

**DEPUTY SECRETARY OF DEFENSE ASHTON B. CARTER AND
VICE CHAIRMAN OF THE JOINT CHIEFS OF STAFF JAMES A. WINNEFELD JR.
PREPARED TESTIMONY
HOUSE ARMED SERVICES COMMITTEE
AUGUST 1, 2013**

Mr. Chairman, Congressman Smith, Members of the Committee, we appreciate the opportunity to appear before you to discuss the findings of the Strategic Choices and Management Review (SCMR). Let us begin by first thanking the members of the Committee for your continued support of our men and women in uniform, as well as our civilian workforce, especially while our nation is still at war.

The Department remains fully committed to the enactment of the President's FY 2014 defense budget proposal because it supports the goal of deficit reduction while providing the adequate level of resources to maintain a strong national defense in a rapidly shifting and highly complex global security environment.

However, since March 1, sequestration has been the law of the land. Exactly one year ago today, Deputy Secretary of Defense Carter testified before this Committee that "sequestration would have devastating effects on the Department and its personnel both because of the size of the sequester cuts and because of the mindless way the law requires that they be allocated... It introduces senseless chaos into the management of more than 2,500 defense investment programs, waste into defense spending at the very time we need to be careful with the taxpayer's dollar, inefficiency into the defense industry that supports us, and causes lasting disruptions even if it only extends for one year."¹

As predicted, sequestration's impacts on the Department's operations have thus far been damaging and far-reaching. And in the absence of an overall longer-term budget agreement between the President and Congress, we have concluded that we must plan for the possibility that sequestration-level budgetary cuts imposed by the Budget Control Act (BCA) will remain in effect.

Accordingly, Secretary Hagel directed the Deputy Secretary of Defense, working with the Chairman of the Joint Chiefs of Staff and the Department's civilian and military leadership, this past March to conduct a Strategic Choices and Management Review in order to prepare the Department for a range of budget scenarios.

¹ See Attachment 1: Deputy Secretary of Defense Ashton B. Carter, Prepared Testimony, House Armed Services Committee, August 1, 2012.

As its title suggests, the SCMR had two parts, one focused on strategic choices and one focused on managerial ones. This is an important moment strategically, as the United States makes the enormous transition from the post-9/11 decade defined by Iraq and Afghanistan to challenges and opportunities, like the Asia-Pacific rebalance and cyber, which will define our future. Changes in our strategy and changes in our budget are in alignment. Managerial matters like IT consolidation and compensation reforms are not strategic, but if we do not make these changes or Congress does not permit them, then we have less money for strategic change. A unified Review was therefore necessary.

The scenarios considered in the SCMR reflect today's budget debates: They range from the President's FY 2014 defense budget proposal, which includes an additional \$150 billion reduction in defense spending over FY 2014-23 (mostly cuts occurring later in that period), to the BCA "sequestration" caps, which would cut another \$52 billion from defense in FY 2014, with similar cuts each year thereafter. Fundamentally, the SCMR was about preparing options for the Secretary in anticipation of an environment of uncertainty.

The formal SCMR process is now complete, and its findings are sobering. We hope we will never have to make the most difficult choices that would be required if the sequestration-level budgetary caps persist. But the SCMR has formulated and framed these kinds of choices for us, and now we are ready if confronted with this scenario.

STRATEGIC TRANSITION

Before addressing the SCMR findings in greater detail, it is important to understand the strategic environment in which we are operating.

As President Obama made clear in the new Defense Strategic Guidance the Department released in January 2012, we are turning a strategic corner, from a post-9/11 era dominated by the two wars in Iraq and Afghanistan to the challenges and opportunities that will define our future security. Those challenges include: continued turmoil in the Middle East, the persistent and evolving threat of terrorism, proliferation of weapons of mass destruction, a range of new threats such as cyber, and rising powers whose future course is uncertain.

We also see great opportunities, among them: shifting the center of gravity of both our intellectual and physical efforts toward the Asia-Pacific region in order to continue our seven-decade old stabilizing role; developing innovative capabilities from a vibrant defense technology effort; capitalizing on the lessons of the last decade regarding the innovative use of force, including special forces and the integration of intelligence and operations; managing presence in new ways; leveraging the Reserve and Guard components that have performed so superbly over

the past decade; and building the capacity of partners and allies so they may shoulder more of the burden of ensuring a peaceful world.

This great strategic transition coincides with the need to absorb some reductions in defense spending in the interest of the nation's overall fiscal security.

In terms of our responsibility to the American taxpayer, we know that in making this strategic transition, we only deserve the amount of money we need and not the amount of money we have gotten used to.

As a down-payment on these reductions, we successfully trimmed the Department's budget by \$487 billion over 10 years. This half-trillion-dollar adjustment came on top of significant adjustments that Secretary Gates made to eliminate unneeded or underperforming acquisition programs and the numerous efficiency initiatives he implemented. At the same time, our Overseas Contingency Operations (OCO) funding – which is not included in the base budget and which is largely for Iraq and Afghanistan – is also decreasing, now that we have exited Iraq and are drawing down our forces in Afghanistan. These reductions, taken together, compare in pace and magnitude to historical cycles in defense spending the nation has experienced in the past when major conflicts have ended, such as after Vietnam, and after the Cold War.

FY 2013 IMPACT OF SEQUESTRATION

On top of all these reductions, we are now confronted with the harmful effects of sequestration. The blunt, arbitrary, across-the-board spending cuts we experienced in Fiscal Year 2013 have been extremely disruptive to every Defense Department program and have had a devastating impact on readiness.

Sequestration reduced our total FY 2013 budget by \$37 billion, including cuts of \$20 billion in our day-to-day operating accounts. We realized last January, before sequestration kicked in, that we had potentially large budget problems, and we began taking action. We imposed hiring freezes, cuts in travel and conferences, reductions in facilities maintenance, and much more.² But these savings were not nearly enough. The need to provide full wartime funding to our troops, and some unexpected growth in OCO costs, led to a total operating shortfall of more than \$30 billion with just six months left in the fiscal year.

Once sequestration was triggered, we did everything we could under this deliberately restrictive law to mitigate its harmful effects on national security. For example, the President

² See Attachment 2: Memorandum from Deputy Secretary of Defense Ashton B. Carter, "Handling Budgetary Uncertainty in Fiscal Year 2013," January 10, 2013.

used his authority under the law to exempt military compensation from sequestration. We also, of necessity, fully protected funding for Afghanistan and other ongoing operations as well as wounded warrior programs. We are fully protecting our core nuclear deterrent, critical elements of homeland defense, some Special Operations Forces, and other critical capabilities. And we are fully protecting other key expenditures such as those, for example, that allowed school children in our military schools to finish the school year in a way that can be fully accredited.

There are accounts we are preferentially protecting to the extent feasible: First, key features of the new defense strategy that we have described. Second, forces forward-deployed to the Asia-Pacific and the Persian Gulf for possible near-term contingencies, though we have had to trim several deployments to these regions. Third, military family programs. And fourth, certain acquisition efficiencies like multi-year contracts.

But we cannot exempt or protect most of our budget, and so we have been seeing the serious repercussions of sequestration as the months go by. Needing immediately accessible savings, we have been forced to make numerous changes to close this huge gap, ranging from civilian hiring freezes to cuts in facilities maintenance to layoffs of temporary workers. We have also been forced to make major cuts in training and maintenance, seriously damaging military readiness, and we were forced to impose furloughs on our valued civilian employees.

For those who continue to believe that the impact of sequestration, the need to fully fund wartime costs, and growth in OCO costs is overstated, let us share some examples of how it is already having an effect:

- Fewer than half of the Air Force's front line fighter squadrons are combat-ready. The Air Force has until recently grounded 12 combat-coded squadrons – over 10 percent of its active duty squadrons – and many support squadrons. If a crisis erupted, these squadrons would either have to respond at a lower readiness level or take additional time to prepare. The Air Force has recently resumed flying operations at some of these squadrons, but it will take months to restore pilot proficiency fully.
- The Army has cancelled all Combat Training Center rotations for those brigade combat teams not slated to deploy to Afghanistan or to be part of the global response force. That is seven units that will only be partially trained to confront any crisis. This means that if we are called upon to defend South Korea, or to secure chemical weapons in Syria, the young men and women the Commander in Chief will need to send in harm's way will never have had the opportunity to work together as a part of large Army formation.
- The Navy has cancelled multiple ship deployments, including for the USS Truman Carrier Strike Group, which was supposed to deploy to the Middle East earlier this year.

Due to cuts in training and maintenance, we are having to reduce deterrent presence in order to retain the ability to surge the ships needed for a crisis.

- We are now in the fourth week of furloughs for approximately 650,000 DoD civilian employees. These furloughs are harming our maintenance and medical capability, slowing contracting, and having negative effects at most support activities in the Department. The furloughs are also seriously damaging workforce morale. By reducing their pay by 20 percent during every furlough week, we have forced many of our dedicated civilian team members into difficult financial situations – all on top of over two years of frozen pay and minimal performance-based bonuses.

These are just a few significant examples of the many cutbacks that have been caused by sequestration and growth in OCO costs.

THE SCMR PROCESS

It is against this background that Secretary Hagel asked Deputy Secretary Carter and Chairman Dempsey, to conduct the SCMR.³ The Secretary directed that all past assumptions and systems be examined in order to help define the major choices and institutional challenges affecting the Department in the decade ahead.

