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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 Mike O'Hanlon, and on behalf of myself and Peter Singer, who's to the far right, and colleagues elsewhere at Brookings, we'd like to welcome you to this event on the implications of the debt deal and the deficit crisis for American foreign policy.

We are honored, Peter and I, to have two fantastic panelists, two great Americans, to my immediate right. Alice Rivlin, senior fellow here at Brookings, who, of course, was the founding director of the Congressional Budget Office; ran the Office of Management and Budget in the Clinton years; and was the vice chairman of the Fed; and has continued, among her other activities, to be involved in D.C. finances, and, therefore, proven her metal in many different ways over the years.

Steve Hadley was George W. Bush's national security advisor, one of the most distinguished national security advisors, as my former colleague, Ivo Daalder, and his co-author explained convincingly in their recent book on that position historically in the United States. Steve also was the co-leader last year with former Secretary of Defense Bill Perry of an assessment of the 2010 Quadrennial Defense Review. This seems like 100 years ago already, in times when, even though we knew we had fiscal issues, the deficit debate was far different than it's become in the aftermath of the November electoral revolution when the Tea Party came to town and everything else that's happened subsequently.

So what we'd like to do this morning is to begin by myself posing some questions to each of the panelists to frame the discussion, and then, of course, go to you. Because we're fortunate to have television coverage today, when we do go to the crowd, please identify yourself, wait for a microphone also, and then ask a short question, being specific about who you're addressing it to, if you would.

I want to begin with Alice, because I think that, for a number of reasons, the broad perspective on what this recent deal might accomplish is important to understand, before we try to get into the specifics of what its implications might be and maybe what they should be or should not be for the broader national security budget, the main focus of our panel today. And so, Alice, if you could begin with, I realize it's too complicated to ask you to do a full primer on the deal, but just a short explanation, because, again, even though there's been a lot of discussion, some of it's been confusing, especially to non-specialists like myself, in terms of exactly what happens over the next four to five months with the current deal.

MS. RIVLIN: Right. Well, I think first it's important to say how did we get here. We got through this dreadful, awful, outrageous process with an artificial crisis, namely, the debt ceiling, and nobody who cares about the U.S. Government can be proud of its performance at that moment. It was brinkmanship and irresponsible, it's hard to think of adjectives that are strong enough. But I do think we have a new opportunity now to solve the real problem and that this deal might be the first step toward a positive resolution.

What did it do? Not as much as its critics from both sides often imply. It capped discretionary spending for the next 10 years at approximately the rate of inflation growth. If you're familiar with the Simpson-Bowles Plan, which I participated in, and the Domenici-Rivlin Plan, which I also participated in, those plans were balanced plans which did three things, which I think are the things you have to do to solve the long-run deficit problem. They reduced the growth of entitlement spending in different ways -- Medicare, Medicaid, Social Security; they got more tax revenues by reforming the tax code in slightly different ways; and they capped discretionary spending. Now, those are the three things you have to do, and this deal has done the first one.

And then it says -- step one. Now, step two is the creation of an extremely powerful 12-member committee, a joint select committee -- half Republicans, half Democrats, half senators, half representatives -- with extraordinary powers.

They get to look at either the spending side, especially they should look at the entitlement side because that's what hasn't been done yet, and the tax side, and recommend additional deficit redemption specified as 1.2 trillion over 10 years minimum. But they have the opportunity and they should take it to do more than that over the 10-year period.

Why is this so powerful? Because if they can get a majority of the committee, 7 out of the 12 votes, around a plan -- and it would have to be a balanced plan to get 7 out of 12, I think -- they take it to the floor, it's subject to an up or down vote, and it's law. That's it. No filibuster, no anything. And that's as powerful a mandate as any committee has ever had, so far as I know, with the possible exception of the BRAC process, but that's much -- that's small potatoes compared to what we're talking about now.

And then the question is what happens if they don't? What happens if they don't is we have what is known as a sequester, which was designed to be unacceptable to both sides; a substantial cut in defense spending, which is what we'll be talking about today; and a substantial additional cut in domestic spending, including some entitlements, but exempting programs for low-income groups and limiting the cut in Medicare to 2 percent. And when you do that, it means that other things would have to be cut very substantially.

So if this committee doesn't succeed, what you get is additional discretionary spending cuts. And these would be cuts, not caps, because the numbers are big enough, so they would actually reduce them below what would happen otherwise, and wouldn't fix the problem, because the problem, remember, is because of the

demographics and the pressure on entitlements coming from longevity, the retirement of the baby boomers, and the increase in cost of medical care, so that's sort of where we are.

MR. O'HANLON: If I could follow up on the issue of what happens if there is no deal or if it's refused by the Congress in that up or down vote, and I know this gets into complex issues of the so-called baseline, but when we look to next year, the tax cuts that have been in effect since the Bush presidency are due to expire at the end of 2012, according to current law.

MS. RIVLIN: Right.

MR. O'HANLON: And if those tax cuts were to expire and not be renewed at all, is it true that even more than 1.2 trillion would be -- I'm just trying to get the arithmetic right. I'm not trying to make a policy statement, but is it true that the targets that you're talking about would actually be accomplished? In other words, we would get that much deficit reduction and then some simply by not extending the tax cuts?

MS. RIVLIN: I don't think so, although I think this is still up for discussion. It's not that the extension of the Bush tax cuts -- the non-extension of the Bush tax cuts wouldn't be a very large number in that, exceeding the 1.2, but it is a question of where you start from. And as I understand, the starting point, the baseline, it is current law. In other words, you'd have to cut the 1.2 below what would happen if current law was followed, which means the Bush tax cuts would expire.

MR. O'HANLON: Thank you. By the way, before I turn --

MS. RIVLIN: There may be some dispute about that.

MR. O'HANLON: Yeah, it could be part of the conversation right there. By the way, I should say as I turn to Steve that there are materials on the front table, but also for the television audience, if you go to Brookings.edu, we will have featured Alice's

task force report that she referred to, as well as Steve Hadley and Bill Perry's report, as well as things that Peter and I have written.

Steve, if I could turn to you, and I guess the broad question that I'm intrigued by in getting your thoughts on, a year ago when you did this report with Bill Perry, a very good report, at that time you were concerned that even the milder efforts towards deficit reduction that were underway then might cut defense more than perhaps would be wise. And, in fact, you and Bill Perry and your bipartisan team called for actually an increase in the size of the Navy, among other policy recommendations, and certainly, therefore, an increase in the size of the defense budget, above and beyond what would be needed to keep up with inflation; in fact, I think well beyond that. You must be, I'm assuming, a bit concerned about some of the numbers you're hearing now, but let me not lead you any further and just ask, how do you square the recommendations that you made with Bill Perry a year ago with the current options that we're seeing now for defense budget cuts?

MR. HADLEY: Great. I just want to thank you for convening this panel; it's a pleasure to be here. And thank all of you for coming out in the middle of August; this is really above and beyond the call of duty. The report that Michael referred to was an independent panel review of the Quadrennial Defense Review. This was DOD's own review of its budgets over the next five years.

It was mandated by statute, and what we were told to do was look at the threat environment over the next 20 years, and then try to describe the requirements we have for defense capability and defense spending, and do it in a financially unconstrained environment. That's what we were told to do and that's what we did, looking only at defense, financially unconstrained. We proposed a lot of measures to reduce cost. What we said is, even if you do all the things we recommend to reduce cost, we thought the

threat environment was such that we might actually still have to increase the top line, even as we harvest savings from reprioritizing and other things.

