

# LOOKING BEYOND THE FOG BANK FISCAL CHALLENGES FACING DEFENSE

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## Backgrounder

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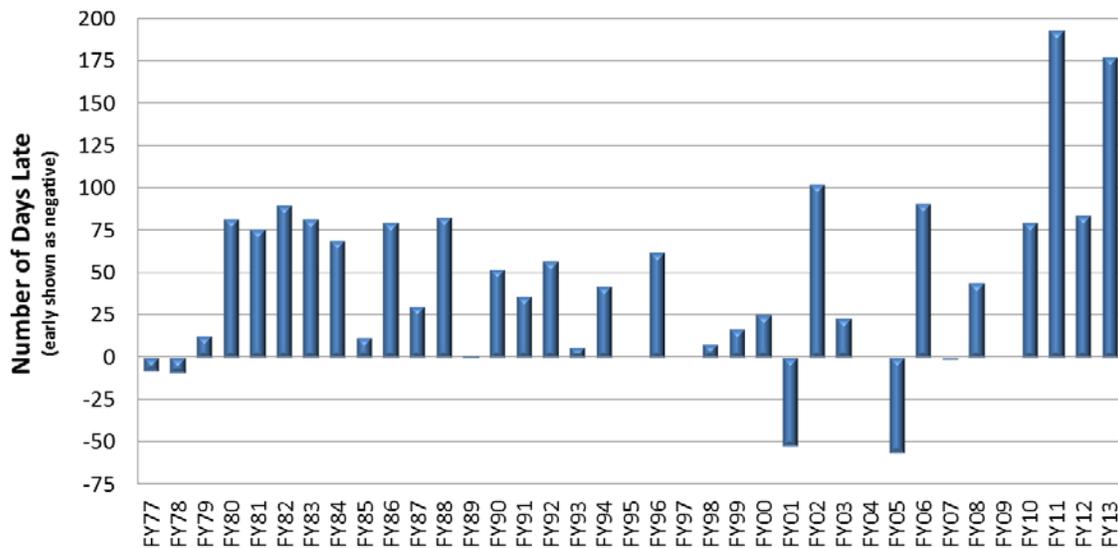
**CSBA**

Center for Strategic and Budgetary Assessments

## LOOKING BEYOND THE FOG BANK: FISCAL CHALLENGES FACING DEFENSE

After months of uncertainty, the FY 2013 defense budget appears to be settled. On March 26, President Obama signed H.R. 933 into law, which replaces the continuing resolution with a regular defense appropriations bill but leaves sequestration in effect. As attention now turns to the FY 2014 budget and the Administration’s much-delayed budget request, the fundamental issues that led to uncertainty and delays in the FY 2013 budget remain unresolved. These issues could lead to a similar outcome in FY 2014—more delays, more uncertainty, and ultimately another sequester.

The FY 2013 budget process was atypical in several respects. Before the new fiscal year began, Congress passed a six-month continuing resolution to fund DoD and the rest of government until March 27. As shown in Figure 1, this led to the second longest delay in passing a defense appropriations bill since the current budget process took effect in FY 1977. From FY 1977 to 2013 the average delay in passing a defense appropriations bill was 43 days, and in nine of those years the budget was passed on or before the start of the fiscal year. In the past four years, however, the average delay has been 134 days.



*Figure 1: Delays in Passing the Annual Defense Appropriations Bill*

Sequestration also created a high degree of uncertainty, almost going into effect on January 2 as Congress and the Administration engaged in last-minute negotiations. These negotiations resulted in a two-month delay, which merely extended the uncertainty. Ultimately, sequestration took effect on March 1, contributing to the largest

single year reduction in the defense budget since the drawdown that followed the Korean War (FY 1955).<sup>1</sup>

The cloud of uncertainty that hung over the FY 2013 budget process is lingering over the FY 2014 budget in a similar fashion. Like last year's request, the FY 2014 budget request is not expected to comply with the budget caps imposed by the Budget Control Act (BCA). The BCA cap for national defense in FY 2014 starts at \$552 billion and is automatically reduced by \$54.7 billion due to the failure of the Super Committee to reach its deficit reduction target.<sup>2</sup> The resulting cap for FY 2014 is \$497.3 billion, and DoD's share of the cap is roughly \$475 billion.<sup>3</sup> If DoD submits a budget request that exceeds its \$475 billion cap, as senior Pentagon officials have indicated it will do,<sup>4</sup> it is implicitly placing its faith in Congress to lift the budget caps or make the necessary cuts in DoD's request to fit within the caps.

