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Future of Defense Procurement: 2014 and Beyond

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EXECUTIVE SUMMARY

Findings

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

- » During the last drawdown (1986-1998) overall DOD 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 \$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 high-tech vision, and Defense Secretary Chuck Hagel appeared to pick technology

Services are charting different ways forward

- » Air Force has made modernization its priority post-sequestration; Navy focuses on readiness

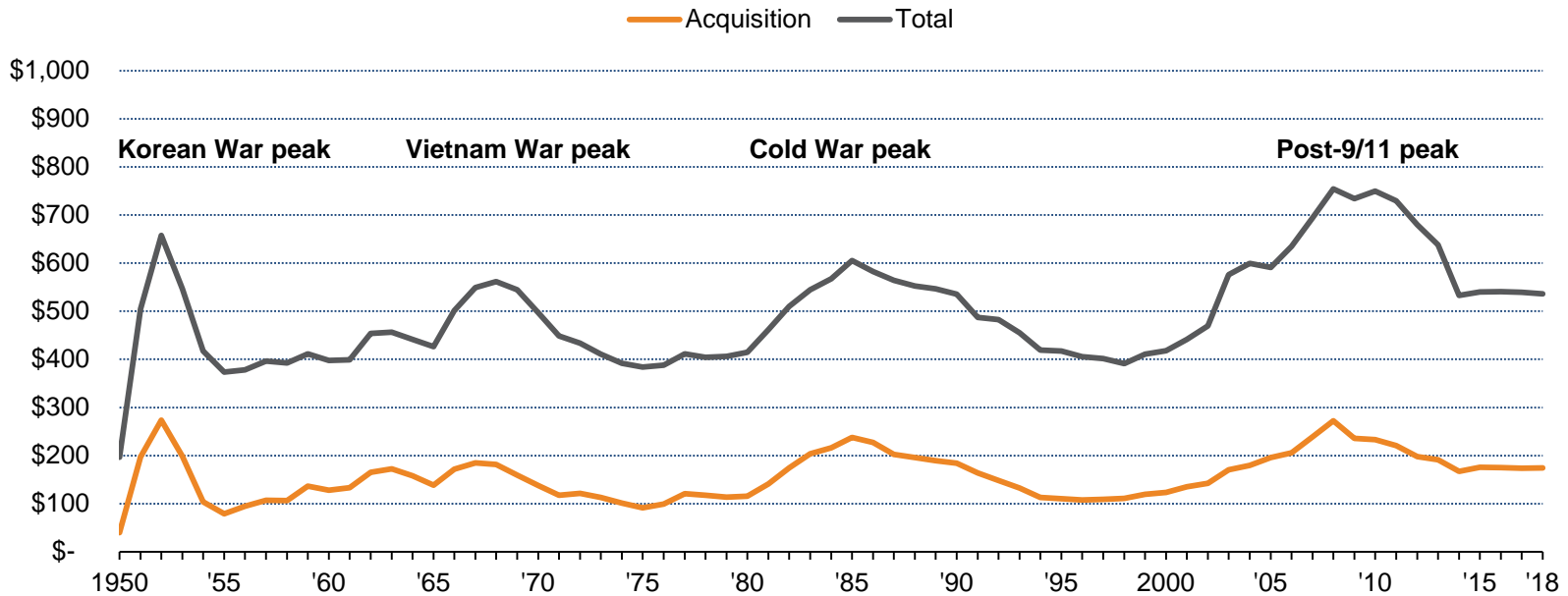
Strong international defense sales opportunities won't offset U.S. decline in most sectors

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 through fiscal 2013
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
- » About 1 percent of civilian defense employees may be laid off

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



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
Total	\$1,056.5	\$966.6	\$1,055.9	\$986.3	\$967.5

