The Growing Challenges in Defense Spending and the Defense Budget: An Overview

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Broader Pressures on the Federal Budget
The financial crisis affected the “advanced world” more acutely than China and the “emerging economies”.

The United States Faces Key Resource Uncertainties—Recovery May Not Be Quick Or Easy

The financial crisis affected the “advanced world” more acutely than China and the “emerging economies”.

GDP Growth Rates May Be Modest

The financial crisis had a profound effect on long-term growth projections.

Emerging economies were already predicted to outpace growth of “advanced economies”. The financial crisis has sharpened the disparity in these predictions.

Total Deficit is Hoped to Decrease

Projection Assumptions

1. Tax provisions assumed to expire as scheduled
2. Cuts in Medicare’s payments for physicians’ services will occur as scheduled
3. Spending for discretionary programs will continue at levels most recently enacted by Congress, adjusted for inflation

Adapted from: CBO. *Budget and Fiscal Outlook for Fiscal Years 2010-2020*. Figure 1-1, pg 3.
However, Outlays Grow and Continue to Outpace Revenues

A real fiscal squeeze may be experienced by the next Presidential term.

Adapted from: CBO. *The Budget and Economic Outlook: an Update.* August 2009. pg XI.
CBO Estimate of Revenues vs. Expenditures in Baseline Budget

Graphic adapted from: CBO, Long Term Budget Outlook, revised August 2010, p. 68
Challenge of Rising Social Security Costs

The Population Age 65 or Older as a Percentage of the Population Ages 20 to 64

Spending for Social Security Under CBO’s Long-Term Budget Scenarios

Source: Congressional Budget Office.

Graphic adapted from: CBO, Long Term Budget Outlook, revised August 2010, pp. 48, 49
Challenge of Rising Medical Costs

CBO Estimates the total cost of US medical care rose from 8% to 15% over the last 30 years, and will rise to 26% in 2035 unless brought under control. Mandatory federal programs will rise from 5.5% of GDP to 9-12% by 2035.
The GAO’s analysis reveals an even gloomier scenario:

- The CBO projection (baseline extended) assumes federal spending increasing in proportion to inflation
- Empirically, this assumption tends to underestimate debt growth
- The GAO recognizes that the federal budget follows a historical trend of growing in proportion to growth in GDP (alternative projection)

This projection implies that rapid debt acceleration has already begun

Figure 1: Debt Held by the Public under Two Fiscal Policy Simulations

CBO Warns of even Sharper Trend in the Federal Debt as Percent of GDP

Graphic adapted from: CBO, Long Term Budget Outlook, revised August 2010, p. 69
CBO Longer Term Estimate of Trend in the Federal Debt Provides Even More Serious Warning

Graphic adapted from: CBO, Long Term Budget Outlook, revised August 2010, p. 69
Interest Payments Could Pose a Major Burden

- As public debt rises, the annual quantity of interest payments increases.

- Consequently, the CBO predicts that interest payments on public debt as a share of GDP will increase exponentially over the next 40 years.

- The OMB predicts that by FY 2018 the government will spend more money just paying debt interest than it will on the entire Defense budget.

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US Defense Burden on GDP is Limited: Especially in Comparison with the Cold War


No strain on US economy by historical standards, even if spending rise by 1-2% (FY 2010 level at 4.9%)

CBO Projected Reduced Burden on GNP Before Current Cuts

But, CBO Has Warned in the Past That Budget Pressures Could Lead to Deep Cuts in Defense Spending

Defense Spending as % of GDP

Graphed based on figures and observations from: CBO. *Long-Term Implications of the Department of Defense’s Fiscal Year 2010 Budget Submission.*
Defense Spending Puts Little Pressure on Overall Trends Within the Baseline Federal Budget
The Bulk of US Federal Spending is not on Defense

(Trend in Total Spending in FY 2005 $US Billions)

Defense Outlays are Limited Relative to Other Titles
(Trend by Category in FY 2005 $US Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Defense</th>
<th>Veterans, Space, Internat'l</th>
<th>Net Interest</th>
<th>Social &amp; Economic</th>
<th>Undistributed Offsetting Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>461</td>
<td>82</td>
<td>256</td>
<td>1,100</td>
<td>-67</td>
</tr>
<tr>
<td>1995</td>
<td>376</td>
<td>87</td>
<td>284</td>
<td>1,216</td>
<td>-65</td>
</tr>
<tr>
<td>2000</td>
<td>361</td>
<td>77</td>
<td>251</td>
<td>1,405</td>
<td>-53</td>
</tr>
<tr>
<td>2005</td>
<td>495</td>
<td>128</td>
<td>184</td>
<td>1,730</td>
<td>-65</td>
</tr>
<tr>
<td>2006</td>
<td>499</td>
<td>119</td>
<td>219</td>
<td>1,792</td>
<td>-66</td>
</tr>
<tr>
<td>2007</td>
<td>509</td>
<td>120</td>
<td>223</td>
<td>1,789</td>
<td>-76</td>
</tr>
<tr>
<td>2008</td>
<td>549</td>
<td>129</td>
<td>232</td>
<td>1,872</td>
<td>-78</td>
</tr>
<tr>
<td>2009</td>
<td>580</td>
<td>148</td>
<td>169</td>
<td>2,371</td>
<td>-82</td>
</tr>
<tr>
<td>2010</td>
<td>626</td>
<td>187</td>
<td>168</td>
<td>2,404</td>
<td>-70</td>
</tr>
<tr>
<td>2011</td>
<td>644</td>
<td>186</td>
<td>222</td>
<td>2,395</td>
<td>-79</td>
</tr>
<tr>
<td>2012</td>
<td>577</td>
<td>186</td>
<td>299</td>
<td>2,259</td>
<td>-77</td>
</tr>
<tr>
<td>2013</td>
<td>549</td>
<td>195</td>
<td>374</td>
<td>2,283</td>
<td>-80</td>
</tr>
<tr>
<td>2014</td>
<td>548</td>
<td>200</td>
<td>431</td>
<td>2,365</td>
<td>-80</td>
</tr>
<tr>
<td>2015</td>
<td>551</td>
<td>205</td>
<td>474</td>
<td>2,432</td>
<td>-82</td>
</tr>
</tbody>
</table>

Drop in Baseline Defense Budget as a Percent of Total Federal Outlays

DOD Funding and Total National Defense Spending Track Closely
(Percentages of Indicated Totals Measured in Budget Outlays)

US Leads the Rise in Military Spending, But Other Countries Present a Challenge

Potential competitors, such as China and Russia, almost doubled their spending on defense in recent years.

These increases were tied to the dramatic economic growth during this period (not pictured).

Moreover, Defense Spending is on the Rise in Most Regions

This graph shows the growth rates of military expenditure for the world and different regions. Thus, all are shown as starting at 100 in 2000. The height of each line after this shows how much military spending has increased.

Competitors, such as China and Russia, almost doubled their spending on defense in the recent years.

These increases were tied to the dramatic economic growth during this period (not pictured).

Key Trends and Challenges in Defense Spending
Challenges Facing the Administration

- Estimating, effectively budgeting, and efficiently paying for costs of national security
- Determining whether the burden on federal spending and the GDP is acceptable, given the threats facing the US and economic crisis.
- Balancing the interaction between national security spending and the overall fiscal squeeze driven by rising mandatory spending and entitlement costs.
- Estimating the true costs of the Overseas Contingency Operations and funding them manageably, without the need for emergency appropriations.
- Bring the overall pattern of operations and support into a well managed and affordable path.
- Make such a path manageable when dealing with different levels of force-sizing.
- Dealing with a cost-escalation crisis in defense manpower.
- Managing the problem of escalating military medical costs.
- Properly funding O&M and reset costs.
- Dealing with a major crisis in defense procurement and the failure to manage military modernization.
The Defense Budget over Time

DOD Budget Authority Nearly Doubled in Real Terms at Peak of War Costs

A Long Pattern of Top-line Instability: Heritage Foundation Estimate

DOD Budget Projections

KEY POINTS:
1. DOD funding nearly doubled in real terms to fund wartime needs since Clinton Era lows.
2. Funding growth is due to both direct war costs and to growth in the Base Defense budget.
3. Current DOD and CBO projections of Defense spending for the out years predict a significant decrease in Defense spending in FY 2012, followed by slow, gradual long-term real growth.
4. DOD and CBO projections are predicated on assumptions of reduced activity levels in Iraq and Afghanistan, but do not take into account alternative scenarios in which current activity levels are sustained or even increased.

