



SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-1000

JUL 10 2013

The Honorable Carl Levin
Chairman
Committee on Armed Services
United States Senate
Washington, DC 20510

The Honorable James M. Inhofe
Ranking Member
Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Chairman Levin and Ranking Member Inhofe:

I remain fully committed to enactment of the President's defense budget for Fiscal Year (FY) 2014 because I believe this budget provides the right level of resources to maintain a strong national defense. I also fully support the President's overall budget plan and his FY 2014 budgetary proposals for other federal agencies, which are necessary to support a strong economy and also contribute to a strong national defense by providing support to our troops, veterans, and their families.

I realize, however, that the Department of Defense (DoD) needs a contingency plan in the event that the sequester-level budgetary caps currently imposed by the Budget Control Act (BCA) of 2011 remain in effect. These caps would lead to an approximately \$52 billion cut to the DoD budget compared to the President's FY 2014 funding request, as well as deep cuts to non-defense priorities including education, infrastructure, innovation and more. The attachment to this letter provides a high-level summary of an early version of DoD's contingency plan for FY 2014 with a \$52 billion cut.

I strongly oppose cuts of that magnitude because, if they remain in place for FY 2014 and beyond, the size, readiness and technological superiority of our military will be reduced, placing at much greater risk the country's ability to meet our current national security commitments. This outcome is unacceptable as it would limit the country's options in the event of a major new national security contingency.

These serious adverse effects occur even if Congress provides flexibility in administering budget cuts and sequestration. Flexibility in this instance would mean that Congress approves program cuts denied in the past and allows reallocation of funding, without regard to existing budget structures or limitations on transfer authority. However, the cuts are too steep and abrupt to be mitigated by flexibility, no matter how broadly defined. These points are well illustrated by looking at the effects of a \$52 billion cut in FY 2014:



- With or without additional flexibility, the Department would not be able to substantially reduce military personnel costs in FY 2014 without draconian actions – a constraint that significantly worsens the pressure on other budgetary accounts and saves very little money upfront.
- Sequestration in FY 2013 is severely damaging military readiness. In FY 2014 the Department would seek to minimize cuts in the day-to-day operating costs most closely related to training and readiness. Instead DoD would, for the second year in a row, impose hiring freezes and sharply reduce facilities maintenance – sometimes leaving the Department with too few people to perform needed work or with employees working in substandard conditions. The Department hopes to avoid a second year of furloughs of civilian personnel, but DoD will have to consider involuntary reductions-in-force to reduce civilian personnel costs. However, these actions alone would not be sufficient. Given a cut of \$52 billion, even with flexibility in administration, training and overall readiness would at best remain constant at current low levels and, in some cases, would continue to decline.
- The difficulty of substantially reducing military personnel funding in FY 2014 would likely require disproportionately large cuts in the Department’s investment accounts – assuming flexibility in implementing changes, cuts of 15 to 20 percent would be common. The resulting marked slowdown in modernization would reduce our long-term, critically important and historic technological superiority and undermine our better buying power initiatives.
- The bottom line: with or without flexibility, administering a \$52 billion cut would have severe and unacceptable effects. In particular, if such a cut and the sequester mechanism were applied to military personnel funding, DoD could accommodate the required reductions only by putting into place an extremely severe package of military personnel actions including halting all accessions, ending all permanent-change-of-station moves, stopping discretionary bonuses, and freezing all promotions.

Part of the solution to the current budgetary impasse will require that Congress become a full partner in ending business-as-usual practices – in areas such as infrastructure, benefits and procurement – that would otherwise require further cuts to readiness, modernization and combat power. We urgently need Congressional support in enacting difficult but necessary measures proposed by the President in his FY 2014 and prior budgets. These include slowing growth in military pay raises in a manner that still supports the all-volunteer force and raising fees for health care programs for retirees while still maintaining the generous benefits they deserve. Other key initiatives include the retirement of some lower-priority weapons, including Navy ships and Air Force aircraft. The Congress also needs to eliminate restrictions on the rate of the drawdown in military end strength for the Army and Marine Corps, permit the Department to end programs such as the C-27 aircraft, and enact other cost-saving proposals, such as a new BRAC round. If Congress does not approve these proposals, even more cuts in combat

power, readiness and modernization would be needed to accommodate cuts of \$52 billion in FY 2014 and similar cuts in later years.

