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P R O C E E D I N G S

MR. O'HANLON: Good morning everyone. Welcome to Brookings. I'm Michael O'Hanlon from the 21st Century Defense Initiative and with my colleague, Peter Singer, we're delighted to welcome you here to an event on U.S. defense strategy and the defense budget. And we're honored to have the Under Secretary of Defense for financial management and the Comptroller of the Pentagon, Robert Hale here to give a keynote address to begin things. Just a quick note on the agenda, after Bob has spoken I'll come up and call on a few folks and we can ask some questions of Bob. So that will be your chance to intercede and to pose questions that may be on your mind.

He'll field questions for about a half hour. At that point, we'll go straight to a panel discussion moderated by Peter Singer and we'll be joined by Paul Wolfowitz and Richard Betts. Paul Wolfowitz the former Deputy Secretary of Defense, Richard Betts who runs the security program at Columbia University. So again, thank you to all of you for being here. Let me say a brief word about Bob Hale for whom I had the great pleasure of working 20 years ago at the Congressional Budget Office. A fantastic career in national security, as noted the comptroller of the Pentagon today, one of the top officials, the key advisor to the Secretary of Defense on all matters financial not only in terms of building budgets, but executing them and trying to figure out how to save money and execute efficiencies and reforms within the defense budget.

Bob has a long career in national security. He was a Navy officer at the beginning of his career. He worked for the Center for Naval Analyses, he

worked for the Logistics Management Institute early in his career, and again later he was my boss at the Congressional Budget Office during the period -- well for a number of years; for a dozen years. But including during the period when the Berlin Wall had just come down and we were building a post Cold War military, thinking through policy choices, working with people like Senator Sam Nunn and Congressman Aspin as well as people on of course, both sides of the aisle. In that period of time, Bob was the comptroller of the Air Force during the Clinton Administration and has also been the Executive Director of the American Society of Military Comptrollers. And so without further ado, please join me in welcoming one of my favorite defense budget experts, Robert Hale.

MR. HALE: Well, good morning. How's everybody doing? Good. Well listen, I'm glad to be here for a number of reasons, but one of them is, you know, comptrollers don't get invited out that much and there's probably a good reason. I remember a story, it was a man who had some pains in his chest, rushed to the hospital, doctor examined him and he said, well sir, I've got good news and bad news. He said, the bad news is you've got a serious heart problem and if you don't get an immediate heart transplant, you're going to die. He said, but the good news is I've got three donors, you can choose any one of them. One of them a 20-year old Olympic athlete; prior to her tragic demise she was practicing every day for the Olympics.

Second one was a 25-year old former triathlon athlete; prior to a terrible accident he was biking, swimming, running every day. Third one's an 80-year old former DOD comptroller. He said, which one would you like? The man thought for a moment and said, I'll take the comptroller. Doctor went off to

prepare for the surgery and the man's wife was there. She said, honey, why would you choose an 80-year old former comptroller for a heart transplant donor? He said, well I figured I'd take the one who's heart has never been used. So folks, I'm afraid I'm going to live up to that billing today, but I'll try my best.

So the key issue facing us right now is, how do we maintain national security and what are clearly leaner budget times? Recently, the main declines in the defense budget have been in our wartime; the Overseas Contingency Operations or OCO budget. But we have seen some real declines in the base portion and there may be more coming. So what do we need to do to accommodate leaner times? I'll offer three thoughts starting with we need a strategy to how we go about maintaining national security but do it at budget levels that seem reasonable. That's the first and maybe most important thing. Second, we've got to make more discipline use of the money we get, we've got to stretch our defense dollars, and I'll tell you what we're trying to do. And third, we need -- I would say desperately need more stability both in terms of budget size and maybe particularly budget process, and I'll say a few words at the end about sequestration and other things that fall in that category.

So let me talk about each of these points starting with the strategy. It is a key to success at all times, it may be particularly when you're facing lean budget times. You know that old saying, if you don't know where you're going, any road will do. And I think without a strategy, we wouldn't know where we're going. We need it to guide decisions. You might say that's obvious, but in some past draw-downs there has been an across the board nature to them. I'd note the Cold War. The draw down after the Cold War had some

across the board aspects to it so it's important that a year ago in January 2012, President Obama announced a new defense strategy.

We believe it is the right one for the times and interestingly, despite a lot of criticism for all the specifics that we proposed in connection with that strategy, criticism on the Hill, most members of Congress seem to have accepted the strategy. It is meant to help us confront a period of time where we face some very complex national security challenges. I mean just think, Syria and the Arab Spring, I think Iran and its relations with the whole world to include Israel, I think North Korea and so many more. So what are the elements of this strategy? I'm not going to spend a lot of time on it, but just briefly it assumes we will be smaller, have leaner forces, but that they will be highly ready forces.

One of the ways they will be leaner is we will no longer assume that we size our forces for large, prolonged stability operations of the sort that we conducted in Iraq. But we will look for ways for reversibility because we understand that we often guess wrong about future threats. We feel those forces must be highly ready because there's very much of a no-notice category or quality to the sorts of threats to national security and that'll be very important when I come back later to a discussion about things like sequester. A second major item in that strategy is to rebalance our forces towards the Asia-Pacific and the Middle East.

We've already done the Middle East pretty well. We are working toward rebalancing toward Asia-Pacific maintaining presence there, maybe moving around some forces, fewer Marines on Guam for example. Some of them -- sorry, on Okinawa and some more on Guam, a rotational presence in

Australia, some more ships in Singapore, possibly a presence in the Philippines. We will pay attention to long-term threats in the Asian area including China. We'll maintain technological superiority is the third element of this strategy and invest more in some high priority types of activity; cyber, special operations.

But we recognize we're going to have to delay or cut back on weapons programs in order to meet budget constraints. We've used this strategy to guide budget decisions, we've proposed some substantial cuts in forces, from Fiscal '12 to '17 100,000 people out of the active duty, 90 percent of those in the ground forces which is consistent with the decision on large prolonged stability operations. We've worked to increase things like cyber investments and a number of other decisions consistent with that strategy. We think this strategy is the right one for the times. We also believe that the current level of plan defense spending is roughly consistent with that strategy and so we hope Congress will continue to support that level or at least something close to it.

But strategy isn't enough in lean budget times. We owe it to the taxpayers to stretch defense dollars wherever we can and we have had a number of initiatives to do that. Economists are often referred to as efficiencies. I don't like the term because little of what we're doing is truly an efficiency. As an economist would define them, same output, less funds. More often what we are doing is eliminating lower priority programs where we think that makes sense in order to hold down spending. So I prefer the phrase, more disciplined used of resources.

So what have we done to make more disciplined use of resources? Two major packages in the last two budgets; one for about 150

billion over 5 years than the budget 2 years ago, the last year about 60 billion and some cuts before that as well. Many involved eliminating lower priority weapons programs. For example, we've terminated the future combat system in favor of the more focused ground combat vehicle, we've terminated the DDG 1000 in favor of buying more DDG 51's, we've terminated TSAT satellite in favor of the AEHF, and we've ended production of both the C-17 and the F-22 aircraft and a number of other initiatives.

Some of the others focused on organization and business process changes. First time ever we disestablished a combatant command, the joint forces command, we have sought strategic sourcing, across the board grouping our buys to try to use our market power to get better prices, we've looked at things like consolidating email networks and other more efficient IT efforts, reducing use of contract services where we can, and some activities that really do qualify as efficiencies. The Air Force for example, has put flight programming software on their transport aircraft, try to help pilots get fuel costs and consolidated wireless contracts, make better use of minutes, I mean simple stuff we all do in our homes, we are trying to do on a bigger scale.

Another major set of initiatives has aimed at slowing the growth in military compensation which has grown very sharply over the past decade. We have proposed and Congress has agreed to some increases in fees for military retirees for their healthcare which hadn't been increased for more than a decade, we have gotten Congress to agree to increases in pharmacy co-pays aimed at causing people to make greater use of mail-order and generics and it saves us a lot of funds, and some slower out year basic pay raises. Overall, we had tried to

slow the growth in DOD healthcare costs which have nearly tripled since the year 2000; I mentioned some of the fee increases.

We have also sought and achieved major changes in the way we pay healthcare providers. For example, using Medicare rates to pay for outpatient care in the Department of Defense, which we weren't doing a few years ago. Some of our initiatives for making better use of defense resources have been oriented toward improving processes and I'll mention one example. We are committed to achieving auditable financial statements in the Department of Defense and I think -- I humbly say for the first time, we have a realistic plan to accomplish what is a very major task.

Auditable statements will help us improve our business processes; they'll force us to do that. But most importantly in my mind, they'll help reassure the public that we're good stewards of their funds. And we're not done seeking ways to make more disciplined use of resources. We still need to consolidate infrastructure using the BRAC technique, we are engaged in restructuring our civilian personnel to try to reduce their numbers in looking at a restructuring of the military health system.

I recognize there's more to do here, that we haven't fundamentally changed some problems for the Department of Defense like growth and operating costs and acquisition costs and indeed, also growth in military compensation, but I think it is fair to say that we have had a fairly aggressive effort to pull down defense costs and that will continue. The last step in my mind that's a key to managing in leaner times is more stability, both in terms of budget size and budget process. Sometime over the next couple of months I hope to

help the department submit a fifth defense budge; the fifth one during my tenure as comptroller. The first two featured increases in the top line, the third one in February 2011 featured some substantial top line reduction, and the last one featured a significant reduction, about 260 billion over a 5 year period relative of our plans, 487 over 10 years.

And of course we may not be done. The American Taxpayer Relief Act which was the bill Congress passed on New Year's Day and the fiscal cliff legislation may force some further reductions, and there is the threat of sequestration. At the same time, I would argue that national security challenges have not gotten any less complex. And this lack of budgetary stability makes it very hard to plan and I think extremely hard to plan well. So I think the nation's security would be better served if the Congress adopted and then stayed with a more stable budget plan. We've also not enjoyed much process stability during my tenure as comptroller.

I have personally coordinated four shut down drills; two of them I was sitting in my office at eight o'clock at night not knowing at midnight whether we would shut down the department or not. Fortunately, we didn't in either case. We've lived under two long-term continuing resolutions, six month continuing resolution; we are under one right now. They really hogtie the department and its ability to manage, they're very difficult to manage. There's just a number of legal restrictions. We had a near brush with sequestration last week, averted for the moment at least, but the continued specter of sequestration is certainly out there.

In more than three decades of working in and around the defense budget, I've never seen a period featuring any greater budgetary uncertainty than

we're looking at over the next few months and through March. It gives a whole new meaning to the term, March Madness and I can't wait for it to be over. So what does the rest of fiscal cliff 2013 look like? I know that we face a -- we know that we face sequestration starting now on March 1, 2013. We're still working on the details, but the total sequestration for DOD appears to be roughly $45 billion if it all went into affect; about nine percent of our budget. That is less than the sequestration we faced before passage of the New Year's Day act.