ANALYSIS: DOD and CBO projections of Defense spending in the out years may be unrealistic in practice. The Administration has stated that draw-down and withdrawal of troops from Afghanistan will begin in the summer of 2011, but simultaneously stated that the specifics of such a draw-down are predicated upon the conditions on the ground.
Consequently, DOD and CBO projections may potentially understate Defense spending growth and/or overstate the reduction of Defense spending post-Afghan “Surge.”
Coming evaluations of Defense costs in the out years will be important to both the Administration for prioritizing amongst other competing fiscal concerns, such as President Obama’s state goal of reducing the federal deficit.
Moreover, Administration’s decisions on Afghan War will shape Defense’s effort to budget for either continued operations in Afghanistan or contingency operations elsewhere.
Defense Usually Underestimates Costs

Current Baseline Budget Requests Won’t Meet Real Defense Needs

- Until FY 2010, the future year defense budget did not fund OEF, OIF, and other OCO titles in the out-years and continued to rely on un-estimated supplementals. This is a continuing problem. The cost projections for the future of OCO could be wholly unrealistic for FY 2011 onwards.

- Future year defense budgets are based on cost and program estimates that do not include future needed programs and historically minimize apparent cost. CBO numbers are already obsolete.

- The current FYDP does not seem to fund the expansion or real-world cost of military and civilian manpower, and separates veterans costs from defense costs. The problem is compounded by Congress’s inability to control these costs and fund OCO or O&M titles appropriately.

- Military medical costs present a key problem -- but then so do civilian medical costs.

- Future procurement costs are underestimated and every service faces a crisis in affordability and cost constraint in spite of Gate’s program cuts.

- No service has a credible program for shaping and maintaining its present forces and or/force goals.

- There is no clear way to model true future year costs. Lack of a meaningful FYDP presents exceptional problem for outside analysis.
The Impact of War Fighting
The Total Cost of Previous Wars

(In Billions of $US Dollars)

<table>
<thead>
<tr>
<th></th>
<th>Actual Dollars</th>
<th>2008 Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>World War I</td>
<td>20</td>
<td>253</td>
</tr>
<tr>
<td>World War II</td>
<td>296</td>
<td>4114</td>
</tr>
<tr>
<td>Korea</td>
<td>30</td>
<td>320</td>
</tr>
<tr>
<td>Vietnam</td>
<td>111</td>
<td>686</td>
</tr>
<tr>
<td>Total Post 9/11: Iraq, Afghanistan and the GWOT</td>
<td>809</td>
<td>859</td>
</tr>
</tbody>
</table>

Graph adapted from data provided in “Costs of Major U.S. Wars” by the Congressional Research Service. July 2008, pg. 2
The Declining Economic Burden of War

Spending as a Percent of GDP in Previous Conflicts and Crises

The Burden of “Hot” vs. “Cold” War

Defense Spending as a Percentage of Total Federal Outlays

Afghan War Costs Rise as Iraq War Cost Drops: FY2001-FY2011

Annual and Cumulative Total Spending on the Iraq and Afghan Wars: FY2001-FY2011

Relative Annual and Cumulative Total Spending on the Iraq and Afghan Wars: FY2001-FY2011

The Other Defense (Wartime) Budget: Homeland Security Funding: FY2010-FY2011

(BA in Current $US Billions)

<table>
<thead>
<tr>
<th></th>
<th>FY09 Enacted</th>
<th>FY09 Supplemental/Emergency</th>
<th>FY10 Enacted</th>
<th>FY10 Supplemental/Emergency</th>
<th>FY11 Request</th>
</tr>
</thead>
<tbody>
<tr>
<td>DoD</td>
<td>19,413.50</td>
<td>69.4</td>
<td>19,040.60</td>
<td>241.5</td>
<td>19,103.00</td>
</tr>
<tr>
<td>Total Non-DoD</td>
<td>43,520.60</td>
<td>3,473.50</td>
<td>43,087.10</td>
<td>241.5</td>
<td>44,998.10</td>
</tr>
<tr>
<td>Total</td>
<td>*70,945.3</td>
<td>*3,550.8</td>
<td>*70,829.2</td>
<td>*241.5</td>
<td>*75,512.4</td>
</tr>
</tbody>
</table>

Annual and Cumulative Spending by Agency on the Afghan War: FY2001-FY2011

--Fail to react to insurgency until FY06.
--Only seriously react in FY10, near doubling FY09 total.
--State/Aid (civil) side of spending on "population-centric" war remains minimal

The “Guns to Butter Ratio:” Comparative Spending by Agency on the Afghan War: FY2001-FY2011

Impact of Supplementals on DoD Budget: FY1999-FY2009
(in $US billions)

Projected Cost of War to DoD: FY2010-FY2011

(in $US billions)

**Overseas Cost by War**

<table>
<thead>
<tr>
<th></th>
<th>FY 2010 Enacted</th>
<th>FY 2010 Supplemental</th>
<th>FY 2010 Total</th>
<th>FY 2011 Request</th>
<th>Delta '10-'11</th>
<th>Percent Change '10-'11</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCO Budget</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operation Iraqi Freedom (OIF)</td>
<td>56.1</td>
<td>1.0</td>
<td>59.1</td>
<td>43.4</td>
<td>-15.7</td>
<td>-26.6%</td>
</tr>
<tr>
<td>Operation Enduring Freedom (OEF)</td>
<td>67.4</td>
<td>28.8</td>
<td>96.2</td>
<td>110.3</td>
<td>+14.1</td>
<td>+14.7%</td>
</tr>
<tr>
<td>Baseline Fuel</td>
<td>—</td>
<td>2.0</td>
<td>2.0</td>
<td>—</td>
<td>-2.0</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Total</td>
<td>125.5</td>
<td>31.8</td>
<td>157.3</td>
<td>153.7</td>
<td>-3.6</td>
<td>-2.3%</td>
</tr>
<tr>
<td>Non-DoD Classified and Other</td>
<td>4.1</td>
<td>1.2</td>
<td>5.3</td>
<td>5.6</td>
<td>+0.3</td>
<td>+5.7%</td>
</tr>
<tr>
<td>Total</td>
<td>129.6</td>
<td>33.0</td>
<td>162.6</td>
<td>159.3</td>
<td>-3.3</td>
<td>-2.0%</td>
</tr>
</tbody>
</table>

*Note: Data shown is notional and will change during execution. Numbers may not add due to rounding.*

**Overseas Cost by Functional Category**

<table>
<thead>
<tr>
<th></th>
<th>FY 2010 Enacted</th>
<th>FY 2010 Supplemental</th>
<th>FY 2010 Total</th>
<th>FY 2011 Total</th>
<th>Delta '10-'11</th>
<th>Percent Change '10-'11</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCO Budget</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operations</td>
<td>74.5</td>
<td>19.0</td>
<td>93.5</td>
<td>89.4</td>
<td>-4.1</td>
<td>-4.4%</td>
</tr>
<tr>
<td>Force Protection</td>
<td>15.2</td>
<td>3.3</td>
<td>18.5</td>
<td>12.0</td>
<td>-6.5</td>
<td>-35.1%</td>
</tr>
<tr>
<td>IED Defeat</td>
<td>1.8</td>
<td>0.4</td>
<td>2.2</td>
<td>3.3</td>
<td>+1.1</td>
<td>+50.0%</td>
</tr>
<tr>
<td>Military Intelligence Program</td>
<td>4.6</td>
<td>1.3</td>
<td>5.9</td>
<td>7.0</td>
<td>+1.1</td>
<td>+18.6%</td>
</tr>
<tr>
<td>Iraq Security Forces</td>
<td>—</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>+1.0</td>
<td>+100.0%</td>
</tr>
<tr>
<td>Afghan National Security Forces</td>
<td>6.6</td>
<td>2.6</td>
<td>9.2</td>
<td>11.6</td>
<td>+2.4</td>
<td>+26.1%</td>
</tr>
<tr>
<td>Coalition Support</td>
<td>1.9</td>
<td>—</td>
<td>1.9</td>
<td>2.0</td>
<td>+0.1</td>
<td>+5.3%</td>
</tr>
<tr>
<td>CERP</td>
<td>1.2</td>
<td>—</td>
<td>1.2</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Military Construction</td>
<td>1.4</td>
<td>0.5</td>
<td>1.9</td>
<td>1.2</td>
<td>-0.7</td>
<td>-36.8%</td>
</tr>
<tr>
<td>Reconstitution/Reset</td>
<td>17.0</td>
<td>1.7</td>
<td>18.7</td>
<td>21.3</td>
<td>+2.6</td>
<td>+13.9%</td>
</tr>
<tr>
<td>Army End Strength</td>
<td>1.0</td>
<td>—</td>
<td>1.0</td>
<td>2.1</td>
<td>+1.1</td>
<td>+110.0%</td>
</tr>
<tr>
<td>Navy End Strength</td>
<td>0.4</td>
<td>—</td>
<td>0.4</td>
<td>0.5</td>
<td>+0.1</td>
<td>+25.0%</td>
</tr>
<tr>
<td>Baseline Fuel</td>
<td>—</td>
<td>2.0</td>
<td>2.0</td>
<td>—</td>
<td>-2.0</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Total</td>
<td>125.6</td>
<td>31.8</td>
<td>157.4</td>
<td>153.7</td>
<td>-3.7</td>
<td>-2.4%</td>
</tr>
<tr>
<td>Non-DoD Classified</td>
<td>4.1</td>
<td>1.2</td>
<td>5.3</td>
<td>5.6</td>
<td>+0.3</td>
<td>+5.7%</td>
</tr>
<tr>
<td>Total</td>
<td>129.6</td>
<td>33.0</td>
<td>162.6</td>
<td>159.3</td>
<td>-3.3</td>
<td>-2.0%</td>
</tr>
</tbody>
</table>