The SCMR was never intended to define the exact composition of the future force as we undergo the titanic transition we must make from the military of the post-9/11, Iraq, and Afghanistan era to the new strategic era. That is simply not possible because of the uncertainty we face as a result of Washington's budget gridlock.

Rather, the SCMR defined the decision-space faced by the Department's senior leadership, and, in turn, will guide the services and defense agencies in developing their Fiscal Year 2015-2019 budgets later this year, as well as ultimately inform the Department's next Quadrennial Defense Review early next year. The services and defense agencies are now in the midst of determining exactly the shape, size, and readiness of a military operating with severely reduced long-term funding – and what it would be capable of doing. So it is important not to think of the SCMR as rendering a final verdict on how the Department will look in the event sequestration-level cuts persist, but it did formulate the hard choices the leadership will face.

With respect to process and methodology, the SCMR's analytical approach was inclusive, collaborative, and thorough. The group included the service secretaries, the Joint

³ See Attachment 3: Memorandum from Secretary of Defense Chuck Hagel, "Strategic Choices and Management Review," March 15, 2013.

Chiefs of Staff, the combatant commanders, and the undersecretaries of defense, because our preparation for future contingencies has to be shaped by those who are going to execute it. They gathered their staffs into 11 working groups and dozens of subgroups to scrutinize every nickel of defense spending – from bombers to cyber, pay and healthcare, to the size of the Office of the Secretary of Defense, and other defense agencies. We looked at every aspect of the defense establishment – business and acquisition practices, contingency planning, force structure, compensation, and modernization investments. We also reexamined how the military operates, evaluates risk, measures readiness, and determines requirements.

The Department’s senior leadership convened 18 times over a period of three months to review emerging insights and refine options surfaced by the SCMR working groups.

To complement this top-down analysis, as part of the SCMR process we also initiated a bottom-up review conducted by each of the services. The services were asked to propose their own solutions for how to bring down costs and reach the various budget targets—particularly in regards to restructuring their forces. These views were synthesized with the results of the working groups and then discussed by the Department’s entire senior leadership team. The Secretary was briefed throughout this effort and on July 9 he briefed the President on the SCMR’s findings.

Two overarching priorities guided the SCMR’s deliberations:

First, we said we would preserve—to the greatest degree possible—the key tenets of the President’s 2012 Defense Strategic Guidance. The reasoning for this was simple: priorities like rebalancing to the Asia-Pacific and cyber security are essential to the strategic transition we must make to ensure the United States is prepared to confront the challenges and capitalize on the opportunities of the 21st century.

Second, we would look first to savings gained from reducing overhead and structural costs (“tail”) in order to minimize the impact on the capability and readiness of the force (“tooth”).

As noted earlier, in undertaking the SCMR, we scrutinized Department spending under three budget scenarios⁴:

- The President’s FY 2014 budget, which we believe is the right level to meet today’s complex national security threats and achieve savings totaling \$150 billion over 10 years on top of the \$487 billion in cuts mandated by the BCA and begun by us in

⁴ See Attachment 4: Memorandum from Deputy Secretary of Defense Ashton B. Carter, “Strategic Choices and Management Review – End State,” May 29, 2013.

FY 2013. This budget, which includes many difficult cuts, is a responsible way to trim the defense budget because the cuts are carefully calibrated and would ramp up over those 10 years, giving us time to plan and adjust.

- The BCA sequestration-level caps – which would cut DoD funding by \$52 billion next year compared to the President’s budget; if the caps remain in place, the cuts would commence immediately rather than building over time, and would total roughly \$500 billion over 10 years.
- An “in-between” level, which would reduce defense spending by about \$250 billion over FY 2014-23, largely in the latter years of this period.

SCMR FINDINGS

With these guidelines and scenarios as our starting point, the SCMR revealed three key findings:

- 1) In all of the budget scenarios we considered, savings from reducing DoD’s overhead, administrative costs, and operating expenses (which we refer to as “efficiencies”), as well as serious reforms to compensation for civilian and military employees, are both crucial. Compensation alone makes up more than half of the defense budget. If overhead and compensation continue to grow as the budget shrinks, then all of the impact of cuts will fall on the other parts of the defense budget – force structure, training for readiness, and investment in new technologies – resulting in reduced combat power and increased national security risk. These reforms are difficult and painful, but we have to do them, and to do them we need the partnership of Congress and the lifting of many legislative restrictions under which we now operate.

Yet we also found that even the most aggressive and ambitious packages of efficiencies and compensation reform mapped out in the SCMR are not by themselves enough to meet the budget reductions called for in any of the scenarios we analyzed. The SCMR showed that cuts in combat power – force structure, readiness, and investment – will be necessary in all three budget scenarios.

- 2) The SCMR found that over time, a combination of carefully chosen efficiencies and compensation reforms, combined with various carefully and strategically chosen alternative approaches to cuts in force structure, investment, and readiness, could achieve sequestration-level cuts over time. But there is no strategically and managerially sound approach to budget cuts that can close that gap within the next few years. We simply

cannot downsize the force prudently in a few years – it takes time to downsize forces, to cut employees, to close bases, and to reap savings from reforms. Strategic adjustments take time. If sequestration-level cuts must be implemented in the meantime, drastic measures that are not strategically or managerially sound are the result. You see this already in FY 2013, where we had sequestration applied immediately, resulting in such actions as readiness stand-downs and furloughs.

These serious adverse effects occur even if Congress provides flexibility in administering budget cuts and sequestration. Flexibility in this instance would mean that Congress approves program cuts denied in the past and allows reallocation of funding, without regard to existing budget structures or limitations on transfer authority. However, the cuts are too steep and abrupt to be mitigated by flexibility, no matter how broadly defined. Flexibility in time is critical.

- 3) The SCMR showed that the President’s FY 2014 budget proposal allows the Department to still implement the main tenets of the President’s Defense Strategic Guidance. Force reductions in this scenario are necessary, but if accompanied by efficiency and compensation reforms, can be made in a way that incurs only minimal risk to our strategy, cutting parts of the force that are, in a sense, excess to our strategic needs—such as reducing the size of our ground and tactical air forces as we draw down from more than a decade of stability operations in Iraq and Afghanistan.

EFFICIENCY SAVINGS

The SCMR sought to streamline the Department’s overhead by shedding less productive activities and consolidating resources, maximizing what we call “efficiencies” that help us save money by reducing staff and costs.

The SCMR looked to build on the efficiencies initiated by Secretary Gates, who found \$150 billion in savings over a five-year period, and Secretary Panetta, who found \$60 billion of cuts that are reflected in the President’s budget request, as well as the \$34 billion that Secretary Hagel submitted in our latest budget. These efficiencies included the overhaul of our acquisition practices that Secretary Gates and Deputy Secretary Carter began in 2009 when he was the Undersecretary of Defense for Acquisition, Technology, and Logistics and that have begun to show much-needed improvements in the buying power of the defense dollar. The Department is continuing to implement these efficiency campaigns, and we have mechanisms in place for tracking progress. Despite good efforts and intentions, not every proposal has generated the savings we expected, or gained the support of Congress – most notably, BRAC.

The SCMR faced the difficult but necessary task of finding additional efficiencies that would help trim the budget while preserving – and in some cases improving – operational effectiveness. We looked at the whole spectrum of how we do business, and came up with proposals for information technology consolidations, resource sharing and optimization of service medical infrastructure, potential combatant command streamlining, and targeted reductions at defense agencies.

Some of these efficiencies are “best practices” that should be implemented regardless of our budget scenario. One of the SCMR findings in this category that we are already initiating is the phased 20-percent budget reduction for OSD, Joint Staff, and Service headquarters announced last month by Secretary Hagel. Although the 20 percent cut applies to budget dollars, organizations will strive for a goal of 20 percent reductions in government civilians and military personnel billets on headquarters staffs.

We will also be reducing the number of direct reports to the Secretary of Defense by further consolidating functions within OSD, as well as eliminating some positions. Additionally, we will be reducing intelligence analysis and production at combatant command intelligence and operations centers in order to foster closer integration and reduce duplication across the defense enterprise. We calculated that these efficiencies could save more than \$10 billion over FY 2015-19 and almost \$40 billion over FY 2014-23 – over and above the savings from initiatives already underway.

Past efficiency campaigns have shown that implementation can be very challenging, so effective follow-through is critical if savings targets are to be realized. This is especially true of OSD reductions. Therefore, Secretary Hagel asked Deputy Secretary Carter to identify an individual from outside the Department, who is deeply knowledgeable about the defense enterprise and eminently qualified, to direct implementation of the OSD reductions and report directly to the Deputy Secretary.

We also identified a number of efficiencies that would cut a bit deeper and have significant and noticeable impacts that need to be weighed against other priorities. Adding the most aggressive of these proposals to the efficiencies mentioned above could save us as much as \$30 billion over FY 2015-19 and up to \$60 billion over FY 2014-23. We are formulating specific plans now and we will present approved proposals as part of the President’s FY 2015 budget.

It is important to emphasize that these savings from efficiencies, though substantial, will only get us a small fraction of the way to sequestration-level cuts of \$450 billion over the next nine years. One of the numerous myths debunked by the SCMR process is that simply trimming the Department’s civilian bureaucracy will somehow solve our fiscal problems. The numbers simply do not support this fallacy. So while we are committed to implementing efficiencies

wherever they can be found, implementing even the most aggressive ones will constitute only a portion of the cuts required by the BCA sequestration caps.