That could have been as much as 12 percent, but we also have two fewer months in which to accommodate those changes. We also cannot rule out an extension of the continuing resolution throughout the rest of this year and that would sharply reduce the operation and maintenance funds that we have available and that we need to maintain readiness and hark back to my -- or think back to my statement earlier, readiness is one of our highest priorities. And to add to the problems, we believe we must protect funds for wartime operations. We can't leave the troops in Afghanistan, we can't short-sheet them, in budgetary terms we'll have to protect those funds and that means even larger cuts in base budget dollars available for readiness.

So the bottom line, we face a confluence of some unfortunate events, a year-long continuing resolution that is going to reduce funds available, especially for readiness, the possibility of sequestration, and this need to protect our OCO or wartime operations budgets. All of these together could lead to some serious adverse affects on DOD readiness, even as we continue to face some complex security challenges. And I've not even mentioned the disruption that sequestration could cause to more than 2,500 DOD investment programs or

projects. So we face a lot of uncertainty, we find ourselves balancing a lot of costs and risks. I'm reminded of a story that I think captures this and put a little lighter note on what I know has been a pretty somber talk.

Story about a speaker who was giving a talk on costs and risk and he asked somebody from the audience to come up. And he said, I've got three questions for you that's going to help illustrate the challenges we face. He said the first question's this: imagine there's a 40-foot long I-beam right here in front of me on the floor. It's six inches high. I'll pay you $100 if you take a chance to walk across that I-beam. I'll pay you $100 if you don't fall off. Would you take the risk? The man said, well sure, if I fall off it's like stepping off. He said, okay, same I-beam, this time strung between 2 40-story buildings. I'll give you $100 if you walk across it and don't fall off. He said, would you take the risk?

He said, well of course not. I mean, if I fall off I'm going to die. He said, okay, the third question. Same I-beam, 40 story buildings, you're at this end, I'm at the other end, I have one of your three children in my hand. If you don't walk across that I-beam, I'm going to throw them off the building. Would you take the chance? This time the man thought a moment and he looked at the speaker and he said, which child have you got? So sometimes as a defense manager, I feel like I'm throwing children, my own children sometimes, off a building and sometimes I realize they may be some of your children as well. Let me sum up and then I'll try to answer your questions. I believe there are three key steps that we need to take as we seek to accommodate leaner budget times.

We need a strategy to guide spending and we think we have a good one, we need to stretch every defense dollar and we are looking and I

mentioned a number of things we're doing, we need to continue to do them, and finally we need more stability both in terms of size of budget and budget process. The decisions that are made over the next few years and months I should say, will be critical to our national security. I think Secretary Panetta put it just right last week when he said and I want to quote, "every day the men and women of the Department of Defense put their lives on the line to protect us all here at home. Those of us in Washington have no greater responsibility than to give them what they need to succeed and to come home safely. My hope is that in the next two months all of us in the leadership of the nation and the Congress can work together to provide that stability. Our national security demands no less." With that, I'll stop and I'd be glad to try to answer your questions.

MR. O'HANLON: You can just stay here if you like. I'll just slide over.

MR. HALE: Okay. All right.

MR. O'HANLON: So I'll just briefly remind you of the ground rules. Please identify yourselves after waiting for a microphone to arrive and then please just limit yourselves if possible, to one clear question. Start here, sir.

MR. CAPACCIO: Tony Capaccio with *Bloomberg News* and one clear question. You said $45 billion if sequestration kicks in in March, just review the bidding. It was up to 62 billion potentially added, kicked in last week. What's changed and will modernization take a disproportionate amount of this hit if it happens because of your O&M burn rates?

MR. HALE: Well Tony, what's changed is that they changed the law which changed both -- what we call a joint sequester or sequestration, the

way they figured if that reduced the amount, and also a potential second sequestration, they reduced the caps or they changed the caps in ways that cut it back. We wouldn't have the authority under sequestration to choose between O&M and modernization because it's the same percentage in each budget account in the case of the operating dollars in each line item in the case of investment. So unless we can reprogram, and that would be pretty limited ability to do that I suspect, we wouldn't have that option.

MR. CAPCCIO: To review the bidding, it was $62 billion.

MR. HALE: It was 62 billion, it was our best estimate for DOD before, and now our best estimate's still rough. These legal changes were quite complex, but it looks like about $45 billion for defense.

MR. O'HANLON: Sir, here in the fourth row.

SPEAKER: Hi, (inaudible), *China Daily*. Yeah, you seem to be quite upset with the smaller budget. Does that mean you're going to be upset with your likely new boss, Chuck Hagel who argues for smaller a budget? Thank you.

MR. HALE: Well first off, I'm not sure what the President will announce today and if I did know, I wouldn't scoop him on that. I'm smart enough not to do that. And I think if it is Senator Hagel, we will work with him and we will work with the American people. We need to balance -- defense budgets are about risk. You get a certain amount of money; you get a certain amount of risk. If the country decides they want to take some more risk, then we can go for lower budgets. We'll need to work with whoever is the nominee today and assuming that person is confirmed to try to make those tradeoffs. They're

hard to do, but we'll find a way to do them.

MR. O'HANLON: I think we had another hand in that same row a minute ago. Okay, further back -- yeah, all the way to the wall, please.

SPEAKER: (Inaudible) *NHK Japan Broadcasting*. On the Pacific realignment defense bill they froze some money for Guam and Okinawa because there's no way to lay out defense and the department has submitted to Congress and the Senate has been saying this for a couple of years. So what is taking you guys so long to get the report out?

MR. HALE: Well I mean, there are a number of complex issues, political and operational with regard to the move of the Marines from Okinawa to Guam and we have been working on it. We think we have a plan, we haven't yet fully convinced the Congress. But I believe we will make this work. It may be later than we'd hoped, but I think we will come up with a plan that they will buy and we will achieve our goal which is to maintain our presence in the Pacific area while also moving some of the Marines off of Okinawa.

MR. O'HANLON: Here in the second row, please. And then we'll go to the front row after that.

MS. BRANNEN: Thank you. Kate Brannen from *POLITICO*. Could you talk about what assumptions you're using to build the 2014 budget and how those might have changed over the last couple of months or even the last week? Thanks.

MR. HALE: Well, basically the strategy is the one we've already announced and I summarized very briefly and many of you know it well. That has been the overall guiding principle. We were planning on the same top line

numbers that were announced with the budget a year ago, that is the out year numbers, and I don't know whether those will change or not. It's a possibility that they will given the American Taxpayer Relief Act, the New Year's Day legislation on the fiscal cliff. I just don't know that yet, so there may be some dollar changes TBD. But I think the strategy will stay the same, we will certainly try to adhere to it because as I said, we think it is the right one for the times.

MR. O'HANLON: Here, please.

SPEAKER: Thank you. I'm (inaudible) with *Voice of Vietnamese Americans*. With your current state of the heart, would you give us the priorities of love of your children and how would you help Senator Hagel to share the same priorities of love of your children?

MR. HALE: I'm not sure I understood that.

SPEAKER: The priorities of the spending in your budget in 2013 and 2014 and --

MR. HALE: What was the first part, Mike?

MR. O'HANLON: The first part of your question we both missed.

MR. HALE: I'm sorry.

SPEAKER: Well, it's the same question. The first one I just referred back to your story about the state of the current heart.

MR. HALE: Hot?

SPEAKER: Your heart.

MR. O'HANLON: The joke. The joke about --

SPEAKER: Your heart.

MR. O'HANLON: Heart. Heart.

MR. HALE: Sorry.

SPEAKER: And would you tell us who is your most loved child? And then in the priorities, what's first, second, and third? And then do you think Senator Hagel will share your love the same way and how do you convince him?

MR. HALE: Well, I know you all want me to say something about Senator Hagel and I'm not going to. As I told you, I may not have a heart, but I do have a head and I'm not going to scoop the President. So whatever is the case or whoever is the nominee and if they're confirmed, we will work with them. Obviously that nominee will have to get in place and be confirmed and that person, whoever it is, will have to tell us what their priorities are. But as of now, we've got one Secretary of Defense. I think his priorities are clear and I would hope that the broad ones would stay in place with regard to the strategy that I mentioned earlier. And I know that's kind of a non-answer, but that's the best I'm going to do.

MR. O'HANLON: I'm going to intercede with a question myself and try to be more specific on the question.

MR. HALE: You can't mention Hagel.

MR. O'HANLON: I will not. However, I will mention for the first time today, Robert Griffin III. You'll notice on the clock, it stopped at 4:42. I think that's an official Brookings decision. I think that's when his knee was injured yesterday and we will forever leave the clocks at that moment until he's back in action next year. But my question is to follow up to some extent on Tony's and the issue of the procurement budget and what will happen to it and my understanding is that of course, we all know there's some prior year defense

budgets that continue to fund industry and so that is sort of good news for industry. As previous year's budget authority, that's working off some of that so the uncertainty about this year's budget authority is mitigated.

On the other hand, it's very hard for industry and for you to enter into any contracts at all with the continuing resolution and the specter of sequestration. So to put it in a quantitative sense, how should we understand the hit that defense industry is taking right now in percentage terms? Is there a 5 percent, a 10 percent, a 20 percent cut in the kinds of spending and jobs that might otherwise be taking place right now?

MR. HALE: Well I mean, it's so hard to define what the baseline is right now. If you go against the '13 budget, the (inaudible) dollars in the thing are actually a little higher than the proposal in the '13 budget. We've been limited to the fiscal '12 spending level, so not much has happened yet. I will say this to try to be helpful. If sequestration occurs, the percentages have to be the same literally by lying on it. We won't have much ability to make changes. But if we simply get a target for a top line reduction, we will try to do it in a balanced manner, but I think there's a long history and good reason why early in a drawdown the cuts tend to be heavily on the investment portion of the budget because it takes us a while to make force level decisions and then to gradually draw down the size of our forces.

So if we are allowed the authority to make choices, they'll probably be investment heavy in the beginning with more reductions in the operating costs after a couple of years and then we can make force changes. And by allowed we have to not only have the authority to do it by law, that is not

be under sequestration, but we got to get the U.S. Congress to agree. And as some of you know if you followed it, they have some misgivings about our force level reductions that we've already proposed, let alone any that might have to come in the future. So we've got our work cut out for us.

MR. O'HANLON: Paul?

MR. PAOLOZZI: Hi, Paul Paolozzi. You mentioned that you had saved quite a bit of money by terminating the C-17 and F-22. But my sense is this was done at the same that we had a stimulus bill of $787 billion in order to create so called shovel ready jobs. And my guesstimate is that cancelling those two programs probably cost somewhere in the neighborhood of 50,000 shovel-ready jobs. And a two part question; one, do you have any idea what the exact number is? But more importantly, number two, am I correct in understanding that DOD got none of the stimulus money meaning that while you're expected to take the same kinds of cuts as domestic programs when it comes to cuts, when it came to increases four years ago, you got none of them or certainly nothing comparable.