FY 2010 War Funding Request

Support the Troops in the Field
FY 2010 Overseas Contingency Operations
(Dollars in Billions)

- Continuing the Fight: $108.5B
- Operations: $74.1B
- Non-DoD Classified: $3.9B
- Reconstitution: $17.6B
- Force Protection: $15.2B
- IED Defeat: $1.5B
- Military Intelligence: $4.7B
- Afghan National Security Forces: $7.5B
- Pakistan COIN Capability: $0.7B
- Coalition Support: $1.9B
- CERP: $1.5B
- Military Construction: $1.4B

$130.0B

FY 2011 War Funding Request

- FY 2011 OCO funding still placed in supplemental request but submitted alongside FY 2011 budget
- FY 2011 OCO supplemental request significantly larger than FY 2010 OCO funding request, suggesting the DOD is making greater efforts to reduce reliance on mid-year “emergency” funding as per the Administration’s request.

Ending Conflicts Could Lower the Baseline Budget

A High Cost Guesstimate of Strategic Partnership: FY2011-FY2015 (in $US billions)

<table>
<thead>
<tr>
<th></th>
<th>FY10 Enacted</th>
<th>FY10 Total w Request</th>
<th>FY11 Request</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
<th>Cum -FY01 FY10</th>
<th>Cum -FY01 FY10 w</th>
</tr>
</thead>
<tbody>
<tr>
<td>State &amp; AID</td>
<td>1.6</td>
<td>3.7</td>
<td>3.9</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>37.4*</td>
<td>43.4*</td>
</tr>
<tr>
<td>VA Medical</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.14</td>
<td>5.1*</td>
<td>6.5*</td>
</tr>
<tr>
<td>DoD</td>
<td>59.6</td>
<td>60.6</td>
<td>45.8</td>
<td>23</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>705.2*</td>
<td>752.0*</td>
</tr>
<tr>
<td>Total</td>
<td>62.8*</td>
<td>65.8*</td>
<td>51.1*</td>
<td>25*</td>
<td>12.4*</td>
<td>12.4*</td>
<td>12.4*</td>
<td>747.6*</td>
<td>801.9*</td>
</tr>
</tbody>
</table>

- State maintains 5 facilities and provides security.
- State takes over police training support.
- No US combat role after FY2011.
- US provides FMS aid to Iraqi forces to give defense capability against Iran

Guesstimate of Annual and Cumulative Cost of “Worst Cost” Success in the Afghan War: FY2010-FY2020
(In Current $US Billions)

--Extremely intense fighting with dropping allied support.
--"Supplemental" in FY2010
--Make decisive gains by FY15.
--US and ISAF withdrawal cautiously during FY15-FY17
--Fully fund ANSF and civil programs through withdrawal

--Maintain significant support funding of Afghan forces and government through FY2020 & beyond

--DoD pays cost of police as well as armed forces, and protection of remaining civil & military advisory presence though FY2020.

Trends in the FY2011 Budget
An Overview of the FY 2011 DOD Budget Request

KEY POINTS:

1. DOD’s total budget request only increased marginally in real terms over FY 2010
2. FY 2011 base budget request calls for an increase in expenditures on military personnel, O&M and procurement at the cost of all other titles
3. O&M cost escalation since the beginning of GWOT related operations in 2001 have led to significant increases in per soldier costs, which exceed per DOD civilian costs as of FY 2003
4. At present, much of this per soldier cost escalation is due to factors related to the high OPTEMPO in Iraq and Afghanistan
Structural Changes for FY 2011

- For the most part, the FY 2010 budget request continues the limited rebalancing and reform measures initiated in FY 2011

**FY 2011 Requested BA by Department, Total: 530.7 $US Billion**

- Defense-Wide: 94.9 ($US Billion) 17%
- Army: 143.4 ($US Billion) 26%
- Air Force: 150 ($US Billion) 28%
- Navy: 160.6 ($US Billion) 29%

**FY 2011 Requested BA by Title, Total: 530.7 $US Billion**

- Military: 138.5
- Operation and Maintenance: 200.3
- Procurement: 112.9
- RDT&E: 76.1
- Military Construction: 16.9
- Family Housing: 1.8
- Revolving Funds: 2.4

DoD Budget Reflects Significant Near Term Turbulence in Discretionary Spending By Service and Program

<table>
<thead>
<tr>
<th>Service</th>
<th>FY 2010 Enacted</th>
<th>FY 2011 Request</th>
<th>Delta '10-'11</th>
<th>Percent Change '10-'11</th>
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<tbody>
<tr>
<td>Army</td>
<td>139.7</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>530.7</strong></td>
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<td><strong>3.4%</strong></td>
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Numbers may not add due to rounding

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<tr>
<th>Base Budget</th>
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<tr>
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<tr>
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<td><strong>Total</strong></td>
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<td><strong>548.9</strong></td>
<td><strong>+18.2</strong></td>
<td><strong>3.4%</strong></td>
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Numbers may not add due to rounding

The FY 2011 Base Budget Request by Service

Department of the Army Discretionary BA by Title

<table>
<thead>
<tr>
<th>Title</th>
<th>FY 2010, Total 139.6</th>
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Department of the Navy Discretionary BA by Title

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<td>Military Construction</td>
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The FY 2011 Base Budget Request by Service

Air Force Discretionary BA by Title

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<td>RDT&amp;E</td>
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<td>Procurement</td>
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<tr>
<td>Military Personnel</td>
<td>33.1</td>
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Defense-wide Discretionary BA by Title

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<td>94.9</td>
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<tr>
<td>Family Housing</td>
<td>1.3</td>
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<td>Military Construction</td>
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<tr>
<td>RDT&amp;E</td>
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<td>4.2</td>
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<tr>
<td>Procurement</td>
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<td>20.9</td>
</tr>
<tr>
<td>Operation and Maintenance</td>
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<td>4.3</td>
</tr>
<tr>
<td>Military Personnel</td>
<td>59.9</td>
<td>64.1</td>
</tr>
</tbody>
</table>

Gate’s Strategy for $100 Billion in Savings Over 5 Years and “Spending Less in the Future”

Defense Department’s plan to cut costs and improve efficiency.
Key Challenges

- Current economic crisis -- “war fatigue,” domestic priorities first
- Dealing with the growth of national debt
- Balancing national security costs in the face of a major fiscal squeeze in the coming years, as “Mandatory” Spending and Entitlement lines on the Federal Budget dramatically increase;
- Creating a meaningful approach to national security by approaching all aspects of national security planning holistically.
- Politically entrenched Pentagon programs.
Key Tasks in Meeting These Challenges

- Determining accurate costs for Overseas Contingency Operations (OCO), and budgeting for them appropriately;
- Developing a proper approach, with appropriate long-term cost resources for: Operation Enduring Freedom (OEF), Operation Iraqi Freedom (OIF), and the Global War on Terror (GWOT);
- Planning affordable levels of readiness while funding increases in Operations & Maintenance (O&M) costs originating from OCO “reset” needs paired with demands on military health care;
- Setting affordable goals for restructuring of defense manpower, and dealing with over-deployment, rising mandatory spending, and dependence upon contractors;
- Ending the “liar’s contest” in defense procurement, and providing an affordable solution to meeting a services-wide need for a modernization of equipment in a well-defined strategic framework tied to specific threats and mission priorities;
- Avoiding over-funding entitlements like military healthcare at the cost of underfunding OCO costs
Avoiding over-optimistic budgeting assumptions:

- The future will be better, as *budgets will grow faster with continued economic growth*;
- *Investment spending will be able to rise faster as O&M costs grow more slowly*;
- *Procurement costs will decrease as production rates increase due to a “learning curve”*—weapons manufacturers get more efficient at producing weapons as time elapses—and thus, procurement process as a whole gets more efficient with time.