COMPENSATION SAVINGS

The SCMR also focused on personnel costs. The pay and benefits we provide for our military and civilian employees account for nearly half of the Department's budget. While, to be very clear, the SCMR did not consider actual reductions in pay, it did look at options to slow the rate of growth of pay and benefits. Overall personnel costs have risen dramatically – some 40 percent above inflation since 2001. Studies have shown that if personnel costs continued growing at that rate and the overall defense budget remained flat with inflation, these costs would eventually consume the entire defense budget.

Any discussion of military compensation must acknowledge that no one in uniform is “overpaid” for what they do for this country. The significant military pay and benefit increases over the last decade reflected the gratitude of a nation and the need to sustain a force under considerable stress – especially the Army and Marines – during the height of the Iraq and Afghanistan campaigns. People are DoD's most important asset – and we must sustain compensation packages that recruit and retain the finest military in the world. But the post-9/11 wars are drawing down and in recent years the military services have all comfortably exceeded their recruiting and retention goals.

Likewise, our civilian personnel – 48 percent of whom are veterans themselves – are critical to enabling our war fighting mission, as well as supporting our military families, retirees, and veterans. Civilians fix our tanks, ships, and planes. They staff our hospitals and teach military children. They perform engineering, contracting, financial management, and many other key tasks which allow the Department to develop, acquire, and field our weapons systems and war fighting platforms. They play a vital role in almost everything that we do. And they have already experienced substantial real pay cuts because of pay freezes and furloughs.

But serious reforms to compensation are essential to avoid deeper reductions in combat forces. The SCMR developed a range of possible reforms. Examples include changing military health care for retirees to increase the use of private-sector insurance when available; changing how the basic allowance for housing is calculated so that individuals are asked to pay a little more of their housing costs; reducing the overseas cost of living adjustment; and continuing to limit military and civilian pay raises.

Beyond these proposals, we explored deeper reforms in compensation, such as eliminating civilian pensions for retired military personnel serving in civilian government

service, ending subsidies for defense commissaries, and restricting the availability of unemployment benefits. This package would yield savings of almost \$100 billion over the next decade, but would have a significant impact on our service members and our workforce. But a sequestration-level scenario would compel us to consider these changes because there would be no realistic alternative that did not pose unacceptable risk to national security.

The Department and the Administration have not made any decisions about specific compensation proposals. Instead, the Secretary has asked the Chairman to develop a set of proposals to achieve savings in military compensation that meets savings targets identified in the review – almost \$50 billion over the next decade. He has his OSD staff doing the same for civilian compensation. Both efforts are building on the compensation options considered by the SCMR, looking for the right scale and mix of compensation savings packages that present the least negative impact to the military and civilian force.

In addition, the Military Compensation and Retirement Modernization Commission, established by the FY 2013 National Defense Authorization Act, has appointed nine members and will be meeting regularly over the next few months to examine military compensation issues.

It is important to emphasize that these savings are on top of, and assume that Congress enacts, the President's FY 2014 budget proposals, including compensation reforms such as a one percent military pay raise and TRICARE co-pays.

Many of the additional measures identified by the SCMR have previously been opposed by some members of Congress. We cannot achieve the savings associated with the implementation of these reforms without congressional support. In the absence of these needed authorizations, we will have to find savings elsewhere, which will degrade force readiness, capacity, and capability. The simple fact is that if we maintain the current trajectory of compensation and other benefits, we will have to send many more of our precious people home because we will not be able to pay them all.

The Department is working to identify the congressional requirements and restrictions that make it harder for us to operate more efficiently – ones that must be re-examined in light of our fiscal situation. We need Congress to partner with us in tackling the growing threat to the financial viability of the Department. If we don't act together, the cost of manning the U.S. military and the civilians who support it will continue to grow at a rate that squeezes out budgets for training and modernization, resulting in a "hollowing out" of the force.

STRATEGIC CHOICES FOR FORCES AND MODERNIZATION

The SCMR showed that even the most aggressive efficiencies and compensation adjustments do not create enough savings to meet topline reductions for any of the budget scenarios – and don't come close to meeting sequestration-level cuts. Consequently, we will have to reduce our force structure well beyond those reductions already planned as a result of the \$487 billion budget cuts built into the FY 2014 budget.

The SCMR explored different options for how to accomplish this. At the President's FY 2014 budget level, force reductions can be modest and incur only minimal strategic risk. There are parts of the current force that are excess to our strategic needs, and it is these parts where we would make reductions.

For example, in drawing down from more than a decade of war in Iraq and Afghanistan, we can reduce the size of our ground and tactical air forces—even beyond the current draw down articulated in the FY 2014 President's Budget. Our approach was not to take reductions proportionally across the military services. While we want to preserve flexibility for each military service to develop the best force possible given reduced resources, the Review found that we could still fulfill required missions while reducing Army end strength to between 420,000 and 450,000 in the active component from today's plan for 490,000, and between 490,000 and 530,000 in the Army reserves, from 555,000 today. Similarly, the Air Force can reduce tactical aircraft squadrons – potentially as many as five – and the size of the C-130 fleet with minimal risk. In doing so, our goal is to ensure that, by the end of the Future Years Defense Program (FYDP), we have the minimum force needed to meet operational requirements and surge for contingencies.

The SCMR showed clearly that the deep cuts mandated by the BCA's sequestration caps will not allow the Department to achieve all the features of the President's strategic guidance even if those cuts were imposed slowly over the ten-year period covered by the BCA.

But, as we stressed earlier, the abrupt timeline of the law as currently enacted provides no avenue to make strategic cuts, since under the BCA the defense budget must be reduced immediately, not phased in gradually. Most cost-cutting measures take time to yield savings. An example is savings from cutting our naval fleet – it takes time to recoup savings from bringing down the number of ships, especially for nuclear-powered vessels where our shipyards have limited capacity to safely and securely decommission ships. Similarly, as we reduce the force, it makes good management sense to close bases, but that takes up-front money to begin the process, time to do it properly and effectively, and a few years to begin recouping savings. Even involuntary separations of military personnel, in an effort to reduce force structure quickly, save little in the year they occur because, for most, there would be added costs associated with separation, travel, unused leave, and unemployment insurance.

This is where the SCMR's findings are particularly alarming. Under sequestration, even the most ambitious efficiencies and most draconian cuts to compensation and force structure would yield less than a third of what we would need to comply with the BCA sequestration caps in the next several years – and thus would not shield the Department from making further deep cuts to readiness and training accounts of the kinds we are experiencing this year, as well as requiring disproportionately large cuts to investment accounts – acquisition and R&D contracts – that risk reducing our long-term technological superiority.

As a result, in order to comply with the law in the near-term, the Department would have no choice but to draw down from accounts that are able to produce the largest savings the fastest – readiness and modernization. This would mean disrupting many carefully-conceived acquisition programs and eating deeply into our seed corn – the very investments that give our military a competitive advantage over others. Services would have to defer equipment maintenance, cancel training, halt construction, slow procurement, and stand down on developing and testing new technologies.

To meet these severe caps in the long-term, the SCMR examined two illustrative strategic options that bracket our choices in each force element – one that seeks to preserve a modernized force by sacrificing capacity, and one that preserves larger force capacity at the expense of modernization programs.

The former approach would compel us to make difficult choices about how we provide military forces to deter adversaries, assure allies, and respond to emerging crises. We would further shrink the Army, reduce the number of carrier strike groups and big-deck amphibious ships, and retire older Air Force bombers. We would protect investments to counter anti-access and area-denial threats, such as the long range strike family of systems, submarine cruise-missile upgrades, and the Joint Strike Fighter. And we would continue to make cyber capabilities and special operations forces a high priority. This strategic choice would result in a force that would be technologically dominant, but would be much smaller and therefore able to go fewer places and do fewer things, especially if crises occurred at the same time in different regions of the world.

The second approach would trade away high-end capability for size. We would look to sustain our capacity for regional power projection and presence by making more limited cuts to ground forces, ships and aircraft. But we would cancel or curtail many modernization programs, slow the growth of cyber enhancements, and reduce special operations forces. This would result in a modernization holiday, and a military with dramatically reduced modernization funding may find its ageing equipment and weapons systems less effective against more technologically advanced adversaries.

Whichever way we leaned, we would be forced to adopt a more modest defense strategy. Neither illustrative option we examined in the SCMR is compatible with current strategy as defined in the President's Defense Strategic Guidance.

Under sequestration, a large number of critical modernization programs would be at risk. With respect to force structure, we could see much larger reductions in ground forces: We could see our active Army force shrink from 490,000 soldiers to between 380,000 and 450,000. The US Marine Corps would have to shrink from its current size of 182,000 to between 150,000 and 175,000. Additional choices could also entail significant cuts to the naval fleet, including capital ships, and cuts to Air Force fighter and bomber squadrons. We could see carrier strike groups fall from the current number of 11 to 8 or 9. These reductions would also result in even more veterans – many who have recently served in combat – entering the domestic labor market in a weakened economic environment.

To reiterate, the SCMR did not make final choices among these possibilities, but it did map out various options to reach each budget scenario. The President and Secretary of Defense would obviously make decisions on particular investment or force changes depending on the budget scenario.

What the SCMR does show clearly is that the President's FY 2014 Budget allows us to preserve the Defense Strategic Guidance, the "in-between" budget scenario we evaluated would "bend" the strategy in important ways, and sequestration-level cuts would "break" some parts of the strategy no matter how the cuts were made.