MR. HALE: Well first off, I don't know the job impacts and I would argue strongly that I would prefer job effects not enter into decisions about what we do in defense. I think we ought to try to propose and implement a good strategy for the nation and the job issue should be -- they're very important, but should be handled separately. We did get some of the stimulus money. We've got if my memory serves me right, about $7 billion. Most of it was --

MR. PAOLOZZI: Seven?

MR. HALE: Seven, I believe.

MR. PAOLOZZI: (inaudible).

MR. HALE: No. Well, yes it was about one percent but it was seven billion and most of it in facilities, sustainment, restoration, and modernization of the bases, there was some military construction and those were the two major categories. A little bit of other personnel related money. So we got some, not huge amounts but seven billion is seven billion. And so we participated I'd guess in the job creation there. But as I said before, I understand how important jobs are in the economy we are experiencing today, but I still believe the department's main job is to propose a national security strategy at a reasonable funding level that defends a nation and the job issue should be handled by other means.

MR. O'HANLON: Let's work further back. Go here in the fourth row, please. Woman in the green sweater.

MS. SCULLY: Hi, Megan Scully with *CQ*. Just following up on the budget question for the FY14 request, when do you expect that to be done? Will it be delayed? And what are you doing right now to kind of game out the different scenarios?

MR. HALE: Well I think it's almost inevitable there will be some delay, I just don't know what. Normally, we would be transmitting data to OMB right now and we're not ready to do that. So I think some is inevitable, but it will be OMB's call as to what delay occurs. I mean, we will quickly start looking at alternatives as we do constantly in the programming process. I'm not going to go further than that because we don't have a lot of guidance yet and I don't know exactly what those alternatives will be. But we will look at a variety in attempts to

be as ready as we can when we get top line guidance.

MR. O'HANLON: Over here on the wall. I'll take both these questions, please. And then move back.

MS. DIMASCIO: Hi, I'm Jenn DiMascio with *Aviation Week.* I have a question; in August you and Secretary Carter testified to Congress about some of the sequestrations impacts, particularly I'm curious about the joint strike fighter that would involve cutting four of the platforms and I'm wondering if that is still the case under sequestration now with the two-month delay or whether that changes the calculus at all?

MR. HALE: Well we were giving illustrations in August and if sequestration goes into effect fully, which I hope it will not incidentally and I got my fingers crossed and I'm hopeful that it will not. But if it does, there would be a nine percent reduction in each line item, roughly nine percent of our budget and that would include joint strike fighter production and separately, it's already RT&E. The program managers then are going to have to look at it and figure out exactly how to accommodate it and I think there could be some reductions in unit buys but I'm not prepared to say until they had a chance to do that, what they would be for sure.

MR. O'HANLON: Sir?

MR. GALE: My name's Jason Gale. I'm probably the only person in the room who's not a journalist. I represent industry. Do you see besides low-cost technically acceptable a path that industry can help improving the efficiency and if so what is that path?

MR. HALE: Well I can only answer that generally. They say, we

need you to sharpen your pencil as much as we are trying to do with regard to your overhead and anything else that would help us hold down costs. I know that's quite general, but I think it's the best I can do. The whole better buying pair initiative or at least one part of it is certainly working more closely with the industry to see what you can do there. And in return, we owe you some stability and as you've heard from my talk, we're not there yet but I'm still hopeful that we will get there after the next set of negotiations and decisions.

MR. O'HANLON: Go here in the fourth row, please.

MR. GARD: Robert Gard, Center for Arms Control and nonproliferation. Would you clarify for me how much of the 487 defense said they could get from what they called efficiencies? I'd like your definition better. And secondly, how does the sequestration figure of 62 billion -- how do you arrive at that? I keep seeing 54.7 billion before the 2-month postponement. Could you clarify those issues?

MR. HALE: I can try. I'm trying to remember. I remember the 5-year number was 259 and then the 10-year number was 487. Of the 259, about 60 were through more disciplined use of resources. I'm trying to remember, but I don't for sure what portion -- so it was what? 20 percent? Probably roughly the same, but I don't frankly remember. I should, but I don't remember the number relative of the 487. So you know, you're starting to go from sequestration 101 to 201 now, but let me try to be helpful. Under the law before the New Year's Day legislation, there was a sequestration of about 54.7. It was in something called, the National Defense Function. We're about 95 percent of that.

Our share was about 52. There's also a cap in the Budget Control

Act and there was a sequestration associated with that that we -- into the prior law, we thought would be about 10 billion, so the total is 62. We now think the total will be more like 45. I hope you'll take those numbers as rough -- roughly nine percent. And it's smaller because they changed the law and they changed some of the caps and they reduced the size of the sequestration and the negotiations on the Taxpayer Relief Act. Is that clear? Sort of?

MR. GALE: It's better.

MR. HALE: Sorry.

MR. O'HANLON: I'm going to take one more prerogative of the chair and ask a question on efficiencies and then we'll go up here.

And we'll take two more after that. I'll be quick though. Base closures. You requested authorization for base closures, but I'm curious as to how much savings really are still there. We've seen that the fifth round of the base closure process which preceded your administration, President Obama's administration, was one where it was difficult to realize savings, even more so than in past rounds. That's perhaps not surprising. A lot of the low-hanging fruit had been harvested. Should we even think of the base closure process as a realistic way to get savings in the defense budget anymore?

MR. HALE: Oh, I think so. I think there's consolidations out there. I'm not going to give you examples because once again, that would end my tenure quickly. But we believe there are and I wouldn't use the 2005 round as a guide. It was more transferring units around and a fair amount of force protection efforts that were quite costly. Although we will get savings there. It'll take a while before we break even. The best I can do is some rough history.

If you look at the ’93 and ’95 was it, rounds, I believe those were the two, the average savings once we were fully in place was two to three billion a year and I think that’s probably realistic if we get base closure authority to see that again. And then we would have -- before we know for sure, we would have to go through the process of going to every base and installation and organization, asking for data, making specific decisions, and then letting the commission review them and make their choices. But I think some -- there are more savings to be had and I believe both in terms of dollars and in terms of civilian personnel, if the Congress wants us to hold down defense spending and they want -- as they’ve said by law, they want us to reduce the number of spending personnel, they need to give us authority to move ahead with infrastructure consolidation.

MR. O’HANLON: Two more questions. Here and then we’ll go to the back.

MR. NICHOLSON: Sir, George Nicholson from StratCorp. You talk about balance, one of the big issues in the last year was the blockage of all the initiatives that the Chief of Staff of the Air Force and the Air Force tried to accomplish, where Congress reversed all those decisions. There’s a push right now to say the Guard is far more cost effective than the active duty and to go ahead and reduce the active duty and increase the Guard. Also the push of saying the governors need to be actively involved in the decisions in the defense budget. Comments?

MR. HALE: Well the National Defense Authorization Act did allow us to move forward to some extent. We got part of what we were looking for and

so that's good. In terms of the governors, I mean we want to work with them but not to the point I think, of releasing predecisional information. That will be a problem. But we need to work with them and we will. But I am concerned generally that the Congress wants votes for lower defense budgets and then it says we can't do the things that are needed to achieve them. They prohibited for example, any retirement of Navy ships in fiscal '13 which we need to do eventually if we're going to hold down this budget.

They turned down many of the requests that we made to slow the growth in military compensation by changes in retiree healthcare. They approved some and I appreciate that, but I believe that we will need to continue to work with them to make changes of that sort and more especially if we're going to make further reductions in the defense top line. It is a challenge.

MR. O'HANLON: And we'll take one last one from the back. I think I saw a hand back there. Okay, here in about the eighth row. Yes, please.

SPEAKER: Hi, (inaudible) with *Inside the Pentagon.* I was wondering if you could provide some insight on guidance that duties releasing regarding sequestration especially now that things have been changed. Are you eyeing guidance, has it come out, and if so -- or if not, when might that guidance be released?

MR. HALE: Well we are looking at that and I'm not in a position to give you either timing or content at the moment. I mean, I think we recognize that we're further along in the process than we were a few months ago. The guidance that is out there remains in effect which is not to take any steps that anticipate sequestration. And I suspect we will want to continue not to take

specific steps in anticipation of sequestration because we still want the Congress to not let sequestration go into effect. I think it is very important that they avoid that. But we are looking again, at what guidance would be appropriate in the near-term and I'm not sure when that will be.

Listen guys, I want to thank you for the chance to be here today and for your thoughtful questions and I appreciate your time. Thanks.

MR. O'HANLON: Thanks, Bob. I'd like to start the panel in just a moment.

(Recess)

MR. SINGER: Fantastic, we're ready to start. I'm Peter Singer, director of the 21st Century Defense Initiative here at Brookings and delighted that all of you could join us.

With all the major, and I would add, exceptionally confusing things going on today in defense and defense budgeting, with various debt ceiling deals, averted sequestration or not averted sequestration, this is a very timely period to be having this conversation, and fortunately we're joined by a fantastic panel of experts to help us cut through some of this confusion, but even more importantly, pull back and look at some of the bigger strategic questions that are out there.

I'm joined by three folks here, Mike O'Hanlon, who you've already met. Mike is senior fellow and director of Research and Foreign Policy here at Brookings where he specializes in defense strategy. He's one of the most important and prolific voices in defense issues, written literally hundreds of op-eds, columns, and articles, including one to point you out to that's up on

ForeignPolicy.com's website right now looking at defense budget scenarios.

His most recent books include *The Opportunity: Why Nuclear Arms Control is Still Important*, and very appropriate to today's event, the book, *The Wounded Giant: America's Armed Forces in an Age of Austerity*.

Then we're joined by Richard Betts, who's one of the top thinkers and teachers in the field of security studies. He's a Saltzman Professor and director of War and Peace Studies at Columbia University. His numerous books have garnered critical success including the Wilson Award from the American Political Science Association for the best book in political science.

He's also a key facilitator of a summer security studies workshop that probably somewhere around 75 percent of all the security studies professors in the nation have attended.

He also has a great deal of experience in the policy field. He's a senior fellow at the Council on Foreign Relations where he previously served as director of National Security Studies. He's a former staff member of the Church Committee, and he worked on the National Security Council and served six years on the National Security Advisory Panel for the CIA director.

Most recently, he was part of a task force of experts behind a report entitled *A New U.S. Defense Strategy for a New Era*.

And finally, I'm joined by Paul Wolfowitz, who's a scholar at the American Enterprise Institute. Paul has more than three decades of experience in public service and higher education in an incredibly wide variety of roles -- as president of the World Bank, as dean of the Johns Hopkins School of Advanced International Studies, at the State Department as Director of Policy Planning and

Assistant Secretary of State for East Asia and Pacific Affairs, and long service at the Pentagon all the way up to Deputy Secretary of Defense. So, it's a great panel to be joined with.

And so what I'm going to do is pose a question to each one of them to kick off the conversation and then turn it over to all of you.

The first question I want to pose to Mike, and it's a basic, simple one. What the heck happened on New Year's Day and Eve, and what does it mean for defense? What do you see playing out in the next days, weeks moving forward? And what are some of the key strategic questions you see coming out from that?

