

**Statement before the House Armed Services Committee,  
Subcommittee on Intelligence, Emerging Threats and Capabilities**

**Perspectives on the Future National  
Security Environment:  
Technological, Geopolitical, and  
Economic Trends Affecting the Defense  
Strategic Guidance**

**A Statement by**

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**February 13, 2013**

**Room 2118, Rayburn House Office Building**

# The Future National Security Environment: Technological, Geopolitical, and Economic Trends Affecting the Defense Strategic Guidance

**Statement of David J. Berteau**  
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**of the House Committee on Armed Services**

**February 13, 2013**

Mr. Chairman, Congressman Langevin, and Members of the Subcommittee, I thank you for the opportunity to appear before you this afternoon as part of this distinguished panel to offer my views on the future national security environment and on some of the key issues that will affect the Defense Strategic Guidance. My statement draws on a number of recent studies of the Center for Strategic and International Studies, but both my written and oral statements are my own. They do not necessarily represent the views of CSIS.

## **Strategic Framework**

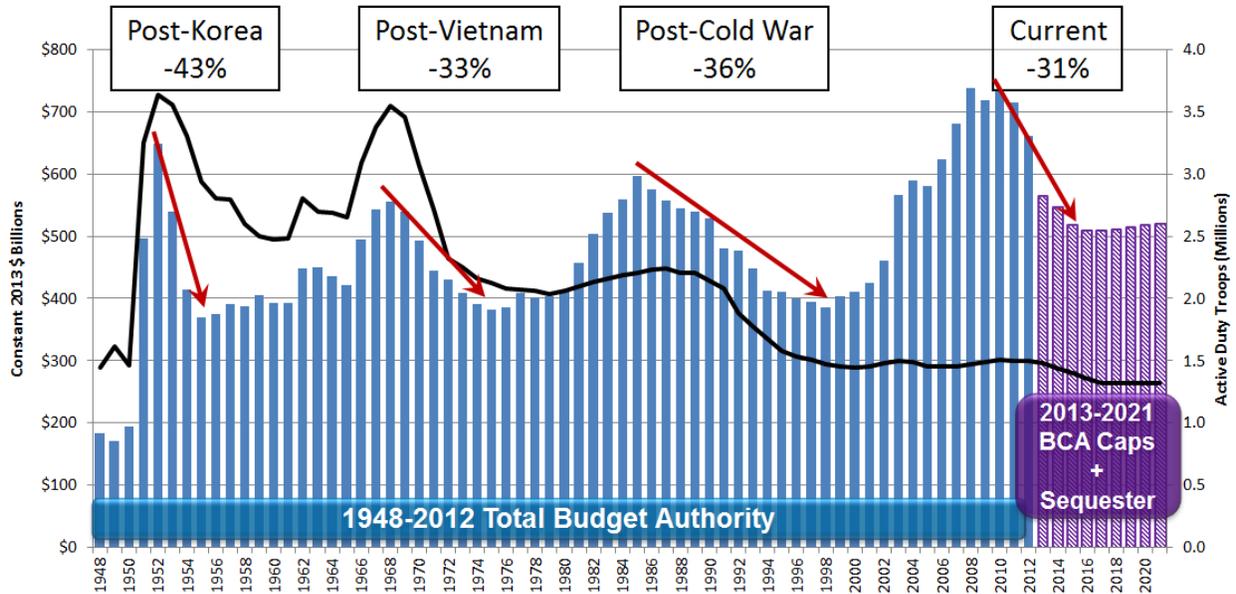
The issues of the moment, of budgets and deficits and sequestration and debt ceilings, dominate our conversation. Just this morning the full committee heard from the Deputy Secretary of Defense and the Joint Chiefs of Staff on the potential impact of the sequestration under the Budget Control Act of 2011 (BCA). The immediate consequences – particularly as described by senior defense officials – seem dire, but it is even more important to view the current situation through a broader strategic framework. If I may, I would like to step back a bit and take that broader view.

