

**DEPUTY SECRETARY OF DEFENSE ASHTON B. CARTER
PREPARED TESTIMONY
SENATE ARMED SERVICES COMMITTEE
TUESDAY FEBRUARY 12, 2013**

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Mr. Chairman, Senator Inhofe, Members of the Committee, thank you for holding this hearing on the effects of sequestration. I am not only pleased, but in fact eager, to testify before you. For over a year, Secretary Panetta and I, together with the uniformed leadership of this Department, have been warning of the devastating effects for national defense that will result from sequestration.

Last August, I testified in detail to the impacts of sequestration that are specific to the Department of Defense, which include all the matters we will be discussing today in more detail, including furloughs, degraded readiness, maintenance cutbacks, and disrupted investment programs. I explained that these devastating effects would result from the size—and, for Fiscal Year 2013, the arbitrary nature—of the budget cuts that would be required under sequestration and the reductions in the discretionary caps mandated by the Budget Control Act of 2011 (BCA).

The consequences of sequestration and a lowering of the discretionary caps are serious and far-reaching. In the near-term, these reductions would create an immediate crisis in military readiness, especially if coupled with an extension of the Continuing Resolution (CR) under which we currently operate. In the long-term, failure to replace these large and arbitrary budget cuts with sensible and balanced deficit reduction would require this nation to change its defense strategy.

I have long understood that the Department of Defense must contribute to the resolution of the nation's fiscal situation. That is why we already accommodated \$487 billion in budget reductions versus the FY 2012 President's

Budget, and managed to do so in a manner consistent with our new defense strategy for the new era that America is entering. This \$487 billion reduction, now even larger, was on top of budget reductions that began under Secretary Gates, when we cancelled many unneeded and poorly performing defense programs.

I also understand that the taxpayer deserves careful use of every dollar we are given. That is why we have striven and must continue to strive to get better buying power for the defense dollar.

Both of these efforts will be severely undermined unless the budget uncertainty and cloud of sequestration that hangs over this Department, its uniformed and civilian employees, and the industry that supports us, is lifted.

What is particularly tragic is that sequestration is not a result of an economic emergency or a recession. It's not because discretionary spending cuts are the answer to our nation's fiscal challenge; do the math. It's not in reaction to a change to a more peaceful world. It's not due to a breakthrough in military technology or a new strategic insight. It's not because paths of revenue growth and entitlement spending have been explored and exhausted. It's purely the collateral damage of political gridlock.

We have long argued that the responsible way to implement reductions in defense spending is to formulate a strategy first and then develop a budget that supports the strategy. If the Department were forced to operate under the mechanistic sequestration rules and the CR for the remainder of the fiscal year, it would achieve precisely the opposite effect by imposing arbitrary budget cuts that then drive changes in national security strategy.

This is why I continue to urge Congress, in the strongest possible terms, to avoid sequestration by devising a comprehensive and balanced deficit reduction

package that both the House and Senate can pass and that the President can sign. I also strongly urge the Congress to pass FY 2013 appropriation bills for all Federal agencies, including the Department of Defense.

HOW SEQUESTRATION WOULD WORK

The American Taxpayer Relief Act of 2012 changed the dates and size of sequestration. The sequestration will now begin for the Department in about two weeks, on March 1, 2013; in addition, a second sequestration due to a breach in the discretionary spending caps for FY 2013 is scheduled to be implemented on March 27. Simply put, the combined effects of these two sequestrations will require the Department to cut roughly \$46 billion from the annualized level of funding provided on the FY 2013 CR, all in the last seven months of the fiscal year.

Sequestration cuts would apply to all of the DoD budget, including the wartime or Overseas Contingency Operations (OCO) portions, with only one significant exception. Exercising his statutory authority, the President indicated his intent to exempt all military personnel funding from sequestration. While I support the President's decision to protect our military personnel from sequestration, as a result, other DoD budget accounts must be cut by larger amounts to offset this exemption. We estimate that all other accounts would be reduced by roughly eight percent by the March 1 sequestration order, and by a total of about nine percent if both March 1 and March 27 sequestration orders occur. (The Office of Management and Budget would eventually calculate the precise sequester percentage and provide it in the sequestration order.)

In addition to requiring a large and sudden reduction in defense spending for FY 2013, the law requires that those reductions be accomplished in a rigid, across-the-board manner – account by account, and item by item. Cuts to the

operating portions of the DoD budget must be equal in percentage terms at the level of appropriations accounts. (Examples of appropriations accounts in the operating budget include Army active operation and maintenance, Navy Reserve operation and maintenance, and Air Force Guard operation and maintenance.) For the investment portions of the budget, the dollar cuts must be allocated proportionally at a line item level of detail. More than 2,500 programs or projects are separately identified as line items and would be reduced by the same percentage. Within each operating account or investment line item, managers could decide how best to allocate the reductions.