MR. O'HANLON: Yeah, thanks, Peter, and again, thanks to all of you for being here. And we just heard Bob Hale wrestle with these unanswerable questions of exactly where we are in the process. We got a two-month reprieve, keeping this among, if not top of the list, for the most unstable budgetary decision-making periods ever, especially when there's no big surprise in terms of military operations, at least not at the moment. In other words, the Afghanistan conflict is ongoing, but it's in its eleventh year and the Pentagon has not met a lot of opposition over its request for funds there.

Now, we don't know exactly how many funds will really be needed because President Obama may soon decide on a faster downsizing of troops, but the $88 billion requested for overseas contingency operations in 2013 is a relatively noncontroversial part of this whole thing.

So, let me just talk about a couple of numbers, and I want to try to just get a couple of them on the table in answer to your question in framing the

broader strategic dialogue we're about to have.

That $88 billion, which is about half of where we were, needs to be added to about $550 billion in the base budget. The base budget for the Department of Defense, plus the nuclear weapons activities of the Department of Energy, is about $550 billion in 2013 according to the Defense Authorization Bill that was just passed by Congress. So, we do have a Defense Authorization Bill, it just has limited significance this year since the appropriations, which actually provide the money, are being done on this ongoing continuing resolution basis and since sequestration is still a possibility in two months.

But to give you a feel for that $550 -- $550 billion in the base budget, how does that compare to a couple of reference points? Let me just give a couple, and I'm sure they'll come up in discussion. You can look at that number as being really big or modest, depending on your vantage point.

Historically in the Cold War, we averaged about $475 billion a year, and I've adjusted for inflation. These are all in 2013 dollars. So, we're actually spending still substantially more in the base budget, not even counting the war costs, than we did for the Cold War average.

On the other hand, we're now down by $100 billion from where we had been just a couple years ago, largely because those war costs are coming down and because the base budget has essentially not been adjusted for inflation in about three years. It's essentially been flat, which means a real cut, and this gets to my other point -- I'm just going to make one other point in this vein and then pass the baton back to Peter, but people talk about how much have we already cut the defense budget and, frankly, the typical answer here

reflects the politics of the person making the argument more than it does budgetary common sense, so let me just explain what I mean.

If you want to say that the budget is still huge, you say, $550 billion plus $88 billion, that's $635 billion, you know, that's more than the next 15 countries combined, it's still well over three times China's budget, it's $150 billion more than the Cold War average, case closed.

If you want to say this is not a lot of money or that it's coming down, you point out that we've already had a freeze, essentially, on that base budget for three years and we've been bringing down the war costs substantially, so this year in 2013 it's about $100 billion less than it had been just a few years ago.

I guess the other point I would make is that Bob Hale mentioned $487 billion. That's the savings the Pentagon has been asked to take over a 10-year period. Now, that is relative to the Pentagon's previous plan, so that previous plan allowed for a little bit of growth above and beyond the inflation rate.

The Congressional Budget Office establishes a much more neutral baseline. It just says, let's consider the baseline for any discretionary program to be current law, current budgets, adjusted upward for inflation. Relative to that baseline, the Pentagon is absorbing $350 billion in 10-year cuts. So, and that does not account war costs. War costs are coming down even faster and even more additionally.

I don't know -- I've probably thrown too many numbers at you to be in any way clear, especially for the television viewer, but in summary, we are at a point where you can have a good spirited debate over whether today's

defense budget is big or small, too big or too small, and I know that's where we're headed, so I'll pass back to you.

MR. SINGER: Thanks. So, Richard, you've worked on issues of strategy for your entire career, most recently part of this major study on a new U.S. defense strategy. What do you see as some of the key priorities in strategy that we should be thinking about today? And then what are the implications of those for budgeting moving forward?

MR. BETTS: Well, I think the key priority is one that will be hard to meet, and that is to rethink some of the basic assumptions behind policy and strategy, which I think were really not rethought or reacted to as they should have been at the end of the Cold War.

In the Cold War we had high defense spending because it was both necessary and affordable, and I'd argue that today it's neither. Now, this may change soon if we get in new Cold War with China. I think we should try to prevent that if we still can, but if not, until then, the main threat to national security is terrorism, and while counter-terrorism is extremely difficult, it doesn't account for the expensive parts of the defense budget.

I'd also argue that the defense budget has been both too high and too small, depending on what you measure it against. And I think it's been too small for the missions that we've defined for ourselves since the end of the Cold War, which is a high degree of military activism and intervention, and I think what has been an attempt to do all this on the cheap. I think with the important exception of the first war against Iraq in 1991, we tend to underestimate significantly the costs of the wars we get into.

The Kosovo war, the second war against Iraq, the war in Afghanistan, and so on, have proven to be much more difficult and taxing and expensive in both blood and treasure than we thought, and if we're going to do this, if we're going to be global cop, I think we're kidding ourselves to think that even the high defense budgets we've had since the end of the Cold War are enough.

But I'd say they're too much in that the need for that degree of military activism really ended with the Cold War. This is a basic political ideological issue that settled at a much higher level than the budgetary problems we're dealing with, but I would argue that we should keep pushing in the direction that things have been moving in the last few years, and that's towards a more modest view of military missions and requirements.

It will be hard to make huge savings in the defense budget, although I think even the problem of sequestration could be a blessing in disguise if that's the only thing that can force the sorts of discipline and choices that the political system is unable to make.

Now, you can make the case that the degree of activism we've had is necessary, that American leadership requires doing what we've done. I think it's a mistake, though, to conflate leadership with the job of -- with the responsibility of doing the job ourselves. We have less than 5 percent of the world's population, less than a quarter of the world's economic product, but over 40 percent of the world's military expenditures and that's with most of the rich countries in the world as our allies, and with them spending roughly about half proportionally of their economic resources on military security that we do.

I think we're providing welfare for the rich in that sense, and leadership doesn't mean having to bear that burden, it means, to me, in part, forcing them to step up to the bar, which they won't do as long as we're making it easy for them to ride free.

So, it seems to me the basic problem is to push further in the policy and strategy direction towards more modest requirements than we've been used to for the last 20 years.

MR. SINGER: So, Paul, this timing of back and forth on budget uncertainty and what happens next with sequestration and the like, takes place at the same moment that we're just starting a big endeavor within the Pentagon of building the next Quadrennial Defense Review. And having gone through these processes both on the budget side but also with QDRs, what's your advice to the people in the building right now who are starting that QDR process? And do you see a way that we might be able to link the strategy side of the QDR to the budget questions? Is that, you know, to dream the impossible dream or can it be done?

MR. WOLFOWITZ: I've been through QDR. It was an awfully bureaucratic process, somewhat overtaken by September 11th, but the process that I remember quite vividly that I think really did produce some radical change in strategy and radical reduction in floor structure and budgets was the one that Secretary Cheney initiated right after the fall of the Berlin Wall when he called General Powell, who was then Chairman of the Joint Chiefs, of course, and myself, to his office and said, I'll go up to the Hill and defend one more Cold War defense budget and I'll get my hide handed to me, but that's okay, I'm going to

buy you guys some time to produce a new defense strategy and new force structure.

And we basically, with enormous staff help, but with -- sorry, virtually no press attention, were able over the course of the next six months to come up with something that was called the New Regional Defense Strategy and the Base Force, and as a matter of fact, President Bush had liked it, was going to announce it in a speech he was scheduled to give in Aspen on August 2nd. One of the radical things about the strategy was to say the Cold War is over, we don't have to plan for global conflict, that's where the big changes are going to come, but there are three regions of the world that are critical to the United States, one of which is the Persian Gulf, and, yes, there's no longer a Soviet threat to the Persian Gulf, but there is an Iraqi threat.

That was written in June of 1990. The President gave his speech the morning of the invasion of Kuwait and a whole lot of attention to the strategy was kind of forgotten by the time that war was over.

But I do think, in parallel with the QDR, I would encourage whoever is the next Secretary of Defense to have a group that works with some privacy, not -- ultimately, these things obviously need to be subjected to enormous public debate, but if that debate begins with the first draft of the first paper, it's guaranteed that the services will dig into positions.

And in that regard, I'd also like to agree with what Bob Hale said about process and stability. We went through an enormous battle when we decided to cancel the Crusader, probably the greatest artillery piece ever not built in history. It was magnificent, but it was definitely a Cold War system. But

when Rumsfeld decided to cancel it, we made a crucial decision, which is all of the money from Crusader would stay with the Army and stay with Army artillery.

Normally a cancellation means that money goes into the general pot and all the services then compete for it, which was one reason the Army was dug in on Crusader, and I will never forget, a few months later I met the former head of the Army Artillery School in Ft. Sill, who had now come to a Pentagon assignment. I expected him to chew me out for cancelling the Crusader. Instead he said, thank you for killing the Crusader. It was a vampire that was sucking the blood out of Army artillery.

Fast forward about 12 months or 24 months, the Army faced another expensive, beautiful, but overly costly system called the Comanche, a stealthy helicopter. It was the baby of the program director, who was, by this time, the Vice Chief of Staff of the Army, a general named Dick Cody. But the army needed helicopters, they didn't need stealthy helicopters.

Based on the experience with Crusader, General Schoomaker and General Cody came to us and said, if we kill the Comanche, can we keep that money for helicopter modernization? We said, yes, every dollar. And because of the experience with Crusader, I believe, they trusted that decision, and as a result, we got new helicopters, not the fanciest, most modern with all the bells and whistles, but new ones that worked at a time when we critically needed them.

So, I think stability in the budget process, predictability is rather important to getting people to say that their favorite toy, which they've maybe invested their careers in creating, really isn't the thing that's most needed, but

don't try to persuade an Army general to give money to the Navy or vice versa. It doesn't work.

MR. SINGER: Okay, I want to give each of you a chance if there are any things that you want to respond to what the other folks have said to those questions. So, I'll just cycle back through.

MR. O'HANLON: Please.

MR. BETTS: I'll pass for now.

MR. WOLFOWITZ: Likewise.

MR. SINGER: Okay, well, let's turn it over to the audience to hear from you. Any questions --

MR. WOLFOWITZ: I'll -- not that they said, but I think it's important to note two things that were -- I observed in Bob Hale's comments that are, I think, missing in most of the discussion of this subject in public. Point number one, and I don't -- he didn't give us the exact numbers, but I know they're huge -- if the defense budget were to just increase with the cost of inflation plus 1 percent, defense programs would be cut every year because the growth in healthcare costs, in particular, and other operational costs that he referred to, which he's trying to control and contain, but with difficulty, even with controlling and containing, those are going to grow.

So, in terms of, if you like, real military capability, our resources are being cut. And secondly, I kind of love it the way everyone says, yes, there's got to be cuts in government spending and defense has to take its share. Well, if we did it on proportional shares, I'm not sure it's the right proportion. Twenty percent, roughly, would be defense, 60 percent, roughly, would be entitlements.