Now, that was then, this is now. What's happened in the intervening is that the focus of the American people on the deficit problem has really riveted Washington's attention. And I largely agree with Admiral Mullin, Chairman of the Joint Chiefs, when he said that getting our own economic and financial house in order is the biggest national security challenge we face because a strong economy underpins everything we do internationally. It is the basis for our strong military, it is the basis for our diplomacy, it gives us economic and financial influence overseas, it is the undergirding of our national power. And if, therefore, we are going to address this number one national security challenge in terms of the budget deficit, then everybody is going to have to contribute, and I think we need to look at defense spending in that context.

But my caveat is the phrase "if we're really going to address this problem in a comprehensive way." You know, there's a tendency in Washington when we get in these budget problems, liberal Democrats say, well, cut the defense budget and everything will be fine, and conservative Republicans say, well, cut non-defense discretionary spending and everything will be fine. Well, it won't, because even if you do both of those things, it will not be enough. And as Alice said, it's about entitlements.

If you look out 10 years, the budget deficit is driven by entitlements -- Social Security, Medicare, Medicaid -- and so what I say to people is, if the country is serious and if those programs are really on the table, and if we are really going to make those entitlement programs fiscally sound and we're that serious about it, then DOD is going to have to do its part, and we can have a conversation of what that means. So that's the context.

But, you know, I will -- and we can talk about the kinds of things you have in mind for doing the defense budget. But I worry about it because, you know, our adversaries out there don't all have our budgetary crisis, and they're not taking a vacation or a holiday from the threats they pose to us. So even as you think about defense spending cuts, it's got to be careful, it's got to be threat-driven, and it's got to be prioritized, and we can talk a little bit about that.

MS. RIVLIN: But if we're not serious, Steve, we don't have a country to defend --

MR. HADLEY: Well --

MS. RIVLIN: -- which is what Admiral Mullin was saying.

MR. HADLEY: -- that's right, exactly right. And I think the measure of seriousness and what the American people need to insist on is, we've got to talk about Social Security, Medicare, and Medicaid, because if we aren't, if we don't talk about those, then we're not going to solve the problem. It's that simple.

MR. O'HANLON: And, Steve, I could follow up in one other area that you alluded to, you mentioned diplomacy and all the other things that you worked on that the foreign policy people have to think about and these include accounts for the State Department for an assistance, security assistance, in a maybe bipartisan accomplishment that often goes unnoticed.

The Bush Administration, and then to some extent the Clinton Administration before and the Obama Administration after, have actually succeeded in rectifying some of the shortfalls that a lot of people had identified on both sides of the aisle over the years in our diplomacy, in the strength of our State Department, the cadre of foreign service officers we've got, and of course in some of the international assistance budgets as well.

Are you concerned about those being at risk? Do you have the instinct

that maybe we could cut a little, that they've grown enough now that we probably can apply some financial discipline there too and a few cutbacks? Do you have any notional sense of how far that process could go? And are you worried that this current effort to cut the debt will also target the State Department and foreign aid excessively because those are also programs that are not always popular in the American political debate?

MR. HADLEY: Right. There's some real risk there. You know, everything is a two-edged sword in the kind of environment we're in. One of the things this process that Alice talked about has done is they have grouped a lot of the accounts into a national security account. They have sort of put in a grouping defense -- Homeland Security, Intelligence, diplomacy, and foreign aid -- in assistance.

Now, on the one hand, I think that's good because a lot of our, what we call foreign aid is actually critical to achieving our national security objectives. And we've been trying to talk about, and one of our recommendations was a consolidated national security account, which is a good idea as a planning tool. The problem, though, is if you're under enormous budgetary pressure, the pressure will be, well, we need to preserve Defense spending so let's cut diplomacy, development, democracy promotion, and the like.

And the irony of it is as our military defense spending comes down as we get out of places like Iraq and Afghanistan, as we are over time, and as we face other challenges in places like Somalia and Yemen and the like, a lot of that non-defense national security spending becomes even more important.

It's also a lot cheaper to do things through that sector than it is deploying American combat troops because deploying and sustaining combat troops overseas is the most expensive thing we do. So the irony is that there is a tradeoff that needs to be between defense spending and what I will call a non-defense national security spending.

Bob Gates was all over this. And Bob Gates, when he was Secretary of

Defense, said I'm willing to send money over to the State Department for some of these civilian activities because I think they are so critical to supporting the defense mission.

And I hope that Leon Panetta, the new Secretary of Defense, will have the same attitude and we start making tradeoffs between defense and non-defense security spending. And I would hope that in some instances we may cut defense and we may actually add some money on the non-defense national security side.

MR. O'HANLON: Peter, if I could turn to you. And you've written a very thoughtful paper, which is now at the ForeignPolicy.com website and worth a read for anyone here today, about not just the numbers of how much we should cut and, you know, how we can take a knife or a scalpel or an ax, depending on the plan to the defense budget, but the process by which we should think about how to set up cuts. And to make sure that in all of this rapid-fire process of cutting quickly, we don't cut unwisely. Can you say a few words about some guidelines that you would suggest the policy community keep in mind to be thoughtful about how to make whatever cuts we decide to make?

MR. SINGER: Sure. Let me first again echo your comment about the honor of being up on this stage with two great American leaders. The numbers that we're talking about here are of such a scale that they're almost shocking. Essentially over the next 5 months we have to figure out how to cut between 400 billion and 1.15 trillion from the national security budget, most of which will come out of defense.

MS. RIVLIN: Over 10 years?

MR. SINGER: Over 10 years. Now, you know, there's lots of different ways to think about those numbers, you know, stocked up, how many Empire State Buildings they equal or, you know, I prefer thinking about it, essentially we have to cut somewhere between using the Department of Defense estimates two Chinese military annual budgets or seven Chinese military annual budgets.

But my problem is that when you look around the discourse in Washington right now there's two types of questions that we're wrestling with. One is the whether to cut or not and that ignores the fact that the first \$400 billion, that train has already left the station. That's going to happen. The second, as Alice pointed to, is the only thing standing between another roughly 750 billion in cuts is the very slender thread of first the super committee showing the I would say sort of intelligence and maturity to come up with a package that hits all of these other areas, like entitlements, like tax reform, that would actually have a real effect. And secondly, the rest of the Congress and the various political parties showing the maturity to vote yes for that. That's the slender thread. And frankly, based on their behavior the last couple of months, I don't think that's something that we can count on.

So the whether question, you know, it's 400 or it's another 750. Then we jump -- most people in D.C. want to jump into the what question, what to cut. And you can already see sort of the debates happening where, you know, the coalitions are lining up of this is a critical program that you can't cut; this is a wasteful program that we must cut. And so it's essentially sort of a battle of everybody identifying their pet rocks or their pet peeves and going after them. And really what we need to do right now is start to focus on the how question: What are the principles by which we might go about it smartly?

And that's what the paper that I was wrestling with goes into and I hope we can talk about it a little bit further. But essentially, it's looking at issues like how do you go about making tradeoffs smartly? How do you identify where real savings are versus false savings? How do you start to mitigate and weigh strategic risk?

So you know, as an illustration, if you are doing cuts, what are capacities that you can bring back quickly if the strategic environment changes and what are cuts that, simply put, you're not going to be able to restore in a matter of decades or not?

That's the kind of thinking that we have to do now.

Unfortunately, that's sort of the tough thinking that Washington often veers away from because we're much easier and much more comfortable either playing the blame game or protecting pet rocks. But, you know, it's well past time for that.

MR. HADLEY: Michael, there's one question that comes out of that that I've been trying to get an answer to, and Alice you may know the answer. Not to put you on the spot. But Alice made the point it is 400 billion or, you know, 1.1 trillion over 10 years. And I'm not sure how you count it.

