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**PARTICIPANTS:**

PANEL 1: THE CURRENT FISCAL CRISIS AND DEFENSE BUDGETS AND STRATEGY:

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## P R O C E E D I N G S

MR. O'HANLON: Good morning, everyone. Thanks for being here. I'm Mike O'Hanlon at Brookings along with Peter Singer and we'd like to introduce essentially the Task Force on Defense Strategy Budgets and the Industrial Base, part of a working group effort that we're carrying out here at Brookings through the year under the auspices of our 21st Century Defense Initiative. If you would allow me a brief moment to thank some of your colleagues also who have been working here with on this starting with Heather Mesara, Ian Livingston, Jordan Schneider, and our colleagues like Gail Challup and Robin Johnson who have done so much. But of all our other members of the Task Force and all of you for being here today, and my fellow panelists Mackenzie Eaglin and Maya MacGuineas.

This is the first panel or three separate parts of the morning and we are going to move right along because as you know we have a bit of a diversity of format. We have this opening panel which will be on the broad issues of defense spending, the defense budget and the deficit, and of course in the context in all the drama that's playing out across Washington these days as well as the broader fiscal challenges facing the country down the road. But we'll talk specifically about not only that broad question, but defense spending within that context. Then Under Secretary of Defense Ash Carter will be here at 10 o'clock to give the keynote address and obviously Ash is always interesting, but on top of that of course at the moment he is sort of the continuity in the Defense Department in many ways and one of the chief personifications of that, one of the smartest people thinking through issues of how you do downsizing in a period of significant potential defense cuts and just a great friend of Brookings, but also I think of all of us, and I know we're all looking forward to hearing what he has to say.

Then the third panel will be led by Peter Singer, my colleague here who runs the 21st Century Defense Initiative. And David Berteau and Tom Davis will be

joining him from CSIS and General Dynamics, respectively, to talk about some of the more specific implications of possible defense budget cuts for the defense industrial base, but also of course considerations about how do you protect key assets and niches and capabilities within that base. How do you avoid excessive cuts? What kinds of cuts would excessive? All those issues as well as perhaps responding to Dr. Carter.

Without further ado, let me just say an additional word of welcome and thanks and admiration for both Mackenzie and Maya and then they will open with some comments, I'll say a couple of words and we'll go to you. We'll begin with Maya MacGuineas who runs the Committee for a Responsible Federal Budget. I think most of you who have been following this issue have read Maya, have seen her in action and have learned a great deal from her. She's been called an anti-deficit warrior by *The Wall Street Journal*, which is a great line. She's also just been a voice of clarity in understanding the kinds of choices I think we're all going to have to grapple with as a nation as we think about how to deal with these trillion-dollar-plus federal deficit issues which have to be seen as not only threats to our economy but potentially to our national security as well. So it makes good sense to begin with her and we will do so in just a second.

Another distinguished panelist and another very good friend of mine on the panel, Mackenzie Eaglin, is a research fellow at the Heritage Foundation. And despite the youth of these two panelists, they've both already done a great deal in their careers. And in the case of Mackenzie, she worked for Senator Collins as her principal defense advisor on Capitol Hill and also spent two years at the Pentagon and now, as I said, has been at Heritage working on a wide array of issues in defense policy for the last several years.

So thank you very much both for being here. We'll launch right into it. Maya, please open up. We'll look forward to hearing your thoughts. Then Mackenzie and then again onward from there.

MS. MacGUINEAS: Thank you. Thank you very much, Mike, for having me on the panel. It's a pleasure to be on it with you, Mackenzie, and thanks to everybody this morning.

I'm going to talk from the thousand-foot level on fiscal policy which obviously is kind of the umbrella of everything that we're thinking about these days, and then we can drill down with the experts more into the actual security and defense policy as well. But obviously the budget and fiscal policy is the topic de jure and it's probably going to last quite some time. I actually was just dropping my seven-year-old off at camp and I said I'll have to run him a little bit late. And he said, let me just tell you what you're going to say, Mom. Stock market not responding well to debt ceiling problems, and this is not what my seven-year-old to be -- then he just said, boring, which is usually how he ends his imitations of me. But I think I've become kind of Johnny One Note in my life, but also in my family apparently.

The point is obviously, though, that this is sucking up all the oxygen of the other discussions. One thing that's really interesting is I got involved in fiscal policy because I enjoyed the fact that it was the umbrella for so many policy issues and it was a great lens to think about education policy or tax policy or energy policy or whatever you are interested in, but also in terms of the budget.

Now, however, it's almost as if we've delayed so long to address the fiscal challenges we have in this country that it's taking out the ability on how to do this policies well and we're going to end up struggling and doing last-minute fixes to our budget which is just going to be about getting the numbers to add up, not how to think thoroughly and deeply about all the policies that make up the budget. So one of my

pleas to start and end this will be that all the policy experts in all the different communities need to be focusing their energy on the big question of how this country is going to do more and do better with fewer resources because I really believe that's going to be the trend of the decade going forward.

Right now where we are, we've got I guess major challenges. One, we've got the debt ceiling which is a self-imposed almost crisis which I actually look at as an opportunity. I do think that the debt ceiling if handled responsibly can be what forces us to put in place some necessary budget fixes, but do I wish we didn't have to go down to the wire to make that happen. It sort of feels like you've put a noose around your own neck, you're pulling it and you're just kind of curious to see how tight you can go and hope that you don't pull it too far. It's not a game that you should play. So it's a little nerve-racking to watch that. But then of course beyond that there's the question of whether we'll fix our fiscal policies and on that I think the question of whether we'll get our debt under control, stabilizing our debt so that it's not growing faster than the rest of the economy in the next couple years and putting it gradually on a downward trajectory.

We're not going to balance the budget anytime soon, unfortunately. It's way too out of kilter for that to even be our objective right now. But we need to put it on a reassuring path both for credit markets and to start freeing up some of the fiscal space and economic needs to help the economy move in a sustainable way going forward.

