

**SECRETARY OF DEFENSE CHUCK HAGEL
SUBMITTED STATEMENT TO THE HOUSE APPROPRIATIONS
COMMITTEE – DEFENSE ON THE FY 2015 BUDGET REQUEST FOR
THE DEPARTMENT OF DEFENSE
THURSDAY, MARCH 13, 2014**

Chairman Frelinghuysen, Ranking Member Visclosky, members of the committee: thank you for the opportunity to be here today.

The President's Fiscal Year 2015 budget submission for the Department of Defense fully reflects the historic transition taking place as America winds down the longest war in its history. This is a defining budget that will begin adapting and reshaping our defense enterprise for years to come.

With this budget, we are repositioning the military for the new strategic challenges and opportunities that will define our future: new technologies, new centers of power, and a world that is growing more volatile, more unpredictable, and in some instances more threatening to the United States. We are also helping navigate through a period of great uncertainty regarding the future level of resources DoD will have to defend the nation.

I have no illusions about the fiscal realities facing DoD. It was almost exactly one year ago that \$37 billion in sequestration cuts were imposed for Fiscal Year 2013 – cuts that came on top of the \$487 billion, ten-year defense spending reductions required by the Budget Control Act of 2011.

We had to implement this \$37 billion cut in a matter of months while trying to avoid catastrophic damage to national security. It wasn't easy, and our people and our mission suffered for it.

Today, DoD is in a better place as a result of the Bipartisan Budget Act passed in December 2013. It provided DoD with some relief in this Fiscal Year and for Fiscal Year 2015. And it gave us much-needed budget certainty for the next fiscal year.

The Bipartisan Budget Act was possible because members of Congress both Republican and Democrat worked together with this Administration for the greater interests of our country.

But we're not yet where we need to be. So our partnership must continue.

Under the spending limits of the Bipartisan Budget Act, DoD's budget is roughly \$496 billion in Fiscal Year 2014 – or \$31 billion below what the President requested last year. The law also meant cutting DoD spending in Fiscal Year 2015 to \$496 billion, which is \$45 billion less than was projected in the President's budget request last year. And sequestration-level cuts remain the law for Fiscal Year 2016 and beyond.

The President's budget request adheres to Bipartisan Budget Act spending limits for Fiscal Year 2015. But it is clear that under these limits the military will still face significant readiness and modernization challenges next year. To close these gaps, the President's budget also includes an Opportunity, Growth and Security Initiative. This initiative is a government-wide proposal that is part of the President's budget submission. It would provide an additional \$26 billion for the Defense Department in Fiscal Year 2015.

These additional funds are paid for with a balanced package of spending cuts and tax reforms, and would allow us to increase training, upgrade aircraft and weapons systems, and make needed repairs to our facilities. The money is specifically for bringing unit readiness, equipment, and facilities closer to standard after the disruptions and large shortfalls of the last few years. I strongly support the President's proposal.

Defense budgets have long included both a one-year budget request, and a five-year plan that indicates expectations for the future. Over five years, the President's plan projects \$115 billion more in spending than at sequestration levels.

Some have asked why the President continues to request budgets above sequestration levels. The reason is clear. President Obama and I are not going to ask for a level of funding that would compromise America's national security interests. We never would. Continued sequestration cuts would compromise our national security both for the short- and long-term.

That said, if sequestration returns in Fiscal Year 2016 and beyond, or if we receive funding levels below the President's request, we are prepared to specify the cuts we would have to make, and the risks we would then have to assume. These cuts are detailed in this testimony.

However, the President, the Chairman, and I do not expect Congress to push us further down a path that has clear risks to our national security. Instead, we expect that all of us can continue working together, as partners, to find a balance... and to assure America's national security. If Congress is going to require us to operate under increasingly constrained budgets, Congress must partner with us so that we can make the right decisions.

The President's budget matches resources to the updated defense strategy in this year's Quadrennial Defense Review (QDR), which builds on the President's January 2012 Defense Strategic Guidance. The QDR is not budget-driven; rather, it is resource-informed, defining the risks assumed under the President's budget as well as the risks that would be assumed under the return of sequestration. A QDR that completely ignores fiscal realities would be irrelevant.

The QDR outlines our top strategic priorities, which weighed heavily on the choices presented in this budget:

- Defending the homeland against all threats;
- Building security globally by projecting U.S. influence and deterring aggression; and,
- Remaining prepared to win decisively against any adversary should deterrence fail.

By prioritizing DoD's strategic interests, we will rebalance our military over the next decade and put it on a sustainable path to protect and advance U.S. interests and America's global leadership.

To fulfill this strategy DoD will continue to shift its operational focus and forces to the Asia-Pacific, sustain commitments to key allies and partners in the Middle East and Europe, maintain engagement in other regions, and continue to aggressively pursue global terrorist networks.

As a whole, this budget allows DoD to implement the President's defense strategy, albeit with some increased risks, which I specify later in my testimony.