In sum, the abrupt, deep cuts caused by the BCA caps in FY 2014 will force DoD to make non-strategic changes. If the cuts continue, the Department will have to make sharp cuts with far reaching consequences, including limiting combat power, reducing readiness and undermining the national security interests of the United States. I directed a Strategic Choices and Management Review to develop options that would accommodate these large cuts, but these options cannot avoid serious damage to our military capabilities.

Because of my great concern regarding the effects of reduced discretionary caps in FY 2014 and beyond, I urge Congress to pass a balanced deficit reduction package that the President can sign that would replace these deep and arbitrary budget cuts in FY 2014 and in future years. A comprehensive solution of this nature would do much to support the mission of the DoD and the mission of other federal agencies, including agencies that provide important support to the Department and to our troops and veterans.

In coming months, my senior team will provide briefings and updated information on the FY 2014 budget to the Committee. I look forward to working on this critical issue with both of you, the Senate Armed Services Committee, and members of Congress.

Thank you for your continued support of our men and women in uniform and our entire civilian workforce.

Sincerely,

A handwritten signature in black ink, appearing to read "Chuck Hagel". The signature is written in a cursive, somewhat stylized font. Below the signature is a horizontal line.

Attachment: As stated.

ATTACHMENT

Contingency Plan for \$52 Billion Cut in FY 2014 Defense Budget

Secretary Hagel remains fully committed to enactment of the President's budget plan for Fiscal Year 2014, including his budget proposal for non-defense agencies and his defense budget proposal. The President's defense budget provides the resources that the President and Secretary of Defense believe are appropriate to maintain a strong national defense in the face of complex national security challenges. The President's budget proposal is consistent with the caps originally imposed by the Budget Control Act (BCA) of 2011, which led to a ten-year reduction of \$487 billion in Department of Defense (DoD) budgets, and the American Taxpayer Relief Act of 2012. However, provisions of the BCA, when coupled with the failure of Congress to enact a deficit reduction package in 2011, have led to additional reductions in the BCA caps (referred to as "sequester-level" caps).

The sequester-level BCA cap reduction for FY 2014 would result in a cut of \$52 billion in funding in FY 2014 compared with the President's budget. If, contrary to the administration's intent, these sequester-level BCA caps remain in effect, DoD would be required to make major changes to its current plans. The plan described in this attachment provides a high-level summary of an early version of DoD's approach to operating at those lower budget levels. All funding cuts in the plan refer to changes in DoD's base budget. The Department assumes that funding for Overseas Contingency Operations (OCO) remains at the level requested by the President.

In formulating this contingency plan, DoD is being guided by inputs from the military services and defense agencies and by the preliminary results of the Strategic Choices and Management Review (SCMR). The SCMR was directed by Secretary Hagel and sought, in the limited time available, to scrutinize every aspect of the U.S. defense establishment to enable the most sensible adjustments assuming various levels of resource reductions. At the same time, the SCMR seeks to adhere, wherever possible, to the tenets of the Defense Strategic Guidance (DSG) such as the rebalance to the Asia Pacific.

While the SCMR was principally oriented towards the FY 2015-2019 budget submission, its principles and findings are applicable to FY 2014 contingency plans. Accordingly, wherever possible DoD would seek management efficiencies and controls on compensation growth before making cuts to force structure, modernization, and readiness. Nonetheless, under any version of sequester-level BCA cuts, reductions to the latter categories will be required. Moreover, the depth and abruptness of the reductions required to fit under the post-sequestration cap would, even with flexibility, substantially limit our ability to implement those cuts in a way that fully protects the tenants of the DSG.

Of note, one of the biggest challenges in formulating our plan for FY 2014 involves uncertainty regarding post-FY 2014 budgetary cuts, especially large cuts such as

those that could occur under the current version of the BCA. What is assumed can determine key decisions such as the timing of personnel reductions.