But in the short-term, as much as a deficit warrior as I am, the economic recovery has some real challenges ahead. And so not only do we need to put in place a debt deal, we need to put in place a debt deal that's consistent with letting economic recovery work which means not frontloading it too much so that you take all the demand out of the economy when we're just starting to get started on the recovery, but also not back-loading is to much so that it's not credible at all. I think we all know that politicians say here is our 10-year budget. We're going to just borrow a lot for nine years, but in that

tenth year we are going to get tough. That's not a very credible plan either. So you need kind of a balanced glide path over a decade to bring this debt under control.

And I also bring up the economic piece because our defense policies do have a whole of effect on that. Another argument I would make is that we need to think about security policy in terms of security objectives, but you can't help avoid that it has profound effects on the economy in terms of jobs, in terms of different regions and in terms of how it plays out politically because our different entrenched interests depending on what kind of defense changes are put in place. One of the questions will be how we break out of the thinking of our security policy as just being a regional jobs issue into a broader what should we be doing for the top-level principals and let the economic conditions compensate as changes are made.

I think what we will certainly see in the budget changes going forward on defense is statutory caps. That's what we've had in the past. There are a couple of questions I would say. Obviously the first one is at what levels. I think we'll be going back. And there are two issues. There's what's going on overseas in wars and what's going on outside of that. I think we'll be going back pretty quickly to the levels of 2008 for both sides of the budget, domestic discretionary and defense, and I think there will be a firewall between them. I think the first round of caps will probably be for five years or so. I'm not sure, but my guess is they'll be five years and they'll have higher thresholds for change in them than we've seen in the past so that once you put these caps in place they are likely to stay. Then the policies filling those in will be done in the coming years and then you'll have to decide what kind of growth there is in the budget that should be based on policy and not just budget needs. I think this area more than any other of the budget really needs to be driven by policy. One thing in health care is I think we need to put a focus on putting a budget in place for health care and keeping it there. That doesn't for

security. Security needs to be a lot more nimble and responsive, but you do have to figure out better ways to budget for that flexibility.

When I think about where the changes will come from I think we'll have to think about how the whole defense budget is structured and that has to do with things like weapons systems and troops, but this big piece that almost should be pulled out is the entitlement component of the defense budget, so compensation. And in many ways as we're looking at Social Security and Medicare and our health and retirement benefits for the rest of the public sector and country, we should be looking at TRICARE as part of those policies as much as we are looking at it in part of the defense budget and I think actually pulling those things out and thinking about health and retirement separately will probably be useful and may lead some of the reforms. There's a lot of momentum in that area.

So I think I'll just end with a couple principles and they're really the ones that I started with. But once there are budgetary caps, when we fix Social Security, we're going to say this is how we're going to do it. We're going to raise the retirement age, we're going to do a small means test, we'll look at the payroll tax cap. The policies are all there. But when we fix the discretionary pieces of the budget, domestic discretionary and defense, those caps will be put in place and it will then be a question of whether we meet those caps thoughtfully arbitrarily, and there is so much rich opportunity right now for there to be all sorts of efforts and task forces and grand rethinking of how we get our security needs met and how we think about the role of the U.S. in the world, how we do our business. It is sort of an intellectually rich moment if not a fiscally frightening one. It's still an opportunity to rethinking in kind of big, bold ways which is though thing to do in this area of the budget, but there is a tremendous opportunity to rethink these areas and start having these fights because there will be fights, but also discussions and tradeoffs in advance of the next couple years when we have to start meeting those spending caps

which I'm pretty certain will be parts of the budget deal in the next couple months. So I'll leave it there and look forward to our questions. Thanks.

MR. O'HANLON: Maya, just one quick question now before we go to Mackenzie, just to clarify my understanding of one of the points you made. You talked about the likelihood of 2008 levels prevailing with a firewall between domestic discretionary and defense. Is that your best guess of where you think the political middle ground will ultimately be found, or do you see even greater movement toward -- in other words, is that sort of a soft prediction or a hard prediction? Do you have a general sense that's the most likely outcome or do you already see it beginning to materialize?

MS. MacGUINEAS: That's a good question and that's so interesting with caps because it really isn't driven up from the policy. What you should be doing is saying we need to spend this, this, this, this and this and this is a maybe and this is a wish list and this is what the budget is. That's not how it's happening at least in my world. Hopefully in your worlds it's happening a lot more thoughtfully. But we're just looking at the numbers and where the compromise is between people who wanted to go back to levels of 1901 and other people who wanted to quadruple and try to split the difference. So somebody should think of a better way to do those numbers. But I do see that there is a lot of focus on that. There is also a lot of focus on what is parity between domestic discretionary and defense. Again it's not a question of what do we need to be spending money on in this country, what are our priorities. It's not done that way in my budget world. It's done in a way that might be kind of frightening to people who saw just how arbitrary it is. But I think that there's a sense that people want to see the growth between those two sides of the budget pretty much equal. Then I say people I mean the average between the different groups that are looking at this. And so I just think it will be fascinating for people to start building up from zero, kind of zero-based budgeting in this area and show what's realistic and you've done a lot of this work, but what kind of



scenarios do you have for different levels of budgeting and I think that will help those of us who aren't experts in it to think about it in more thoughtful ways.

MR. O'HANLON: Thank you. Mackenzie, that's a great lead-in because as you know with our Task Force and your participation here today, we're trying to illuminate the choices and think through the question of what's a policy-based decision about where the defense budget should go. So over to you for one perspective on that.

