

Is the U.S. Counter Terrorism Campaign Economically Sustainable?

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Is the U.S. Counter Terrorism Campaign Economically Sustainable?

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PREFACE

The efforts of the Global War on Terrorism (GWOT) are most often discussed in terms of the more visible direct actions taken to defeat insurgents militarily or law enforcement activities to prevent or apprehend terrorists. When it comes to the financial actions taken in the GWOT, discussions are more often focused on what is being done to go after terrorists' ability to finance their operations.

What is not often discussed, except during the time of year when the President's budget is submitted to the Congress, is the economic element of national power and the U.S. ability to sustain the GWOT. Since 11 September 2001, the nation has had the will to do what is necessary to prevent another terrorist attack within the United States. It has been a national priority operating under the assumption that we will do what ever it takes and the money will be there to accomplish national security objectives.

The questions that have to be answered though are how much is the nation willing to pay, what opportunity costs are the American people willing to embrace to continue to pay to sustain the GWOT, and for how long are we capable of doing so? The answers to these questions are complex, often politically convenient to discount, extremely costly to resolve, and even more damaging to ignore.

It is for these reasons that I chose to analyze this issue. In order to sustain GWOT efforts in the long-run, it is the economic element of national power that provides the United States the ability to create conditions for enduring success in the GWOT. Several people contributed their expertise to this project and I am greatly appreciative of their efforts.

I want to thank Dr. Chris Harmon and LTC Michael Parkyn of the Marine Corps University for their mentorship as I researched and developed my draft products. I also want to thank Dr. John P. White, Lecturer of Public Policy at the John F. Kennedy School of Government, for taking the time to share his experience and expertise in fiscal policy issues. Finally, I want to thank my wife Marianne for all the proof reading and numerous suggestions on how to better communicate the ideas in this project.

EXECUTIVE SUMMARY

Title: Is the U.S. Counter Terrorism Campaign Economically Sustainable?

Author: Major Mark. A. Towne, United States Army

Thesis: If the U.S. is to be successful in the GWOT, it is essential for the nation to sustain strong economic capabilities.

Discussion: The economy is a U.S. center of gravity that is also a target of Al Qaeda and other jihadis. Terrorists are patient and prepared to let internal pressures on the U.S. economy weaken other elements of U.S. national power. Specific threats include critical vulnerabilities such as the oil supply, the budget deficit, and lack of unity of effort in interagency strategy, policy and resource management. Opportunities exist for the U.S. to marginalize the threat to the U.S. economy. However, the complexity of the problems, political risk associated with some of the solutions, the duration to realize the outcomes, and institutional drag make unity of effort extremely difficult to achieve. Sustainable solutions are achievable if the political will can be generated to make effective long-run fiscal policy decisions.

Conclusions: The U.S. has the economic advantage in the GWOT campaign. However, we must improve fiscal responsibility to sustain our domestic capability to finance counter terrorism efforts. Additionally, in collaboration with other nations, private industry, and academia, the U.S. should use market forces as a weapon against terrorists. Federal government spending should be limited to 20 percent (plus or minus three percent) of Gross Domestic Product. Discretionary and mandatory spending programs should be redesigned with spending caps in order to be sustainable and minimize the drag they place on the budget deficit. Furthermore, the U.S. government should establish an economic fusion cell in the National Security Council to improve strategy, policy and resource integration. Finally, the U.S. should accelerate efforts to bring viable fuel alternatives such as the Hydrogen Fuel Cell Initiative to the mass-market. This will create a means to expand economic capabilities while marginalizing critical vulnerabilities in the energy industry on which the global economy depends. Through implementation of these initiatives, the U.S. will be able to successfully sustain the strength of the economy and the ability to finance the GWOT campaign for the long-run.

I. Introduction – Economic Strength and GWOT Success

Most experts agree that the U.S. will be engaged in fighting the Global War on Terrorism (GWOT) for the foreseeable future. A center of gravity for the United States in the GWOT is its economy. It is the strength of the economy that enables the nation to fund and project credible national power and protect U.S. interests domestically and globally. Therefore, if the U.S. is to be successful in the GWOT, it is essential for the nation to sustain strong economic capabilities.

Since 11 September 2001, the U.S. has achieved significant success in fighting terrorism globally and protecting the homeland. The capabilities the federal government has resourced to achieve the success have come at a significant cost to the U.S. taxpayer. With the FY 2006 President's Budget, total costs for the GWOT will exceed \$275 billion and are expected to continue to increase.¹ If the U.S. is to successfully sustain the GWOT campaign, it will require the federal government to exercise efficient fiscal policy to protect and strengthen economic capabilities and aggressively defend economic critical vulnerabilities.

¹Jonathan Weisman, "President Requests More War Funding: Money for Iraqi Forces Raises Sharply," *Washington Post*, 15 February 2005.

II. Framing the Analysis

There are many disparate views regarding how the GWOT is defined. Some do not acknowledge it as a war at all. Others differentiate components of the effort: partly a war, combined with something closer to a criminal problem for law enforcement to address. Regardless of the how GWOT does or does not fit the traditional definition of war, any useful analysis requires an adequate boundary to put the problems, findings, and conclusions in to context.

The boundary for this analysis is focused on the comprehensive terrorist threat and the collective response of the U.S. government. The threat itself is asymmetric and therefore requires nontraditional solutions for strategy development and resource allocation. As indicated in the budget of the United States Government, there are 32 different federal agencies with efforts and funding allocated to protecting the U.S. from the threat of terrorism.² The solutions to waging GWOT are not limited to the traditional definitions of war or the actions of the Department of Defense or law enforcement agencies. The solutions to GWOT are vested in planning and action that requires a strategy for resource allocation across

²Office of Management and Budget, *Analytical Perspectives Budget of the United States Government Fiscal Year 2005*, URL: www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf, accessed 28 December 2004, 26.

several domains while maintaining inter-agency unity of effort to address threats wherever they exist. Following the money managed through fiscal policy decisions presents a comprehensive boundary to define GWOT and a means to assess the effectiveness of the national strategy to combat terror. The real cost of GWOT therefore includes military and inter-agency costs of operations such as Operations Noble Eagle, Enduring Freedom, and Iraqi Freedom. The cost of GWOT also includes those resources associated with Homeland Security (HLS) requirements that align federal, state, and local counter-terrorism efforts. Furthermore, consideration must also be given to private sector impacts of terrorist actions and costs associated with protecting critical vulnerabilities.

III. Why is the U.S. Economy important to the GWOT?

The asymmetric character of GWOT is quite different than any war the United States has faced. It has state and non-state actors with cultural and religious boundaries instead of traditional national borders. Military action is not the primary means by which to achieve victory. It is a political war fought as much with information and economic power as with military force and diplomacy.

Economic strength is a common thread in keeping the Clausewitzian trinity³ of the people, the government, and the military in balance. The strength or weakness of the economy shapes political will to support policy and financial trade-offs necessary to fund government, military, and private sector capabilities. Regardless of the form of national power, it is the strength of the economy and the mechanism of fiscal policy that sustains the ability to pay for capability. Without the resource engine of a strong economy and effective fiscal policy, the government does not have the financial capacity or credibility to employ and sustain strong diplomatic, information, or military capabilities, or maintain popular support for developing and implementing policy to protect national interests.

Terrorist organizations such as Marxist-Leninist groups and Al Qaeda have recognized the economy as a U.S. center of gravity for years. In a 1998 Fatwa, Osama Bin Laden and five other jihadis effectively declared war through their stated policy objective to "kill Americans and plunder their money wherever and whenever they find it."⁴ Al Qaeda also recognizes and takes advantage of critical vulnerabilities inherent in free-market societies. Their strategy revolves around the ability to

³*Carl von Clausewitz, On War* ed. and trans. Michael Howard and Peter Paret (New Jersey: Princeton, 1976), 89.

