

# Bloomberg

## GOVERNMENT

### Future of the Defense Budget: 2014 and Beyond

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# EXECUTIVE SUMMARY

## Findings

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### **Procurement and the overall U.S. defense budget will decline, as they do after every war**

- » During the last drawdown (1986-1998) overall defense spending dropped 33 percent and acquisition (Procurement plus Research, Development, Test and Evaluation) fell 51 percent
- » That pattern yields a \$500 billion budget in fiscal 2018, down from a \$754 billion in fiscal 2008
- » Sequestration lowers defense budget caps by about \$55 billion a year through fiscal 2021

### **Pentagon's fiscal 2014 posture isn't sustainable**

- » Budget request, House and Senate appropriations, and temporary funds bust fiscal 2014 caps
- » Pentagon planned a 3.9 percent average annual increase in procurement through fiscal 2018

### **Pentagon is expected to accept reality in its fiscal 2015 budget proposal**

- » Strategic Choices and Management Review sets up a choice between a large force or a hi-tech vision, and Defense Secretary Chuck Hagel is signaling that hi-tech is the way forward

### **Services are charting different ways forward**

- » Air Force has made modernization its priority post-sequestration; Navy focuses on readiness; Army future still in question

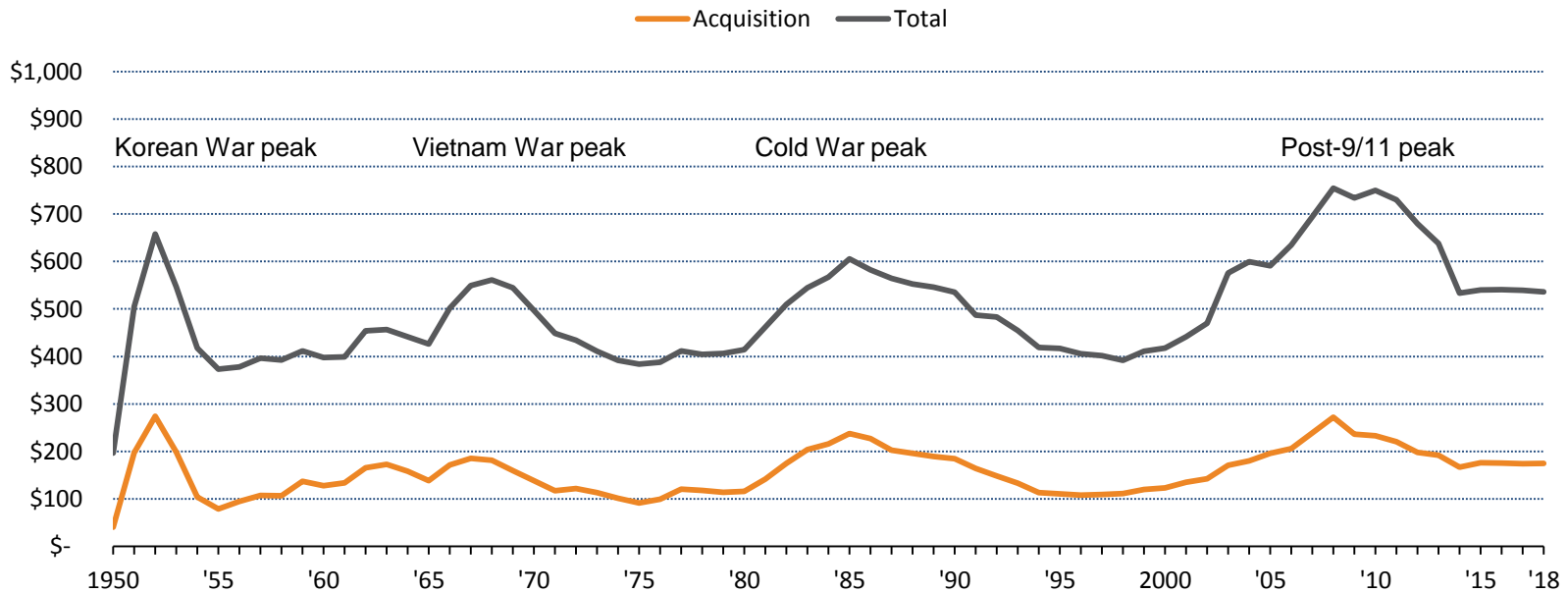
### **Strong international defense sales opportunities won't offset U.S. decline in most sectors**