In 2010, Admiral Mike Mullen, then-Chairman of the Joint Chiefs of Staff, stated unequivocally that the single biggest threat to U.S. national security is our national debt. Others have made similar remarks, including at public events held last September at CSIS under the auspices of a bipartisan coalition of former Members of Congress, ranging from Sam Nunn and Pete Dominici to Dave McCurdy and Bill Frenzel. Our task this afternoon is not to fix the nation's fiscal and economic challenges but rather to examine what they might mean for defense, especially for the technology and economic drivers and industrial base issues that this subcommittee will face in the coming months.

The nation is entering its fourth major drawdown in defense spending in the last 60 years. As you can see from Figure 1, all of the previous Department of Defense (DoD) drawdowns – following the Korean War, the Vietnam War, and the Cold War – reflected higher percentage reductions than the current projected drawdown. In addition, the lowest point for each of those

three drawdowns were far lower level than current projections, even after sequestration and the new caps on defense spending from the BCA.

Figure 1: Defense Drawdowns Compared



Note: Topline in out-years includes the Congressional Budget Office (CBO) estimate of overseas contingency operations (OCO) based on a phased drawdown to 30,000 troops in 2017 and remaining flat thereafter.

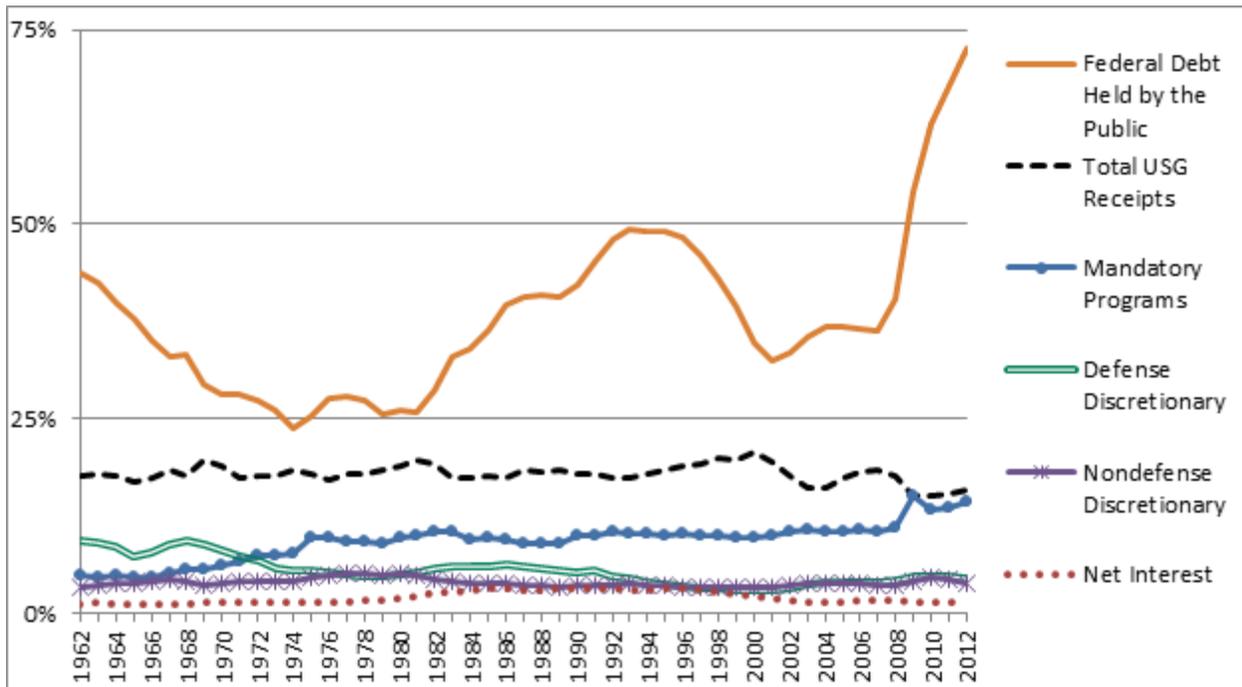
Sources: Department of Defense, *National Defense Budget Estimates for Fiscal Year 2013 (Green Book)*, Office of the Under Secretary of Defense (Comptroller), March 2012; Congressional Budget Office, *Long-Term Implications of the 2013 Future Years Defense Program*, July 2012. Analysis by CSIS Defense and National Security Group.