- Estimating, accounting for and halting cost escalation in budget titles such as Defense health care and procurement
- Holding defense contractors responsible for unexpected cost escalation in weapons acquisition programs
- Reprioritizing weapons acquisition portfolios and strategies to reflect future asymmetric and anti-access threats rather than Cold War threats
Prior Cuts for FY2010

• C-17 Airlifter. Terminated
• F-22 stealth fighter. Terminated.
• Future Combat Systems. Slashed.
• Multiple Kill Vehicle. Dead.
• Kinetic Energy Interceptor. Eliminated.
• Airborne Laser. Truncated.
• Combat search and rescue helicopter. Killed.
• Presidential helicopter. Terminated.
The Gates’ Guidance Roadmap

Target Affordability and Control Cost Growth
- Mandate affordability as a requirement
  - At Milestone A set affordability target as a Key Performance Parameter
  - At Milestone B establish engineering trades showing how each key design feature affects the target cost
- Drive productivity growth through Will Cost/Should Cost management
- Eliminate redundancy within warfighter portfolios
- Make production rates economical and hold them stable
- Set shorter program timelines and manage to them

Incentivize Productivity & Innovation in Industry
- Reward contractors for successful supply chain and indirect expense management
- Increase the use of FPIF contract type where appropriate using a 50/50 share line and 120 percent ceiling as a point of departure
- Adjust progress payments to incentivize performance
- Extend the Navy’s Preferred Supplier Program to a DoD-wide pilot
- Reinvigorate industry’s independent research and development and protect the defense technology base

Improve Tradecraft in Services Acquisition
- Create a senior manager for acquisition of services in each component, following the Air Force’s example
- Adopt uniform taxonomy for different types of services
- Address causes of poor tradecraft in services acquisition
  - Assist users of services to define requirements and prevent creep via requirements templates
  - Assist users of services to conduct market research to support competition and pricing
  - Enhance competition by requiring more frequent re-compete of knowledge-based services
  - Limit the use of time and materials and award fee contracts for services
  - Require that services contracts exceeding $1B contain cost efficiency objectives
- Increase small business participation in providing services

Reduce Non-Productive Processes and Bureaucracy
- Reduce the number of OSD-level reviews to those necessary to support major investment decisions or to uncover and respond to significant program execution issues
- Eliminate low-value-added statutory processes
- Reduce by half the volume and cost of internal and congressional reports
- Reduce non-value-added overhead imposed on industry
- Align DCMA and DCAA processes to ensure work is complementary
- Increase use of Forward Pricing Rate Recommendations (FPRRs) to reduce administrative costs

Promote Real Competition
- Present a competitive strategy at each program milestone
- Remove obstacles to competition
  - Allow reasonable time to bid
  - Require non-certified cost and pricing data on single offers
  - Require open system architectures and set rules for acquisition of technical data rights
- Increase dynamic small business role in defense marketplace competition
Carter Objectives*

- Deliver the warfighting capability we need for the dollars we have
- Get better buying power for warfighter and taxpayer
- Restore affordability to defense goods and services
- Improve defense industry productivity
- Remove government impediments to leanness
- Avoid program turbulence
- Maintain a vibrant and financially healthy defense industry

Obtain 2-3% net annual growth in warfighting capabilities without commensurate budget increase by identifying and eliminating unproductive or low-value-added overhead and transfer savings to warfighting capabilities. Do more without more.

From September 15, 2010 Speech by Ashton B. Carter, Under Secretary of Defense for Acquisition, Technology, and Logistics (AT&L)
Gates Cuts Bottom Lines

- Key pressures are economy, deficit, domestic politics.
- Driven more by search for savings than any strategy or QDR-related issues.
- This is only an interim step. Next year’s war and politics critical -- deficit and entitlements could force back to Clinton lows in real dollars.
- Current goal is $100 billion savings over five years actually gave DoD a higher outyear mark than OMB proposed.
  - Affects $400 Billion of $700 billion Defense budget.
  - $200B for contracts for goods (weapons, electronics, fuel, facilities, etc.)
  - $200B for contracts for services (IT, maintenance, facilities upkeep, knowledge-based.)
- Assumes still spend over $50 billion on new procurement programs in FY11-FY15 with total value of over $200 billion.
- Cost containment or else
- Laid out in detail in memos of June 28th and September 15th
Target Affordability and Control Growth of Costs

- Require affordability.
- Increase productivity using “will cost/should cost” management.
- Eliminate redundancy in war fighter portfolios.
- Make production rates economical and hold them stable.
- Set shorter program timelines and manage according to them.
Create Incentives for Productivity and Innovation in Industry

- Reward contractors for successful expense management.
- Increase use of “fixed-price incentive firm” contract type where appropriate, using 50-50 share line and 120 percent ceiling as point of departure.
- Adjust progress payments to create performance incentive.
- Extend Navy’s Preferred Supplier Program to department-wide pilot program.
- Reinvigorate industry’s independent research and development, and protect defense technology base.
Providing Incentives for Greater Efficiency in Industry

• LEVERAGING REAL COMPETITION: Avoid directed buys and other substitutes for real competition. Use technical data packages and open systems architectures to support a continuous competitive environment.

• USING PROPER CONTRACT TYPE FOR DEVELOPMENT AND PROCUREMENT: Phase out award-fee contracts and favor fixed-price or cost-type incentive contracts in which government and industry share equally in overruns and underruns, and overruns have analytically-based caps. Use cost-reimbursement contracts only when either government requirements or industry processes cannot be adequately specified to support pricing. Adjust sole-source fixed-price contracts over time to reflect realized costs. Work down undefined contract actions. Seek authority for multi-year contracts where significant savings are possible.

• USING PROPER CONTRACT TYPE FOR SERVICES: Phase out Time and Material and sole source ID/IQ contracts wherever possible. Utilize fixed-price performance-based contracts when requirements are firm and can be measured, with payments tied to performance. Utilize fixed-price level of effort or cost-plus-fixed-fee contracts (with profit/fee tied to weighted guidelines) when requirements are still being defined. Award fees should be used only by exception. Maximize the use of multiple-source, continuously competitive contracts.

• ALIGNING POLICY ON PROFIT AND FEE TO CIRCUMSTANCE: Align opportunity to earn profits/fees to both value to the taxpayer and risk to the contractor. Apply weighted guidelines to profit/fee levels. Reward higher productivity with higher profits. Incentivize investment in innovation.

• SHARING THE BENEFITS OF CASH FLOW: Ensure that taxpayers receive adequate consideration (price reductions) for improved cash flows. Progress payments must reflect performance but can be increased above customary levels in return for consideration by the contractor. Reduce over time the gap between proposed and actual rates in forward price rate agreements.

• TARGETING NON-VALUE-ADDED COSTS: Identify and eliminate non-value-added overhead and G&A charged to contracts. Limit fees for subcontractor management to reflect actual value provided (risk assumed by prime and continuous subcontractor risk reduction). Limit B&P allowable costs in sole source contracts and encourage effective use of IRAD.

• INVOLVING DYNAMIC SMALL BUSINESS IN DEFENSE: When establishing multiple award contracts for services, make every effort to provide for small business participation. If at least two small businesses are deemed capable of performing on such a contract, consider setting aside that work for competition among them.

• REWARDING EXCELLENT SUPPLIERS: Emulate the Navy’s pilot program to provide special benefits to consistently excellent industrial performers.
Promote Real Competition

- Present a competitive strategy at each program milestone.
- Remove obstacles to competition.
- Increase the dynamic small business role in defense marketplace competition.
Improving Tradecraft in Services Acquisition

- Create a senior manager for services acquisition in each component.
- Adopt uniform classification for different types of services.
- Address the causes of poor tradecraft.
- Increase small business participation in providing services.
Reduce Non-Productive Processes and Bureaucracy

- Reduce number of Secretary of Defense office-level reviews to those needed to support major investment decisions or uncover and respond to significant program execution issues.
- Eliminate low-value-added statutory processes.
- Reduce by half the volume and cost of internal and congressional reports.
- Reduce non-value-added overhead imposed by industry.
- Align processes in agencies for contract management and audit to ensure work is complementary.
- Increase use of “forward pricing rate recommendation” to reduce administrative costs.

