



Debt and Defense

November 16, 2012

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Three Key Questions

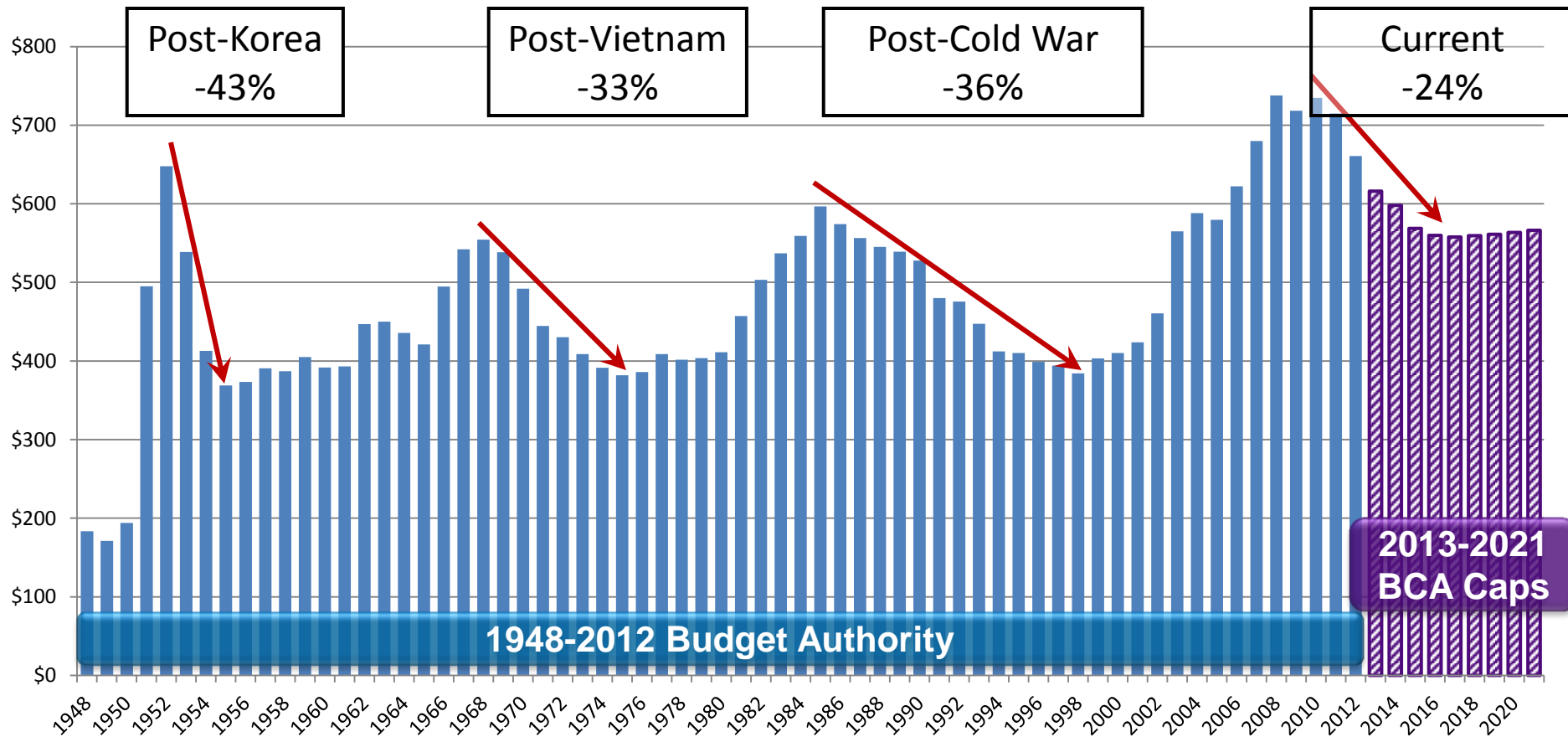
- **Where Are We?**
- **How Did We Get Here?**
- **Where Are We Going?**



Where Are We?



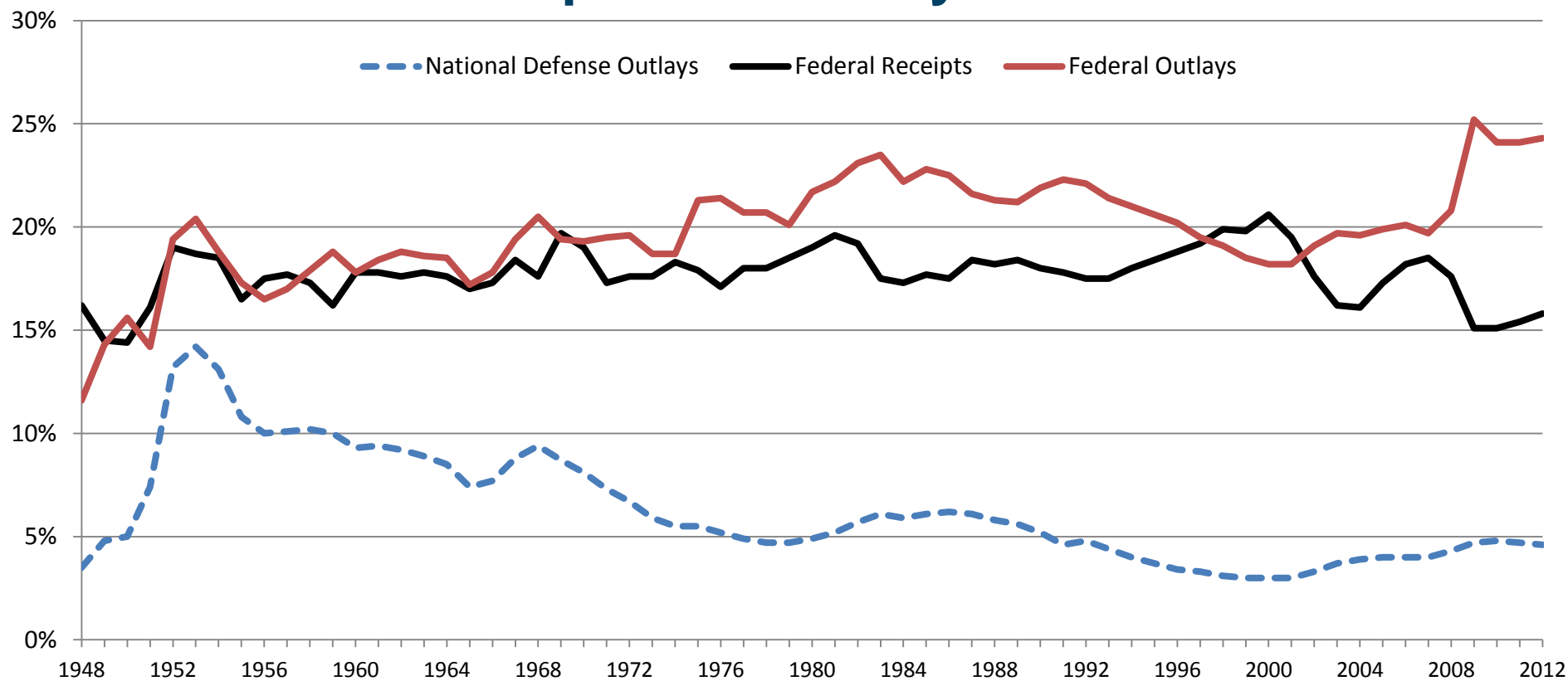
Where Are We: The Current Drawdown in Context



Source: Department of Defense, *National Defense Budget Estimates for FY 2013 (Green Book)*, Office of the Under Secretary of Defense (Comptroller), March 2012; Congressional Budget Office, *Long-Term Implications of the 2013 Future Years Defense Program*, July 2012.

Analysis by CSIS International Security Program

National Defense Outlays and Federal Receipts and Outlays as a % of GDP



Source: Office of Management and Budget, *Historical Tables*, Tables 1.2 and 3.1

FY2013 Continuing Resolution

- **Capped at \$1.047 Trillion (BCA Cap) rate for full FY (slight increase for DoD)**
- **Did not address sequester, fiscal time bombs, or debt ceiling**
- **Clean bill – few anomalies**
 - No new starts, production rate changes, new or extended authorities
- **CR “No” Votes**
 - 70 House Republicans, 21 Democrats
 - 29 Senate Republicans, 1 Democrat
- **Expires March 27, 2013**

How Did We Get Here?