If in year 1 there's a procurement program say -- and none of them look like this -- there's a system that's being purchased and it's going to cost you \$40 billion a year for 10 years, if you cut that program in year 1, and then save the \$40 billion in year 1, do you get credit for the full \$400 billion over the 10-year period? If you do, then you know, the impact is a lot less draconian than something that says, well, if you cut something that saves you 40 billion the first year, in addition to that you've got to cut something that saves you 40 billion more in year 2, if you see what I mean, through the years to the end?

MS. RIVLIN: Oh, you get credit for the whole thing. I mean, if it's going to cost 400 billion over 10 years and you get rid of it, then that's 400 billion.

MR. HADLEY: Got it.

MS. RIVLIN: And let me just reinforce what Peter -- the 750 that Peter is talking about. That happens only if the committee fails. And two points about that. I think the committee by itself may be a slender reed. It will work only if the President and Speaker Boehner and the rest of the leadership want it to work, and then it's a slam dunk. And so that's really the big question.

MR. O'HANLON: But there's an interesting point, you know, in the space of national security, we have to do contingency planning.

MS. RIVLIN: Yeah.

MR. O'HANLON: And right now this contingency is one that, you know, I would not put in the extremely unlikely based on the past events. I'd put it in the potential or the likely category.

There's another thing that Steve brought up, though, that I think is one of these principles that we need to think about is that, for example, we are only talking about this in terms of cuts right now. But we're talking about a 10-year period. One of the things that plays out is that sometimes you have to spend money to save money in the long term.

So you know, as an example, the Department of Defense's energy spending is a big cost driver. The amount it spent on gasoline has gone up over 225 percent on an annual basis. But if you say, okay, I'm cutting efforts to increase energy efficiency, where you're spending at the start of it, you lose those savings afterwards. But that, unfortunately, has kind of been the way we've gone about it. So far it's (inaudible) annual basis.

MS. RIVLIN: But it doesn't have to be. And that's the benefit of the 10-year horizon. But another point about likelihood. The sequester, these big amounts that would be cut if the committee fails, was designed to make it unpleasant to both sides. And cuts of the magnitude you're talking about would be unacceptable to most Republicans and many Democrats.

So it's not a sure thing that they will happen even if the committee fails because they can be overridden. I mean, it's a law. Another law can be passed.

MR. O'HANLON: Alice, just to clarify, Peter is talking about this 350 billion that's essentially going to come out of the Defense budget that's already agreed to and that's the result, to go back to your original intervention, if I understand correctly, of this cap. In other words --

MS. RIVLIN: Capping, defense, and domestic discretionary spending at the rate of inflation, rather than at the rate of GDP growth, which -- nominal GDP growth, which is what the baseline assumes.

MR. O'HANLON: So they are allowed to go up with inflation, but no more than that?

MS. RIVLIN: That's my understanding. And so using the word "cut," which sounds like we're going to have a smaller Defense budget in the future than we are now, is not necessarily right.

MR. O'HANLON: And one more point of clarification. I think it's important for viewers and all of us to make sure we're agreeing on and that it's clear, the expected reduction in war costs is not something you can, if you're on the committee, point to as the big savings that we're delivering to the country.

MS. RIVLIN: No, because that's going to happen anyway.

MR. O'HANLON: That's already assumed.

MS. RIVLIN: It's assumed to be happening anyway.

MR. O'HANLON: I just mentioned for the crowd that the peak of war costs was around 180 billion a year in roughly the '07, '08, '09 period. Now we're down in the 2012 fiscal year, which begins of course in about 6 weeks, where we'll be down to 120 billion in estimated combined costs for Iraq and Afghanistan together. Right now the Iraq mission is supposed to entirely end in the course of calendar year 2012 -- or excuse me, calendar year 2011. Even if that's changed a bit, the Iraq cost will be very small by the first of the year.

Afghanistan of course will be a little slower reduction, but that's already scheduled to come down a great deal in the coming two to three years as well. So the numbers we're talking about for savings are not sort of, you know, double-counting those benefits. They've already been factored into the baseline.

MR. HADLEY: Should we talk a little bit if we get into the issue of defense spending, and Peter alluded to it. I think there are sort of four to five things that people need to have in mind.

First, I would hope the people who are charged to do this will recognize that our defense spending needs to be threat-based. We need to start as what are the threats we face out there?

Secondly, it needs to be prioritized. Things that we don't need any more we should cut; things that are lower priority we should think about cutting. The most foolish way to do this would be a 10 percent across-the-board cut or a 5 percent across-the-board cut because that does not allow you to fit your military to the threats you face.

Peter talked about sometimes you need to invest in order to cut costs. I would elaborate on that by saying three things. One, there are things that actually if you -- you can cut them in a way that forces you to reform and actually come up with a force that makes a lot more sense. In the personnel area, I think you can do some cutting that will actually really force you to reexamine the personnel system in ways that not only make a better force, but also one that will cost you less money.

Similarly, you can do reforms that are going to drive the process and reduce costs. Acquisition reform is something we need to do. It will give us military equipment that's better, sooner, but it also can be less costly.

And finally, as we do these costs, we also have to recognize that if we're looking over 10 years, we need to cut things we don't need enough so we actually have money that we can invest in some of those capabilities we know we're going to need. We're going to need better capability to deal with biological weapon threats, with cyber threats. I think we're going to need more money for Special Forces and some of these other things.

And I think what we ought to try to do, and what I hope the folks

responsible for this do, have seven or eight principles along these lines that they have posted on their blackboard in front of their desks that really guide them in this process. So, it can be an intelligent process that cuts in a way that drives reform and can actually lead to a more appropriate and, in some sense, maybe even a better force than we have now when you look at the threats that we're going to force.

MS. RIVLIN: I thoroughly agree with that. I mean, who could not? But let me make one more point about the defense budget. Steve mentioned earlier the importance of entitlements and health care growth in the budget generally. That is also true of the defense budget. The fastest growing major category in the defense budget is health care and has been for some time, and now we're not talking about threats or weapons. We're talking about promises made to retirees over a long period, a very powerful political group, and the TRICARE for Life program is an extremely generous and costly health care program.

And if I'm allowed an anecdote, I sat at a meeting with a distinguished military retiree recently who was recovering from a kidney transplant which had not gone well at first, but he's fine now. He said the total bill was half a million dollars of which he paid 500. He was outraged by this. And he should have been outraged by this. But the basic story is there is no contribution, little co-insurance, or deductible under TRICARE for Life, and we're paying a big price for it.

MR. HADLEY: And it's one of the things actually we looked at in this Independent Panel Report, and one of the things that was interesting -- I was talking to George Casey, who was then the Army Chief of Staff, about this issue as well as some retired military who were on our panel, and what I found heartening was they focused on this problem and said it's really not fair to the active force that the retired force has as good a deal as it does.

MS. RIVLIN: But try to change it. It's very hard.

MR. HADLEY: George Casey -- it is hard, and it's up to Congress right now. But what I was heartened by is that the Retired Military Inter-Panel -- and George Casey said, you know, I can tell you it's time to do that; it is time for retirees to pay more. And the only things they asked were really two things: One, phase it in, so people are not surprised; and, secondly, try to means test it, because there are some military retirees that can afford it, some that can't. But I thought it was heartening that you had a retired community that began to say we need to make a contribution to this process as well.