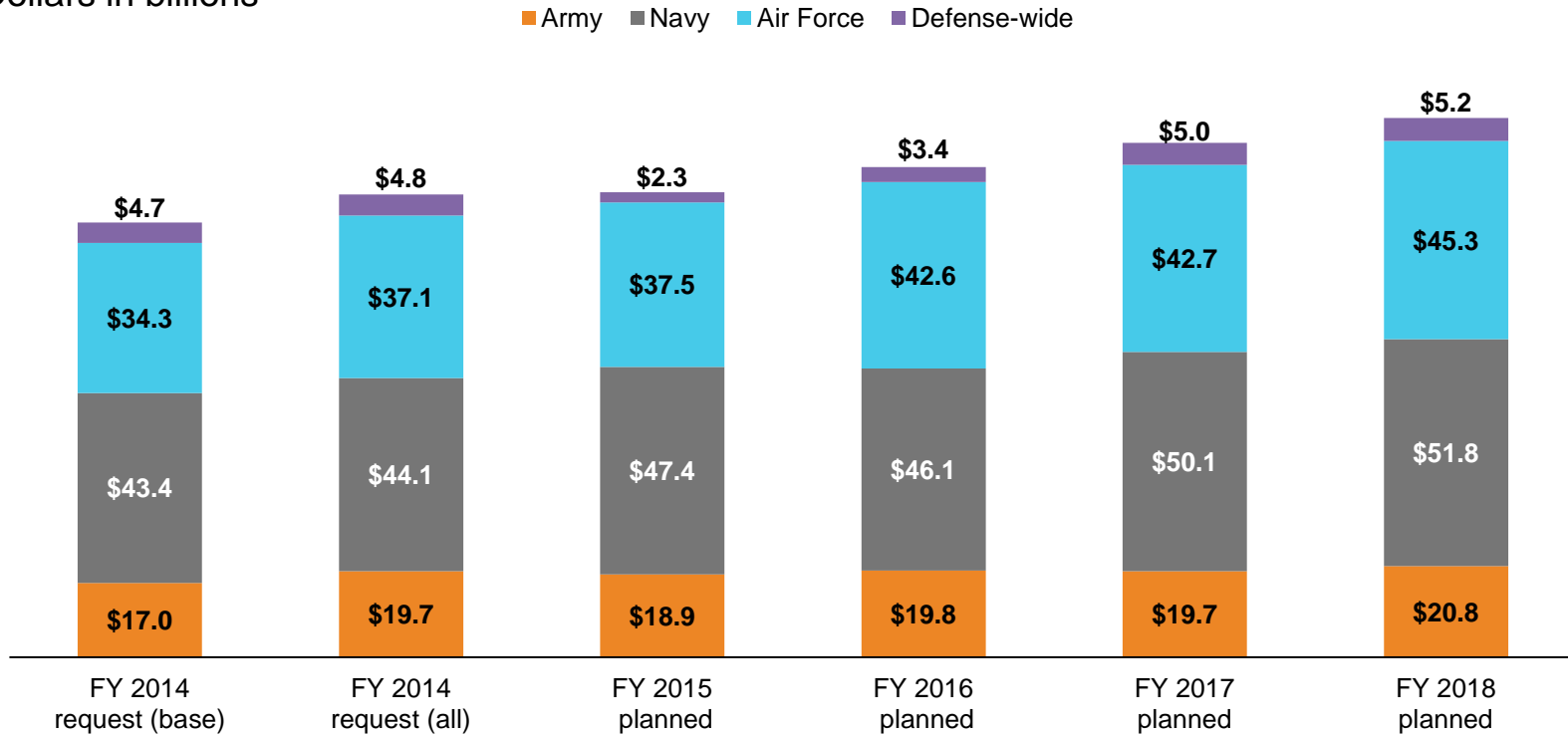
Notes: Totals may not add due to rounding; Budget Control Act specifies separate spending caps for defense (function 050) and nondefense but does not explicitly state an aggregate cap; OMB scoring is based on latest versions of spending bills, including subcommittee versions
 Sources: [OMB Final Sequestration 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

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](#)

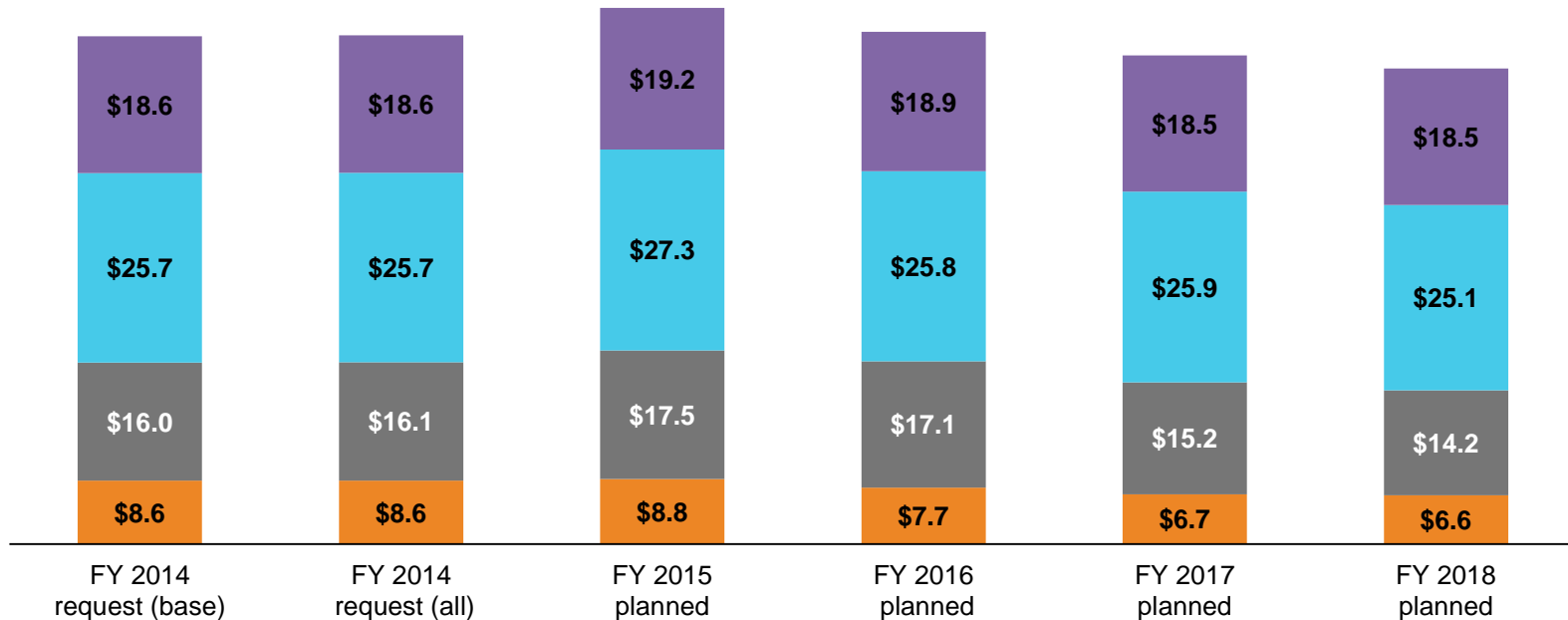
IS RDT&E SUFFICIENT TO MEET HIGH-TECH FUTURE?