FY 2014 IMPACTS

The SCMR focused on options for the 10-year budget period covered by the BCA, and more immediately for the FYDP covering FY 2015 through FY 2019, but we must also plan for possible sudden cuts in FY 2014 below the President's budget. In FY 2014, the Department would not be able to meet sequestration-level budget reductions by making only the strategic cuts identified in the SCMR; on the contrary, even if we embarked on these profound strategic changes in FY 2014, we would still be \$30-35 billion per year short of the topline target in FY 2014 and FY 2015 – *nearly the whole size of the sequestration cut we took in FY 2013.*

If Congress does not permit us to make rapid cuts in areas like compensation, we would be short even more. We would have no choice but to continue some of the damaging, non-strategic cuts we incurred in FY 2013, compounding an already-serious readiness deficit.⁵

⁵ See Attachment 5: Letter from Secretary of Defense Chuck Hagel to Sens. Levin and Inhofe, "Contingency Plan for \$52 Billion Cut in FY 2014 Defense Budget," July 10, 2013.

We are looking for ways to make these immediate cuts in the least damaging way, but there are few ways to limit their impact. Given the reality that up to half of our budget is essentially placed off limits for savings and that we cannot turn to much of our budget for immediate savings – for example, we cannot generate quick savings from cutting personnel and infrastructure – the only way to implement an abrupt 10 percent reduction in the defense budget is to impose disproportionate reductions in training, maintenance, and investment. Readiness would not improve much from its current degraded level and in some cases would continue to decline. We would also be forced to make disproportionately large cuts in funding for modernization programs, eroding our technological superiority and damaging our Better Buying Power initiatives.

The SCMR analysis showed in the starkest terms how a 10 percent defense spending reduction in reality causes a much higher reduction in military readiness and capability – particularly as we protect necessary spending like funding for Afghanistan, our core nuclear deterrent, and other programs we mentioned earlier. Unlike the private sector, the federal government – and the Defense Department in particular – simply does not have the option of quickly shutting down excess facilities, eliminating entire organizations and operations, and shedding massive numbers of employees – at least not in a responsible, moral and legal way.

The bold management reforms, compensation changes and force structure reductions identified by the SCMR can help reduce this damage, but they will not come close to avoiding it altogether.

CONCLUSION

The abrupt, deep cuts caused by the BCA caps in FY 2014 will force DoD to continue to make the kind of harmful, yet unavoidable, decisions we have had to make during the present fiscal year. If these caps continue in future years, the Department will have to make sharp cuts with far-reaching consequences that will limit combat power, reduce readiness, and irrevocably alter the way the military supports the national security interests of the United States. The SCMR produced options that would prepare the way for these large cuts, but plans alone cannot avoid serious damage to our military capabilities.

The Review demonstrated that strategic cuts are only possible if they are “back-loaded.” While no agency welcomes additional budget cuts, a scenario where we have additional time to implement reductions – such as in the President’s budget – would be far preferable to the deep cuts of sequestration.

Tragically, the prospect of serious damage to national security detailed in this testimony is not a result of an economic emergency or recession that makes a sudden reduction in expenditures necessary. It is not because defense cuts are a mathematical answer to the nation's overall fiscal challenge, or because paths of revenue growth and entitlement spending have been explored and exhausted. It is not because the world has suddenly become more peaceful. It is not due to a breakthrough in military technology or a new strategic insight of some sort that makes continued defense spending unnecessary. It is purely the collateral damage of political gridlock. And friends and potential enemies around the world are watching our behavior.

To be sure, America will remain the world's strongest military power. But we are accepting unnecessary risk. As Secretary Hagel said yesterday, it is unworthy of the service and sacrifice of our nation's men and women in uniform and their families. And even as we confront tough fiscal realities, our decisions must always be worthy of the sacrifices we ask America's sons and daughters to make for the country.

We in the Department of Defense are prepared to make difficult strategic and budgetary choices. We are also committed to finding new ways to improve the way we do business and obtain greater efficiency and productivity in defense spending. But in order to sustain our military's unrivaled strength, we need the cloud of uncertainty dispelled, and not just moved to the horizon, kicking the budget can down the road year by year. Along with budgetary stability, we need time to make changes strategically. And we need the support of Congress to make budget cuts in a managerially sensible way. We need a return to normal budgeting and a deal that the President can sign. Then, together with Congress, we can continue the strategic transition upon which we have embarked, with certainty and stability.

**DEPUTY SECRETARY OF DEFENSE ASHTON B. CARTER AND
VICE CHAIRMAN OF THE JOINT CHIEFS OF STAFF JAMES A. WINNEFELD JR.
PREPARED TESTIMONY
HOUSE ARMED SERVICES COMMITTEE
AUGUST 1, 2013**

ATTACHMENTS

Attachment 1: Deputy Secretary of Defense Ashton B. Carter, Prepared Testimony, House Armed Services Committee, August 1, 2012.

Attachment 2: Memorandum from Deputy Secretary of Defense Ashton B. Carter, "Handling Budgetary Uncertainty in Fiscal Year 2013," January 10, 2013.

Attachment 3: Memorandum from Secretary of Defense Chuck Hagel, "Strategic Choices and Management Review," March 15, 2013.

Attachment 4: Memorandum from Deputy Secretary of Defense Ashton B. Carter, "Strategic Choices and Management Review – End State," May 29, 2013.

Attachment 5: Letter from Secretary of Defense Chuck Hagel to Sens. Levin and Inhofe, "Contingency Plan for \$52 Billion Cut in FY 2014 Defense Budget," July 10, 2013.

**DEPUTY SECRETARY OF DEFENSE ASHTON B. CARTER
PREPARED TESTIMONY
HOUSE ARMED SERVICES COMMITTEE
WEDNESDAY AUGUST 1, 2012**

**EMBARGOED UNTIL RELEASED BY THE
COMMITTEE**

DEPUTY SECRETARY OF DEFENSE ASHTON B. CARTER
PREPARED TESTIMONY
HOUSE ARMED SERVICES COMMITTEE
WEDNESDAY AUGUST 1, 2012

I appreciate the opportunity to join with the Acting Director of the Office of Management and Budget (OMB) in testifying today regarding the effects of sequestration.

Secretary Panetta and I have been emphasizing for many months that sequester would have devastating effects. While I will focus on the impact on the Department of Defense (DoD), Acting Director Zients' testimony makes clear that the effects on non-defense agencies would be equally devastating. We urge Congress to avoid sequestration by devising a comprehensive and balanced deficit reduction package that both the House and Senate can pass, and that the President can sign. Back in February, the President's Budget for FY 2013 in fact contained a proposal for such a balanced reduction. Secretary Panetta and I strongly urge that the Congress enact a balanced deficit reduction plan to avoid sequestration.

Acting Director Zients already described the mechanism by which sequester would work. In my statement today, I describe some impacts specific to DoD. But much of what I say would be echoed by managers in other federal agencies and by industry leaders who furnish critical goods and services to the federal government. And, while I can describe many of sequester's impacts on DoD, I cannot describe a "plan" that somehow eliminates these consequences, or even mitigates them substantially. The reason for this is that sequester was designed to be an inflexible and mindless policy. It was never designed to be implemented. Instead, it was enacted as a prod to Congress to devise a comprehensive package to reduce the federal deficit.

As I illustrate some of the impacts of sequester, it will be clear that it is a policy that should never be implemented. It introduces senseless chaos into the management of more than 2,500 defense investment programs, waste into defense spending at the very time we need to be careful with the taxpayer's dollar, inefficiency into the defense industry that supports us, and causes lasting disruptions even if it only extends for one year. Sequester in FY 2013 would seriously disrupt our forces and programs. Over the longer term, the lower caps in FY 2014 through FY 2021 would require that we substantially modify and scale back the new defense strategy that the DoD leadership, working under the guidance of the President, so carefully developed just a few months ago.

How Sequester Would Work in DoD

If sequestration occurs, it would be governed by the Balanced Budget and Emergency Deficit Control Act (BBEDCA) of 1985, as amended by the Budget Control Act (BCA) of 2011. Congressional report language also specifies some of the detailed procedures for DoD.

Sequestration requires that national defense programs be reduced by almost \$55 billion in FY 2013, and the lowering of the discretionary caps would result in reductions of the same amount in each year from FY 2014 through FY 2021. The DoD budget would bear more than 95 percent of this reduction.

While sequestration and lowering of the discretionary caps could have important effects for each of the next nine years, I will focus today mostly on the effects in FY 2013. In FY 2013 special rules govern the sequester and require an across-the-board application of the cuts that is designed to be inflexible. To determine the size of the sequester by project and account, a percentage will be calculated based on the prescribed dollar cut (almost \$55 billion) and the total of the FY 2013 appropriation and unobligated balances from prior years. Obviously, that percentage cut cannot be estimated precisely until we know the level of FY 2013 appropriated funds and the level of prior-year unobligated funds.

Sequester would apply to all of the DoD budget, including the wartime or Overseas Contingency Operations (OCO) portions of the budget – with only one potential exception that is significant. Under the 1985 Act, the President has the authority to exempt all or parts of military personnel funding from sequestration. If the President chooses to utilize this authority for FY 2013, he must notify the Congress by August 10, 2012, about the manner in which he will exercise the authority. If the President exempts military personnel funding from sequester in FY 2013, then other DoD budget accounts must be cut by larger amounts to offset the military personnel exemption. DoD estimates that the percentage reductions under sequester could range from 8 percent for all DoD accounts (if military personnel funding is fully sequestered) to 10 percent for accounts other than military personnel (if “milpers” funding is fully exempt from sequestration). These estimates assume that Congress provides funds for FY 2013 equal to the President’s request and reflects DoD’s best estimate of unobligated balances from prior years.