That last point bears repeating: in constant-dollar terms, the projected floor of the current drawdown will be markedly (roughly 25 percent) higher than the three previous drawdowns (i.e., roughly \$500 billion per year, including the Overseas Contingency Operations accounts, compared to approximately \$400 billion per year in the past).

### Budget Figures Over Time

It may be that the cuts from sequestration and the impact of caps from the BCA will be replaced, avoided, or mitigated through future legislation, but long term fiscal challenges will remain. The growth over time in mandatory spending and in the publicly-held portion of the total federal debt is reflected in Figure 2. This chart reflects the annual percentage of U.S. Gross Domestic Product (GDP) since 1962 for six categories: defense spending, domestic discretionary spending, net interest on the debt, spending for mandatory programs, total receipts of the U.S. Government, and publicly-held federal debt.

Figure 2: Federal Government Spending, Revenue and Debt (as a % of GDP)



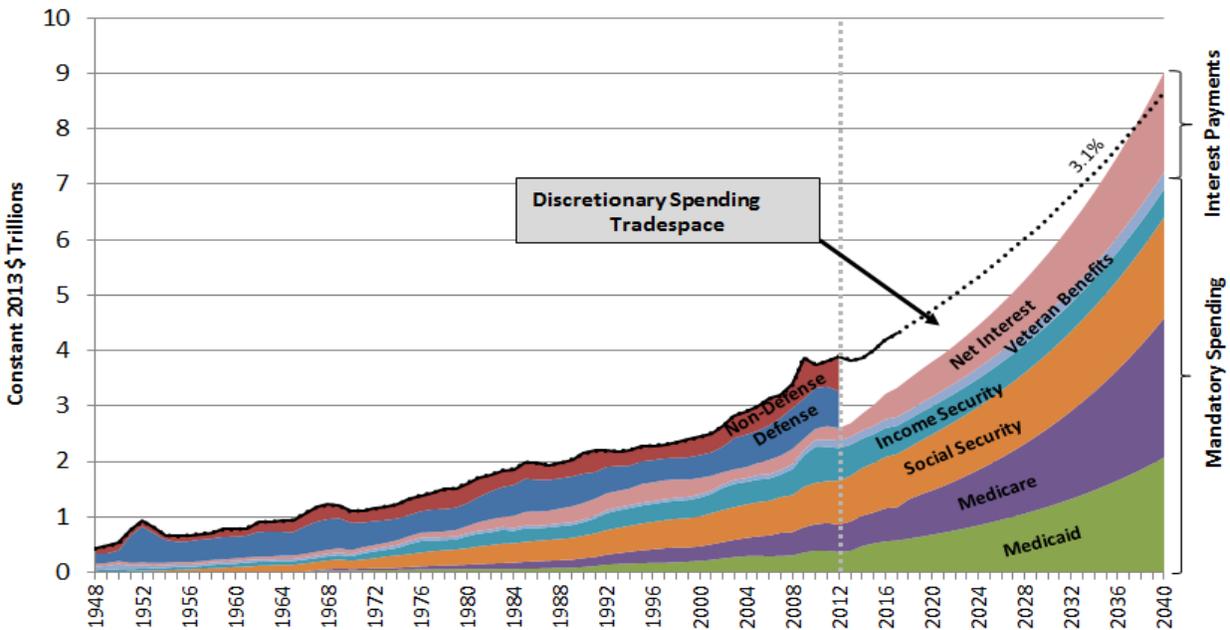
Source: Office of Management and Budget, *Historical Tables*, Tables 8.5 and 8.7, available at <http://www.whitehouse.gov/omb/budget/Historicals/>; Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2013 to 2023*, February 5, 2013, available at <http://cbo.gov/publication/43907>

There are two points worth highlighting from these particular data. First, the share of GDP devoted to defense and domestic discretionary spending has been relatively flat roughly since the end of the Cold War. Second, the growth in mandatory spending over the past five years has been matched by a reduction in the percentage of total government receipts. In other words, U.S. expenses have gone up as a percent of GDP while the percent of GDP paid to the government has gone down. In fact, in 2008, total receipts covered only mandatory spending, as shown in Figure 2.

Of course, Figure 2 addresses past spending, revenue, and debt. But what will the situation look like going forward?