There are other things you can do. You know, we let people retire after 20 years, and they many times are fairly young, they get other jobs, and they still get military retirement. So, one of the things we suggested in our report is let's lengthen the period of service. Let's extend the military career. Let's have people in 30 or 40 years. Let's not make it up it or out. If people are good at a job, let them stay in that job, and that way we're paying people but we're getting something for it in terms of our contribution to our military.

So, there are things -- and finally a longer period of time allows military officers and enlisted to get the kind of educational exposure that will make them more effective in dealing with the kind of challenges they face in places like Afghanistan and Iraq.

So, my point is there is an interaction and a set of reforms that can both make the military better and more effective and also less costly. And one of the things we called for was establishment of a military commission on the military personnel system, a national commission on military personnel to take a look at all these issues and to try to make the kind of reforms that both adapt the military to the situation we face and are also going to get a lot of the costs out of it, because this is a huge driver of the defense budget, as Alice said.

MR. O'HANLON: Let me make one point and ask one more question of Peter and then we'll go to you.

And, by the way, on the military retirement issue, there's a very interesting study that's coming out now from the Defense Business Board, which you may be intrigued by, which is very much in the spirit of what Steve just mentioned, although an additional point that may have also been in your report -- I can't recall, Steve -- is that while full military retirement benefits might be delayed, there might also be a change that would allow people to just stay in the military for 5 or 10 years to get some kind of retirement benefit the way you typically would in the private sector in the United States now as well at a more modest level, some kind of a contribution by employer to a 401(k)-type fund, which doesn't currently exist. You have to stay 20 years to get anything. And then if you do stay 20 you get a lot. And that's an aspect that the Defense Business Board takes on.

The point I wanted to make -- and then invite Peter to comment on a couple of things and we'll go to you -- is the following. I think one broad question a lot of people have on their minds, especially people who think that big cuts can come out of defense and should come out of defense is basically stated the following way: Under Bill Clinton at the end of the Clinton administration we were spending in 2011 dollars, if you adjust for inflation, about 400 billion year. And, by the way, George W. Bush, when he campaigned for President, did not to increase that a lot. If you go back to his speeches, he did think there were some things that needed to change in American defense policy, and I think Steve Hadley was one of the advisors encouraging some of his ideas. But the overall number was not going to increase a lot according to the original Bush plan. 9-11 changed much of that. So, people would say, well, we had a \$400 billion benchmark that a couple of administrations seemed relatively comfortable with, and now we're closer to 700 billion, and we account for almost half of world expenditure on armed forces

activities: 400 billion a year in 2001 to 700 billion a year in 2011. How could that possibly be true, a \$300 billion annual increase. So, if you just were to get rid of that, times 10 years, there's \$3 trillion right there. Well, it would be nice if it was quite that easy.

Let me, in the interest of just trying to explain a little bit of the arithmetic, explain what happened to get us from 400 to 700. And, by the way, I do believe that we can make substantial defense reductions, but the trillion-dollar target scares me and I think it would be excessive, and let me give you a little sense of what.

Okay, that 300 billion increase, going from 400 to 700; of that 300 billion increase, and again sort of in the annual budget -- I'm comparing a certain year, 2001, to a subsequent year that we're in today -- of that increase, about 175 billion is in war costs. So, right there you have more than half. Now, that number is going to be coming down, which is why the 700 billion number will be coming down. But nonetheless, if you're trying to understand what happened that's a big chunk of it right there.

Secondly, a lot of the personnel system changes that we've made in the last years have been very costly. I agree with the points that Steve and Alice have made that some of them have been inefficient. But as a nation at war with two conflicts simultaneously and an all-volunteer force, I think most of us would agree that we certainly have to take care of men and women in uniform and be especially attentive to those who are deployed, those who are injured, and so forth, which means that a fair amount of that increase, while it may not be optimal and we probably should reexamine it, is understandable. And so some if it, again, does require reexamination, but let's understand where that number came from.

A third piece is that a lot of normal defense costs, just in the regular peacetime activities of the Department of Defense, go up faster than inflation, because they're part of our economy, too, and we all know a lot of costs go up faster than inflation,

whether it's health care, which now costs the Department of Defense 50 billion a year; even leaving aside Veterans Administration activities, which are separate; whether it's environmental cleanup, whether it is pay to try to entice good people into the military at a time when you need to have competitive wages to do that, some of these costs just go up faster than inflation. And I don't want to double count or suggest that this allows for any increase that somebody might propose, but it explains some of it.

And the last piece -- and this is crucial to keep in mind -- in the Clinton years I think we made a sound strategic decision not to buy a lot of weaponry, because in the 1990s we did not need to buy a lot of weaponry because we had bought so much during the Reagan buildup of the 1980s. So, planners, first in the Bush 41 Administration, the George H. Bush Administration, and then in the Clinton Administration, cut the procurement budget by more than half. It was disproportionately targeted for reductions in that period of time. I think it was the right strategic call. Some people would argue it went too far. But in any event, it is not an option available to us today, because we have never managed to repeat anything like the 1980s Reagan buildup. We do not have military equipment that is particularly young, dependable, reliable today. At best, we've been trading water for the last few years. At worst, we've continued to exacerbate the problem because of the intensity and the pace of activity overseas. So, you have to bear these things in mind, and that procurement issue explains another \$50 billion increase, at least, in the 300 billion growth.

So, when all is said and done, I don't want to suggest Defense should get a pass, but the 400 billion to 700 billion increase, you probably have 50- to \$75 billion of that total amount that is really within the reasonable realm of policy discussion and debate. That's a lot of money, but to even save half of that is going to get us to the 350 billion 10-year target. That's going to be hard work by itself. So, the notion that a trillion dollars is easy and there for the picking I just think does not understand the

arithmetic on what's contributed to this cost growth. It doesn't explain the whole situation, but I wanted to lay that out. Thank you for the indulgence.

Alice and then Peter.

MS. RIVLIN: Well, go to Peter, but I have one more point. Since I'm the only dove on this panel I need to have some moment to rebut.

MR. O'HANLON: Well, once we start, I'm not sure if Peter is going to respond directly to that, because I wanted to ask him -- my question for Peter is going to be about any ideas he may have that should be thrown into the mix on reductions so it's a little more specific. So, why don't you go ahead?

MS. RIVLIN: Well, I just want to say why are we having this conversation at all about defense or about domestic discretionary? It's because we face a really big, catastrophic problem of our debt rising faster than our economy can grow. That's programmed in. And when you sit down in a bipartisan group, as I have twice with Simpson-Bowles and Domenici-Rivlin, and say what are going to do about this, then you start with entitlements, as Steve did, and you do various things that will be politically unpopular to reduce the rate of growth of Medicare and Social Security. Then you realize we haven't done anything in the near term, because they figure, well, talking about the retirement programs, you can't change them right away. You've got to face it very slowly and far in the future. So, you're driven to discretionary spending, and you say some of this is not being done as efficiently as it might be, and we need to take this fiscal imperative to do some things that committees and commissions have recommended for a long time. I don't know whether we need a new committee on military personnel. So, most of the things you talked about have been around for a long time and are in lots of reports.

But the acquisition process, everybody knows that it's not very efficient that the Congress weighs in. First, the military is smart enough to set every big weapon

system has to be built in 234 congressional districts, and then if you try to cut anything, including an additional engine for a plane you may not need, then there is congressional weigh-in. So, we have to take this fiscal imperative to do some of the sensible things that might have been done sooner.

And then after you've done all that, you are driven to the revenue side, because even if we do quite drastic reprioritization on both the both the domestic and the defense sides and the entitlements, we're not going to be able to accommodate a larger population of older people that need medical care without some tax increase. So, you've got to have the three things there.