I've never heard anyone say, well, if defense is going to take its share, entitlements have to take their share. And, in fact, as we just learned a few minutes ago when we had a $787 billion stimulus bill designed to create shovel-ready jobs, DoD got 1 percent, $7 billion out of that $787 billion. And as a result, roughly, I agree with Bob, ideally you don't make defense decisions based on jobs considerations, but to put 50,000 people out of work in the 2009 economy was not good economic policy and we could have had a few more C-17s, I don't think anyone would have minded, and a few more F-22s, I don't think anyone would have minded.

So, so far from being on an equal playing field, I would submit, defense is always the first one -- the first target. It's so much easier to say we're spending too much on defense than to say we're spending too much on Social Security.

MR. BETTS: I'd just pick up on that and say that I think Paul is right in many respects, but this also relates to the problem politically, I think, that as time goes on, implicitly what we'll see politically is a contest between general spending on healthcare and most other programs, especially discretionary spending, and although some people see the defense budget in terms of entitlements, it's part of the discretionary budget.

And politically I think it will be a miracle if defense manages to win that fight politically. The -- well, it seems to me this is just part of the overall political gridlock problem that has, you know, become so dispiriting in recent years.

I think there's a coherent argument for why recent levels of

defense spending or even higher ones are warranted, but if you make that argument, if you believe it's necessary, I'd like to hear people say exactly where the money is going to come from, whether it's going to come from healthcare, Social Security, farm subsidies, additional taxes, whatever. We can afford whatever defense we need, but it's a question of what else gets cut, and that's what the political system doesn't want to face along with all the other choices.

MR. O'HANLON: I'll add one comment too, which is sort of a neutral comment about whether we should cut more or not, but it's really a comment about the practicalities of doing so.

There's a lot of talk about how we can get more efficiencies out of the Defense Department. Bob Hale used his own definition of that, reminded us that usually, even though the Pentagon looks very bloated, and in some ways it is, when you wind up trying to reform or become more efficient, you wind up cutting away certain things that you would like to have. Now, some of that's okay. Some of the things that we like to have we don't really need, maybe the Crusader was an example just to give one case, but when you try to make efficiencies, when you try to carry these processes of reform out, it takes time, and that's one thing we have to bear in mind as we're focused on a five- or a ten-year savings horizon.

For example, base closures. I asked Bob Hale about base closures. The 2005 route is not going to save us any money in the first 10 years. It's going to cost money, and those of us who are residents of Bethesda or Alexandria or certain other parts of the area are painfully aware of the amount of money being put in to the base closure process first in the hope that someday it

might yield savings.

Now, Bob pointed out, that round is not the best surrogate or best example of future possible savings, but base closures always take five to seven years even to start to break even on an annual basis, so if you make those kind of reforms, it's going to take time.

One other example, and I'll just stop with this for now, is military compensation, and this is a very delicate subject in a democracy at war, a democracy that's been asking so much of its men and women in uniform, and I think 99.9 percent of the country would never want to touch veterans' benefits for those who have been wounded in war, and would not want to touch support for people in the field. But there's a whole separate category of issues having to do with compensation for people back home, how much military families pay into their healthcare plans, the nature of the military retirement system, the fact that now we're spending about $25,000 per person in uniform per year, more than we did a decade ago, $25,000 per person per year more in the defense budget, this is not the Veterans budget, this is the defense budget.

Now, I think most of that was probably the right thing to do for the demands we were placing on the all volunteer force and how much we were asking of them, but it still raises a fair question as we go to a period when hopefully we'll be asking a little bit less -- let's hope and pray -- can we rethink whether we needed all of that $25,000 per person per year increase in military compensation? It's a political hot potato, to put it mildly, and the Congress just rejected even the very modest changes the Administration had requested in the 2013 budget.

But I think we have to consider going back to that debate. However, even if you do, you're not going to get, nor should you try for, $25,000 a year in cuts in military pay per person per year. That would be excessive. It's going to be a process of ongoing reform; it's going to take time. The savings will typically start to kick in in five, seven, eight years, and we just need to bear that kind of reality in mind as we construct our goals for ten-year savings.

MR. WOLFOWITZ: I want to -- just -- I know you want to get to the audience, but just to provoke a little on the strategy issue. Dick used the term "military activism". I'm not sure exactly how he would define it, but when I hear it I think no more Afghanistans, no more Iraqs. Not that we necessarily get a choice in the matter. But I think about it in terms of American leadership, of which the military is just a part, but the most valuable contributions made by our Defense program are the things that don't happen.

We have had an extraordinary degree of stability in Northeast Asia now for 50 years since the end of the Korean War. Maybe we would have had it if we had left Japan on its own to increase its defense budget to 5 percent, maybe they would have bought a few nuclear weapons with some of that money, maybe they and the Koreans would have somehow managed to get along in spite of that. I prefer the bet that we did make.

I'm all in favor of getting the Japanese to pay more, by the way, I'm proud of the fact that when I was Undersecretary for Mr. Cheney we got our allies to pay the entire $55 billion cost of Desert Storm, we didn't pay a nickel of the added costs. We actually had a net positive balance of payments that year, as a matter of fact, and it took some rather heavy diplomacy with the Japanese.

But, by the way, one reason we were successful is because the Japanese needed us.

The people in the Persian Gulf are too weak to manage on their own. They need us. I think they're not quite sure whether we'll be there when they do need us, but the fact that we have been there ever since -- almost ever since, the British abandoned east of Aden, with, I think, what would have been terrible consequences, is the fact that there has been no serious effort to block energy flows from the Persian Gulf since that 1973 oil embargo is because we've been there and because we were there when Saddam invaded Kuwait.

I really worry that this rebalancing may not be a rebalancing and may really be a pivot, as it was originally described, and that we will move from the Middle East, and God knows, I can understand the desire to leave that terrible part of the world to the people who are always making problems there. I spent a good part of my career working in East Asia, and by the way, the one job you didn't mention, I think, was my favorite, which is Ambassador to Indonesia. I love the focus on Asia, I think it's important, but unfortunately, the Middle East isn't going to leave us alone.

I've thought about the fact that Americans are notoriously short memories, except when it comes to our own Civil War. It has its great advantages. One cannot imagine the French treating Germany, post-World War II, the way the U.S. treated Germany, and we're all -- not just the Germans, we're all better off for it.

But, you know, we don't like vacations as much as the French probably do, but we love vacations from history. We took one for 20 years after

World War I; that was probably the longest and most consequential. We took one right after the magnificent victory of World War II, and we almost lost the Korean peninsula as a result. Korea was a terrible war, what, 36,000 dead? It was very unpopular. Truman basically couldn't run for reelection because of it. So, we took a vacation. We had nuclear weapons to supposedly make up for it, but then we had Vietnam, which was a terrible experience, we took another vacation after that.

I actually think we more or less got it right after the Cold War but I think now we're into a different era, more than any of the ones that I remember previously, the economic impacts of spending are a national security problem. I would absolutely agree with that. And I would agree with people who say, we can't continue to lead unless we fix our economy.

What I think is wrong is to say, we'll fix our economy by reducing defense spending. We can't fix our economy unless we tackle the entitlements issue. We could eliminate the entire defense budget and before long the entitlements would eat up -- would put us in a terrible deficit problem.

So, if we have to lead, which I think we do, and if we have to be able to afford to lead, which I think we must, then I think we have to fix our economy, and it's a much bigger problem than just the defense budget.

MR. SINGER: Dick, Mike, do you want to weigh in on this?

MR. O'HANLON: No, I think I'm ready to hear from the crowd myself.

MR. SINGER: Okay, well, let's -- right there.

And please, wait for the mic and stand and introduce yourself.

SPEAKER: (Inaudible) for China Daily. Professor Betts just mentioned, you know, U.S. and China must go into a new Cold War. I don't know if the panelists agree with this. And you also said we should try to do everything to prevent that. Would you share some wisdom how to do that? And Undersecretary Hale also mentioned rebalancing to Asia, he said dealing with stress. He also said including stress from China.

Is that the right signal to send across the Pacific? Thank you.

MR. BETTS: Well, my view is an unpopular one and I don't think has much chance of being acted on, and that is that the United States ought to make a clearer choice between containment and accommodation of China. China's a rising power and unless it, for some reasons, chooses to act differently from almost all rising powers in history, it will expect to have more prerogatives and disproportionate influence in its region, and this is going to come up in ways that are problematic for the United States and its allies, as we've just had a wakeup call about in recent months in the disputes in the South China Sea and over the Senkaku Islands.

And what I worry about is an American drift into an unanticipated confrontation with China because of this ambivalence because we don't want a new Cold War, we don't want to get into a competition that might be avoided, but we don't want to make the choice of appearing to appease China. So, I think the natural political reaction in the United States will be to kick the can down the road and to wait until some catalyst brings out the problem, which I think is a dangerous way to approach it.

But that would be my recommendation and, in a way, cynically I'd

say, it's important to choose the tilt towards containment or accommodation, whichever it is, because I worry about the risks that could come from muddling the issue.

MR. O'HANLON: I'll add a word on this, and by the way, I think Dick Betts' book, *American Power*, is to me, the best critique of post-Cold War American security policy. I recommend it to everyone. Just out last year, right?

MR. BETTS: Yeah. *American Force.*

MR. O'HANLON: *American Force.* I remember the substance of the arguments even if I forgot the title.

But let me say on China, that -- and this may or may not be at some odds with what Dick just said, I actually think current policy is at -- current American policy has been good on balance, but it always risks deviating too far in one direction or another because it is trying to strike a perfect balance.

What I'd like to see us do is remain resolute and strong as China rises, but avoid unnecessary fights over, for example, the Senkakus. So, I'd like to see a strong posture. I think the Obama Administration has done a good job with the rebalancing on, you know, on most of the aspects to it. What do I mean by that? They've done a lot of little things and they've tied them together with some good rhetoric and diplomacy, but the individual military pieces of rebalancing are actually quite modest, and I'm glad for that because I don't want to see us go towards excessive confrontation.

But nor do I think that appeasement is necessary or accommodation is necessary in the sense that I think we have very strong allies in the region, we have a lot of economic and strategic strengths that China does

not have, for example, our population trajectory, for example, the openness of our political system and what that does to make the American economy still a haven for a lot of investment dollars even though China is obviously the world top manufacturer. There are a lot of ways you can go down the list and when you compare the two countries, you see a lot of American strengths that are enduring. And when you mention our allies on top of that, which Dick did earlier, you see that there's no particular reason for us to think that we need to shrink back.

But I would worry a lot about potential disputes that are unnecessary over issues like the Senkakus and let me just give you one very concrete example, which is -- which I couldn't say if I was in government, and it's not meant to be an invitation to Chinese aggression, but if the Chinese do something dumb in the Senkakus, if they seize one of them or if they, again, try to plant a flag there, I don't think the right reaction is for the Americans to help the Japanese retake the Senkakus with a new amphibious force, and actually there are some Defense Department discussions about how we should be helping the Japanese get ready to possibly do just that as a deterrent, admittedly, and I'm not radically disagreeing with some of the prudence behind this.

