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The FY2013 Defense Budget, Deficits, Cost-Escalation, and Sequestration

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Tying Security Strategy to the US Role in the Global Economy

- The US may not face peer threats in the near to mid term, but it faces a wide variety of lesser threats that make maintaining effective military forces, foreign aid, and other national security programs a vital national security interest.
- The US does need to reshape its national security planning and strategy to do a far better job of allocating resources to meet these threats. It needs to abandon theoretical and conceptual exercises in strategy that do not focus on detailed force plans, manpower plans, procurement plans, and budgets; and use its resources more wisely.
- The US still dominates world military spending, but it must recognize that maintaining the US economy is a vital national security interest in a world where the growth and development of other nations and regions means that the relative share the US has in the global economy will decline steadily over time, even under the best circumstances.
- At the same time, US dependence on the security and stability of the global economy will continue to grow indefinitely in the future. Talk of any form of “independence,” including freedom from energy imports, is a dangerous myth. The US cannot maintain and grow its economy without strong military forces and effective diplomatic and aid efforts.
- *US military and national security spending already places a far lower burden on the US economy than during the peaceful periods of the Cold War, and existing spending plans will lower that burden in the future. National security spending is now averaging between 4% and 5% of the GDP – in spite of the fact the US has been fighting two wars in Iraq and Afghanistan – versus 6-7% during the Cold War.*

The Strains of War: Ten Years of DoD “Topline” Budget Outlays in \$US Billions in Current and Constant Dollars

These dollars include all enacted war and supplemental funding

Wartime spending peaked in FY2010. It was 2.3 times (129%) higher in current dollars than in FY2001 (the last pre 9/11 budget) and 1.8 times (77%) higher in constant dollars

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY 2011	FY2012
Current	281.2	291.0	332.1	387.3	436.5	474.2	499.3	529.1	594.6	636.3	666.7	678.0	688.2
Constant	397.2	398.6	442.6	505.3	550.2	572.4	582.7	600.1	651.3	686.5	705.3	702.2	699.1

But, Ten Years of War Have Placed a Limited Burden on the National Economy, and One Consistently Lower than in the Last Years of “Peace” in the Cold War

National Defense Totaled 5.2% to 6.2% of the US GDP from FY1980-FY1089; It had shrunk to a Post-WWII low of 3% in FY200 and FY2001. By comparison, it peaked at 37.8% in WWII, 14.2% in Korea, and 9.4% in Vietnam.

Fiscal Year*	% of Federal Budget		% of Net Public Spending		DoD as a % Public Employment				DoD as % of Total Labor Force	% of Gross Domestic Product	
	DoD	National Defense	DoD	National Defense	Military & Civilian		Civilian Only			DoD	National Defense
					Federal	Federal, State & Local	Federal, State & Local	Federal, State & Local			
2002	16.5	17.3	9.8	10.3	51.4	9.3	24.8	3.0	1.5	3.1	3.3
2003	17.9	18.7	10.8	11.3	51.1	9.3	24.3	3.0	1.5	3.5	3.7
2004	19.0	19.9	11.5	12.0	51.3	9.3	24.6	3.0	1.4	3.7	3.9
2005	19.2	20.0	11.7	12.2	51.0	9.1	24.7	3.0	1.4	3.8	4.0
2006	18.8	19.7	11.5	12.0	51.3	9.1	25.1	3.0	1.4	3.8	4.0
2007	19.4	20.2	11.6	12.1	50.3	8.9	24.4	3.0	1.4	3.8	4.0
2008 Base	15.9		8.1							3.3	
2008 Total	19.9	20.7	10.2	10.5	50.6	8.9	24.5	3.0	1.4	4.1	4.3
2009 Base	14.0		7.6							3.5	
2009 Total	18.1	18.8	9.7	10.1	51.3	9.1	25.4	3.1	1.4	4.6	4.7
2010 Base	14.6		7.6							3.5	
2010 Total	19.3	20.1	10.1	10.5	51.4	9.4	26.3	3.3	1.4	4.6	4.8
2011 Base	14.6		7.7							3.5	
2011 Total	18.8	19.6	9.9	10.3	52.6	9.6	27.7	3.5	1.5	4.5	4.7
2012 Base	14.9		7.9							3.6	
2012 Total	18.1	18.9	9.7	10.0	52.6		27.6			4.4	4.6
2013 Base	15.1		7.9							3.5	
2013 Total	17.7	18.5	9.3	9.7	52.2		27.3			4.1	4.3

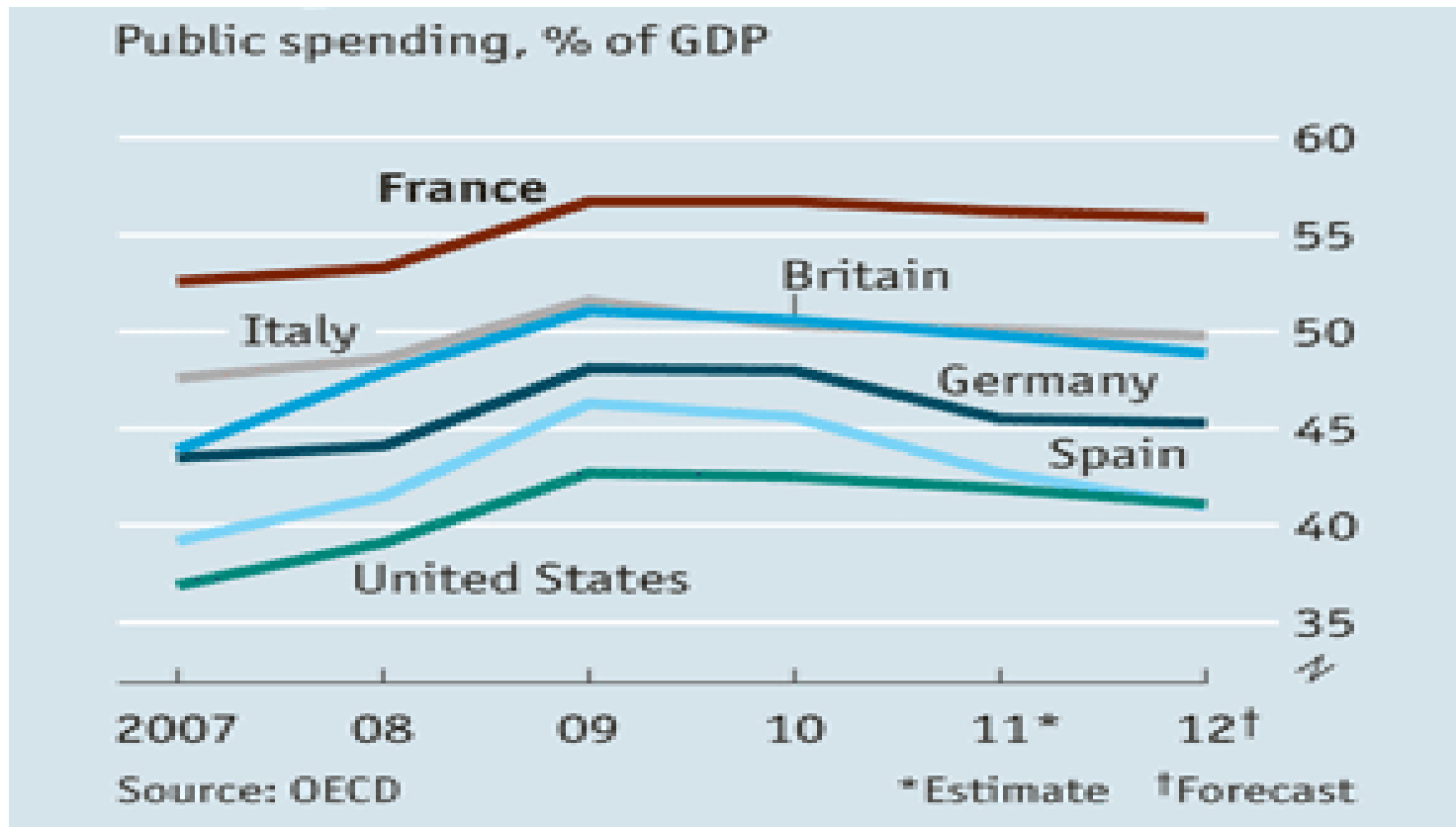
Source: DoD FY2013 Green Book, pp. 264-265

The Realities that Should Shape US Strategy and US Military Forces for FY2013 and the Next Decade

- *Concepts are not a strategy. Broad outlines do not set real priorities. A strategy requires a plan with concrete goals numbers schedules and costs for procurement, allocation, manpower, force structure, and detailed operational capabilities.*
- *For all the talk of 10 years of planned spending levels and cuts, the President and Congress can only shape the actual budget and defense program one year at a time. Unpredicted events and realities will intervene. There is a near zero real world probability that the coming plan and budget will shape the future in spite of changes in the economy, politics, entitlements, and threats to the US.*
- Strategy will, however, be driven as much by changes in the national economy, national resource and cost constraints, and entitlements pressures, as by threats.
- Real world forces and mission capabilities will be budget and cost driven-barring unexpected existential threat. The command and JCS must develop resource-constrained joint plans and budgets.
- New threats, strategies, and tactics – cyberwarfare, space, cost-oriented asymmetric warfare -- will pose a growing challenge putting constant additional new pressures on force plans and resources.
- But, the global emergence of new economic powers and economic competition will be as important as military threats.
- A valid national strategy must increasingly consider the actions of potential allies and threats, global economic changes, domestic spending needs, foreign policy and aid, homeland defense,
- Non-traditional alliances and relations will continue to become steadily more important.
- The military aspects of strategic choices should be joint choices made by major mission and command. The services should not be strategic planners, only enablers. Interservice rivalry will be self-destructive.
- The quality of execution and cost control is critical, and must have top down Secretarial and Service Chief responsibility.

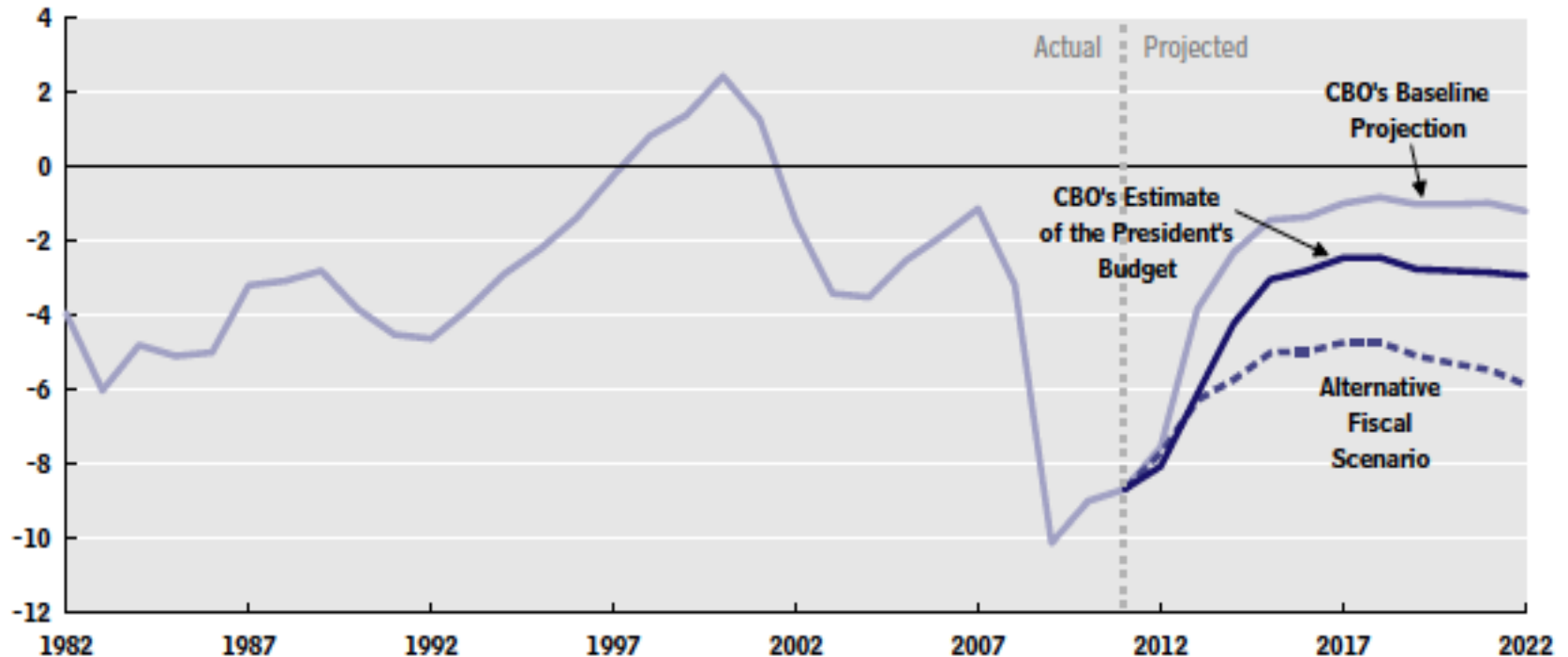
**Living with a Continuing Crisis
over Entitlements, Taxes,
deficits, and Pressures on
Discretionary and Defense
Spending**