As requested, DoD's contingency plan addresses the effects of sequester-level cuts of \$52 billion assuming Congress grants DoD flexibility in implementing the reductions. Flexibility would mean that Congress approves program cuts denied in the past and allows reallocation of funding, without regard to existing budget structures or limitations on transfer authority. However, even with such flexibility, DoD would not be able to mitigate the significant and detrimental impacts associated with sequester-level cuts.

DoD's contingency plan addresses the effects on each of the Department's major categories of funding.

Military Personnel Effects

Even if faced with the large and steep cut of \$52 billion in FY 2014, DoD would likely be able to impose only relatively modest cuts in currently planned funding for military personnel, assuming it had the flexibility to limit the size of those cuts. Military personnel funding cuts would be disproportionately small (probably only a few percent of total military personnel funding) because reducing the size of the military yields relatively small savings in FY 2014. Even involuntary separations of military personnel save little in the year they occur because of added costs associated with separation payments for those with more than six years of service along with added travel costs, costs for payments of unused leave, and in some cases unemployment insurance costs. Achieving a proportional, 10 percent cut in military personnel funding in FY 2014 would require that DoD put in place an extremely severe package of military personnel actions including halting all accessions, ending all permanent-change-of-station moves, stopping discretionary bonuses, and freezing all promotions.

The inability to reduce military personnel costs quickly would put additional downward pressure on other portions of the FY 2014 budget. To avoid a repeat of this situation in future years, DoD could draw down the size of the military more quickly beginning in FY 2014 in order to free up resources in later years. To permit a more rapid drawdown, Congress would need to repeal laws restricting the military end strength reductions in the Army and Marine Corps. A substantially faster drawdown would probably require significant numbers of involuntary separations in FY 2014, a decision that raises the unfortunate prospect of forced separations of personnel who have recently served in Afghanistan.

Implementing sequester-level cuts would be made even more difficult if Congress fails to support the military pay raise of 1.0 percent proposed in the President's FY 2014 budget. If that raise grows to 1.8 percent, as some in Congress have proposed, it would add about \$0.5 billion in FY 2014 funding requirements – which would force even larger cuts in other spending categories.

Effects on Operation and Maintenance and Readiness

Reductions in day-to-day operating costs, which are financed out of the operation and maintenance (O&M) appropriation, would pose particularly difficult problems in the event of a \$52 billion cut -- even with flexibility. O&M finances much of the cost of training and readiness, both of which have already been severely affected by the FY 2013 sequester. DoD needs additional FY 2014 funds, not further cuts, in order to recover. The O&M appropriation also pays for most of the Department's civilian personnel, who have already been hit with a series of pay freezes along with furloughs. For all these reasons there is strong pressure to increase O&M funding.

Despite this pressure, O&M funding could not be protected if DoD had to accommodate a reduction of \$52 billion in FY 2014 because this appropriation makes up almost 40 percent of the budget in FY 2014. Indeed, most services and agencies would likely cut O&M by roughly 10 percent -- the same size as the cut in the total budget -- and some would cut O&M by even more. Wherever possible, O&M cuts would be achieved through reductions in funding for activities such as facilities maintenance, base operating funding, and support to community events. While less directly related to readiness than training and maintenance, these funding cuts cause significant harm. Cutbacks in community support hurt recruiting efforts and disrupt or halt community activities that help build bonds between the military and local citizens. Limits on FY 2014 facilities maintenance, especially in the wake of sharp cuts in FY 2013, would add to the list of facilities that need work. A military that prides itself on technical superiority would increasingly have to ask its workforce to labor in substandard facilities. Overall these various actions would reduce jobs in local communities, including many jobs in small businesses, and so contribute to disrupting community life in areas near military bases.

Cuts in O&M funding would also affect DoD's civilian workforce because many civilians are paid with O&M dollars. DoD is hoping to avoid furloughs of civilian personnel in FY 2014, but the Department might have to consider mandatory reductions-in-force (RIFs). As with involuntary separations of military personnel, RIFs don't save much in FY 2014 but would help accommodate funding caps in later years. While painful, RIFs would permit DoD to make targeted cuts in civilian personnel levels rather than the more across-the-board cuts associated with furloughs.