⁴John Mintz, "Bin Laden Lauds Costs of War to U.S.: Recent Videotape Boasts of Inflicting Economic Damage," *Washington Post*, 2 November 2004.

destroy the U.S. economy, which will cause the military and diplomatic strengths to crumble and enable them freedom of movement to pursue regional and global objectives.

The attacks of 11 September 2001 delivered direct economic blows to the U.S. economy. Examples include "over 200,000 layoffs in October of 2001, airline losses of \$15 billion, lost sales to New York City of \$1.7 billion, and global insurance industry losses of \$50 billion."⁵ It also put in motion federal, state, and local government changes in strategy, organization, and fiscal policy to hunt down terrorists and protect U.S. citizens from further attack.

IV. The economy is a center of gravity of the U.S. but how strong is it?

The United States has the largest economy (see appendix C) in the world with a GDP projected to be approximately \$11.5 trillion in 2005.⁶ Prior to the attacks of 11 September 2001, the U.S. and global economy was experiencing a slow down. Several factors influenced the slow down but by the middle of 2003 the economy started to turn around and actually experienced substantial growth in the third quarter of 8.2 percent – the

⁵Francis X. Taylor, "Impact of Global Terrorism," Remarks to Executives Club of Chicago Leadership Symposium, Chicago, IL, 14 March 2002, URL: www.state.gov/s/ct/rls/rm/8839.htm, accessed 5 Dec 2005.

⁶Budget of the United States Government: Fiscal Year 2005 Historical Tables, URL: www.whitehouse.gov/omb/budget/fy2005/hist.html, accessed 11 September 2004.

largest quarterly increase in 10 years.⁷ The attacks had exacerbated a problem that was already in motion with more cyclical and demand side effects rather than inflicting any real long-term supply side economic effects that would impair growth capacity.

Three years after the start of the GWOT, the U.S. economy is rebounding. Although energy prices are a concern, key indicators such as national payrolls, inflation, unemployment, consumer and investor confidence, and corporate profits indicate the economy is rebounding and the impacts of GWOT to date are effectively being absorbed by the economy. With the ability to rebound so quickly, it brings to question how much GWOT can actually affect the U.S. economy and specifically, how attainable is the policy objective of organizations such as Al Qaeda?

V. What the Experts Say

Conclusions of various analyses of the impact the GWOT is having on the U.S. economy range from minimal to catastrophic. According to an economic survey conducted by the National Association for Business Economics, terrorism has moved ahead of the rising federal deficit as the biggest problem facing the

⁷OMB, *Analytical Perspectives Budget of the United States Government Fiscal Year 2005*, 171.

U.S. economy.⁸ An assessment by Jeff Record begins with the idea that the "GWOT's fiscal sustainability is inseparable from its military sustainability,"⁹ continues with concerns about the escalating and unanticipated costs and the impact they will have on the growing federal deficit, and concludes that the war on terrorism "may not be sustainable over the long haul"¹⁰ due to the fiscal pressures the war is having on discretionary spending. Other observers minimize the escalating GWOT costs and federal budget deficit by comparing the magnitude of the budget imbalance as a function of the nation's Gross Domestic Product (GDP) and assume solutions to other fiscal concerns of mandatory spending on programs such as Social Security.¹¹

Two other studies, one by George Perry¹² and one by William Nordhaus,¹³ conclude the most dramatic economic effects of the GWOT are not necessarily from the short-run direct costs of waging the war but from the long-run impacts on oil markets that affect real income and business cycles. The danger of this

⁸Duncan Meldrum, National Association for Business Economics, *NABE Economic Policy Survey*, August 2004, URL: www.nabe.com/publib/pol/04/pol0408.html, accessed 4 November 2004.

⁹Jeffrey Record, *Bounding the Global War on Terrorism*, Strategic Studies Institute (Carlisle Barracks, PA. December 2003.), 39.

¹⁰Record, iii.

¹¹Thomas H. Terry III, "Is the War on Terrorism Sustainable?," *Proceedings of the United States Naval Institute*: Feb 2004, v 130 Issue 2.

¹²George I. Perry, "The War on Terrorism, the Word Oil Market and the U.S. Economy," Brookings Institution, 2001, URL: www.brook.edu/views/papers/perry/20011024.pdf, accessed 11 September 2004, 7.

¹³William D. Nordhaus, "The Economic Consequences of War in Iraq," 14 November 2002, URL: www.econ.yale.edu/~nordhaus/homepage/iraq.pdf, accessed 11 September 2004, 44.

problem is that "oil prices are determined in the world market, oil is a fungible commodity, and a price shock anywhere affects importers everywhere."¹⁴ Sustained terrorist disruption of the oil supply puts significant inflationary and recessionary pressure on the global economy.¹⁵ Given the policy of organizations like Al Qaeda targeting the U.S. economy, these two studies highlight a critical vulnerability to a U.S. center of gravity. Oil production and distribution are credible targets since attacks do not have to be directed at the U.S. in order to have a dramatic impact on the U.S. economy.

Even though there are disparate approaches to assessing the economic threat of GWOT, the common economic threads between most analyses are the ways costs are compounding the pressures on the deficit and the threat to the global economy should the terrorists successfully interdict the global oil supply. These issues are the two most credible long-range critical vulnerabilities to the U.S. economy, but how much of a threat is it to sustaining GWOT capabilities, and what can be done about it? Assessing the economic capability of the U.S. to sustain GWOT starts with the complex connection between government actions and economic activity.

¹⁴Nordhaus, 29.

¹⁵Perry, 7-9.

VI. What is the relationship between the U.S. Government, the Economy, and GWOT?

The federal government's budget represents merely 20 percent of GDP.¹⁶ Given that, and the nature of a global free market economy, one must ask: what tools does the government really have to protect and strengthen the economic well-being of the nation?

The federal government's primary role in maintaining healthy economic activity is "establishing the legal and institutional framework within which the economy operates and an overall level of government spending and taxes."¹⁷ The federal government's actions set the conditions under which the actions of businesses and individuals function and thereby influence economic performance. They have several tools that can have a dramatic effect on economic activity. These tools include monetary policy, fiscal policy, and specific actions to strengthen U.S. economic interests and protect critical vulnerabilities.

¹⁶*Congressional Budget Office's Estimate of the President's Budget, An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*, URL: www.cbo.gov/showdoc.cfm?index=5151&sequence=1&from=0, accessed 23 August 2004, 1.

¹⁷*CBO Analysis of The President's Budget Proposals for Fiscal Year 2005*, 28.