MS. EAGLIN: I really enjoyed Maya's framing of this discussion. It's just an excellent overview and there is no doubt that we are in a period of a defense builddown and trying to manage that properly without just picking a number, a thumb in the air and then jamming some strategy behind it. I know a lot of people in the Pentagon are earnestly working on the roles and mission review but it's pretty useless at this point because only the President can change foreign policy. We often forget that the military is a tool of foreign policy. It's derivative. Defense policy and strategy is derivative of foreign policy which pretty much rests in the White House. And so for the President to ask the DOD establishment to give him all the answers really just isn't going to work out very well so I fear we're doing this process in reverse much like the QDR which was ineffective for the same reason since there was no national security strategy. So unfortunately I see these things replaying themselves over time and so the department, let's look at the last three years when defense budgets have been already -- they've been cut in multiple ways and now we're coming down in real terms and we'll see that go more dramatically, real negative growth over the next 5 years of course on an accelerated level.

But if we look at the way that defense budgets have been cut in the last three years, if that's any guide for the future, we're in big trouble. So the 2010 budget we know the secretary eliminated 20 to 40, who knows, I haven't counted them all, but basically over 2 years, 50 modernization programs. So we've basically said we need to mortgage the future because today is so expensive, Iraq and Afghanistan and budgets

aren't going up enough as strange as that might sound to some people to pay for all of these bills. So he started those kinds of cuts and then he started efficiency reforms to free up money for modernization, ironically the things he was cutting out the 2010 budget he tried to salvage in 2011. Obviously those are efforts. That's not hard dollars. It's a lot of Monopoly money, but actually it's really outstanding work on his part.

The White House said that's great. We love that 101 billion. We'll take 78 more as part of your 2011 budget over 5 years, 78 billion instituting now the real dollar cuts. Then of course Congress said as part of the near government shutdown, wildly inefficient funding for all federal agencies but particularly DOD's, there were a series of continuing resolutions and six months into the fiscal year the one we're in now. Said basically we can't meet the President's request so we'll take 20 billion off that. So DOD is roughly operating at 2010 levels right now for spending and of course that offered a lower baseline of 2012, about 15 billion from what the President had said he would ask for, and here you go.

Now we've instituted -- we've already begun these cuts and more are certainly coming. The President then renounced his own budget for 2012 in April of course saying we need 400 billion in defense cuts over the next decade, largely defense cuts, just assume it's defense. And the guidance inside the building right now is 430 to 460 is what the services are running their models basically saying and that's the assumption, the ceiling right now for scenarios internally at the Department of Defense are up to 500 billion. Basically that trickles down to each service loses this much and then what are you going to give up? And of course everybody is going to go to the modernization accounts, primarily first procurement. We already know this. We've seen it a million times particularly in the '90s. And as Maya eloquently outlined, we're not going to -- there's conversation about touching that entitlement side but I'm not seeing nearly enough political appetite to do this.

So what I instead here are -- if you look at the four major accounts in the defense budget, operations and support are 65 percent roughly of the total budget, so people and operations, maintenance, readiness training basically is what that means. And then 30 percent is weapons and R&D equipment. On that 65 percent that's set to grow to 70 percent of the defense budget at the end of this 5-year budget outlook.

What we're hearing as a solution to tackle entitlements on that side or compensation or infrastructure or overhead or however you want to say that, I think it's kind of a big larger piece, is we'll just cut end strengthen for the ground forces and that's going to save is. So that's a big, big problem because that's not even going to free up one dollar. In fact, we've seen this -- we have case studies. We have the Navy and the Air Force, 2005 through 2008 started slashing the number of people in uniform in the Air Force's case because they needed to buy more equipment for the people who were in uniform. And what they found was this. Over the last 7 years for the Air Force for example, the force has come down by 7 percent, so several tens of thousands. I don't have the number right now. The cost of that same smaller force grew 16 percent. There is no dollar savings by reducing end strength because the trajectory, the compensation costs are on an exponential path. It's just like the big three entitlements. So you can cut them and your smaller force, the cost is still growing and we underbudget for that every single year as we just saw with the reprogramming request that's on the Hill. So cutting end strength is not reform and it's not dealing with the structural problems internal to the defense budget.

So what I'm seeing are no priorities, no hard choices being made. We're just going to continue to raid modernization and that's a problem because we took the procurement holiday in the '90s, we've been still living off much of the Reagan buildup even in this decade. A lot of the new things that we have built are related to unmanned systems for example. Peter would know a lot about this than me. But a lot of the

procurement is devoted now to helicopters, drones, vehicles and not new ones of course. Legacy. Ships. So we're not really -- this is not an innovative side of this ledger. And so now we're cutting into the muscle when you have to start taking legacy programs off the table.

Then you get inefficient. So let's say we finally after so many years got the Virginia Class submarine to two per year this year and now what probably is going to happen when we take a carrier strike group out of the budget and you bring your Virginia Class procurement down to one a year, then the cost is going to go back up. And so then we're going to say we can't afford that and then you see the death spiral on procurement that everyone in defense knows all too well.

But the other challenge here is that we've continued to defer those bills so they just grow the longer you defer them and we actually have I would, Mackenzie would say, a readiness crisis in the military today. We have F-18s catching fire abroad ships, one in March, one in April. We have F-15s literally breaking in half in the skies in the Missouri National Guard four years ago. We have fuselage cracks in A-10s. We have whole cracks in every single Ticonderoga Class cruiser. We have the entire Navy surface fleet that's been taking out of commission and was frozen in place basically back in 2008 and now we're seeing these numbers pop back up again. Basically a third of the surface fleet is not combat ready. I have a long list. I could keep going. But you see the challenge here. We're raiding the account that needs to buy the new stuff. And we have the equipment that's so old that we continue to extend and use longer than we had planned for. That makes your O&S, that other side of the budget, the 65 percent, those costs only grow because when things are old they have to go into depot and maintenance much, much longer.

So the solutions are a lot -- with this. The solutions which I agree should be based on something much more strategic although we don't tend to do that very well.