But if that were our default plan, I think it would be a mistake. If the Chinese are that dumb, let's let them, you know, hang by their own weight in the sense of mobilizing international pressure against them in the form of sanctions, in the form of other kinds of diplomatic response, maybe listen more to the Vietnamese or Filipinos if they're more interested in an American military cooperation relationship or even a base. Let's do a little bit more of an indirect

approach and not necessarily get drawn into a direct confrontation.

So, this is -- it's a hedging strategy. It's been essentially our strategy for 30 years. I would agree with Paul that I think it's been generally working. Now, it's getting harder, because China's rising and they're more powerful, but I'm not sure that requires us to pull back, it just requires us to be aware of unnecessary fights.

MR. SINGER: I want to take this question of strategy in China and link it back to budgets and research and development and investment. So, Paul mentioned that there was a change in the geopolitical environment and that forced a re-look at a number of systems that were seen as necessary, systems like Comanche, et cetera, and then we said, okay, hold it, but you know what, it's a great system, but we don't need, because of a change in the geopolitical environment, this kind of stealthy helicopter or we don't need this kind of high end artillery.

Based on what you're seeing in the geopolitical situation, what does that mean for our future investment and purchasing? That is, what are the kind of systems we should be investing in relative to, be it, China's rise or the continuing demands that you see in terms of American leadership -- what are the kind of things that we should be continuing to buy? What should we be doing more of? Less of? Are there vampire programs, using your phraseology, that are out there right now that should be cut? What does this geopolitical environment mean for defense investment?

MR. WOLFOWITZ: Well, I'm going to get my friends in the Army mad at me, but unfortunately I think there is, here, a shift -- what was the phrase

Bob Hale used about no longer large -- didn't use the word occupation forces, but basically large, prolonged, ground presences --

MR. O'HANLON: Stabilization.

MR. WOLFOWITZ: Yes. Certainly, that looks like a good prediction today, but who in August of 2001 predicted that we'd have one in Afghanistan? So, I think prediction is a very, very dangerous thing in this business.

But it does seem to me that we need to strengthen our maritime capability in the Western Pacific. And not to contain China, and not to fight a war with China, God forbid, but I think the goal has got to be to try to sustain this peaceful situation, which is only 30 years old; it's called the Pacific, but it hasn't been Pacific until rather recently. We have a huge interest, I think, in keeping it that way and I don't think we want to see a crisis start no matter how silly it might seem, that you end up with a choice between going to war and having Japan become another nuclear power -- both of those are bad choices.

So, I think that's where the strengthening probably has to come. But then I would raise a different question, which goes back to my comment about prediction. I believe it was the case that when Cheney went up for confirmation hearings, the word Iraq was not mentioned once. When Rumsfeld went up for confirmation hearings, I think Afghanistan may have been mentioned, but basically trivially. So, whoever is the new nominee for Secretary of Defense, and I'm not commenting either, check his hearings and see what country doesn't get mentioned and then look out.

Joking aside, if we think that the capability probably isn't needed

in the near term, don't base your whole posture on the idea that it's never going to be needed. And it's fine to talk about emphasizing readiness, but readiness, which is critically important, comes at the expense of modernization, and I think one of the things that is happening in this constrained environment is, we're focusing on the near term and what we can see in front of our eyes at the expense of what's out further that we have very little idea about, and I guess if I had my biases, I would lean more toward the longer-term.

MR. SINGER: Mike?

MR. O'HANLON: There are two areas that I would mention in terms of specific modernization of weaponry, and there are obviously a number of debates we need to have on this subject. Let me start with the category of nuclear weapons modernization. I think we do need a reliable nuclear force that is at parity with Russia, but I don't think we need to be thinking about modernizing all three legs of the strategic triad. In fact, I'm not sure we need to be thinking very hard about modernizing any of them. They need to be refurbished, they need to stay reliable and safe, but -- and we're not spending a whole lot of money right now on these programs.

But a replacement for the Trident submarine, for example, I would say, build more Trident submarines. To me they're totally fine, they're totally up to the requirements that we have for them. So, that's just one example of where I think we can save money is a more economical approach towards nuclear weapons, force modernization and maintenance.

Another example, which reveals my old-fashioned CBO sensibilities, when I worked for Bob Hale we had these coffee mugs that said, on

the one hand, on the other, and we had a thumb pointing up and a thumb pointing down, and that's the way I am and, you know, God bless my friends at Lockheed and elsewhere on the F-35 program. I think we need the F-35. I think it's a very good plane. Yes, it's having some problems because it's very innovative, but I don't think we need 2,500 of them, so I would buy something in the range of 1,200 to 1,500 for the three services combined and I would size the program largely to the plausible missions we could have in and around the Western Pacific vis-à-vis China, not that I ever want to use them that way, obviously, but there's no other argument I can see for a large F-35 program -- I'm not saying the F-35 would be the entirety of the required effort. We should have a debate about a long-range bomber for conventional missions, we should have other kinds of debates too, but I think the F-35 program right now is sized to replace for structure more than it is sized for contingencies that are plausible. So, I would scale that one back.

It doesn't mean I would necessarily slow it down, but I would scale it back.

MR. BETTS: I would agree with most of what Paul and Mike both said. I'd push a little bit further though in that insofar as it's possible, and in practical terms it would be difficult, we should push even further towards fortifying the mobilization base for rapid increases in capability at a later date, emphasizing research and development and production of smaller numbers of current models, to experiment with, to provide a minimal critical mass, but insofar as it's practical, trying to reserve large-scale production of state-of-the-art models until a later date when things really go bad.

MR. SINGER: Peter Schoettle back there.

MR. SCHOETTLE: Thank you. Peter Schoettle, retired State Department, retired Brookings. First, I want to compliment Mike and Dick for your opening lay of the land, but I want to build on that question about the size of the Pentagon budget.

Back during the Cold War, our mortal enemy had the second largest economy in the world, millions of men under arms, 30,000 plus nuclear weapons, et cetera. Now our enemy are groups of terrorists living in caves, small groups around, and I don't see how we could spend hundreds of millions -- billions more against that enemy than against the world's second largest economy back in the Cold War.

I think the Pentagon is riddled with fat. It's like Kobe beef, fat throughout all. Why does the Air Force need a full-fledged symphony? Why does every regional CINC need a Boeing 737? Why does the Pentagon spend $60,000 on an individual to send him to a civilian grad school? Why are there more generals now than there were when the Army and the Marines and everybody was much larger? Why do they keep having a larger staff?

Cutting all those won't save you hundreds of billions, but it just shows you the kind of fat spread throughout the Pentagon.

MR. O'HANLON: I'll say a couple of things. I probably agree with two-thirds of what you said, Peter, and I also salute your service in the Foreign Service and at Brookings. It's good to see you. A couple of things, though, just to -- in the interest of debate, because that's the fun we have together always, you mentioned a long list of potential areas of waste, but one of the most

expensive things you mentioned is something I would strongly support and say that the State Department should do more of if the Congress would fund it, which is this idea of a mid-career sabbatical. The idea of mid-career military education, not only do we benefit from it enormously here at Brookings because we have a half dozen or seven of these mid-career officers and intelligence community personnel and Coast Guard officers who teach us a lot, but they go back, we hope, with some different ideas, with some new ideas.

And if you look at the history of a lot of our leaders who have made a big difference in the last decade, they point to their mid-career education as important elements of the thinking, the ideas that they later implemented in command in one way or another. So, I would strongly support that, and that may have been the most expensive thing you mentioned.

Now, on some of the other stuff, like business jets -- actually, regional commanders probably do need their own transportation, but domestic commanders probably don't, and so that's an example. Military bands, I would probably agree with you on two-thirds of the savings there. So, there are a lot of ways to save, but the biggest question you asked, of course, was why do we have to spend so much at a time when our enemies are so much less impressive than the Soviet Union, and that's a big discussion, but I would simply point out, there are a lot of things that are still on our plate. There have probably never been more things on our plate simultaneously.

Now, I agree, individually, each one is substantially less in terms of its scale or its scope, but we still have 67,000 U.S. troops in Afghanistan. We still have -- we haven't talked yet about Iran today -- we could be at war with Iran

in the next one to two years. I'm not necessarily a supporter of a lot of the logic that might get us there. I'm actually glad that Chuck Hagel's confirmation hearings, if they happen, will actually air this issue, since he's been a critic of some of our thinking too, but I cannot dismiss the possibility of a U.S. conflict vis-à-vis Iran.

And then vis-à-vis China, I've already expressed my view that we need to essentially hold firm the foundations of Western Pacific stability similar to what I think Paul argued a minute ago. Even if you don't expect or want or think there will be a war, the idea of sort of pulling back as China rises, I think, is about the most destabilizing decision that I could imagine, and China has become the second largest economy, it has become, far and away, the second largest defense budget. And while I'm a general support of much of what China is doing, rising powers are inherently tumultuous and dynamic and dangerous in terms of what they can do for the international environment.

So, I would wind up wanting to stay roughly where we are in defense spending, but I think there are some specific reforms and savings that can probably save another $100 billion, $200 billion, in the 10-year defense projections.

MR. WOLFOWITZ: Two comments, one, it would take someone more powerful than the president of the United States, probably, to get this done, but I think it would be very sensible to take some of that money that you talked about -- not all of it, I'm with Michael on that point -- from the defense budget and move it to the State Department. If you talk about rebalancing, that's where we need to rebalance.

But the problem is on Capitol Hill. We, when I was in the Pentagon, tried, and eventually, after a lot of struggle, succeeded, but it was difficult to get peacekeeping money moved into the State Department out of the DoD budget. The problem is, one committee controls the DoD budget, the other committee controls the State Department budget, and guess which committee is more powerful.

But I think that is a place where we should try to rebalance resources.

On the question of threats, however, it's not -- just because the Soviet Union was bigger didn't mean it was more dangerous. During one of those not terribly enlightening presidential primary debates that we had earlier last year, I think it was Governor Perry of Texas was asked, what would you do if you got that 3:00 a.m. phone call and was told that terrorists in Pakistan had just gotten a hold of one of Pakistan's nuclear weapons? I'm not criticizing him for not knowing how to answer the question. The fact that the question was a plausible one, I think, says -- and I don't know how I would answer it. My first comment would be, well, I'd want to know an awful lot more about who has them and where they are and what we know.

But trying to prevent that scenario from happening or to be able to deal with it if it does happen, is enormously important, and the costs to this country are almost incalculable if somehow terrorists got a hold of nuclear weapons and were able to set them off. It's not -- it's a -- you know, we always said the possibility of a war with the Soviet Union was low probability but a very serious event to plan for. I would say there are things -- other things like that in

the world too.

So, I come back to my point. I think American leadership, which includes diplomacy, very definitely, is important for maintaining the relatively peaceful -- it's all relative -- but historically relatively peaceful situation that we have in critical parts of the world and we would be very sorry to lose it, and once you've lost it, then it takes huge costs in blood and treasure to get it back.