The CR also plays a deleterious role in shaping the FY 2013 budgetary landscape. The CR provides funding for OCO at the level requested in the President's Budget for FY 2013. However, the current CR directs that the base budget remain at the level enacted for FY 2012. That provides sufficient total base budget dollars to DoD, but the dollars are in the wrong appropriations. Compared to our needs for FY 2013, the CR provides too much funding in most investment accounts and insufficient funding in the Operation and Maintenance (O&M) accounts that sustain day-to-day operations and military readiness.

WHAT SEQUESTRATION MEANS

If sequestration is triggered, we will be required to make cuts of \$46 billion from virtually every category of the budget, except for military personnel. Moreover, these cuts must be accommodated in the last seven months of Fiscal Year 2013. The impact of these cuts will be compounded by the misallocation of funding under the CR.

The combined effects of sequestration and the CR will be especially problematic for the Operation and Maintenance accounts, which most affect military readiness. So allow me to focus on O&M, and in particular on the O&M

in the base budget for active forces, since this portion will be heavily impacted. As part of the overall cut of the \$46 billion cut caused by the two sequestrations, these O&M accounts will be reduced by \$13 billion from the annualized CR level. We must obviously protect the O&M dollars for our men and women in combat, which under sequestration rules we can only do by cutting base-budget O&M disproportionately—this results in an additional shortfall of \$5 billion in active base-budget dollars.

Then the CR comes into play. If it is extended in its current form throughout the year, it exacerbates problems because it does not provide enough dollars in O&M – adding an additional shortfall of \$11 billion.

Next, we are anticipating higher-than-expected wartime operating costs due to factors such as unexpectedly high operating tempo, increased transportation costs associated with difficulties experienced with Pakistan grounds lines of communication, and an expanded Persian Gulf presence to deal with contingencies in the region. This will add another \$5 billion to \$6 billion to the shortfall in active O&M dollars.

The cumulative effect of adding all these factors is a DoD-wide shortfall of about \$35 billion compared to our FY 2013 budget request (about 23 percent of that request) just in base-budget O&M dollars for Active forces. Some Services will experience base-budget O&M reductions much larger than 23 percent. The Army, for example, has a greater share of wartime operating dollars to protect and is also experiencing higher-than-expected use of wartime operating funds.

Greatly adding to our concern is that we would have only about 7 months to accommodate these formidable shortfalls. The result in the near-term will be a readiness crisis.

NEAR- TERM ACTIONS IN RESPONSE TO THE POSSIBILITY OF MARCH 1 SEQUESTER AND YEAR-LONG CR

Because the prospect of these developments is now all too real, and because the time in the fiscal year to absorb them is slipping away, on January 10 I authorized all Defense Components to begin taking immediate actions to slow spending in order to prevent even more dire consequences later in the year. I directed each of the Defense Component heads to report back to me by February 1 with a list of proposed actions and an implementation plan. I subjected the plans to three ground rules: first, protect wartime operations, urgent operational procurement needs, and wounded warrior programs; second, protect, whenever possible, key features of the new defense strategy and acquisition efficiencies; and third, ensure, to the extent feasible, that these near-term actions are reversible if action is taken to formulate a balanced deficit reduction deal that averts these developments.

Let me provide you some examples of the steps that are now being taken:

1. Most services and defense agencies will institute *civilian hiring freezes*, with exceptions for mission-critical activities. DoD hires between 1,500 and 2,000 people per week. It is important to note that this freeze will *disproportionately affect veterans*, who make up 44 percent of the DoD civilian workforce. Hiring freezes will also be felt across the nation, since 86 percent of DoD's civilian jobs fall outside the Washington, D.C. metro area.
2. Most services and defense agencies will begin *laying off a significant portion of our 46,000 temporary and term employees*, again with exceptions for mission-critical activities.
3. Most services and defense agencies will *curtail facilities maintenance*. More than \$10 billion in funding— mostly to contractors and small businesses—

would be affected, translating into lost jobs in the private sector. The Air Force, for example, plans to cut facilities maintenance projects by about half, including cuts to 189 projects at 55 installations in 26 states.

4. As of March 1, services will begin *cancelling ship and aircraft maintenance work* for the 3rd and 4th quarters. It is estimated that about 25 ships and 470 aircraft will be affected unless we can reverse these actions.
5. The Army and other services are *curtailing training* not directly related to missions.
6. The Army has directed *a reduction of 30 percent in base operating services* relative to FY 2012 levels and other services are also limiting base support.