# POSTWAR DECLINE IN DEFENSE SPENDING

## Department of Defense Budget Authority

U.S. defense spending has dropped an average of about 30 percent during the seven years after wars end; acquisition spending has dropped about 46 percent

Constant 2014 dollars in billions



Note: Includes Overseas Contingency Operations  
Source: Department of Defense

# DEFENSE SEQUESTRATION PAST, PRESENT & FUTURE

## **Past: Fiscal 2013 sequestration cuts weren't really "across-the-board"**

- » Reprogramming pushed money into operations from procurement
- » As a result, the CR carries over more fiscal 2013 funds into fiscal 2014, in areas where Pentagon leadership would already want it
- » Military paid its sequester bill using unspent money from prior years
- » Earnings calls show that major defense companies are adapting to new budget reality

## **Present: In fiscal 2014, sequestration would cut \$20 billion from the CR level**

- » Carryover of fiscal 2013 funding level means partial short-term relief from sequestration caps
- » Pentagon is spending at rates near the CR level
- » The fiscal 2014 defense budget request is \$34 billion more than a full-year CR
- » Leaked Pentagon memo shows a preference for protecting major defense acquisition programs while cutting other procurement
- » Possible layoffs of civilian defense employees

## **Future: Fiscal 2015 budget plan is the beginning of the new normal**

- » Secretary Hagel "We do not have the option of ignoring reality or assuming something will change."



# PROPOSED FISCAL 2014 SPENDING EXCEEDS CAPS, WOULD REQUIRE SEQUESTRATION

## CR, House, Senate and White House plans exceed at least one spending cap

### Scenarios

- » White House request exceeded the defense cap by \$53.9 billion and nondefense cap by \$35.1 billion
- » A CR at fiscal 2013 levels would still exceed defense cap by \$19.9 billion
- » If House spending bills became law, complying with caps would require \$47.9 billion defense cut, no cuts to nondefense
- » If Senate spending bills became law, they would require \$54.1 billion in cuts to defense activities and \$34.3 billion to nondefense to comply with caps

Dollars in billions

Spending category	Administration request	House appropriations	Senate appropriations	CR at 2013 levels	FY 2014 caps
Defense	\$552.0	\$545.9	\$552.2	\$518.0	\$498.1
Nondefense	\$504.5	\$420.6	\$503.7	\$468.2	\$469.4
<b>Total</b>	<b>\$1,056.5</b>	<b>\$966.6</b>	<b>\$1,055.9</b>	<b>\$986.3</b>	<b>\$967.5</b>