Figure 3 shows that, based on projections from the Congressional Budget Office and the Office of Management and Budget, by 2040 there will be no funding available for any expenditures other than mandatory programs and net interest on the debt.

Figure 3: Pressure on the Defense Topline



Note: Topline assumes that total federal spending from 2018 to 2040 grows at 3.1 percent above GDP (the average annual growth rate planned for 2013–2017 in the FY2013 budget request).

Sources: Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2011 to 2021, January 2012*; Office of Management and Budget, *Historical Tables, February 2012*. Available at <http://www.whitehouse.gov/omb/budget/Historicals>; Department of Defense, *National Defense Budget Estimates for Fiscal Year 2013 (Green Book)*, Office of the Under Secretary of Defense (Comptroller), March 2012. Independent analysis based on CBO federal spending projections from 2022-2040

What does this mean for DoD? What actions can this subcommittee take to affect these pressures? As compelling as the long-term problems are, today’s challenge is to deal with the immediate budget problems, the fiscal year (FY) 2013 impact of sequestration and the BCA caps for fiscal years 2014 through 2021.

Sequestration for FY 2013 will reduce DoD spending by \$46 billion over the remainder of this fiscal year, using the priority-free approach of equal percentage reductions to every account. Those cuts have projected impacts which are becoming more apparent as DoD officials have refined, and reported to Congress, planning and preparation for sequestration.

However, for the purposes of protecting future technology and preparing for future threats, one must recognize that the post-sequestration BCA caps will take an additional \$438 billion from fiscal years 2014 through 2021. Those reductions are in addition to the \$487 billion from the initial August 2011 BCA caps .

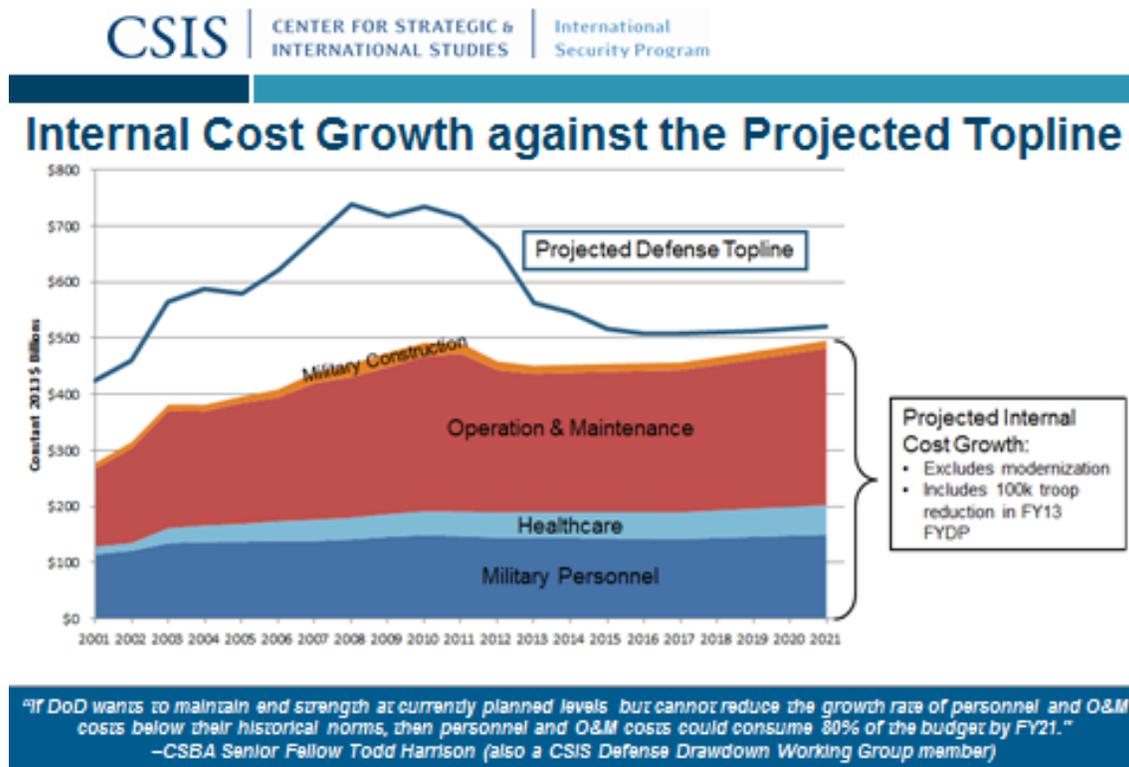
## Internal DoD Cost Growth

As stated earlier, the defense budget is not going down as far as it has in the past, and on the surface, that looks like good news. With 25 percent more funding, DoD should be able to afford 25 percent more capability.