ADDITIONAL ACTIONS THAT WILL NEED TO BE TAKEN SHOULD SEQUESTRATION AND A YEAR-LONG CR OCCUR

We are taking these steps now reluctantly, since they are obviously harmful, because we can no longer be confident that the March sequestrations and a year-long CR will be avoided, and by acting now we can make the damage in later parts of the year somewhat less severe. While these near-term actions will cushion the blow in later months, they are not nearly enough to accommodate a year-long CR or sequestration. If these unfortunate developments actually come to pass, in March we will have to take more drastic and irreversible actions. Accordingly, I also directed all Defense Services and Agencies to provide me by February 8 with a list of actions that they would take in the event that either budget contingency occurs. We are still formulating these plans, which are complex and require input from thousands of activities. We do not yet have complete information, but I can provide examples of the actions that the Defense Components have proposed to meet budgetary targets in FY 2013:

1. All the Services and Agencies are likely to have to *furlough most DoD civilian employees for an average of one day per week for up to 22 weeks.* This action will seriously harm our ability to do important work, which will, in turn, harm national security: civilians fix our ships and tanks and planes, staff our hospitals, handle contracting and financial management, and much more. During this period, furloughs will result in a 20 percent cut in pay for civilians who support our national defense – which will affect their morale. Senate-confirmed political appointees like me cannot be furloughed under the law. But if our employees are furloughed, I intend to give back to the Treasury the same portion of my salary, and I encourage all of us – Executive Branch and Legislative Branch – to do the same. In addition, these furloughs, like other spending cuts, will adversely affect economies in the communities where our civilians live and work. Savings from furloughs will be critical to meeting budgetary cuts by the end of the year. However, it is important to note that even if all 800,000 civilian DoD employees are furloughed to the maximum extent permitted by law, the savings of \$4 billion to \$5 billion will still leave us \$41 billion short of our \$46 billion total target. Thus, much more cutting of DoD spending will result, affecting many defense workers who are not direct DoD employees.
2. *The Army will curtail training and reduce maintenance for units that are not scheduled to deploy to Afghanistan.* This could put readiness for future contingency operations elsewhere at risk. By year end, about two-thirds of Active and most Reserve Brigade Combat Teams (excluding those in OPERATION ENDURING FREEDOM) will be at reduced readiness levels. As part of accommodating sequester cuts, the Army may have to cancel up to five full-spectrum training rotations at its premier training centers.

3. The Air Force will be forced to cut flying hours sharply and will reduce remaining weapon system sustainment funding by about 30 percent. *Current planning suggests that most flying units (especially later-deploying units) will be below acceptable readiness standards by the end of FY 2013.* As a result, the Air Force will be substantially less able to respond on short notice to contingencies, which is one of their key missions.
4. The Navy and Marine Corps will be forced to cut back on readiness and fleet operations. *That could include a reduction of one-third in operations of Navy ships and aircraft in the Asia-Pacific region and gaps in availability of Marine Amphibious Ready Groups.*
5. DoD would be short between \$2 billion and \$3 billion in funds needed to pay for costs in the Defense Health Program. If we protect the operations of our in military treatment facilities, in order to maintain health readiness for Active-duty forces, then it is possible that *DoD might not have enough funds to pay TRICARE bills toward the end of the fiscal year.*
6. DoD will have to make cuts of roughly nine percent in each of more than 2,500 investment line items. These cuts will disrupt programs, add to unit costs, and damage the defense industry.

Overall, these actions will seriously disrupt programs and sharply degrade readiness. The acute effects on O&M and readiness are of particular concern to the Secretary and me and the Department's senior military leaders. The Chairman of the Joint Chiefs of Staff, the Vice Chairman, and all the Joint Chiefs recently signed a "28 star letter" stating: "The readiness of our Armed Forces is at a tipping point. We are on the brink of creating a hollow force."

LONGER-TERM EFFECTS OF SEQUESTRATION AND REDUCTIONS IN DISCRETIONARY CAPS

So far I have focused on the effects of sequestration and the CR in FY 2013. But current law also reduces the budgetary limits for defense spending by about \$50 to \$55 billion in each year from FY 2014 through FY 2021. These lower caps would constitute a second long-term budget cut as large as the one DoD has already carried out. Cuts of this magnitude will require that we substantially modify and scale back the new defense strategy that the DoD leadership, working under the guidance of the President, so carefully developed just a little more than a year ago.

Last year, we emphasized that we were at a strategic turning point – a transition from the era of Iraq and Afghanistan to the security challenges that will define our future.

