

**Testimony**

**Of**

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**Senate Committee on Appropriations**

**Subcommittee on Defense**

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Chairman Durbin, Vice Chairman Cochran, distinguished members of the Subcommittee, I am Larry Farrell, President and CEO of the National Defense Industrial Association. It's my pleasure to testify on behalf of our more than 1600 corporate members and 90,000 individual members. The subject of today's hearing, Sequestration and the Defense Industrial Base, could not be more important. With your permission, I will make a very brief statement and submit the remainder of my prepared testimony for the record.

### **Brief Statement**

- NDIA's mission.
- Sequestration impacts.
  - o Industrial base is smaller than the taxpayer investment.
  - o Less agile/responsive.
  - o Fewer R&D investments.
  - o Danger of losing critical industrial capabilities.
- Reason: abandoned regular order of budgets & rational planning.
  - o Creates uncertainty for industry.
  - o Future budgets and priorities are impossible to anticipate with three month CRs and arbitrary percentage cuts.
  - o Exemptions to sequester (e.g., mil pay) & impossible pace of sequester place the largest cuts on training and investment/R&D.
    - Impossible to bring force structure and overhead down quickly enough to meet sequester-level cuts.

- Highly constraining nature of equal percentage cuts removes the budget flexibility needed to make mandated cuts in a rational way.
- Another insidious effect of sequester is the discrepancy between budget authority cuts and outlay cuts, or cuts to real spending.
  - FY13: \$37B in BA cuts, \$10B in outlay cuts
  - FY14: \$52B in BA cuts, \$30B in outlay cuts
  - FY15: \$52B in BA cuts, \$45B in outlay cuts
- FY14/15 are the critical years for defense and defense industry.
- In those years, we can expect massive disruption to investment and R&D spending, and large program instability.
- In summary, uncertainty and tight constraints of sequester have already caused business failure, reduction of investments/R&D.
  - Companies are putting their money into stock buybacks. (Helps stock price.)
  - Companies depending on commercial & international sales. (Helps stock price.)
  - Smaller suppliers being absorbed or failing.
  - In FY14/15, that trend will accelerate.
  - Leading to further investment/R&D reductions.
  - More businesses fail.
  - Loss of critical industrial capabilities.
  - Major program disruption.
- Impossible to absorb sequester without major damage to industry.

## Testimony for the Record

NDIA's primary mission is to advocate for cutting-edge technology and superior weapons, equipment, training, and support for the warfighter and first responder. Sequestration thwarts every element of that advocacy. If left in place, sequestration will deliver a defense industrial base that is smaller than the investments taxpayers make in it, less agile than our military needs it to be, that makes fewer investments in research and development on its own dime, and is much more at risk of losing critical capabilities we will need in the future. The most frustrating part of this bleak forecast is that it is totally avoidable. Instead of budget sequestration, we need a return to regular order in the budgetary and appropriations processes so that the defense industrial base can plan and adapt to future spending levels.

Although it is by no means perfect, the planning, programming, budget, and execution process, called PPBE, is surely the best long-range planning process in government. Under this system, strategy dictates the budget, and defense manufacturers can anticipate what future budget trends will mean for their businesses. Much less preferred to a system where strategy leads the budget is a system where the budget leads strategy. Worse still is when budget uncertainty leads strategy – which is our system today under sequestration.

Neither our military nor defense industry can cope with the levels of uncertainty we have faced for the past few years. Sequestration, the government shutdown, continuing resolutions, budgeting on a monthly or quarterly basis all create cascading uncertainties

worsened by program-level uncertainties resulting from acquisition employee furloughs, no new starts, and funding, legal, and contract delays. Larger companies may have some ability to weather the uncertainty, albeit very inefficiently in the short term. But mid-size and smaller firms that comprise the majority of the industrial base cannot, and they either exit the government market or go out of business. Either way, they take their innovations, investments, and workforce with them which raises costs, diminishes competition, and reduces the government's alternatives. Even at the level of the prime contractors, continuing uncertainty will likely drive industry consolidation.

Publicly-traded defense companies have enjoyed surging stock values, but this phenomenon may only be temporary. Share values have grown because of international defense business and commercial sales on the revenue side and workforce reductions, the repurchase of stock, and shareholder dividends on the expense side. The last three factors in particular bolster a company's short-term outlook at the expense of investments in future technology. But what alternative is there? Without budgets and appropriations bills from the Congress and clear guidance from the Pentagon about where it will spend money, a dollar invested in internal research and development is as likely to be wasted as well-spent. Because share prices obscure these realities, the crisis in the defense industrial base may only become visible after the military has lost years of technological innovation.