Source: Department of Defense
Adopting Government Procedures that Encourage Efficiency

• ADOPTING “SHOULD-COST” AND “WILL-COST” MANAGEMENT: Use historically informed independent cost estimation (“will-cost” estimates) to inform managing of programs to cost objectives (“Should-cost estimates).

• STRENGTHENING THE ACQUISITION WORKFORCE: Achieve SECDEF goal of adding to government acquisition workforce with increased skill levels. Leverage unique qualities of non-profit FFRDCs and UARCs to augment acquisition workforce capability.

• IMPROVING AUDITS: Improve consistency and quality of government audits, and focus them on value-added content.

• MANDATING AFFORDABILITY AS A REQUIREMENT: In new programs such as the SSBN-X nuclear missile submarine, the Presidential Helicopter, the Ground Combat Vehicle, and the Air Force/Navy Long Range Strike Family of Systems, cost considerations must shape requirements and design.

• STABILIZING PRODUCTION RATES: To ensure more programs are in stable economically favorable rates of production and avoid cost escalation, program managers may not adjust production rates downward without head of component authority.

• ELIMINATING REDUNDANCY WITHIN WARFIGHTING PORTFOLIOS: Emulate the Army’s Precision Fires Capability Portfolio approach to identify where multiple programs are pursuing similar objectives.

• ESTABLISHING SENIOR MANAGERS FOR PROCUREMENT OF SERVICES: Follow the Air Force lead in establishing a Program Executive Officer for services in each DOD component to focus on improving policy and practice in this high-dollar-value area.

• PROTECTING THE TECHNOLOGY BASE: Protect the future by sustaining investment while focusing on high value-added work.
Key Trends in the Budget: Why Major Procurement Programs are Under So Much Pressure
The Procurement and Modernization Challenge

KEY POINTS:

1. Many DOD procurement programs still reflect Cold War era acquisition requirements rather than the capabilities needed to execute new missions such as CT, CS and humanitarian operations.

2. Moreover, rampant cost growth and long time delays have become the norm for DOD procurement programs.

3. Secretary of Defense has cut a number of “unnecessary” programs.

4. The DOD has often attempted to fudge its way out of procurement problems by cutting RDT&E funding and slipping procurement funding into the outyears.

5. In turn, procurement program failures and inefficiencies may lead reset crises as the military needs to repair and refit degraded capital as well as investment crisis as the military may in the near future find itself without the capabilities it requires to fulfill its missions.
Legacy of Cold War Programs and Past Efforts At Force Transformation that Are Fundamentally Unaffordable

- **Legacy Problems**
  - FCS.
  - Ship building.
  - Aircraft
  - Net and IT Systems: Agency-wide
  - Space

- **New Requirements**
  - Counterterrorism
  - Counterinsurgency
  - Stability/Humanitarian Operations
  - Cyber-warfare
Major Weapons Program Cost Escalation

- From FY2001 to FY2007, the DOD has doubled its planned investments from $750 billion to $1.6 trillion.

- In a review of 72 major weapons programs, GAO found that their cost has grown by 26% since the first estimate. The cost of the 72 programs in FY2007 portfolio was $295 billion more than had been projected initially.

- DOD’s annual investment in RDT&E and procurement of major weapon systems is at its highest level in two decades. Over the next five years, the DOD plans to invest $900 billion with more than $335 billion, or 37% going to new major weapon systems.

- Even though for the period 2000-2006 defense spending accounts grew at an annual average of a 5.4%, DOD projects that for the 2008-2012 period the growth rate will be -8.5%!

- The same programs have also experienced an increase in the time needed to deliver initial capabilities. The average schedule delay has risen from 16 months in FY 2000 to 17 and 21 months in FY 2005 and FY 2007, respectively.

Weapons Systems: Budget Request by Title

Weapons Systems: Budget Request by Title

FY 2011 Missile Defense – Base and OCO: $9.9B

Tactical Ballistic Missile Defense $6.2
Ballistic Missile Defense System $3.7

Source: FY 2011 PRCP – Investment Categorization
Note: $0.9B includes the Missile Defense Agency $0.2B for BRAC and Science and Technology (S&T).

Numbers may not add due to rounding

FY 2011 Space Based and Related Systems – Base and OCO: $9.9B

Support $2.6
$1.3 Launch
Satellites $6.0

Source: FY 2011 PRCP – Investment Categorization
Numbers may not add due to rounding

Weapons Systems: Budget Request by Title

FY 2011 Ground Programs – Base and OCO: $23.3B

- Weapons: $1.0B
- Combat Vehicles: $2.6B
- Heavy Tactical Vehicles: $4.4B
- Light Tactical Vehicles: $1.5B
- Medium Tactical Vehicles: $1.6B

Source: FY 2011 PRCP – Investment Categorization
Numbers may not add due to rounding

FY 2011 Shipbuilding and Maritime Systems – Base and OCO: $25.1B

- Outfitting and Post Delivery: $0.3B
- Submarine Combatant: $6.4B
- Technology Development: $2.7B
- Support: $2.6B
- Surface Combatant: $12.3B
- Support Ships: $0.8B

Source: FY 2011 PRCP – Investment Categorization
Support ship subcategory includes MLP ship in the National Defense Sealift Fund (NDSF)
Numbers may not add due to rounding

The GAO estimates that 60 of the 72 programs assessed had to reset their business case at least once because they lacked necessary knowledge to reasonably estimate the cost and time it would take to develop and produce the product.

GAO estimates the cost growth of the major defense acquisitions programs to be $42 billion in the FY 2000 portfolio, $202 billion and $295 billion in the FY 2005 and FY 2007 portfolios, respectively.

Roughly half of the assessed programs show more than 25 percent growth in program acquisition unit cost.

The total RDT&E cost of the FY 2007 major acquisition program portfolio changed by 40 percent from the first cost estimate.

Top 25 MDAPs by Total Acquisition Cost

Source: December 2009 Selected Acquisition Report Summary Tables; Joint Strike Fighter Nunn-McCurdy Certification, June 1, 2010; analysis by CSIS Defense-Industrial Initiatives Group
Delays Became the Rule and Not the Exception

Note: This reflects planned or actual delivery of initial capabilities for programs with comparable schedule data.

Procuring Defense to Death: “Transformational” Cost Escalation
(Measured as Percent Rise in Unit Cost by Program)

From 2001 to the present, the DoD has doubled its planned investments from $750 billion to $1.5 trillion.

The Need for Success and Cost Containment in Major Weapons Programs

- Weapon systems comprise one of the largest discretionary items in the federal budget, and will face pressure from rising mandatory spending obligations.
- Weapon systems face competing demands from other DOD priorities, i.e. operations in Afghanistan and Iraq.
- Weapons programs now take far longer to develop and deploy and cost far more to buy, than is acceptable:
  - Future Combat Systems costs have escalated 54% to $131 billion since the program started.
  - F-22A Raptor program unit costs have escalated 177% while the quantity to be procured has decreased by 71%.
  - The unit cost of the extended range guided munitions programs have escalated 94% while the quantity to be procured has decreased by 76%.
  - The cost of the SBIRS-High program has escalated 149% in eight years.
  - Services, contractors, and DOD are trapped in a mutually destructive “liar’s contest” to out promise competing programs, branches, and services.
## Examples of Key Program Management Failures

<table>
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<tr>
<th>Program</th>
<th>Initial Investment ($US billions)</th>
<th>Initial Quantity</th>
<th>Latest Investment ($US billions)</th>
<th>Latest Quantity</th>
<th>% Unit Cost Change</th>
<th>% Quantity Change</th>
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<td>Joint Strike Fighter</td>
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<td>2,866</td>
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<td>2,458</td>
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<td>Future Combat System</td>
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<td>15</td>
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<tr>
<td>F-22A Raptor</td>
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<td>5.9</td>
<td>173</td>
<td>160</td>
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<td>Evolved Expendable Launch Vehicle</td>
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<td>Space-Based Infrared System High</td>
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<td>Expeditionary Fighting Vehicle</td>
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Defense Acquisition Programs Recommend for Termination