We tend to back in to our defense planning. But the solutions -- there are -- there's a lot of money in the defense budget where you can save and make these choices, but they're structural. They're not quick fixes. It's not just kill this program and you're going to free up money. As Michael's Defense Industrial Base Report very appropriately stated, you don't eliminate the need for that system. You just defer it. So you say I'm not going to buy it this year but I'm going to buy something in the next five years because I've got this person in uniform who needs this vehicle. It's just pretty much that simple. So you're not really saving any money. You're simply deferring.

But the real challenge is how to get at 100 billion in the defense budget at least according to my research. Lots of ways to do this through performance-based logistics for example. The way we buy things. I don't mean acquisition reform the way a lot of other people mean it. But the things like multiyear contracts. Thankfully Dr. Carter will speak to some of this. Reducing wear and tear on hardware. Modernizing base operations and supply systems. These aren't easy. They're multiyear processes. Some of these came from the Debt Commission and some came from Gates' initiative. Some just came from my own idea factory. But they're there and you can find this money and then you can allocate it. You can either put it for debt reduction; you can reprioritize and buy new things. Feed it into the growing cost of people, whatever you want. But that means Congress can't fund the government inefficiently. They actually have to pass policy and spending bills for defense. If you fund defense through continuing resolutions, you're never going to get at these kinds of structural because it has to come from the department and from Congress and everybody has to do it thoughtfully and I'm just not seeing that. So I'm not pessimistic.

MR. O'HANLON: Thank you. I just want to make a couple of broad comments before we go to you for your thoughts and questions. I would lay out a couple of my thoughts this way to begin with. I believe we can consider fairly significant defense

budget reductions roughly of the magnitude that are now being proposed by the White House and the Pentagon provided that we think of this in the following terms, as a way to minimize our long-term risk to our national security because the deficit itself as Admiral Mullen has said is a major threat to our security and we're not going to have the economic foundations, the industrial base foundations, to continue with a strong global role if we don't do something about this.

However, the corollary to that is it doesn't make any sense to do this effort on the backs of the discretionary budgets alone, and if you try to which is sort of half of what I hear coming out of Washington these days, that we're going to maybe pocket savings primarily in the discretionary accounts for now, Republicans don't want to talk reform or tax increases, Democrats don't want to talk entitlement reform in many cases and of course there are plenty of people from both parties who are crossing over not so much to offer to sacrifice but to also defend the kinds of things they don't want to see cut. If you take that attitude and you just try to do this on the backs of discretionary, it does not accomplish the national-security objective of strengthening the long-term foundations of our economy and, therefore, it doesn't make sense. Because 5 to 10 percent real reductions in the defense budget do carry risk and here you have the hawk from Heritage kindly pointing out that we have a lot of efficiencies that we can find, but here you have the progressive from Brookings acknowledging that if you try to do cuts of this magnitude you're going to lose real capability and don't pretend otherwise for a second. Four hundred to 500 billion over 12 years is too much to do through efficiency. It's too much even to do through compensation and entitlement reform within the defense budget. You're going to lose military capability.

I think having done some first-blush assessments of this problem it's a magnitude of savings one can consider because I think the risk of doing this as part of broader national fiscal reform and deficit reduction is probably less than the risk of trillion-

dollar deficits as far out as the eye can see. And as one I think interesting manifestation of those trillion-dollar deficits can affect our national security policy, look at President Obama's June speech this past year on accelerating our drawdown in Afghanistan. I admire the President's overall Afghanistan policy, but I'm not very happy about the June speech and I actually think there's a logical inconsistency in the pace at which he's reducing. He is in a way feeling pressure to cut around some of the corners on his own Afghanistan plan because of the national climate on the deficit and the economy and to me that's the simplest interpretation of what's going on.

We still have a decent chance of the military plan working pretty well. He's still done a lot of good things. He's still tripled the forces. We still have great commanders in the field even on Monday when we lose General Petraeus and have General Allen take over, but the bottom line is this President who has been generally hawkish on Afghanistan felt a need to show the country that he was thinking enough about the economy and the budget that he was going to accelerate the drawdown in Afghanistan probably six months faster than his commanders would have wanted. And guess what? With the exception of a couple of my GOP friends, most of them aren't even complaining that much because the nation's political center of gravity has so shifted on how we think about national security given the economic and budgetary risks.

So the deficit itself, the debt itself, are not national security threats and that's why we should be prepared to consider accepting some additional risk in our short-to medium-term national security policy if we get enough deficit reduction in the effort to make it worth the while. But it won't be worth the while if we don't touch tax policy and we don't touch entitlements because the domestic and defense discretionary accounts only represent in the vicinity of a third to 40 percent of the total budget. It's just not going to be enough to make a big difference in a trillion-dollar deficit problem.

That is a point that I think is worth emphasizing and really is the centerpiece of how I wanted to open today with my own presentation because I think it's sometimes forgotten and we hear people say let's just agree on where we can achieve some initial consensus because no one really knows what's inside that domestic discretionary budget anyway and it's easy to pillory and caricature it as bridges to nowhere, but actually it's mostly science, R&D, education, infrastructure, food safety, things people really want or that our long-term economy mostly needs even if we can find efficiencies there, too. And then we say we've got a big defense budget. It's almost half the world's total. We're all sick of these wars in Afghanistan and Iraq anyway. So don't we just agree to cut there as well? But it's sort of done in a reflexive almost unthinking way.

And we've heard terms like "Monopoly money" and "arithmetic exercise" from my co-panelists to describe the way in which these numbers are just tossed around haphazardly. That won't do. The risks here of these kinds of defense budget reductions are significant enough that while I think they are manageable if done carefully and done well, they should not be viewed just as efficiencies or just as overdue belt-tightening within a bloated defense budget. Yes, there's a lot of waste, but you are not going to find 40 or 50 billion a year in annual savings from waste in the DOD budget. You just aren't.