OMB will eventually calculate the sequester percentage and will use the percentage to calculate reductions in dollar terms for each budget account. How these reductions are applied in DoD varies between the operating and investment portions of the budget, as specified in law and applicable Congressional report language. Cuts to the operating portions of the DoD budget must be equal in percentage terms at the level of budget accounts. (Examples of budget accounts in the operating budget include Army active operation and maintenance, Navy reserve operation and maintenance, and Air Force Guard operation and maintenance.) Within each budget account in the operating portion of the budget, DoD can determine how best to allocate the reductions based on management judgments. For the investment portions of the budget, the dollar cuts must be allocated proportionally at a lower level of detail identified as “program, project, and activity (PPA)”. More than 2,500 programs or projects are separately identified and must be reduced by the same percentage. Absent a reprogramming action, the inflexible nature of the sequester law

means that DoD would have no authority to vary the amount of the reduction. Within a PPA, however, managers can decide how best to allocate the reductions.

It is important to note that reprogramming – a method used by DoD to shift funding from lower to higher-priority projects during the year when funds are being executed – would at most offer a limited ability to modify the effects of sequester. Under current law, the amount of funds that can be transferred is limited. Moreover, any reprogramming that adds funds to a program or project must be offset by a cut to another program or project, which may be difficult because, as a matter of policy, we seek Congressional approval of reprogramming actions. Reprogramming might be used to offset some effects of sequester but, realistically, it would not offer a means for making wholesale revisions.

To close this description of sequestration, let me say what sequestration would NOT do. Sequestration would generally not affect funds already obligated as of the date the sequester cuts are calculated.

Impacts of Sequester

Acting Director Zients discussed some of the potential effects of the sequester on non-defense programs. Just as in non-defense agencies, sequestration would have devastating effects on DoD and its personnel both because of the size of the sequester cuts and because of the mindless way the law requires that they be allocated. Although we strongly believe that Congress should enact a balanced deficit reduction package and avoid sequestration, we have reviewed the law and identified some of the key impacts sequestration would have on the Department.

As noted earlier, OCO funding – which pays for the added costs of wartime activities – is subject to sequester. Supporting our warfighters in combat is DoD's highest priority. We would therefore endeavor to protect wartime operating budgets as much as possible, including the key operation and maintenance (O&M) accounts. The O&M accounts contain OCO as well as base-budget funding, and these two categories of O&M funding merge together during execution of DoD budgets. We could reduce the base-budget portions of O&M disproportionately and spare the OCO portions. We could take similar steps as needed in other accounts that include OCO funding.

However, especially in the Army and the Marine Corps, this action would lead to large cuts in base-budget O&M. We would seek to minimize effects on training and readiness of units deploying, but we could probably not do so fully. As a result, some later-deploying units (including some deploying to Afghanistan) could receive less training, especially in the Army and Marine Corps. Under some circumstances, this reduced training could impact their ability to respond to a new contingency, should one occur.

Sequestration could also affect training in the other military services. We will seek to minimize effects on readiness. However, Air Force flying hours for pilots could be reduced by several hours a month and Navy steaming days could decline by several days a quarter. The result will be reduced training and lower readiness.

The sequester would force us to reduce funding for civilian personnel, and I would join other senior federal managers in making difficult personnel decisions that will harm all of our departments. Although it is premature to describe in detail how sequester would impact the DoD civilian workforce, it might be necessary to impose a partial hiring freeze or unpaid furloughs. These actions would reduce our capability in important ways: fewer people to fix our weapons including those damaged in war, less expert time and attention available to enter into well-crafted contracts and handle financial transactions, and less support for other critical day-to-day operations.

Military families and retirees would be adversely affected by sequestration. For example, we could be forced to cut back on base support services, facility maintenance, and maintenance of government owned family housing. Commissary hours might have to be reduced. Funds for the Defense Health Program, which provides health care for retirees and military dependents, would be sequestered, resulting in delays in payments to service providers and, potentially, some denial of service.

These various sequestration actions, taken together, would represent a major step toward creation of an unready, “hollow” military force. Military readiness would be added to the list of programs in other departments harmed by sequestration including nutrition assistance for low-income women, education for young students, and research projects designed to improve American lives.

Sequestration would also inevitably lead to universal disruption of DoD’s investment programs. Under current rules that govern the sequester process, every one of our more than 2,500 procurement programs, research projects, and military construction projects would each be indiscriminately reduced. Those who manage these programs would be forced to join many other acquisition managers in non-defense agencies as they seek to accommodate the reduced funding for FY 2013, three months after the fiscal year starts.

Some military managers would be forced to buy fewer weapons. For example, assuming proportional cuts and DoD’s current estimate of the size of the sequester, we would buy four fewer F-35 aircraft, one less P-8 aircraft, 12 fewer Stryker vehicles, and 300 fewer Army medium and heavy tactical vehicles compared with the requests in the President’s Budget for FY 2013. Reductions in buy sizes will cause unit costs of weapons to rise, which will in turn

demand further cuts in buy sizes. In cases where we cannot feasibly reduce the quantity of items bought – ships come immediately to mind – we would have to delay projects. There could be a delay of several months in the new CVN-78 carrier along with delays in the Littoral Combat Ship program and DDG-51 destroyer procurement. Some military construction projects could be rendered unexecutable by sequester. We could be forced to delay fixing schools, defer construction of new medical facilities, and delay environmental cleanup.

I have focused on the effects of sequestration on DoD. But much of the Intelligence Community's funding is within the DoD budget and is also subject to sequestration. As it would in DoD, sequestration would have devastating effects on the Intelligence Community. If sequestration occurs, senior managers in the Intelligence Community would join me and leaders in all affected non-defense agencies as we strive to meet the needs of American citizens while operating under a law that was purposely designed to be inflexible.

While I have focused on effects in FY 2013, sequestration and lowering of the discretionary caps reduces DoD budgets by \$50 to \$55 billion in each year from FY 2013 through FY 2021. The cuts beyond FY 2013 would not have to be implemented in the across-the-board manner that I have just described. But the cuts are still large. Even if the President elects to exempt military personnel funding in FY 2013, the outyear cuts would force the Department to make substantial reductions in military personnel and units in the years beyond FY 2013. Otherwise we will end up with too many units and not enough funds to train and equip them. Significant cuts in military units would, in turn, require that we revisit the national security strategy that the President put in place last January. While it is premature to outline specifics, sequestration would force DoD to revise a strategy that was carefully crafted and designed to meet current national security needs.

Next Steps on Sequester

While we can foresee the harmful impacts of sequester, as I have described, we cannot devise a “plan” that eliminates, or even substantially mitigates them. Sequester defies rational “planning.” It was designed to be irrational. We are working with OMB to understand this complex legislation, and we are assessing impacts. Because we are still five months from implementation, Congress has the time to enact a balanced deficit reduction plan and halt implementation of this inflexible law. In the unfortunate event that sequestration is actually triggered, we will work with OMB and – like all the federal agencies affected by this law – we will be ready to implement.

But we are equally worried about a different type of error. This would occur if sequestration does not happen but we end up triggering some of its bad effects anyway. For example, we do not want to unnecessarily alarm our employees by announcing adverse personnel actions or by suggesting that such actions are likely. We do not want to hold back on the

obligation of funds – either for weapon projects or operating programs – that would have been obligated in the absence of a possible sequester, since this would introduce inefficiency and waste. Nor do we want to cut back on training, which would harm military readiness in a period when we face a complex array of national security challenges. In the charged budgetary environment in which we are operating, this type of error is very real.

Finally, we understand that private companies that serve the Department of Defense and constitute important members of our national security team will be making decisions on issues related to sequester. They face many of the same dilemmas we do, and a number of them have expressed to me their alarm at such a wasteful and disruptive way of managing the taxpayers' money and the talents of their employees. The best thing that can happen for private companies is for Congress to enact a balanced deficit reduction plan that halts implementation of this inflexible law.

Summary

I believe that my testimony today makes clear that sequester would be devastating to DoD, just as it would to every other affected federal agency. It is important to remember that sequester was not a policy designed to be implemented. It was enacted as a prod to Congress to act on the federal deficit.

Congress needs to deal with the debt and deficit problems in a balanced way and avoid sequestration. The men and women of this Department and their families need to know with certainty that we will meet our commitments to them. Our partners in the defense industry, and their employees, need to know that we are going to have the resources to procure the world class capabilities they can provide, and that we can do so efficiently. Allies, partners, friends, and potential foes the world over need to know that we have the political will to implement the defense strategy we have put forward.



DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

JAN 10 2013

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
DEPUTY CHIEF MANAGEMENT OFFICER
DIRECTOR, COST ASSESSMENT AND PROGRAM EVALUATION
DIRECTOR, OPERATIONAL TEST AND EVALUATION
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARIES OF DEFENSE
DEPARTMENT OF DEFENSE CHIEF INFORMATION OFFICER
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTOR, NET ASSESSMENT
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Handling Budgetary Uncertainty in Fiscal Year 2013

Two sources of uncertainty are creating budgetary challenges for the Department of Defense (DoD) in 2013. The first is the fact that the Department is operating under a Continuing Resolution (CR) through at least March 27, 2013. Because most operating funding was planned to increase from Fiscal Year (FY) 2012 to FY 2013, but is instead being held at FY 2012 levels under the CR, funds will run short at current rates of expenditure if the CR continues through the end of the fiscal year in its current form. The Secretary will continue to urge the Congress to enact appropriations bills for FY 2013. But if the CR were to be extended through the end of the fiscal year, it would hinder our ability to maintain a ready force.