Recession, War Costs, and the Burden of US Public Spending are Limited Compared to Other Major Democracies, But Too High for American Politics and Tax Levels



CBO Estimates That There Will Be a Critical Rise in Deficit Without a Massive Increase in Taxes and Cut in Entitlements

(Percentage of gross domestic product)



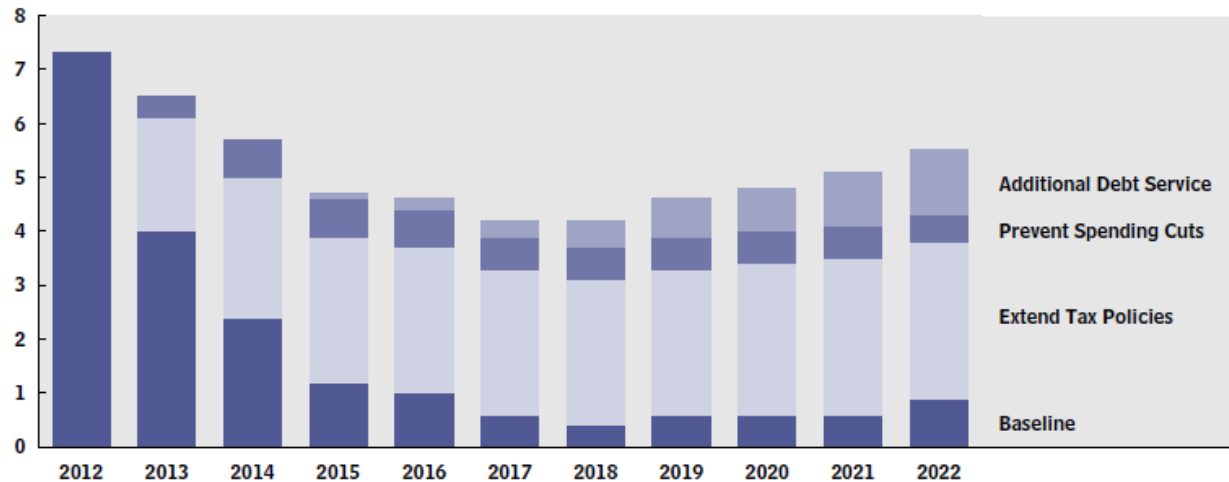
Source: Congressional Budget Office.

Note: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic spending reductions specified by the Budget Control Act of 2011 do not take effect.

The Expiration of Tax Cuts and Imposing of Sequestration in FY2013 Could Prompt Significant Reductions in the Deficit – But at What Cost?

Deficits Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)



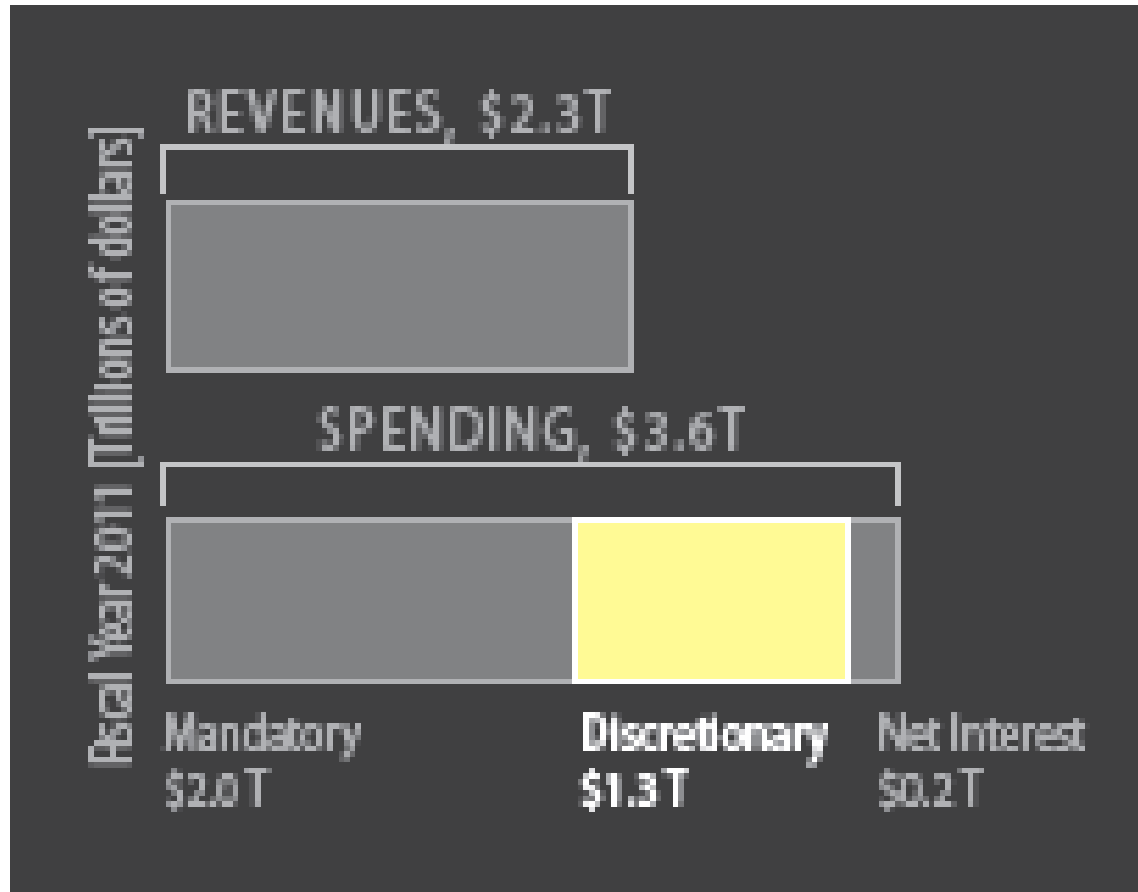
Source: Congressional Budget Office.

Note: "Additional Debt Service" is the amount of interest payments on the additional debt issued to the public that would result from the policies in the alternative fiscal scenario. "Prevent Spending Cuts" involves holding Medicare's payment rates for physicians' services at their current level (rather than permitting them to drop, as scheduled under current law) and preventing the cuts to federal spending that will occur under the automatic enforcement procedures of the Budget Control Act of 2011 from taking effect (but leaving in place the original caps on discretionary appropriations in that legislation). "Extend Tax Policies" reflects the assumptions that expiring tax provisions (other than the payroll tax reduction) are instead extended and that the alternative minimum tax is indexed for inflation.

Source: "An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022," Congressional Budget Office, August 2012.
http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf, p. 3.

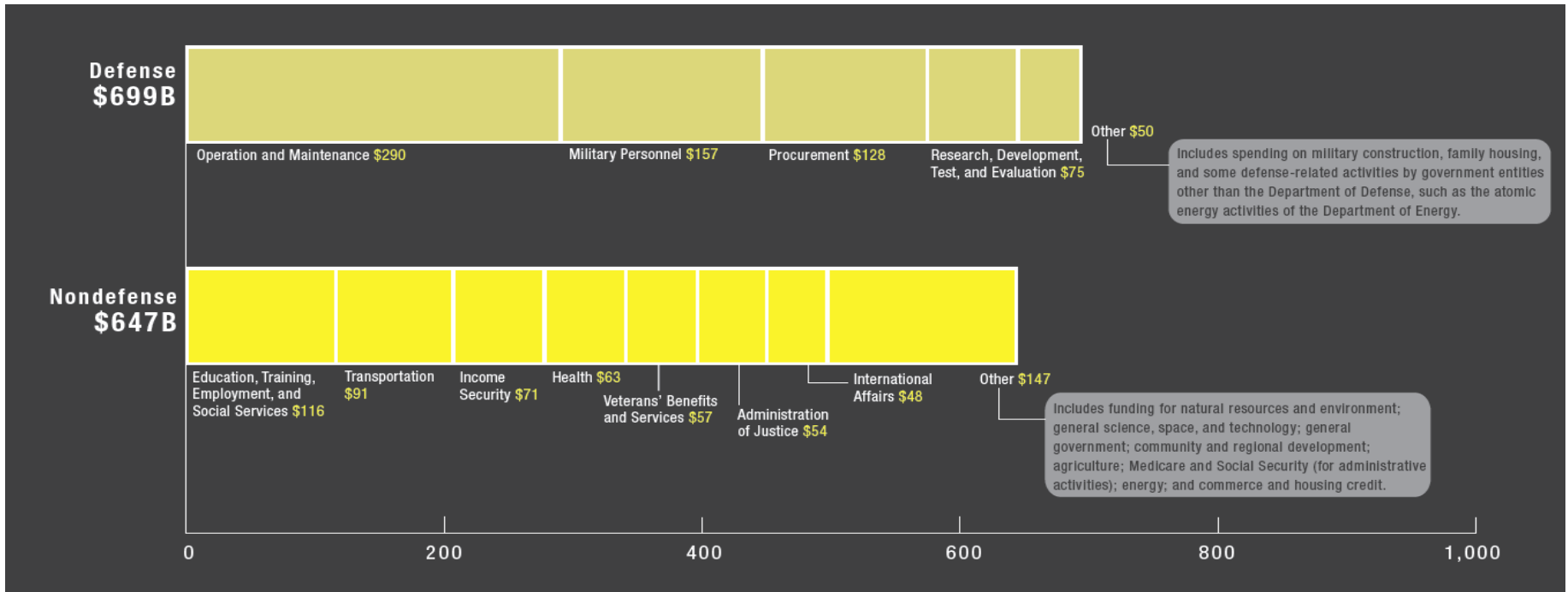
-The taxes referenced in "Extend Tax Policies" involve the soon-to-expire cuts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

Federal Spending in FY2011 (Latest Year with Hard Data): Revenues vs. Mandatory and Discretionary Spending



Source: CBO, 2012

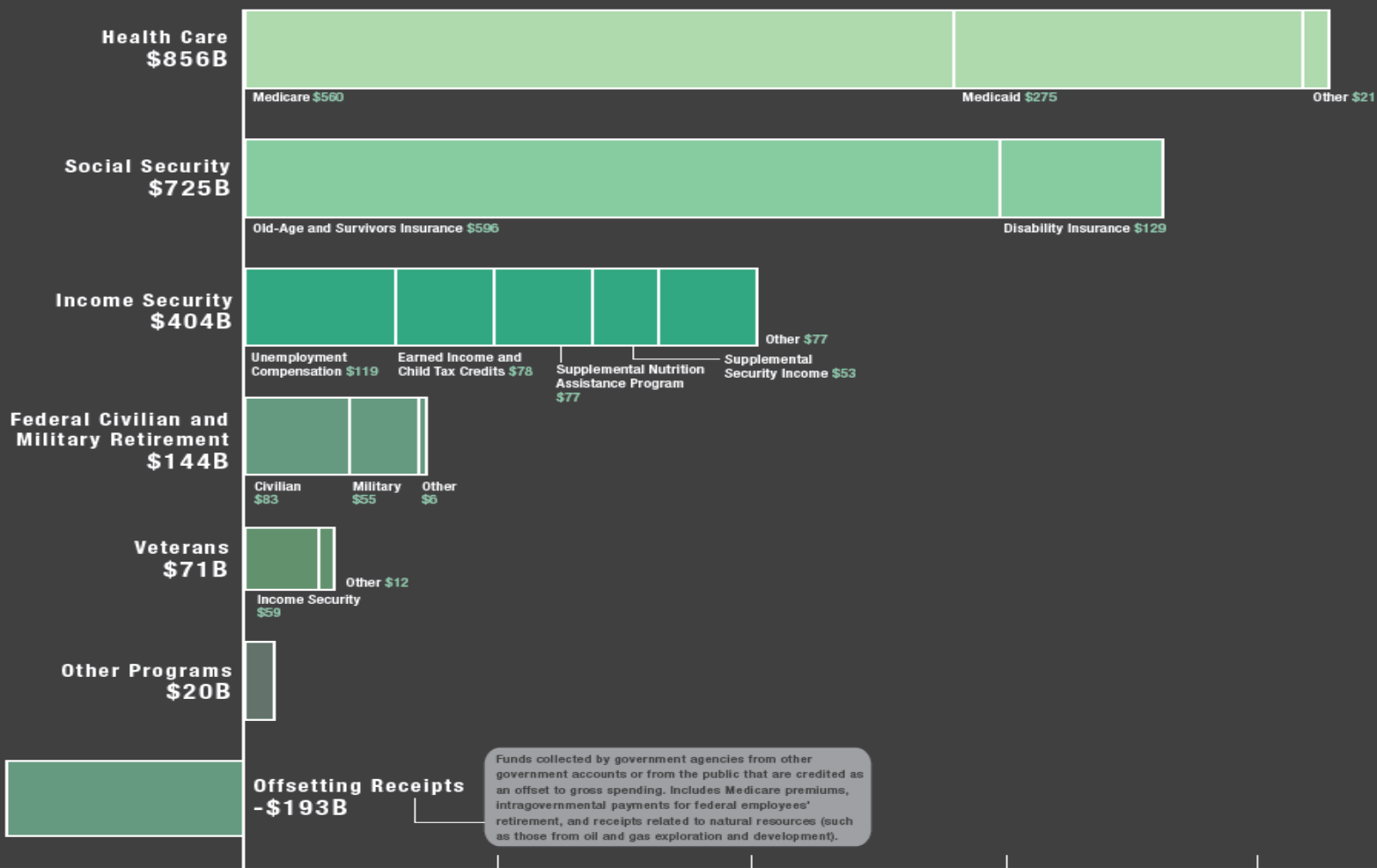
Where Federal Spending Actually Goes: Discretionary Spending