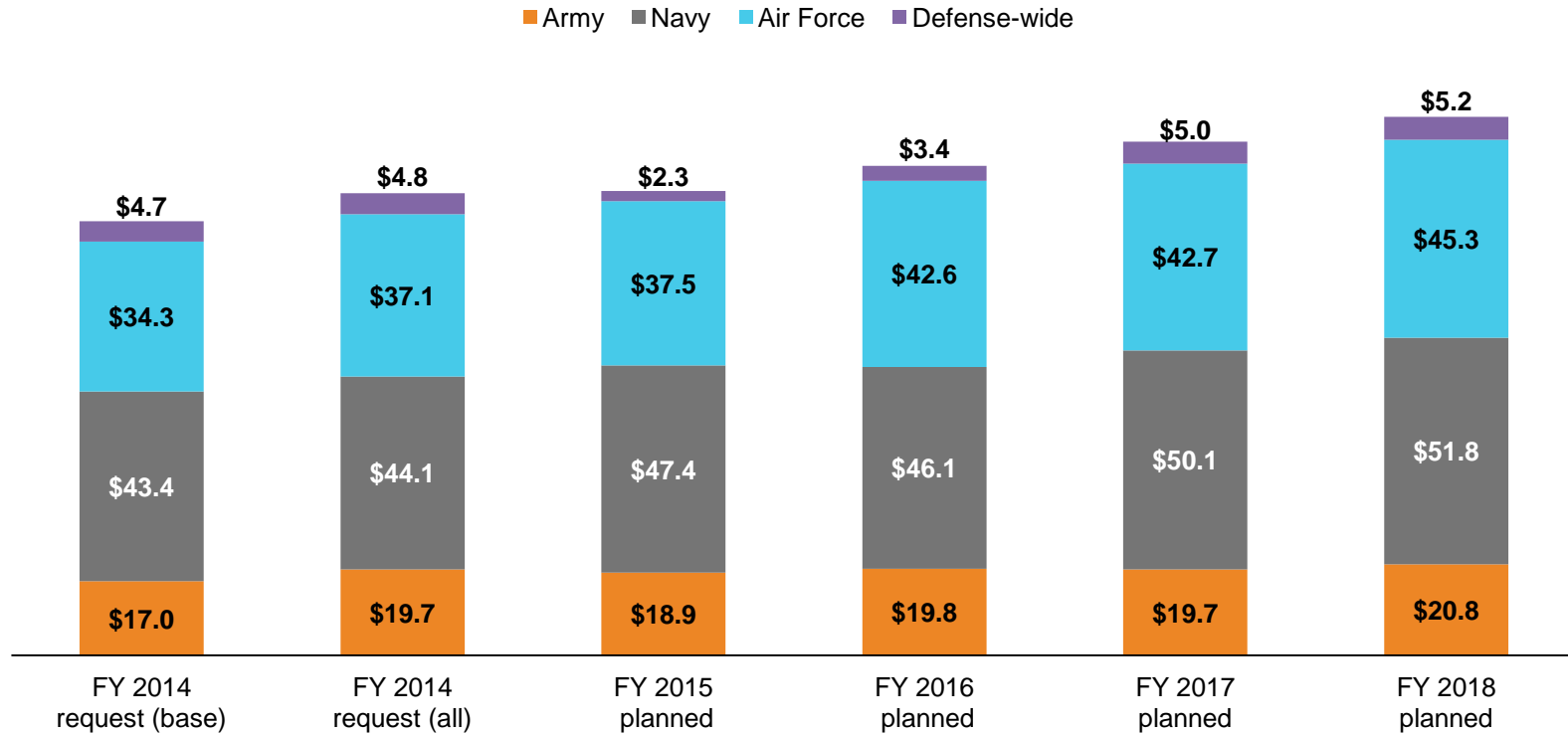
Notes: Totals may not add due to rounding; Budget Control Act specifies separate spending caps for defense (function 050) and nondefense but does not explicitly state an aggregate cap; OMB scoring is based on latest versions of spending bills, including subcommittee versions  
 Sources: [OMB Final Sequestration Report to the President and Congress for Fiscal Year 2013](#), [CBO Estimate of the Budgetary Effects of H.R. 8](#), [OMB Sequestration Preview Report To The President And Congress For Fiscal Year 2014](#), [OMB Sequestration Update Report to the President and Congress for Fiscal Year 2014](#), [CBO Letter to Paul Ryan](#)

# PROCUREMENT WOULD HAVE TO BE CUT IMMEDIATELY

## Pentagon procurement plan is at odds with fiscal reality

In the FYDP, procurement grows to \$123.2 billion in fiscal 2018 from \$105.7 billion in fiscal 2014

Dollars in billions



Source: Department of Defense Fiscal 2014 Future Years Defense Program

# FISCAL 2015 AND BEYOND DEPENDS ON FISCAL 2014 BUDGET CHOICES AND STRATEGIC PLANS

## Results of Strategic Choices and Management Review process

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### Services building two budgets for fiscal 2015 through fiscal 2019

- » One would continue the \$150 billion cut in the fiscal 2014 budget request
- » The other will meet the sequester-level caps

### Cuts are required to meet president's budget proposal for fiscal 2014 through fiscal 2018

- » Reduce Army by 40,000 to 70,000 troops below current plan of 490,000
- » Cut 5 fighter squadrons and C-130 fleet