The second source of uncertainty is the potential sequestration recently deferred from January 2, 2013 to March 1, 2013 by the American Taxpayer Relief Act of 2012. The possibility of sequestration occurring as late as the beginning of the sixth month of the fiscal year creates significant additional uncertainty for the management of the Department.

Either of these problems, in isolation, would present serious budget execution challenges to the Department, negatively impacting readiness and resulting in other undesirable outcomes. This situation would be made even more challenging by the need to protect funds for wartime operations.

Near-Term Actions

Given the overall budgetary uncertainty faced by the Department, and in particular the immediate operational issues presented by the CR, it is prudent to take certain steps now in order to help avoid serious future problems. I therefore authorize all Defense Components to begin implementing measures that will help mitigate our budget execution risks. For now, and to the extent possible, any actions taken must be reversible at a later date in the event that Congress acts to remove the risks I have described. The actions should be structured to minimize harmful effects on our people and on operations and unit readiness.

Categories of approved actions are identified in Table 1. The authority to implement these actions shall remain in effect until they are revoked in a subsequent memorandum from my office. If Components believe they must take actions that go beyond the categories listed in Table 1, they should present the options for my review and approval prior to their implementation.

Intensified Planning for Longer-Term Budgetary Uncertainty

Given the added challenge of a potential sequestration in March, we must also intensify efforts to plan future actions that might be required should that happen. This planning does not assume these unfortunate events will occur, only that we must be ready.

As they formulate draft plans, Components should follow the guidance that directs the Department to take all possible steps to mitigate harmful effects associated with this budgetary uncertainty and to maintain a strong defense. The details of the guidance are summarized below:

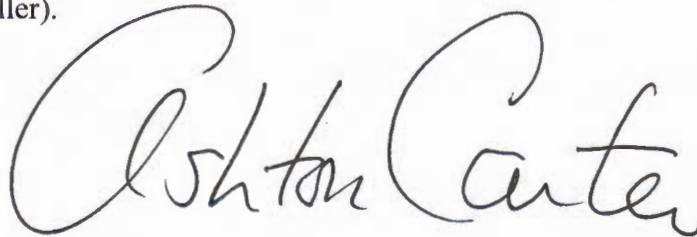
- For the operating portions of the DoD budget:
 - Exempt all military personnel funding from sequestration reductions, in accordance with the decision made by the President in July 2012.
 - Fully protect funding for wartime operations.
 - Fully protect Wounded Warrior programs.
 - To the extent feasible, protect programs most closely associated with the new defense strategy.
 - Reduce civilian workforce costs using the following actions (all subject to mission-critical exemptions, and appropriate consultation with union representatives consistent with Executive Order 13522):
 - Release temporary employees and do not renew term hires.
 - Impose hiring freezes.
 - Authorize voluntary separation incentives and voluntary early retirements to the extent feasible.
 - Consider the possibility of furloughs of up to 30 calendar days or 22 discontinuous workdays.
 - To the extent feasible, protect family programs.

- To the extent feasible, protect funding most directly associated with readiness; focus the necessary cuts on later deploying units.
- For the investment portions of the DoD budget (procurement, RDT&E, construction):
 - Protect investments funded in Overseas Contingency Operations if associated with urgent operational needs.
 - To the extent feasible, protect programs mostly closely associated with the new defense strategy.
 - Take prudent steps to minimize disruption and added costs (e.g., avoid penalties associated with potential contract cancellations where feasible; prudently manage construction projects funded with prior-year monies).

While we are hopeful of avoiding budgetary problems, draft Component plans should reflect the possibility that we may have to operate under a year-long CR and that sequestration takes place. Table 2 shows the types of information that should be included in the plans. Components should submit these draft plans to the Under Secretary of Defense (Comptroller) by February 1, 2013. The Under Secretary of Defense (Comptroller) will work with the Components to adjust this schedule if changes are required due to the deadlines for the preparation of the FY 2014 President's Budget submission.

I appreciate your patience as we work through these difficult budgetary times. The Department will continue to do its best to resolve these budgetary uncertainties in a manner that permits us to support our current defense strategy and maintain a strong defense.

If addressees have questions about this memorandum, they should direct them to the Under Secretary of Defense (Comptroller).

A handwritten signature in cursive script that reads "Ashton Carter". The signature is written in dark ink and is positioned in the lower right quadrant of the page.

Attachments:
As stated

Table 1. Categories of Approved Near-Term Actions

- Freeze civilian hiring (with exceptions for mission-critical activities*).
- Provide authority to terminate employment of temporary hires and to notify term employees that their contracts will not be renewed (with exceptions for mission-critical activities and when appropriate in terms of personnel timing*).
- Reduce base operating funding.
- Curtail travel, training, and conferences (all with exceptions for mission-critical activities* including those required to maintain professional licensure or equivalent certifications).
- Curtail facilities maintenance or Facilities Sustainment, Restoration, and Modernization (FSRM) (with exceptions for mission-critical activities*).
 - If necessary, services/agencies are authorized to fund FSRM at levels below current guidance.
- Curtail administrative expenses such as supply purchases, business IT, ceremonies, etc. (with exceptions for mission-critical activities*).
- Review contracts and studies for possible cost-savings.
- Cancel 3rd and 4th quarter ship maintenance availabilities and aviation and ground depot-level maintenance activities. Take this action no earlier than February 15, 2013.
- Clear all R&D and production contracts and contract modifications that obligate more than \$500 million with the USD(AT&L) prior to award.
- For Science and Technology accounts, provide the USD(AT&L) and the Assistant Secretary of Defense (Research & Engineering) with an assessment of the impact that budgetary uncertainty may have on meeting Departmental research priorities.

*Approvals will be granted by Component heads or by senior officials designated by the Component head.

Components with personnel serving Combatant Commanders (COCOMs) must consult with the COCOMs before implementing actions that affect them. Disputes will be brought to the attention of the Chairman of the Joint Chiefs of Staff for further resolution.

Components receiving reimbursements should coordinate with customer before taking actions that would affect the customer's mission.

Table 2. Information to Be Included in Draft Implementation Plans

The following information should be provided at the Component level. Information by commands and bases/installations is not required.

- For operating accounts, identify major actions to include, at a minimum:
 - Extent of civilian hiring freezes; expected number of temps/terms released; expected number, duration, and nature of furloughs.
 - Reductions in flying hours, steaming days, vehicle miles, and other operations/training/support activities that affect force readiness.
 - Areas of budgets experiencing disproportionate cuts.
- For investment accounts:
 - Plans for large programs (ACAT 1D and 1C, and MAIS programs).
 - Include major changes in unit buys, delays, etc.
 - Significant changes in all joint programs.
- Identify and prioritize any essential reprogramming actions with offsets.



SECRETARY OF DEFENSE
1000 DEFENSE PENTAGON
WASHINGTON, DC 20301-1000

MAR 15 2013

MEMORANDUM FOR DEPUTY SECRETARY OF DEFENSE
SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
CHIEFS OF THE MILITARY SERVICES
COMMANDERS OF THE COMBATANT COMMANDS
DIRECTOR, COST ASSESSMENT AND PROGRAM EVALUATION
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Strategic Choices and Management Review

The Department of Defense must constantly examine the choices that underlie our defense strategy, posture, and investments, including all past assumptions and systems. This will be especially important in the period ahead, as both budgetary and strategic uncertainty affect our planning. We must think and act ahead of this uncertainty, and not in reaction to it.

Accordingly, I am directing the Deputy Secretary of Defense, working with the Chairman of the Joint Chiefs of Staff, to conduct a Strategic Choices and Management Review. This review will:

- Define, for my consideration, the major strategic choices and institutional challenges affecting the defense posture in the decade ahead that must be made to preserve and adapt defense strategy and management under a range of future circumstances.
- Consider the 2012 Defense Strategic Guidance as the point of departure and be informed by the Chairman's Risk Assessment. The results will frame my Fiscal Guidance for the FY 2015 budget and ultimately be the foundation for the statutorily required Quadrennial Defense Review due in February 2014.
- Be inclusive but confidential to allow for the free exchange of ideas. Service Secretaries and Chiefs, Office of Secretary of Defense Principals, and Combatant Commanders will serve as essential participants.

This will be an iterative process, reporting to me at regular intervals with the aim to conclude the process by May 31, 2013. I appreciate your efforts and support in this process. Thank you.



Clark Hagel



OSD003024-13



DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

MAY 29 2013

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
UNDER SECRETARIES OF DEFENSE
CHIEFS OF THE MILITARY SERVICES
COMMANDER, U.S. SPECIAL OPERATIONS COMMAND

SUBJECT: Strategic Choices and Management Review – End State

I appreciate the thorough discussions we have had at the Strategic Choices and Management Review (SCMR) meetings, and am sending out this additional guidance to clarify our end states and discuss the near term due outs. Let me begin by emphasizing that the Secretary and I remain fully committed to the President's defense budget proposal for FY 2014 and the out-year budgetary levels that accompany that proposal. This budget provides the appropriate level of defense resources needed to meet today's complex national security threats. Moreover, the President has proposed a balanced package of deficit reductions, including some further cuts in defense funding, which exceeds the targets in the Budget Control Act. It is our hope that Congress will work to enact this proposed package of deficit reductions, or another package that the President can sign, and then replace sequestration.