The reality of reduced resources and a changing strategic environment requires us to prioritize and make difficult choices. Given the uncertainty about funding levels, our current five-year plan reduces selected end strengths and forces to levels consistent with sequestration-level cuts. Those additional reductions could be reversed if funding rises above sequestration levels. I explain this in greater detail later in my testimony. The way we formulated our budget gives us the flexibility to make difficult decisions based on different fiscal outcomes.

Budget Top-Lines: Balancing Readiness, Capability, and Capacity

Consistent with the strict spending limits of the Bipartisan Budget Act, President Obama is requesting \$495.6 billion for DoD's Fiscal Year 2015 base budget. Since last year's plans expected \$541 billion for Fiscal Year 2015, this represents a \$45 billion cut. It will allow the

military to protect U.S. interests and fulfill the updated defense strategy – but with somewhat increased levels of risk. DoD can manage these risks under the President’s Fiscal Year 2015 budget plan, but risks would grow significantly if sequestration-level cuts return in Fiscal Year 2016, if proposed reforms are not accepted, and if uncertainty over budget levels continues.

In formulating this budget, our priority was balancing readiness, capability, and capacity – making sure that whatever size force we have, we can afford to keep our people properly trained, equipped, compensated, and prepared to accomplish their mission. That’s the only reasonable course under constrained budgets. There’s no point in having a larger military if you can’t afford to keep it ready and capable.

Accordingly, a little more than two-thirds of DoD’s Fiscal Year 2015 budget – \$341.3 billion – funds our day-to-day costs, what a business might call their operating budget. These funds pay for things like fuel, spare parts, logistics support, maintenance, service contracts, and administration. It also includes pay and benefits for military and civilian personnel, which by themselves comprise nearly half of the total budget.

The remaining third of our budget – \$154.3 billion – pays for investments in future defense needs, or what a business might call their capital improvement budget. These funds are allocated for researching, developing, testing, evaluating, and ultimately purchasing the weapons, equipment, and facilities that our men and women in uniform need to accomplish their mission.

Broken down in a more specific way, our budget includes the following categories:

- Military pay and benefits (including health care and retirement benefits) – \$167.2 billion, or about 34% of the total base budget.
- Civilian pay and benefits – \$77 billion, or about 16% of the total base budget.
- Other operating costs – \$97.1 billion, or about 19% of the total base budget.
- Acquisitions and other investments (Procurement; research, development, testing, and evaluation; and new facilities construction) – \$154.3 billion, or about 31% of the total base budget.

Those figures do not include funding for Overseas Contingency Operations (OCO) in Fiscal Year 2015. Since the Administration is still determining its post-2014 presence in Afghanistan and the President of Afghanistan has yet to sign the Bilateral Security Agreement, the President’s budget currently includes a placeholder for DoD’s OCO request, equal to last year’s request. I appreciate the Congress’s understanding that OCO funding is particularly important to our service members deployed around the world, and request that it be approved expeditiously once the President submits his complete OCO funding request for Fiscal Year 2015.

Being More Efficient

But first, asking taxpayers for half a trillion dollars means that DoD must make every dollar count – particularly under budget constraints. So we’re continuing to find new ways to use our resources more wisely and strategically, be more efficient, reduce overhead, and root out waste, fraud, and abuse.

This year, a new package of reforms in these areas – the second-largest submitted by this Administration – produced \$18.2 billion in savings for Fiscal Year 2015, and some \$93 billion in savings through Fiscal Year 2019. This enabled us to make smaller cuts in other areas. Building on a 20% cut in management headquarters operating budgets – which we began implementing in

December for the Office of the Secretary of Defense and the Joint Staff, and which the services and agencies are implementing during the five-year defense plan – this package includes savings from reducing contractor costs and civilian personnel; terminating or delaying some troubled weapons and procurement programs in favor of higher priorities; and cutting back on costs at certain defense agencies. It also includes health care savings that we found by cutting back lower-priority research projects and construction and by taking advantage of slower growth of health care costs in the private sector.

We are also continuing to monitor previous years' initiatives to use our resources more efficiently, as well as making progress toward auditability on our financial statements. DoD remains committed to becoming fully audit-ready by 2017, and to achieving audit-ready budget statements by this September. This is an ambitious goal for an organization of our size and complexity, and there is still much more work to do. But we are making real progress. Several DoD organizations have achieved important, positive audit results. Last year, for example, the Marine Corps became the first military service to receive an unqualified audit opinion – in this case for the current year of its budget statement.

In addition to these efforts, we must take a serious look at responsible procurement and acquisition reforms that will further increase the buying power of defense dollars. This is particularly important if we're going to protect investments in modernized capabilities. DoD officials are already working closely with Congressional efforts to go over defense acquisition and procurement laws line-by-line, and we hope to start implementing legislative reforms as soon as this year.

No reasonable discussion of allocating our resources more efficiently can avoid the need to reduce excess facilities. With this submission, we are asking you to authorize a round of Base Realignment and Closure (BRAC) to begin in Fiscal Year 2017.

I understand Congress' concerns about BRAC, including your desire to reduce overseas infrastructure first and your frustrations with BRAC 2005. That's why this round will be focused on finding savings rather than reorganization and will feature a rapid payback of up-front costs, and why DoD will continue to reduce overseas infrastructure.