### Cuts larger than \$150 billion require trade-off between force size and capability

- » Option 1: Rely on technological dominance
  - Long-range strike bomber, submarine upgrades, F-35, cyber and special ops protected
  - Army loses another 70,000 soldiers; two to three Navy carrier groups cut; 7,000 to 32,000 fewer Marines
- » Option 2: Maintain force size
  - No programmatic details
  - A “decade-long modernization holiday”\*
  - “Massive cuts to procurement and research and development funding”

**Implication:** Continued decline in defense R&D in the fiscal 2014 Future Year Defense Program (FYDP) could jeopardize the Pentagon's ability to maintain technological edge

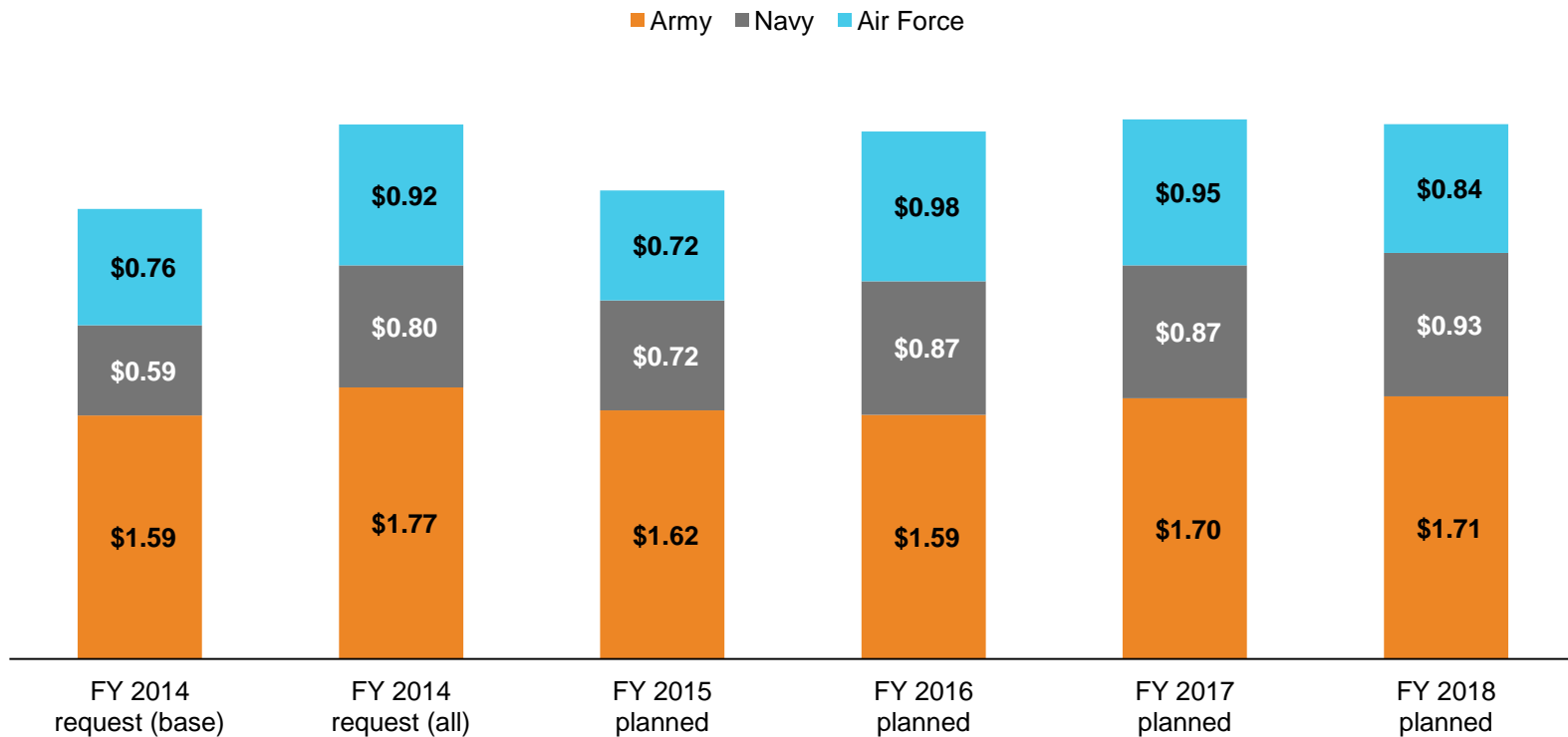
\*Department of Defense [Statement on Strategic Choices and Management Review](#)