MR. BETTS: I'd say the problem of preventing terrorists from getting access to weapons of mass destruction would be the first priority of American national security policy, and it requires optimizing intelligence and special operations capabilities. But it's not going to be helped all that much by what are the really big ticket items in defense or the secular changes in personnel costs, healthcare costs and other things that are driving the magnitude of the problem.

MR. SINGER: Another question from the audience, way in the back there.

MR. SHELDON: John Sheldon. I'm a consultant. Recently, General Shelton, who's the commander of Air Force Space Command, was quoted as suggesting that in the current budget cuts, space and cyberspace funding should be ring fenced. Does the panel agree with that? And if so/if not, why?

MR. SINGER: Do you want to weigh in? I'll weigh in on the cyber side of it. Part of the big dynamic changes that are going on in warfare today is the emergence of new domains of conflict, you know, literally we're planning on conflicting on fighting in a place that didn't exist and hadn't even been named as

late as 1982, you know, the very concept of cyberspace. And yet one of the things we have to figure out as a nation is, is this a domain where scale of personnel and spending actually benefits? Is cyberspace a problem that throwing money and personnel will get you the same kind of payback? And I don't know if we've figured that out yet. That's been the approach so far, just keep adding people, adding money, creating new organizations, and you've certainly gained greater capability, but there may be a point where you don't see that kind of return.

And arguably, there may even be a point that you see a diminishing return, and I think that's one of the aspects we have to figure out, particularly -- it links very nicely to these other geostrategic discussions in that it's not a domain where you can say, okay, this is my one central threat. You've got 100 nations out there building cyber capacity, most of whom are probably far less in capability than any number of non-state actor groups.

So, I think that's part of the kind of strategic debate that we aren't yet having in the U.S., and yet when you see these various reports that are put out there, you know, the two things that they always say, spend more on special operations and cyber, but they never say on what, what does that mean, and sort of the same thing could happen on special operations. You have a discussion, at what point do you grow it to the point that it becomes not greater in capability, but less special, and that's part of an interesting debate that I think is, you know, it's easy to -- you see these and there's a report to say that, but no one gets to the next step of discussion.

Anyone else?

MR. WOLFOWITZ: I mostly agree with that. I would emphasize the thought that you said at the beginning rather too quickly, which is, it is potentially the most serious area of technological change and advance. We have become so dependent -- dependent isn't quite the right world -- but all of the agility and efficiency that we're able to brag about and use as a vehicle for getting more efficient and leaner and so forth depends on our invulnerability to cyber threats.

So, we are very dependent on having a secure cyber environment and there are a lot of other people who don't need it but who are trying to figure out, some of them just for fun, I imagine, how to make life more difficult for us. So, I think it's incredibly important.

I'm not sure we can successfully have a public debate, though, about the question you raise, which is a valid one, which is, do we need more quantity or do we need more quality. Of course, the American way always has been quantity. We won the Civil War that way and a few others, but so much of this stuff is so highly classified, I don't know how you can really have an intelligent discussion in public. It's hard enough, frankly, within the government, but it's a crucial -- it is a crucial -- absolutely crucial question.

MR. SINGER: But it's interesting, given this discussion group, that links to long-term questions in the defense industrial environment, the nature of our debate over cyber, so far, has been -- and mostly coming out of the Pentagon -- has been the so-called digital Pearl Harbor, when I would argue the greater national security threat is just the gradual but steady loss of intellectual property where, you know, it's not Pearl Harbor, it's death by a thousand cuts,

and where you're investing -- you know, part of the challenge, I would say, for F-35 is not just scaling costs, but the leakage through cyber theft, which doesn't mean someone else can build it, but they're gaining knowledge, they're gaining capacity in a way that they wouldn't have been able to before this, and so something that might have given you a 10, 20 year advantage, doesn't give you those kind of years advantage in technologic capacity.

Let's get a couple other questions in here. Right here in the front.

MS. NGUYEN: Thank you, I'm Jeanie Nguyen with Voice of Vietnamese Americans. I'd like to tie it back with our economy, our jobs, and I think President Obama said that his pivot/rebalancing to Asia; mainly the focus is to increase jobs and increase revenue for our current economy. So, I come back to Paul, and I agree with you. You said that the success of DoD mainly stays in that not happening and maintaining our market shares globally, and I would like to suggest, I agree with you to channel some of the budget from the DoD to the State Department --

MR. WOLFOWITZ: Just a small amount.

MS. NGUYEN: Okay, but I take this time to thank Secretary Clinton who is coming back to work today, and I wish her well. I hope this on the record and I wish her complete recovery, because she's done a great job.

Now, come back to the diplomacy. I'm asking if we have actually projected our intention to China and to the world, because looking at the way China has increasingly been aggressive, many ways, in the South China Sea and in the East China sea with the Senkaku and all the 80 percent of the South China Sea area, how do we look into that without freedom of navigations? And

how do we look into that with our market shares? Have we done adequately to project our intentions to China? And where is the limit before we call to the international sanction and global law? Thank you.

MR. BETTS: Well, I'd argue again, I think the problem is the U.S. government doesn't know what its intentions are in a hypothetical contingency that would be most worrisome. We haven't faced that question and decided. I think there's a lot of complacency that the status quo can last indefinitely. Things on the Taiwan issue have gotten better in recent years. But, for example, on the islands disputes, what disturbed me was the initial American reaction was a statement from the State Department, a policy statement saying, the United States does not take a position on the Senkaku or Diaoyu Islands, but we do say it's covered by the U.S.-Japan treaty.

Well, now maybe that's creative obfuscation, but it seems to me it's also an invitation to miscalculation, and that's why I worry.

I think if you asked most Americans, even in the foreign policy elite, let alone average voters, what should the United States do in the event of a genuine crisis over these islands or, more significantly, over Taiwan, they wouldn't really be sure, and what worries me is the repetition of situations we faced in 1950 and 1990, and that was contingencies that had not been on the radar screen.

I think Paul indicated a concern like this where before June 25, 1950, General MacArthur and Secretary of State Acheson had made public statements that indicated South Korea was not inside the U.S. defense perimeter, but then when the invasion took place and Truman focused on it, the

reaction was to fight.

The same thing happened more or less with the invasion of Kuwait. It was an unexpected contingency. If we had really made an effort to be clear about deterrents in advance, probably neither of those wars would ever have occurred, and so the reason I'm perhaps pessimistic or alarmist about the situation in Asia is it seems to me there are potential contingencies of that sort, which if they happened would not seem as crazy as they seem if you just ask the average person right now.

MR. WOLFOWITZ: You could add to that list the British ambiguity about whether they would oppose a German attack on France in 1914. It was only the -- I think the diplomatic history says it was only when Belgium neutrality was violated, as though that were the big issue that Britain decided to enter the war. If the Germans had known in advance that that was going to happen, maybe they would have behaved differently.

I recall in 1990 the U.S. position on Kuwait was we don't take a position on the territorial dispute between Iraq and Kuwait, and what was wrong in that position -- it happens to be true, we didn't take a position, and the border was ill defined, but we should have added to that unhelpful statement that we would oppose strongly any use of force by either party, Kuwait or Iraq. I think the message would have gotten across. Instead it was a very ambiguous almost invitational one.

MR. O'HANLON: I agree with these points, but I'm going to sound a little more dovish than these two gentlemen and, I think, sort of in spirit of your book, actually, although you can correct me if I'm wrong, I worry also about a

dynamic where over unimportant stakes, because the Senkakus don't count like Belgium or France or South Korea or Kuwait. They are unimportant. In fact, we can't even -- we're not even clear that the law of the sea treaty would give an importance for development of underwater resources to the owner of the Senkakus. There's ambiguity on that point since they're uninhabited.

And so I think were the Chinese to make a mistake -- and I'm using this as an example, but I think it's the kind of example that you mentioned also and that has been in the news and that Dick mentioned too. If there were a dispute over these, I do not believe that our greatest concern should be the perception of American irresoluteness. I think we also have to worry about action/reaction dynamics and security dilemmas and the kind of spirals that got us into World War I in a different way or at least got that conflict sort of accelerating once it began.

So, my view is we actually need to make it very clear to China there would be a strong response, but not necessarily pre-commit ourselves to a military response, and now if China attacked Japan, that would be different, but the Senkakus are not Japan, and neither are most of the islands in the South China Sea.

So, now I'm interested in looking at some ways to develop fairly resolute responses that are actually non-military, but at the same time that we keep our military posture robust to make sure that the worst case scenarios do not become tempting to the PRC.

MR. SINGER: I'm going to weigh in here as the moderator with an observation and then a question to you all. So, it's interesting that we have a

panel that followed a speech on sort of what the impact of sequestration and defense budgets and its link to strategy, and we'll have to go back to the transcript to see what percentage of it has referenced China. That's my observation, and maybe that's a telling point or not. We have sort of a limited study group here.

The question though is I want to take what she said and ping it to different direction because there was something that Bob Hale said, and she complimented you on Paul, for your comments, which was we shouldn't -- Bob said we shouldn't look at jobs. It shouldn't be a consideration in our decision-making when it comes to defense. And in a sense you kind of pushed back on that and noted the small percentage that had been spent on job stimulus relative to defense and the like. And this links to this broader discussion that's taken place around sequestration over the last year where essentially the strategy around the discussion was, don't let sequestration happen because of all the job impact that it will have in industry and the knock on effect on local communities and states. And that was the centerpiece of a massive lobbying effort, and we can argue whether it was successful or not.

But I want to go ask each of you as sort of three distinguished voices in this community, is that a valid argument? Do you agree or not with the proposition that jobs should not be part of the discussion, which was said in the speech beforehand? And if you don't, then what part of the discussion should they be?

MR. WOLFOWITZ: Look, you'd never cut any programs if you said we're not going to cut programs if they lose jobs. The point is, one should

be very careful about large cuts, sudden cuts. One should be careful about cuts in an economy that is already very, very severely -- where the employment situation is already very bad. It's one thing to cut into a more or less full employment economy and it's another to cut now.

My real point with Bob Hale was to say, look, if you're going to throw $787 billion at shovel-ready jobs, why do you discriminate against shovel-ready jobs in the defense industry? I'm not saying keep spending defense dollars on F-22s if you don't need them, but if you're going to spend money on things that you don't need simply in order to create jobs, I think those programs should have been candidates as well instead of putting 50,000 people out of work all of the sudden.

MR. SINGER: Mike, on the idea of jobs versus strategy and budgeting.

MR. O'HANLON: The main concern -- the way I'd answer your question, Peter, is the main concerns I have are those parts of the defense industrial base that as we go to smaller budgets and we're building weapons that tend to cost more, that we could lose because we curtail a certain kind of production and then there's a capability that is hard to recreate.