- **Budget Control Act – Debt ceiling deal, not a deficit reduction deal**
 - Tranche 1: Increased debt ceiling by \$900B, offset by \$900B in cuts (BCA caps)
 - Tranche 2: Increased debt ceiling by \$1.5T, offset by \$1.2T in sequestration
- **House passed with $\frac{2}{3}$ of Republicans and half of Democrats**
- **Senate passed by $\frac{3}{4}$ bipartisan**
- **The trap – force Republicans to choose between cutting defense or raising taxes**

Ratings Agencies

- **Who Are Those Guys? (Moody's, Fitch's, Standard & Poor's)**
- **Impact of Downgrade**
- **The Problem of One Data Point**

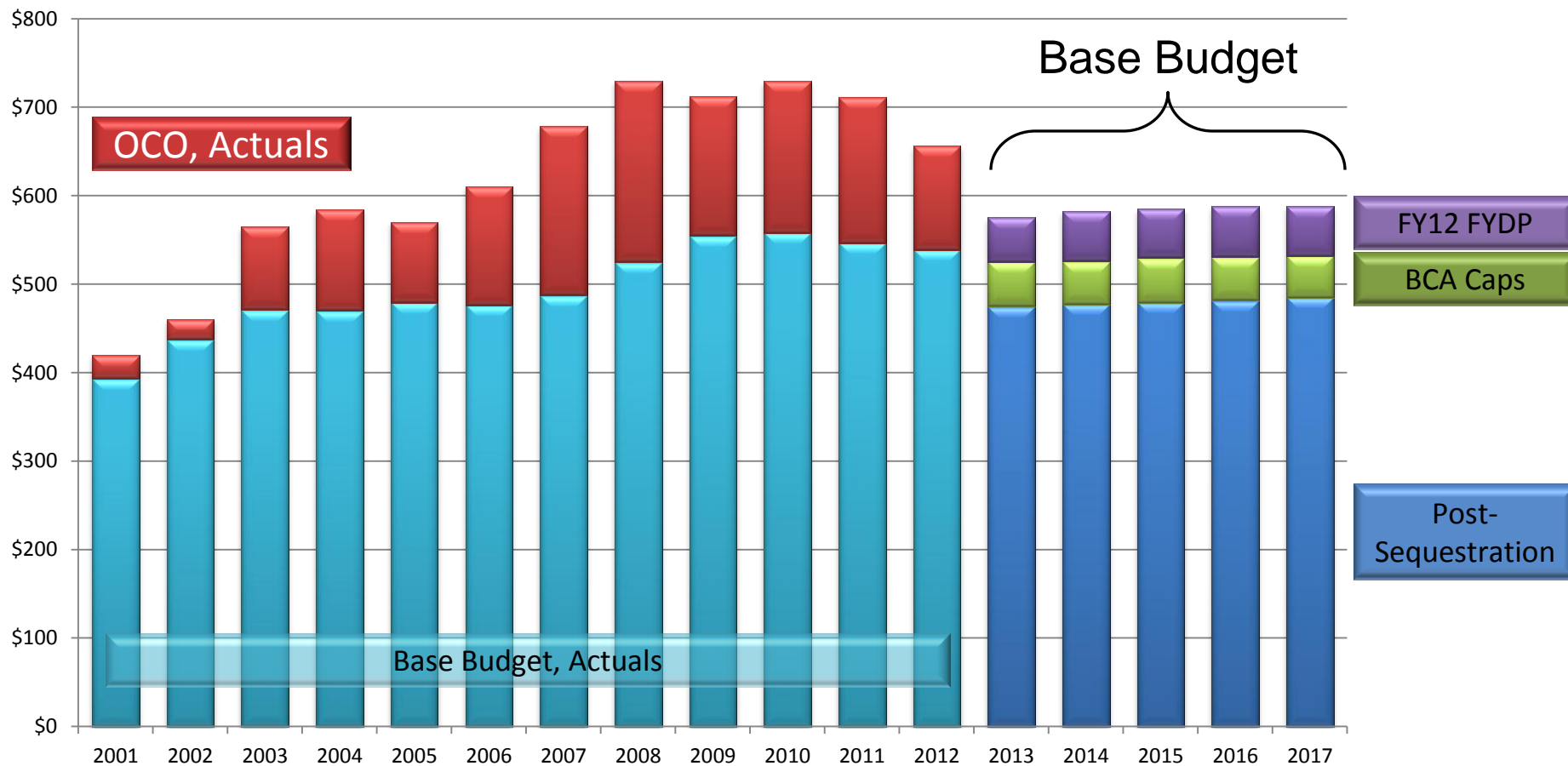
Where Are We Going?



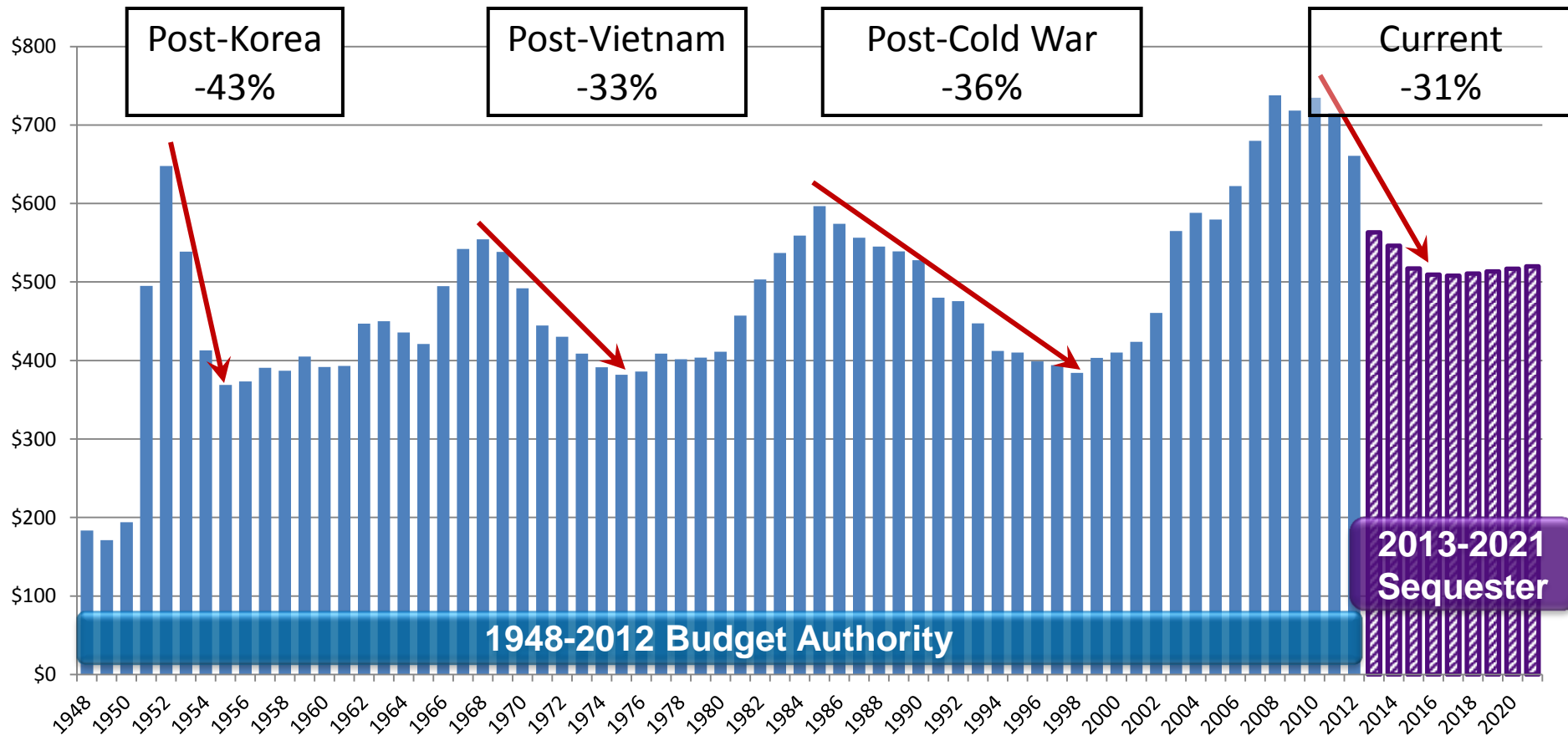
Fiscal Time Bombs – December 31, 2012

- **Expiring Tax Cuts**
- **AMT**
- **Payroll Tax Reductions**
- **Extenders**
- **Medicare “Doc” fix**