<table>
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<tr>
<th>System</th>
<th>Total estimated cost (dollars in billions)</th>
<th>Secretary's comments</th>
<th>Congressional action</th>
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<tbody>
<tr>
<td>Recommended termination</td>
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<td>Conferees recommended $100 million for technology capture that DOD has budgeted for the VH-71 program.</td>
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<tr>
<td>VH-71 Presidential Helicopter</td>
<td>$13</td>
<td>Plan to develop options for a new program</td>
<td>Did not authorize appropriations for the program.</td>
</tr>
<tr>
<td>Combat Search and Rescue Helicopter</td>
<td>Unspecified</td>
<td>Plan to reexamine requirements</td>
<td>Did not authorize appropriations for the program.</td>
</tr>
<tr>
<td>Next-Generation Bomber</td>
<td>Unspecified</td>
<td>Will not initiate new development program without better understanding of the requirement and technology</td>
<td>Supported development of a Next-Generation Bomber Aircraft, but did not authorize appropriations.</td>
</tr>
<tr>
<td>Future Combat System--Manned Ground Vehicles</td>
<td>87</td>
<td>Plan to reevaluate requirements, technology, and approach before relaunching and recompeting program</td>
<td>Directed Army to develop, test, and field an operationally effective and affordable next generation ground combat vehicle. Conferees recommended rescission of $26 million in existing funding.</td>
</tr>
<tr>
<td>Transformational Satellite</td>
<td>26</td>
<td>Plan to buy two more AEHF satellites as alternative</td>
<td>Did not authorize appropriations for the program.</td>
</tr>
<tr>
<td>Ballistic Missile Defense--Multiple Kill Vehicle</td>
<td>Unspecified</td>
<td>Plan to reexamine requirements; no mention of new program</td>
<td>Did not authorize appropriations for the program.</td>
</tr>
</tbody>
</table>

“Dancing to the Right”: Disguise Procurement Problems by Slipping to Outyears and Cutting RDT&E

In Constant FY 2011 $US Billions

Source: FY2011 Green Book, p. 6-8 and Table 6-11
Paying for Transformation at the Expense of RDT&E

(In Billions of Constant Dollars)

Source: Adapted by Anthony H. Cordesman from data provided by Office of the Under Secretary of Defense (Comptroller), National Defense Budget Estimates for FY2011, Washington, Department of Defense, March 2010, Table 6-8
RDT&E since the Beginning of GWOT Operations

FIGURE 14. RDT&E FUNDING BY BUDGET ACTIVITY
(in FY 2011 dollars, includes war funding)

RDT&E since the Beginning of GWOT Operations

**Figure 15. Increase in RDT&E Funding**

(Compares request to actual for each year)

Key Trends in the Budget:
Procurement And RDT&E
Procurement Funding by Category in FY 2011

Future Procurement and Force Transformation Not Properly Funded

- FYDP does not fund adequate RDT&E and procurement funds for current service force and modernization plans.
- CBO estimates show the FYDP calls for major ramp up in procurement in BA, but slips BO to post Bush years
- Crisis not new, all too apparent in 2007
- GAO estimated that the Pentagon often underestimated procurement time and costs by 20-50%.
- Top five weapons programs’ costs escalated by 85% between FY 2001 and FY 2005, from $281 billion to $521 billion.
- 26 major systems showed RDT&E cost escalation of $42.7 billion last year.
- RDT&E costs are expected to rise 28% between FY 2005 and FY 2009, from $144 billion to $185 billion.
- “Liar’s contest” mentality.
Real World Future Investment Costs Are Higher Than DOD Budgets and Plans for

The Ongoing Army Investment Crisis


Notes: Only the 2009 supplemental appropriations and the 2010 contingency request are separately identified in this figure. The supplemental and emergency appropriations for earlier fiscal years are included with the funding categories.

FCS = Future Combat Systems; C4ISR = command, control, communications, computers, intelligence, surveillance, and reconnaissance.
Re-Shaping the Army Vehicle Fleet: The Uncertain Legacy of FCS

Source: CBO, Long Term Implications of Defense Spending, March 2008, Figure 3-5.
$336 Billion, and the Future US Force Posture, at Hazard in Major Procurement Programs

Planned RDT&E and Procurement Funding for Major Defense Acquisition Programs, as of December 2006

<table>
<thead>
<tr>
<th>Program</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ballistic Missile Defense System</td>
<td>$8.9</td>
<td>$9.1</td>
<td>$9.1</td>
<td>$8.9</td>
<td>$8.8</td>
<td>$44.9</td>
</tr>
<tr>
<td>Joint Strike Fighter</td>
<td>6.7</td>
<td>6.9</td>
<td>8.1</td>
<td>8.4</td>
<td>11.3</td>
<td>$41.4</td>
</tr>
<tr>
<td>Virginia Class Submarine</td>
<td>2.9</td>
<td>3.7</td>
<td>3.9</td>
<td>3.8</td>
<td>4.7</td>
<td>$19.0</td>
</tr>
<tr>
<td>Future Combat Systems</td>
<td>3.6</td>
<td>3.2</td>
<td>3.2</td>
<td>3.2</td>
<td>3.7</td>
<td>$17.0</td>
</tr>
<tr>
<td>V-22 Joint Services Advanced Vertical Lift Aircraft</td>
<td>3.0</td>
<td>3.1</td>
<td>3.1</td>
<td>2.8</td>
<td>3.0</td>
<td>$15.0</td>
</tr>
<tr>
<td>DDG 1000 Destroyer</td>
<td>3.5</td>
<td>2.8</td>
<td>2.9</td>
<td>2.7</td>
<td>2.6</td>
<td>$14.4</td>
</tr>
<tr>
<td>Future Aircraft Carrier</td>
<td>3.1</td>
<td>4.6</td>
<td>1.7</td>
<td>0.6</td>
<td>3.4</td>
<td>$13.4</td>
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<tr>
<td>F-22A</td>
<td>4.4</td>
<td>4.3</td>
<td>0.5</td>
<td>0.4</td>
<td>0.5</td>
<td>$10.1</td>
</tr>
<tr>
<td>P-8A Multi-mission Maritime Aircraft</td>
<td>0.9</td>
<td>1.2</td>
<td>2.9</td>
<td>2.7</td>
<td>2.5</td>
<td>$10.1</td>
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<td>F/A-18 EF</td>
<td>2.1</td>
<td>1.7</td>
<td>1.9</td>
<td>1.6</td>
<td>1.5</td>
<td>$8.8</td>
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<tr>
<td>Funding for Top 10 MDAP programs</td>
<td>39.1</td>
<td>40.6</td>
<td>37.3</td>
<td>35.2</td>
<td>42.0</td>
<td>$194.2</td>
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<tr>
<td>Funding for other 85 MDAP programs</td>
<td>33.2</td>
<td>31.5</td>
<td>26.9</td>
<td>25.4</td>
<td>24.1</td>
<td>$141.1</td>
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<td>Total</td>
<td>$72.3</td>
<td>$72.1</td>
<td>$64.2</td>
<td>$60.6</td>
<td>$66.1</td>
<td>$335.3</td>
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<tr>
<td>Top 10 MDAP programs (percentage of total)</td>
<td>54</td>
<td>56</td>
<td>58</td>
<td>58</td>
<td>64</td>
<td>58</td>
</tr>
</tbody>
</table>

The Ongoing Navy-Marine Corps Investment Crisis

Unilateral Naval Disarmament by the US Navy: Creating an Unaffordable Fleet

Source: CBO, Long Term Implications of Defense Spending, March 23 2008, Figure 3-11.
The Ongoing Air Force Investment Crisis

Heading Towards an Air Force of One (Aircraft)

Source: CBO, *Long Term Implications of Defense Spending*, March 23 2008, Figure 3-21.
The F-22: A High Technology Force Shrinker

![Graph showing Aircraft Quantity and Program acquisition unit cost (in $millions) from 1986 to 2003.]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft Quantity</td>
<td>750</td>
<td>648</td>
<td>442</td>
<td>339</td>
<td>279</td>
</tr>
<tr>
<td>Program acquisition unit cost (in $millions)</td>
<td>149</td>
<td>162</td>
<td>187</td>
<td>257</td>
<td></td>
</tr>
</tbody>
</table>

Can Defense Agency Budget Creep Be Contained?

Is Missile Defense Affordable? Budgeted?

