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Living Perilously in a Bubble

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For the past decade, we have become accustomed to hearing the sound of bursting bubbles. During the late 1990s, it was the giddy days of the dotcom bubble. Internet-based companies gained rock star popularity as stock prices soared, venture capital flowed freely, and traditional blue-chip companies scurried to mimic the dotcoms who gained success by bypassing standard business models. By March 2000, the environment of exuberance ended and the dotcom bubble finally burst, with Internet stocks plunging nearly 90 percent. Companies such as Pets.com, eToys, and Webvan littered the stock exchange floor as reality and rational thinking returned to the marketplace.

More recently, the real estate market began its bubble as American enthusiasm for owning a home pushed U.S. homeownership rates from 64 percent in 1994 to an all time high of 69.2 percent in 2004. The renewed American dream of owning a home drove housing values up an incredible 16 percent per year from 2002 to 2006. Fueling the house-buying mania was the popular expectation that, as a rule, home prices do not fall and "flipping" a house was a relatively safe investment.

Accompanying the real estate bubble was a commodities bubble as prices for energy, basic metals, and foodstuffs soared. By early 2008, cocoa prices had risen 40 percent, copper 24 percent, and corn 33 percent. Mini-bubbles emerged as Americans convinced themselves that they were wealthier than they really were. Auto sales climbed as customers were allowed to buy cars at employee prices or through no-interest loans for up to 6 years. The zeal and eagerness to consume was widespread throughout other sectors such as retail sales, the bond market, and leisure travel. Far too many Americans concluded that living beyond one's means was worth the risk as U.S. household debt rose from just under 80 percent of disposable income in 1986 to 140 percent in 2007.

In the now well-known series of events, however, the housing market collapsed, and overextended homeowners struggled to meet their mortgage payments. Banks with mortgage-backed assets stopped lending, and the resulting disintegration of the credit bubble joined the bursting of the housing, auto, retail sales, and commercial real estate bubbles. Despite constant warnings that the nation was living in a bubble of irrational exuberance, most Americans were caught off guard by the current financial crisis.

Unfortunately, the U.S. military is operating in a similarly precarious bubble. Over the last 8 years, Congress has steadily increased the Pentagon's budget by 86 percent, from $361 billion to $672 billion in inflation-adjusted dollars. The money has supported success in Iraq and progress in Afghanistan, but it has also created the expectation that any event, contract, or program that can be remotely construed as "supporting the Global War on Terror" will be funded. In the words of Representative John Murtha, chairman of the House Appropriations defense subcommittee, "The Pentagon has gotten anything it wanted mainly because of the wars."

And yet, the U.S. military would have to be extremely naïve not to see the likelihood of the bubble bursting. After every major conflict, to include the Cold War, the nation has been quick to harvest a peace dividend from the defense budget. The apparent success in Iraq, combined with the $780 billion plan to bail out Wall Street, will undoubtedly cause many lawmakers to question the record high levels of defense spending. As Representative Murtha cautioned, "We're going to be to the point where they're going to have to come to some real justifications of what's needed. You can't have everything, and you're not going to get everything."

In addition to waning congressional support, societal willingness to allocate federal dollars to the military is also changing. When asked about the amount of money the U.S. Government is spending for national defense, the percentage of Americans who responded that it was "too much" rose from 19 percent in 2001 to 44 percent in 2008. Although a large majority of Americans—84 percent in 2007—still have a favorable view of the U.S. military, they are becoming increasingly reluctant to fund it, not to mention recommending it as a career for their sons or daughters.

Of course, bubbles are not all bad. As author Daniel Gross points out, a bubble is an opportunity for rapid and major technological and commercial innovation. When the dotcom bubble burst, there were hundreds of casualties, but survivors like Facebook, MySpace, YouTube, and Google live on. More importantly, when a bubble bursts, all the creativity and innovation, all the lessons learned, and all the new ways of doing business are not lost.

During the last 8 years of the defense bubble, the U.S. military—and especially the Army—has literally transformed itself with incredible advances such as modular forces, support for families and wounded warriors, counter-IED technology, an acquisition process that can be forced to work in months not years, and evolving counterinsurgency doctrine. Before the defense bubble bursts (and it will), the military must institutionalize all the good that has come out of the last 8 years and prepare for a new era of funding and societal support. The warning signs of a bursting defense bubble are clear. It is now up to the military to determine if the fall from the heights of the bubble will be a hard or soft landing. One thing is sure, however. To continue operating in the status quo, as we have seen with so many other bubbles, is folly.

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