However, CSIS research indicates that this may not be the case. In a “Preparing for a Deep Defense Drawdown” briefing released on February 8<sup>th</sup>, we found that for the past decade, cost growth in Operation and Maintenance (O&M) and Military Personnel accounts has far exceeded inflation.

As you can see from Figure 4, if those growth rates continue at their present pace, they will adversely impact investment in Procurement and Research and Development (R&D) accounts: by the start of the next decade, there will be almost no funding available for investment, including in Science and Technology spending. It is important to note that this outcome would happen even if FY 2013 sequestration is avoided and if BCA caps are lifted.

Figure 4: Internal Cost Growth and the Defense Topline



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In other words, even while sequestration and the BCA are drawing down the defense topline, cost growth in O&M and military pay and benefits is reducing internal value of remaining defense dollars. My CSIS colleague, Dr. Clark Murdock, has proposed a way to tackle this

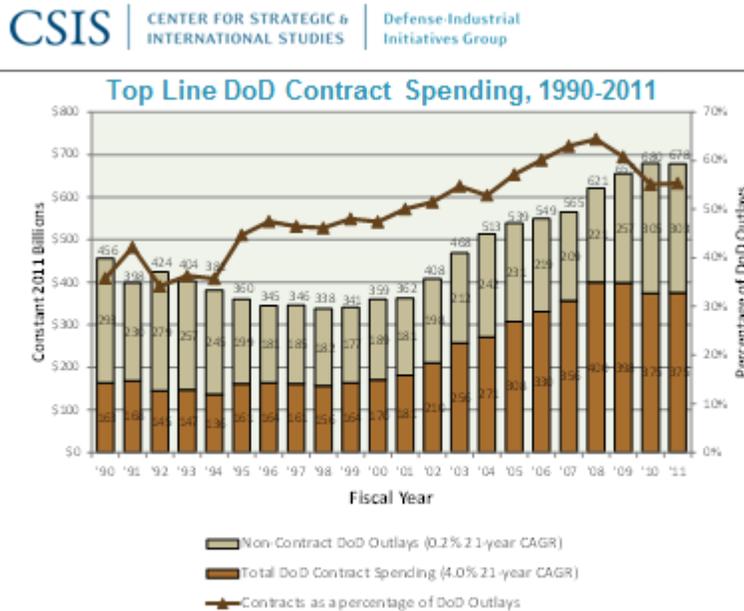
issue; we will be glad to provide to the subcommittee the document for that approach when it becomes available later this month.

### Impact on Defense Contracts

Those are projections for the future, but we can see the impact already of defense reductions from the past three years. Since 2008, the total amount of defense spending has declined slightly, and most of that decline has been in spending on contracts. CSIS produces an annual report on Defense Contract Trends, and the charts below are excerpted from the most recent such report. Because of the delay in access to data, our report goes through FY 2011, but we expect to have an updated version for FY 2012 by April, and we will be glad to provide it to the subcommittee when it is available.

Figure 5 shows total DoD spending from fiscal years 1990 through 2011. The vertical bars for each year divide total defense spending into two categories. The bottom of each bar is total obligations on contracts, as reported by DoD in the Federal Procurement Data System that is run by the General Services Administration. This is the best public source of government-wide contract data, as certified by each agency’s procurement officials. The top of each bar is non-contract spending, which is principally pay and benefits for military and government civilian personnel. The chart reports all spending in constant FY 2011 dollars, so inflation is taken out of the data.

Figure 5: DoD Spending on Contracts and Personnel



Note: Dollar figures may not sum to total due to rounding.  
Source: FPDS; CSIS analysis

This chart clearly demonstrates the effects of the rising personnel costs. In FY 2011, total DoD non-contract spending was \$303 billion (mostly personnel). This is nearly the same as the \$297

billion in FY 1990, but the total force in 2011 (active military personnel and federal civilian employees) was more than one third smaller than in 1990. We are paying the same amount for one third fewer people.