We will also continue to defend aggressively the specifics of the President's FY 2014 defense budget proposal at the right level for the Department. However, we do need to develop options in the event that fiscal realities differ from the funding level in the President's budget.

Therefore, a critical output of the SCMR will be internal fiscal guidance for POM 15-19 at the President's Budget level. This guidance will be informed by the SCMR and take into account adjustments needed to bring the DoD topline into compliance with the President's budget. Because we do need to develop options in the event that fiscal realities differ from the funding level in the President's budget, a second output of the review will be separate guidance for Alternative POMs (ALT POMs) at overall Departmental resource levels five percent and ten percent below the resources provided in the President's current budget. Each Service will be provided topline guidance informed by the SCMR work which takes into account the full sequestration cuts.

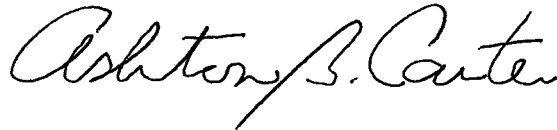
You should also develop options for a FY 2014 budget that is executed at levels other than the level in the President's budget. Specifically, you should consider two assumptions: (1) a cut of 10 percent from each appropriation level proposed in the President's FY 2014 budget and (2) a cut of 10 percent for the total dollars proposed in the President's FY 2014 but with authority to move money among appropriations. Finally, we need to know the adjustments to the President's budget submission for FY 2014 that would be necessary to take into account the currently experienced impacts of the FY 2013 sequestration. These results are due by July 1. At a later date we may need to ask for an alternative at a level 5 percent below the President's budget.



OSD006303-13

We will also be working on additional strategic guidance that will be incorporated into our SCMR products. First, the outcome of our ranking of the refined DSG military missions will indicate potential break points for capacity, capability, and readiness that will be important as you shape your forces to support strategic ends. Second, USPACOM is producing a rapid turnaround adjustment to plans in the Pacific theater.

Finally, we will produce a White Paper that documents the options we considered and their implications for both management and strategy.

A handwritten signature in black ink, reading "Ashton B. Carter". The signature is written in a cursive style with a large, sweeping initial 'A'.

cc:
Chairman of the Joint Chiefs of Staff
Commanders of the Combatant Commands
Chief of the National Guard Bureau



SECRETARY OF DEFENSE
1000 DEFENSE PENTAGON
WASHINGTON, DC 20301-1000

JUL 10 2013

The Honorable Carl Levin
Chairman
Committee on Armed Services
United States Senate
Washington, DC 20510

The Honorable James M. Inhofe
Ranking Member
Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Chairman Levin and Ranking Member Inhofe:

I remain fully committed to enactment of the President's defense budget for Fiscal Year (FY) 2014 because I believe this budget provides the right level of resources to maintain a strong national defense. I also fully support the President's overall budget plan and his FY 2014 budgetary proposals for other federal agencies, which are necessary to support a strong economy and also contribute to a strong national defense by providing support to our troops, veterans, and their families.

I realize, however, that the Department of Defense (DoD) needs a contingency plan in the event that the sequester-level budgetary caps currently imposed by the Budget Control Act (BCA) of 2011 remain in effect. These caps would lead to an approximately \$52 billion cut to the DoD budget compared to the President's FY 2014 funding request, as well as deep cuts to non-defense priorities including education, infrastructure, innovation and more. The attachment to this letter provides a high-level summary of an early version of DoD's contingency plan for FY 2014 with a \$52 billion cut.

I strongly oppose cuts of that magnitude because, if they remain in place for FY 2014 and beyond, the size, readiness and technological superiority of our military will be reduced, placing at much greater risk the country's ability to meet our current national security commitments. This outcome is unacceptable as it would limit the country's options in the event of a major new national security contingency.

These serious adverse effects occur even if Congress provides flexibility in administering budget cuts and sequestration. Flexibility in this instance would mean that Congress approves program cuts denied in the past and allows reallocation of funding, without regard to existing budget structures or limitations on transfer authority. However, the cuts are too steep and abrupt to be mitigated by flexibility, no matter how broadly defined. These points are well illustrated by looking at the effects of a \$52 billion cut in FY 2014:



- With or without additional flexibility, the Department would not be able to substantially reduce military personnel costs in FY 2014 without draconian actions – a constraint that significantly worsens the pressure on other budgetary accounts and saves very little money upfront.
- Sequestration in FY 2013 is severely damaging military readiness. In FY 2014 the Department would seek to minimize cuts in the day-to-day operating costs most closely related to training and readiness. Instead DoD would, for the second year in a row, impose hiring freezes and sharply reduce facilities maintenance – sometimes leaving the Department with too few people to perform needed work or with employees working in substandard conditions. The Department hopes to avoid a second year of furloughs of civilian personnel, but DoD will have to consider involuntary reductions-in-force to reduce civilian personnel costs. However, these actions alone would not be sufficient. Given a cut of \$52 billion, even with flexibility in administration, training and overall readiness would at best remain constant at current low levels and, in some cases, would continue to decline.
- The difficulty of substantially reducing military personnel funding in FY 2014 would likely require disproportionately large cuts in the Department’s investment accounts – assuming flexibility in implementing changes, cuts of 15 to 20 percent would be common. The resulting marked slowdown in modernization would reduce our long-term, critically important and historic technological superiority and undermine our better buying power initiatives.
- The bottom line: with or without flexibility, administering a \$52 billion cut would have severe and unacceptable effects. In particular, if such a cut and the sequester mechanism were applied to military personnel funding, DoD could accommodate the required reductions only by putting into place an extremely severe package of military personnel actions including halting all accessions, ending all permanent-change-of-station moves, stopping discretionary bonuses, and freezing all promotions.

Part of the solution to the current budgetary impasse will require that Congress become a full partner in ending business-as-usual practices – in areas such as infrastructure, benefits and procurement – that would otherwise require further cuts to readiness, modernization and combat power. We urgently need Congressional support in enacting difficult but necessary measures proposed by the President in his FY 2014 and prior budgets. These include slowing growth in military pay raises in a manner that still supports the all-volunteer force and raising fees for health care programs for retirees while still maintaining the generous benefits they deserve. Other key initiatives include the retirement of some lower-priority weapons, including Navy ships and Air Force aircraft. The Congress also needs to eliminate restrictions on the rate of the drawdown in military end strength for the Army and Marine Corps, permit the Department to end programs such as the C-27 aircraft, and enact other cost-saving proposals, such as a new BRAC round. If Congress does not approve these proposals, even more cuts in combat

power, readiness and modernization would be needed to accommodate cuts of \$52 billion in FY 2014 and similar cuts in later years.

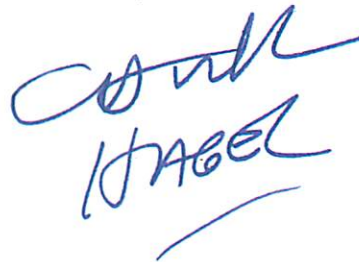
In sum, the abrupt, deep cuts caused by the BCA caps in FY 2014 will force DoD to make non-strategic changes. If the cuts continue, the Department will have to make sharp cuts with far reaching consequences, including limiting combat power, reducing readiness and undermining the national security interests of the United States. I directed a Strategic Choices and Management Review to develop options that would accommodate these large cuts, but these options cannot avoid serious damage to our military capabilities.

Because of my great concern regarding the effects of reduced discretionary caps in FY 2014 and beyond, I urge Congress to pass a balanced deficit reduction package that the President can sign that would replace these deep and arbitrary budget cuts in FY 2014 and in future years. A comprehensive solution of this nature would do much to support the mission of the DoD and the mission of other federal agencies, including agencies that provide important support to the Department and to our troops and veterans.

In coming months, my senior team will provide briefings and updated information on the FY 2014 budget to the Committee. I look forward to working on this critical issue with both of you, the Senate Armed Services Committee, and members of Congress.

Thank you for your continued support of our men and women in uniform and our entire civilian workforce.

Sincerely,

A handwritten signature in blue ink, appearing to read "Carl Habel", with a horizontal line underneath the name.

Attachment: As stated.

ATTACHMENT

Contingency Plan for \$52 Billion Cut in FY 2014 Defense Budget

Secretary Hagel remains fully committed to enactment of the President's budget plan for Fiscal Year 2014, including his budget proposal for non-defense agencies and his defense budget proposal. The President's defense budget provides the resources that the President and Secretary of Defense believe are appropriate to maintain a strong national defense in the face of complex national security challenges. The President's budget proposal is consistent with the caps originally imposed by the Budget Control Act (BCA) of 2011, which led to a ten-year reduction of \$487 billion in Department of Defense (DoD) budgets, and the American Taxpayer Relief Act of 2012. However, provisions of the BCA, when coupled with the failure of Congress to enact a deficit reduction package in 2011, have led to additional reductions in the BCA caps (referred to as "sequester-level" caps).

The sequester-level BCA cap reduction for FY 2014 would result in a cut of \$52 billion in funding in FY 2014 compared with the President's budget. If, contrary to the administration's intent, these sequester-level BCA caps remain in effect, DoD would be required to make major changes to its current plans. The plan described in this attachment provides a high-level summary of an early version of DoD's approach to operating at those lower budget levels. All funding cuts in the plan refer to changes in DoD's base budget. The Department assumes that funding for Overseas Contingency Operations (OCO) remains at the level requested by the President.