This concern does not apply to all kinds of technology equally, as you well know. For example, take ground combat vehicles. We make great ground combat vehicles, but a lot of the technology behind them is not so unique to the military that I'm -- or not so hard to recreate that I'm concerned about producing each and every kind of ground combat vehicle continuously just to keep the industrial base alive.

However, in some high tech areas of avionics, of stealth, of submarine production, certain kinds of optics, I think that once you lose the capability, you may have a very, very hard time recreating it, and so that's where my greatest concerns go on the intersection between strategy and economics.

MR. BETTS: I agree.

MR. SINGER: All right, right there in the middle. Paul?

MR. PELOSI: Paul Pelosi, federal executive fellow here at Brookings and currently United States Army.

I'm interested -- my question sort of dovetails into the jobs question. Every time we hear one of the discussions with regard to defense dollars, you'll always hear the conversations about compensation, whether it's through healthcare dollars or you'll also hear the conversation about maintenance and equipment.

But you never hear the conversation about our reliance on contractors now and how that has become commonplace, almost a part of the new normal for the defense establishment. I'd like to get your thoughts on that.

MR. BETTS: Well, I'm ignorant of the relevant issues, but I'd like to see what studies there are or promote studies that really get an answer to how much of the trend to contracting out has actually saved money and how much hasn't, because I'm sure it's a mix, and the answer to that is important because intuitively, or at least impressionistically, the trend has gone very far and it seems to me probably too far.

MR. WOLFOWITZ: Just an anecdote in support of that. A former colleague of mine who ended up in charge of the training command in

Afghanistan said, contractors were impossible. If it wasn't in the contract to train for such and such a capability, they wouldn't do it. If it wasn't in the contract to work past 3:00 o'clock in the afternoon, they wouldn't do it. It sounds extreme, but I guess that's what it was like, and in that respect, there's no substitute for a volunteer soldier or sailor or airman or marine who will do whatever the job takes, whatever hours are required, whatever danger and risk is involved.

So, it seems -- there are some perfectly routine, especially state-side civilian type functions that would be better performed by civilians and contractors, but the sense that we're trying to get contractors in combat zones to perform jobs like that would suggest to me we've gone too far.

MR. SINGER: I would say, Paul, to weigh in, one of the issues here is that while we typically talk about the Pentagon as -- in its relationship to private industry is going out and buying goods, and we've had this discussion here, you know, whether it should buy ground combat vehicles or keep that base inset or, you know, carrier submarines or whatever, the reality is that we're moving to a period where the Pentagon spends more on buying services rather than buying goods, and that goes to the relationship in terms of jobs. It's not paying people to go make things, it's paying them in terms of the hours that they're billing.

And the two -- and the answer to what Dick said is we haven't seen the kind of savings that have been continually promised in the studies beforehand that say we're going to save all this money, in execution we haven't seen that. The savings have been more political cost savings where you're able to keep your deployed numbers down, keep your floor size down even though

the overall number of people, both contractor and military, are roughly the same.

I think the two sort of strategic questions we really should be wrestling with is, first, what's appropriate for contractors or not. I think that's what Paul was hitting on. There may be some roles that are highly appropriate to turn over to contractors, and other ones that are not. We've been pretty willy-nilly about that.

And then the other aspect is, once you figure it out what's appropriate to contract out, then developing really good management structures so that you're getting the best price, so you're having good competition, and so we can point our fingers at the contractors and say, oh, they've done a terrible job, or what everyone must say, but it actually comes back to how they've been managed, how the contracts have been structured. That's the problem, we're sort of keeping our blinders from these fundamental changes in a defense economy.

Let's do two more questions. Right there behind you.

MR. ULLMAN: I'm Harlan Ullman. Thank you for a very thoughtful and intelligent discussion so far.

I find it telling, however, that one term that did not come up so far in terms of strategy and budget, is NATO. Is NATO relevant? Is it a relic? And how could we rejuvenate it?

MR. WOLFOWITZ: It's not an accident, comrade, as the old Soviets used to say. You know, the one region of the world where it does seem to me we can pivot from, for the most part, but with risk, there's certainly risk, is Europe, but maybe that's assuming way too much in terms of the extraordinary

stability that has been achieved.

It is extraordinary. We complain endlessly that our European allies aren't spending enough, which is, I guess, true. They're fighting with us, they're taking casualties with us, yes, we might prefer more aggressive posture, but who would have dreamed, back -- when was it? I think in the mid 1990s when Senator Luger was saying about NATO, either you're out of area or you're out of business. Who would have dreamed that they would be fighting in Afghanistan, of all places?

I think it's an incredibly valuable alliance. I think it is still the case with all of its troubles that Europe, as a collectivity, is one of the world's great economic powers. It's in our interest to keep it stable; it's in our interest to keep it friendly. How much effort it takes to do that, I don't know, but you could never create NATO if you had to start all over again. It has seen us through, I'd say, good times and bad. I think a modest effort to stay engaged and keep our allies engaged, and, God forbid, to have it there should there be some serious problems in, for example, Eastern Europe, is a good thing.

MR. O'HANLON: I'll just add one point, and this builds on something I learned from reading Dick Betts, and I think I am inclined to agree, although it's out of the mainstream of both political parties. NATO expansion makes me nervous. I think even the steps that have been taken so far, and certainly any next steps, would not be worth the consequences of a deteriorating relationship with Russia, the impact of which we continue to see to this day.

And Paul may not agree with me on this, but I want to actually commend the Bush Administration for how they handled the Russian invasion of

Georgia. Georgia, of course, not a NATO member, a prospective NATO member, but nonetheless, the Bush Administration was extremely clear and resolute that the U.S.-Russia relationship would not and could not be the same if Russia actually overthrew the government of Georgia, but the Bush Administration stopped short of threatening an American military response, and I think that was the right way to handle that sort of situation.

And so, for the range of countries that could conceivably be candidates for NATO expansion in the future, I would rather not just go slow, but probably not go at all. And I think, you know, again, the U.S.-Russia relationship is too important and we are still living with some of the consequences, I think, of expansion in the 1990s and earlier part of the last decade.

MR. SINGER: Let's do one last question.

MR. WOLFOWITZ: The Nobel Peace Prize committee didn't ask me, but I think they should -- NATO should have shared that prize along with the EU.

MR. SINGER: Okay. All the way in the back there.

MR. WEINTRAUB: Thank you. I'm Leon Weintraub. I'm retired from the Foreign Service now with University of Wisconsin. I'd like to ask members of the panel their thoughts on the idea if a little higher expenditure on the use of intelligence might be able to lower expenditures on operational capabilities for structures or equipment. For example, maybe the better use of intelligence would have showed how hollowed out was the Soviet economy, or also perhaps on weapons of mass destruction in Iraq.

So, is it possible that hiring a relatively small degree of higher

expenditures on intelligence would have a big effect on lower expenditures elsewhere?

MR. BETTS: I think we have to differentiate between the functions of intelligence in collecting basic information and reporting things that are simple facts that policy makers need to know, and intelligence in terms of interpreting what all of this means for policy. The latter is always going to be a matter of dispute, it's going to be the subject of charges of politicization, it's not going to resolve the important policy questions.

So, both things have to be done, but you're going to get more reliable payoff or more agreed payoff from the reporting function, I think, than from the analytical one that you brought up, although I'm a great fan of investing in intelligence analysis maybe just because I'm a professional analyst.

MR. O'HANLON: A derivative to that point, very briefly, is that I think the intelligence budget today is actually quite high. I'm not against it, but while I agree with the spirit of what you said, as an actual policy option, I'm not really sure that I would support spending more on intelligence and expecting somehow better results.

MR. SINGER: I would say it's parallel to the issue in cyber, which is, of course, crossing much into intelligence. Is it a field where throwing money -- more money at it actually gets you the kind of results you want? I would argue organizations, atmospherics, the priorities that are being set by the policy makers to the intelligence community probably have more impact than each -- you know, adding that one extra dollar or one million extra dollars or the like.

Well, we're getting close to the witching hour, so I want to turn to

each of you if you have any closing comments, but I want to pose a pointed question.

In the discourse over national security over the last couple decades, we've seen an evolution when we talk about the most important threat to America. You know, at one point in time it was very easy, the most important threat to America was these 30,000 Soviet nukes facing us. And then we get to the post-Cold War period and we say, okay, it's not the one central thing, it's all the small snakes that are out there in the grass the we don't know about. Then we get to 9/11 and it's clear the most important threat is terrorism, and now we've heard discourse, okay, it's the fear of, for example, a loose nuke.

But over the last couple years there's been a change where we started to say, no, the most important national security threat to us was our debt, and that was actually something the Chairman of the Joint Chiefs said. The last couple days, though, there's been a change in that discourse where some people are starting to put out the idea that, no, the most important national security threat to America is our dysfunctional political system.

What do you think is the most important national security threat? And we'll just go in order from Mike to Dick to Paul.

MR. O'HANLON: In the last 12 hours it's Mike Shanahan's decision making. But thank you, Peter, for that question, because it's a great way you framed it and a big question to debate. I will simply say that there are two categories. There is the broad, sort of holding the international system stable, where I'm a relative supporter of what we've been doing. I think it builds on some of what Paul said earlier, and then there's the managing the specific

crises. The crises are what tend to be things you talk about. In the short-term, if we go to war again, it's probably going to be with Iran, and I think that is my greatest concern in terms of where we could wind up in conflict in the next one or two years.

But I'm not going to go so far as to predict that that will be where we fight or that that should be seen as the top threat.

I think holding together our system of alliances and our presence in the Western Pacific has to rate just as high, even though my expectation is that will actually preclude combat. If we do that right that should actually reduce even further the odds of war. So, it's a little bit of an apples and orange comparison.

MR. BETTS: I think the tendency to define national security broadly is unhelpful and it's a better way to focus, to differentiate the security of our political autonomy and military security from other threats to our national welfare or wellbeing, and the debt and the dysfunctional political system I would put in the latter category. They may be more important problems, ultimately, because, at least since the end of the Cold War, I believe, we've been relatively blessed with a decline in the severity of external security threats, but I would distinguish them.

And we're not going to be able to deal, ultimately, with national security effectively if we don't solve the other problems. So, in that sense, they're linked. The short-term inability of American democracy to face the real choices is going to create longer-term bigger problems if it's not resolved.

MR. WOLFOWITZ: I think I'm in the same place. I think it -- and

of course, it depends on the timeframe -- if you're talking near-term, I guess we should -- and if it's in fact the case that whatever gets mentioned in a Secretary of Defense confirmation hearing is not the next immediate threat, then we can decide where you're wrong.

No, but if one looks over 10, 20, 30 years, which isn't that long when you think about defense cycles or historical cycles, I think absence of American leadership -- there is no one to step in behind us the way we stepped in behind the British, for example. And I think it would be a very dangerous world for everybody, including ourselves, but I also agree that we can't maintain that leadership if we don't get our economic house in order. So, they really are not one more important than the other, they're two sides of an inseparable coin

MR. SINGER: I want to thank our panelists and thank all of you for joining this. Please join me in a round of applause.

(Applause)

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