

"THE IMPACTS OF SEQUESTRATION AND THE CONTINUING RESOLUTION ON DEFENSE INDUSTRIAL BASE ACTIVITIES"

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House Armed Services Committee—Subcommittee on Readiness

Washington, DC

Thursday, February 28, 2013

Chairman Wittman, Ranking Member Bordallo, other distinguished committee members, thank you for the opportunity to appear today and discuss the negative consequences of the continuing resolution and sequestration on the U. S. aerospace and defense industrial base and critical government programs that we support. My name is Cord Sterling and I am a Vice President at the Aerospace Industries Association (AIA). AIA represents 380 U. S. manufacturing firms in the aerospace and defense industry, a sector of our economy with over one million dedicated and talented employees.

The U. S. aerospace industry is one of the nation's most vibrant manufacturing sectors. The industry generated \$324 billion in sales in 2010 and is the nation's largest net exporter. Aerospace and defense contributes 2.2 percent to the nation's GDP, including the payment of \$38 billion in federal, state, and local taxes.

Economic Impacts of Sequestration

Many of you have seen some of the studies that we have made available which look at the economic and industrial impact of the current budget situation. Most widely used is the study conducted by George Mason economist Dr. Stephen Fuller that outlines the economic impact of the Budget Control Act. We estimate that sequestration will put at risk 2.1 million jobs nationwide. This includes 473,000 manufacturing workers and 510,000 federal employees. Many of these will be in the aerospace industry, which provides good, middle class wages and benefits for a highly skilled workforce. We estimate an additional 1.5 percent will be added to the nation's unemployment rate, which would put us back over 9 percent. While the timing of these impacts will be spread over a couple years and may be slightly diminished as a result of the small reduction in cuts made as part of the American Taxpayer Relief Act of 2012, they will still be large and devastating to families and communities across the country.

The economic impact of sequestration would be felt nationwide. No state would be immune from job losses and cutbacks in federal services. However, some states are hit especially hard. In fact, ten states would experience more than half of the job losses. When you add up the defense and non-defense cuts, Virginia, Maryland and Washington, DC would lose 450,000 combined jobs. California would lose 225,000 and Texas 159,000. The entire nation will face a tidal wave of job losses, just as we struggle to recover from the economic recession.

Mr. Chairman, these are not theoretical impacts or future projections. As you know, defense manufacturers have been laying off workers and canceling future plans for many months now because of this uncertainty. The process accelerated so significantly at the end of last year that our national economy actually shrunk in the fourth quarter of 2012. This was a shock to economists, who attributed it largely to the decline in defense spending. And this process continues. Just last week, the federal government reported that defense contract awards dropped by almost two-thirds in January, from \$36 billion in December 2012 to only \$12 billion in January 2013. This is forty percent below the amount experienced in the same month for the previous year.

Defense Impacts of Sequestration and the Continuing Resolution

Mr. Chairman, the impacts of sequestration on Department of Defense (DOD) programs are dangerous to both our national security and our economic revitalization. The fact is that DOD is being asked to bear a disproportionate amount of the cuts. Defense spending accounts for 20 percent of federal spending but must absorb 50 percent of the budget cuts. This comes on top of \$487 billion reduction already imposed by the first round of the Budget Control Act.

Last year, we formed the Defense Industrial Base Task Force in partnership with the National Defense Industrial Association and the Professional Services Council. The task force worked with senior executives at manufacturing and service companies that support the U.S. military. As they looked at their business and the initial impact of the \$480 billion in budget cuts projected over the next decade as part of the Budget Control Act, they determined these cuts could cripple certain defense sectors, resulting in an industrial base that is smaller, less innovative, and less responsive to urgent wartime needs. Impacts of major cuts would most likely include:

- Forcing firms to close production lines and lay off skilled full-time workers – beyond the thousands already let go in the wake of previous budget cuts and program cancellations– specialized manufacturing capacity and human capital that cannot be regenerated without great cost and significant time;
- Reducing or eliminating investments in capabilities beyond those needed to meet existing contracts; and
- Making defense companies and business units – manufacturing and service, up and down the supply chain – more likely to exit the sector altogether, consolidate further, or be divested by their parent corporation.

Consequently, defense executives predicted an erosion of the continuum of goods and services provided by industry – from R&D to advanced development and design, to production, and then sustainment and upgrade – that could result in critical gaps in military capability over time--and all of this is based just on the first \$487 billion in defense cuts, not the \$500 billion extra from sequestration.

We must also take into account that in the case of the Pentagon, Military Personnel, which constitutes 25 percent of defense spending, is exempt from sequestration, which means the other accounts such as Operations and Maintenance and Procurement, will have to absorb a larger portion of the cuts. This means the operating, training, and equipment maintenance accounts – and civilians supporting the DOD – must bear a heavier burden. Second, the BCA requires sequestration to “reach back” and cut not only FY13 accounts, but also prior year appropriations that remain unobligated.