Key Trends in the Budget: Combined Impact of Personnel Plus Operations and Maintenance (O&M)

**Operations & Maintenance: Title Budget Request FY 2011**

O&M Request Synopsis

- $200 billion of budget authority → $133,000 per active duty service troop, excluding war funding ($210,000 including war funding)

- Per troop costs were at just $64,000 in FY 1990 in preparation for Operation Desert Storm and $95,000 just before invading Afghanistan

- There is an additional $117 billion in O&M budget authority for OCO
Operations & Maintenance—Vectors of Cost Escalation

KEY POINTS:
1. O&M Costs are consistently under-estimated.
2. O&M costs have the ability to “crowd-out” other titles within the Pentagon’s budget in the coming years.
3. The unpredictability of future war costs renders accurately predicting future O&M costs highly challenging.
Rising Operations and Support Costs: CBO Estimate

- Operation and Support (O&S) accounts for about 60 percent of defense funding and pays for DOD’s day-to-day operations as well as for military and civilian payrolls. CBO created subcategories of O&S funding based on the force and infrastructure codes used within DOD. O&S funding will reach $366 billion in 2025 not including potential unbudgeted costs, CBO projects.

- Most of the projected growth in O&S funding results from the growing cost of medical benefits for military personnel and from rising wages for both military and civilian personnel.

- As the dashed red lines in the figure show, growth in the demand for O&S resources could be greater than DOD anticipates. CBO estimates that with unbudgeted costs, the O&S budget might reach $426 billion in 2025. The largest potential unbudgeted costs are those the following:
  
  - Continued involvement in contingency operations associated with the war on terrorism, such as those in Afghanistan, Iraq, and elsewhere (those unbudgeted costs decrease to about $30 billion in 2025 under the assumption that the U.S. forces comprising about 75,000 personnel continue to be deployed overseas as part of the war on terrorism.
  
  - Faster-than-expected growth in DOD’s health care costs ($12 billion of unbudgeted costs in 2025).

Rising Operations and Support Costs: CBO Estimate

- Increases in military and civilian pay account for all of CBO’s projected funding growth in every subcategory except “Operating Forces” and “Medical”. CBO projects that those pay levels will grow at the same rate as the employment cost index (ECI), a measure of the average pay level in the U.S. civilian economy.

- In comparison with last year’s FYFP (covering 2007 to 2011), the 2008 FYDP shows an average increase in total O&S funding of 6 percent. That increase is largely the result of planned growth in the number of Army and Marine Corps personnel. For the 2007-2013 period, the 2008 FYDP shows a cumulative end-strength increase of 65,000 active-duty Army personnel and nearly 28,000 active-duty Marine Corps personnel.

War Has Led to Far Higher Operating Costs of US Forces

O &M Costs May Continue to Increase Rapidly

Key Trends in the Budget:
Finding the Right Personnel Mix
Military Personnel: Title Budget Request FY 2011

Military Personnel Request Synopsis

• $139 billion total.
• $104 billion for pay and allowances
• $15.3 billion for Military Personnel involved in OCO
  ➔ More than 75% of these funds are directed to the Army

Analysis of Military Personnel Increases—Sources of Budget Escalation

• 2.1% increase from FY’10
• End-strength is unchanged from FY ’10 at 1,405,000
• Full-time guard and reserve personnel remains nearly constant at 79,000
• Increase of military pay by 1.4%
• Increase of health-care related expenses by 3.4%
Failing to Deal with the Impact of War and Strains on US Forces

- Wars have sharply stressed force posture. Clear too few forces to fight two major regional contingencies or one major regional and one counterterrorism case.
  - Marginal, not “hollow”
- QDR2006 and service studies have produced “100 Flowers of Uncertainty” in undefined plans and budgets.
- FY2009-FY2013 FYDP Green Book projections show only marginal effort to fund the necessary changes.
  - Rolling “get well” costs versus slipping outlays to out years and “dancing to the right”
- Much depends on Army and Marine Corp modularity and force restructuring.
- Under-planned Iraq War and other resets increasing interact with procurement problems?
- Manpower entitlement cost legacy is growing; as yet no clear effort to “rebalance” actives, reserves, career civilians, and contractors.
- Questions about should the US fight wars involving massive armed nation building; If limited wars are limited and optional, should the US commit itself.
Decline in Total DOD Manpower Since End of Cold War
(Trend in Total Manpower in End Strength in Thousands)

Defense Manpower Places Limited Burden as Shares of Public Employment and Total Labor Force
(Percentages of Indicated Totals)

<table>
<thead>
<tr>
<th>Year</th>
<th>DOD Civilian as % of Public Employment</th>
<th>DOD as % of Labor Force</th>
<th>DOD Mil as % of Public Employment</th>
<th>DOD Total as % of Public Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>5.6</td>
<td>2.7</td>
<td>11.1</td>
<td>16.1</td>
</tr>
<tr>
<td>1985</td>
<td>6.2</td>
<td>2.7</td>
<td>11.5</td>
<td>17.1</td>
</tr>
<tr>
<td>1990</td>
<td>5.3</td>
<td>2.4</td>
<td>10.2</td>
<td>15.6</td>
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<td>1995</td>
<td>4.2</td>
<td>1.8</td>
<td>7.5</td>
<td>11.7</td>
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<td>2000</td>
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<td>2001</td>
<td>3.1</td>
<td>1.4</td>
<td>7.9</td>
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<td>2002</td>
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<td>7.9</td>
<td>10.7</td>
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<td>2003</td>
<td>3.0</td>
<td>1.5</td>
<td>8.0</td>
<td>10.7</td>
</tr>
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<td>2004</td>
<td>3.0</td>
<td>1.4</td>
<td>7.6</td>
<td>10.6</td>
</tr>
<tr>
<td>2005</td>
<td>3.0</td>
<td>1.4</td>
<td>7.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2006</td>
<td>3.0</td>
<td>1.4</td>
<td>7.5</td>
<td>10.4</td>
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<td>2007</td>
<td>3.0</td>
<td>1.4</td>
<td>7.6</td>
<td>10.4</td>
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<tr>
<td>2008</td>
<td>3.0</td>
<td>1.4</td>
<td>7.6</td>
<td>10.4</td>
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<td>2009</td>
<td>3.0</td>
<td>1.4</td>
<td>7.6</td>
<td>10.4</td>
</tr>
<tr>
<td>2010</td>
<td>3.1</td>
<td>1.4</td>
<td>7.6</td>
<td>10.4</td>
</tr>
<tr>
<td>2011</td>
<td>4.7</td>
<td>1.4</td>
<td>7.6</td>
<td>10.4</td>
</tr>
</tbody>
</table>

Continuing Problems in Funding the Intense OPTEMPO of OCO

KEY POINTS:

1. The wars have added a tremendous strain to troops, especially O& M costs.

2. The approach of supplemental spending has made the process of determining the “real costs” of the wars extremely difficult.
Army and Marine Corps Gains Partly Offset by Air Force and Navy Losses

(Trend by Key Force Element in End Strength in Thousands)

Currently Planned Army and Marine Corps Gains Do Not Lead to Dramatic Shifts in Force Share
(Percentage by Key Force Element in End Strength in Thousands)

Planned Manpower Expenditures Do Not Reflect Future Plans for Constant Manpower Levels and Major Rises in Costs

Military Personnel and O&M Costs May Be Much Higher than DOD “Baseline” Budget Estimates

Need More Realistic Plans and Budgets to Determine Contingency Capability as well as Army and Marine Corps End Strength

- Recent deployment levels have strained active and reserve force to limit, if not beyond.
- Need fully deployable forces, not Cold War legacies or stay at home “battle buddies”
- Planned changes in land force structure and deployability at least partially address these issues, but unclear are enough to deal with current and future long wars.
- Similarly, boosting of Army and Marine Corps end strength is affordable, but may not be enough for long war era if it continues.
- Can’t have a two major regional contingency strategy with a one major regional contingency manpower base.
Reshaping the Defense Personnel: How Many Personnel Are Enough?

- Reshape commitments or live with a “One Major Regional Contingency” mix of land forces?
- What does “Hybrid Warfare mean -- if anything -- in terms of specific plans and costs?
- What war(s) to plan for? What does “full spectrum” mean?
  - Iraq vs. Korea vs. Taiwan
  - Long War
  - War “X?”
  - Contain Iran, North Korea, police world?
- Limit Technology or Personnel: High tech “RMA” versus Legacy Systems on Hand?
- How much do changes in alliances add to, or reduce, manpower needs?
- “Civilian partners?” What should the future manpower impact of the State Department and other civilian agencies be?
Reshaping the Defense Personnel Structure: How Much is Affordable?