But we must also divest ourselves of excess domestic facilities, and BRAC is the most responsible path. I am mindful that Congress has not agreed to our BRAC requests of the last two years, but if Congress continues to block these requests while reducing the overall budget, we will have to consider every tool at our disposal to reduce infrastructure. We can't keep financing overhead that we don't need, because we're taking that money away from areas that we do need. The more we delay now, the more we'll have to spend later on unneeded installations instead of on training, equipping, and compensating our people – robbing our troops of the resources they need to be able to fight and win decisively when we send them into harm's way.

Congress and DoD must work together as partners to make these decisions wisely – because no matter what, we must reduce force structure and end strength in order to sustain a ready and capable force under constrained budgets.

Sustaining a Ready and Capable Force – Now and in the Future

This is the lesson of every defense drawdown over the past 70 years. Whether after World War II, Korea, Vietnam, or the Cold War, the U.S. military retained more force structure than it could afford to properly train, maintain, and equip – giving too much weight to capacity

over readiness and capability. Because readiness and modernization were sacrificed, it took much more money for the military to recover and be sufficiently trained and equipped to perform assigned missions. And conflict ultimately did resurface.

We can't afford to repeat those mistakes, which is why we decided to trade some capacity for readiness and modernized capabilities, in order to ensure that our military will be well-trained and supplied in arms and equipment. All of our force structure decisions were made strategically – protecting investments in the forces that would be uniquely suited to the most likely missions of the future, and minimizing risk in meeting the President's defense strategy.

Our decisions for investing in a modernized and capable future force were made in a similar way. With the proliferation of more advanced military technologies and other nations pursuing comprehensive military modernization, we are entering an era where American dominance on the seas, in the skies, and in space – not to mention cyberspace – can no longer be taken for granted. Because it is essential for deterring aggression, and because the risk of failure against those potential adversaries would be far greater than against any others, the President's budget puts a premium on rapidly deployable, self-sustaining platforms that can defeat more technologically advanced adversaries.

Sustaining these critical investments under restrained budgets required setting strategic priorities and making difficult tradeoffs. That's why each service's budget allocations were made based on strategy and with the goal of maintaining balance in the readiness, capability, and capacity of the force.

Army: (24% of the President's Fiscal Year 2015 budget)

The Army's \$120.3 billion will support 32 active-duty brigade combat teams in Fiscal Year 2015. Since we are no longer sizing the force for large and prolonged stability operations, the Army will accelerate the pace and increase the scale of its post-war drawdown – reducing by 13%, from about 520,000 soldiers to a range of 440,000-450,000 active-duty soldiers instead of 490,000. To maintain a balanced force, the Army National Guard and Reserves will also draw down, but by a smaller percentage and by a smaller amount than the active Army – reducing by an average of 5%, from about 355,000 Guardsmen and 205,000 Reservists to 335,000 Guardsmen and 195,000 Reservists.

Analysis conducted by the QDR indicated that under the President's budget, the U.S. military's resulting post-war ground force will be sufficient to meet the updated defense strategy: capable of decisively defeating aggression in one major combat theater – as it must be – while also defending the homeland and supporting air and naval forces engaged in another theater.

In terms of capabilities, we chose to terminate and reevaluate alternative options for the Army's Ground Combat Vehicle program, which had become too heavy and needed an infusion of new technology. The Army will also streamline its helicopter force from 7 to 4 airframes. Aging Kiowa helicopters and older training helicopters will be retired and replaced with more advanced Apache helicopters that will move from the National Guard to the active force. In return, the Guard will receive much more versatile Blackhawk helicopters, which are not only critical for warfighting, but also more apt for the missions the Guard conducts most frequently, such as disaster relief and emergency response.

The past decade of war has clearly shown that Apaches are in high demand. We need to put the Apaches where they will be ready to deploy fast and frequently when they're needed. This decision will also help the Guard's helicopter force more closely adhere to state and federal

requirements for homeland defense, disaster relief, and support to civil authorities while still serving as an important operational and strategic complement to our active-duty military. The Guard's helicopter fleet would only decline by 8% compared to the active Army's decline by 25%, and the overall fleet will be significantly modernized under the President's budget plan.

In making these difficult decisions on the Guard and Reserves, we affirmed the value of a highly capable reserve component, while keeping the focus on how our military can best meet future demands given fiscal constraints. We made choices based on strategic priorities, clear facts, unbiased analysis, and fiscal realities... and with the bottom line focus on how best we can defend the United States.