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

Army Navy Air Force Defense-wide



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

- » 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

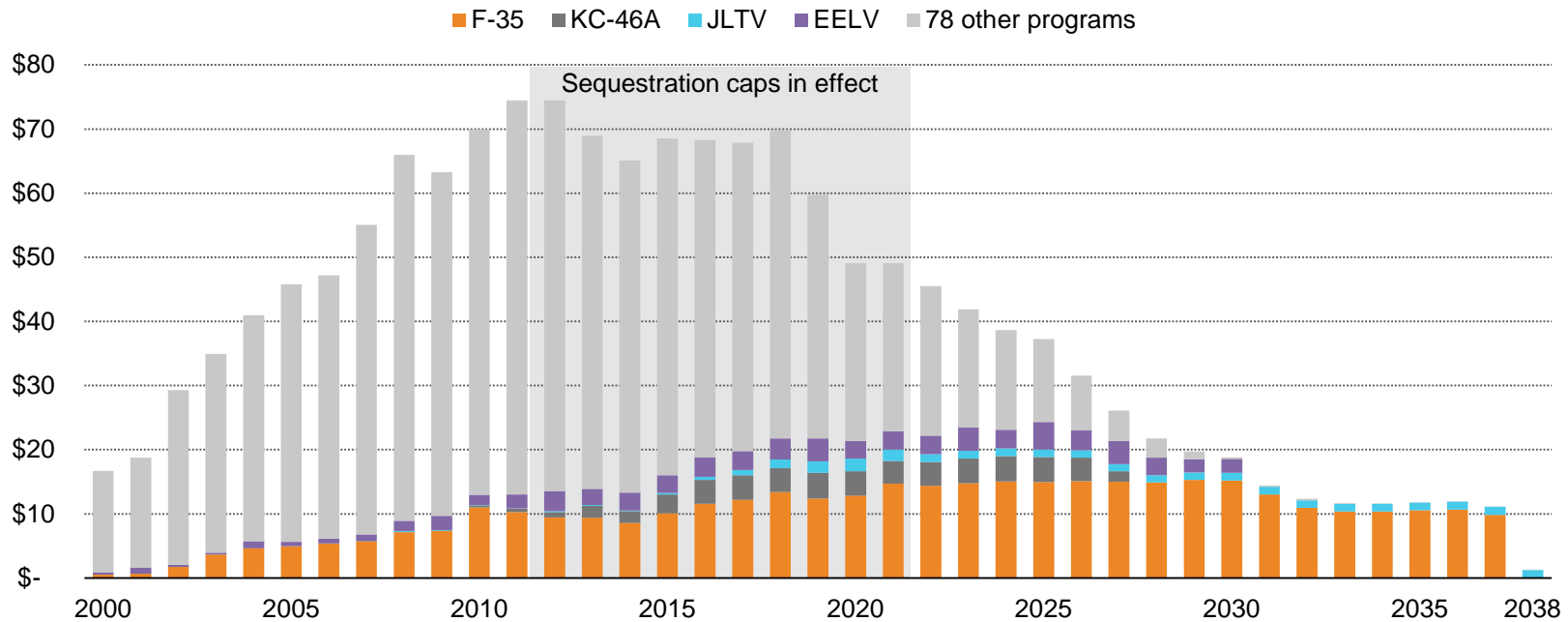
- » F-35 jet
- » Helicopters
- » Logistics support
- » Troop equipment
- » Transport/tactical vehicles
- » Aircraft carriers and supporting surface ships
- » Nuclear bombers
- » Strategic-level missile defense

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

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 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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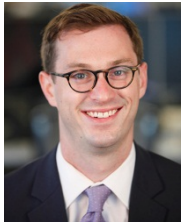
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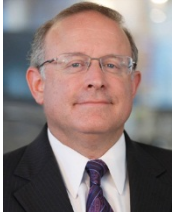
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[Charting Military Priorities](#)

[Drawdown Impact on Defense R&D Spending](#)

[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](#)