MR. O'HANLON: Peter, if I could turn to you, you may want to respond to this debate as well. But the question I had for you was that, as many in the crowd know, you've written some extremely influential books, including maybe the two definitive books on private military contractors and on military robotics, and these suggest potentially interesting areas of exploring cost savings. And I realize that you've encouraged us not to jump to -- you know, have our detailed proposals the day after the target is announced and to set up a process that's thoughtful. But do you have some instincts about the kinds of options we might at least set out and study further and consider that might spring from either of your two well-known books, either the way in which the private workforce -- the private contractor workforce -- has grown so much over the years or the way in which robotics may now offer possibilities to do certain things more inexpensively?

MR. SINGER: I'll try and weave in answers to both. I think it goes back to this question of what principles are going to guide us in this process. And there are a couple of principles that I think matter and I'll get some heads nodding and then I think I'll also get some heads disagreeing with me as they're laying out.

The first one, it's interesting, we had Ash Carter here, the undersecretary of defense, a couple of weeks ago, and he liked to use the phrase that the famous bank robber, Willie Sutton, said as to they asked him, you know, Why do you rob banks? And he said, because that's where the money is. And so one principle is follow Sutton's Law. And that's true whether you're talking about -- every dollar that the Pentagon spends on weapons, 30 cents of it goes towards buying the weapon, 70 cents of it goes towards maintaining it.

On this question of private military contractors, the Pentagon spends 55 cents on services -- that is billable hours from private military contractors -- versus 45 cents on buying goods. And yet when we look at all of these commissions and the like, they're always about cut this program. Well, that's not where the money is. That's -- you know, it's like robbing the drugstore right beside the bank. This was -- the personnel system is another part of this where it's actually where the much of the cost growth within the Pentagon is.

This leads to the second principle, which is we have to be willing to question 20th century assumptions about 21st century national security. One of those assumptions is the personnel and benefits system. We have a personnel and benefits system that's designed for the generation of "Mad Men," that is now the generation of Google is utilizing. It's expensive. It doesn't fit their needs. It's just antiquated. It's a 1960's model. But -- and this is where I'll get Steve not to nod happily with me -- is questioning assumptions also goes into other areas. So as an illustration, we have to admit that there are certain areas within Pentagon spending where the emperor has no clothes, and we need to stop spending on his wardrobe. National missile defense -- we have spent more on that project than we spent on the entire *Apollo* space program that put a man on the moon.

Now presently, its success rate for the Ground Intercept System is 7 -- sorry, 8 out of 15 in limited tests, so a man on the moon versus a not-that-reassuring success rate. But more importantly if it does become successful, it still is a system that is inadequate to stop the missiles that actually can reach us from Russia or China and maybe big enough to reach the missiles that don't yet reach us. But yet under the current budget, its budget is supposed to increase.

Or another example, our nuclear weapons complex which we only look at through the lens of negotiations with the nation that lost the Cold War. That is, we need to look at nuclear weapons not just through what can we give up in negotiations or not. Another way of putting it is we need to ask ourselves if you cut, say, 200 or 500 warheads from the 5,500 warheads you have, what is the tradeoff? What is the national security value, the protection that you're getting from that 5,252nd warhead versus where could you spend that money on actual military value? I'm not arguing for global zero. I'm just saying these are the kind of tradeoffs that we have to make.

And then to Mike's point on robotics and other new technologies, we have to be willing to look at how we organize ourselves presently, and maybe be willing to cut certain pet rocks. So, you know, whether it's the fact that -- how many tanks do you think the Army actually has? The Army actually has over 5,700 tanks. How many did we use in the 1991 Gulf War? Nineteen hundred. So as an example there, even if we were somehow to get into three mass armored campaigns on the size of the Gulf War in '91, which no military planner would think of, we don't have the logistics to actually get the tanks there. Or in terms of Air Force structure, the cost value of 13 F-35s, we could alternatively package that as 8 F-35s; 2 F-18EF, the electronic warfare growlers; 4 MQ-9 reapers, the current generation of unmanned strike systems; and a Global Hawk. So 13 versus that package and, oh, by the way, you'd still have an extra \$180 million left over.

So it's not, again, whether to cut the entire F-35 program. It's what are alternatives that might give your force planners a better option and a wider array of contingencies? But we're not willing to break those structures because essentially that's the way we've always done it.

MR. O'HANLON: Did you want to respond?

MR. HADLEY: I'll make three quick points. I think this is exactly the kind of debate we need to have. And I do think we need to adapt to the 21st century. I'll give you my example. We're not going to do an Iraq again. We're not going to do an Afghanistan again. I don't think we need to do them again to keep this country safe from the terrorist threat. I think we're going to use a different model in places like Yemen and Somalia. And it's going to be about training and equipping and supporting the local forces, sharing intelligence with them, maybe using our manned aircraft or *Predator* aircraft, maybe occasionally Special Forces. I think that's the model of how we're going to wage the war on terror over the next 10 years.

Then you say what does that mean for our military? What does it mean for our ground forces? And you have to ask exactly the questions Peter asked about the big tank formations. I would argue that if we're going to have that model, we're also going to need civilian capacity to help these states better perform for their people as they deal with these terrorist threats.

Second, strategic forces. You know, arms control I think has been one of the great forces for preventing countries to do smart things with their military because they wait to have a negotiation where they can get some credit for it. And I would like to see us not have a next, you know, strategic arms negotiation with the Russians. I'd like our Russian and American military planners to sit down and talk about how they would like to streamline their respective forces in a transparent and reciprocal way so that we can actually move much more quickly.

Missile defense, we can have that conversation. Of course, it's not directed at China. It's not directed at Russia. It's directed at North Korea and Iran. And I can tell you when the last time we had a Taepodong missile test. We've had two major tests by North Korea. It's a long-range intercontinental ballistic missile. It doesn't work very well -- that's the good news -- but on both occasions --

MR. SINGER: The North Korean one or ours?

MR. HADLEY: The North Korean one. One, also, these systems perform I think a little better than Peter would suggest, but I will tell you that once in the Bush Administration and once in the Obama Administration we put our national missile defense system in Vandenberg Air Force Base in Alaska (sic) on alert so that we could protect against that missile if, in fact, it were coming to Hawaii or the western part of the United States. Now we also used those systems to take out a satellite that was headed towards Earth that was not making a controlled reentry and was going to come and hit potentially at somewhere on the ground. So it has been a big investment for a limited system that is directed at North Korea and Iran, and those are very unstable powers.

But again, my point is not to dispute Peter, but this is the kind of conversation we ought to have, to say what are the real threats out there and what are the real capabilities we need to meet those threats? And then we've got to have the courage to make some bets and prioritize and cut some things.

MR. O'HANLON: And with that, let's go to you. Please, as I say, identify yourselves after a microphone has arrived and pose a question as specifically as you can, preferably just to one panelist.

Ma'am, we'll start here with you. We have microphones coming.

SPEAKER: I'd like to ask both panelists their reaction to the composition of the super committee. Are you encouraged? Do you have concerns?

MR. O'HANLON: Alice, would you like to start?

MS. RIVLIN: Oh, I don't want to comment on the individuals. I think it is a group of people appointed by the leadership; that was the point. And it does not -- it strikes me as a pretty good group, representing the Congress and no -- with one possible exception -- no real extremists.

MR. O'HANLON: Any other comments?