Source: CBO, 2012

Where Federal Spending Actually Goes: Mandatory (Entitlements) Spending

BREAKDOWN of Mandatory Spending in 2011 Billions of dollars



CBO Estimate of 10 Year's More Deficit Spending, Driven by Entitlements, Even with Defense Cuts if No Sequestration

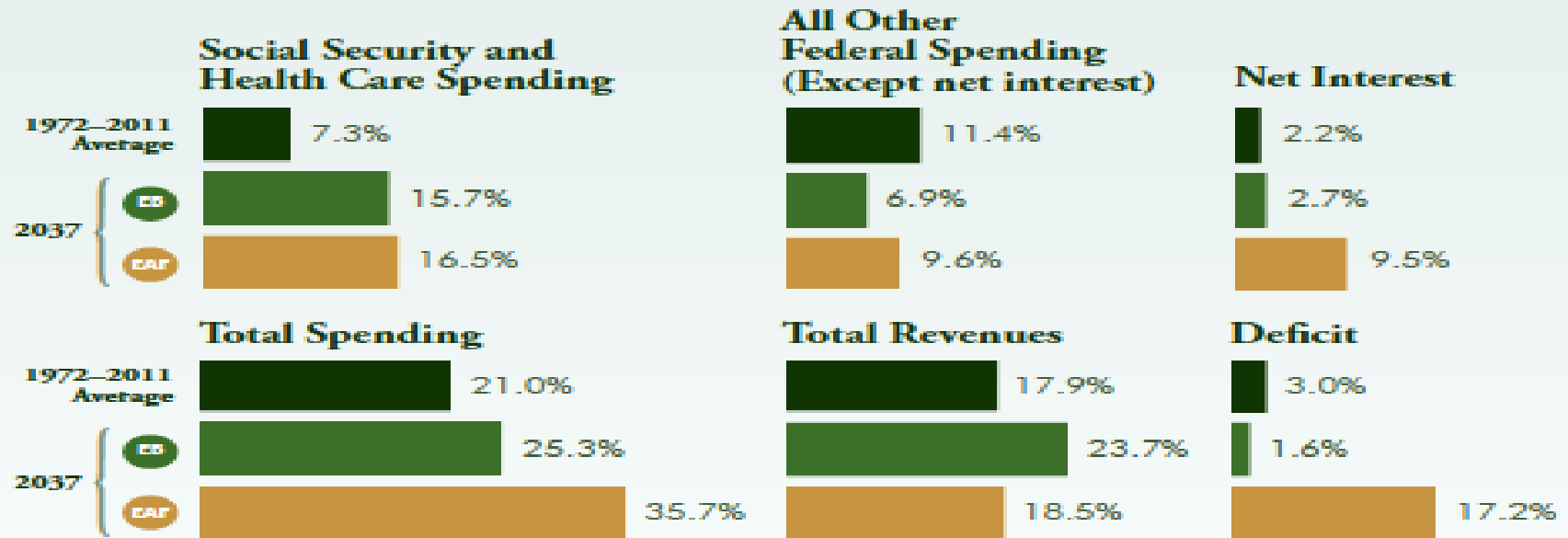
	Actual,												Total	
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2017	2013-2022
In Billions of Dollars														
Revenues														
On-budget	1,738	1,838	2,066	2,374	2,641	2,836	2,996	3,124	3,263	3,435	3,606	3,783	12,912	30,123
Off-budget ²	566	556	675	731	772	821	872	919	965	1,010	1,055	1,102	3,871	8,921
Total	2,303	2,394	2,741	3,105	3,413	3,657	3,868	4,043	4,227	4,445	4,661	4,885	16,783	39,044
Outlays														
Mandatory	2,026	2,119	2,221	2,368	2,497	2,659	2,756	2,869	3,050	3,217	3,399	3,588	12,501	28,624
Discretionary	1,347	1,303	1,259	1,183	1,155	1,158	1,158	1,170	1,198	1,225	1,248	1,282	5,914	12,035
Net interest	230	225	237	255	300	370	442	513	581	642	692	743	1,604	4,775
Total	3,603	3,647	3,717	3,807	3,952	4,186	4,356	4,553	4,829	5,083	5,339	5,613	20,018	45,434
On-budget	3,104	3,144	3,078	3,098	3,197	3,386	3,507	3,654	3,876	4,071	4,264	4,472	16,266	36,603
Off-budget ²	499	504	639	708	755	800	849	899	953	1,012	1,075	1,141	3,752	8,832
Deficit (-) or Surplus	-1,300	-1,253	-977	-702	-539	-529	-488	-510	-602	-638	-678	-728	-3,235	-6,390
On-budget	-1,367	-1,306	-1,012	-725	-556	-550	-511	-530	-613	-636	-658	-689	-3,354	-6,480
Off-budget ²	67	53	36	23	18	21	22	20	12	-2	-20	-39	119	90
Debt Held by the Public	10,128	11,427	12,517	13,331	13,982	14,618	15,215	15,825	16,519	17,246	18,007	18,819	n.a.	n.a.
Memorandum:														
Gross Domestic Product	14,954	15,508	15,914	16,575	17,618	18,704	19,708	20,661	21,616	22,603	23,614	24,655	88,519	201,666

Source: CBO, *An Analysis of the President's 2013 Budget*, March 2012, p. 3

CBO Estimate of Long-Term Impact of Deficit Spending Through 2037 With & Without Tax Rises & Spending Cuts

Components of the Federal Budget

(As a percentage of GDP)



Note: Numbers may not add up to totals because of rounding.

Sources: Congressional Budget Office; Office of Management and Budget
For details, see *The 2012 Long-Term Budget Outlook*, June 2012; <http://go.usa.gov/dKY>

EB

CBO's Extended Baseline Scenario

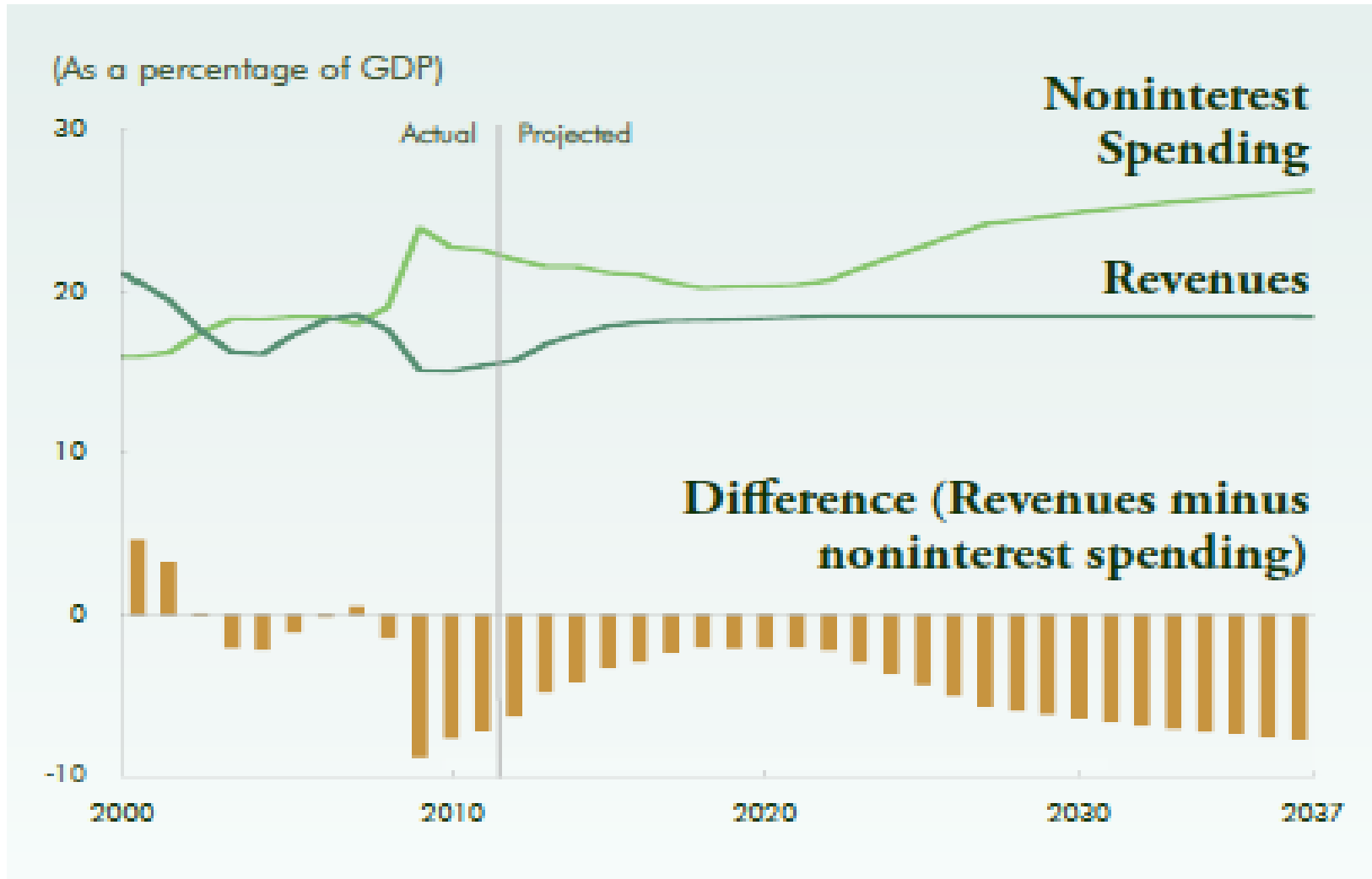
Reflects the assumption that current laws generally remain unchanged, implying that lawmakers will allow tax increases and spending cuts scheduled under current law to occur and that they will forgo measures routinely taken in the past to avoid such changes. Noninterest spending continues to rise, however, pushed up by the aging of the population and the rising costs of health care, and revenues reach historically high levels.

EAF

CBO's Extended Alternative Fiscal Scenario

Maintains what might be deemed current policies, as opposed to current laws, implying that lawmakers will extend most tax cuts and other forms of tax relief currently in place but set to expire and that they will prevent automatic spending reductions and certain spending restraints from occurring. Therefore, revenues remain near their historical average, and the gap between noninterest spending and revenues widens over the long term.

CBO Estimate of Deficit as % of GDP Without Tax Rises and Spending Cuts

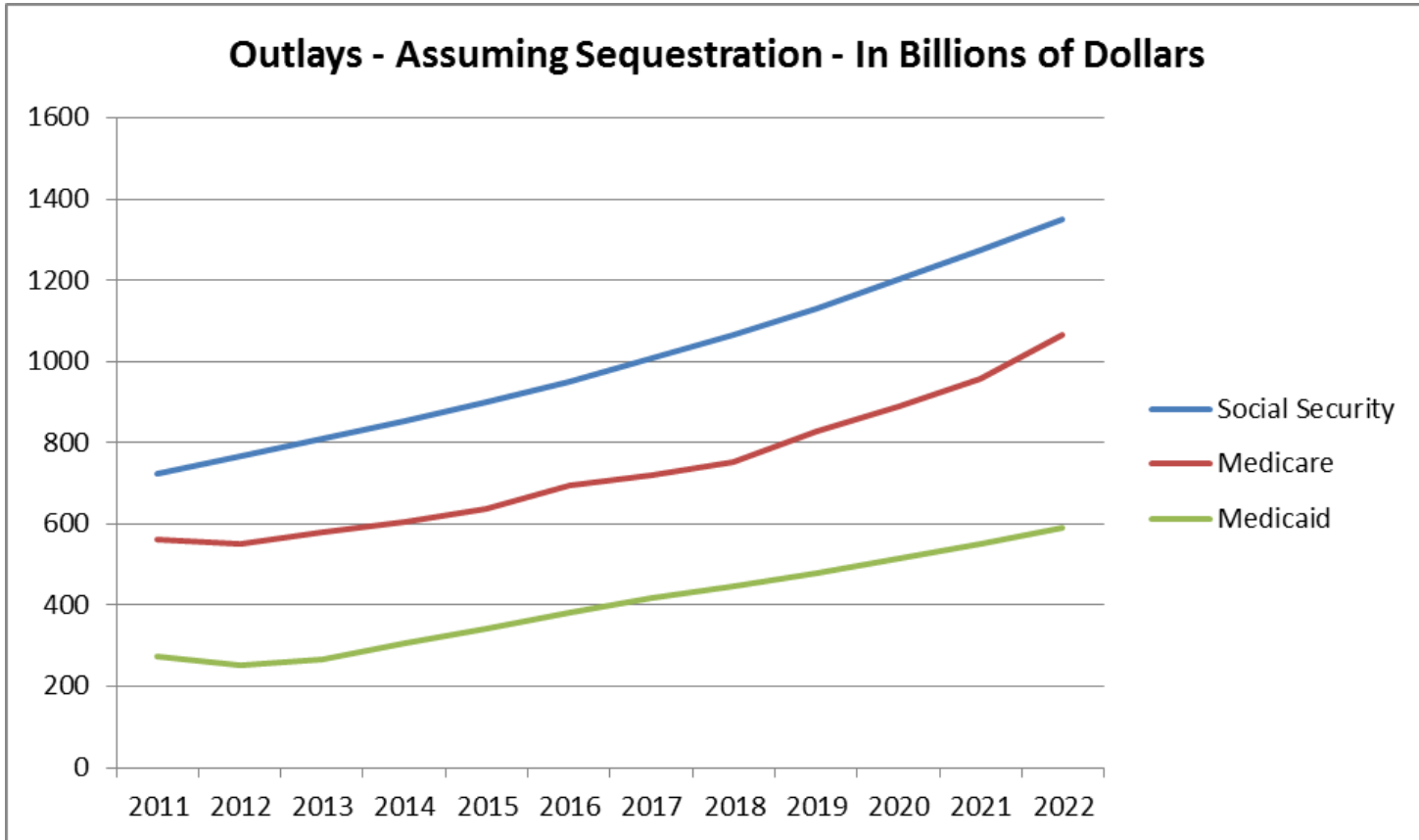


The Underlying Problem is *Not*
Federal Spending But the
National
Cost of Medical
Treatment and the Lack of
Savings for Retirement