Department of Defense Budget, 2001-2017



The Sequester Drawdown in Context



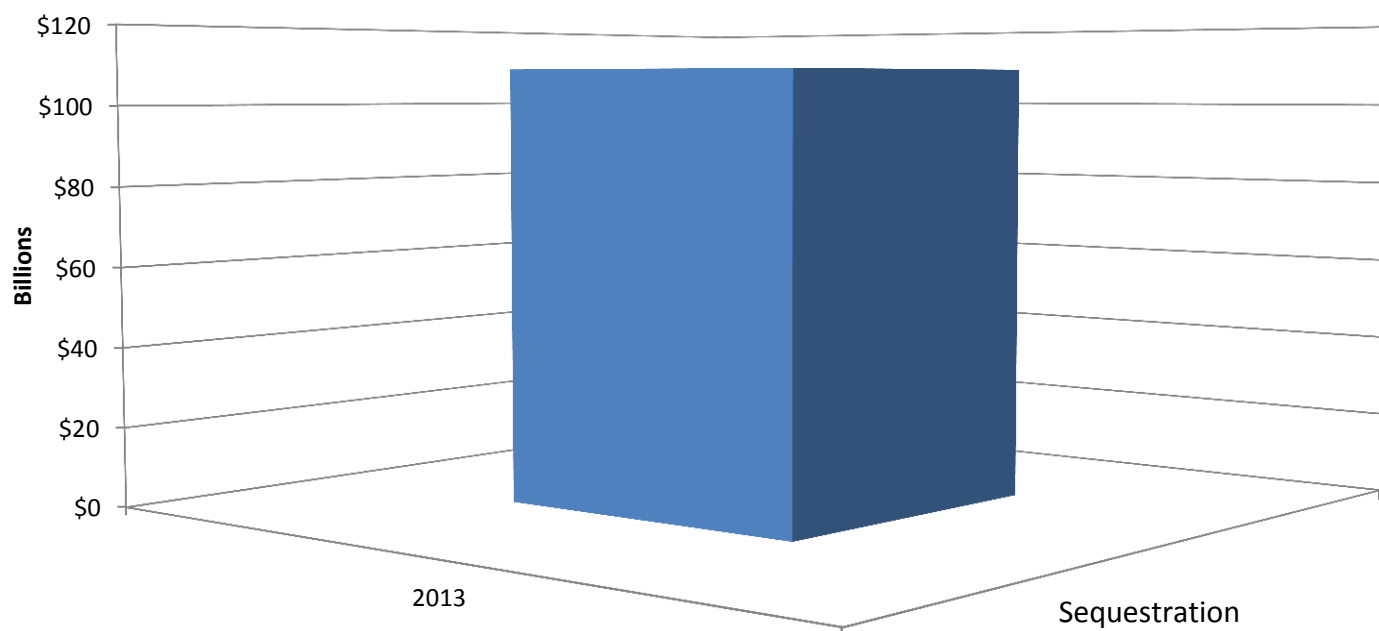
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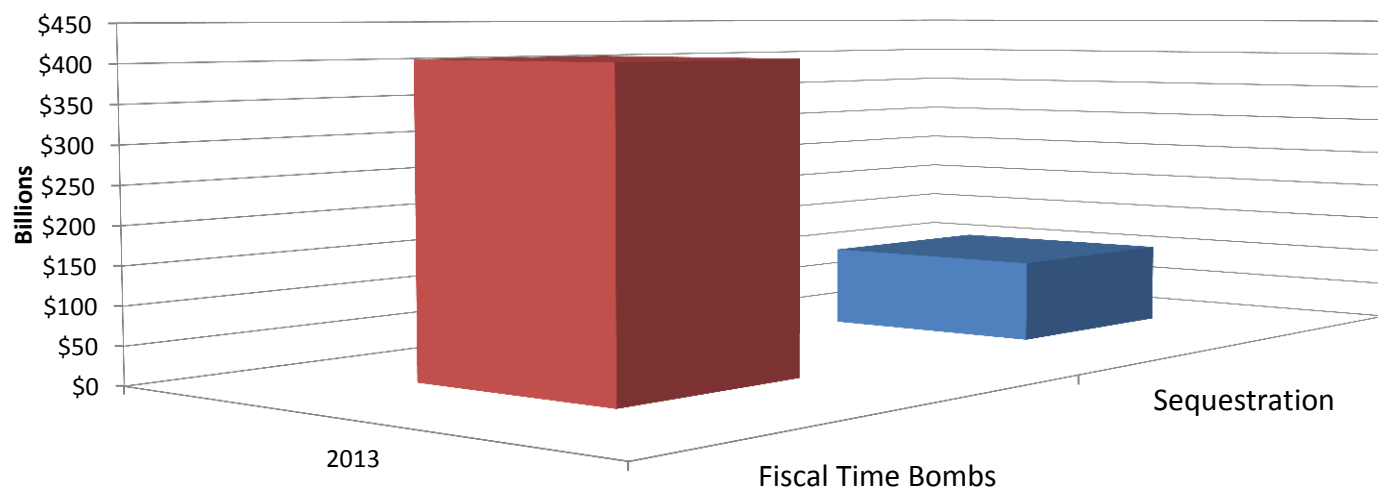
Debt Ceiling

- **Treasury Dept. Notice**
- **Flexibility to Delay Ceiling**
- **Impact of Expiring Tax Provisions**
- **Impact of Sequestration**

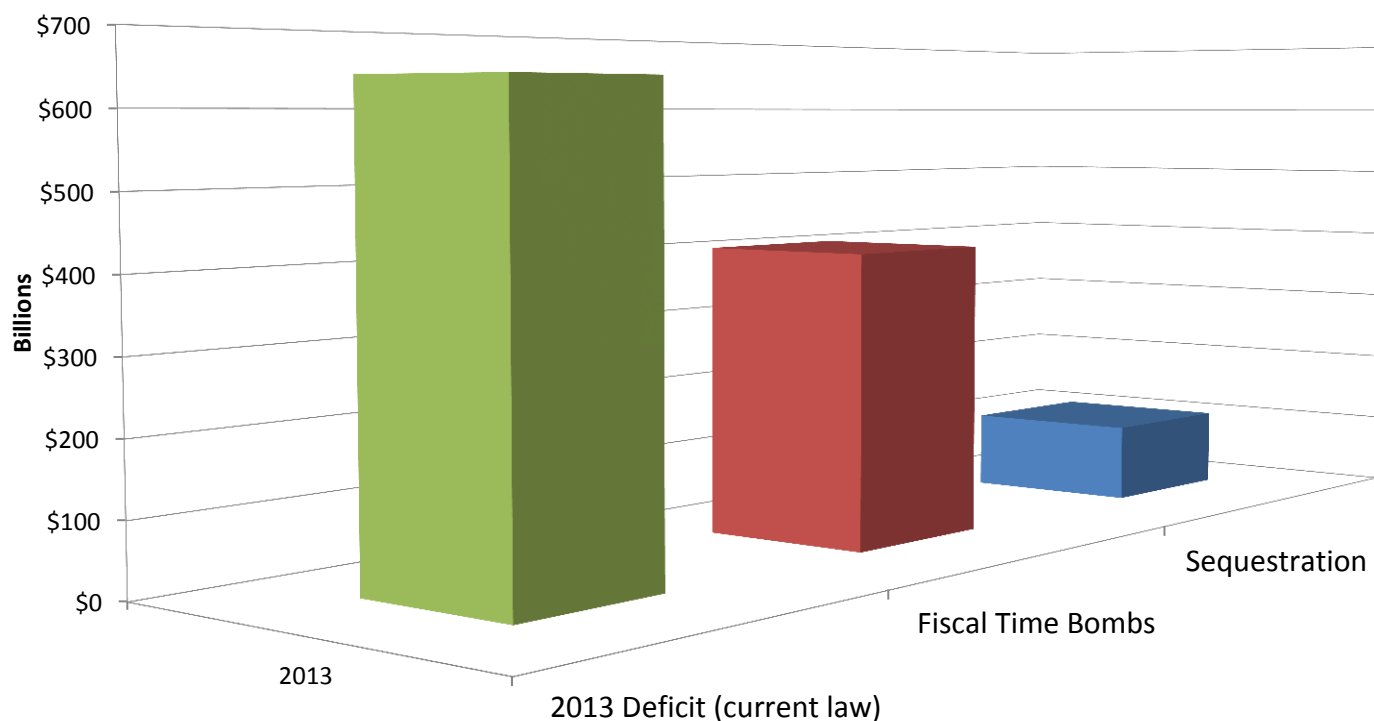
The Comparative Effects of Sequestration, the Fiscal Cliff, and the Debt Ceiling in FY 2013