# AMMUNITION PROCUREMENT

## Ammunition procurement basically flat over the FYDP

As Army force structure comes down, munitions budget will drop

Dollars in billions



Source: Department of Defense Fiscal 2014 Future Years Defense Program



# PROJECTED WINNERS AND LOSERS IN DRAWDOWN

Bloomberg Government did an extensive analysis of DOD policies, budgets and statements and reviewed major think-tank work. Analysis revealed strong consensus on likely winners and losers

## Less Vulnerable to Cuts

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- » Special operations
- » Cybersecurity
- » Unmanned systems
- » Satellites
- » Space launch
- » Attack submarines
- » Non-nuclear bombers
- » Data analytics
- » IT services
- » Modeling and simulation
- » Maintenance – fewer systems, retained longer

## More Vulnerable to Cuts

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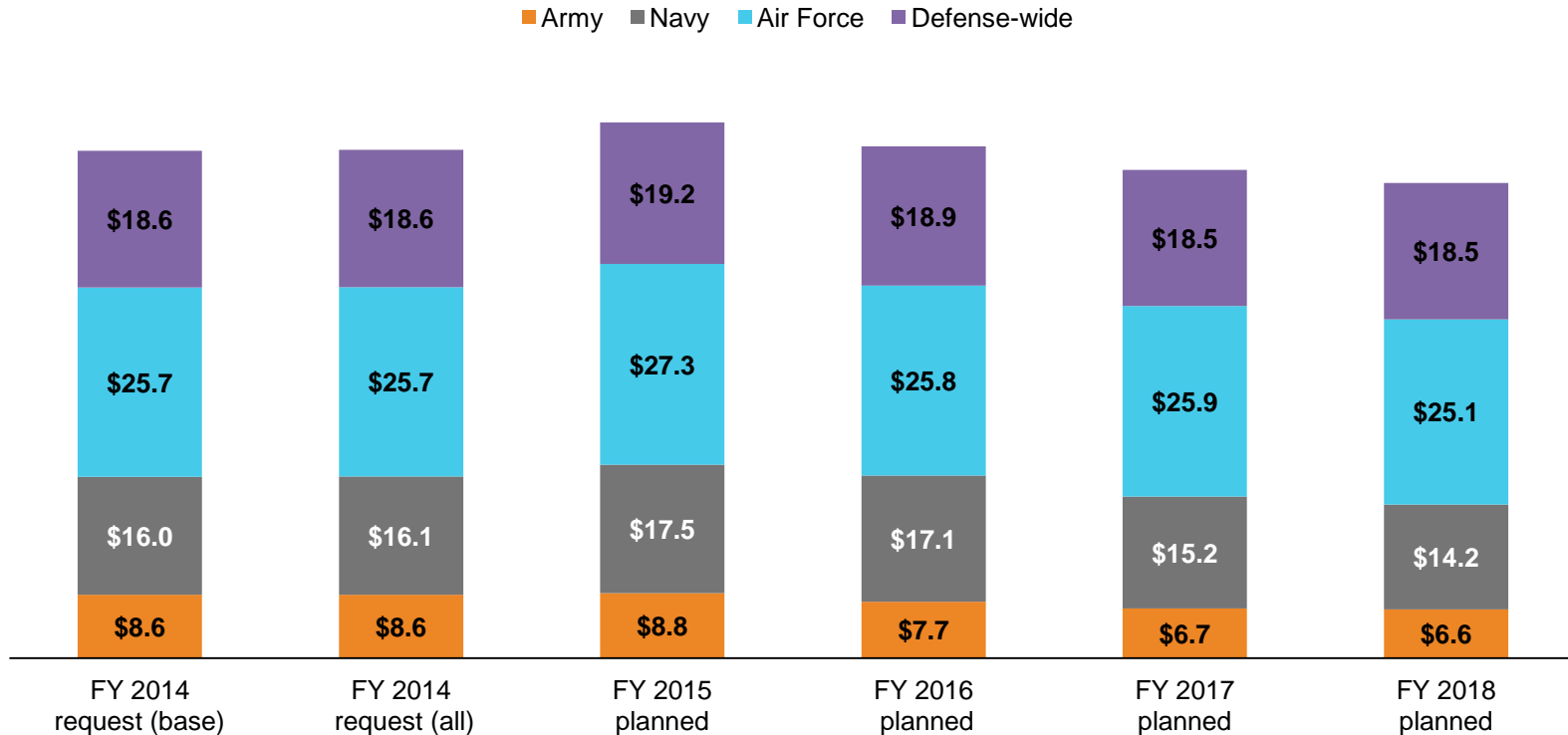
- » F-35 jet
- » Helicopters
- » Logistics support
- » Troop equipment
- » Transport/tactical vehicles
- » Aircraft carriers and supporting surface ships
- » Nuclear bombers
- » Strategic-level missile defense