We Cannot Solve the Federal Deficit Problem or Create Stable, Functional Programs for Defense and Other Discretionary Spending Without Addressing the Underlying Causes

- The real pressures on Federal spending are driven by entitlements which are driven by the fact Americans do not save for retirement, and massive rises in the burden all medical care costs – government and private put on the economy.
- Liberal or conservative, federal programs must address solutions to the entire problem, and not just federal spending.
- The current federal budget debate borders on the absurd because it fails to address these issues, and neither party has anything approaching credible facts, much less credible solutions.
- Private or public, solutions are needed to the fact American life expectancies are nearly 20 years over the retirement age of 65 – which once was the average life expectancy.
- Private or public, the nation cannot afford a rise in medical spending from less than 6% of the GDP to 20%+.

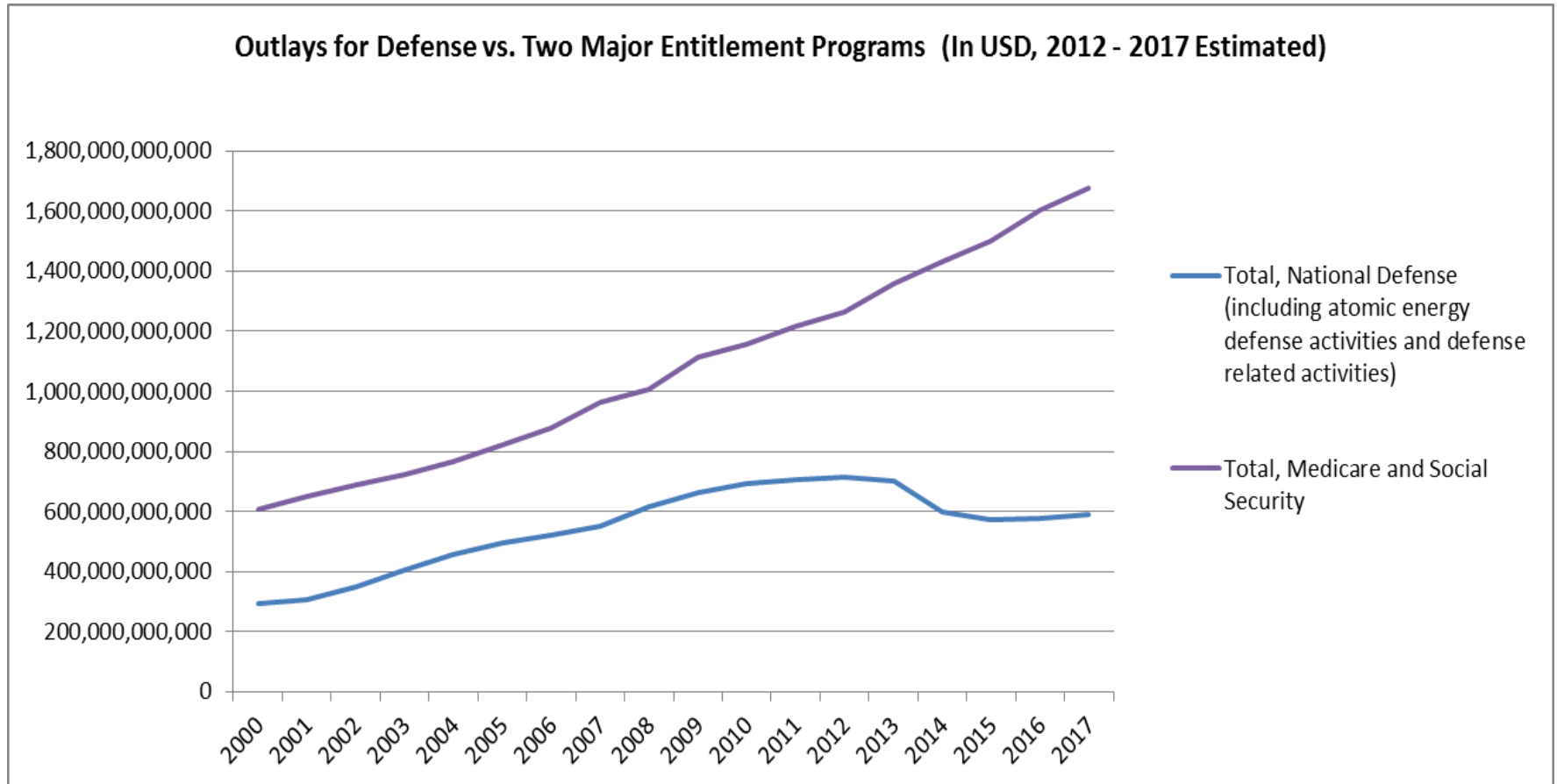
The CBO Forecasts Major Growth in Medicare, Medicaid, and Social Security Outlays Through 2021



*Actual figures for 2011, projected figures for 2012-2022.

Graph created by author using data from: "An Update to the Budget and Economic Outlook: Fiscal Years 2012-2022," Congressional Budget Office, August 2012. http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf, p. 6.

Entitlements, Not Defense, Drive the Federal Budget: Its Burden on the National Economy



-Graph created by author, reflects data from OMB.

Our Greatest “Threat” is not Foreign, it is Managing The Domestic Economic and Social Forces that Drive the Rise in The Cost of Entitlements

- Mandatory or “entitlement” outlays will increase by 5.1% in 2011 and by an average of 4.4% annually between 2012 and 2020, compared with an average growth rate of 6.4% between 1999 and 2008.
- They will average 17% to 20% of the GDP during FY2012 to FY2020.
- Defense spending will average only 3.3% to 4.3%, dropping from a peak war year level of 4.7% in FY2010.
- All other discretionary federal spending will equal 4.1% to 3.1% of the GDP.*
- The defense share of federal spending is so low as a percentage of total federal spending, GDP, and rising entitlements costs that no feasible amount of cuts in US national security spending can have a major impact on the US deficit and debt problems.
- The most serious single threat the US faces to its national security does not come from foreign threats, but from the pressures on defense spending created by these domestic social and economic trends, and the rising cost of US federal entitlements spending.
- These rises in total spending are driven by two critical factors that cannot be addressed simply by altering the federal budget.
 - Cost of mandatory retirement and spending on the aging
 - Medical costs that extend far beyond government spending

* CBO, <http://www.cbo.gov/ftpdocs/108xx/doc10871/Chapter3.shtml>.)

An Aging Population Threatens National Security by Lacking Pensions and Savings

- In 1940, the life expectancy of a 65-year-old was almost 14 years; today it's almost 20 years. By 2036, there will be almost twice as many older Americans as today – from 41.9 million today to 78.1 million.
- The proportion of Americans with a any pension plan with defined benefits is steadily shrinking, and the funding of such plans, adjustments for inflation, and medical coverage are highly uncertain.
- 401K and other programs are steadily losing employer contributions, and most Americans either do not fund them or fund them far below retirement level.
- There are currently 2.9 workers for each Social Security beneficiary. By 2036, there will be 2.1 workers for each beneficiary.
- In 2011, 9% of Americans over 65 had no retirement savings and did not receive Social Security benefits. Three out five families headed by someone over 65 had no retirement savings.
- In addition, 8.4 million disabled Americans and 2 million of their dependents (19% of total benefits) depended on Social Security, plus 6.3 million survivors of deceased workers (12% of total benefits). (Social Security Administration)
- It is projected that there will be growth in the number of Social Security beneficiaries from 56 to 91 million between now and 2035. By 2033, only $\frac{3}{4}$ of benefits will be financed unless taxes are increased or the system is reformed.

“News Summary: Social Security’s Financial Woes Could Be Solved With Politically Tough Changes,” *Yahoo Finance* via *Associated Press*, August 20, 2012. <http://finance.yahoo.com/news/news-summary-social-security-changes-163551468.html>

The Limits of Social Security and 401Ks Increase the Pressure for Future Increases in Entitlements Spending

Social Security:

- According to a 2012 fact sheet, 53% of elderly married couples and 74% of elderly unmarried individuals rely on Social Security for at least 50% of their income (Social Security Administration).
- About 23% of married couples and 46% of unmarried persons receiving benefits relied on Social Security for at least 90% of their income.
- Average payment per year is \$14,400 vs. poverty level of \$10,890 (NYT, Sullivan).

401K:

- \$3.3 trillion is assets, seven times large than two decades ago, but:
 - “The typical worker” had \$54,000 invested in a 401(k) in 2010, an anemic amount for one to retire off of. Moreover, Under half of the U.S. private-sector workforce participates in these programs, and those that do grossly underinvest.
 - Even twice the savings – \$120,000 – would be under ¼ of the recommend minimal savings for retirement and pay some \$7,000 a year.
 - Many participants empty accounts when laid off, use to buy houses or education for children.
 - Relatively high fees, and those who do save often take excessive risks: 38% of participants between the ages of 55 and 64 keep over 80% of 401K invested in stocks (NYT, Greenhouse).

Fact Sheet: Social Security, Social Security Administration, July 30, 2012. <http://www.ssa.gov/pressoffice/basicfact.htm>; Paul Sullivan, “The Tightwire Act of Living Only on Social Security,” *New York Times*, September 11, 2012. <http://www.nytimes.com/2012/09/12/business/retirementspecial/living-only-on-social-security-is-a-tightwire-act.html?pagewanted=all>; Steven Greenhouse, “Should the 401(k) Be Reformed or Replaced?,” *New York Times*, September 11, 2012, corrected September 13, 2012. <http://www.nytimes.com/2012/09/12/business/retirementspecial/should-the-401-k-be-reformed-or-replaced.html?pagewanted=all>

Rise in National Medical Costs is Another “Threat” to National Security

- The entire pattern of federal spending will be driven by the rising cost of Medicare, Medicaid (and potentially national medical care under the Affordable Care Act as of 2014).
- **By 2021, health care will account for nearly 20% of the U.S. economy, the report found, up from 5.2% in 1950, 7.2% in 1980, 12.5% in 1990, 13.8 percent in 2000 and 17.9% in 2010.**
- Expenditures in the United States on health care surpassed \$2.3 trillion in 2008, more than three times the \$714 billion spent in 1990, and over eight times the \$253 billion spent in 1980. Without major changes in cost, they will equal some 25% of the GDP in 2025.
- They are costs for which roughly one quarter of Americans have no insurance, and many only partial insurance coverage. Even so, the average health insurance premium for family coverage has more than doubled over the past decade to \$13,770 a year.
- **Some 45.1% of the workforce from ages 18 to 64 had no coverage as of September 2011, and many retirees lacked the savings to pay for any additional payments above Medicare.** These figures did not include Americans who had not worked in the last 12 months, and coverage had dropped substantially since 2008. If one includes self-financed medical insurance, some 50 million Americans or 16% of the population had no coverage in 2010.
- In 2010, 31% of Americans relied on the government for health insurance, up from 24.2% in 1999. A total of 9.8% of children under age 18 are uninsured despite the government programs. (US Census Bureau, Kaiser Family Foundation, CNN Money)

Why Medical Care is Headed Toward 20% of GDP

- By 2021, health care will account for nearly 20 percent of the U.S. economy, the report found, up from 5.2% in 1950, 7.2% in 1980, 12.5% in 1990, 13.8 percent in 2000 and 17.9% in 2010.
- By the beginning of the next decade, health care spending will be growing roughly 2 percentage points faster than the overall economy, "which is about the same differential experienced over the past 30 years," said the report from Medicare's nonpartisan Office of the Actuary.

