



March 27, 2014

Letter from Washington

Under ordinary circumstances this letter would have featured the detail in the rollout of the administration's FY 2015 budget request, and the assumptions that underpin the numbers. However, since this has been an extraordinary couple of weeks with zombie airplanes flying around Asia and a return to the Cold War in Europe, much of the budget planning and process may have been overtaken by real world events.

You have to feel sorry for an American President when the simplest foreign policy challenge on his plate is the Israelis and the Palestinians, but that is where Barack Obama is right now. Ordinarily a US President turns to foreign policy in the second term when his domestic political capital has been expended, in a quest to remain relevant and with an eye toward legacy. President Obama has been jerked into a foreign policy crisis that has taken the administration and most of the world by complete surprise.

(Vocabulary alert: the word "feckless" has been so overused in the last month by pundits describing the Obama foreign policy that it will not be used here, no matter how perfectly it describes the situation).

As Americans we have a particular mind-set, characterized by optimism and the concept of merit-based success. Tomorrow will be better than today, and children will enjoy a higher standard of living and more opportunity than their parents. People succeed or fail as individuals, and the common interests of getting ahead economically in America overcome the differences of race and culture.

Unfortunately, the world is populated with people who view things through their own prism of self-interest, which often includes nationalism, religion and history, all of which tend to negate the American economic mobility model.

One of the results of the end of the Cold War was to reinforce the view in the United States that capitalism had defeated communism, validating the view that economic betterment would overcome the traditional motivations for international behavior. The happy thought was that international trading relationships would become the paramount national interest, and global interdependence would eliminate the potential for conflict as countries acted

in their economic self-interest and sublimated the old enmities and conflict points.

As Americans we fall into the same trap time and again of superimposing our beliefs and values on the rest of the world. We disregard the realities on the ground in favor of our own ideology and political belief, and view the world as we think it should work, not the way that it often does (recall for example the failure to plan for securing Iraq after the overthrow of Saddam Hussein, based on the notion that the Iraqis would self-regulate in their new-found freedom).

As a result, the President and NATO have been forced to confront the vacuous strategy of accommodating Russia in the hope that Putin will cooperate in Syria and Iran, and act as a responsible member of the interdependent global community of interest. Whatever his particular motivations, it is now apparent that Putin will act and react to events in accordance with a completely unanticipated set of interests that have destabilized the presumed order of things in Europe.

At this writing, Russia has (in addition to the 20,000 or so troops in Crimea) another 25-35,000 troops on the eastern border of Ukraine, deployed in formations similar to the previous invasions of Chechnya and Georgia. Intelligence analysts believe that the potential of further Russian incursions into eastern Ukraine, and possibly all the way across Ukraine to Moldova, are more likely than previously believed. Again, US policy makers have assumed that Putin would act in accordance with their perception of his self-interest, and may again be caught flat-footed.

With those thoughts as background, the administration's budget rollout this month looks all the more naïve. Underpinned by a Quadrennial Defense Review document that makes some startling assumptions about a benign global security environment, and the need for fewer and less capable forces.

In fairness, the administration is playing the hand it has been dealt by prior Congressional budget decisions, particularly by the January Ryan-Murray agreement capping defense spending. However, the President's approach to the entire government budget has been to create a fantasy document incorporating about \$1T in tax increases on the top 1% and large spending increases on pet Democrat base programs that have zero chance of being passed by both Houses. The President's view seems to be that since the Congress will rewrite his budget anyway, he might as well submit one that will do no harm to Democrats up for reelection in November.

What this really means is that the President has accepted the permanence of the spending cuts forced by House Republicans in 2012, and has surrendered any leadership role in reducing entitlement spending and deficit reduction.

The DoD had outsmarted itself in the previous budget cycle by predicting disaster but managing to muddle through with a combination of unobligated prior year funds and overhead reductions, so the effect of sequestration was largely muted. Those accounting devices have all been used up and the reality is fairly grim. It has been estimated that the DoD already has a backlog of \$20B of deferred and delayed acquisition contracting, hoping for some budgetary windfall.

For the 2015 cycle, the Department chose a different tack and actually prepared two budget alternatives for the Congress to ponder. One incorporates the agreed budget cap level of \$496B for 2015, but proposes an additional \$115B of spending between 2016 and 2019.

The alternative to the additional \$115B would require the Army to reduce to an end strength of 420,000. General Odierno has stated repeatedly that the 450,000-troop level is the minimum required to carry out the National Military Strategy, even assuming significant risk at that level. The Navy would be forced to retire the George Washington battle group, and the Air Force would retire its KC-10 and A-10 fleets, among other equally draconian actions.

As a first step in the \$115B bump-up, the administration is proposing a \$26B package in 2015 of unfunded priorities, euphemistically called "Investment Opportunities". In prior years the unfunded priorities list was made up of nice-to-have items that didn't make the cut for the services' budgets. This time around, the list is comprised of items that have been previously budgeted and programmed and have been cut by the necessity of fitting under the caps.

The Congress has some clear choices to make, but probably will not make them given that 2014 is an election year, and the Republicans will not want anything to upset their probably regaining control of the Senate. As a result, the difficult choices will be punted again to the 2016 budget.

In the administration's proposed budget for 2015 there are programs that fare well and some that don't:

- Special Operations Forces will increase modestly, based on the assumption that their unique capabilities are more suited to the requirements of the future.
- Infrastructure in the United States, which needs to be reduced to fit the force size, is also probably safe at least through the 2016 election. DoD, however, can close bases in Europe, without specific Congressional authorization.
- Cybersecurity in all forms gets plused up.

- Military compensation is mixed. The DoD is apparently not going to venture into reforming the military retirement system in 2015, but will start shaving active duty compensation through reducing allowances and other benefits.
- The Army as previously stated will shrink by close to 100,000 troops and the National Guard and Army Reserve will also be reduced. The Ground Combat Vehicle program is terminated, making the Army institutionally the biggest loser.
- The Navy results are mixed. The LCS program is curtailed by the last 20 ships in the two classes, but the Navy is directed to start development of a more survivable small combatant. The George Washington is on the bubble, but the Navy has been directed to lay up and modernize eleven cruisers rather than retire them early.
- The Air Force will retire its entire A-10 fleet, and potentially additional aircraft if the caps are not exceeded. F-35 buys are stretched out.

More so than the administration, the Congress is aware that the assumptions that underlie sequestration and the budget environment generally start with the premise that the primary threat to the United States is economic, driven by the federal deficit. Sequestration was seen as the blunt instrument that would tame government spending, but in a benign national security environment. If that assumption turns out to be false it would give political cover to those vulnerable members to increase defense spending, even if it increases the deficit. A lot will depend on what Russia does in regard to invading and annexing additional bits of its neighbors.

Ideally the Congress would come together to vote a special defense appropriations increase, which would be a strong message of US resolve which has been heretofore not visible from either the Congress or the President. Failing that, the Congress could add funds to the Overseas Contingency account, the off-budget funding mechanism that has paid for the wars in Iraq and Afghanistan. Either way, the DoD would be spared the full effect of the budget caps.

As has been true for the last six years, the administration is reactive and the initiative lies elsewhere. Major changes to the DoD budget and appropriations are likely, driven by external events.