Navy and Marine Corps: (30% of the President's Fiscal Year 2015 budget)

The Navy and Marine Corps are allocated \$147.7 billion for Fiscal Year 2015. The Navy's \$124.9 billion will support a fleet approaching 300 ships and some 323,600 active-duty sailors, as well as help preserve the fleet's modernization programs. The President's budget plan protects our investments in attack submarines, guided missile destroyers, and afloat staging bases – all of which we will need to confront emerging threats. Specifically:

- Virginia-class Attack Submarines: We are requesting \$5.9 billion for FY 2015, and \$28 billion over the FYDP, to support buying two submarines a year through FY 2019.
- DDG-51 Guided Missile Destroyers: We are requesting \$2.8 billion for FY 2015, and \$16 billion over the FYDP, to support buying two DDG-51 destroyers a year through FY 2019. This will grow our destroyer inventory from 62 at the end of FY 2014 to 71 (68 DDG-51s, 3 DDG-1000s) at the end of FY 2019.
- Afloat Forward Staging Bases: We are requesting \$613 million over the FYDP to support buying one afloat forward staging base between now and FY 2019.
- Aircraft Carriers: The President's budget plan enables us to support 11 carrier strike groups, including the U.S.S. *George Washington* and its carrier air wing. If we receive the President's funding levels through FY 2019, we will keep the *George Washington* in the fleet and pay for its nuclear refueling and overhaul. We are requesting \$2 billion in FY 2015 and \$12 billion over the FDYP to support completion of the *Gerald Ford*, construction of the *John F. Kennedy*, and initial procurement of the next carrier.
- F-35 Joint Strike Fighter: The Department of the Navy is acquiring two F-35 variants – the Navy carrier-based variant, the F-35C, and the Marine Corps short-take-off-and-vertical-landing variant, the F-35B. The Navy is requesting \$3.3 billion for eight aircraft in FY 2015 (two F-35Cs and six F-35Bs), and \$22.9 billion for 105 aircraft over the FYDP.

Again, trade-offs were required to prioritize those investments under current budget constraints. In order to help keep its ship inventory ready and modern at reduced budget levels, half of the Navy's cruiser fleet – or eleven ships – will be placed in a long-term phased modernization program that will eventually provide them with greater capability and a longer lifespan. This approach to modernization enables us to sustain our fleet of cruisers over the long term, which is important because they're the most capable ships for controlling the air defense of a carrier strike group.

AS PREPARED – EMBARGOED UNTIL DELIVERY

Despite preserving the fleet's modernization programs and providing for increases in ship inventory over the next five years, I am concerned that the Navy is relying too heavily on the Littoral Combat Ship (LCS) to achieve its long-term goals for ship numbers.

The LCS was designed to perform certain missions – such as mine sweeping and anti-submarine warfare – in a relatively permissive environment. But we need to closely examine whether the LCS has the independent protection and firepower to operate and survive against a more advanced military adversary and emerging new technologies, especially in the Asia Pacific. If we were to build out the LCS program to 52 ships, as previously planned, it would represent one-sixth of our future 300-ship Navy. Given continued fiscal constraints, we must direct future shipbuilding resources toward platforms that can operate in every region and along the full spectrum of conflict.

Therefore, no new contract negotiations beyond 32 ships will go forward. With this decision, the LCS line will continue beyond our five-year budget plan with no interruptions. Additionally, at my direction, the Navy will submit alternative proposals to procure a capable and lethal small surface combatant, generally consistent with the capabilities of a frigate. I've directed the Navy to consider a completely new design, existing ship designs, and a modified LCS. These proposals are due to me later this year in time to inform next year's budget submission.

While these decisions still keep the Navy on track for a 300-ship inventory by 2019, finding the money required to modernize older ships and buy new ones will depend on the Navy's success in its aggressive and ambitious plans to reduce acquisitions costs and use available resources more efficiently, particularly in the acquisition of contracted services. My office will be keeping a close eye on these efforts.

The Marine Corps' \$22.7 billion will support 182,700 Marines, including about 900 more Marines devoted to increased security at embassies around the world. It will also support a geographically-distributed force posture in the Asia-Pacific, which will be critical as we continue rebalancing to the region.

Air Force: (28% of the President's Fiscal Year 2015 budget)

The Air Force is allocated \$137.8 billion in Fiscal Year 2015. We chose to protect funding for advanced systems most relevant to confronting threats from near-peer adversaries – including the F-35 Joint Strike Fighter, the new Long Range Strike Bomber, and the KC-46 refueling tanker. These platforms will be critical to maintaining aerial dominance against any potential adversaries for decades to come. Specifically:

- F-35 Joint Strike Fighter: We are requesting \$4.6 billion for 26 aircraft in FY 2015, and \$31.7 billion for 238 aircraft over the FYDP.
- Long Range Strike Bomber: We are requesting \$900 million for development funds in FY 2015, and \$11.4 billion over the FYDP.
- KC-46 Tanker: We are requesting \$2.4 billion for seven aircraft in FY 2015, and \$16.5 billion for 69 aircraft over the FYDP.

Because we believe research and development is essential to keeping our military's technological edge, the President's budget also invests \$1 billion through Fiscal Year 2019 in a promising next-generation jet engine technology, which we expect to produce improved performance and sizeable cost-savings through less fuel consumption. This new funding will also help ensure a robust industrial base – itself a national strategic asset.

AS PREPARED – EMBARGOED UNTIL DELIVERY

Protecting these investments required trade-offs. In the next five years, in order to free up funding to train and maintain no less than 48 squadrons, the Air Force plans to reduce the number of active-duty personnel from 328,000 airmen at the end of Fiscal Year 2014 to 309,000 airmen by the end of Fiscal Year 2019. The Air Force will also retire the 50-year-old U-2 in favor of the unmanned Global Hawk system, slow the growth in its arsenal of armed unmanned systems, and phase out the aging A-10 fleet.