National Health Expenditures and Selected Economic Indicators, Levels and Annual Percent Change: Calendar Years 2006-2021

Item	2006	2007	2008	2009	2010	Projected										
						2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
National Health Expenditures (billions)	\$2,162.4	\$2,297.1	\$2,403.9	\$2,495.8	\$2,593.6	\$2,695.0	\$2,809.0	\$2,915.5	\$3,130.2	\$3,307.6	\$3,514.4	\$3,723.3	\$3,952.3	\$4,207.3	\$4,487.2	\$4,781.0
National Health Expenditures as a Percent of Gross Domestic Product	16.2%	16.4%	16.8%	17.9%	17.9%	17.9%	17.9%	17.8%	18.2%	18.2%	18.3%	18.4%	18.6%	18.9%	19.2%	19.6%
National Health Expenditures Per Capita	\$7,250.6	\$7,627.7	\$7,910.9	\$8,148.6	\$8,402.3	\$8,660.5	\$8,952.8	\$9,214.2	\$9,807.5	\$10,272.0	\$10,817.6	\$11,360.2	\$11,955.0	\$12,618.3	\$13,345.6	\$14,102.6
Gross Domestic Product (billions)	\$13,377.2	\$14,028.7	\$14,291.5	\$13,939.0	\$14,526.5	\$15,093.0	\$15,696.8	\$16,387.4	\$17,223.2	\$18,204.9	\$19,224.4	\$20,243.3	\$21,295.9	\$22,318.1	\$23,344.7	\$24,395.3
Gross Domestic Product (billions of 2005 \$)	\$12,958.5	\$13,206.4	\$13,161.9	\$12,703.1	\$13,088.0	\$13,323.6	\$13,616.7	\$13,998.0	\$14,487.9	\$15,067.4	\$15,640.0	\$16,156.1	\$16,640.8	\$17,040.2	\$17,415.0	\$17,780.8
Gross Domestic Product Implicit Price Deflator (chain weighted 2005 base year)	1.032	1.062	1.086	1.097	1.110	1.133	1.154	1.171	1.190	1.210	1.232	1.256	1.284	1.315	1.346	1.379
Consumer Price Index (CPI-W) - 1982-1984 base	2.016	2.073	2.153	2.145	2.181	2.207	2.244	2.287	2.333	2.379	2.427	2.480	2.545	2.616	2.689	2.765
U.S. Population ¹	298.2	301.2	303.9	306.3	308.7	311.2	313.8	316.4	319.2	322.0	324.9	327.7	330.6	333.4	336.2	339.0
Population age less than 65 years	261.2	263.4	265.2	266.8	268.9	270.4	271.7	272.9	274.3	275.8	277.2	278.6	279.8	281.0	282.1	283.1
Population age 65 years and older	37.1	37.8	38.7	39.5	39.8	40.8	42.1	43.5	44.9	46.2	47.7	49.2	50.8	52.4	54.1	55.9

Source: U.S. Centers for Medicare and Medicaid Services, 7500 Security Boulevard. Baltimore, MD 21244. USA. Department of Health and Human Services; <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/tables.pdf>; <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/Proj2011PDF.pdf>; Gov't report: Health cost relief only temporary, *By RICARDO ALONSO-ZALDIVAR, Associated Press – Tue, Jun 12, 2012*

Medicare in Particular Poses Serious Challenges to Reducing the Budget Deficit

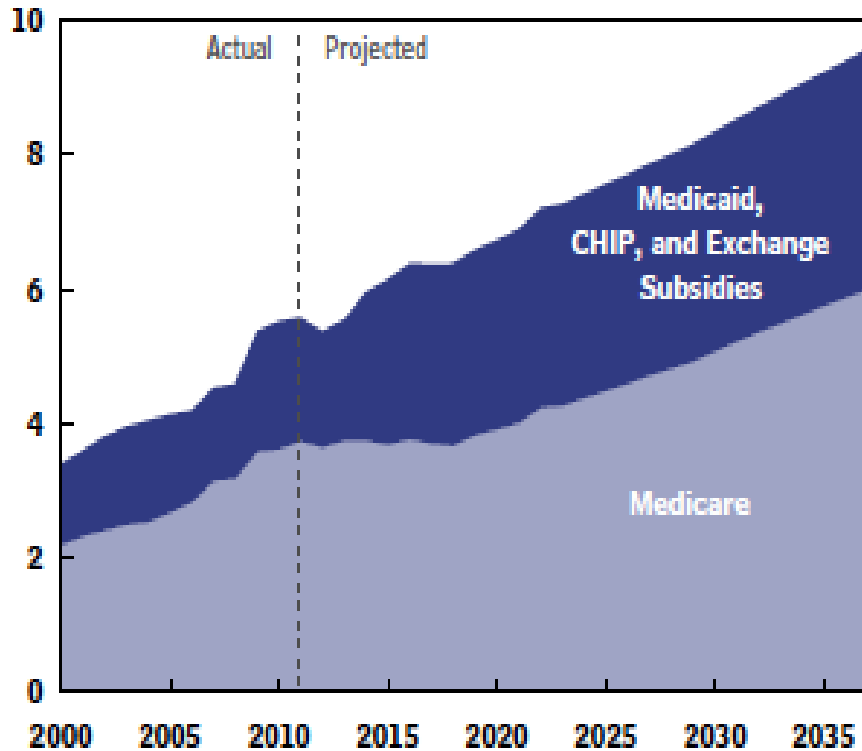
- As with Social Security, it is forecast that there will be growth in the number of Medicare recipients in the long term – a jump of 15 million recipients from 2010-2021.
- Government healthcare is also complicated by the rising cost of healthcare. Health related costs per capita have been rising at a greater rate than per capita GDP.
- Participation in Medicare is also forecast to increase by over 30% during the same period.
- As a result of these phenomenon, the CBO estimated that there will be a nearly twofold increase in Medicare outlays from 2010-2021 (\$520 billion-1.021 trillion) without sequestration. A more recent CBO assessment concludes that even with sequestration, Medicare outlays will surge from \$560 billion in 2011 to \$956 billion in 2021 and \$1.064 trillion in 2022.

-Figures referenced in first three bullets and first sentence of last bullet from “Reducing the Deficit: Spending and Revenue Options,” Congressional Budget Office, March 2011. <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12085/03-10-reducingthedeficit.pdf>. p. 14-15. Note that this report does not take into account sequestration. Figures referenced in last sentence of last bullet from “An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022,” Congressional Budget Office, August 2012. http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf. p. 6.

CBO Estimate of Rise in Federal Social Security and Medical Costs: 2000-2037 (% of GDP)

Medical Costs

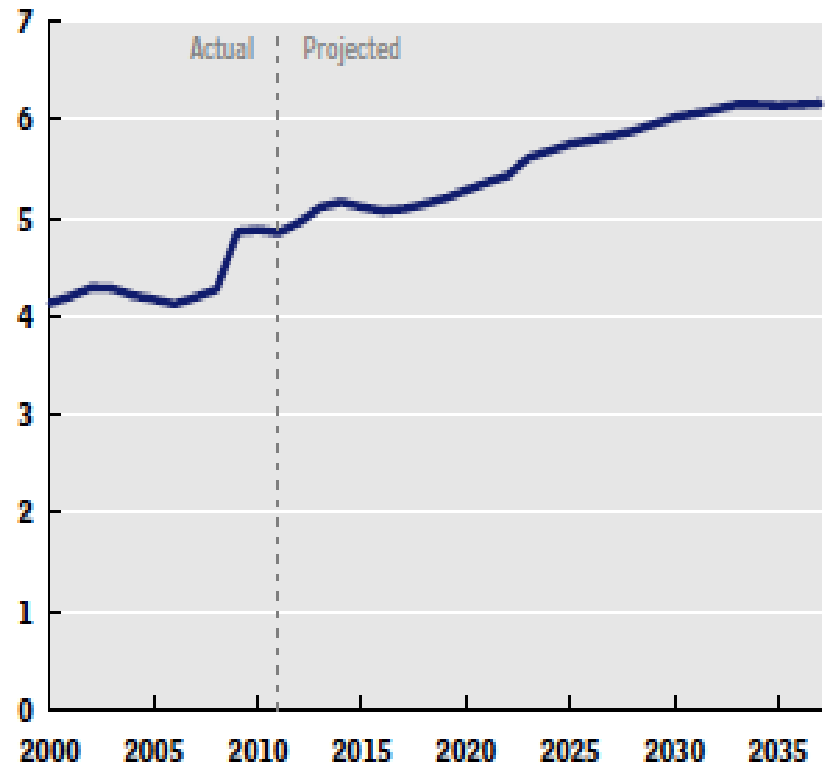
(Percentage of gross domestic product)



Source: Congressional Budget Office.

Social Security Costs

(Percentage of gross domestic product)



Source: Congressional Budget Office.

CBO Estimate of Deficit Impact of Affordable Care Act

Comparison of Estimates of the Budgetary Effects of the Insurance Coverage Provisions Contained in the Affordable Care Act

	March 2012 Baseline	July 2012 Estimate Incorporating Supreme Court Decision	Difference Between July 2012 and March 2012 Estimates
11-YEAR EFFECTS ON THE FEDERAL DEFICIT, 2012-2022^{a,b}			
<i>(Billions of dollars, by fiscal year)</i>			
Medicaid and CHIP Outlays	931	642	-289
Exchange Subsidies and Related Spending ^c	808	1,017	210
Small Employer Tax Credits ^d	23	23	*
Gross Cost of Coverage Provisions	1,762	1,683	-79
Penalty Payments by Uninsured Individuals	-54	-55	-1
Penalty Payments by Employers ^d	-113	-117	-4
Excise Tax on High-Premium Insurance Plans ^d	-111	-111	*
Other Effects on Tax Revenues and Outlays ^e	-231	-231	*
Net Cost of Coverage Provisions	1,252	1,168	-84

OMB Estimates Entitlement Budget Authority Rises From 204% of National Security Costs in FY2012 (\$1,570.7B vs. \$738.0B) to 351% in FY2017 (\$1,850B vs. \$649.5B)

		<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
050	National Defense	717.4	676.7	647.4	566.3	579.0	589.4	601.3
150	International Affairs	53.6	61.3	69.8	39.6	42.5	45.4	48.2
250	General Science, Space and Technology	29.7	29.1	29.6	30.1	30.7	31.2	31.9
270	Energy	6.7	9.2	15.7	10.3	8.1	6.3	6.2
300	Natural Resources and Environment	35.4	37.1	34.8	36.2	37.0	37.9	39.1
350	Agriculture	21.5	17.1	24.0	18.4	20.2	20.1	20.1
370	Commerce and Housing Credit	-55.2	10.5	-7.7	-12.2	-16.6	-11.1	0.2
400	Transportation	86.5	138.6	89.2	101.9	108.3	115.1	121.5
450	Community & Regional Development	14.9	44.8	17.2	11.8	12.1	12.3	12.6
500	Education, Training, Employment, and Social Services	76.5	170.1	93.8	100.7	100.3	103.0	110.8
550	Health	359.7	364.8	366.8	484.2	548.2	575.2	607.5
570	Medicare	502.4	499.3	530.3	558.6	576.8	626.3	641.6
600	Income Security	583.7	566.6	551.2	536.9	542.3	552.3	553.7
650	Social Security	101.9	140.0	61.7	34.7	38.5	42.8	47.2
700	Veterans Benefit/Services	123.1	124.6	137.7	147.4	154.1	161.0	169.3
750	Administration of Justice	53.6	59.2	54.6	55.5	56.3	59.2	58.5
800	General Government	23.9	28.7	25.3	26.3	28.1	30.2	32.4
900	Net Interest	346.3	336.9	356.8	415.8	496.5	588.3	673.1
920	Allowances		0.5	5.5	34.8	33.4	33.9	34.4
950	Undistributed	-71.4	-83.3	-79.8	-79.4	-81.5	-82.7	-82.0
Grand Total		3,010.2	3,231.8	3,023.8	3,118.0	3,314.4	3,536.4	3,727.6

Data is from OMB Historical Table 5-1 (Budget Authority by Function and Subfunction).