In formulating this contingency plan, DoD is being guided by inputs from the military services and defense agencies and by the preliminary results of the Strategic Choices and Management Review (SCMR). The SCMR was directed by Secretary Hagel and sought, in the limited time available, to scrutinize every aspect of the U.S. defense establishment to enable the most sensible adjustments assuming various levels of resource reductions. At the same time, the SCMR seeks to adhere, wherever possible, to the tenets of the Defense Strategic Guidance (DSG) such as the rebalance to the Asia Pacific.

While the SCMR was principally oriented towards the FY 2015-2019 budget submission, its principles and findings are applicable to FY 2014 contingency plans. Accordingly, wherever possible DoD would seek management efficiencies and controls on compensation growth before making cuts to force structure, modernization, and readiness. Nonetheless, under any version of sequester-level BCA cuts, reductions to the latter categories will be required. Moreover, the depth and abruptness of the reductions required to fit under the post-sequestration cap would, even with flexibility, substantially limit our ability to implement those cuts in a way that fully protects the tenants of the DSG.

Of note, one of the biggest challenges in formulating our plan for FY 2014 involves uncertainty regarding post-FY 2014 budgetary cuts, especially large cuts such as

those that could occur under the current version of the BCA. What is assumed can determine key decisions such as the timing of personnel reductions.

As requested, DoD's contingency plan addresses the effects of sequester-level cuts of \$52 billion assuming Congress grants DoD flexibility in implementing the reductions. Flexibility would mean that Congress approves program cuts denied in the past and allows reallocation of funding, without regard to existing budget structures or limitations on transfer authority. However, even with such flexibility, DoD would not be able to mitigate the significant and detrimental impacts associated with sequester-level cuts.

DoD's contingency plan addresses the effects on each of the Department's major categories of funding.

Military Personnel Effects

Even if faced with the large and steep cut of \$52 billion in FY 2014, DoD would likely be able to impose only relatively modest cuts in currently planned funding for military personnel, assuming it had the flexibility to limit the size of those cuts. Military personnel funding cuts would be disproportionately small (probably only a few percent of total military personnel funding) because reducing the size of the military yields relatively small savings in FY 2014. Even involuntary separations of military personnel save little in the year they occur because of added costs associated with separation payments for those with more than six years of service along with added travel costs, costs for payments of unused leave, and in some cases unemployment insurance costs. Achieving a proportional, 10 percent cut in military personnel funding in FY 2014 would require that DoD put in place an extremely severe package of military personnel actions including halting all accessions, ending all permanent-change-of-station moves, stopping discretionary bonuses, and freezing all promotions.

The inability to reduce military personnel costs quickly would put additional downward pressure on other portions of the FY 2014 budget. To avoid a repeat of this situation in future years, DoD could draw down the size of the military more quickly beginning in FY 2014 in order to free up resources in later years. To permit a more rapid drawdown, Congress would need to repeal laws restricting the military end strength reductions in the Army and Marine Corps. A substantially faster drawdown would probably require significant numbers of involuntary separations in FY 2014, a decision that raises the unfortunate prospect of forced separations of personnel who have recently served in Afghanistan.

Implementing sequester-level cuts would be made even more difficult if Congress fails to support the military pay raise of 1.0 percent proposed in the President's FY 2014 budget. If that raise grows to 1.8 percent, as some in Congress have proposed, it would add about \$0.5 billion in FY 2014 funding requirements – which would force even larger cuts in other spending categories.

Effects on Operation and Maintenance and Readiness

Reductions in day-to-day operating costs, which are financed out of the operation and maintenance (O&M) appropriation, would pose particularly difficult problems in the event of a \$52 billion cut -- even with flexibility. O&M finances much of the cost of training and readiness, both of which have already been severely affected by the FY 2013 sequester. DoD needs additional FY 2014 funds, not further cuts, in order to recover. The O&M appropriation also pays for most of the Department's civilian personnel, who have already been hit with a series of pay freezes along with furloughs. For all these reasons there is strong pressure to increase O&M funding.

Despite this pressure, O&M funding could not be protected if DoD had to accommodate a reduction of \$52 billion in FY 2014 because this appropriation makes up almost 40 percent of the budget in FY 2014. Indeed, most services and agencies would likely cut O&M by roughly 10 percent -- the same size as the cut in the total budget -- and some would cut O&M by even more. Wherever possible, O&M cuts would be achieved through reductions in funding for activities such as facilities maintenance, base operating funding, and support to community events. While less directly related to readiness than training and maintenance, these funding cuts cause significant harm. Cutbacks in community support hurt recruiting efforts and disrupt or halt community activities that help build bonds between the military and local citizens. Limits on FY 2014 facilities maintenance, especially in the wake of sharp cuts in FY 2013, would add to the list of facilities that need work. A military that prides itself on technical superiority would increasingly have to ask its workforce to labor in substandard facilities. Overall these various actions would reduce jobs in local communities, including many jobs in small businesses, and so contribute to disrupting community life in areas near military bases.

Cuts in O&M funding would also affect DoD's civilian workforce because many civilians are paid with O&M dollars. DoD is hoping to avoid furloughs of civilian personnel in FY 2014, but the Department might have to consider mandatory reductions-in-force (RIFs). As with involuntary separations of military personnel, RIFs don't save much in FY 2014 but would help accommodate funding caps in later years. While painful, RIFs would permit DoD to make targeted cuts in civilian personnel levels rather than the more across-the-board cuts associated with furloughs.

While DoD would attempt to protect the O&M funding most closely related to training and readiness, full protection would be impossible. Therefore most services conclude that military training and readiness would remain at currently degraded levels or, in some cases, would even continue to decline if a sequester-level cut of \$52 billion occurred in FY 2014. For example, faced with a \$52 billion cut in FY 2014, two Navy air wings might not be able to achieve full flight hours and special operations units, which are key to counter terrorism activities, would experience declining readiness. The Army, which this year has cancelled many of the culminating training events at its combat training centers, would have difficulty avoiding similar cutbacks in FY 2014. The Air Force, which this year has had to stop all flying at about one third of its combat-coded active squadrons, would significantly reduce training at more than half of its active

flying units. Maintenance cutbacks would continue or worsen, threatening future readiness levels.

These major cutbacks in military training and readiness are of great concern primarily because they would reduce deployable U.S. combat power. In the event of a major military contingency, they might leave the country without the ready forces needed to fight effectively. A lack of training also contributes to accidents. For example, data for pilots show that those who fly for fewer hours experience a greater mishap rate caused by pilot error. Simply put, training cutbacks put our military's pilots at greater risk. Finally, training cutbacks hinder morale and our ability to retain our best people. Military personnel join to train hard and, if necessary, to fight the nation's wars – not to remain idle because of funding problems. As Chairman of the Joint Chiefs of Staff, General Martin Dempsey, aptly stated: "Today's readiness problem is tomorrow's recruiting and retention problem."

Congress should avoid exacerbating these serious training and readiness problems by accepting changes already proposed in the President's budget that hold down O&M spending. Specifically, Congress should accept the TRICARE fee changes proposed in the President's budget. Otherwise the Department will be faced with finding almost \$1 billion in additional O&M cuts, which inevitably will further hurt training and readiness. Congress should also permit DoD to immediately retire the seven cruisers and two LSDs proposed for retirement – an action that would eliminate lower-priority ships and save about \$0.6 billion in FY 2014 operating costs – and support the retirement of all Air Force aircraft proposed in last year's budget. DoD also urges the Congress to enact other cost-saving proposals made by DoD such as ending the C-27 aircraft program. As it works to reduce numbers of civilian personnel, DoD would benefit from changes in the law in order to carry out reductions by targeting lower-performing individuals. Finally, the Department hopes that Congress will support DoD's request for another round of Base Closure and Realignment (BRAC) in 2015. While BRAC will not save near-term dollars, the past five BRAC rounds are now saving more than \$12 billion a year, and another round will eventually add to these substantial savings.

Effects on Modernization

Given the difficulty of cutting FY 2014 military personnel funding, to accommodate a \$52 billion cut in its topline, DoD would be forced to sharply reduce funding for procurement, RDT&E, and military construction. Indeed, cuts of 15 percent to 20 percent might well be necessary, even though the total budget is reduced by only 10 percent. The services would seek to protect most or all funding for a few programs that are most critical to the President's DSG. However, funding for hundreds of program line items, large and small, would have to be cut significantly. We would be forced to buy fewer ships, planes, ground vehicles, satellites, and other weapons. Modification programs would be cut sharply, even though these programs maintain the effectiveness of older weapons. Nor would cuts be limited to buys of weapons. Research funding represents more than 10 percent of the defense budget, and many research projects –

including those performed by universities and small companies – would inevitably have to be scaled back.

Marked cuts in investment funding, especially if they continue for several years, would slow future technology improvements and may erode the technological superiority enjoyed by U.S. forces. In some future conflict, less capable weapons could mean a less desirable military outcome and more casualties. Investment cutbacks are of particular concern because they would occur during a period when many categories of U.S. weapons are aging sharply.

Slowing investment would also adversely affect DoD's efforts to improve its acquisition practices and become a better buyer. Hundreds of weapon and support program line items, which are now being bought based on stable and efficient acquisition plans, would be disrupted. Unit costs would rise, reversing successful efforts in recent years to hold down unit cost growth or even reverse it. The disruption would spill over to defense industry. Defense industry jobs would be lost and, as prime contractors pull back work to protect their internal work forces, small businesses may experience disproportionately large job losses.