The A-10 “Warthog” is a venerable platform, and this was a tough decision. But it is a 40-year-old single-purpose airplane originally designed to kill enemy tanks on a Cold War battlefield. It cannot survive or operate effectively where there are more advanced aircraft or air defenses. And as we saw in Iraq and Afghanistan, the advent of precision munitions means that many more types of aircraft can now provide effective close air support, from multirole fighters to B-1 bombers to remotely piloted aircraft, which can all execute more than one mission. Moreover, the A-10’s age is making it much more difficult and costly to maintain. Analysis showed that significant savings were only possible through eliminating the entire support apparatus associated with the aircraft. Keeping a smaller number of A-10s would only delay the inevitable while forcing worse trade-offs elsewhere.

Defense-Wide: (18% of the President’s Fiscal Year 2015 Budget)

The remaining share of the budget – about \$89.8 billion – is allocated for organizations across the Department of Defense.

For Fiscal Year 2015, this includes more than \$7.5 billion for the Missile Defense Agency, which is critical for defending our homeland and reassuring our European allies. This funding will enable DoD to increase the number of Ground-Based Interceptors and make targeted investments in additional defensive interceptors, discrimination capabilities, and sensors. The budget continues to support the President’s schedule for the European Phased Adaptive Approach.

Since special operations forces play a key role in counterterrorism, crisis response, and building partner capacity, the President’s budget for Fiscal Year 2015 allocates \$7.7 billion for Special Operations Command. This is equal to what we requested last year, a 10% increase over what Congress appropriated for Fiscal Year 2014, and will support a special operations force of 69,700 personnel.

The President’s Fiscal Year 2015 budget increases cyber funding to \$5.1 billion and maintains funding for intelligence agencies and other support activities. Through funds allocated to the Navy and the Air Force, the President’s budget also preserves all three legs of the nuclear triad and funds important investments to ensure a safe, secure, and effective nuclear deterrent.

Compensation Reform & Structural Adjustments to Some In-Kind Benefits

For all the money that goes into maintaining a modernized and capable force, people are the core of our military. In this era of constrained budgets, ensuring that our people are properly trained, equipped, prepared, and compensated requires looking at difficult trade-offs and making some difficult choices. Compensation adjustments were the last thing we looked at, because you take care of your people first.

While Congress has taken a few helpful steps in recent years to control the growth in compensation spending, we must do more. At this point, given the steps we’ve already taken to

reduce civilian personnel costs in compliance with Congressional direction, no realistic effort to find further significant savings – savings needed to close serious shortfalls in training, maintenance, and equipment – can avoid dealing with military compensation... That includes pay and benefits for active and retired troops, both direct and in-kind.

We could reduce overall payroll spending by further reducing the total number of people in uniform. But since too small a force adds too much risk to our national security, we must also address the growth in pay and benefits for service members so that we can afford to provide them with the training and tools they need to successfully accomplish their missions and return home safely.

Since 2000, Congress has in some cases boosted pay increases above the levels requested by the Department of Defense. Benefits were added and increased by more than what most active-duty personnel sought, expected, or had been promised when joining the military. Congress also added a new health care benefit and approved DoD proposals to increase housing allowances. As a U.S. Senator I supported such proposals. It was the right thing to do at the time, given the burdens being placed on our service members, the military's recruiting and retention challenges, and the fact that we had few constraints on defense spending.

But today DoD faces a vastly different fiscal situation – and all the services have consistently met recruiting and retention goals. This year we're concluding combat operations in America's longest war, which has lasted 13 years. Now is the time to consider fair and responsible adjustments to our overall military compensation package.

America has an obligation to make sure service members and their families are fairly and appropriately compensated and cared for during and after their time in uniform. We also have a responsibility to give our troops the finest training and equipment possible – so that whenever America calls upon them, they are prepared with every advantage we can give them so that they will return home safely to their families. The President's budget fulfills both of these promises to our service members and their families by making several specific proposals.

Basic Pay Raises

For Fiscal Year 2015 we are requesting 1% raise in basic pay for military personnel – with the exception of general and flag officers, whose pay will be frozen for a year. Basic pay raises in future years will be similarly restrained, though raises will continue.

DoD rightfully provides many benefits to our people; however, finding the money to meet these commitments while protecting training and readiness under tighter budgets will require a few structural adjustments to three of them – housing, commissaries, and TRICARE.

Housing

In the early 1990s, DoD covered only about 80% of service members' total off-base housing costs. Since then, we increased that rate to 100%.

To adequately fund readiness and modernization under constrained budgets, we need to slow the growth rate of tax-free basic housing allowances (BAH) until they cover about 95% of the average service member's housing expenses. We would also remove renters' insurance from the benefit calculation.