While DoD would attempt to protect the O&M funding most closely related to training and readiness, full protection would be impossible. Therefore most services conclude that military training and readiness would remain at currently degraded levels or, in some cases, would even continue to decline if a sequester-level cut of \$52 billion occurred in FY 2014. For example, faced with a \$52 billion cut in FY 2014, two Navy air wings might not be able to achieve full flight hours and special operations units, which are key to counter terrorism activities, would experience declining readiness. The Army, which this year has cancelled many of the culminating training events at its combat training centers, would have difficulty avoiding similar cutbacks in FY 2014. The Air Force, which this year has had to stop all flying at about one third of its combat-coded active squadrons, would significantly reduce training at more than half of its active

flying units. Maintenance cutbacks would continue or worsen, threatening future readiness levels.

These major cutbacks in military training and readiness are of great concern primarily because they would reduce deployable U.S. combat power. In the event of a major military contingency, they might leave the country without the ready forces needed to fight effectively. A lack of training also contributes to accidents. For example, data for pilots show that those who fly for fewer hours experience a greater mishap rate caused by pilot error. Simply put, training cutbacks put our military's pilots at greater risk. Finally, training cutbacks hinder morale and our ability to retain our best people. Military personnel join to train hard and, if necessary, to fight the nation's wars – not to remain idle because of funding problems. As Chairman of the Joint Chiefs of Staff, General Martin Dempsey, aptly stated: "Today's readiness problem is tomorrow's recruiting and retention problem."

Congress should avoid exacerbating these serious training and readiness problems by accepting changes already proposed in the President's budget that hold down O&M spending. Specifically, Congress should accept the TRICARE fee changes proposed in the President's budget. Otherwise the Department will be faced with finding almost \$1 billion in additional O&M cuts, which inevitably will further hurt training and readiness. Congress should also permit DoD to immediately retire the seven cruisers and two LSDs proposed for retirement – an action that would eliminate lower-priority ships and save about \$0.6 billion in FY 2014 operating costs – and support the retirement of all Air Force aircraft proposed in last year's budget. DoD also urges the Congress to enact other cost-saving proposals made by DoD such as ending the C-27 aircraft program. As it works to reduce numbers of civilian personnel, DoD would benefit from changes in the law in order to carry out reductions by targeting lower-performing individuals. Finally, the Department hopes that Congress will support DoD's request for another round of Base Closure and Realignment (BRAC) in 2015. While BRAC will not save near-term dollars, the past five BRAC rounds are now saving more than \$12 billion a year, and another round will eventually add to these substantial savings.

Effects on Modernization

Given the difficulty of cutting FY 2014 military personnel funding, to accommodate a \$52 billion cut in its topline, DoD would be forced to sharply reduce funding for procurement, RDT&E, and military construction. Indeed, cuts of 15 percent to 20 percent might well be necessary, even though the total budget is reduced by only 10 percent. The services would seek to protect most or all funding for a few programs that are most critical to the President's DSG. However, funding for hundreds of program line items, large and small, would have to be cut significantly. We would be forced to buy fewer ships, planes, ground vehicles, satellites, and other weapons. Modification programs would be cut sharply, even though these programs maintain the effectiveness of older weapons. Nor would cuts be limited to buys of weapons. Research funding represents more than 10 percent of the defense budget, and many research projects –

including those performed by universities and small companies – would inevitably have to be scaled back.

Marked cuts in investment funding, especially if they continue for several years, would slow future technology improvements and may erode the technological superiority enjoyed by U.S. forces. In some future conflict, less capable weapons could mean a less desirable military outcome and more casualties. Investment cutbacks are of particular concern because they would occur during a period when many categories of U.S. weapons are aging sharply.

Slowing investment would also adversely affect DoD's efforts to improve its acquisition practices and become a better buyer. Hundreds of weapon and support program line items, which are now being bought based on stable and efficient acquisition plans, would be disrupted. Unit costs would rise, reversing successful efforts in recent years to hold down unit cost growth or even reverse it. The disruption would spill over to defense industry. Defense industry jobs would be lost and, as prime contractors pull back work to protect their internal work forces, small businesses may experience disproportionately large job losses.