What Lays Ahead?

NDIA Munitions Executive Summit
February 20, 2008

-- What we know
-- What I think we know
-- What I think
-- Questions
What we know
“If tax revenue as a share of GDP remains at current level (19%), additional spending for Medicaid, Medicare and Social Security will eventually cause future budget deficits to become unsustainable.” CBO 1/23/07
FY08 FEDERAL BUDGET (Table S-3)
($ 2.9 Trillion)

Discretionary
($ 930 Billion)

$871B + $46B + $13B = $930B
$871B + $44B + $36B = $953B
+11%  +3%
+10%  +8%

$435B + $46B = $481B

Defense
($ 481 Billion)

Ammo
($ 3.9B + $1.2B Supp)

2008 Election Year Positioning

Presidential “veto threat” held line on spending
POLITICAL WASHINGTON

FY09 FEDERAL BUDGET (Table S-3)
($ 3.1 Trillion in BA)

Discretionary
($ 988 Billion)

Defense
($ 515 Billion)

Ammo
($4.3 B + ??B Supp)

2008 Election Year Positioning

May have seen this movie before: will standoff continue?

$941B + $36B + $10B = $988B
+7.5%  +2.2%

$480B + $36B = $515B

3/13/2008
FY 2009 Budget Cycle DoD View

- FY 2009 DoD budget $515M
  - ~4.5% real growth
  - *Real ~2.2% procurement increase*
    - *Slight decrease from ’09 column in ’08 PB*
  - FY09 GWOT Supplemental (~$140B) after FY08 GWOT supp enacted (~April-ish)
    - $70B Bridged in PB09
    - ~$170B estimated FY09 GWOT funding
- Buying power continues to be squeezed
- Near term readiness vs. future modernization
<table>
<thead>
<tr>
<th></th>
<th>FY 08</th>
<th>’08 GWOT</th>
<th>FY 09</th>
<th>’09 GWOT</th>
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<tr>
<td></td>
<td></td>
<td>Approved</td>
<td>Pending</td>
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<tr>
<td>Army</td>
<td>2,2223</td>
<td>154</td>
<td>360</td>
<td>2,276</td>
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<tr>
<td>Navy/USMC</td>
<td>1,064</td>
<td>305</td>
<td>305</td>
<td>1,123</td>
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<tr>
<td>Air Force</td>
<td>754</td>
<td>0</td>
<td>104</td>
<td>895</td>
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<tr>
<td>Total</td>
<td>4,041</td>
<td>459</td>
<td>769</td>
<td>4,294</td>
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## FY 06/08 DoD-Military Appropriations FY 09-13 Budget/POM ($B)

<table>
<thead>
<tr>
<th>Year</th>
<th>'06</th>
<th>'07</th>
<th>'08</th>
<th>'09</th>
<th>'10</th>
<th>'11</th>
<th>'12</th>
<th>'13</th>
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<tbody>
<tr>
<td>Total</td>
<td>410.7</td>
<td>435.5</td>
<td>479.5</td>
<td>515.4</td>
<td>527.0</td>
<td>533.1</td>
<td>542.4</td>
<td>552.7</td>
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<tr>
<td>Procurement (Ammo)</td>
<td>77.7</td>
<td>81.3</td>
<td>99.0 (3.9)</td>
<td>104.2 (4.3)</td>
<td>114.8</td>
<td>117.7</td>
<td>123.8</td>
<td>125.2</td>
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<tr>
<td>R &amp; D</td>
<td>72.0</td>
<td>75.1</td>
<td>76.5</td>
<td>79.62</td>
<td>77.1</td>
<td>72.6</td>
<td>70.7</td>
<td>68.1</td>
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<tr>
<td>Milpers</td>
<td>109.1</td>
<td>110.9</td>
<td>116.5</td>
<td>125.2</td>
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<tr>
<td>O &amp; M/Other</td>
<td>151.9</td>
<td>168.0</td>
<td>187.5</td>
<td>206.4</td>
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**Probably as good as it is going to get**

3/13/2008
Supplementals ($B)