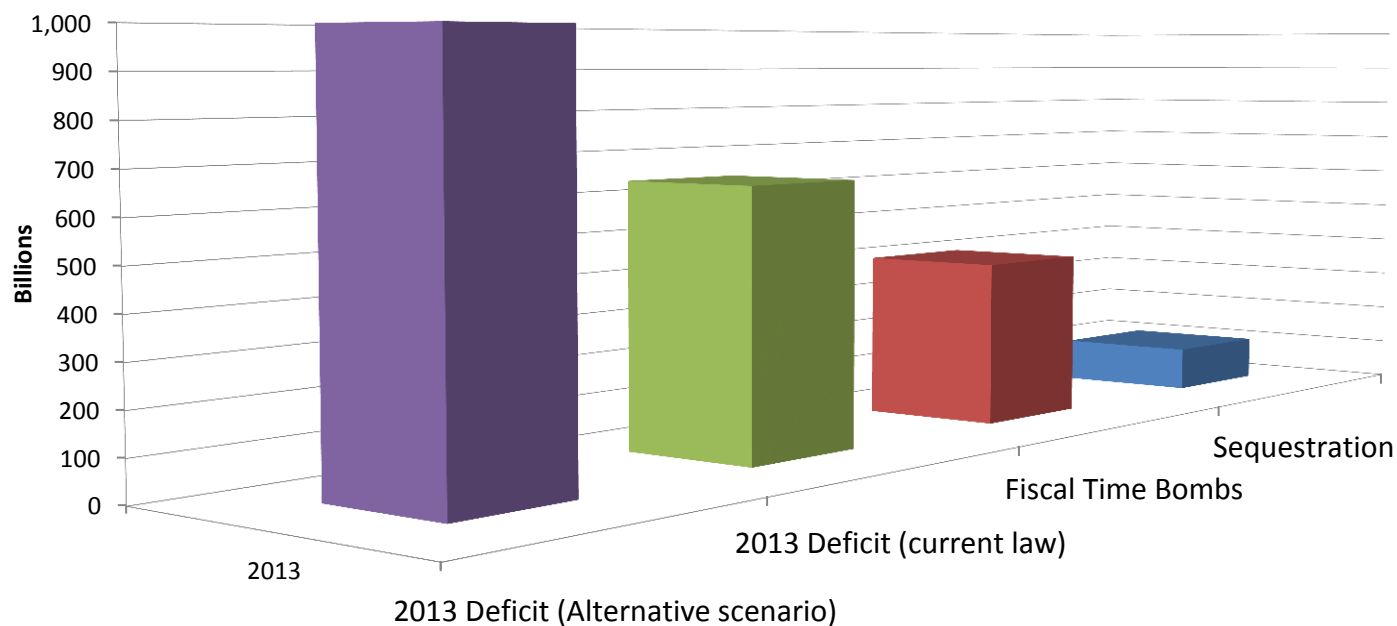
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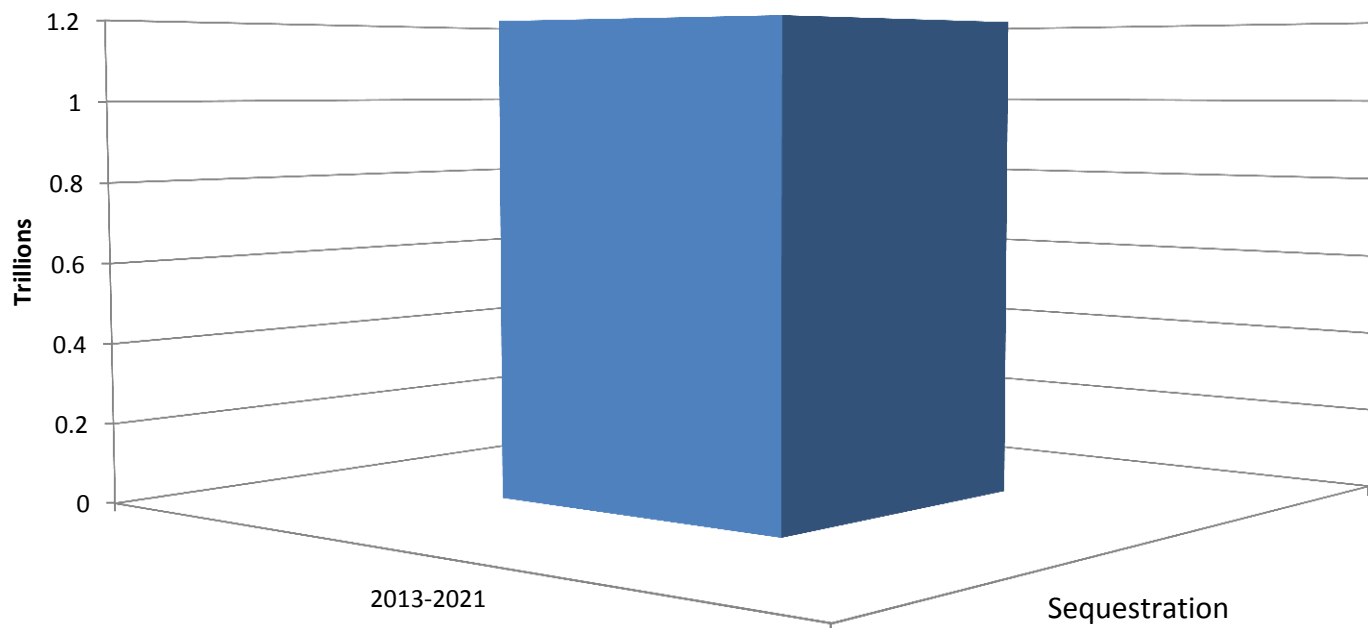
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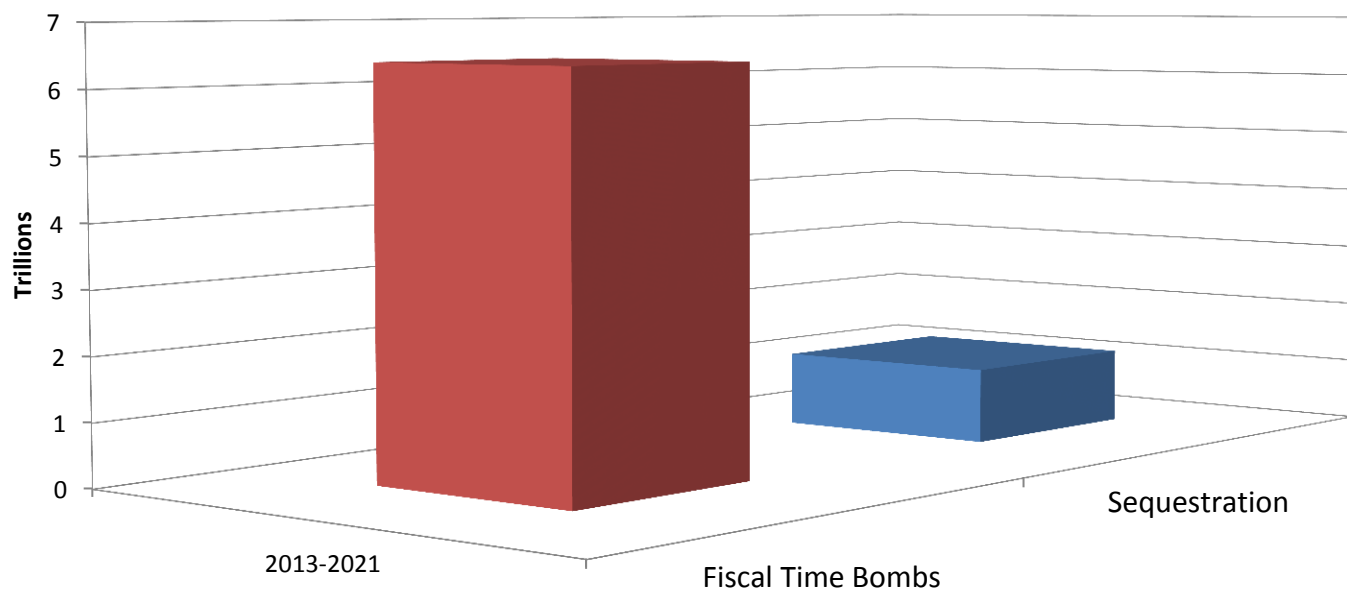
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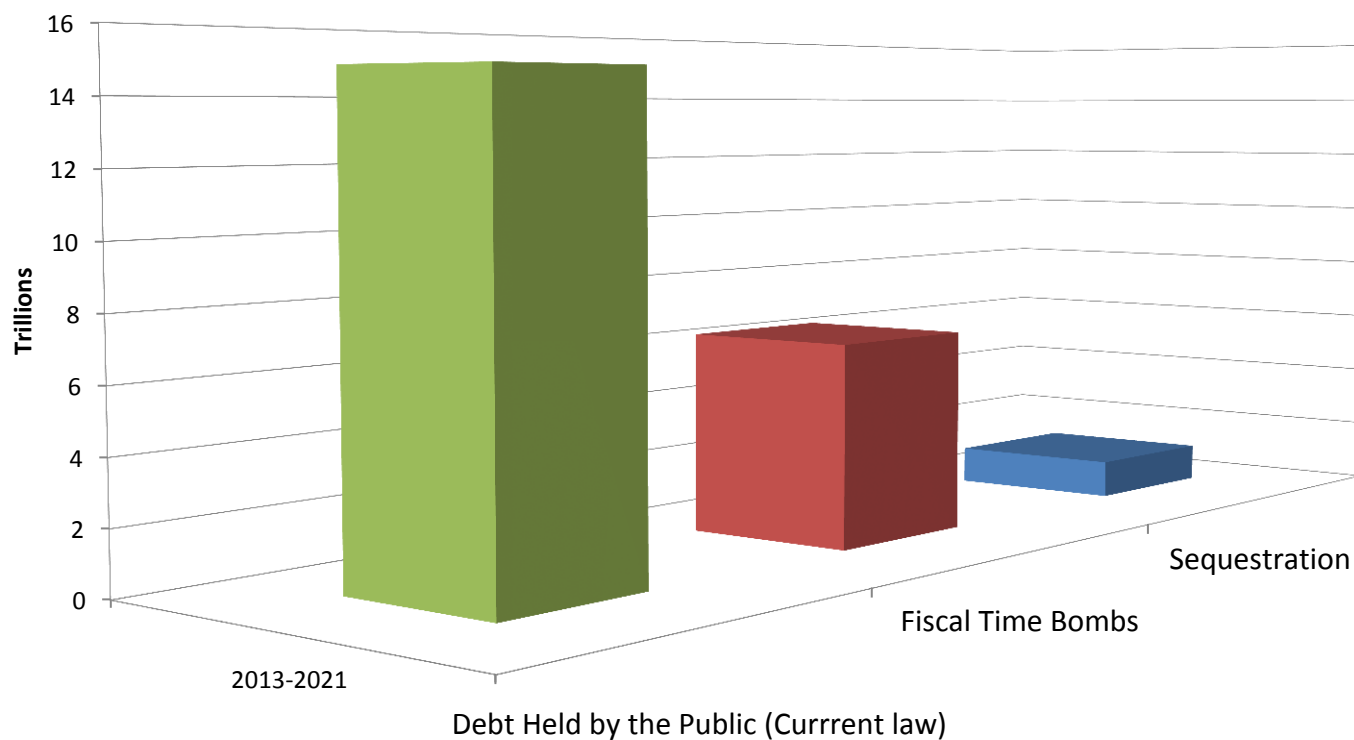
The Comparative Effects of Sequestration, the Fiscal Cliff, and the Debt Ceiling in FY 2013-2021