This change will happen over several years, to ensure that our people have time to adjust to it. And, in order to ensure that military personnel don't have to pay more out-of-pocket after

they've signed a lease, a service member's allowance won't be adjusted until they've moved to a new location. This means that no one currently living in a particular area will see their housing allowances actually decrease; only service members moving into the area will receive the lower rate, which is what already happens under the current rules when housing market prices go down.

To account for geographic differences in housing costs, we will also design this adjustment to ensure that all service members in the same pay grade have identical out-of-pocket costs. That way, once the overall change has been fully phased-in for all personnel, service members in the same pay grade but living in different areas would end up paying the same dollar amount toward their housing costs – and they'll know exactly how much that will be so that they can make informed decisions and trade-offs in their own budgets.

All of these savings will be invested back into the force, to help keep our people trained and equipped so they can succeed in battle and return home safely to their families.

Commissaries

There's no doubt that commissaries provide a valued service to our people, especially younger military families and retirees. For this reason, we're not directing any commissaries to close.

Like our base exchanges, commissaries currently do not pay rent or taxes. That won't change under any of our proposals. But unlike base exchanges, commissaries also receive \$1.4 billion in direct subsidies each year. In order to adequately fund training and readiness under constrained budgets, we need to gradually reduce that subsidy by \$1 billion (about two-thirds) over the next three years.

Stateside commissaries have many private-sector competitors, and it's not unreasonable for them to operate more like a business. Since commissaries still operate rent-free and tax-free, they will still be able to provide a good deal to service members, military families, and retirees as long as they continue to shop there. Going forward, only commissaries overseas or in remote U.S. locations would continue receiving direct subsidies, which, for example, not only helps pay to ship U.S. goods to bases overseas, but also helps those who either may not have the option of a local grocery store or are stationed where food prices may be higher.

TRICARE

In recent years, Congress has permitted DoD to make some changes that slow the growth in military health care costs; however, these costs will continue to grow, and we need to slow that growth in order to free up funds for training and readiness. So we need to make some additional smart, responsible adjustments to help streamline, simplify, and modernize the system while encouraging affordability.

Merging three of our TRICARE health plans for those under 65 – Prime, Standard, and Extra – into a single, modernized health plan will help us focus on quality while reducing complexity and administrative costs. The new plan would adjust co-pays and deductibles for retirees and some active-duty family members in ways that encourage TRICARE members to use the most affordable means of care, such as military treatment facilities and preferred providers.

AS PREPARED – EMBARGOED UNTIL DELIVERY

Some important features of the military health care system will not change. The scope of benefits will not change, and we will continue to distinguish between in-network and out-of-network care. Active-duty personnel will still receive health care that is entirely free – that’s the promise we make when they sign up, and it’s a promise we intend to keep. Medically retired personnel and survivors of those who died on active duty will continue to be treated favorably, with no participation fees and lower co-pays and deductibles. And DoD will continue to support our programs for wounded warriors.

With the TRICARE single health plan, active-duty family members and retirees under age 65 will be able to save more money by using military treatment facilities (MTF) if they’re close to home, which are often under-used. More than 90% of active-duty service members and their families live within an MTF’s 40-mile-radius service area. For families of active-duty service members stationed far away from MTFs, such as recruiters, all their care will continue to be considered “in-network” even if there are no network care providers in their remote location.

Under this proposal, the share of costs borne by retirees will rise from about 9% today to about 11% – still a smaller cost share than the roughly 25% that retirees were paying out-of-pocket when TRICARE was initially set up in the 1990s. And while we will ask retirees and some active-duty family members to pay modestly more, others may end up paying less. Overall, everyone’s benefits will remain substantial, affordable, and generous – as they should be.

Given these proposed efforts to modernize and simplify TRICARE for retirees under age 65, we will not resubmit last year’s request for sharp increases in enrollment fees for these retirees.

For retirees who are old enough to use Medicare and who choose to have TRICARE as well – what we call TRICARE-For-Life (TFL) – we would ask new members to pay a little bit more as well. Since TFL coverage currently requires no premium or enrollment fee, DoD again proposes a small per-person enrollment fee equal to 1% of a retiree’s gross retirement pay up to a maximum of \$300 per person – comparable to paying a monthly premium of no more than \$25. For retired general and flag officers, the maximum would be \$400 per person. Current TFL members would be grandfathered and exempted from having to pay enrollment fees. Even with this small enrollment fee, TFL members will still have substantial, affordable, and generous benefits – saving them thousands of dollars a year compared to similar coverage supplementing Medicare.

Congress has taken helpful steps in the past, authorizing adjustments to the TRICARE pharmacy co-pay structure and initiating a pilot program for TFL members to refill prescriptions for maintenance medications (such as those that treat high blood pressure and high cholesterol) by mail order. These are good practices that we must now build upon in order to better encourage more TRICARE members to use generics and mail-order prescriptions, which help save the most money. Under our plan, MTFs will continue filling prescriptions without charging a co-pay, while all prescriptions for long-term maintenance medications will need to be filled either at MTFs or through the TRICARE mail order pharmacy. To ensure that our people aren’t caught off-guard and have time to make the necessary adjustments, our plan would be slowly phased in over a 10-year period.