Sequestration was supposed to be too terrible to ever come to pass. Most policy makers and political leaders seemed to recognize that aside from the obvious adverse impact to

the defense industrial base, near term readiness rates would diminish to levels too dangerous for our leaders to tolerate. But today, after almost a year of spending at sequester levels, few people anywhere, including in the Congress, seem to appreciate just how negative the impact of sequestration has been to the industrial base and our readiness, and how much worse that impact is likely to become in the future.

To illustrate this point, think back to 2011. Our country struck back against Osama bin Laden, provided humanitarian support in the aftermath of the Japanese tsunami, and responded to the Libyan crisis while simultaneously fighting the war in Afghanistan. Now think forward five years, imagining that sequestration is still in place. Our special operators pinpoint a major terrorist suspect for capture. A devastating natural disaster just struck an ally, killing thousands. Extremists threaten an allied democracy. Intelligence chatter indicates imminent threats to the homeland from ungoverned regions. And the President has a military able to respond to just one of these contingencies – take your pick.

Many Americans reasonably ask how we can spend so much on defense – even under sequestration – and seem to get so little. As defense spending has grown over the past decade, defense output has waned. Where did the money go? In a recent opinion piece for *Defense News*, former Pentagon Director of Cost Analysis and Performance Evaluation, Ms. Christine Fox, identified a few places. She noted the growth in the number of defense civil servants spread across a huge number of installations, all of which are very costly. And

she identified substantial growth in compensation. If we choose to address these cost drivers, it will take time to see savings.

But time is exactly what we do not have under sequestration. If Congress believes that we have too much defense overhead, or that we need a different installation footprint, or that we should slow the growth of compensation, all of those changes take years to produce savings. The savings the Pentagon can produce right now come from our training and operational budgets and ending investments in modern, cutting-edge equipment.

While some argue that sequestration is valuable leverage to force budget discipline, it does not meaningfully impact the imbalance between outlays and revenues, nor does it address the long-term drivers of that imbalance. Responsible defense budget reductions can and should contribute to getting our fiscal house in order. But whatever level of discretionary spending the conference committee adopts, spending bills must provide certainty and flexibility. Sequestration makes both impossible.

The major impacts of sequester, and particularly those covered by the media, are the impacts to high visibility programs like the F-35, Virginia-class Submarines, and DDG-51 Destroyers to name only a few. Sequestration brings these three programs down 22 percent in FY14 from FY13 enacted levels. The media seem to scoff at our military leaders raising the alarm over these substantial reductions, playing up their concerns as though

our leaders are asking for more than their share. So why are our generals sounding the alarm?

The House Armed Services Committee recently sent an analysis to the budget conferees detailing a loss of 100,000 troops under continued sequestration, a Navy of just 230 ships, the smallest Air Force ever, and the fewest ground forces since 1940. The Bipartisan Policy Center recently projected reductions in Army divisions from 10 to 6 (down 40 percent), Air Force fighter and attack aircraft declining from 1493 to 1157 (down 23 percent), Navy carriers declining from 10 to seven (down 30 percent), and Navy combatants declining from 275 to 228 (down 17 percent). This shrunken military will not be able to respond to multiple contingencies at once. In fact, we may be reluctant to dispatch forces under almost any circumstances, fearing that any deployment might provoke opportunistic aggression elsewhere.

The reductions do not just impact the total size of the force. In FY13 alone, the Air Force reduced flying hours by 15 percent and the Navy can only respond with one Carrier Strike Group and one Amphibious Ready Group compared to the three it had ready just a year ago. In the Army, 85 percent of the active and reserve Brigade Combat Teams (BCTs) are unprepared. Only two of 42 BCTs are combat ready and BCTs now deploying to combat zones are unqualified for combat.



And things are actually set to get worse if sequestration continues. Although reductions in appropriated funds are relatively steady year by year under sequestration, cuts to outlays, or actual spending, compound every year that sequestration is allowed to continue. That means defense industry and our fighting forces will face even more severe reductions in the coming years than they have already experienced. In FY13, a budget authority sequester of \$37 billion produced a reduction in outlays of just \$10 billion. In FY14 a budget sequester of \$52 billion translates to a reduction in outlays of over \$30 billion, and a like sequester in FY15 hits outlays for more than \$45 billion. The defense industry and the defense budget overall cannot cope with these reductions in outlays in the coming years. Force structure adjustments cannot come on fast enough to compensate for the magnitude of these cuts. We need a minimum delay of sequestration for at least two to three years to make the necessary adjustments as part of a rational plan executed by the services.

One wonders why all of these unsatisfactory outcomes do not drive an immediate replacement of sequestration cuts with some other deficit reduction measure. Perhaps we have been lulled into thinking that the superb performance of our military over so many years, and even generations, will occur regardless of the level of our investment. Many years of funding to field world class troops and technology have paid off, and handsomely. But we should not delude ourselves. Sequestration, if allowed to continue, will reverse that trend, result in serious damage and degradation to our military capability, and seriously harm our national security. We must replace sequester cuts. The time to act is now.