A couple of quick points and I'll then turn to you. One is that in addition to the discussion of military compensation and DOD entitlement reform that we've already heard today, I would agree with my panelists, with much of what Gordon England wrote today in *The New York Times* and other people who point out that we cannot do this all by cutting procurement. And so if we're going to think about deficit reduction and defense reductions of the magnitude of \$400 billion over 10 to 12 years, almost a necessary element of that is going to be returning the U.S. ground forces, the active duty ground forces, back to roughly their 1990s levels. There are risks associated with that



and obviously we began this decade with a ground force that was too small for the two wars it then found itself in. But we also found we could ratchet up the ground forces by roughly 15 to 20 percent in size. It took Secretary Rumsfeld too long to agree to that, but once we agreed to it we did it fairly well. And the corollary to that or what follows to me from that is we can probably and should probably run that risk rather than say let's just cut modernization across the board because the risks of doing the latter I think are greater than the risks of going back to 1990s ground forces. It doesn't mean we leave the acquisition accounts alone, and we're going to hear from Dr. Carter shortly on some of the ideas I'm sure that he's considering within that account.

I could go on and suggest my own list of ways in which the acquisition accounts might be rethought, but we'll hear more of that I think also in the last panel so I'm not going to dwell on that. That's not to suggest that we should somehow sequester and protect all acquisition programs, but we're going to have to do this in a broad-based way because we're not going to find it all from waste and we're not to find it all from so-called Cold War defense acquisition systems.

MR. O'HANLON: With those general principles in mind, let me stop, and we've now got about 20 to 25 minutes. I should just say one point of order, what we're going to do is wait for the signal that Dr. Carter's close, and then we'll give you a five-minute break. That will be, I'm afraid, your only break of the morning because in the possibility that his Q&A session will sort of, you know, go right up until 11:00, not wanting to cut that short, not wanting to cut Panel 3 short, we're just going to go continuously from Dr. Carter's keynote and Peter Singer's moderating of the Q&A to the panel that Peter will then convene right after. So, your break will be at about five minutes to 10:00 once we get the word that Dr. Carter is en route. Just to give you that head's up.

Okay, so if you could, please raise your hand, and once you get a

microphone let us know where you're from and please pose your question, if possible, to one specific person. Others may comment as well, but if we could begin with the comment being directed or the question directed to one specific person.

Yes, sir, here in the third row.

MR. NICHOLSON: Good morning. George Nicholson from Strat Corp. Last month CSIS had a major session over at the Willard Hotel and one of the panels chaired by John Hamry that had David Chu, Onachano Kief, and Ron Fogleman -- one of the issues they brought up that was fundamentally different that we're dealing with right now -- in the past, we had a floor for drawdown, we had the base case, bottom up review, too, and that's not there right now. So, without that, they expressed the concern is that we could be in freefall, that we don't have that floor of measuring our capabilities, I guess, as to what the requirements. The other quick part of the question is General Fogleman said one of the biggest concerns he'd got in terms of personnel accounts, is he said we're being bankrupted by the all volunteer force and something needs to be done with that.

MR. O'HANLON: You want to try that?

MS. EAGLEN: I'd be happy to. Yes. They're right. This is something the QDR independent panel examined very closely. I was a staff member to that 20-person -- Bill Clinton's secretary of defense, George Bush's national security advisor, the Perry/Hadley Commission led it last year, and basically those were the exact two findings. We've abandoned completely any force planning construct. So, you know, for a while we legitimately had two major wars and then it was sort of just on paper, and then we sort of stretched them out and then it was 1 plus a lot of other things, 2-4-1-2, I can't even remember them all now. And then I call the Gates 2010 QDR the kitchen sink because we just like threw it all in, didn't prioritize, and don't forget, you know, humanitarian and disaster relief and climate change and everything else.

So, that's where we are, complete missed opportunity, the unanimous

conclusion of the panel, which I obviously agree with. But what does that mean in terms of the now budgeting? That is a very real scary proposition and prospect that it is just like I sort of describe it to you. They're just flailing, I guess, is what I'm saying.

When I asked a couple senior leaders in DOD in the last few months, you know, typically we all know the normal process, Congress is debating -- we're executing the '11 budget, Congress is debating the '12, and the building is putting together a '13 budget. I keep asking everybody, I said, who's gone back and examined the impact of not ---- of a \$20 billion cut -- obviously, that's a relative term here -- below the President's budget request for this current fiscal year? You didn't get anything close to what you thought you were going to get. We can expect the same exact thing for 2012. We already saw the House appropriators take \$9 billion. That was where we were last year at this point as well. So we're probably talking another \$20 to 40 billion this year if debt ceiling is linked to this somehow.

How are you building a 2013 budget? Do you have any idea what's going on? No one -- no service has gone back to examine what this means, so how -- I don't understand how they're actually legitimately executing this. So, that's quick point one. It's a problem.

Point two, so, again, they're just flailing. On your second question -- remind me.

MR. NICHOLSON: The all volunteer force.

MS. EAGLEN: Yes.

MR. NICHOLSON: (inaudible) right now in personnel talks.

MS. EAGLEN: Correct. So, Rudy deLeon over at the Center for American Progress and I worked very closely on this with Dick Cohen down at UNC. What we did was stress test the all-volunteer force as part of the QDR independent panel work, and it was just a really fantastic opportunity because the department -- it was post-

QDR, gag orders were lifted, and boy, everybody wanted to spill their guts to us, and we had access to anything we asked for. And we literally left, I hope, no stone unturned from suicide rates to academy applications to mid-career-level field grade officers and NCOs. I mean, we looked at sort of every propensity to serve. You name it, we looked at it. And it's cracking right in front of us and yet we have thrown so much money at this very expensive force -- it's expensive to take professionals to war, the longest war in history.

