

Defense Update

John Ferrari on the USG budget process and what it may mean for defense

Industry Overview

John Ferrari on the impacts of a year long CR

We hosted a call with Major General John Ferrari (USA, Ret.), nonresident fellow at the American Enterprise Institute, to discuss the ongoing US government (USG) budget and appropriations debate as well as possible outcomes. On January 18, 2024, the Senate and House both voted to extend the continuing resolution (CR) into March, consistent with Ferrari's predictions. From there, he believes it is likely that all appropriations bills will be passed, and the USG will avoid a year-long CR.

Appropriations, border security, tax cuts all tied together

Ferrari highlighted a number of competing and interwoven interests impacting the budget process. Tied up in the emergency supplemental appropriations bill is border security legislation as well as funding for Ukraine/Israel. While border security funding only encompasses \$8-9bn of the \$106bn bill total, Ferrari asserts it is not the dollar value but the policy changes (including how much authority the President will have) that matter to its supporters. Ferrari also expects to see legislation for tax cuts for business and relief through child tax credits for families to get wrapped up into the negotiations. Additionally, the upcoming election and political posturing may be playing a role in how representatives vote on these issues. Including the emergency supplemental funding, FY24 will likely imply a ~8% Y/Y growth and we note that Ferrari seemed confident that the practice of using "supplemental funding" is likely here to stay.

DoD the "biggest loser" in year-long CR scenario

While Ferrari was optimistic a budget will be based and the government will not fall under a full year CR, if that were to happen and Fiscal Responsibility Act (FRA) reductions come into play, Ferrari called out the Department of Defense as being the "biggest loser". Domestic agencies will likely fare better. Under a full year CR, no military construction would occur, and major procurement programs would not be started. Ferrari is optimistic that appropriations bills in tandem with money for Israel/Ukraine, border security measures, and tax cut measures will become "too big to fail" and will get passed, thus avoiding a year-long CR.

FY25 set up likely to squeeze procurement accounts

Even assuming the top line agreed to for FY24 gets passed, Ferrari noted that FY25 is set up to be an interesting year. He believes the FY25 request will be closely in line with the FRA and only increase the DoD budget by ~1%. However, pay is expected to increase 3-4%, leading to a cut in real discretionary spending, largely impacting procurement accounts. Ferrari sees readiness bills and nuclear modernization as being funded at all costs, meaning we would likely see a decrease in other procurement areas (such as Naval vessels or fighter aircraft) as well as potential program cancellations. While Ferrari still expects to see the Replicator program be funded, he was less sure about FARA and FLRAA, the DoD's Future Vertical Lift (FVL) programs. He sees FY25 as the year for potentially one if not both of these programs to be cut. In Ferrari's view, a "smart" Black Hawk helicopter equipped with AI and autonomous features could be a more cost-effective way for the Army to achieve future long-range helicopter flight.

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