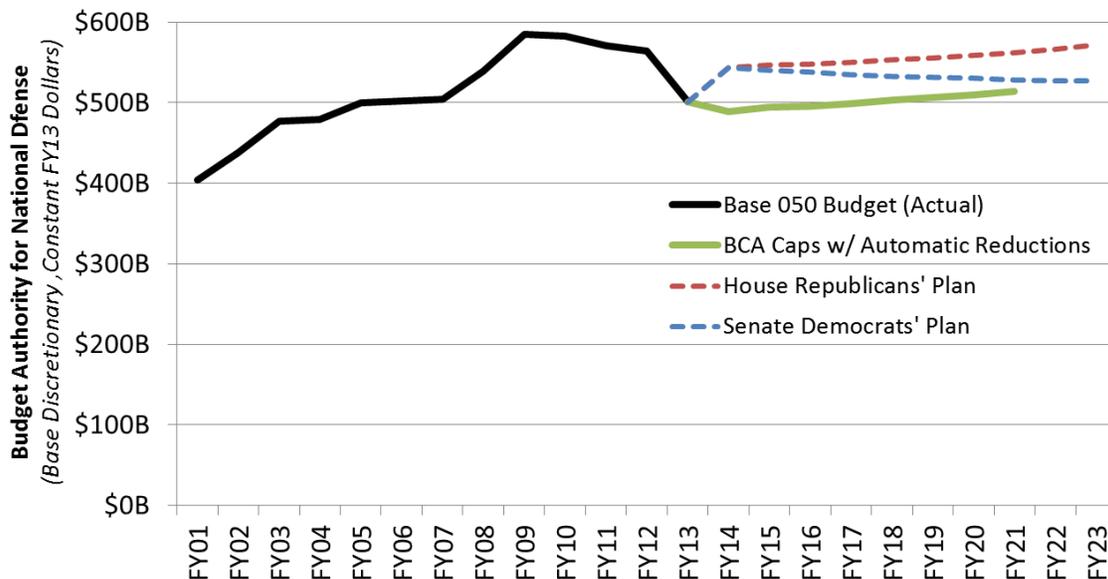


Figure 2: Comparison of House and Senate Budget Resolutions to the BCA Budget Caps

That faith may be misplaced because both the House and Senate budget resolutions, shown in Figure 2, also exceed the budget caps. The competing budget resolutions propose virtually identical amounts of funding in FY 2014 for national defense, \$552 billion in discretionary funding.<sup>5</sup> They disagree sharply, however, on how to replace the cuts in the BCA and lift the caps. Moreover, neither party has proposed a plan for how to cut the defense budget to fit within the BCA caps. If the two sides do not pass legislation

<sup>1</sup> Including the reduction in war-related funding, the overall defense budget fell 12 percent in real terms from FY 2012 to FY 2013.

<sup>2</sup> The BCA defines the security category in this context as the National Defense (050) budget function.

<sup>3</sup> This assumes DoD receives 95.6 percent of funding in the national defense budget function, as has been projected in previous budget requests.

<sup>4</sup> Christopher J. Castelli, "Hale: DOD's FY-14 Topline To Exceed Budget Control Act Levels By Up To \$55 Billion," *Inside Defense*, March 5, 2013.

<sup>5</sup> The budget resolutions do not specify how much of this funding would be allocated to DoD, leaving this work to the appropriations committees.

that alters the BCA, the current caps will remain in effect for FY 2014 and beyond. If the budget caps are breached, it will again trigger an automatic, across-the-board sequester to reduce the level of funding to the caps. If the FY 2013 budget process is instructive, Congress may prefer to let sequestration cut the budget rather than make the hard decisions itself.

The threat of sequestration does not end in FY 2013 unless Congress acts to change the BCA. The political divide on how to reduce the deficit, however, is largely unchanged from the debt ceiling fight that led to the BCA being enacted in the first place. Further complicating matters, another debt ceiling crisis is looming later this summer that may result in additional spending cuts. Unless the two sides can come together on a deficit reduction deal to replace the BCA—a deal that has eluded them for nearly two years—it seems likely that DoD will see its budget cut to \$475 billion in FY 2014 through the blunt, indiscriminate mechanism of sequestration.

Moving from one crisis to the next without resolution of the underlying issues has created a fog bank of uncertainty for defense planners. With the FY 2013 budget apparently settled, that fog bank has merely moved a few months into the future to the start of the next fiscal year. Because of this uncertainty, DoD and Congress have not yet begun to grapple seriously with major structural issues in the defense budget—issues that over time will erode the military's ability to support a well-trained, modernized force of sufficient size to meet the nation's security commitments.

Because of these structural issues within the defense budget, this downturn in defense spending is likely to be different from previous downturns. Unlike previous buildups, the increase in defense spending over the past decade did not involve a significant increase in the size of the military—active duty end strength fluctuated between 1.45 million and 1.51 million. The size of the military is essentially the same today as it was when the current buildup began, making it difficult for the Department to reap savings of the order experienced in previous drawdowns simply by reducing the size of the force.