Monetary Policy

Although monetary policy, which involves managing the money supply to control inflation and ensure liquidity of the financial markets, is beyond the scope of this analysis, it is important to identify the significant accomplishments of both the public and private sector to protect the financial infrastructure as it is a critical vulnerability to economic well-being. Continuity of operations and maintaining market liquidity is essential for economic activity. Monetary policy decisions enabled the Federal Reserve to manage liquidity of the money supply and maintain the confidence of the domestic and global markets in the U.S. financial system through the post 9-11 period and concurrent recession. Liquidity was maintained, inflation kept in check, and the economy rebounded. Additionally, since 9-11, the Federal Reserve has enacted over 40 different initiatives to improve the protection of the financial system.¹⁸ According to the Federal Reserve, one significant vulnerability that is still of concern is protection of the telecommunications infrastructure which is essential for

¹⁸Mark W. Olson, "Protecting the Financial Infrastructure," testimony before the U.S. House of Representatives Committee on Financial Services, Washington D.C., 8 September 2004, URL: www.federalreserve.gov/boarddocs/testimony/2004/20040908/default.htm, accessed 30 September 2005.

the protection of the financial infrastructure and assurance of continuity of operations.¹⁹

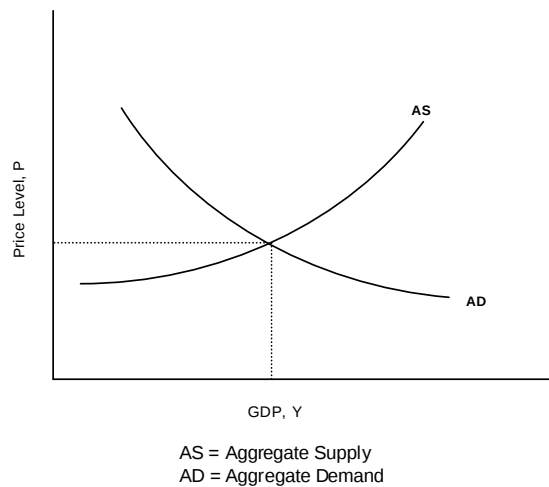
Fiscal Policy

Fiscal policy is the primary tool the Executive and Legislative Branches of government use to manage “fluctuations of national output and to stimulate long-term growth.”²⁰ The fiscal policy decisions of the federal government provide agencies with the resources necessary to perform their functions and fund programs the Congress has decided are in the national interest to implement. It is this budgetary process through which the policy priorities are communicated and provided the means for program implementation. Through fiscal policy, they also establish regulatory boundaries and tax rates that influence commercial and private sector investment and consumption behavior. These policies have both “long-run supply-side effects and short-run demand-side effects.”²¹ These distinctions are important for assessing both the potential for terrorist threats to disrupt the U.S. economy and the effect fiscal policy decisions have on consumption and production behavior vs sustainable capacity to produce goods and services.

¹⁹Olson Testimony.

²⁰Roy H. Webb, “The National Income and Product Accounts,” Federal Reserve Bank of Richmond, URL: www.rich.frb.org/pubs/macro/madnipa.html, accessed 21 December 2004.

²¹CBO Analysis of The President’s Budget Proposals for Fiscal Year 2005, 28.



Fiscal policy decisions that influence cyclical demand are generally temporary whereas supply-side actions have a longer lasting effect because it is directly related to the capability for the economy to sustain economic growth. When assessing the ability of the U.S. government to sustain the GWOT campaign, GDP is one of the essential variables as it is a measurement of national wealth. However, the two critical components that help set the conditions for growth are the government receipts and outlays. They are a function of taxation and spending policies which is where the ability to resource GWOT capabilities intersects the nation's ability to sustain the effort while balancing them against other spending priorities.

It is this relationship that validates experts concluding that the deficit is a critical vulnerability in the GWOT. Although GDP is a valuable indicator of national wealth,

minimizing the impact of GWOT by comparing costs as a function of GDP does not effectively measure the nation's ability or willingness to pay for the GWOT effort at the expense of other priorities. Looking into the fiscal policy decisions within the budget receipts and outlays is how to directly correlate the ability and willingness to pay for national priorities.

Record was correct when he stated that "GWOT's fiscal sustainability is inseparable from its military sustainability."²² It is the relationship between fiscal policy trade-offs and national priorities that highlights the growing deficit as problematic in sustaining the GWOT.

VII. The Budget Deficit and GWOT.

The following chart puts into perspective the upward pressure GWOT spending has on the deficit.²³

In Billions of Dollars	2003	2004	2005	2006	2007	2008	2009	2010
Federal Deficit	375	423	348	298	308	318	312	298
Debt Held by the Public	3,914	4,334	4,694	5,009	5,329	5,660	5,984	6,295
GWOT Supplemental	74.7	87						
HLS Funding	37.1	41.3						
GWOT and HLS % of Deficit	29.8%	30.3%						

These figures do not include the expenditures that are embedded in base appropriations that are fixed overhead costs that could also be allocated as GWOT expenditures such as the Department of Defense and Justice budgets not associated with Homeland

²²Record, 39.

²³Data compiled from several OMB sources, FY 03 and 04 Supplemental requests, FY 05 Budget, *"Analytical Perspectives" of the FY 05 Budget*, and the *Congressional Budget Office's September 2004 Baseline Budget Projections*.

Security. They also do not include state, local, or private sector investment in HLS. The figures also highlight different perspectives of defining costs associated with fighting terrorism.

The GWOT supplemental, Defense, and Homeland Security funding are distinctly separate but are integral to the nation's strategy of fighting terrorism. The table below demonstrates the increasing importance of Homeland Security in the fight against terrorism with an increase of 130% in funding since 2002.²⁴

Homeland Security Funding	2002	2003	2004	2005
In Billions of Dollars	20.6	37.1	41.4	47.4
Percent Change	N/A	80%	12%	15%

As funding for GWOT continues to put greater upward pressure on the deficit, it also exacerbates the problem with discretionary spending that is being squeezed by the growing mandatory spending requirements, specifically, Social Security, Medicare, and Medicaid which alone represented 51% of total outlays in 2003²⁵ and is growing. Without a solution to control escalating mandatory spending requirements, the federal budget is not sustainable.

²⁴OMB Analytical Perspectives Budget of the United States Government Fiscal Year 2005, 26.

²⁵Congressional Budget Office's Current Budget Projections, CBO's September 2004 Baseline Budget Projections.

On 2 August 2004, the Comptroller General presented a briefing regarding the financial position of the United States and the fiscal imbalance the nation faces. The financial condition of the United States was characterized as "a burning platform."²⁶ The challenge with the deficit is that the economy is so large that problems are often minimized in relationship to the size of production and expenditures. It makes deferring dealing with the problems politically expedient. Long-term impacts develop slowly and it is extremely difficult to generate the political will necessary to make meaningful change. If solutions are not acted upon early, draconian measures are required to avoid financial insolvency or worse economic collapse. For example, the GAO projects without significant structural change to federal programs, balancing the budget by 2040 would require "cutting federal spending by 60 percent or raising taxes to about 2.5 times the current level."²⁷ This level of government consumption would have a crippling effect on the economy by drastically reducing private sector resources available for investment and overall consumer demand.

Within the next 10 years, the deficit is expected to begin a steady increase due to the retirement of baby-boomers and the

²⁶David W. Walker, Comptroller General, "America's Financial Condition and Fiscal Imbalance: Truth, Transparency, and Accountability," 2 August 2004, URL: www.gao.gov/cghome/worldcongress20040802/index.html, accessed 1 October 2004, Slide 6.

²⁷Walker, Slide 18.

corresponding mandatory spending requirements. Even without the added pressures of GWOT and HLS expenditures, the U.S. budget is not sustainable in the long-run. Discretionary spending pressures from GWOT and HLS exacerbate the fiscal problem and create the opportunity for an organization like Al Qaeda to view their policy of destroying the U.S. economy to be a viable threat.

VIII. The Character of the Threat

The connection between the character of terrorist organizations such as Al Qaeda and the weakness of sustaining the U.S. economy resides in the fact that fiscal policy decisions often take years to have an impact or for that matter to conclude that a problem exists. Failing to understand the relationship leads to falsely minimizing the danger to the economy or inaccurately concluding the threat has been defeated. If Al Qaeda is able to cripple the U.S. economy by direct action or exacerbating internal problems such as the federal deficit, the financial capability to project national power in the long-run will be diminished. This condition enables terrorists to more effectively expand their anti-American agenda regionally and globally and minimizes the ability of the U.S. to counter their efforts.