Even with Unrealistic Tax Rises, Entitlements Costs Could Cripple Federal Discretionary Spending: CBO 3/2012

	Actual,												Total	
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2017	2013-2022
In Billions of Dollars														
Outlays														
Mandatory	2,026	2,101	2,129	2,225	2,361	2,534	2,633	2,742	2,923	3,096	3,283	3,535	11,882	27,462
Discretionary	1,347	1,303	1,219	1,195	1,198	1,220	1,233	1,250	1,283	1,312	1,343	1,381	6,065	12,634
Net Interest	230	224	233	248	286	343	401	454	503	544	573	604	1,511	4,189
Total	3,603	3,627	3,580	3,668	3,846	4,097	4,267	4,447	4,708	4,953	5,200	5,520	19,457	44,285
On-budget	3,104	3,124	2,941	2,959	3,091	3,296	3,417	3,547	3,754	3,939	4,123	4,377	15,704	35,443
Off-budget ^a	499	503	639	709	755	801	850	900	954	1,014	1,077	1,143	3,754	8,841
Deficit (-) or Surplus	-1,300	-1,171	-612	-385	-257	-259	-201	-175	-224	-234	-237	-303	-1,713	-2,887
On-budget	-1,367	-1,224	-647	-408	-275	-279	-223	-194	-235	-231	-216	-262	-1,833	-2,971
Off-budget ^a	67	53	36	23	18	21	22	19	11	-3	-21	-41	119	84
As a Percentage of Gross Domestic Product														
Outlays														
Mandatory	13.6	13.5	13.4	13.4	13.4	13.5	13.4	13.3	13.5	13.7	13.9	14.3	13.4	13.6
Discretionary	9.0	8.4	7.7	7.2	6.8	6.5	6.3	6.1	5.9	5.8	5.7	5.6	6.9	6.3
Net Interest	1.5	1.4	1.5	1.5	1.6	1.8	2.0	2.2	2.3	2.4	2.4	2.5	1.7	2.1
Total	24.1	23.4	22.5	22.1	21.8	21.9	21.7	21.5	21.8	21.9	22.0	22.4	22.0	22.0

Much of the projected decline in the deficit only occurs because, under current law, revenues will rise considerably as a share of GDP – from 15.8 percent in 2012 to 19.8 percent in 2014 and 21.2 percent in 2022. In particular, in CBO’s baseline, revenues shoot up by more than 30 percent over the next two years, mostly because of the recent or scheduled expirations of tax provisions – such as those that reduce income and payroll tax rates and limit the reach of the alternative minimum tax (AMT) – and the imposition of new taxes, fees, and penalties that are scheduled to go into effect. **Under that alternative fiscal scenario, deficits over the 2013–2022 period would be much higher, averaging 5.3 percent of GDP rather than the 1.4 percent reflected in CBO’s baseline projections. Instead of declining to 61 percent of GDP, debt held by the public would climb to 93 percent in 2022, the highest percentage since just after World War II.**

The Impact of the Budget Control Act and Sequestration

CBO Summary of Impact of Budget Control Act

The Budget Control Act of 2011 (BCA, Public Law 112-25) made several changes to federal programs, set caps on discretionary appropriations through 2021, and included automatic enforcement procedures that would take effect if lawmakers failed to enact further legislation to reduce future budget deficits by specified amounts.

At the time of its initial consideration, the Budget Control Act's original caps on discretionary appropriations called for appropriations over the 2012–2021 period that would be roughly \$0.8 trillion lower in nominal dollars during that period than if they were allowed to grow at the rate of inflation. The caps do not apply to funding for overseas contingency operations (OCO) and certain other activities.

The BCA stated that if legislation originating from a newly established Joint Select Committee on Deficit Reduction that was estimated to produce at least \$1.2 trillion in deficit reduction (including an allowance for interest savings) was not enacted by January 15, 2012, automatic procedures for further

limits on both discretionary and mandatory spending would be triggered. Because no such legislation was enacted, those procedures are now scheduled to go into effect at the beginning of January 2013.

Triggering the automatic enforcement procedures generated two changes to the way the caps will be implemented: It allocated the overall limits on discretionary appropriations between defense and non-defense budget functions, by setting separate caps for each, and it reduced the allowed amounts of funding below those caps. For 2013, the additional reductions will be achieved by automatically canceling a portion of the budgetary resources already provided to that point in an action known as sequestration; from 2014 to 2021, the reductions will be achieved by lowering the original caps on discretionary appropriations.¹

1. For more information on those reductions, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2012 to 2022* (January 2012), Box 1-2; and *Final Sequestration Report for Fiscal Year 2012* (January 12, 2012).

CBO Estimate of Impact of Budget Control Act and Sequestration

CBO estimates that, if no legislation originating from the deficit reduction committee was enacted, the automatic enforcement process specified in the Budget Control Act would produce the following results between 2013 and 2021:

- Reductions ranging from 10.0 percent (in 2013) to 8.5 percent (in 2021) in the caps on new discretionary appropriations for defense programs, yielding total outlay savings of \$454 billion.
- Reductions ranging from 7.8 percent (in 2013) to 5.5 percent (in 2021) in the caps on new discretionary appropriations for nondefense programs, resulting in outlay savings of \$294 billion.
- Reductions ranging from 10.0 percent (in 2013) to 8.5 percent (in 2021) in mandatory budgetary resources for nonexempt defense programs, generating savings of about \$0.1 billion.
- Reductions of 2.0 percent each year in most Medicare spending because of the application of a special rule that applies to that program, producing savings of \$123 billion, and reductions ranging from 7.8 percent (in 2013) to 5.5 percent (in 2021) in mandatory budgetary resources for other nonexempt nondefense programs and activities, yielding savings of \$47 billion. Thus, savings in nondefense mandatory spending would total \$170 billion.
- About \$31 billion in outlays stemming from the reductions in premiums for Part B of Medicare and other changes in spending that would result from the sequestration actions.
- An estimated reduction of \$169 billion in debt-service costs.

In all, those automatic cuts would produce net budgetary savings of about \$1.1 trillion over the 2013–2021 period, CBO estimates.

“That amount is lower than the \$1.2 trillion figure for deficit reduction in the Budget Control Act for three reasons. First, because of the lag in timing between appropriations and subsequent expenditures, part of the savings from the automatic cuts in budgetary resources would occur after 2021. Second, CBO expects that some reductions—particularly those related to Medicare—would have other effects that would boost net spending (by the \$31 billion mentioned above). Third, CBO estimates that the reduction in debt-service costs would be lower than the amount of such savings stipulated in the Budget Control Act.” (CBO, p. 2-4)

How the BCA and Sequestration Would Be Applied

According to the Congressional Budget Office:

“Section 302 of the Budget Control Act specifies procedures that, if triggered, would result in automatic cuts in mandatory and discretionary spending beginning in 2013. The law requires that any necessary automatic reductions be calculated as follows:

1. The deficit reduction amount of \$1.2 trillion for the 2012–2021 period would be reduced to account for any estimated savings stemming from legislation originated by the deficit reduction committee and enacted before January 15, 2012...
2. To determine the amount of the reductions in spending for the government’s programs and activities that would be necessary to achieve the required savings, the act stipulates that 18 percent of the savings should be assumed to come from decreases in debt-service costs. Thus, if the required savings were the entire \$1.2 trillion, \$216 billion would be assumed to come from reduced debt-service costs, leaving \$984 billion to come from reductions in budgetary resources through 2021.
3. That adjusted target would be divided evenly over the nine years from 2013 to 2021, requiring a reduction of about \$109 billion per year to produce a nine-year total of \$984 billion.
4. That annual total would be allocated equally between defense spending (accounts in budget function 050, most—but not all—of which finance activities of the Department of Defense) and nondefense spending (all other budget functions). Thus, reductions of roughly \$55 billion per year would be required in each of those two broad spending categories if no savings resulted from legislation originated by the deficit reduction committee.
5. Within the defense and nondefense categories, the required reductions would be allocated proportionally between discretionary and mandatory spending, according to various rules...

Each year, OMB would determine the proportional allocations of required cuts in budgetary resources for mandatory and discretionary programs in both the defense and nondefense categories. The President would order any necessary sequestrations for mandatory programs and activities or reductions in discretionary spending caps in order to achieve the required reductions. For discretionary spending, reductions in 2013 would be executed by canceling new budget authority made available in that year (that cut would take the form of a sequestration of existing appropriations because it would occur in January 2013, well after the start of the fiscal year). Reductions in discretionary spending from 2014 to 2021 would be achieved by reducing the caps on such spending for each year, pursuant to the procedures specified in the Budget Control Act.⁸ For mandatory spending, reductions in all years would be achieved through sequestrations.”

OMB Assessment on the Implementation of Sequestration

Reporting by the OMB sheds light on the breakdown of the cuts called for by the BCA. The report highlights the disproportionate emphasis placed on both mandatory and discretionary defense cuts:

Spending Category	Cuts
Non-exempt defense mandatory	10%
Non-exempt defense discretionary	9.4%
Non-exempt nondefense discretionary	8.2%
Non-exempt nondefense mandatory	7.6%
Medicare	2%

Table compiled by author using data from “OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112-155),” Office of Management and Budget, undated.

http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf. p. 1.

Sequestration in Perspective

- Both defense and non-defense discretionary spending are expected to decrease in 2012 (before sequestration) by 4%, while mandatory spending is expected to increase by 1%. It is expected that the DoD reduction in 2012 outlays will be \$3 billion more than all non-defense discretionary reductions combined.
- Social Security, Medicare, and Medicaid alone are anticipated to reach 55% of federal expenditures – 12.2% of GDP – by 2022, *even if sequestration is enacted*. Sequestration does not adequately address growth in mandatory spending, but rather forces disproportionate cuts to discretionary spending.
- While the CBO groups together sequestration and the expiration of tax cuts as one scenario, policymakers may not consider these issues in tandem when legislating on the budget. The decision to continue the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 cuts could cost the budget \$2.7 trillion in potential revenue from 2013-2022 – offsetting the \$1 trillion in savings incurred from sequestration by over two-and-a-half times. *Sequestration cannot be expected to balance the deficit in the event that revenue-generating measures are not supported by Congress.*
- By the same token, *sequestration will trigger significant damage to the American economy without making a considerable impact on shrinking the deficit if enacted*. Sequestration – coupled with the expiration of tax cuts – is forecast to trigger an unemployment rate climbing to 9.1%, -0.5 real GDP growth, and a possible recession in 2013.
- The grouping together of sequestration and the expiration of tax cuts by the CBO makes it difficult to decipher the macroeconomic consequences of sequestration alone. *A thorough assessment of sequestration – including an evaluation of what programs would be impacted, how large that impact would be, and what the macroeconomic fallout would be on the US economy – is necessary by the CBO to gain better perspective.*

-Figures referenced above from “An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022,” *Congressional Budget Office*, August 2012.
http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf

The Impact of Sequestration on the FY 2013 Defense Budget: OMB Assessment of Procurement, RDT&E, and O&M Cuts

Procurement Category	FY 2013 Sequestration (% Cut)	RDT&E Category	FY 2013 Sequestration (% Cut)
Naval Aircraft	\$2.240 billion (9.4%)	Air Force	\$2.717 billion (9.4%)
Air Force (Other)	\$2.226 billion (9.4%)	Defense-wide	\$2.007 billion (9.4%)
Naval Shipbuilding and Conversion	\$2.141 billion (9.4%)	Navy	\$1.777 billion (9.4%)
Air Force Aircraft	\$2.010 billion (9.4%)	Army	\$954 million (9.4%)
Defense-wide	\$705 million (9.4%)	Operations and Maintenance Category	FY 2013 Sequestration (% Cut)
Navy (Other)	\$692 million (9.4%)	Army	\$6.867 billion (9.4%)
Air Force Missile	\$668 million (9.4%)	Navy	\$4.291 billion (9.4%)
Naval Weapons	\$369 million (9.4%)	Air Force	\$4.267 billion (9.4%)
Marine Corps	\$366 million (9.4%)	Defense-wide	\$3.879 billion (9.4%)
Mine Resistant Ambush Protected Vehicle Fund	\$314 million (9.4%)	Marine Corps	\$854 million (9.4%)
Joint Improvised Explosive Device Defeat Fund	\$296 million (9.4%)		

Note: Military personnel not subject to sequestration according to OMB report.

Compiled by author using data from “OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112-155),” Office of Management and Budget, undated.

http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf. p. 42-49, 56-59.