As with our structural adjustments to housing and commissaries, all these savings will go toward providing our people with the tools and training they need in order to fight and win on the battlefield and return home safely to their families.

Military Retirement

Our proposals do not include any recommended changes to military retirement benefits for those now serving in the Armed Forces. Because military retirement is a complex and long-term benefit, it deserves special study. Therefore, we are working with and waiting for the results of the Military Compensation and Retirement Modernization Commission, which is expected to present its report in February 2015, before pursuing reforms in that area. But DoD continues to support the principle of “grandfathering” for any future changes to military retirement plans.

Why Now

DoD’s military and civilian leaders conducted substantial analysis to arrive at our proposed package of compensation adjustments. We concluded that, even after we make these changes and slow the growth in military compensation, we will still be able to recruit and retain a high-quality force and offer generous, competitive, and sustainable benefits.

These proposed compensation adjustments will be phased in over time, but they must begin now because budget limits are already in place. If we wait, we would have to make even deeper cuts to readiness or force structure in order to comply with the budget caps that Congress has passed into law. We must be able to free up funds in order to provide our men and women in uniform with the tools and training they need to succeed in battle and return home safely to their families. Sustaining a well-trained, ready, agile, motivated, and technologically superior force depends on it.

To be clear, our proposals were carefully crafted to reform military compensation in a fair, responsible, and sustainable way, making the most modest adjustments we could afford. We took a holistic approach to this issue, because continuous piecemeal changes will only prolong the uncertainty and create doubts among our personnel about whether their benefits will be there in the future.

We recognize that no one serving our nation in uniform is overpaid for what they do for our country. But if we continue on the current course without making these modest adjustments now, the choices will only grow more difficult and painful down the road. We will inevitably have to either cut into compensation even more deeply and abruptly, or we will have to deprive our men and women of the training and equipment they need to succeed in battle. Either way, we would be breaking faith with our people. And the President and I will not allow that to happen.

We’re also recommending freezing generals’ and admirals’ pay for one year. And as I’ve already announced, I’m cutting the budget of the Office of the Secretary of Defense by 20%. The Joint Staff, the Service Chiefs, and the Combatant Commanders are cutting their management headquarters operating budgets by 20% as well. We’re also continuing to focus on acquisition reform and asking for another round of authority for Base Realignment and Closure.

Risks in The President’s Budget

I’ve outlined the funding levels we need and the decisions we had to make to stay within the limits agreed to in the Bipartisan Budget Act. They add some risks to our defense strategy, but manageable ones.

Over the near-term, because of budget limitations even under the Bipartisan Budget Act and after 13 years of war, the military will continue to experience gaps in training and maintenance – putting stress on the force and limiting our global readiness even as we sustain a heightened alert posture in regions like the Middle East and North Africa. The President’s Opportunity, Growth, and Security Initiative would provide an additional \$26.4 billion to DoD and would allow us to make faster progress in restoring and sustaining readiness – significantly mitigating this risk by closing these near-term gaps in readiness and modernization.

This Opportunity, Growth, and Security Initiative is not a wish list of “unfunded priorities” or “unfunded requirements” – the government-wide Initiative is fully paid-for, and for DoD, this money is specifically intended to bring unit readiness, equipment, and facilities closer to standard after the disruptions and shortfalls of the last few years. Each service receives a share of this funding. For example:

- The Army’s share would go toward additional training and increasing its investment in Blackhawk helicopters.
- The Navy’s share would go toward aviation depot maintenance and logistics and increasing its investment in P-8 Poseidon, E-2D Hawkeye, and Joint Strike Fighter aircraft.
- The Marine Corps’ share would go toward unit-level training and increasing its investment in the H-1 and KC-130 aircraft.
- The Air Force’s share would go toward additional readiness and training range support and increasing its investment in F-35, C-130J, and MQ-9 Reaper aircraft.
- Across the services, DoD would be able to increase funding needed for military construction and facilities repair and maintenance.

We also face the risk of uncertainty in a dynamic and volatile security environment. Budget reductions inevitably reduce the military’s margin of error in dealing with these risks, as other powers are continuing to modernize their weapons portfolios, to include anti-air and anti-ship systems. And a smaller force strains our ability to simultaneously respond to more than one major contingency at a time. But with the President’s budget, our military will still be able to defeat any aggressor.

Sequestration’s Effect on Programs and Risk

However, if sequestration-level cuts are re-imposed in Fiscal Year 2016 and beyond, if our reforms are not accepted, or if uncertainty on budget levels continues, our analysis has shown that we would have to make unavoidable decisions that would significantly increase those risks. As I’ve made clear, the scale and timeline of continued sequestration-level cuts would require greater reductions in the military’s size, reach, and margin of technological superiority.

At a minimum, we would be forced to draw down the active Army to 420,000 soldiers, the Army Guard to 315,000 soldiers, and the Army Reserve to 185,000 soldiers. We would also have to draw down the Marine Corps to 175,000 Marines, and retire a 25-year-old aircraft carrier – the U.S.S. *George Washington* – and her carrier air wing ahead of her scheduled nuclear refueling and overhaul. Keeping the *George Washington* and her carrier air wing in the fleet would cost \$6 billion over the FYDP.