Terrorist organizations such as Al Qaeda recognize the United States economy as a source of national strength. It is a center of gravity that enables the United States to generate its military and diplomatic power. They also understand the political dynamics and internal fiscal pressures on the U.S. economy in the long-run. The strength of the terrorist threat is in the ability to exercise patience, stay committed to achieve political objectives without a timeline, interdict economic vulnerabilities, and wait as long as it takes for the U.S. to weaken.

Al Qaeda's policy to attack the U.S. economy closely resembles fundamentals described in Mao Tse-tung's tenets of guerrilla warfare.²⁸ It is a strategy that relies on the belief that the U.S. lacks the political will to sustain the counter terrorism campaign over time. Their underlying assumption is that the U.S. will continue to make short-run policy decisions at the expense of the long-run health of the economy. They do not need short-term decisive victories. By not losing strategically in the short-run they are positioned to take advantage of economic pressures that threaten U.S. capabilities in the long-run. Through a complex global effort organized and politically unified through asymmetric associations of Islamic

²⁸Fleet Marine Force Reference Publication (FMFRP) 12-18, *Mao Tse-tung on Guerrilla Warfare* (Washington, DC: Department of the Navy, 1989), 43. See also Appendix B.

extremist organizations²⁹ they focus on long-term strategic objectives, not merely short-run tactical success.

IX. How viable is the threat to the economy?

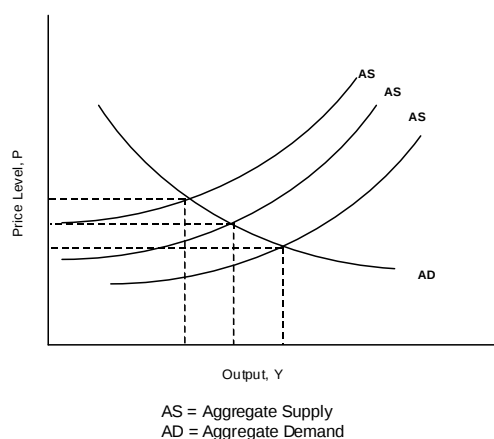
Given the U.S. Gross Domestic Product (GDP) is just over \$11 trillion, can terrorism really have much impact on our economy? Mao's fundamentals and Hammes'³⁰ concept of fourth generation warfare demonstrate the validity of threats based on political will that can take advantage of vulnerabilities in democratic societies and free market economies. Terrorists exploit weaknesses in Western economies that come from the real and psychological effects of business cycles and short-run economic policies that can be influenced by physical interdiction and domestic politics. They seek to create both direct physical and supply-side effects through attacks on critical global economic targets.

In an effort to destabilize governments and the global economy, terrorists and insurgents have increased attacks on the global oil supply in vulnerable areas such as Iraq and in "recent months in Indonesia, Pakistan, India, Russia, and

²⁹*The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States* (New York, NY: W.W. Norton & Company, 2004), xvi.

³⁰Thomas X. Hammes, "4th Generation Warfare: Our Enemies Play to Their Strengths," *Armed Forces Journal*, November 2004, URL: ebird.afis.osd.mil/ebfiles/s20041104334625.html, accessed 5 November 2004.

Nigeria.”³¹ Western economies are globally interdependent to the extent that indirect attacks on production and distribution of critical commodities have a direct impact on consumer prices and economic well-being. Attacking economic critical vulnerabilities such as the oil supply influences producer-consumer and business behavior and drives aggregate prices up. Successful disruption of oil production and distribution puts upward pressure on prices and downward pressure on production.



Disruption of the oil supply also has significant derivative effects on other goods and services. The global impact ultimately “increases the cost of doing business, increases the cost of production, and decreases equilibrium output.”³² Unlike other critical economic vulnerabilities such as information and financial networks, transportation, and the food supply, shifting production sources to minimize the global impact is

³¹Justin Blum, “Terrorists Have Oil Industry in Cross Hairs: Economic Disruption is a Key Goal,” *Washington Post*, 27 September 2004.

³²Oliver Blanchard, *Macroeconomics* 2nd ed. (Upper Saddle River, NJ: Prentice Hall, 2000), 143.

limited to the capacity and political interest of petroleum exporting nations.

The use of oil has such an integral role in society, disruption of the supply would be devastating throughout the entire economy resulting in lower productivity and increases in general prices. Such a condition would put tremendous additional pressure on the U.S. deficit because of the decline in the ability to generate revenue while maintaining both mandatory spending commitments and discretionary programs such as the GWOT and HLS.

X. Fiscal Policy Response to the Threat

The fiscal policy dilemma is how to meet counter terrorism requirements while optimizing macroeconomic supply and demand effects that ensure sustained growth and fund capabilities necessary to achieve GWOT objectives. The current strategy substantially funds offensive capabilities and the defense of critical infrastructure. The resources allocated to GWOT and the 32 federal agencies for HLS invests in several initiatives in the mission areas of intelligence and warning, border and transportation security, domestic counter terrorism, protection

of critical infrastructure and key assets, defense against catastrophic threats, and emergency preparedness and response.³³

The fiscal policy decisions to fund the costs associated with GWOT and these HLS mission areas to protect critical vulnerabilities such as transportation, financial systems, information networks, and the food supply³⁴ are indicative of the commitment by both the Congress and the Administration to fighting terrorism. However, sustaining these capabilities and the political commitment is problematic due to fiscal constraints in the federal budget. The Congressional Budget Office projects escalating deficits (see appendix D) even without additional GWOT and HLS costs.³⁵

Given the character of terrorist organizations such as Al Qaeda, time is on their side. They do not necessarily have to win. They merely have to keep from losing until economic bills come due putting unsustainable pressure on U.S. military, economic, and diplomatic capabilities.

The escalating costs to mandatory spending programs, direct and indirect GWOT program changes, and the inability to meet the intent of the Government Performance Results Act of 1993 (GPRA)

³³OMB, *Analytical Perspectives Budget of the United States Government Fiscal Year 2005*, 27.

³⁴Office of Management and Budget, *Winning the War on Terror*, URL: www.whitehouse.gov/omb/budget/fy2005/pdf/budget/winning.pdf, accessed 11 September 2004.

³⁵Congressional Budget Office's *Estimate of the President's Budget, An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*, 33.

can no longer be minimized as dysfunctions inherent in the bureaucracy of fiscal policy or as political and public confidence concerns. The policy objectives necessary to succeed and the nature of GWOT with an unlimited duration make problems with fiscal policy a serious long-term national security concern.

XI. The Budget Process and Protecting National Security

The Administration and the Congress optimize the financial resources in the President's Budget and congressional appropriations to ensure funding adequately supports policy objectives. They have to make fundamental decisions such as what constitutes mandatory spending and which discretionary programs should be funded, how much should be spent, who should receive the funding to meet policy objectives, how the nation will pay for it, what are the trade offs, and what are the down-stream effects of the fiscal policy decisions? The difficulty with these decisions and meeting GPRA objectives is often based in the bureaucratic approach to budget development and adjudication of agency priorities.

Agencies submit their budget requirements to the Office of Management and Budget in preparation for the President's Budget. The President's Budget request is then sent to the Congress for assessment and modification that results in authorization and

appropriation bills that provide the government the authority and funding necessary to function. The appropriations provide the duration that funding is available, the purpose for which resources are to be used, and the amount accessible for use. Agencies submit a budget request and manage shortfalls by taking risk in program requirements that are not funded. This risk, if not manageable, is addressed in funding requested in the form of a supplemental appropriation.

Risk and performance of programs is evaluated by the Office of Management and Budget through mechanisms such as the Program Assessment Rating Tool (PART) to determine if programs are meeting performance objectives. Additionally, the Congress also exercises their oversight responsibilities to ensure appropriated resources are adequately provided and properly used to support national priorities.