The Impact of Sequestration on the FY 2013 Defense Budget: Formulation of Cuts as Estimated by CSBA

$$\text{Percentage Cut} = \frac{\$56.5 B}{\$525.4B + \$88.5B + \$81.6B - \$149.4B} = 10.3\%$$

Required DoD Cut

Base DoD Budget

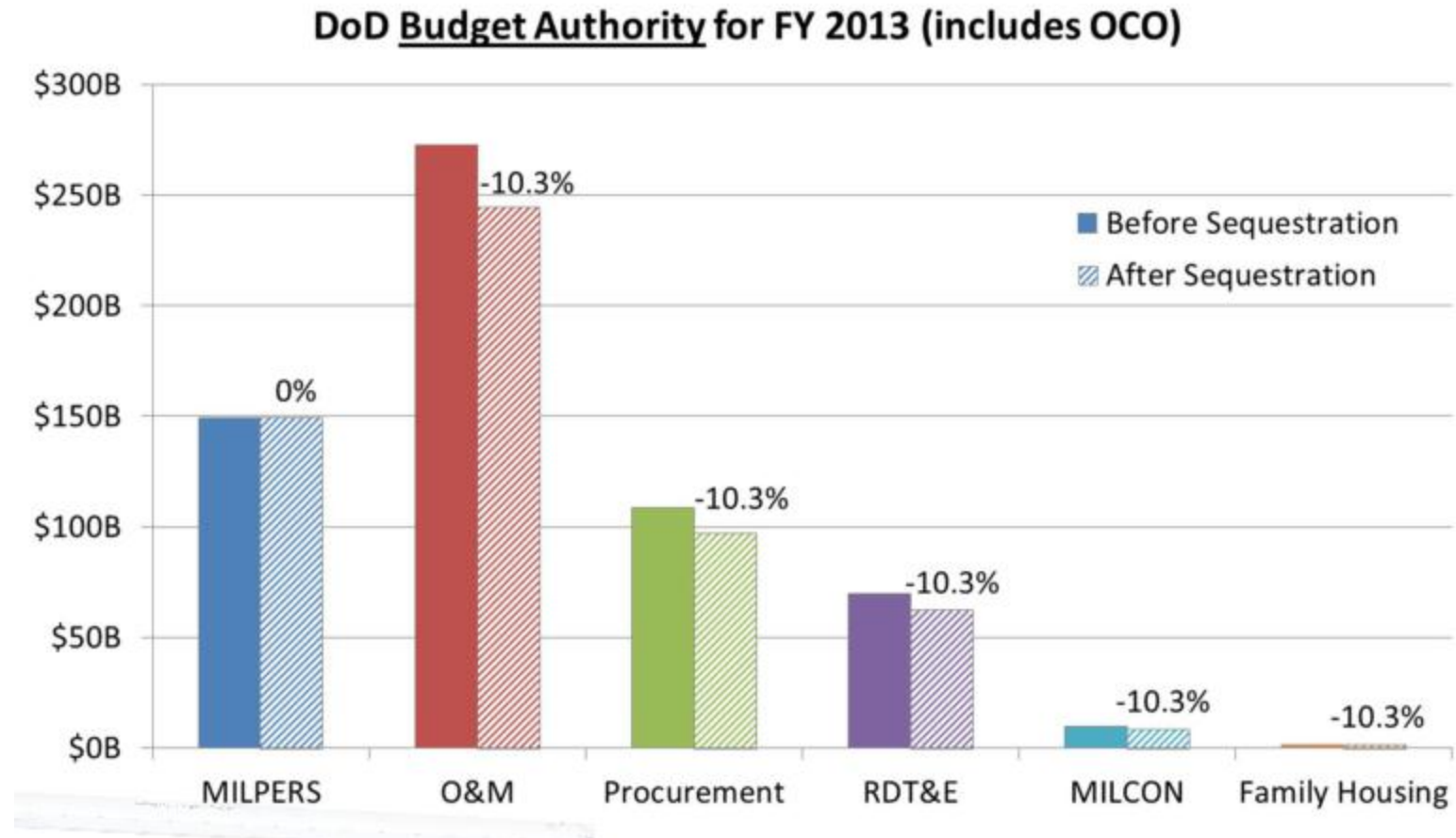
OCO Budget

Unobligated Balances

MILPERS Accounts Exempt

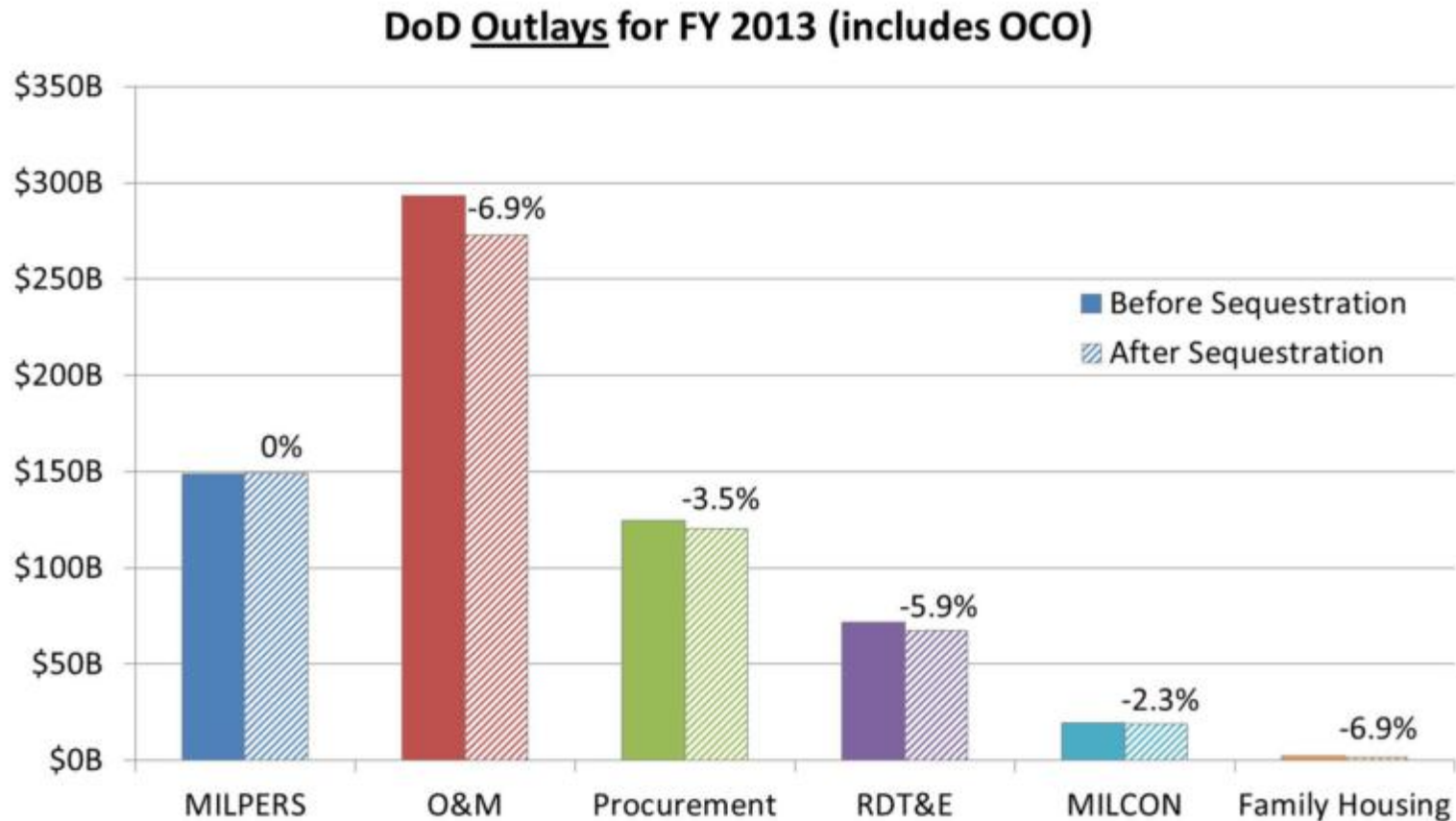
Source: Todd Harrison, "Analysis of the FY 2013 Defense Budget & Sequestration," Center for Strategic and Budgetary Assessments, August 24, 2012. p. 8.

The Impact of Sequestration on the FY 2013 Defense Budget: Impact on Budget Authority as Estimated by CSBA



Source: Todd Harrison, "Analysis of the FY 2013 Defense Budget & Sequestration," Center for Strategic and Budgetary Assessments, August 24, 2012. p. 9.

The Impact of Sequestration on the FY 2013 Defense Budget: Impact on Outlays as Estimated by CSBA



Source: Todd Harrison, "Analysis of the FY 2013 Defense Budget & Sequestration," Center for Strategic and Budgetary Assessments, August 24, 2012, p. 11.

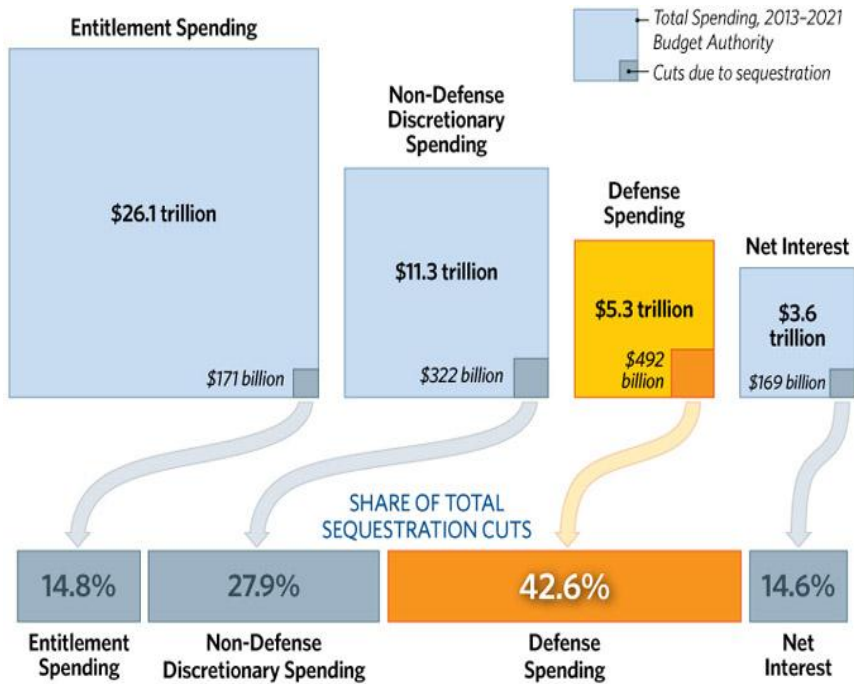
The Impact of Sequestration on the FY 2013 Defense Budget: Uncertainties Remain

With FY 2013 fast approaching, there are still many uncertainties that make it difficult to forecast what the exact impact of sequestration will be on US defense and national security.

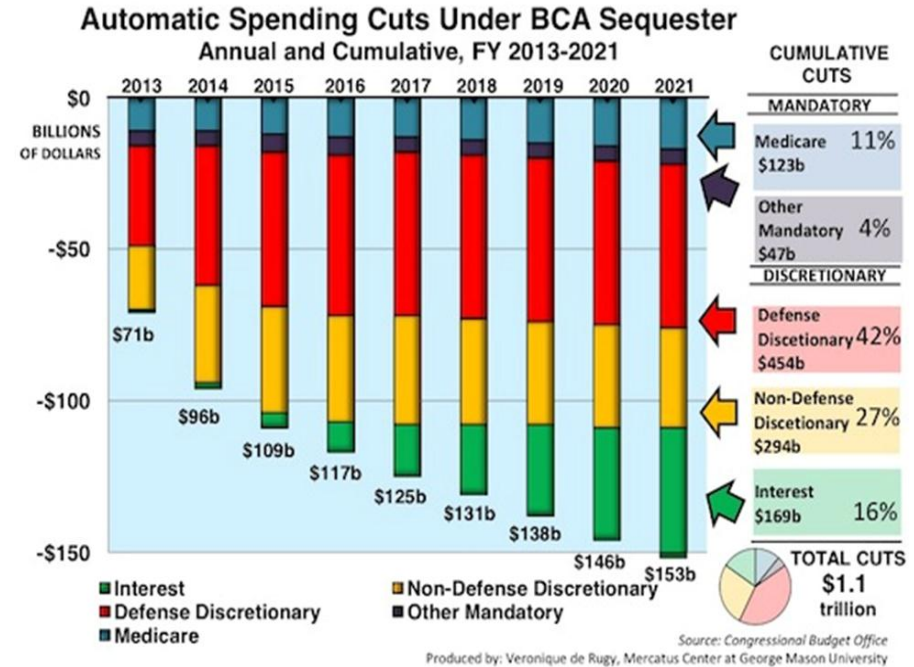
- As the preceding slides indicate, estimates differ between the OMB and the CSBA as to what the exact percentage of cuts will be to the defense budget. While CSBA indicates a 10.3% cut, OMB reports 9.4% for non-exempt defense discretionary and 10% for non-exempt defense mandatory spending.
- As the OMB points out, appropriations have yet to be set by Congress for FY 2013 as of the publishing of their report (OMB report, p. 4). This means that even their ability to forecast the exact impact of sequestration for the next fiscal year is limited.
- It remains unclear what action – if any – Congress will take to mitigate, postpone, or avoid sequestration.

Defense Will Bear the Largest Share of the BCA Sequestrations, But Think Tank Estimates Differ

Defense will see the largest share of spending cuts under the Budget Control Act of 2011's automatic cuts. While entitlement spending is responsible for the largest share of federal government expenditures, discretionary cuts significantly outweigh entitlement cuts under this legislation.



-Nominal Dollars, data from CBO, compiled by Heritage Foundation



-Graphic from *National Review Online*, <http://www.nationalreview.com/corner/281604/more-supercommittee-sequester-veronique-de-rugy>

CBO Summary of Impact of Budget Control Act on Defense Budget

- Defense appropriations are defined as appropriations for budget function 050 (national defense), which includes the military activities of the Department of Defense (DoD), the nuclear weapons activities of the Department of Energy and the National Nuclear Security Administration, and the national security activities of several other agencies. On average during the past 10 years, funding for DoD has represented 95.5 percent of total funding for budget function 050.
- Under the allocation of the BCA's caps on discretionary appropriations stemming from the automatic enforcement procedures—but before the reductions in the caps due to those procedures—funding for national defense during the 2013–2021 period would be about \$80 billion less than what would have been provided if appropriations increased with inflation starting from the amount appropriated in 2012.
- The automatic reductions will lower the caps on discretionary funding for national defense by an additional \$492 billion over the 2013–2021 period, with the reduction spread evenly at nearly \$55 billion per year. The resulting caps start at \$491 billion in 2013 and rise to \$589 billion in 2021; adjusted for inflation, the cap for 2021 is about 9 percent lower than the amount appropriated for 2012.
- If DoD was assessed the same share of the \$55 billion per year in automatic reductions for national defense as the department has received in funding historically, its budget authority would be reduced by about \$52 billion each year.
- For 2013, sequestration will apply to both the base budget and funding for OCO, and the effect on the base budget alone is unclear; the amounts discussed here are estimated as if the sequestration is applied entirely to the base budget.
- Expressed in 2013 dollars, the average annual reduction from the caps on national defense funding would be about \$49 billion over the whole period, beginning with \$52 billion in 2013 and ending with \$45 billion in 2021.