<table>
<thead>
<tr>
<th>Year</th>
<th>'05 Bridge</th>
<th>'05</th>
<th>'06 Bridge</th>
<th>'06</th>
<th>'07 Bridge</th>
<th>'07 Full</th>
<th>'08 Bridge</th>
<th>'08 Full</th>
<th>'09 Full</th>
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</thead>
<tbody>
<tr>
<td>Milpers</td>
<td>1.3</td>
<td>17.4</td>
<td>6.2</td>
<td>10.2</td>
<td>5.4</td>
<td>13.5</td>
<td>1.1</td>
<td>16.7</td>
<td>17.0</td>
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<tr>
<td>OPS</td>
<td>16.4</td>
<td>37.1</td>
<td>33.2</td>
<td>37.9</td>
<td>44.3</td>
<td>50.4</td>
<td>61.1</td>
<td>30.5</td>
<td>86.0</td>
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<tr>
<td>Proc.</td>
<td>1.4</td>
<td>17.4</td>
<td>8.0</td>
<td>15.0</td>
<td>19.8</td>
<td>25.6</td>
<td>6.1</td>
<td>48.7</td>
<td>60.0</td>
</tr>
<tr>
<td>Other</td>
<td>5.9</td>
<td>4.0</td>
<td>2.6</td>
<td>2.7</td>
<td>.5</td>
<td>6.0</td>
<td>1.8</td>
<td>6.5</td>
<td>7.0</td>
</tr>
<tr>
<td>Total</td>
<td>25.0</td>
<td>75.9</td>
<td>50.0</td>
<td>65.8</td>
<td>70.0</td>
<td>95.5</td>
<td>70.0</td>
<td>102.5</td>
<td>~170</td>
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</table>

*$16.8B Appropriated separately for MRAP
** FY 2008 Full GWOT Supplemental yet to enacted
*** Split $70B Bridge + $70B Full
Ammo Funding ($B)
(no '09 supp$ included)
Ammo Funding ($B)
(no supp$ shown after ’08)

Budget Year

$ in Billions

APA □ PA,N □ PA,AF

Total ’08 ($B)

3/13/2008
What I think we know?
Washington Political Environment

• Shaped by 2008 election tactics and media coverage
  – Little White House-Congressional negotiations except stimulus package
• FY09 Domestic Funding – a “wedge issue”
• NCLB, Health, Farm, Energy, AMT and Immigration Policy
• Middle East/Iraq Strategy and Strategic direction
  – FY08 Iraq/GWOT Supplemental
  – FY09 Supplemental: CY 2008 or 2009?
• Tax adjustments for deficit control, fairness and “pay/go” policy
  -- $50+T USG “fiscal exposure”
• FY09 Appropriations Bills
  – Initially, one at a time (trial balloons)
  – Then big CR or “omnibus”

Primaries will identify agenda setters – specifics later
Congressional Budget Schedule – CY 2008
(up to Memorial Day Recess)

• After February recess
  – Second stimulus bill??
  – Hearings on FY09 President’s Budget
  – Start FY08 GWOT Supp
    • General Petraeus updates Congress in March
    • House moves first: Senate after mid-March Easter recess
    • Probable completion: late April/early May
    • Veto resolution by Memorial Day, if necessary
• ~April 15 Congressional Budget resolution done
  – HASC/SASC start authorization bills

Time to deal under “emergency funding” rules
Congressional Budget Schedule – CY 2008 (After Memorial Day)

- May 15th – FY09 Appropriations process starts
  - Defense early start & finished/signed before election break
    - “mini bridge maybe”
  - ’09 GWOT Supplemental “later” (Bridge in CR)
- Party Conventions in August
- Fall full of “election theatrics”
- “Lame duck” to finish work in “post election political environment”
  - Domestic agency CR w/ real bills from 111th Congress or omnibus appropriations bill
  - GWOT Bridge
  - Full GWOT from 111th Congress

Congress anticipating a more hospitable environment
FY 2009 Congressional Budget Results