There is a lot of activity within the Executive Branch, the Congress, and within government Departments and Agencies to communicate requirements and acquire the funding necessary to support the GWOT strategy. Substantial effort is spent evaluating and adjudicating requirements, resources, performance, and program results. Organizations such as OMB, the CBO, GAO, and internal audit agencies help the Congress and the Executive branch shape the budget. The process is extremely laborious and results are often focused on incremental change vs

evaluation of total program performance. Measurement of incremental change can be a valuable metric to evaluate level of effort. For example, the data below is a comparison of the incremental change in discretionary spending excluding supplemental appropriations.³⁶

Percent Change in Discretionary Budget Authority	2001	2002	2003	2004	2005
Homeland Security	14%	21%	85%	18%	10%
Defense	5%	8%	11%	3%	7%
Non-Defense/NonHomeland Security	15%	6%	5%	4%	1%

Unfortunately incremental change metrics do not measure performance in achieving policy results. Initiatives such as the PART are useful decision support mechanisms and assist in meeting the intent of GPRA. However, they do not effectively facilitate interagency integration of efforts to coordinate policy and funding. It is the lack of interagency integration between policy initiatives and resource allocations that several studies, publications, and former senior officials³⁷ have concluded inhibit government capability.

The lack of integration is demonstrated in the discrete roles of the various stakeholders in the process. The National

³⁶Office of Management and Budget, *Overview of the President's 2005 Budget*, URL: www.whitehouse.gov/omb/budget/fy2005/overview.html, accessed 20 December 2004.

³⁷Multiple sources include the *9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States*, Ashton B. Carter and John P. White, *Keeping the Edge: Managing Defense for the Future*, Cambridge, MA: MIT Press, 2001, and a personal interview with former OMB Deputy Director Dr. John White, Lecturer of Public Policy at the John F. Kennedy School of Government. 27 October 2004.

Security Council (NSC) generally coordinates national security strategy and policy. Fiscal policy is the responsibility of the President and the Congress. It is the OMB that traditionally makes decisions regarding the “allocation of resources for national security issues.”³⁸ Departmental requirements and budget formulation are focused on agency specific interests and Congressional oversight generally emphasizes specific program priorities and “tends to follow the overall lead of the president on budget issues with respect to national security matters.”³⁹

Structurally, a more active role by OMB in the NSC and a macroeconomic program analysis and evaluation capability to support NSC decisions would improve the integration of fiscal policy with strategy and Return On Investment (ROI) of public dollars supporting national priorities. As the 9-11 report concluded “when agencies cooperate, one defines the problem and seeks help with it. When they act jointly, the problem and options for action are defined differently from the start.”⁴⁰ With the complexity of combating the global terrorist threat, the number of different agencies of the federal government formulating requirements and receiving resources, unity of effort in strategy and financial stewardship is crucial to

³⁸*The 9/11 Commission Report*, 105.

³⁹*The 9/11 Commission Report*, 105.

⁴⁰*The 9/11 Commission Report*, 400.

maximize the ROI. Maximized ROI would come in the form of improved performance in developing and implementing sustainable national policy. More efficient allocation of resources and interagency coordination would provide greater opportunity to expand capabilities across the U.S. government and private sector with sustainable fiscal policy support of national security capabilities.

XII. What has the fiscal process yielded?

The Congress has supported the Administration resourcing GWOT and HLS requirements. The cooperation has been contentious at times but the accomplishments are sizeable including massive supplemental appropriations, passage of intelligence reforms recommended by the 9-11 commission,⁴¹ and initiatives to fund the defense of critical infrastructure. These accomplishments are indicative of the fiscal policy effectiveness to support the protection of critical vulnerabilities. Specific initiatives supporting the Administration's mission areas include the protection of the agriculture and food system, transportation, border security, improved biosurveillance, financial systems, information/telecommunications systems and strengthening law enforcement authorities with the Patriot Act. Funding counter

⁴¹*The 9/11 Commission Report*, 403, 411.

terrorism efforts for example includes \$5.1 billion for the FBI in the 2005 budget – a 60% increase since 2001.⁴²

In supporting the fiscal increases, both the Administration and congressional leadership have determined that in the GWOT and HLS, the cost of putting the additional 30% upward pressure⁴³ on the deficit is a must-fund priority for national security. The increases to Defense, Justice, and HLS at the expense of other domestic programs are problematic, but these GWOT costs are the higher domestic priority.

This shift in discretionary spending priorities has not yet created unmanageable drag on economic productivity. Maximum economic productivity occurs “when government expenditures represent about 20% of GDP.”⁴⁴ Although there have been fluctuations in the size of government, this level of spending has been relatively constant for over 40 consecutive years.⁴⁵ Spending on Defense and the GWOT is sustainable at 3.5 to 4.5 percent of GDP as long as total federal expenditures do not dramatically exceed historic levels of approximately 20 percent

⁴²Office of Management and Budget, *Winning the War on Terror*, URL: <http://www.whitehouse.gov/omb/budget/fy2005/pdf/budget/winning.pdf>, accessed 11 September 2004.

⁴³The 30% is a conservative approximation. See chart in Chapter 7 for FY 2003 and 2004. Some estimates indicate a supplemental in 2005 ranging from \$50-\$100B which would be larger than 30%.

⁴⁴Daniel J. Mitchell, “The Impact of Government Spending on Economic Growth,” Backgrounder No 1831, Washington, DC: Heritage Foundation, 15 March 2005, 12.

⁴⁵Frank Wood, “Leadership in the Commons,” *Armed Forces Comptroller*, Volume 55, Number 1, Alexandria, VA: American Society of Military Comptrollers, Winter 2005, 10.

(plus or minus three percent). Unfortunately, unless there are substantial structural changes in programs that include placing a cap on mandatory spending, funding federal outlays will require levels of taxation and shifts in spending priorities that will impede economic growth and inhibit the ability to sustain a robust counter terrorism campaign.

To deal with these fiscal realities, the current Administration has committed to "cut the deficit in half, and still overhaul Social Security and the federal tax code."⁴⁶ Cutting the deficit is going to take the continued strong political will of the Administration and the cooperation of the Congress to acknowledge that it is not just a political and fiscal challenge but a long-term threat to national security should the attempt to overhaul these carefully protected mandatory spending programs fail. Sustaining GWOT and HLS capabilities will require driving down expenses in both mandatory and discretionary spending by restructuring of federal programs and the continued divestiture of nonessential governmental functions to optimize federal outlays.

It will take the collective will of both the Administration and the Congress to face the fiscal realities and political pressure from constituencies whose interest is to protect

⁴⁶Melissa Charbonneau, *Bush Pledges to Cut Deficit in Half*, Christian Broadcasting Network, URL: www.cbn.com/CBNNews/News/041215b.asp, accessed 31 December 2004.

mandatory spending programs regardless of the cost. In the interest of national security they will have to have the political will to make difficult and unpopular decisions to manage both mandatory and discretionary spending programs in a manner that will ensure the sustainable economic growth, GWOT programs, and protection of critical vulnerabilities.

XIII. How Strategy and Fiscal Policy Measure Up

There are several strengths, weaknesses, threats, and opportunities⁴⁷ that are inherent in the capabilities of the United States to manage fiscal policy and sustain the GWOT campaign. There are also others that have emerged since the terrorist attacks of 11 September 2001.

Strengths

This analysis has demonstrated that the U.S. economy is a center of gravity of the U.S. and requires aggressive fiscal policy to ensure economic strength is maintained and critical vulnerabilities are protected. It has also demonstrated that Al Qaeda underestimated the Administration, which has emerged as a center of gravity in the U.S. counter terrorism campaign and is essential to protecting our nation's fiscal strength.