Much of the growth in defense spending since September 11, 2001, has been in contract obligations. In 2001, 50 percent of total defense spending was on contracts. That number rose to about 62 percent by 2008, but it has fallen to 55 percent in 2011 and is expected to decline further when we update this report in two months. (Note: The apparent flattening in 2011 is largely the result of a one-time boost in Navy shipbuilding contracts, which we do not expect to be repeated.)

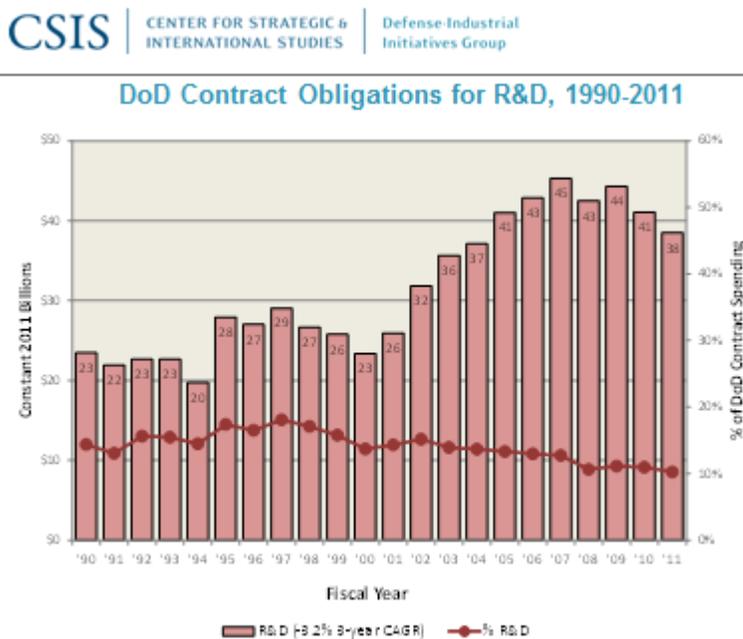
Recent reports from the Commerce Department show that contract spending declined dramatically in the fourth quarter of 2012, both from DoD and from across the federal government. Obviously, if sequestration hits, these numbers will not go back up.

### Impact on R&D

CSIS research breaks down these data into numerous categories. We look at spending by military department, we look at the types of contracts and the level of competition, and we look at the nature and size of the companies that are awarded these contracts.

We also look at contract spending on products, services, and R&D. Because of data limitations, we cannot easily break down R&D spending into the Science and Technology (S&T) portions covered by 6.1, 6.2, or 6.3a funding, but it might be useful nevertheless to examine the trends for R&D (see Figure 6).

Figure 6: DoD Contract Obligations for R&D



Source: FPDS; CSIS analysis

This figure shows that total DoD contract spending on R&D rose steadily after September 11, 2001, but it has declined in three of the past four years and is expected to decline further in 2012.

More importantly for this subcommittee, the percentage of total DoD contract spending on R&D declined steadily even as the budget went up. In FY 2002, 15 percent of defense contract spending was on R&D, but by 2011 that percentage had fallen to 10 percent. [This can be partially explained by the growth in OCO, which had little R&D funding, but the reduction of OCO does not seem to have reversed that trend so far.] As R&D spending on major platforms migrates to procurement accounts [and OCO levels continue to decrease], we expect that trend to continue.

I should note that the numbers in these charts do not include classified contracts, because such contracts are exempt from reporting in the Federal Procurement Data System. Our independent assessment of other data shows that the trends would be roughly the same even if classified contracts were included in the data.

Spending trends for S&T portions of the R&D budget do not necessarily follow the overall R&D trends for any given year, and DoD officials have stated that they will try to protect S&T spending in future budgets. Our expectation, however, is that over time, the budget pressures on the overall R&D budget will likely drive S&T spending in the same direction. This is an issue worthy of the subcommittee's attention in the coming months.

### **Impact on the Industrial Base**

Let us turn now to the Defense Strategic Guidance and its relevance to the impact of the defense drawdown on the industrial base. Shortly after the guidance was issued on January 5, 2012, CSIS conducted a conference on that issue. Let me summarize our views on that impact.