- Shift focus from Net-centric to Human-centric to Cost Containment to Allied Reliance?
- Legacy of high military manpower costs which limit ability to pay for adequate force levels.
  - Cost containment is a key issue, but so is force quality.
  - Need “risk premiums” when so few Americans serve
  - Military medical costs are creating major new “entitlement” cost.
- Need to re-examine military-civilian trade-offs in terms of cost-effectiveness:
  - Military versus career civilian.
  - Future role and size of active and reserve components
  - Career military and civilian versus contractor.
  - Role of contractors in combat.
- Uncertain calls for “Supersoldier” in QDR
  - Everyone above average with unusual foreign language skills?
- Need more realism in determining how combat ready and deployable reserves can and should be.
- Can modularity, changing MOS specialties, rebalancing actives and reserves really do the job?
Rebalancing the Force: Meeting the Needs of the U.S. Active and Reserve Military

- Impact of Past Cuts in end strength:
  - Military from 2.1 million in FY1990 to 1.5 in FY2007, and 1.51 in FY2011
  - Civilians from 997,000 in FY1990 to 664,000 in FY2007, and 789,000 in FY2011.
  - Contractors?

- Problems of determining risk premium when so few serve.

- Realism of uncertain calls for “Super soldier” in QDR
  - Everyone above average with unusual foreign language skill.

- Real-world life cycle cost and productivity of military vs, civilian vs. contracting out?
  - Civilians as supplements to military end strength?

- Need for “rebalance” actives and reserves, and ensure all take a turn in combat.

- Impact of over-deployment and the need for a new “Social Contract”
  - Need for time to train; career development and family.
  - Need for longer reserve duty cycles less frequently.

- Deployment cycles as of 2010 QDR
  - Active component: two years at home for every one year deployed
  - Five years demobilized for every one year mobilized

Key Trends in the Budget: The Troop Cost Challenge
Defense Manpower Affordability

KEY POINTS:
1. The DOD has seen an essentially static ends strength in active duty military personnel since 1990, but the per soldier O&M costs have risen continuously and quickly, even after accounting for “temporary” costs associated with war.
2. Per troop cost growth is primarily attributable to pay raises, growth in healthcare costs, and expansions of other benefits.
3. Per troop cost growth has the potential to threaten Defense strength, as the DOD may not be able to achieve manpower end strength goals.
4. The DOD may be forced into budgeting dilemmas in which it must select from the lesser of two evils by cutting from one important budget title to fund another.
Per troop costs are calculated as the ratio of total military personnel to military personnel funding.

Since FY 2000, personnel spending has risen at a real annual rate of 4.5% (3.4% excluding war costs).

Driving Factors of Per Troop Cost Growth

- Several years of pay raises exceeding the Employment Cost Index (ECI)
- New and enhanced benefits for both active-duty troops and retirees
- Growing healthcare costs

This Has Reduced “Pay Gap” Reduced But Military Costs Remain Lower than Private Sector Equivalent

Pay gap that had once stood at 13.5 percent (in 1998 and 1999) down to 2.9 percent


Estimates Do Indicate
Military Costs Outpacing Career Civilian Costs

Key Trends in the Budget: Military Retirement and Medical Costs
Rising Military and Veterans’ Entitlement Costs—Creating an Unaffordable Military?

KEY POINTS:

1. The armed forces may see extreme cost escalation in the near-term and long-term due to rapid growth in health service costs

2. Costs due to health services are projected to rise in both real terms and as a percentage of DOD total outlays

3. Costs associated with veterans’ entitlements are also likely to increase as more and more troops both become eligible for and actually utilize veteran’s benefits as a result of many years of sustained deployment stress

4. These costs are mandatory; thus, without reform, they have the capacity to crowd-out other titles in the Pentagon’s budget

5. In turn, these costs may compel the Pentagon to cut military end strengths, leaving the military less capable of executing manpower intensive Counterinsurgency and humanitarian operations
Added Causes of Per Troop Cost Growth: Retirement Benefits

- Retirement pay for 20+ years of service increased from 40% to 50% of base pay
- Retirement pay for surviving spouses of deceased service members with 20+ years of service rose from 35% to 55% of the service member’s base pay
- In some situations, military retirees are entitled to concurrently receive both military retirement pay and veteran’s compensation
- Age requirement reservists to being receiving retirement pay reduced

An Unaffordable Military Medical Burden?  
CBO Estimate

- CBO estimates that total real medical funding will increase by 77 percent, from $39 billion in 2008 to $68 billion by 2025. Real medical funding including potential unbudgeted costs could more than double, reaching $80 billion by 2025, CBO projects.

- Accrual payments for beneficiaries over age 65 will make up more than 41 percent of the increase in medical funding. CBO projection indicates that by 2025, accrual payments will be twice as large in real terms as they are currently, reaching a total of $23 billion. (Note that payments are made out of the accrual fund to cover pharmaceuticals, purchased care, and direct care for Medicare-eligible beneficiaries. The amounts spent on those beneficiaries are therefore excluded from the remaining categories described below.)

- Pharmaceutical expenditures are projected to more than double, from $3 billion in 2008 to $8 billion in 2025; with cost risk included, real drug expenditures will more than triple, to $11 billion in 2025.

- Purchased care and private-sector contracts are projected to grow by 75 percent in real terms, form $8 billion in 2008 to $15 billion in 2025. Funding for that category including cost risk could increase by 117 percent in real terms, reaching $18 billion in 2025.

The category that comprises the military’s direct-care system and other medical funding is projected to grow by nearly 60 percent in real terms, from $9 billion in 2008 to $15 billion in 2025. If costs grew more quickly than DOD has anticipated, funding in that category could rise by 114 percent in real terms, reaching $20 billion in 2025, and contributing (along with other factors) to the dashed line labeled “With Unbudgeted Costs” in the figure.

CBO anticipates that funding for uniformed medical personnel will grow by 14 percent in real terms by 2025 as a result of pay increases that outpace inflation. CBO expects real funding in the military personnel category to grow from $7 billion on 2006 to $8 billion in 2025.

Causes of Per Troop Cost Growth: Medical Benefits

- Total military healthcare costs in FY 2011 equaled $20.7 billion or approximately one-tenth of the total DOD BA

- Funding for the Defense Health Program (DHP) has increased at a real annual rate of 6.9% since FY 2000

- Reasons for rapid cost growth:
  - New and expanded benefits
  - Healthcare cost inflation throughout the country
  - Increased utilization of DHP resources by eligible beneficiaries
  - TRICARE premiums and co-pays have not increased since 1995
  - Retirees and eligible family members of service members are increasingly substituting alternate health insurance programs for TRICARE, expanding the number of DHP users
  - TRICARE for Life Program: enacted by Congress in FY 2001; “provides premium-free supplemental insurance for military retirees enrolled in Medicare and applies retroactively to retirees who retired before the benefit was enacted”

- The final section of this brief analyzes the impacts of medical care cost growth on the DOD as whole

The Unaffordable Military Medical Burden?
CBO Estimate

The FY 2010 Request for Health Services: Smallest Amounts to Active-Duty Soldiers

Figure 2.1 MHS Eligible Beneficiaries

(Beneficiaries in millions)

- Active Duty: 1.7 (22%)
- Medicare-Eligible: 2.0 (25%)
- Eligible Retirees and Family Members: 3.3 (18%)
- Active Duty Family Members: 2.3 (35%)

Total: 9.3M


Key Trends in the Classified Budget
Classified Funding in the FY 2011 Budget Request

Overall Trends

• FY 2011 classified procurement funding is at its highest level in real terms since FY 1987
• Increase of 2.8% over FY 2010

Classified Funding Request Synopsis

• $57.8 billion in total budget authority (includes OCO)
  → 19% of total acquisition funding in DOD’s BA
• $19.4 billion for RDT&E
• Air Force has the highest request (80% of total classified funding)
  → 43% of its procurement request is classified
  → 46% of its RDT&E request is classified

Previous Results of Classified Funding—Mixed Success

• Successful programs include: Corona Satellite Program (1960-72); F-117 Stealth Fighter; B-2 Bomber; and SR-71
• Unsuccessful programs: Future Imagery Architecture Program of next-gen spy satellites—$4 billion loss

Classified Budget Request FY 2011

FIGURE 18. CLASSIFIED FUNDING IN THE DOD BUDGET
(in FY 2011 dollars, includes war funding, classified O&M funding not reported in FY08 and earlier)