⁴⁷The approach of evaluating Strengths, Weaknesses, Opportunities, and Threats (SWOT) is a common technique used in business to analyze resources and capabilities to develop executable organizational objectives.

The Administration can be criticized for several things in the management of GWOT. However, the Administration, in collaboration with the Congress, has provided the leadership and political will to develop and resource comprehensive domestic and international action by 32 different U.S. federal agencies in support of GWOT and HLS. They have demonstrated the capability to supplement the resources to support state and local government counter terrorism efforts and have capitalized on the strength of public-private sector collaboration through joint investment and research and development initiatives.

The Administration has also implemented policies and developed strategic partnerships that have high potential for supply-side growth and minimization of critical vulnerabilities. An example is the Hydrogen Fuel Initiative. International efforts like this between government, industry, and academia, have the long-term potential to neutralize the supply-side effects from terrorist threats to oil production and distribution as well as pressures from increasing global demand in other regions. These collaborative programs are capable of enabling substantial economic expansion domestically and globally. By developing a viable substitution of energy supply, the success of the program will limit exposure to the asymmetric critical vulnerabilities inherent in oil production and distribution.

The other strength in the economy that the terrorist threat underestimated is the character of the private sector. The nature of private industry requires individual and collective action to do what is necessary to remain a going concern. With a GDP of over \$11 trillion, even without government action, it is in the interest of the private sector to protect its financial assets from the effects of terrorism. Market conditions are driving private sector investment in technology and protective activities that ensure continuity of their operations. Terrorism creates conditions that put the financial stability of the private sector at risk and therefore make it in their interest to increase collaboration with the public sector. It is not a moral judgment -- rather it is a good business decision -- to collaborate on initiatives that promote market stability, economic growth, and minimize capital and financial risks.⁴⁸

Weaknesses and Threats

There are also several fiscal policy weaknesses inhibiting sustainment of the GWOT campaign. These critical vulnerabilities are the inability to manage the federal deficit, exposure to interdiction of the oil supply and critical

⁴⁸Some examples of public-private sector collaboration include port container security initiatives, financial market continuity-of-operation plans that include international back up systems and the Hydrogen Fuel Cell initiative that is a combined effort by the government, academia, and auto and energy industries to bring a viable fuel alternative to the market.

infrastructure, inefficient interagency integration of strategy and resource management, and the lack of a mechanism to effectively integrate state and local economic costs into national planning.

The threats these weaknesses reveal are the negative effects they have on economic growth and the fiscal policy challenges of sustaining the resources for a long-term GWOT and HLS campaign. The inability to resolve these fiscal policy weaknesses and threats to economic stability is an underlying assumption necessary for the policy of Al Qaeda to succeed. They continue to target critical economic vulnerabilities such as the global oil supply and exhaust U.S. resources in the GWOT and HLS protection of critical infrastructure such as energy, transportation, financial networks, food supply, and information and telecommunications systems. Meanwhile, they wait out the macroeconomic effects of escalating debt pressure to degrade U.S. capability.

Opportunities

The threat conditions have also created the opportunity for political and economic unity of effort necessary to make the changes necessary for the sustainable GWOT campaign to succeed. The threat has necessitated private industry and government collaboration in research and development, information and

supply-chain security and protection, and policy that promotes market stability and economic growth. Fighting terrorism is a national and global priority of the people and the government. The GWOT has provided the conditions to significantly unify public and private sector political will and presented a window of opportunity to solve the problem of an unsustainable federal budget while maintaining the capabilities necessary to fight the GWOT, provide HLS, and sustain economic growth. The conditions provide the opportunity to make the difficult choices to seek viable solutions for a sustainable federal budget, interagency fiscal management and cooperation, and serious alternatives to energy sources that are both vital to economic well being but long-term threats to national security if not resolved.

XIV. Conclusions and Recommendations

The Character of Terrorism

Understanding the character of terrorism is important in order to know how to define success and resource a successful strategy. Terrorism is like cancer: one cannot kill one cell and declare victory. We must attack the cells, put the disease into remission, and defend against its resurgence. Even then, the threat is still there and one must be prepared to go after it wherever it shows up. The metaphor of cancer is useful in

another way: terrorism is a fight that only gets more dangerous the longer it goes undetected.

Terrorists have employed various strategies to defeat America. Al Qaeda has correctly identified the economy as a center of gravity of the United States. However, the strategy can be defeated by comprehensive efforts and resources the U.S. is providing to sustain GWOT and HLS. Sustained success of the U.S. strategy will take significant national leadership and will to overcome bureaucratic and political weaknesses that can threaten the ability to manage fiscal policy necessary to sustain GWOT, HLS, mandatory spending priorities, and economic growth.

The U.S. Strategy

As a result of the U.S. efforts in GWOT and HLS, the terrorist capability to inflict long-term economic damage has been limited to supporting insurgencies and attacking critical vulnerabilities such as the oil industry. Other effects, although potentially catastrophic (e.g. WMD in a domestic population center), would merely have adverse short-term demand-side economic effects that would adjust in the long-run as capital and labor markets adjusted. The greater long-run threat is not directly from terrorist interdiction but the ability to affect the economic capacity of the U.S. to sustain the counter

terrorism campaign. U.S. economic strategy and fiscal policy should reinforce protection of the critical vulnerabilities and expand supply-side opportunities that strengthen economic growth. Sustained economic growth is the most important factor to sustaining national power, public will, and the practical ability to pay for GWOT and HLS requirements.

Maintaining Economic Strength to Strengthen the Center of Gravity

Maintaining the means necessary to win the GWOT requires sustainable long-term economic growth. Sustainable government spending for GWOT requires fiscal policy that will reduce the federal deficit; implements a mechanism that integrates strategy, policy, and resource requirements generation and allocation; and invests in reducing exposure to economic critical vulnerabilities.

Deficit Reduction

Financial stewardship is not just an issue of public confidence in federal government. When the federal deficit grows out of control and threatens the ability of the government to protect the nation it becomes a national security problem. Even without the added GWOT and HLS pressures on the budget, mandatory spending makes the budget unsustainable (see appendix E) and is a long-term threat to national security.

It is the structure of mandatory spending programs that requires reorganization. Failure to do so maintains unsustainable pressure on the budget. Appendix D demonstrates the strain mandatory spending is placing on fiscal policy. The problem becomes even worse by 2010 as baby-boomers start to reach retirement age.

Changes to mandatory spending programs are a domestic political problem. Even if it is the right thing to do fiscally, morally, or for the safety of the nation, anyone attempting to change Social Security, Medicare, or Medicaid, faces tremendous political pressure and puts their chances of being reelected at risk due to the tremendous lobby efforts by the groups these programs support. However, failure to make fundamental changes to these programs and enact sustainable financial management practices is a long-run threat to national security. Without fiscal policy decisions to balance mandatory spending with revenue growth, terrorist organizations such as Al Qaeda and other potential emerging global adversaries merely have to wait until the internal fiscal pressures force reductions in discretionary spending programs and increased taxation policies that will stagnate economic production.

Strategy, Policy and Resource Integration

Improvements are also necessary to link strategy, policy, and resource requirement and budget development. The resources supporting the GWOT and HLS are allocated across 32 different federal agencies. However, no mechanism exists to efficiently link economic and financial analysis to evaluate the impact and sustainability of policy initiatives. Legislation already exists in the form of GPRA mandating the need to improve government resource management. The outcomes of the legislation for each Agency have had varying degrees of success in the attempt to meet the tenets of GPRA. However, several analyses⁴⁹ have identified the continued problematic lack of integration between management of inter-agency resources and the national security agenda. The problem lies within the stove-piped mechanism that promotes financial management action in the interest of Agency initiatives instead of inter-agency unity of effort in support of National Security objectives.