You can kind of see why the rational has -- you know, why the personnel numbers have just exponentially grown, in many cases, with good reason, over so many years, but the path that it's on, this active duty end strength relative to the cost per service member, the way the panel turned this out was like \$400,000 per year, per capita. That's unsustainable. And like I said, you don't find that money through end strength cuts. So, that means you have to actually go in and look at that pie. How do we pay people? Forty-eight percent of any service member's compensation is cash, the rest is deferred in in-kind benefits. But four out of five don't serve a full career, so they don't care about those as much, not as important, but it's at great cost to the taxpayer. That is something Congress is not talking about. They are talking about end strength cuts. They're not talking about structural changes to the pay system or the up or out, or the retirement and health care.

MR. O'HANLON: Another question. We'll stay on the aisle, in the white shirt.

MR. GURSKY: Just a clarification question and a bit of a follow-up to that.

MR. O'HANLON: Would you please identify yourself?

MR. GURSKY: Yeah, I'm Jason Gursky from Citigroup. Mackenzie, you mentioned 430 to a 460 number and then later in the discussion there was talk of 500. I just wanted to clarify that those are the cuts that you're talking about, the potential cuts?

And then secondly, what are the swing factors in those numbers?

And then, lastly, is that all at DOD or is that security spending?

MS. EAGLEN: Yup. This is DOD guidance, internal to the building, inside the department -- oh, I forgot one other little fact about the 2013 budget and how screwy everything is right now. It's sort of upside down day in Washington. So, normally the services, we all know the kind of usual process: the services build their budget, they send it to OSD, they send it back and say cut more, then they send it back, OAC sends it to OMB, OMB says cut more, it comes back, you know, and we get all the PVDs and out comes a budget in February. That's sort of a very generic -- I made that very simple.

This year the services are building a budget, but on his way out the door Secretary Gates tasked CAPE to build an alternate budget for 2013. What does that mean? That's very unusual. The services have very little input. There were some questions that were asked, and it's kind of a shell game, I suppose. What I think that means is they're going to supplant whatever the services send over eventually in this year with this OSD budget, because of the magnitude of cuts.

But what we've -- what I've been told is that the guidance right now is 430- to \$460 billion in defense cuts over 10 years, up to 500. But basically each service is running these scenarios saying, so if it's 430, I'm the Air Force, and so that comes out to \$12 billion in 2013 from what we thought we were going to get. You know, this is all on the cutting room floor. We're not going to see this until the President's budget is just going to be what it is, and then here's what we're going to offer up. So, you know, you've seen Navy saying, we'll give up a carrier and delay construction of one. These are -- that's a direct result of them running these numbers.

MR. O'HANLON: Another question. We'll step into the second row, please, and then work back.

SPEAKER: Hi. My name is Dr. Nick Trang (inaudible) from Tory Group,

and this question is for Eaglen. Could you elaborate what percentage of the DOD budget right now is for the entitlement program? And also, are there any mitigation plans to address this issue?

MS. EAGLEN: Quickly, I will be brief. So there are four pieces to the defense -- well, I'm going to talk about the base budget and I'm going to leave aside the war, OCO spending, but -- of about \$120 billion roughly this year. So, it's about -- well, between Congress' cuts and the President's level, we're talking about a 535-, roughly, \$550 billion defense budget, people, operations and maintenance, R&D, procurement. This guy taught me everything I know about that. And the people and the readiness accounts, basically, the operations and support, are about 63 percent of the defense budget.

The military personnel account doesn't represent the true cost of compensation, of course, because it's -- it excludes the Defense Health Program, which is funded in ONM; it excludes DOD civilians, of which there are 700-750,000 DoD employees. I mean, the Department of Defense is the largest employer in America, 3 million people are on its payrolls total when you talk active, guard, reserve, civilian.

So, basically, you know, we've kind of masked the true cost of people and it depends on are we including civilians in that number. Basically you're talking over half the defense budget is just for people. We've just sort of crossed that tipping point right now if we're talking all people. We're just over 200 -- we're in the 220, 250 range and we're getting close to a \$500 billion top line, so -- and that number will continue to grow. And, unfortunately, I'll just tell you again, I'm not seeing -- there's talks of ground forces and strength cuts, and maybe even more to the Navy and the Air Force, but not necessarily compensation change beyond the TRICARE copayment increases and potentially as part -- a very small drop in the bucket. You know, if there's a debt ceiling grand bargain, I did hear -- Maya might speak to this -- that they were going to talk about

military retiree contributions and health care and just that component of it, and possibly some veteran's benefits. But as every day goes by, I don't see a bargain, so that goes away.

MS. MacGUINEAS: Yeah, the chance of that bargain seems to be -- we seem to be missing it, but that's true. Finish, and I'll jump in on the grand bargain. Do you have more?

MS. EAGLEN: I'm done. Thanks.

MS. MacGUINEAS: Yeah, just on the grand bargain because I also wanted to reinforce a couple things that Mike said, and this reminded me of a story. So when I took over this group, the Committee for a Responsible Federal Budget, the co-chairman was Leon Panetta, so this was seven years ago. And he said -- this was my welcome, you know, welcome, this is going to be a great job, you're going to love it -- basically, this was his speech. Well, we're not going to get this job done, but we're going to be able to say I told you so. I'm like, that is the least inspiring "welcome to your new job" talk.

As Mike was making his point about the cuts in discretionary spending, what's happening, the way it's happening, it really does remind me that this year in many ways has felt like the unfortunate "I told you so" moment. Because what has happened is stepping out from this part of the budget into the rest of the budget all the things that we have not done on reforming our tax code and reforming our major entitlement programs in the country, have left us in this terrible moment where it's just kind of this mindless squeeze that's going along, it's going along, and it's going to get worse in the domestic, discretionary, and security pieces of the budget. Because when people have to put deals out there, it is a lot easier then to say, I'm going to raise the retirement age, I'm going to raise the payroll tax cap, I'm going to cut this, this, and this, to say, we're going to put caps at this level, because it just isn't something that people get upset about because

they don't know what it means, until they know what it means.

