AIR, SPACE, AND CYBERSPACE POWER IN THE 21ST CENTURY

38th IFPA-Fletcher Conference on National Security Strategy and Policy

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DAY ONE

SESSION 4

5:00 TO 6:30 P.M.

Michael J. Bayer

MAJOR GENERAL RANDY MANNER: Will all the folks that are outside in the lobby come on down. We have plenty of seats. It's a tough situation here being the last panel of the day. Okay. Good afternoon. My name is Randy Manner. I'm the Deputy Director of the Defense Threat Reduction Agency at Fort Belvoir. And, together with the Air Force, we help to bring this-- and IFPA, of course, we help to bring this symposium together.

Okay. Now, what I'd like to do is to briefly introduce the members of the panel that's focusing on the way ahead. First presenter will be Michael Bayer. He is the Chairman of the Defense Business Board and President and CEO of Dumbarton Strategies. Next to him, Dr. Werner Dahm, Chief Scientist of the U.S. Air Force. To his right is Neil Sheehan, author and journalist and winner of the National Book Award and also the Pulitzer Prize. Next to his right, Dr. Kamal Jabbour, Senior Scientist for Information Assurance, Information Directorate, Air Force Research Lab. And finally, Jon Jones, President Space and Airborne Systems and Vice-President of Raytheon.

So, without further adieu, Mr. Bayer.

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MICHAEL BAYER: Well, thank you. It's a pleasure to be here. Thank you, Randy, for that introduction. Because of time, I'm going to launch right into this thing. But, I'm obligated to say, at the beginning, that I am here as an individual, not as part of the Department of Defense, obviously not as part of the Defense Business Board. So, these are my views and my views only.

The topic of this thing is "The Gathering Storm." And, I really want to focus on some of the pressures that lie-- that I see out in the future in for defense spending, and some of the challenges that those that care about this are going to have to deal with. I realize that may seem like a very odd title, based upon what you've been exposed to. Anyone who went to the Air Force Association or the Army Association Conference in the fall would have seen an amazing array of equipment, an astonishing wealth of intellect and energy and power assembled. And, very difficult, from that, to think that anything is amiss.

If you look at the size of the defense budget in the United States, you have seen these charts many times. We dwarf all comers. And, the narrative, whether you're listening to the Secretary, combatant commanders, or the general accounting office, the narratives are, things look pretty good. And, if you look at the 2010 budget, you can see all the trends are at least, while not as steep as they were in the past-- Chief, how are you?-- not as steep as they are in the past, they are, nonetheless, all relatively positive.

So, why in heaven's name would I start a discussion with a group of adults titled, "The Gathering Storm"? Well, what I want to talk about today are four different things. First and foremost is, what I see as some long-term trends in defense spending, some of which you may have seen, some not, pressure within the Department of Defense budget. And then, thirdly, I'll do a brief discussion about competing demands. And then, I'm going to wrap the whole thing up with a couple of concluding thoughts so that we can do questions at the end of everyone's presentations.

First is top line trends. You've all seen this. This is what the fit up looks like. The worst kept secret in town is the Secretary of Defense has gotten a little bit more money to put in there. The important point, though, is noticing the flattening out of the top line, not without the OCO, the old supplementals. The real delta between the top line, as we know it, and the actual expenditure rates really does get under pressure in the out years and depends upon whether or not the administration will continue to provide OCO at the rates it was in the past.

But, that is all dependent, obviously, from year to year, on political and congressional ...(inaudible). But, most importantly, if you want to know what's going on in the Department of Defense, generally-- forgive me guys-- the budgeters are the wrong people to ask. For those of you that haven't seen it, these are-- The black line is the budget reality over all those years, from 1980 to present. Those dotted lines are what everybody thought the fit up was going to be.

As you can see, if that was your investor strategy, you would have not done terribly well over all those years. And, the consistency of errors tends to be very much based upon what had happened over the last few years projected forward. The cyclicality you all know. You've seen this chart. This is the budget and defense dollars and constant dollars. The important thing I want to focus here is that-- This is top line, by the way, in constant dollars.