The solution to this problem is the creation of an OMB-NSC Economic Fusion Cell to ensure resource requirements are efficiently shaped by policy objectives and executed with minimal redundancy. It is a program analysis and evaluation cell

⁴⁹Several analyses have cited this shortfall including, *Keeping the Edge*, *The 911 Report*, and the SAIS study on *Beyond Goldwater-Nichols* by Clark A. Murdock, and others. *Beyond Goldwater-Nichols: BG-N Defense Reform for A New Strategic Era*. Center For Strategic and International Studies, Washington D.C., March 2004.

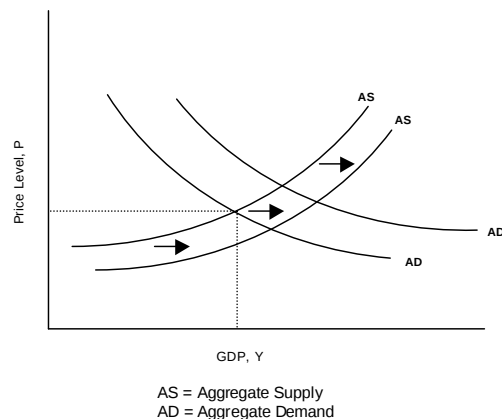
that can capitalize on the expertise and analytical capabilities to utilize all government agencies such as the OMB and Bureau of Economic Analysis and make impact analysis and supportability recommendations to the NSC leadership that improves strategic policy and financial performance. They would focus on program analysis to maximize return on investment in support of strategy options, not merely the measurement of incremental programmatic change from one budget to the next.

Protection of Critical Vulnerabilities

The analysis of resources allocated to the GWOT and HLS demonstrates the commitment the Administration and the Congress have to protecting the U.S. from future terrorist attacks. Sustained protection of domestic critical infrastructure is important to facilitate economic activity. Fiscal policy should continue to resource programs for protection and mitigation of WMD and attacks of critical infrastructure such as transportation, financial, food supply, and information networks. However, the greatest economic critical vulnerability this analysis has demonstrated is the exposure to the potential disruption in the energy market - specifically, the oil supply.

The global oil supply is a critical vulnerability over which the U.S. has little control. It is a commodity that does not offer ease of substitution should the supply be

significantly constrained. It is also a commodity that has derivative effects throughout the entire economy. Rising energy prices increase the aggregate cost of doing business. Fiscal policy should view dependence on oil as a long-term threat to national security and invest in development of alternative energy sources.



With escalating global demand for oil, a viable fuel alternative would have revolutionary change on global markets and diminish regional threats to the U.S. economy. Greater investment in programs such as the President's Hydrogen Fuel Cell initiative with the intent to transform the market place would offer a substitutable energy alternative, limit the energy market exposure, and introduce a technology that would stimulate supply-side economic growth.

XV. Final Comments

The Road Ahead

The Administration and the U.S. economy are formidable centers of gravity in the GWOT. However it will require continued strong leadership by the Administration and the Congress to generate the political will necessary to face the domestic political challenges to making meaningful change to sustain the GWOT campaign. These recommendations provide the roadmap to enhance the substantial efforts already implemented in the Federal Government to fight terrorism. Successful achievement of GWOT objectives is attainable only if the political and institutional change can produce and manage sustainable fiscal policy, implement resource management practices that fuse interagency policy and financial requirements, and continue to fund programs that protect critical vulnerabilities, limit exposure in the energy market, and generate long-term economic growth opportunities.

Congress and the Administration in FY 2006

The President presented his vision for the Administration in his inaugural speech on 20 January 2005 and in his State of the Union address on 2 February 2005. He articulated his priorities of National Security, strengthening the economy, and

deficit reduction. He further demonstrated how he plans to meet these priorities in the FY 2006 budget he submitted to Congress.

The debate over the President's FY 2006 budget will set the course of what the nation will accomplish in the GWOT and domestically for the next four years of this Administration. Misconceptions about the federal budget and the impacts of proposed changes to spending programs persist. The difficulty will be in the ability to get through the political rhetoric of both Democratic and Republican parties as well as special interest groups' efforts to narrowly frame the debate. The issues are complex, and sustainable solutions will require difficult choices that carry political risk.

Most experts agree that the deficit is a problem and mandatory spending programs are not sustainable. Current projections estimate the deficit in FY 2006 will reach \$512 billion. The President's FY 2006 budget proposal contains cuts that trim the deficit in FY 2006 to \$427 billion.⁵⁰ Other estimates project that the reduction proposals merely push the escalating deficit down the road to deal with after the current Administration leaves office.⁵¹ Both political party estimates

⁵⁰Brian DeBose, "Nonsecurity Programs Cut to Reduce Deficit: Education, HUD Hit Hard in Budget Plan," *Washington Times*, 8 February 2005.

⁵¹Jonathan Weisman and Peter Baker, "After Bush Leaves Office, His Budget's Costs Balloon," *Washington Post*, 14 February 2005.

have flaws in them;⁵² the political reality is that the Congress and the American people simply may “not be ready to embrace the changes that would shore up the system’s finances.”⁵³

If the nation is to sustain the counter terrorism campaign, the Administration is going to have to demonstrate that it is as much of a center of gravity when it comes to fiscal policy as it is in the GWOT campaign. The Congress is also going to have to emerge as a center of gravity that has the political will to make changes to mandatory spending programs that strengthen long-run economic growth. Both the Administration and the Congress are going to have to emerge with the political will to restructure mandatory spending programs so they do not crowd out critical discretionary funding priorities or cause government expenditures and debt to stagnate economic productivity. If they are unable to do so, the only choice they will have is to cut discretionary expenses in the short-run and significantly raise taxes in the long-run.

The debate over the President’s FY 2006 budget will be indicative of what is politically achievable in the GWOT campaign. Bi-partisan leadership is necessary if the Administration and the Congress are to protect long-run national

⁵²Jim Vande Hei and Jonathan Weisman, “Partisan Social Security Claims Questioned: Budget Experts Say Both Sides Flawed,” *Washington Post*, 27 February 2005.

⁵³Richard Morin and Dale Russakoff, “Social Security Problems Not a Crisis, Most Say,” *Washington Post*, 10 February 2005.

security against adversaries willing to wait for the effects of the economic drag created by U.S. fiscal policy that is not sustainable in the long-run.

Appendix A

GLOSSARY

Center(s) of Gravity

Essential source(s) from which national power is generated.

Demand Side Economic Effects

Temporary short-run changes in the total demand for goods and services.

Monetary Policy

Actions taken by the Federal Reserve Bank to manage the money supply to promote economic growth and stability. Management of the money supply has a direct impact on liquidity of financial markets and is a tool used to control inflation.

Fiscal Policy

Action taken by the federal government to manage taxation and spending. This includes all the actions and processes to formulate and execute the federal budget.

Going Concern

The concept that financial resources are available to continue operations from year to year.

Gross Domestic Product

The value of the goods and services produced by the nation. It is often represented by the equation $GDP (Y) = C + I + G + NE$ where C = the personal consumption expenditures of goods and services, I = gross domestic investment, G = government purchases and NE = net exports.

Supply-Side Economic Effects

Long-term changes in the potential to produce goods and services based on the size and quality of the labor force, stock of productive capital, and technology.

Appendix B

Mao's Tenets

- 1) Arousing and organizing the people.
- 2) Achieving internal unification politically.
- 3) Establishing bases.
- 4) Equipping forces.
- 5) Recovering national strength.
- 6) Destroying enemy's national strength.
- 7) Regaining lost territories.