MR. HADLEY: Yeah, I thought it was a pretty good group as well. It's an experienced group. There are a number of people who know how the legislative process works and know how to reach a deal. There are clearly some members who reflect fairly extreme positions within their parties. I think it's going to be a question of leadership. I think the leadership of the co-chairs -- because Alice mentioned something that's terribly important. If you do these groups, they really are most effective if they can be unanimous in their views and --

MS. RIVLIN: They are, but they don't need to be. And one other point, I think it is -- a lot depends on the leadership, but not just of the co-chairs. It's the leaders behind the scenes or hopefully out front. And by that I mean the Speaker and the President particularly.

MR. HADLEY: And that's why I think it is important that the leadership of this group of 12 really try to put pressure on the group to reach something that has fairly broad consensus. I think it will make it more powerful politically with the American people. You need 7 out of 12 if you're going to get the streamlined consideration that Alice talked about.

MS. RIVLIN: Right, so it can't break on party lines.

MR. HADLEY: Right, and we had this problem with the group that Bill Perry and I did, and we got a fairly wide-ranging group and we got a fairly good set of consensus recommendations. And our sense was rather than going for the lowest common denominator, we found that if you are bold and could make your

recommendations a vehicle for proposals for a wide range of your people, you actually got more likely to get consensus by being bold rather than being the lowest common denominator. And if there was one hope I would have for this group, I would hope that they would be bold and see if they can go even beyond the 1.5 that they've been asked to --

MS. RIVLIN: Oh, far beyond it. I think --

MR. HADLEY: That's what I would hope is that they would be bold and see if we can really get something that is going to say to the international community and to our own people we -- this government can perform, can make tough decisions, and can really take on this problem. That's what the American people want to see, and that's what I hope these folks will consider their charge.

MR. SINGER: And there's also, aside from the question of composition, there's a principle I hope they follow, but also the folks within the other agencies like the Pentagon that are now having to wrestle with the potential implications of it. The first thing we need to cut is the chatter. They're not going to be able to be bold if they're constantly running to press conferences and the like. I think, for example, in a past budget drill, Secretary Gates required staffers to sign nondisclosure agreements. I think we're going to need something along the equivalence of this. So that my fear is that we'll constantly see options being floated out there in the press, which will shut down the kind of bold thinking that's needed. And, you know, lobby groups are going to pop up and the like.

And the other aspect of this that we need to remember is that if the group and if these other entities are really going about this seriously, everything's got to be on the table. But in the act of putting everything on the table, it's going to feel like to those within the military or within the other agencies that their programs, even their jobs, are under a threat. And so what you don't want to have happen during the next few months

is sort of a demoralizing effect where people are only hearing about various cuts floated and not understanding the context that they are made in, the strategic tradeoffs that you're doing, et cetera.

MS. RIVLIN: I agree with that, but we keep talking as though this group was going to be talking about defense cuts. I don't think it is. The defense cuts are the fallback position. This group has got to be focused on entitlements and taxes.

MR. O'HANLON: Yes, here. We'll stay in the same row and work our way back.

MR. JOSHIPURA: Sanjeev Joshipura from the Commodity Markets Council, and my question is specifically for Steve Hadley. We've been talking about your report, and I think, if I understood correctly, one of the recommendations in there was to increase spending on the Navy. And I'd just like to understand a little bit more about that. Why specifically the Navy and not the other branches?

And then I have a Part B which is concurrently we've been talking about some of the other sort of non-defense foreign spending in terms of, you know, whether it's democracy promotion or foreign aid or that kind of thing. Could you help us understand what you would increase or decrease in that portion of the foreign budget?

MR. HADLEY: Yeah. The Navy is all about Asia, and if you look over the next 10 years, the United States has a huge interest as does the rest of the globe in what happens in Asia. If you look at the projections for economic growth over the next 10 years -- and Alice is the expert on this -- it's all Asia all the time at this point in time.

Secondly, you have the emergence -- you know, everybody talks about the major emerging countries: China, Brazil, India. I call them the major surging countries. And the integration of China into the global system is a very big challenge for all of us. China is the big player in Asia. It scared a number of our allies in that region. And it's very important if we are going to participate in Asia's economic growth and if we

are going to continue to provide a stabilizing influence in Asia as we have since the end of the Second World War, we need to be present in Asia in every dimension: with our diplomacy; with our military, which has a reassurance effect with our allies and also says to China that we have some capacity there if it adopts a more aggressive posture with respect to allies.

And the key to our military presence is our Navy. And our Navy, you know, 10, 15 years ago was 500+ ships. We're now projected to go to something over 200 ships. And the world isn't any smaller and the surface area that's covered by water is not any less.

So, that's the point about we've got a problem in terms of trade. You know, Asia is being knit together by trade agreements and we're on the sidelines. So, that's driven, really, by the need for the United States to be present in Asia.

Second of all, you know, the point is we've spent since World War II a lot of money, a lot of resources to learn how to recruit, train, exercise, fight, and improve our military. And it has given us the best military in the world by far. It is a huge resource. And that's why as we talk about defense cuts we've got to be careful not to squander that resource.

We have not made anything like that effort to develop the civilian capabilities that will go in after a conflict -- conflict and help rebuild countries and governmental institutions, train their police, train and stand up their law enforcement capabilities, get economic activity going, increase the competence of their government to provide services -- all the things you need to do post-conflict to get a country like Afghanistan and Iraq back on its feet, but also pre-conflict so countries don't descend into violence.

Every time we have one of these challenges we do it as a pickup game. We don't do it very well. We have not made the kind of investment to develop these

civilian capabilities like we have other military. It's a very hard thing to call for the country to do at a time when we're in the kind of budget crunch we are, I grant that. But over the long term, I think we need to invest in these kinds of capabilities. And that's why, I hope, that we follow what Bob Gates said. And at the same time, as we deal with our budget capabilities, we don't do it on the backs of these kinds of capabilities, which not only need to be preserved, if anything they need to be expanded over the next decade.

MR. O'HANLON: Let's go to another question. Here in the third row, please, in the blue shirt.

MR. COLANGER: Thanks very much. Michael Colanger from the Australian Strategic Policy Institute. And this question sort of follows the previous one about those broader principles that are going to guide the kind of cuts that the U.S. is facing.

It's interesting. I mean, this debate has been much about sort of internal dynamics. But the size and the shape of the U.S. military has real implications for allies such as Australia, countries like us and the South Koreans, who are, in fact, growing their militaries quite quickly in response to the point that Stephen just made about the changes in Asia.

So I'm wondering -- my question is both to Peter and to Stephen, perhaps. What are the implications of these cuts that are coming through in the defense budget here for sort of grand strategy, if you like, and in particular, grand strategy in Asia?

MR. O'HANLON: Peter, want to start?

MR. SINGER: I think you hit upon another one of those principles which is through this process not within the super committee, but within particularly the Pentagon, NSC, et cetera, and really the broader policy community. As we're wrestling through this over the next five months a principle is keep your friends in the tent. And

that relates to engaging with allies both about this process -- the first level of engagement actually may be for all the frustration we sometimes have with other allies reducing their defense budgets. They now have lessons learned to pass on to us.

But the other aspect of it is that looking for where are our alliances creating capacity that's doubled rather than where can we be sharing. A particular area in Asia is that essentially the Navy and the Air Force -- the U.S. Navy and the Air Force -- is we're moving towards what's called the Air-Sea Battle Doctrine, which is designed to deal with the growing threats from anti-ship and anti-submarine warfare capabilities emanating from a certain large Asian power that, like Voldemort, shall not be named. The problem of that doctrine is that we actually haven't engaged with our allies about that doctrine even though it relies on those allies. It's a similar thing in NATO. There's certain capacities where we're doubling up.