The important thing I want to focus are those steep declines that occurred after Korea, Vietnam, and the Reagan buildup, where, as you see that slope, this is what actually happened into procurement. Procurement really falls off first in down budgets. Now, why am I talking about procurement falling off in down budgets when the budget's going up? Well, there is the procurement cuts that have occurred in the last couple of years, at a time of which we have had a significant increase in budget. In real and absolute sense, we have made headroom for something by ejecting an enormous amount of equipment over the side.

So, as we go forward, what I want you to think about is less about where the top line is, and I want to spend a little bit of time about what goes on within it. Because, in the old days, you sort of knew what was going on in Department of Defense by where the top line was. Now you really have to kind of think about what's happening within.

So, let's look at the erosion within the Department. I'm going to first start with the hardware stuff. This first chart is something that we did in the Defense Business Board, which created no small amount of misery, from a couple of points. This is MDAP numbers, Major Defense Acquisition Programs all in. So, it's a big number.

I want you to look at the Reagan numbers, and you'll see that we started it, in those days, at about 400 and ended at about 800, all in MDAP. And, all those other colors are increases that occurred within there, program cost, baseline changes, program cost changes, estimation, misses, things like that. So, if we're going to do this really gross, we would call that gray-brown, whatever that color is, that's sort of "stuff." And the ramp is the increase in "stuff." And, all the other colors are not "stuff."

Now, go over and look at the 2001 to 2008 growth, and you see we started about 400 and we ended 600. And, notice how large the blue, green and yellow is in that. You'd say, "How did that happen?" Well, here is where much of those are. That-- You add the numbers on the left side of the chart, and you get a really big batch of billions, 401 of which are those programs above. That 401 are those runs there: future combat system, joint strike, fighter. These are the cost-growth-by-programs.

And, that ends up being a significant amount of money. And, it's what has-- one of the contributing factors, although I'm going to argue one of the smaller contributing factors to the internal pressure on the budget. The real pressure on the budget-- Oh I'm sorry, one more piece. You've all seen this. This is Norm Augustine's Rule-- I forgot what number this is. But, this is the one that says, "If we don't get all this under control, when we're all done, there's only going to be enough money for one airplane out in the future. And, everybody's going to have to share it." And everyone giggles.

But, if you look at some of these ramps, you think “Ew!” You know, we’re never going to get there. But, we have to pay attention to it. I have a corollary of this, which is coming. But, this is the real problem, people. This is what’s at the heart of the beast right now. Not acquisition, it’s people. And, people are what’s causing the acquisition problem, not the other way around.

That chart tells you that we’ve added 90,000 people to the Department of Defense and the combats are in the Army and the Marine Corps at a billion and a half a piece-- a billion and a half per 10,000, and a billion per 10,000 to acquire them. So, each and every year, that 90,000 costs the taxpayers $1.5 billion times nine. That’s the bill that’s in there.

And, you may have seen this. This is what happens-- This is what’s happened over time. As the active duty end strength has decreased-- This is a very old chart. I, frankly, have not been able to find an updated one, probably because the story is so bad. But, if you look at civilian pay, mil. pers, contracts for services, all those have gone up as the numbers have gone down.

It’s more than just pay raise, it’s healthcare. Tricare for life is-- at least it was, as of a couple of months ago-- one-half of one trillion dollars unfunded. This is a non-consequential bill. And, if you look at that rate increase, this is pretty steep. And, this is a community that ejects unhealthy people to the Veterans Administration and moves them off the rolls. So we need to know, this is a big, big bill. And, it’s eating up the Department.

You are also getting an enormous amount of help from the Hill. But, Congress keeps adding all of these programs, and they make the cost of manpower, of personnel, more and more expensive. Now, I’m not going to argue whether any of these are good, bad or otherwise. But, they are ever increasingly expensive.

And so, my corollary to that is this, is that my fear is, if we don’t stop this, we’re only going to have one person left in uniform. And, the Air Force is going to get him-- General Schwartz will get him two days a month, a week. Gary Roughhead(?) will get him two days a week. George Casey will get him two days a week, and the Marines will get him on Sunday. And, that’s my corollary to Norm Augustine’s personnel problem.