The U.S. defense industry depends on projections from DoD in order to invest, hire and retain skilled technicians, and develop and sustain technology and supplier networks for future demands. In other words, industry relies on DoD for its demand signals.

For the past few years, those demand signals have been absent. This has resulted from a combination of two wars, a decade of supplemental funding (including Overseas Contingency Operations), and a weaker long-term program from DoD (i.e., the Future Years Defense Program, or FYDP).

The Defense Strategic Guidance of 2012 provided some initial indications of future demand signals, and industry welcomed those. There are four key priorities in the Defense Strategic Guidance:

- Counter the threats of violent extremists.
- Contribute to security globally but rebalance toward the Asia-Pacific region.
- Continue military presence and support in the Middle East.
- Evolve and rebalance the military in Europe.

The Defense Department stated that the President's FY 2013 budget request was aligned with that Guidance, and there were some decisions that reflected that alignment. However, in some cases, as revealed in the budget justification material provided to the Congress, the implementation of the Defense Strategic Guidance was deferred to the FY 2014 budget and the FY 2014-2019 FYDP. Because of budget uncertainty, we have yet to see that budget and FYDP, so we cannot assess its implementation of the Guidance. What we do know is that the execution of sequestration does not appear to permit the application of the priorities of the Defense Strategic Guidance to the distribution of the reductions.

Industry is in that same situation: they cannot assess DoD's priorities and therefore cannot know where to invest or which workers are most important to hire or retain. The impacts of the FY 2013 Continuing Resolution and the potential impacts of sequestration, which was the subject of hearings today and earlier this week, have made it harder for industry to make decisions.

For the DoD major prime contractors, this uncertainty, while hard to deal with, is manageable. In their earnings calls with Wall Street, chief executive officers for major defense contractors all expressed confidence in their ability to survive this uncertainty.

Smaller firms, including technology companies, have less confidence. Their cash position is sometimes less favorable than the major prime contractors, and they are more dependent on subcontracts for future work. The subcommittee could usefully pay close attention to the survivability of such firms.

### **Impact on Innovation**

Given the reductions in both total R&D spending and the share R&D has in the overall DoD budget, a clear demand signal on how DoD will generate innovation is also needed. In words that have been oft repeated: "We have run out of money. Now we have to think." This is especially true today. The identification, development, adoption and dissemination of innovation of all types – technological but also budgeting, contracting, management, etc. – that would result in improved national security capabilities will be critical if the U.S. national security enterprise is to continue to meet its current and emerging missions on a tighter budget.

Fortunately, innovations for the warfighter can increasingly be generated outside the traditional R&D/6.1-6.5 process. Unfortunately, as an upcoming CSIS report shows, DoD is not positioned well to take advantages of innovations occurring within the Department, let alone in the commercial world and overseas. DoD needs to better articulate who it will turn to for future innovations and what mechanisms it will use to do so. This too could be a topic worthy of the subcommittee's consideration. I think there is much room for improving how innovation is identified, disseminated and adopted in the defense/national security enterprise.

### **Impact on the Workforce**

My final point is that the future development and application of science and technology for national security depends on a skilled technology workforce. It is bureaucratically straightforward to use furloughs for cutting costs in FY 2013 to meet sequestration targets.

Similarly, industry will lay off workers and may soon have to issue notices (called WARN Act notices) to employees.

The long-term impact of workforce caps and cuts are less obvious. The lesson of the last drawdown is that it is far easier to get rid of workforce than it is to rebuild it. DoD has been rebuilding the acquisition and technical workforce for 12 years now, and it is still not back to the sustainable demographic balance that was present at the end of the Cold War in 1989. I would suggest that this subcommittee could usefully pay attention to this issue in the coming months.

### **Conclusion**

Mr. Chairman, Congressman Langevin, Members of the Subcommittee, there is much more to discuss and assess on all of these issues. The information presented above provides the highlights of our work at CSIS over the past two years on these issues. We are happy to provide you with additional material on these and other related issues, should you desire. Thank you for the opportunity to appear today before the subcommittee, along with the other panel members. I welcome your comments and questions.