This aspect of maybe -- of having that communication and finding where can we share, also, though, has another aspect. A tough message needs to be sent out to other allies that essentially we're not in the position to do some of the 20th century things that we did before. To put it more directly, we can't both be creating capacities and only one party is willing to use them, something we've specifically seen in the Libya operation. And that essentially we're getting to the point now where we're going to have to say, you either get in the game, you either pay for someone else to play, or you know what? We're not going to provide that service. And that's the tough part of this dilemma that we're facing.

But, you know, it's an important reminder, though, when we're talking about the comparison between the American budget on -- and to other powers out there. And you know, I did it myself in comparing this scale to the Chinese budget. The difference, though, why we spend so much, is that we are a global power with a global network of alliances, and there's real relationships there. And regardless of decisions that I would

disagree with in terms of where we deployed force in the last decade, we do -- you know, we've engaged in certain discretionary operations, but we have some other enduring alliances that don't change. And that's why, you know, we can't look at this as just going back to 2001 levels.

MR. O'HANLON: Steve?

MR. HADLEY: I agree with that. Australia has been a terrific ally, you know. When we really need someone to be with us, Australia is a country that has been there.

I think some of our European allies -- Europe has really got to decide, are they going to have a real military force or not? Because they have, you know, so cut their budgets and the forces are shrunk, they don't work together in an integrated way, and you're seeing that in Libya. And I think Europeans are going to have to make some tough choices about where they go on their defense establishments, even while they deal with some very severe economic prospects. They have a tendency to have been -- I have to say it -- a free rider, and those days are over.

MR. O'HANLON: Another question. Here in the front row. Sorry. Then we'll work back.

MR. CAPLAN: I'm Mort Caplan, a Washington lawyer. And I don't see how this special committee can be a success unless they face the whole question of meaningful tax reform. I mean, both commissions -- and Alice, you've been part of both -- talked about \$1.1 trillion of tax expenditures a year.

Now, a lot of them have to cut back and maybe it's not fully \$1.1 trillion available. But what success do you think this committee can have when so many members have already committed not to have any tax increase? And even if you take away a loophole for one particular group, it's considered a tax increase by this group of people. So what do you think the chances are?

MS. RIVLIN: I couldn't agree more, Mort. I think tax reform that increases revenues is essential to the success of this committee, as is entitlement reform that reduces future growth. Those are the two imperatives. And if they're successful in bringing forward a package that includes serious tax and entitlement reform -- and it probably can't all be done at once, but at least good steps in that direction -- then we're not going to have this conversation about the defense budget. And we will have moved forward from a precarious position in which we might clearly face a double-dip recession and worse to a sustainable budget.

So, I think you're absolutely right. You've got to do two things, and this is the committee that can do it.

MR. O'HANLON: Another question. Here in the third row on this side.

MR. WILSEE: Clint Wilsee with the American Foreign Service Association. I'd like to go back to a point that you made earlier, Mr. Hadley, about integrating defense and diplomacy more tightly. I think that makes a lot of sense, but in terms of the current budget debate do you think that grouping them has put them in competition, especially given Secretary Panetta's very vigorous defense of the defense budget, State's less vigorous defense, and the fact that defense spending is very popular with the public, the State department less so? And in some cases, foreign aid is not popular at all.

And how do you think we get past those incongruities to something more like what you described?

MR. HADLEY: It's a little bit of a case of be careful what you wish for. Foreign aid is -- you know, one of the problems is foreign aid. It sounds like a giveaway program. And Americans, unfortunately, tend to understand it as such. They think it's a much bigger portion of the federal budget than, in fact, it is. So, I think they really don't understand its purposes and they think it's much more substantial than it is.

So, to counter that -- and the Bush Administration and I think the Clinton Administration tried to do this well -- we tried to make people understand that foreign aid is not actually foreign aid. It is something we do overseas that advances our national security interests. So we were very much interested in putting these kinds of diplomacy and development assistance programs into the national security context as a way of protecting them for cuts.

Fast forward now two years to the deficit problem that we face having succeeded putting them together. Now it's a bit of a Hobson's choice because if the whole package has to shrink, the concern is we will preserve defense spending at the expense of these items.

I think it is right to think of them as an element of our national security strategy. It is the risk that they will suffer as a consequence. And I think the only way to do it is to have a discussion so that people understand what those programs actually do and the contribution they do make to national security.

I think Bob Gates was front and center on that, and I suspect you'll see Leon Panetta when he gets into it picking up the drumbeat. Because a lot of these programs, their principle supporters are actually the U.S. military because they -- our men and women overseas have seen the value of some of these programs. But again, it's a reason why we have to have an informed debate on these subjects, because there is a risk there.

MR. O'HANLON: Another question. Yes, ma'am. In the fifth row. Yes.

MS. GLICK: Thank you. My name is Katy Glick. I'm from the *Wall Street Journal*. My question is, I guess, to whoever on the panel would like to weigh in.

Last week, President Obama highlighted the increasing challenge of unemployed veterans, especially those who are returning from Iraq and Afghanistan. They're unemployed in greater numbers than other groups of veterans. So I'm

wondering, any discussions that any of you may have participated in. Is there any chance that cuts to the defense budget could have an adverse impact on those returning veterans, given that the Department of Defense has played a role in helping them with the transition process?

MR. HADLEY: I think people will be pretty sensitive to that. If you look at the Quadrennial Defense Review, which reviewed -- they talked about the commitment to maintaining the all-volunteer force. But they had also talked about our commitment to the veterans.

General Jim Cartwright, who was vice chairman of the Joint Chiefs, retired last week and I went to his retirement ceremony. And one of the things he said that I think resonated with the audience -- and I think will resonate with the American people -- is that our men and women in uniform who have gone in harm's way on behalf of all of us -- and too many of them have come back grievously wounded -- that we have a lifetime commitment to these people. This isn't just to get them back, heal their wounds, and get them started on the integration into society. We need -- we have a commitment to these people, really, that extends throughout their life. And I think the American people get that.

You know, one of the big differences -- and Alice and I can remember this -- between, you know, the Iraq experience and the Vietnam experience is that the men and -- the American people really love this military and they respect it. And you see it when military people go through airports and people spontaneously break out in applause.

So, I think the American people get it and I think they will provide support to these programs, and I hope the people who are tasked with the responsibilities will keep that in mind.

Michael, can I say one thing? I'm sitting here on this taxes thing, and this is way outside my expertise, but I would just say one thing. I think a lot of Republicans, particularly conservative Republicans, when they hear "balanced approach," they hear "tax increases." And a lot of people think that when you're in a situation where your economy is soft, the last thing you want to do is increase taxes.

MS. RIVLIN: Immediately, but nobody's talking about that.

MR. HADLEY: And that's the point, though. Alice has made exactly the point. We've got to have a measured debate on this because there are some, for example, Republicans who would like to see some tax reductions, they'd like to see the corporate tax rate reduced because corporations are at a competitive disadvantage overseas. So, the question is whether we can be wise enough and clever enough to basically get some people to say, yes, you may get some tax relief, but the only way you're going to get tax relief is if we can do some closing of loopholes and things like this.

I think one of the problems is this debate has gotten politicized and what we need is -- Alice is shocked. (Laughter) Shocked. And we need to have a sensible discussion on this because this is a tricky business. We've got a huge deficit problem and have a very soft economy, and the last thing we need is a double-dip recession. So, we're going to have to work these things, and, again, I'm way outside of my area of expertise, but.

MS. RIVLIN: No, you're not. You're saying exactly the right thing, but it applies to all of the things that we're talking about.