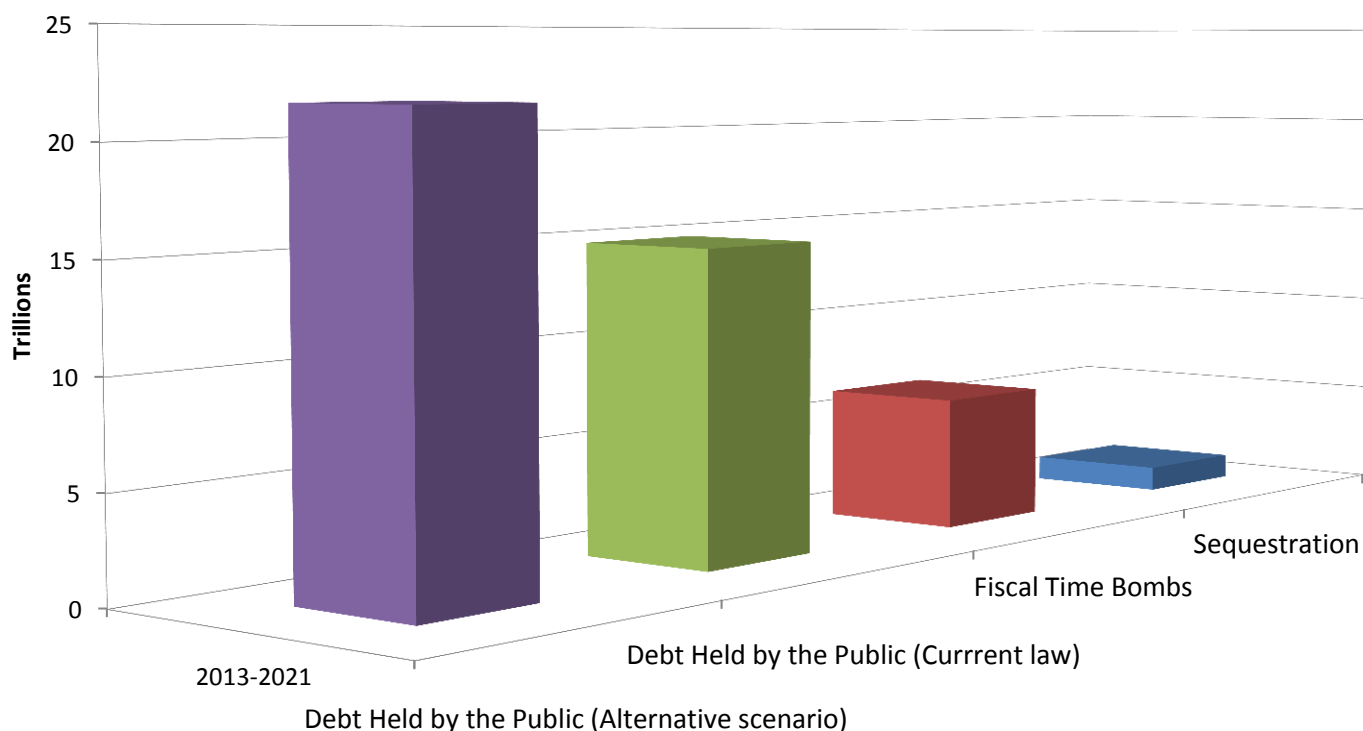
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The Comparative Effects of Sequestration, the Fiscal Cliff, and the Debt Ceiling in FY 2013-2021



Possible Paths Forward

- Execute Sequestration
- Modify Sequestration
- Punt



Executing Sequestration in DoD: Mapping the Budget Planning Calendar

	Oct 2012	Nov 2012	Dec 2012	Jan 2013	Feb 2013	March 2013	April 2013	May 2013
FY 13	CR	CR	CR	Sequestration	OMB Approval		First Furloughs	
FY 14				Budget locks	PB submitted	Budget Resolution	302(b) Allocations	Markup
Debt Ceiling		Treasury notice (notional)		Debt Ceiling Day		Ultimate Debt Ceiling Day		

Modify Sequestration

- **Flexible application of reductions**
- **Priorities – who sets them? On what basis?**
- **FY 14-21 impact**
- **Role of Congress**

Punt

- **Terms and Conditions – how long? at what price?**
- **Ratings Agencies Reaction**
- **Link to Tax Cuts? Debt Ceiling?**
- **What's the Next Hostage?**

Touchstones – What do we watch for?

- **Lame Duck Movements**
- **DoD Planning**
- **Non-defense discretionary cuts**
- **Debt Ceiling Notice**