So, there is constantly this sort of frog in the boiling water or the vice that's squeezing down the discretionary part of the budget and it's just this kind of depressing moment to watch, you know, doing these things not strategically and cutting out the parts of the budget that are sort of core public investments or things that might be the most necessary.

So, on the debt ceiling where I do think we could end up, there's three major models. The one is some kind of a political process punt and that would be basically putting in place a mechanism -- and we've actually been advocates for certain kinds of budget mechanisms of targets and triggers if they go hand-in-hand with real policy choices. So, you put in place some policy choices and then you kind of lock them in by saying if they don't happen, this triggering event will create automatic cuts to the budget. But I'm afraid that what we'll see is basically budget process triggers without any real policy changes or just with caps, and a promise to get this done, that's kind of the smallest deal and I think that with each day that we don't get this done, that plan B becomes more likely.

Then there's the mini deal, which I also think is reasonably likely. And it's basically, I don't know, \$2 trillion -- it's more between 1.5, \$2 trillion, 2.5 trillion over 10 -- that doesn't sound like a small amount of money, but given how many gimmicks will be in there, it's actually a reasonably small amount of money. And that focuses completely on the discretionary part of the budget, and a little bit of other mandatories, basically the parts of the budget that aren't the problem. It will mean that Congress comes together with a deal that says, we can't make any progress on taxes and we can't make any progress on Social Security or health care, so we're going to do the everything else: put in place a deal that, one, doesn't stabilize the debt, and two, doesn't fix the parts of the budget that are broken, and three, quite possibly doesn't reassure credit markets that



what we've done is good enough. Moody's has in fact said, we're not just looking at a potential downgrade, whether you lift the debt ceiling; we're looking at how you lift the debt ceiling. And there are many people involved in these negotiations who know that if we put together a crummy deal that looks like a good top line number, but doesn't go at the real problems, that's not going to be reassuring for long at all.

Then there's the grand bargain, which I kind of futilely spend my time, you know, trying to grab that brass ring and working for it, really is the long shot. There was that moment last week when it seemed like we might be able to move forward when the President and then Leader Boehner were talking about if we were going to do this, we need to go big. And the reason you do that, I mean, there's so many reasons in my mind that that's the way you want to focus on this because it means that you don't have to go back and do this deal over and over again, right; that if you shed all this political blood, you might as well, as Mike was saying, get the job done. I actually think there's a much better political recipe for success if, one, the deal is big enough to fix the problem, because there's no heroism in putting together a tough deal where you haven't fixed the problem. Nobody -- you know, the editorial boards don't greet the leaders as heroes, whereas if they put out the grand bargain, heroes will be made from that moment. And on top of that, the grand bargain, which does involve all parts of the budget, again, to what Mike was saying, is the notion that it's fair. Like you wouldn't be willing to sacrifice your piece of the budget unless it's an overall fix, and you sort of have created enough of a public good from each one of us being a part of it that then the deal gets done and it's worthwhile.

I think there are numerous reasons why the grand bargain is right. I think strategically for Republicans, if they think that they're going to get entitlement reform on better terms after an election without Democratic help, that's a miscalculation. You don't want to fix Social Security and Medicare in a way that isn't bipartisan. It becomes

much harder. I think the Democrats, if they're going to get more tax increases by waiting until after the election, they are quite likely wrong and we're going to just continue to see this squeezing out of the domestic discretionary part of the budget, which is sort of what progressives should be fighting for the most.

So, I could sort of lay out the strategies, you know, if you're a political strategist on either side, why you should want to see this deal get done as quickly as possible with the debt limit pushing along so you can say, I don't like this deal at all, but the debt ceiling made me do it, and everybody has a little bit of bipartisan cover. And I just -- I worry that the economy is going to be hurt if we don't put something that's good enough, big enough, and balanced enough to be reassuring in place. But with every moment that goes by -- I mean, that's my like -- why can't we do this? Why can't we get the right deal in place? But with every moment that goes by it seems increasingly likely that people are getting more entrenched and will fall back onto one of those smaller policy punts or a whole process punt.

The only saving grace, I guess, I have in my hope for something bigger, more balanced, is that it's so politically difficult to get any of these deals done, I actually believe it makes a lot more sense, for the reasons I've just laid out, to go big. And so maybe we're on this trajectory of the political arena sort of going through each process, going through the different models and realizing that none of them are very good either, and then we come back to something that's bigger and thoughtful. And I just -- I think you lay it out really well when you say, the hits in security, as you both have explained, are going to be real, and they're going to take a toll, they're not going to be without a downside. There's no more free lunches left in the budget, there's no more things just to squeeze out. The only possible way to be willing to accept that is if the upside is that we fix the problem, and that's true in so many parts of the budget.

I've been really depressed this week. I don't think we're going to do it.

MR. O'HANLON: Next question, all the way in the back. Right there, yes, please.

MR. PERZICKI: Michael Perzicki, Rutgers University. Mr. O'Hanlon, if the five-year caps that were mentioned are imposed, what do you think will be the wisest items in the budget to actually cut?

MR. O'HANLON: Thank you. I'll just say a couple of words briefly on this. I've already mentioned that I think we would have to go back to 1990s ground force levels, roughly, you know, plus or minus a few percent in either direction. It's worth a serious debate and analysis on that, and there was a good question earlier about what paradigm do you use for sizing the forces. I could explain at greater length the paradigm that I'm trying to work towards, but basically you need to be able to do one large war of the type that we've been planning for the last 20 years, and probably two to three smaller things simultaneously. That's the rough framework I would use without going into great detail on that.