The new strategy has five pillars:

First, we said that our force has got to be leaner, but also agile, ready, and technologically advanced. In other words, we wanted to absorb the lessons we learned over the last decade of war – the lessons of counterinsurgency, IEDs, rotational presence intelligence and operational integration, adaptability – and apply them to the challenges of the future to create a new post-Iraq and Afghanistan concept of readiness for each of our services.

Second, we said that we would continue our focus on the Middle East, which will remain an enduring commitment of the United States, but also execute our so-called rebalance to the Asia-Pacific region, where so much of our future security and economic interests lie.

Third, we said we would strengthen our global alliances and partnerships to achieve shared objectives and to build the capacity of our security partners.

Fourth, we said we would ensure that the United States military remains capable of confronting aggression and defeating any opponent anywhere, anytime.

Fifth, we said we would continue to invest, even in hard budgetary times, in future-focused capabilities and technologies, like cyber and space, as well as special operations.

If the budget cuts described were sustained for the full nine years, we would need to make substantial changes to our strategy that will directly diminish our military strength. Large reductions in force structure would almost certainly be necessary. These force structure changes would not happen instantly; in order to meet the new budget levels, we would almost certainly be forced to gut our acquisition programs in the near-term. This would cancel or significantly delay most of our major modernization programs until after the force reductions are achieved years from now. On top of this, we would have little choice but to reduce military compensation and reduce civilian personnel costs.

The resultant force would not be able to rapidly respond to major crises in the world or to be globally positioned to deter our adversaries. To protect the most warfighting capability possible, this Department would need relief from constraints on how the Department manages non-warfighting costs, including such authorities as BRAC.

Just as sequestration and the reductions in the discretionary caps will have devastating effects on the nation's defense force, it will also be harmful to the defense industry upon which we depend. The quality of the weapons systems produced by our defense industry is second only to the quality of our people in uniform in making our military the greatest in the world. As such, a technologically vibrant and financially successful defense industry is in the

national interest. The act of sequestration and longer-term budget cuts, and even the prolongation of uncertainty, will limit capital market confidence in the defense industry, and companies may be less willing to make internal investments in their defense portfolio. The impact will be even greater on our subcontractors, who lack the capital structure to withstand turmoil and uncertainty. Of note, 60 to 70 percent of our defense dollars are subcontracted, and many of our subcontractors are small businesses. Above all, sequester will cause a spike in program inefficiency by stretching out programs and driving up unit costs.

Already, we saw the threat of sequestration drag on GDP growth in the 4th quarter of 2012, and consumer confidence took a hit over two months through January. According to private sector and CBO forecasts, sequestration impacts could reduce GDP growth in 2013 by over half a percentage point. That lost growth would deprive American workers of hundreds of thousands of jobs.

In the long run, national security rests on a strong economy, and also on non-defense functions – like education, especially science, technology, engineering, and math (STEM) – provided in other parts of the federal budget. While not part of this hearing, the drastic nature of sequestration would obviously be harmful to these functions too.

Finally, we must be mindful that the world watches – our friends and enemies watch – and continued turmoil and uncertainty take a toll on our international reputation for excellence and resolve in national security affairs.

SEQUESTRATION MUST BE AVOIDED

My testimony today makes clear that sequestration, especially if accompanied by a year-long CR, would be devastating to DoD—just as it would to every other affected Federal agency. The difference is that, today, these devastating events are no longer distant problems. The wolf is at the door.

If we end up with an extended CR, we will need help from Congress in modifying the CR to get the dollars in the correct appropriations. We will also need Congress to support our efforts to use the reprogramming process to shift money so as to meet our highest priorities.

But additional flexibility at this late date would do little to offset the devastating effects of sequestration since cuts of this abruptness and magnitude cannot be absorbed without significant and damaging cuts in nearly every budget category. Congress needs to deal quickly and broadly with our country's deficit problems in a balanced way that the President can support. Then Congress needs to de-trigger sequestration and pass appropriations bills for all Federal agencies. Given that there is not enough time to accomplish these far-reaching actions before sequestration is triggered on March 1, I would urge that Congress at least delay sequestration. But as I have emphasized, the cloud of uncertainty hanging over the nation's affairs is already having lasting and irreversible effects. Ultimately, the cloud of sequestration needs to be dispelled, not just moved to the horizon.

However it is done, we need relief from the twin evils of sequestration and a year-long CR. The magnificent men and women of this Department, and their families, deserve no less. They need to know with certainty that we will meet our commitments to them. Our partners in the defense industry, and their employees, need to know that we are going to have the resources to procure the world-class capabilities they can provide, and that we can do so efficiently. And perhaps most important, allies, partners, friends, and potential foes the world over need to know that we have the political will to implement the defense strategy we have put forward.

Again, I want to thank the Committee for providing us an opportunity to highlight our grave concerns. I welcome your questions.