



July 26, 2010

Letter from Washington

Anxious Democrats could only stand by as the White House released the projection for the 2010 budget deficit. The deficit will rise to US\$1.4T in the last quarter of the year, forcing the federal government to borrow .41 cents for every dollar it spends. Republicans have wasted no time in trumpeting the gloomy forecast as evidence of the failure of the President's economic policies, with unemployment still high and the housing market still in the tank, despite the trillion or so in economic stimulus money that has been spent.

In fact the President's approval rating has sunk to a new low with 57% disapproving of his handling of the economy in the latest CNN poll. In that same poll 47% responding indicated that the economy is their greatest concern. These disapproval numbers are driven primarily by the persistently high unemployment rate that is also forecast to remain between 9 and 10% until the end of 2012.

A similar Bloomberg poll from the previous week shows that Americans disapprove of Obama's handling of every major issue in addition to the economy --- health care, financial regulation, the Gulf oil spill and the war in Afghanistan. These numbers are as low as any mid-term President in recent memory. Hopeful Democrats point to the fact that Ronald Reagan had similar numbers at the end of his first two years, lost seats in the Congressional mid-terms, and then went on to a landslide victory two years later. While this is unarguably correct, there was an important difference between Reagan and Obama: people felt that they knew Reagan well, and even if they disagreed with his policies, they liked him.

Almost two years into his Presidency, Obama is still a cipher and his core beliefs and interests remain a mystery. Reagan had a long career as an actor, two terms as governor of California and one unsuccessful Presidential nomination campaign to become well known. There was a long public record of his speeches, statements and positions, and no doubt as to where he stood. Obama, on the other hand, entered the White House with four years as a US Senator, two of which were spent campaigning for President. Reagan, a skilled actor, could summon the appropriate emotion for every occasion, and could be the hard cold warrior when dealing with the Soviet

Union (Mr. Gorbachev, tear down this wall) or the empathetic mourner, memorializing the Beirut barracks Marine dead at Camp LeJeune. Obama keeps his emotions so tightly in check that he seems unreal, and when he tries to summon up anger or indignation for the cameras it comes across as phony.

At this point in his term, low approval numbers may not seem that important to the President. In fact, there is a school of thought that says that he should welcome a Republican takeover of one or both houses of Congress in November. That would at least take him off the hook for accomplishing anything due to the inevitable gridlock of divided government, and at the same time give him something to campaign against. Bill Clinton's most successful period was when he was running against Newt Gingrich and the Republican Congress in the mid-90's --- the birth of the perpetual campaign. Unfortunately, both parties have become expert at campaigning and inept at governing.

Approval numbers, however, do matter to Obama at this point. A US President has little real authority other than the moral and political power of his position. In the arm-twisting and in-fighting that occurs in getting his agenda enacted, the less popular the President is perceived to be, the more difficulty he has in herding his own party much less the opposition.

While the Republicans have been cheered by the Democrats' disarray and infighting, they shouldn't be too happy that the polls do not show any great groundswell in their direction. Rather, they are the beneficiaries of public discontent with the incumbent party. The Republicans have responded to the circumstances by carefully not articulating any policy of their own, and simply pointing out the administration's failures. This may be good strategy for the moment, but it allows the Democrats to claim that the same economic policies of the previous administration will be reinstated with the same disastrous results.

Obama clearly understands that he needs to focus on the economy, particularly unemployment, and make substantial progress in the next two years or he will be a one-term President (this assumes the Republicans won't commit political suicide by nominating an unelectable candidate like Sarah Palin). Part of the administration realization now is that significant budget reductions are going to be required, and that defense, which has enjoyed ten years of growth, will now need to take its fair share (or more) of reductions.

House Majority Leader Steny Hoyer, called the country's rising debt a "national security threat" and called for defense budget cuts to reduce foreign borrowing.

"The deeper our nation sinks into debt, the more our choices will be constrained and the more our leadership will be challenged by nations, especially China, that hold our debt," Hoyer said at the Center for Strategic

and International Studies. "It's time to stop talking about fiscal discipline and national security threats as if they were separate topics," he added.

You know that things are getting truly strange when two Congressmen like Barney Frank and Ron Paul come together to collaborate on a plan for cutting defense. They and several other colleagues have sponsored the "Sustainable Defense Task Force", a collection of think-tankers that has produced a report recommending a trillion dollars in defense reductions over the next decade. There are 14 specific suggestions:

- Reduce the US nuclear arsenal.
- Limit the planned modernization of the nuclear weapons infrastructure.
- Reduce missile defense & space spending.
- Reduce US global military presence and end strength by a third.
- Rollback US ground forces in Iraq and Afghanistan.
- Reduce Navy fleet size from 286 ships to 230.
- Retire two aircraft carriers and air wings.
- Retire two Air Force tactical fighter wings.
- Cancel or delay the F-35 for Navy and Air Force.
- End procurement of MV-22 Osprey.
- Delay procurement of the KC-X Aerial Refueling Tanker.
- Terminate the Expeditionary Fighting Vehicle.
- Reduce R&D by \$5 billion annually.

While these suggestions have little chance of being enacted in total, some variations are likely and defense is definitely on the table.

The visit this past week of British PM David Cameron underlines the administration's dilemma in regard to the budget and defense spending in particular. Cameron has taken office and instituted a series of drastic cuts to the British budget, on the order of 25%. These cuts have been taken despite the political costs, and may well make him a one-term Prime Minister. If in two years the British economy has responded to the reduced spending and the US has not yet started, it will make Obama's position even more difficult. As a result, defense represents an area for savings that has fairly high visibility but lower political cost than social and service program cuts.

Probably no one in Washington understands this better than Defense Secretary Gates, and for the last year he has been preaching to the defense

establishment that the "gusher" of funding is about to be reduced. Gates believes that the national security requires maintaining the current force structure with increases of 2-3% annually to keep pace with inflation. In a proactive move, Gates has directed the DoD to undertake cuts to "overhead" that will produce the 2-3% annual growth requirement from internal reprogramming. These efficiencies are probably within reach but Gates' plan depends on two key things. First is that Congress will allow Defense priorities to overcome local interests, and that the cuts will not be subsequently restored by appropriators or the reprogramming efforts denied. Second is that the administration itself doesn't claim the DoD savings and redirect the funds to other departments. Either of which are real possibilities.

Earlier this month and again in a speech at the Farnborough Air Show, Defense acquisition chief, Ashton Carter, laid out the methodology for achieving the 2-3% growth figure. First are eight incentives for greater efficiency in industry, starting with leveraging real competition. "Avoid directed buys and other substitutes for real competition," Carter says.

The other incentives include using the best-suited contract type for development and procurement; using the proper contract type for services; aligning policy on profit and fee to the individual company's circumstances; sharing the benefits of cash flow; reducing non-value-added costs; involving small business to a greater degree; and rewarding excellent suppliers for performance.

Further, Carter urges adoption of eight policies: adopting "should cost" and "will cost" management; restoring the acquisition workforce; improving audits; ensuring cost considerations in developing requirements for new programs; maintaining stable production rates; eliminating redundancies across the services; establishing senior managers for procurement of services; and protecting the US defense industrial technology base.

This ambitious agenda may also require Congressional action beyond acquiescence, in that some of the policies (e.g., "should cost" and "will cost" management) have no clear definition and are not mentioned in the Federal Acquisition Regulations.

At this point the only thing that is clear is that Defense is on the table, and that there are a range of possible outcomes, all driven by politics rather than national security.