But I think the bottom line is you're going to have to accept a little bit of risk that some of the bigger plausible ground force scenarios, or the simultaneity issue, would in fact pose greater risk if you go to a smaller ground force, but that's one of the things you have to consider accepting.

Within acquisition, I'm not going to go through a detailed list, but I'll mention two things. First of all, I do think that we very much need the F-35, and I'm very grateful to colleagues who have taught me about the F-35, shown me the F-35, but it's an example of a program where we may be able to do with a bit less, not in the sense of slowing it down now or curbing the initial production by us, because that would create some inefficiencies in the production process, but by a more thorough examination of manned aircraft versus drone aircraft. I think we can reassess the balance between the two. That's one concrete example.

It's not going to alleviate the need to buy probably at least 1,500 F-35s, which I would advocate doing efficiently, quickly, and in a way that is in partnership with Lockheed and in a way that is effective for the Department of Defense replenishing its aircraft fleet, but that's the kind of savings we may have to consider.

On the nuclear side, even though we just had a debate in December about the new START Treaty and we heard a lot of people say to Senator Kyle and others, yes, we'll agree to more spending on nuclear modernization as a condition for essentially your support of this ratification of the treaty, on balance, while I accept that some parts of the nuclear infrastructure need help, it's not where I want to spend scarce defense dollars, on weapons that we're most likely never going to use. And there are a number of ways in which I would advocate essentially maintaining projected nuclear force levels in a more economical way. Basically, I think the logic that I grew up with, with nuclear exchange calculations dominating the way we thought about force planning, is obsolete and we don't need to worry about spreading our warheads across the maximum number of platforms any longer. We actually can afford, from the point of view of security, to consolidate more warheads per platform and also eliminate a lot of tactical and surplus nuclear weapons.

So, you have savings at both the DOE and -- the Department of Energy and Department of Defense side of this issue. Those are just a couple of examples. But again, I highlight the F-35 case.

And I would want to close by emphasizing a point Mackenzie made, we do need to buy things. We have an aging tactical aircraft fleet, and let's not pretend that we should stretch this out or otherwise just punt the problem. You want to buy a lot of these things fairly soon. You need to replenish modern tactical fighter aircraft pretty quickly. All the services need this. And so if you're going to go to a smaller buy, the way to do it is to think about drones giving you some capabilities you didn't have before,

perhaps, going to a somewhat smaller force structure for attack air, but not pretending that there are easy choices to just punt and postpone. That's usually -- and especially in this case -- the worst approach.

Other questions? I think we have time for maybe one more. How are we doing on -- two more minutes? One last question. Ma'am, here on the aisle, and then we'll wrap and give you your break.

SPEAKER: (inaudible) from the Institute for Policy Studies. So, regarding the potential defense budget cut, what impact would it have on the U.S. military posture in the Asia-Pacific region considering China's increasing military spending and naval capabilities? Will it have -- will it lead to a balance of power in favor of China? Thank you.

MR. O'HANLON: Great question. I'll take a crack at it -- okay.

MS. EAGLEN: Well, our force structure there is declining already, our actual presence. It's an open question about our sort of -- our people on the ground as well. And I'm not just talking Japan and Korea, but Guam, Okinawa, there's a lot of uncertainty about the numbers of people we're going to have in the region and where they're going to be, but I think those are coming down as well. And I fully expect we'll hear some sort of overseas basing BRAC all over again next year or the year after that, which is a whole other issue. But in terms of particularly in our naval presence, the goal is to keep it at least where it is as we try to build more things. But we're building a fleet that's increasingly of less capable ships, like LCS and joint high-speed vessel. Those aren't the kinds that we need for presence in the Asia-Pacific in particular.

We heard the Navy tell the House Armed Services Committee just this week, we could barely meet the demands. Actually, we don't meet the demands. Of course we know combatant commander demands are insatiable, but nonetheless, the force structure's coming down and it's going to be a challenge for the Navy, and

particularly as they have these readiness problems. Ships go away for longer periods of maintenance than they have in the past, or they're just being canceled or deferred altogether, so it's a question of how quickly it's declining.

I think there's a political consensus that the focus is on that region beyond Iraq and Afghanistan, that's where we need to be looking. That's where the strategy, you know, ARC Battle, and new concepts of operations, that's where the building is focused, and I agree with that. The problem is the numbers aren't adding up in terms of the size of our fleet.

MR. O'HANLON: And there are a few more things that one can do to mitigate the risks of sending the wrong signal in the Western Pacific, and I'm very glad you asked the question because it's a very important concern as we think about defense downsizing. You have to, I think, consider a number of options that may be difficult to implement, may already have been partially implemented, and, therefore, not offer huge additional savings. But everything from putting more of our Navy focused on the Western Pacific, a little less, even, than it has been the case on the Atlantic or the Med, that would be one option. Trying to do more rotating crews by airlift and keeping some of the ships deployed so you can maintain more presence with a smaller fleet is a second option.

This underscores the need, by the way, for some aspects of the F-35, just to prove that I'm trying to be fair to this program, because we actually need not only the Air Force variant, but we need the Marine Corps variant in short takeoff and vertical landing to be able to use runways that may have been struck by Chinese precision missiles in the early phases of a conflict. We need to work with allies to get them to harden airfields, to build more aircraft shelters.

So, just to conclude, the book that I'm working on now on thinking through a 5 to 10 percent defense budget reduction, I'm going to have to have a chapter on shoring up our posture in the Asia-Pacific, even as we downsize, because you have to

think about this very explicitly, and to some extent it's a damage control strategy. I admit, if you cut, you cut. And if you have less, you'll have less. But there are ways to emphasize the Western Pacific more and to be more creative and clever in how we deploy forces there that I think can still send a pretty robust message that we're still planning to be an Asia-Pacific power well into the 21st century.

Okay, please, if you can, be back within five minutes in your seats and we'll start with Dr. Carter. Please join me in thanking these two panelists very much.

(Applause)