- Fewer “earmarks” -- AMT fix – not pretty
- Democratic Congress expected to try to increase domestic funding (~$25B or more)
- Congress likely to reduce FY09 Defense (051) top line slightly (~$2B)
  - Likely to alter funding priorities/allocations
  - Could fund some items in GWOT
  - Possible hot button issues:
    - Over cost/behind schedule programs
    - Shipbuilding
    - More C-17s/F-22s
    - JSF Alternate Fighter Engine
    - National Guard equipment/readiness/reset
- FY09 GWOT adjusted based on FY08 Iraq performance/situation & other needs
## FY08 Procurement Plus-ups

<table>
<thead>
<tr>
<th></th>
<th>ARMY</th>
<th>NAVY/MC</th>
<th>AIRFORCE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>&lt;$1M</strong></td>
<td>7</td>
<td>9%</td>
<td>5</td>
</tr>
<tr>
<td><strong>$1M - $5M</strong></td>
<td>63</td>
<td>80%</td>
<td>57</td>
</tr>
<tr>
<td><strong>$5M - $10M</strong></td>
<td>6</td>
<td>7%</td>
<td>6</td>
</tr>
<tr>
<td><strong>$10 M+</strong></td>
<td>3</td>
<td>4%</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total # of Requests</strong></td>
<td>79</td>
<td>72</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total $ Amount</strong></td>
<td>$374.5M</td>
<td>$912M</td>
<td>$401.6M</td>
</tr>
</tbody>
</table>

… And President wants this cut in half
What I think?
Ammo Funding ($B)
(no supp$ shown after ’08)

~ 2x 1990’s
+60% real

Budget Year

$ in Billions

APA  PA,N  PA,AF

Total ’08 ($B)
Observations

• New era of “persistent surveillance and conflict”
  – Fleeting targets within urban populated areas
  – Co-lateral damage avoidance essential
  – Precision fires becoming more important
  – Requirements/demand realignments probable
• Additional money for ammo unlikely
• Today’s problems get worse with less money
  – Address issue and impacts with PM/PEO
  – Get budget/POM/contractual help
  – Get issue on Service UFR list, as needed
  – Vet issue and options with Congress, as needed
Industrial Base Problems Today? (Name your top 3!)

• Inadequate small caliber capacity
  – Off-shore sourcing
  – Difficulty in training up “skilled work forces”

• Insufficient plant modernization/investment
  – Having to accept “risk”

• Unused (under used) private “assets” tend to be converted to profitable applications
  – Capacity moved off-shore or lost
Final thoughts

• Absent “terrorist event” defense will come under pressure
  – No “current” political rhetoric for “peace dividend”, yet
• Looming adjustment back to “peace” or next GWOT phase
  – FY10 and beyond funding strong but real decline
  – Supplemental funding is the biggest uncertainty
  – FY10-13 POM ~2x pre-OIF levels (+60% real growth)
  – Platform modernization will put ammo funding at “risk”
  – Sense is “hard work” will be needed to preserve funding levels beyond 110th Congress
  – “Soft Landing” (as last year) should be on agenda!

Fact free analysis: “heading for procurement down turn in ammo”
Soft Landing Policy Options
(We’ve been here before -- $ are only part of the answer)

• Continue consolidating industry in to larger organizations with shared overhead
• Move to more flexible manufacturing – facilities and personnel
• Move to “stop and start/batch production”
• Recognize criticality of “artful” work force
• Adopt “Best of World” production models for variable “run” sizes
• Stockpiling components
• Layaway
• Design out low density obsolescent parts/components
• Recognize industry globalization
• Enforce Section 806
• Recognize “Wall Street” factor: stock prices, earnings, ROI, …
• Balance capacity – requirements – demand – MSR – Surge – available $ - risk

Need “consensus building” Service-PEO-industry concept talks to prepare for competition for Congressional support
Industrial Policy Initiatives

• Public-Private Partnerships
  – Architecture/plan for “affordable” 21\textsuperscript{st} century ammunition supply chain
    • \textit{Sizing construct: WWII or GWOT?}
  – Risk allocation/distribution

• Supply Chain Management
  – Allowable cost for “idle” investments
  – Skill preservations through simulator based training programs
  – Exploit business tax incentives in 2008 stimulus package(s) (HR 5140, Sec 102-103)
Munitions Industrial Base Current Study Summaries

• Ammunition Sourcing Study pending

Should we be talking about a managed or controlled “build down”? 
QUESTIONS