Rather than getting larger and more expensive over the past decade, the military just grew more expensive. For example, from FY 2001 to FY 2012, compensation costs per active duty service member grew 57 percent, adjusting for inflation, or 4.2 percent annually.<sup>6</sup> As a result, the share of the base DoD budget devoted to military personnel-related costs grew from 30 percent in FY 2001 to 34 percent in FY 2012. Even if the cost per service member returns to its historical norm of 2.6 percent real annual growth, by FY 2021 total military personnel-related costs (including active and reserve component forces) could consume 46 percent of the DoD budget.<sup>7</sup> The cost of peacetime operations and maintenance (O&M) per active duty service member also increased, growing 34 percent

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<sup>6</sup> Military personnel-related costs for active duty service members includes all Military Personnel funding not designated as war-related, minus accounts marked for Guard and Reserve personnel, plus the Defense Health Program account from Operations and Maintenance.

<sup>7</sup> This assumes a \$563B DoD budget in FY 2012, consistent with the budget caps imposed by the Budget Control Act of 2011, and no additional reductions in end strength beyond those currently planned.

in real terms since FY 2001, or 2.7 percent annually.<sup>8</sup> Even if peacetime O&M costs return to their historical norm of 2.5 percent real annual growth, by FY 2021 these costs could consume 40 percent of the DoD budget.<sup>9</sup>

Together, 86 percent of the defense budget could be consumed by military personnel and O&M costs by FY 2021. Moreover, if growth in these accounts were to continue at the higher rate experienced over the past decade, by FY 2024 these costs could consume the entire defense budget, leaving no funding for procurement, research, development, test and evaluation (RDT&E), military construction, and family housing.

To slow the rate of growth and prevent personnel and O&M accounts from crowding out other areas of the budget, DoD needs to make a number of structural reforms. For example, to slow the growth in military personnel costs DoD will need to make fundamental reforms to its compensation system. Instead of continuing to propose changes in military benefits that are all cuts with no improvements—an approach Congress has rejected repeatedly—DoD should propose a package of reforms that cut benefits undervalued by service members and reinvest some of the savings into forms of compensation that are more highly valued.<sup>10</sup>

Likewise, to reduce operations and maintenance costs, DoD should re-examine the size and structure of its civilian workforce and begin the process of closing excess bases and facilities—two of the major components driving O&M costs. Under sequestration, DoD has little choice but to reduce its civilian payroll expenses for FY 2013 using furloughs. But furloughs are a temporary means of reducing costs. When the new fiscal year begins on October 1, DoD will still have more civilian employees than it can afford under the BCA caps and will need to begin the painful work of initiating a reduction-in-force (RIF) process to reduce the size of the civilian workforce in a thoughtful manner. Likewise, as spending and the number of personnel decline in the coming years, DoD will be left with an even greater level of excess infrastructure.<sup>11</sup> While the Department proposed two rounds of base closures in its previous budget request, such a proposal should also allocate funding for the upfront costs associated with closing and transferring facilities.

None of these long-term structural issues can be resolved by DoD alone. Without the support and flexibility it needs from Congress, DoD can make little progress on these critical issues. Moreover, the current cycle of managing from budget crisis to budget crisis is preventing the Pentagon from managing for the long term. To break out of this

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<sup>8</sup> Peacetime operations and maintenance costs include all O&M funding not designated as war-related minus the Defense Health Program.

<sup>9</sup> This assumes a \$563B DoD budget in FY 2012, consistent with the budget caps imposed by the Budget Control Act of 2011, and active duty end strength remains at the currently planned level of 1.4 million.

<sup>10</sup> For a more in-depth explanation of this approach, see Todd Harrison, *Rebalancing Military Compensation: An Evidence-Based Approach* (Washington, DC: CSBA, July 2012), available at <http://www.csbaonline.org/publications/2012/07/rebalancing-military-compensation-an-evidence-based-approach/>.

<sup>11</sup> In congressional testimony, DoD noted that before the last round of base closures in 2005 it had 24 percent excess capacity, only 3 percent of which has been eliminated to date. See Dorothy Robyn, Deputy Under Secretary of Defense (Installations and Environment), testimony before the Subcommittee on Readiness, House Armed Services Committee, *Request for Authorization of Another BRAC Round and Additional Reductions in Overseas Bases*, March 8, 2012.

cycle, DoD should accept the reality of the budget caps currently in effect and begin planning for this lower level of funding. DoD has never and will never have complete certainty about its future budget level—Congress only appropriates funding one year at a time. DoD can, however, avoid introducing additional uncertainty by submitting a budget request that is compliant with the budget caps already enacted by Congress.

As part of planning for a reduced budget, the Pentagon should address the structural challenges in its budget. It should present to Congress the choices it would make and the force it could afford if it were given the flexibility to close bases, reform military compensation, and reduce the civilian workforce. It should also present an alternative—a smaller, less capable force that would result from not addressing these difficult structural issues. DoD should not expect Congress to make the tough decisions if it is not willing to make tough decisions itself.

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