The strength of these tenets is that they are used in pursuit of political victory. It creates unity of effort by organizing and taking action that solidifies the will of the people in support of the objective.

Source: Fleet Marine Force Reference Publication (FMFRP) 12-18, *Mao Tse-tung on Guerrilla Warfare*. Washington, DC: Department of the Navy. April 1989, 43.

Appendix C

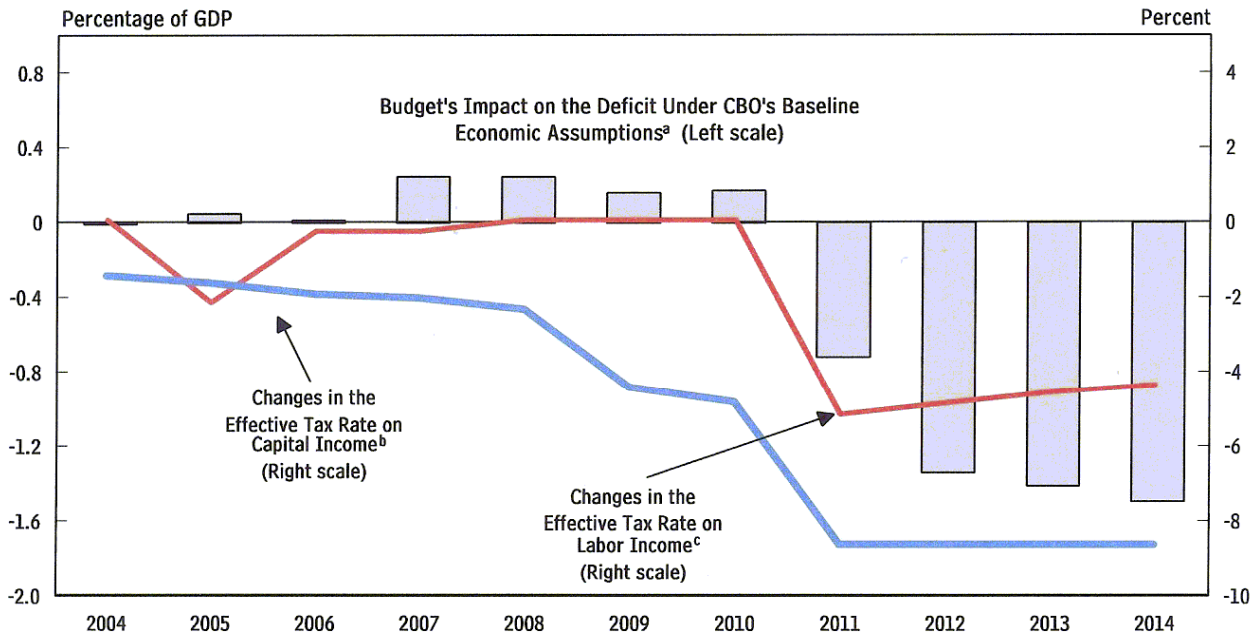
World's Largest Economies

Percent of World GDP*			
1992	% of Total	2002	% of Total
United States	21.3	United States	21.1
Japan	8.8	China	12.7
China	7.2	Japan	7.1
Germany	5.4	India	4.8
Russia	4.2	Germany	4.4
Rest of World	53.1	Rest of World	49.9
World	100.0	World	100.0
<i>*based on Purchasing Power-Parity (PPP) International Monetary Fund, World Economic Outlook Database</i>			

Source: Government of Newfoundland and Labrador, "Global and Economic Environment," 16 March 2004, URL: www.economics.gov.nf.ca/E2004/global.asp, accessed 19 December 2004.

Appendix D

Selected Inputs Used for CBO's Estimates



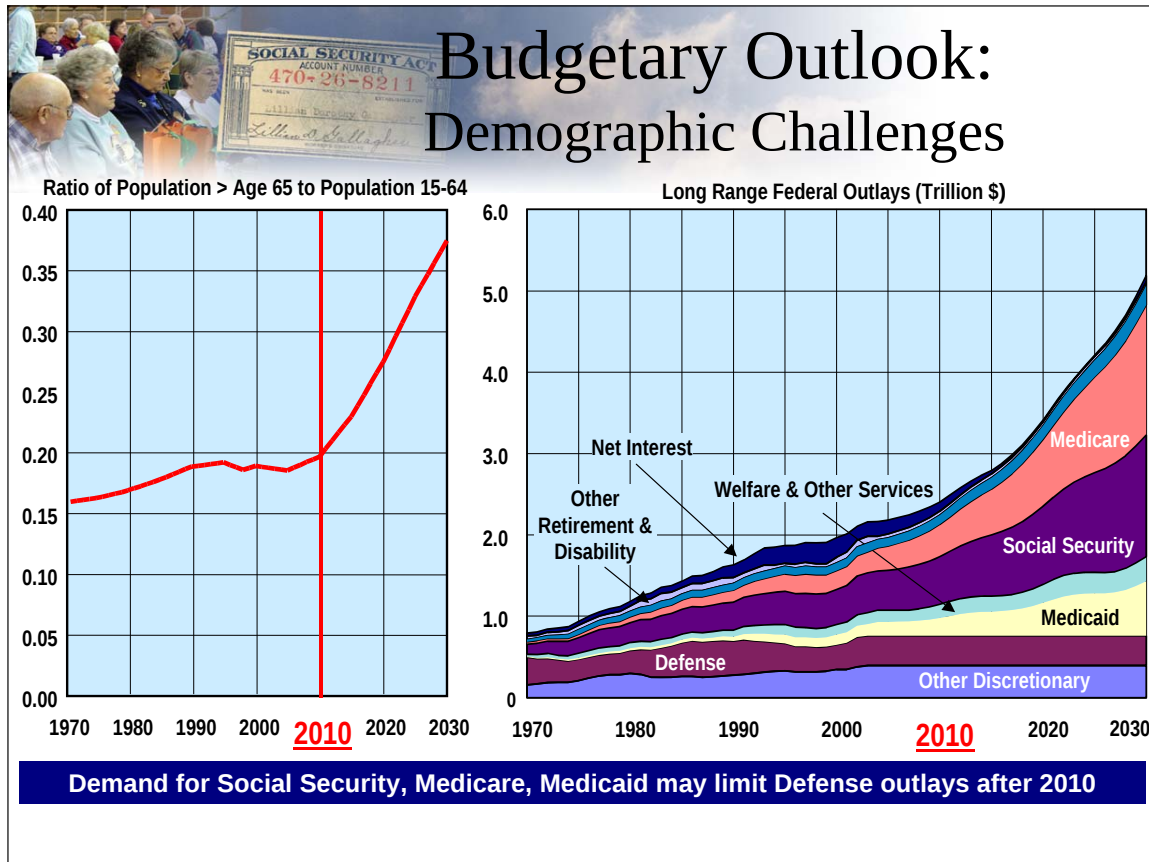
Source: Congressional Budget Office.

- a. Positive changes reduce the deficit, and negative changes increase it.
- b. Changes in the effective federal marginal tax rate on income from capital (in principle, the share of the last dollar of such income taken by federal individual income and corporate income taxes).
- c. Changes in the effective federal marginal tax rate on income from labor (in principle, the share of the last dollar of such income taken by federal individual income and payroll taxes).

Source: Congressional Budget Office's Estimate of the President's Budget, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2005," 33.

Appendix E

Mandatory Spending Outlook



Source: Corley, John D., LT Gen, USAF, Principle Deputy, Office of the Assistant Secretary of the Air Force for Acquisition and Military Director, USAF Scientific Advisory Board. Lecture presented at the USMC Command and Staff College. Quantico, VA, 17 December 2004.

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