# IS RDT&E SUFFICIENT TO MEET HIGH-TECH FUTURE?

## Pentagon RDT&E plan may require adjustment to meet future requirements

RDT&E would decline by 6.5 percent to \$64.6 billion in fiscal 2018 from \$69 billion in fiscal 2014

Dollars in billions



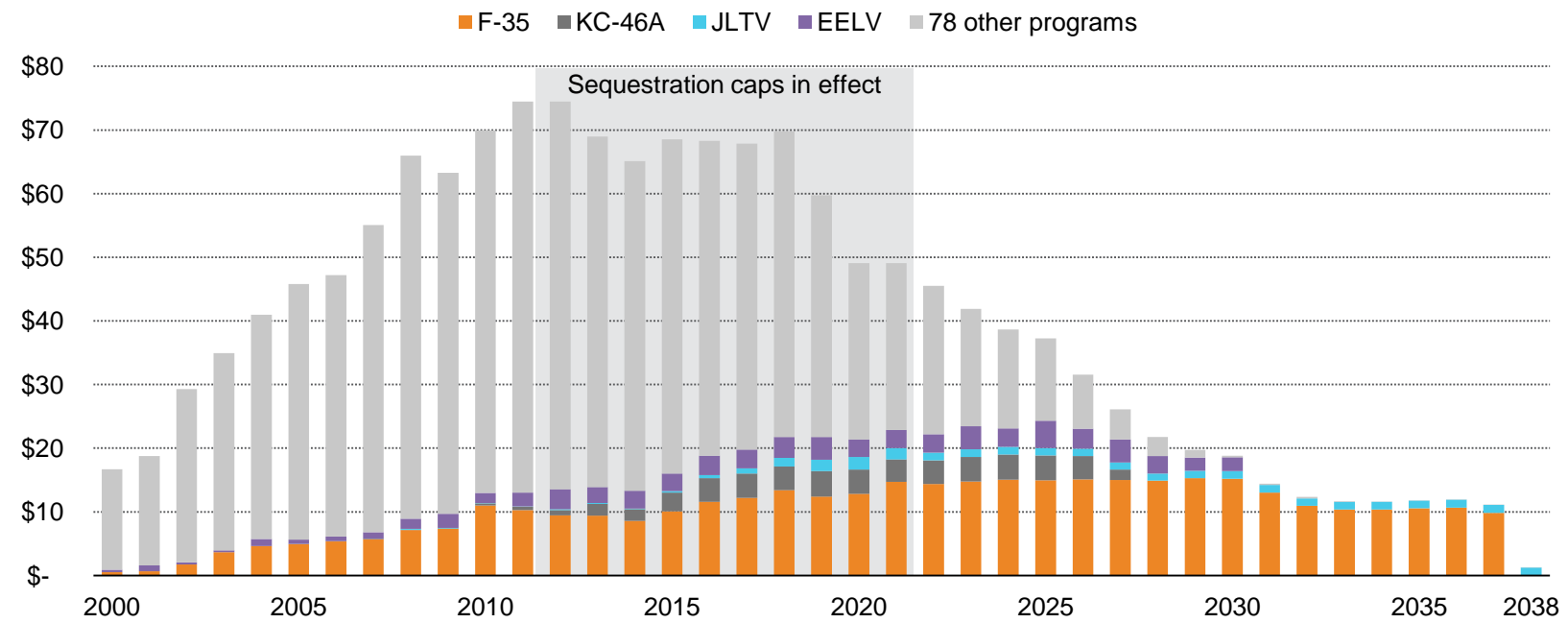
Source: Department of Defense Fiscal 2014 Future Years Defense Program