The Economic Vise on the Defense Budget

Dr. Clark A. Murdock

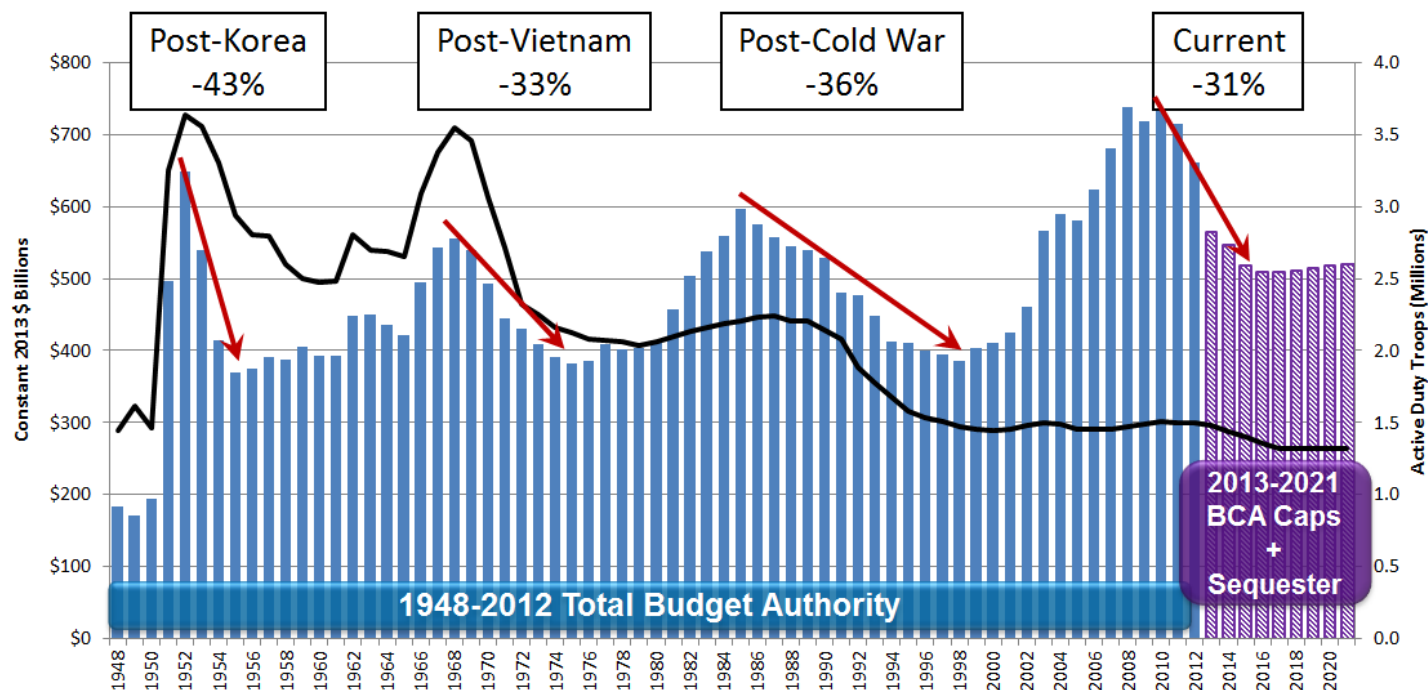
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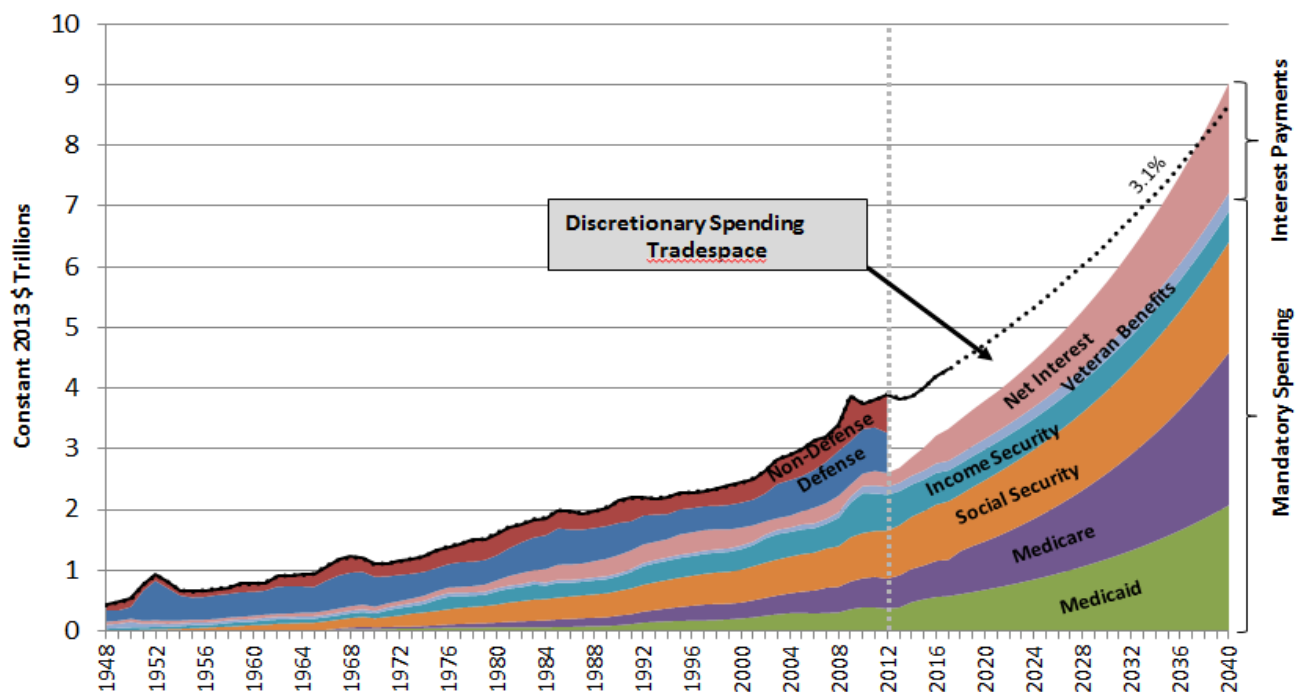
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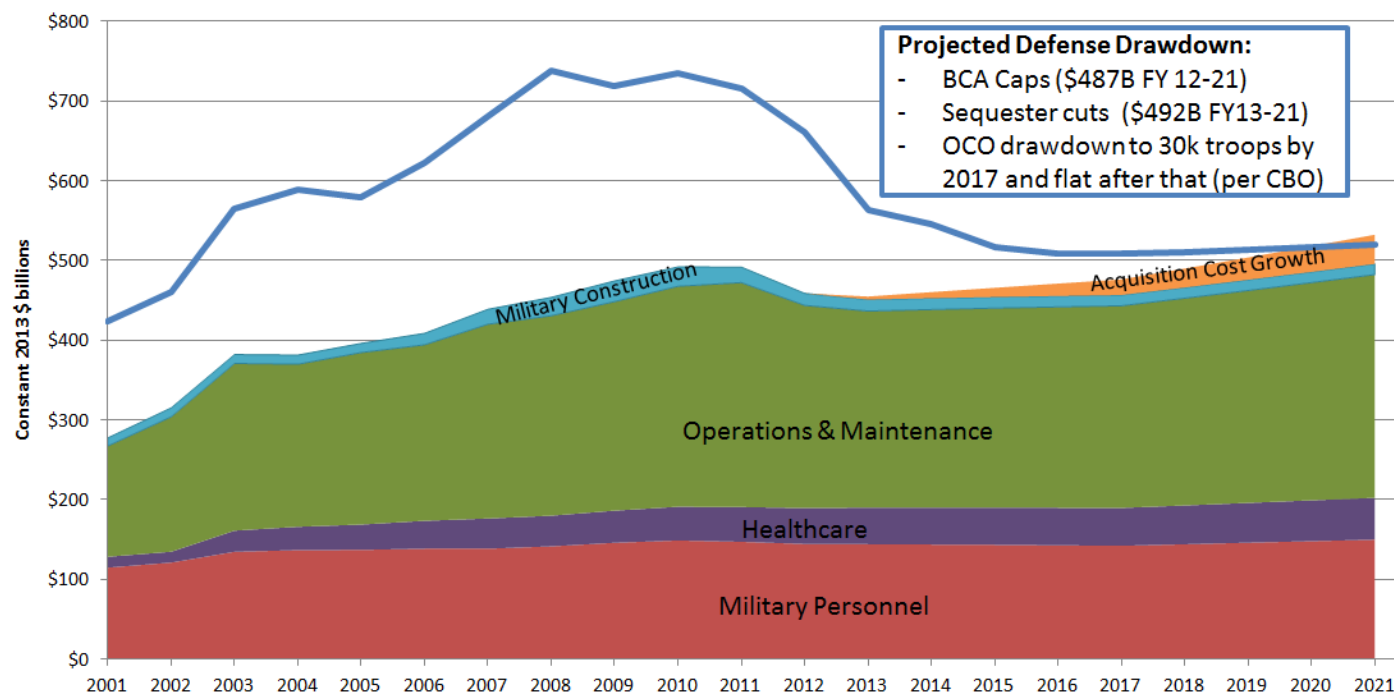
Defense Drawdowns Compared