But, there is another thing looming. And that’s the consequences of the fix of that economic crisis. And, this is why this program has to be fixed sooner than later. Normally, we regard all these as, “Well, we’ll get to it later.” There is something else that has to get handled first. And that is, in federal spending-- you’ve seen these numbers-- there is defense discretionary at the bottom, non-defense discretionary. Notice that, if you take all the civilian agencies, including DHS, Secret Service, all those things, they're in that non-defense discretionary.

And then, you’ve got the mandatory spending, of which a good piece of which is interest on the debt. And, those of you that have remembered from your government courses, the first thing that the government has to pay, the first dollar with, is interest on the debt. Notice how small it is right now. And, for those of you who don’t know, Treasury is paying about half a percent for money right now.

Now, there’s a bunch of it that’s old debt, so the number is actually higher. We’re going to get to that in a minute. This is another way to look at it. If you think of the 100-- you cap all of Defense, I mean, all of federal expenditures at 100%, you can begin to see how mandatory eats away at it. But, notice the big dip in interest, because we’re not paying normal interest rates right now. We’re paying exceedingly abnormal interest rates right now. More of that to come.

There is the interest rate curves over time, from 62 to 2,017. I’m actually going to compress just a little bit and show you-- I’m sorry, show you what that looks like over time, a narrower timeframe. Today, we have, right now, $339.8 billion dollars worth of interest payments per year on $12 trillion-eight of debt. That is at a weighted average, all in, at 3.347%. That's why the number is so low. Now, that started out at a different number in the Bush administration. This is not about differences in administrations. This is just sheer reality.

This is what the CBO sees as deficit projections going out into years as a percent of GDP. That's a pretty steep climb. Here is what it looks like in dollars. And, this gets to be a lot of money. At the end of the administration in 2017, it's $21.990 trillion dollars, $21.990 trillion. What does that look like?

I told you I'd give you a different average of interest. If you took the entirety of the Bush and Clinton administrations, George Herbert Walker-- sorry, George W. Bush and Bill Clinton's interest rates, you're going to get 5.899. That's the weighted average of the whole thing. Today I told you weighted average is actually 3.34.

This is what happens if just the current 12 moves up. As you can see, that $12 trillion at 5.89 is $598-- almost $600 billion dollars. It becomes larger than the Defense budget, and it becomes larger than the civilian discretionary budget, just by recalculating interest to the current rate, to what was the weighted traditional average of interest.

At 2017, the end of the administration-- By the way, that 2017 number does not include healthcare, does not include cap and trade, does not include a single legislative initiative for the next seven years. Now, let me repeat that. Nothing happens for seven years. And, the total is $977. And, you don't have to be a ranger to know that's almost a trillion dollars.

Next. We don't need to do that. That's boring. So, what's it all mean? This is the wrap-up here. It seems, to me, that things that I would encourage you to pay attention to is, people expenses are the heart of the purchasing power challenge. That's pretty well known. And, acquisition accounts are the symptom of a people problem, not the other way around. Acquisition pressure, to me, is a symptom of people money.

And, this growing mountain of debt is going to trigger the government, the Congress and the Executive Branch, to act. And, it'll put immense pressure on the discretionary side of the Department. And, most importantly-- this is the really bad news-- The faster the economy recovers, the quicker the interest rates go back up. The only reason the interest rates are so low right now is because everybody's into treasury bills. There is no other place to put it.

And last is that we've had nine straight years of budget increases. Very few people at the senior level of either flags or civilians in the Department of Defense have ever experienced having to make some of these tough trades if compression really begins. And, the systems and processes that work really well in up years really don't always work well down.

And so, in my real quick run through this-- this is typically about an hour's discussion-- I think the bottom line is Bob Gates'. He said this better than anyone else, which is that we have a lot of money, and we have to figure out how to spend it as wisely as possible. So, with that, I'm going to retire from the stage. You're going to do questions at the end for everybody, right? Thank you for your time and your attention.

[applause]

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