Sequestration would severely undercut our long term national security efforts. The United States must invest in military capabilities to deny potential adversaries the ability to counter technological advantages that allow us to see battlefields with greater clarity and strike targets from greater distances with minimum collateral damage. We are already witnessing some of the world’s major military powers making large strategic investments in anti-satellite weapons, cyberwarfare, advanced submarines, unmanned undersea vehicles, and other capabilities that could put our technological edge at risk. These investments are a potent reminder of the importance of maintaining robust defense procurement and research and development funding in the context of future budget decisions.

Mr. Chairman, amid all the discussion and debate about the negative impacts of sequestration, relatively little has been reported about the negative impacts of operating the Department of Defense under a long-term continuing resolution. However, we know that there is a \$14 billion shortfall in the Operations and Maintenance accounts under the CR. This means that critical training and sustainment activities will not be performed unless this shortfall is corrected.

For example, the Navy, which has a \$4.5 billion O&M shortfall, has reported that 23 ship availabilities will not be performed if increased funding is not provided in the next CR. Aircraft maintenance will be cancelled in the 3rd and 4th quarters, and modernization programs will be deferred as we are forced to rely upon aging, antiquated systems that are less capable and more expensive to maintain.

Sustaining current readiness will be impossible with the Joint Chiefs reporting that we are “on the brink of creating a hollow force” with sequestration coupled with the continuing resolution triggering a 20 percent cut in the operating budgets—grounding aircraft, idling ships, and parking combat vehicles. With less funding available for maintaining the equipment, buying fuel, and purchasing spare parts, training on our equipment will not be possible at the levels determined necessary by operational commanders.

The Continuing Resolution is also preventing a number of programs from moving forward as the rules of the CR do not allow "new starts." As a result, personnel and equipment stand idle, waiting for the authority to begin work. This increases costs, and creates programs delays, that will be felt for years.

Common Misperceptions of the Sequester

There are three common misperceptions about the sequester. All are dangerous, because they foster the impression that sequestration's impacts would not be as immediate or as bad as many have predicted.

The first misperception is that any agency should be able to find 7.2% in savings to its budget. This sounds plausible until you realize that the actual reduction is greater than that. Sequestration cancels a uniform percentage of each agency's annual appropriation on March 1, 2013. However, at this point in the fiscal year, agencies already have spent 40% or more of their appropriation. In reality then, DOD will have to cut its programs by at least a third more than this percentage suggests.

The second misperception we hear from some Congressional offices is that leaders can survey the damage after March 1 and restore funding to the hardest hit programs in the next CR. As you know, the sequester order is scheduled for March 1 and the current CR expires on March 27. Some have speculated that Congress could decide final funding levels for fiscal year 2013 in the next CR and selectively restore funds cut by the sequester.

The problem with this approach is that the impacts will not all be immediate. They will build over time, as agencies grapple with implementing the order. Our analyses all concluded that most private sector job losses would occur within 6-18 months of the sequester order as contracts expire. Furloughs of DOD civilians are not scheduled to begin until April 1. The sheer magnitude of these nationwide effects will not be evident in the first month.

Soon after these line-item cuts are announced- presumably this Friday -- individual programs will begin notifying industry of contract cutbacks and cancellations. Many of these changes include termination liabilities that will cost the agencies precious funding. And once the workers are gone, it will be difficult or impossible to get them back.

The final misperception is that increased flexibility can solve all of DOD's problems. While greater flexibility would undoubtedly aid the DOD in absorbing these huge reductions, it is not a panacea for providing an adequate budget. These cuts hit in the middle of the year, and as you know the Office of Management and Budget directed DOD and other agencies not to slow down obligation rates at the beginning of the year. Now in crisis mode, it is not surprising that DOD needs flexibility to address its near-term operating shortfalls.

However, when you look more closely, flexibility without additional resources ends up savaging the very accounts that warfighters depend on for advanced equipment and long-term readiness. The investment accounts would lose billions of dollars which translate to significant equipment

reductions. Mr. Chairman, I would respectfully submit that this committee did not overestimate the military's needs by \$9 billion when you reviewed and authorized these programs for FY13. This magnitude of cuts in the investment accounts would result in fewer, older, and less capable tools for our young warfighters in harm's way. It would terminate promising R&D that would help us keep our technological advantage in future conflicts. And it would cause irreversible damage to a fragile defense industrial base. Mr. Chairman, the echoes of the old phrase "hollow Army" are ringing in our ears. We cannot let that happen again.

In conclusion, AIA supports approaches to our long-term fiscal situation that do not cause irreparable harm to our national security or to our defense industrial base. Thus far, our deficit reduction efforts have disproportionately targeted discretionary programs, which are a relatively small and decreasing share of the federal budget. Continuing to hold these programs hostage to a broader agreement has not worked for the past two years, and has brought us to the brink of disaster where we find ourselves today.

We also support reaching some resolution so that will end the use of long-term continuing resolutions that hinder the Department's, and industry's ability to operate efficiently and effectively starting new programs when they are ready and required, not when there is a political solution.

Mr. Chairman, thank you again for the opportunity to testify today on this important topic.