# MAJOR PROGRAMS WILL ADAPT TO LOWER CAPS

## Major Defense Acquisition Programs in the Selected Acquisition Reports

The F-35 program has the largest share of the money during and after sequestration

Dollars in billions



Source: Department of Defense

Note: Acquisition funding includes both procurement and RDT&E. Program value doesn't reflect potential cuts from sequestration. KC-46A is the Air Force's aircraft refueling tanker, JLTV is the Joint Light Tactical Vehicle, and EELV is the Evolved Expendable Launch Vehicle

# MILITARY LEADERS: MODERNIZATION ISN'T OPTIONAL?

## The military services don't agree on how to respond to sequestration

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### Air Force

- » “When forced to make tough decisions, we will favor new capabilities over upgrades to our legacy forces”
- » “Significant erosion of our readiness in the near term”
- » “Renders pre-Milestone B programs unaffordable”
- » “May not generate sufficient funds to sustain depot activity with a positive balance”

### Navy

- » “Sequestration will compel us to forfeit long-term priorities to fund near-term readiness”
- » “The maintenance backlog will continue to compound, eventually leaving Navy with insufficient aircraft available in inventory to meet deployment and training readiness objectives”

### Army

- » “An unprecedented challenge in delivering capability to Soldiers now and well into the future”
- » “The Army will assume significant risk in its aviation modernization efforts”
- » “Investment in the Army’s seed corn for future capabilities... will also be significantly affected by sequestration-level reductions in fiscal 2014 and beyond”

Source: Oct. 23, 2013 testimony before the Subcommittee on Tactical Air and Land Forces Subcommittee of the House Armed Services Committee. [Air Force](#): Dr. William A. LaPlante and Lt. Gen. Michael R. Moeller. [Navy](#): Sean J. Stackley, Vice Admiral Allen G. Myers, Lt. Gen. Glenn M. Walters. [Army](#): Heidi Shyu and Lt. Gen. James O. Barclay III

# INTERNATIONAL SALES PROSPECTS ARE REAL, BUT MAY NOT OFFSET U.S. DECLINE

## BGOV analysis is examining some of the largest international opportunities

- » Countries with high growth in military spending and military imports from the U.S.
  - Pakistan, Turkey, Kuwait, Canada, South Korea and Poland ([link](#))
- » Individual procurement markets show different patterns
  - Fighter jets ([link](#))
  - Armored vehicles ([link](#))
  - Helicopters ([link](#))
  - Defense logistics support in the Middle East and Southwest Asia is focused on getting out of Afghanistan as quickly as possible ([link](#))

## Such international defense sales could help make up for U.S. decline, but...

- » Eased export rules may not vastly increase addressable market size for most sectors
- » International sales don't correlate with U.S. defense budgets
  - International F-35 sales would have increased anyway
  - Countries in Middle East are buying aircraft, missiles and missile defense
- » Sales will shift as U.S. commitments – Japan, S. Korea – become more like partnerships

# Q&A

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# ABOUT THE ANALYSTS



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[Budget Deal Failure Would Cut Defense \\$20 Billion](#)

[Debt Limit and Shutdown Deal: What Happens Next?](#)

### Defense Budget Data

[Database of 2014 Future Year Defense Plan \(Insight\)](#)

[Database of Selected Acquisition Reports \(Insight\)](#)

### International Sales

[International Military Sales: Greener Pastures](#)

[International Heavy Armor Sales](#)

[International Jet Fighter Sales](#)

[Defense Logistics Support, Middle East/Southwest Asia](#)