And take entitlements, for instance. One has to make the same point about Medicare and Social Security and Medicaid. One would only reduce those benefits with a lot of lead time, but people don't understand that. You talk to people in the street, and they say I need my Medicare; it's going to get cut. Nobody has been talking about cutting benefits immediately or, indeed, raising taxes immediately. It hasn't even been

part of the conversation, but people have such fear that they're afraid of it. And I made this point on a television program recently, that no one was talking about cutting Medicare or Social Security immediately, and I got a raft of hate mail saying, oh, yes, they are.

MR. HADLEY: Interesting.

MR. O'HANLON: I'm going to take two last questions, take them together, and then give the panel a chance to respond and conclude with any final observations. And we'll take the two at the very end on opposite sides of the aisles. One after the other, please.

MR. HARRISON: Peter Harrison, Headquarters, Air Force. First of all, I wanted to applaud Stephen and Peter for recognizing the importance of Asia and AirSea Battle, but I wanted to say that a lot of the challenges that are being faced are challenges in air and space power. And the Air Force being no less a strategic force and a stabilizing force within Asia, faces some of those problems.

And so, as you discuss your principles for where you want to go, how prominent will be considerations of the industrial base to protect those aspects that give the United States a distinct and asymmetric foreign policy, freedom of action that rely upon global warning, and surveillance to rely upon air mobility and that real high ponderability to have air superiority and to reach out and touch the world to make effects when needed?

MR. O'HANLON: And before we get the responses, ma'am, over to you.

SPEAKER: Thank you. My name is Jenin (inaudible) and I'm with (inaudible) Vietnamese Americans. And I thank you for bringing up the balance approach in Asia.

And my question has to do with business because that's the whole focus. I would believe that the next battle is economic and right here in America. So, would you

address why we're cutting the budget? Would we somehow have some focus to build capacity of our small businessmen here in defense of our own jobs to protect our jobs for our veterans in case Chinese come here and establish companies here with support from their own government without SOEs built in the companies? So, was there any thought of transferring some of the budget from the defense, Air Force, and other weapons into budget to support our small businessmen? Thank you.

MR. O'HANLON: Okay. So, I think we'll just work the other way from which we began. So, Peter, if you don't mind starting and responding any way you'd like to the questions on the table?

MR. SINGER: Sure, and I actually wanted to hit the prior question about veterans, as well. One of the things we need to recognize, and it goes back to that principle of cut the chatter first, is that folks within the military -- and I've experienced this through conversations very recently, including one just last night -- are starting to phrase things in terms of, oh, but what if my job gets cut? Or thinking they're making their decisions on how and where, what service, what offices they choose to go towards based on what they think might happen in the budget. And, so, we need to realize that there are real people behind this. And this leads to another part of it is that what we do not want to happen is the sentiment of someone coming back from Afghanistan or Iraq and the vibe given of thank you very much and we'll see you later. That has to be avoided at all costs.

The second part of that, though, is that we need to be very clear in our discourse related to the Pentagon, and this is not just in these discussions, but even in things like promotion strategy, that we don't turn cost-cutting into the Holy Grail. We're talking about warfighters, and yet, I'm seeing that kind of vibe starting to happen right now. And so that concerns me because this aspect of war-fighting is what distinguishes a veteran from another type of benefit of benefits program or entitlements program. It's

the fact that you're still talking about men and women who are being asked to go into harm's way on behalf of the nation.

To the point about what we can do related to the industrial base in Asia and the like, I think it hits, again, that idea of where are there capacities that will be needed more in the 21st century versus the 20th century? So, another reason why we can't sort of just go back to the 2001 budget is well, back in 2001, you didn't have a cyber command. Back in 2001, you didn't have over 7,000 unmanned aerial systems in the force. Back in 2001, you also didn't have 44 other nations also building unmanned systems. That's the strategic situation today.

But also another aspect of this is the importance of areas like research and development. In every budget cut process in history and in the U.S., and, unfortunately, in every bipartisan advisory commission related to the current crisis, they've always proposed that R&D be cut by a greater amount than the rest of the force, and yet, R&D is your seed corn for when the strategic situation changes. And so, that's an example. And, also, by the way, R&D, in my mind, is what really sustain a national defense industrial base and not so much thinking about it in terms of the distributing jobs in every congressional district. And so, those are some of the principles I hope we keep in mind in this process.

MR. O'HANLON: Thank you. Steve?

MR. HADLEY: I very much agree with Peter. I think you have to say that every time we've done these defense budget cuts, we've tended to do it wrong. And we've in some instances regretted it when a military challenge subsequently emerged in this country. So, it's very hard to do it right. And Peter has laid out in his articles and writings, and I've tried to do, as well, getting some criteria and really forcing the process to be responsive to those criteria.

Second thing I'd just like to say, this is a very challenging time for the country, and sometimes I think there's a sense out there where Americans are beginning almost for the first time to wonder whether the challenges before us are too big for us to handle.

And I was at an event last week with Madeleine Albright talking about 9-11, and one of the things she said at the end of it, which I think was very important, she said, look, 9-11 was a huge challenge. I don't think people really remember how traumatic that was for our country and the kinds of terrorist attacks we anticipated at the time. And through a lot of effort by a lot of Americans, most of what we feared after 9-11 -- follow-on mass casualty attacks, weapons of mass destruction attacks -- did not happen. And the United States actually got through the subsequent 10 years and we dealt with the problem of the terrorist challenge and we did it in a way that didn't require us to fundamentally change our society and be other than who we are and always have been.

That was a huge challenge, and we pulled together as a nation and we overcame it. We now face a huge challenge in terms of this budget deficit. I think we need to remember from things like 9-11, this is an extraordinary country, and we can do these things. We do it in our own messy way, there's a lot of politics. Churchill said the Americans always get it right, they always try every alternative first, and finally in the end, come up with the right, but we do tend to do it right and we can get this done. We can overcome these challenges. And I think that's the thing we have to recognize. We've just got to do it in a smart way.

MS. RIVLIN: I thoroughly agree with that. I think we have to keep in mind that we are facing a new threat and a new situation with respect to the future of the federal budget. We have not been in this situation before. We have done other budget-cutting and we will do other budget-cutting in the future, but, right now, we are facing a

situation which is totally unsustainable. We cannot go on like this. We cannot borrow more and more money because our federal spending under the impact of health care and aging is rising faster than our economy can grow. We can't go on that way.

And it's not a blame game. We got into this for good intentions and we created programs that were very popular, but we have to cut back and we have to raise more revenue and improve our tax code. All of these things are important. They have to be done, as we keep saying over and over on this panel, in intelligent ways and phased in over time, but they have to be done. There's no escape. And that is the challenge to this new process, and we will see in the next few months whether it works or not. The deadline is Thanksgiving. That's not very far from now. So, we will either have a solution or we'll be steering into a pretty deep abyss.

MR. HADLEY: We'll know whether we have a solution sooner than we'll know if the Redskins are going to the Super Bowl.

MS. RIVLIN: You bet. (Laughter)

MR. O'HANLON: And I just wanted to make one very brief comment in response to the question about helping our businessmen and businesswomen. This is maybe an unusual note to finish this sort of a panel on, but domestic discretionary accounts are often severely criticized and they should be scrutinized, but that's also where we sometimes do our investment because these accounts include support for education, for scientific research. They provide a lot of the services that many of us want, like food safety, airplane safety, and so on, and, so, all the more reason why we need a balanced approach that does look at where the big money is, which tends to be as much as anything entitlements. And so, I just wanted to underscore on that last point that if you're worried about investment in our future economy, there are actually some programs the federal government does that are important for that, and we have to remember what they are, as well.

Let me thank you all for being here and please join me in thanking this panel. (Applause)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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