This budgeting process has been marked by uncertainty and irregularity, with changes to our spending assumptions that came late in the process – including congressional action on a Bipartisan Budget Act that provided a new level of spending for Fiscal Year 2015. We also face

the reality that sequestration remains the law of the land beginning in Fiscal Year 2016. As a result, I chose to be conservative in my direction to the military services for this budget submission and directed them to first plan in detail for sequestration-level funding.

Even though the five-year budget plan submitted along with the President's budget request assumes \$115 billion more than sequestration-level funding, in its later years we have programmed for sequestration-level force sizes for the active duty Army, Army Guard and Reserve, and Marine Corps end-strength, as well as for carrier strike groups. It takes time to plan and execute a successful drawdown that preserves capability in the process. Past drawdowns have reduced force structure too fast with too little planning. The resulting problems required significant amounts of time and money to fix.

DoD leaders have assessed that our desired force levels – 440,000-450,000 for the Active Army, 195,000 for the Army Reserve, 335,000 for the Army Guard, 182,000 for the Marine Corps, and 11 carrier strike groups – are sustainable over the long term at the President's budget level. Therefore, Fiscal Year 2016 will be a critical inflection point. DoD will be looking for a signal from Congress that sequestration will not be imposed in Fiscal Year 2016 and the budget levels projected in this five-year plan will be realized. If that happens, we will submit a budget that implements our desired force levels. I have given the military leadership formal guidance that documents these levels.

The bottom line is that if Congress indicates it will build on the precedent of the Bipartisan Budget Act and provide relief from sequestration by appropriating at five-year funding levels equal to those in the President's budget, we will not need to take end strength down to those lowest levels or decommission the *George Washington*.

But if we don't get some clarity in our future funding, we will have to start implementing those changes. And if sequestration-level cuts are re-imposed in 2016 and beyond, we would have to make many other cuts not only to force structure, but also to modernization and readiness – all in addition to making the changes proposed in the President's Fiscal Year 2015 budget plan. That means fewer planes, fewer ships, fewer troops, and a force that would be under-trained, poorly-maintained, and reliant on older weapons and equipment:

- The Army, in addition to shrinking the active-duty force to 420,000 soldiers and the Guard and Reserves to lower levels, would have 50 fewer Light Utility Helicopters in the Guard force.
- The Navy, in addition to retiring the U.S.S. *George Washington* and her carrier air wing, would have to immediately lay up six additional ships, defer procurement for one submarine, and buy two fewer F-35Cs and three fewer DDG-51 guided missile destroyers between Fiscal Year 2015 and Fiscal Year 2019. The Navy would ultimately have 10 fewer large surface combatants than would be expected under the President's funding levels.
- The Marine Corps, as mentioned, would have to shrink to 175,000 Marines. While we would still devote about 900 Marines to increased embassy security around the world, this reduction would entail some added risk for future contingencies as well as sustaining the Marines' global presence.
- The Air Force would have to retire 80 more aircraft, including the entire KC-10 tanker fleet and the Global Hawk Block 40 fleet, as well as slow down purchases of the Joint Strike Fighter – resulting in 15 fewer F-35As purchased through Fiscal Year 2019 – and sustain 10 fewer Predator and Reaper 24-hour combat air patrols. The Air

Force would also have to take deep cuts to flying hours, which would prevent a return to adequate readiness levels.

- Across DoD, operation and maintenance funding – an important element of the budget that supports readiness – would grow at only about 2% a year under sequestration compared to about 3% a year under the President’s budget. This will hamper or even prevent a gradual recovery in readiness. Funding for research, development, testing, and evaluation would decline by 1.3% a year under sequestration instead of increasing by 1.6% under the President’s budget. And there would be no recovery in funding for military facilities repairs and construction.

Although future changes in the security environment might require us to modify some of these specific plans, the strategic impacts are clear. Under the funding levels that the President and I are asking for, we can manage the risks. Under a return to sequestration spending levels, risks would grow significantly, particularly if our military is required to respond to multiple major contingencies at the same time.

Our recommendations beyond Fiscal Year 2015 provide a realistic alternative to sequestration-level cuts, sustaining adequate readiness and modernization most relevant to strategic priorities over the long-term. But this can only be achieved by the strategic balance of reforms and reductions the President and I will present to the Congress next week. This will require the Congress to partner with the Department of Defense in making politically difficult choices.

Our Shared National Interest

Formulating this budget request took courage on the part of many involved in the decision-making process – from the Joint Chiefs to the President. It required new ways of thinking about both short-term and long-term challenges facing our country.

I look forward to working with the Congress to find the responsible ground of protecting America’s interests with the required resources.

As we all know, these challenges and choices before us will demand moral and political courage on the part of everyone who has a stake in our national security and our national leadership. They will demand leadership that reaches into the future without stumbling over the present. Now is the time to summon that leadership – not for any one specific interest, but for our shared national interest.

I appreciate this opportunity to discuss the President’s Fiscal Year 2015 budget request for the Department of Defense, and I look forward to your questions.

Mr. Chairman, thank you.

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