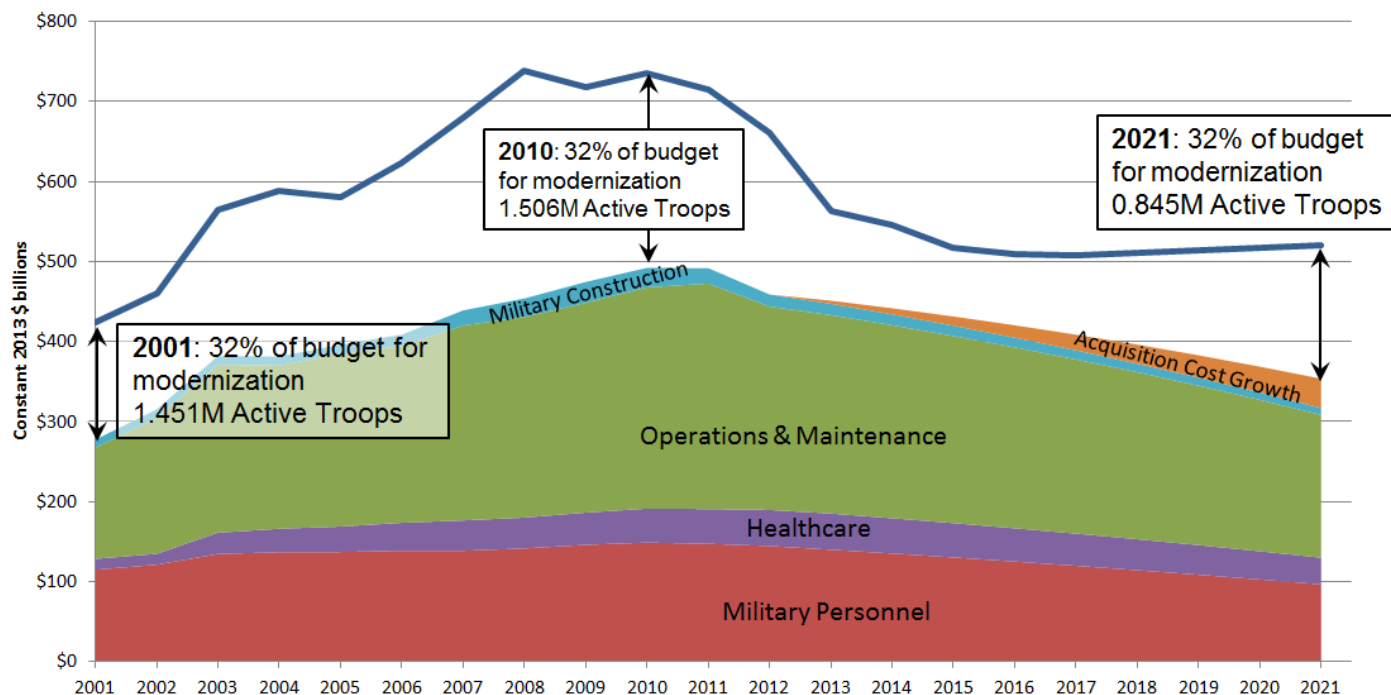
Unrelenting Pressure on the Defense Topline



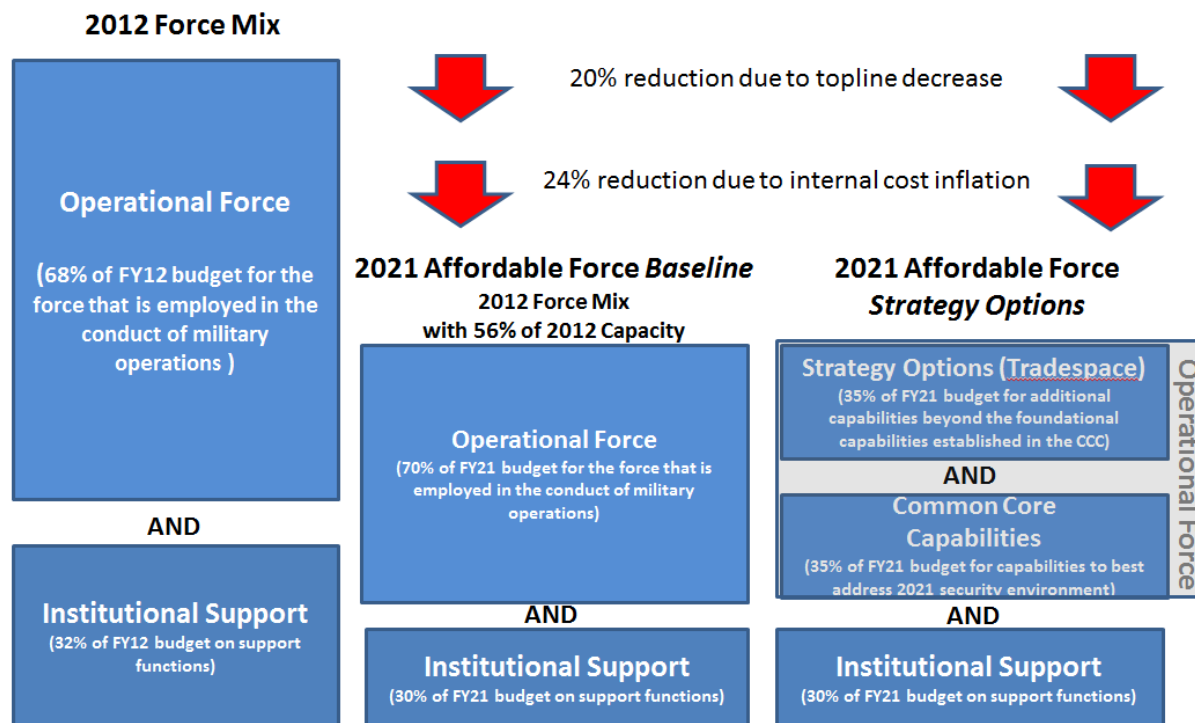
Internal Cost Inflation against the Projected Topline



Restoring Modernization in the Base Budget



The 2021 Affordable Force

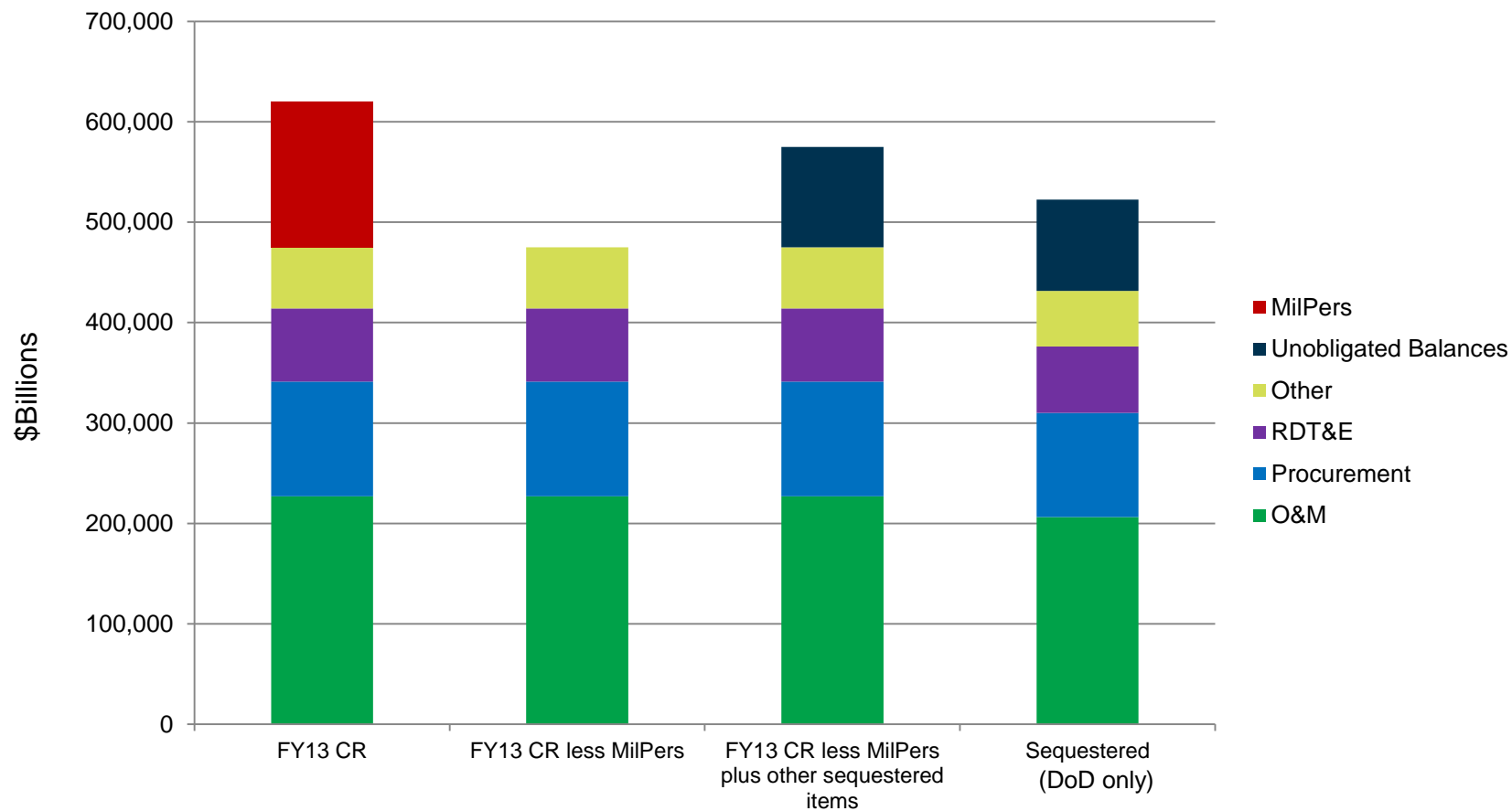


Build the "2021 Affordable Force Baseline," Then Consider Possible "Strategy Options"

