology, we kept maturing it. And then in the ’80s, when we had money, we actually, you know, procured those systems and developed them in greater quantities.

So I think in this drawdown we’ve got to look for opportunities like that. Where are the key technology investments where we can put a few dollars now and it will actually pay off in the future when we actually have money to spend?

MR. MURDOCK: And, Michael, you’ll have the last word.

MR. O'HANLON: Harlan, on the question of overseas contingencies, you focused on a couple of the aspects of where the expenses are. And part of the reason of course that it’s a million dollars a troop in Afghanistan per year is because we depended a lot on hiring people and capabilities, contractors and others, that we didn’t have in the force structure, that we decided to spend money on quickly and acutely in that period of time.

Part of it is because of counter-IED technology. Some of this, in other words, was inevitable, given the way we did the planning, and I’m not sure I have answers to how to bring down the $1 million per troop per year. So I think the question becomes, how do we find a different model of midlevel intensity intervention?

Right now, based on last January’s guidance, we’re all supposed to assume that these kinds of missions have just gone away, even as we watched Syria be as bad as anything we’ve seen, you know, in 25 years. And frankly, what I’m struck by is how much less plausible various limited interventions seem in Syria than they did in Bosnia 20 years ago. Remember how paralyzed we felt about Bosnia? But if anything, there were more activist discussions of options for what to do in Bosnia than there are now about Syria, and maybe that’s just as well. I don’t know. I’m not making a big pitch for this.

But in Afghanistan in the last few years we’ve obviously gone with the very intensive surge-level robust kinds of counterinsurgent capabilities, at least in the south and east, as we had done in Iraq. Maybe the model is to go back and do the counter-factual: What would have been required in Afghanistan ’02 to ’06 if we had done it right in the first place? Some of the kinds of advise and assist brigades that would have allowed us to be maybe in the 30(,000) to 50,000 range and built up the Afghanistan security forces before they came under such duress from a revitalized Taliban.

That’s just one example, but it’s the kind of thinking we might need to consider instead of just deciding we’re either going to do these interventions that Petraeus’ standard of 25, you know, peacekeepers for every thousand civilian population, or zero. And we’ve got to think about whether there’s an intermediate range where we can actually, if we need to, get involved in a difficult conflict but do it with 30(,000), 40(,000), 50,000 troops rather than either 100,000 or, you know, 10,000.

(END)