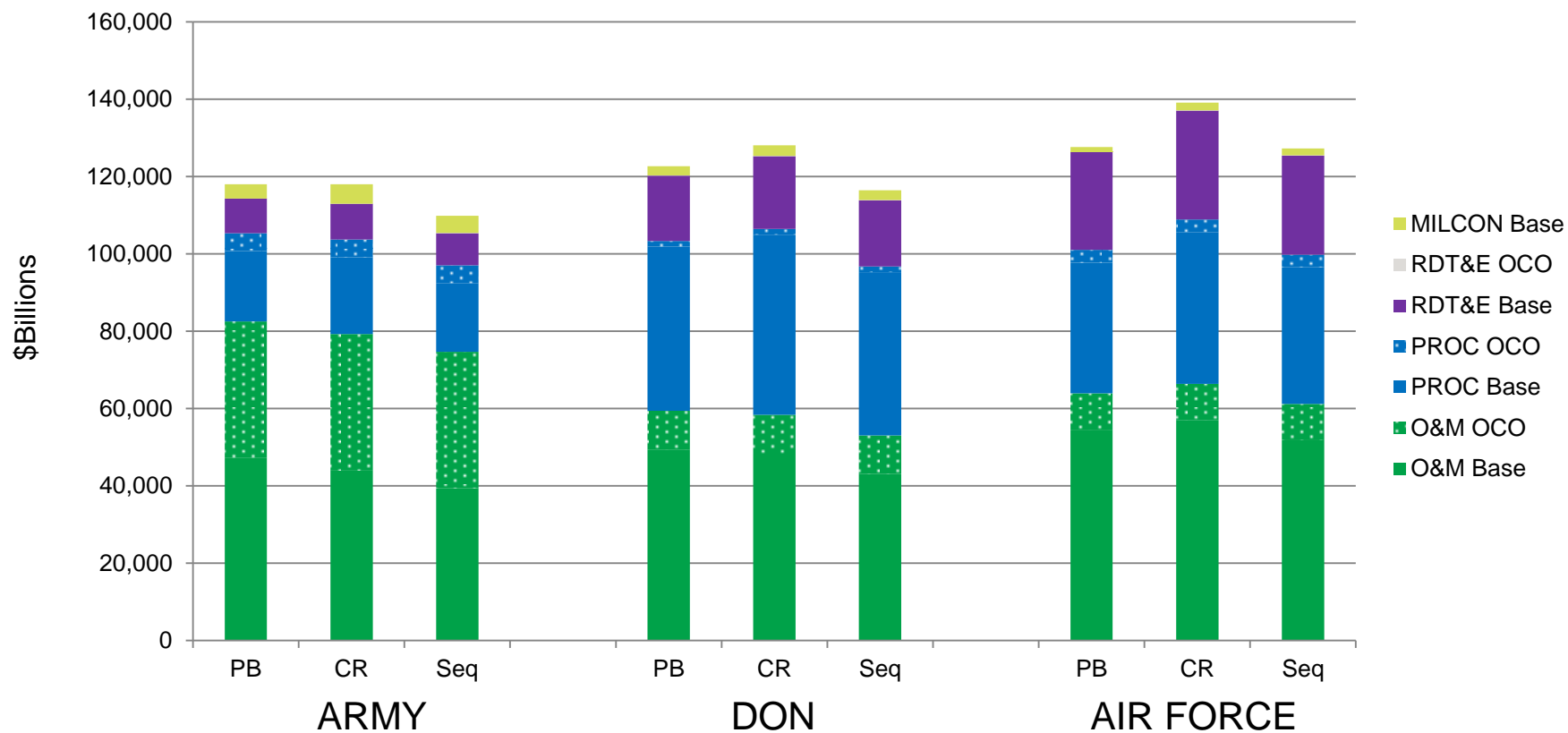
Where we currently stand

- **Guidance remains not to plan**
- **Much ambiguity remains, particularly in specifics of how sequester would be applied**
- **Automatic cuts only apply to FY13, but significant challenges in FY14 and beyond**

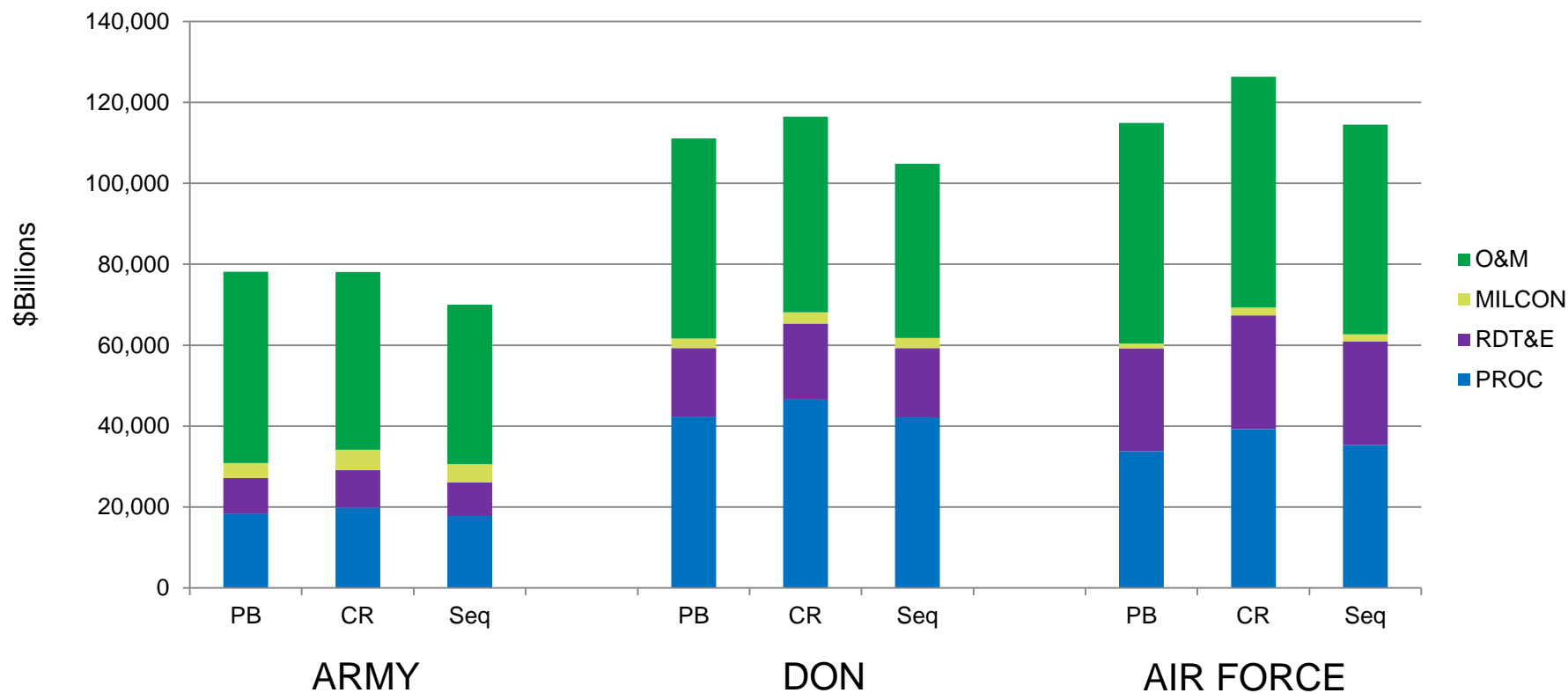
Implications for FY13 by Appropriation



Sequestration by Military Department & Appropriation (FY13)



Sequestration by MILDEP and Appropriation (FY13 Base Only)*



Key sequester questions/implications

- **How much flexibility will there be?**
- **If decentralized execution, how will tensions and/or risks be managed, addressed?**
- **What's the process for litigating Dept-wide execution?**
 - How much oversight will (can) there be, and by whom?

Key questions/tensions FY14+

- New strategy required?
 - Future of OCO?
 - How much A2/AD is enough?
- Endstrength – how much, how fast, how much force structure?
- AC/RC mix
- Readiness models
- “Rightsizing the insatiables” – e.g., cyber, space, intel
- Pay and benefits
- Key programs (e.g., Ohio Class replacement, JSF, GCV)