CBO Estimates Sequestration Impact Could Cripple Defense Spending: Force \$54.6 Billion a Year Cut in Budget Caps: \$2,598B Over Five Years and \$4,878 Over Ten Years

Limits on Discretionary Budget Authority for Fiscal Years 2013 to 2021

(Millions of dollars)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Caps Set in the Budget Control Act^a									
Defense	546,000	556,000	566,000	577,000	590,000	603,000	616,000	630,000	644,000
Nondefense	501,000	510,000	520,000	530,000	541,000	553,000	566,000	578,000	590,000
Total	1,047,000	1,066,000	1,086,000	1,107,000	1,131,000	1,156,000	1,182,000	1,208,000	1,234,000
Effect of Automatic Enforcement Procedures^b									
Defense	n.a.	-54,649	-54,649	-54,650	-54,650	-54,651	-54,651	-54,651	-54,652
Nondefense	n.a.	-37,937	-37,321	-36,568	-36,218	-35,648	-34,672	-33,301	-32,910
Total	n.a.	-92,586	-91,970	-91,218	-90,869	-90,298	-89,323	-87,952	-87,562
Revised Caps									
Defense	546,000	501,351	511,351	522,350	535,350	548,349	561,349	575,349	589,348
Nondefense	501,000	472,063	482,679	493,432	504,782	517,352	531,328	544,699	557,090
Total	1,047,000	973,414	994,030	1,015,782	1,040,131	1,065,702	1,092,677	1,120,048	1,146,438

Source: Congressional Budget Office.

Note: Numbers in the table may not add up to totals because of rounding; n.a. = not applicable.

- Section 251A of the Budget Control Act of 2011 (Public Law 112-25) specified that a different set of caps would take effect for 2013 through 2021 to cover defense (budget function 050) and nondefense budget authority if recommendations of the Joint Select Committee on Deficit Reduction that would reduce deficits by \$1.2 trillion over that period were not enacted by January 15, 2012.
- The automatic enforcement procedures delineated in the Budget Control Act would reduce the caps on discretionary budget authority for 2014 through 2021. For 2013, a sequestration of budgetary resources is scheduled to take effect, but no further reduction in the caps is specified in the law. Discretionary budget authority for 2013, CBO estimates, would be reduced by \$97,469 million through that sequestration. In addition, a sequestration of mandatory spending is scheduled each year between 2013 and 2021.

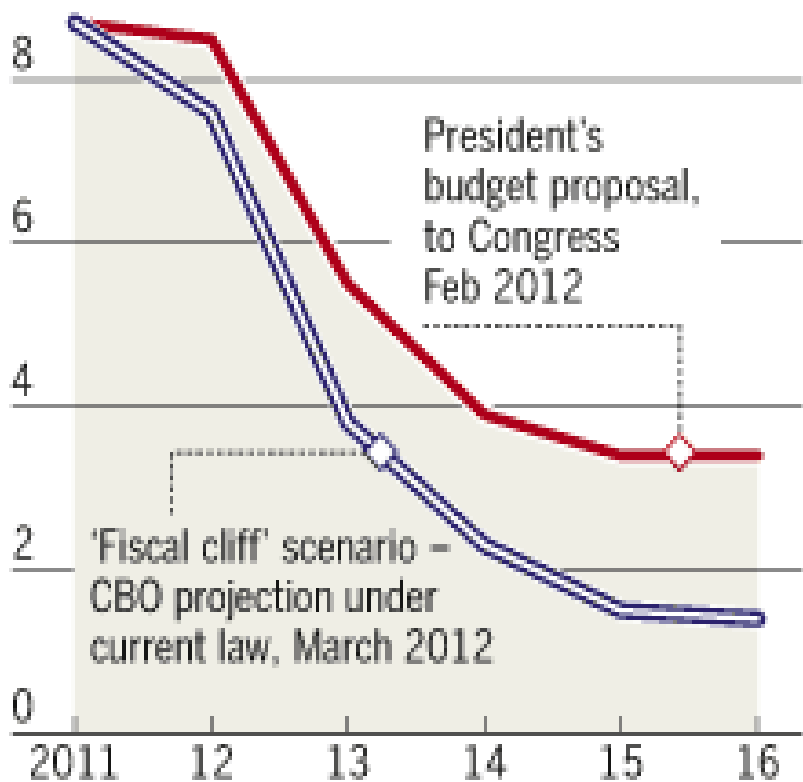
CBO Estimates of Sequestration Impact by Size of Cuts in Discretionary Expenditures (\$USB by FY)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total, 2013- 2021
Defense²										
Mandatory sequestration	*	*	*	*	*	*	*	*	*	*
Reduction in the cap on discretionary budget authority	-55	-55	-55	-55	-55	-55	-55	-55	-55	-492
Total	-55	-55	-55	-55	-55	-55	-55	-55	-55	-492
Nondefense²										
Mandatory sequestration										
Medicare spending subject to 2 percent limit	-11	-11	-12	-13	-13	-14	-15	-16	-17	-123
Other nonexempt programs	-3	-3	-4	-4	-3	-3	-3	-3	-3	-30
Additional sequestration applied to other programs because of the 2 percent limit for Medicare ²	-2	-2	-2	-2	-2	-2	-2	-2	-2	-17
Subtotal	-16	-17	-18	-19	-19	-19	-20	-21	-22	-170
Reduction in the cap on discretionary budget authority										
Preliminary reductions	-25	-24	-24	-23	-23	-23	-22	-21	-21	-206
Further reductions because of the 2 percent limit for Medicare	-14	-14	-13	-13	-13	-13	-12	-12	-12	-116
Total	-55	-55	-55	-55	-55	-55	-55	-55	-55	-492
Memorandum:										
Percentage Cut to Nonexempt Budget Accounts										
Defense	10.0	9.8	9.7	9.5	9.3	9.1	8.9	8.7	8.5	n.a.
Nondefense										
Discretionary	7.8	7.4	7.1	6.8	6.6	6.4	6.1	5.8	5.5	n.a.
Mandatory										
Medicare spending subject to 2 percent limit	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	n.a.
Other	7.8	7.4	7.1	6.8	6.6	6.4	6.1	5.8	5.5	n.a.

Financial Times Estimate of Economic Impact of Sequestration

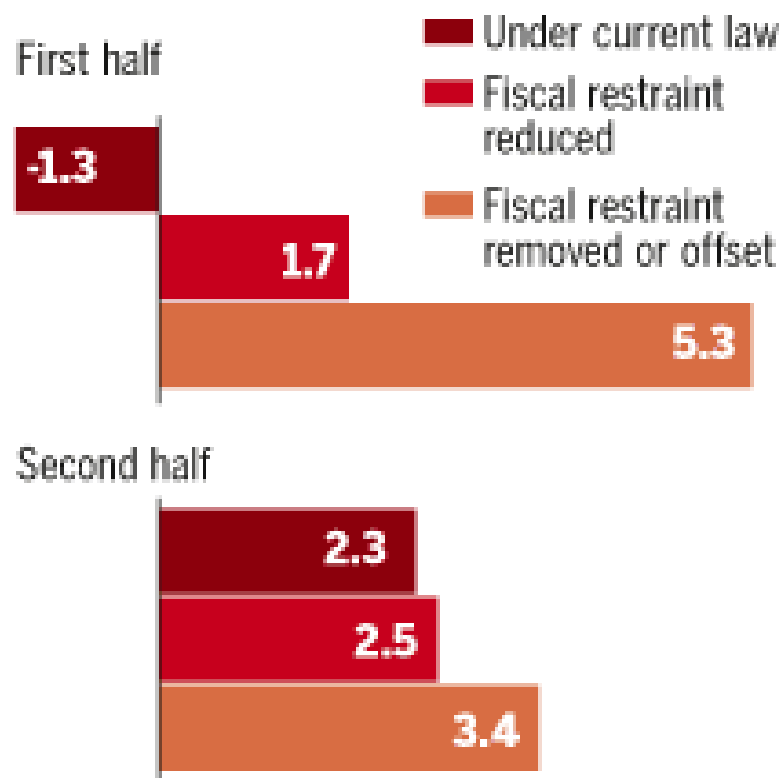
Far to fall

Federal budget deficit forecasts (% of GDP)



Sources: Congressional Budget Office; IMF

CBO growth forecasts for 2013
(annualised % change in real GDP)



Strategy by Constraints on Topline Defense Spending: FY 2001-FY2017

*No Matter What Rationale is Provided, Our Real-World
Strategy is Now Driven by Budget Limits*

Secretary Panetta on the Risks of Letting Budget Limits Drive Strategy

- “The risks come with the fact that ... we will have a smaller force...when you have a smaller force, there are risks associated with that in terms of our capability to respond ... We think we've dealt with those risks because the combination of the forces we have in place and the ability, if we have to, to mobilize quickly will give us the capability to deal with any threat.”
- “We’re depending a great deal on being at the technological edge of the future ... Can we develop the kind of technology we're going to need to confront the future? I’m confident we can, but there are risks associated with that.”
- “The reality is that as we draw down from Iraq and Afghanistan, we still face a number of very important threats in the world ... Obviously we're continuing to fight a war in Afghanistan, and we continue to face the threat of terrorism.”
- “We see the threats coming from Iran, and a nuclear-capable Iran represents a threat to us and to the world ... Weapons of mass destruction and proliferation of weapons of mass destruction are a concern. North Korea is a concern because they, too, are developing a nuclear capability.”
- “You can see the vast array of threats that we have to confront with the force that we've designed here ... So it's all of those that are my concern for the future.”

Jim Garamone, “Panetta, Dempsey Discuss Future Risks, Threats,” *American Forces Press Service*, Washington, Jan. 26, 2012.
<http://www.defense.gov/news/newsarticle.aspx?id=66945>

Chairman Dempsey on the Risks

- “The greater risk would be had we decided that we would just wish away any particular capability or any particular form of conflict.. So, say, ‘no, ... we're just never going to do that.’ What you're expressing here is the recognition that we are retaining our full-spectrum capability, and that we didn't take any risk with that.”
- “At the same time, we put national security above parochial interest -- exactly what the American people should expect of us.”
- “Capability is more important than size... We get leaner. But this budget does not lead to a military in decline. It leads to a joint force that is global and networked, that is versatile and innovative, that is ably led and that is always ready.”
- “[aforementioned joint force] can win any conflict, anywhere,”
- According to Karen Parrish of the American Forces Press Service, “There are no proposed pay freezes or reductions, and department officials will not change health care benefits for active-duty troops, those with combat injuries or service members who have medically retired [...]” As Chairman Dempsey stated, “But we cannot – we cannot – ignore some hard realities...Pay and benefits are now roughly one-third of defense spending. ... pay will need to grow more slowly in the future.”
- “We’ll take the time to determine how to enact any retirement reforms over the next year.”
- “It represents responsible investment in our national security...But make no mistake, the tradeoffs were tough. The choices were complex.”
- “The primary risks lie not in what we can do, but in how much we can do and how fast we can do it. [...] The risks, therefore, are in terms of time and capacity.”
- “I am convinced we can properly manage them by ensuring we keep the force in balance, investing in new capabilities and preserving a strong reserve component...As I’ve said before, we will face greater risks if we do not change the way we’ve been doing things.”
- “Much will be said and written about the individual decisions underlying this budget...Some may be tempted to view them through the prism of a zero-sum game, parsing through each cut, each change, to look for a winner and a loser. That is actually the least-productive way to assess this budget...I’m confident it meets our nation’s needs in our current fights and for our future.”

Jim Garamone, “Panetta, Dempsey Discuss Future Risks, Threats,” *American Forces Press Service*, Washington, Jan. 26, 2012. <http://www.defense.gov/news/newsarticle.aspx?id=66945>; and Ken Parrish, “Dempsey: Defense Budget Reflects Clear Strategic Choices,” *American Forces Press Service*, Washington, Jan. 26, 2012. <http://www.defense.gov/news/newsarticle.aspx?id=66941>

Topline By the Numbers

- \$525 topline (Baseline) billion for FY2013, rising to \$567 billion in FY217 in current dollars. Down from \$531 billion in FY2011.
- Wartime (OCO) account drops from \$115 billion in FY2011 to \$88.4 billion in FY2012.
- Conforms to 2011 Budget Control Act requirement to reduce future DoD expenditures by \$487 billion over next decade (a cut of nearly 9%), or \$259 billion over next five years.
- The new budget level for the Defense Department will rise from FY 2013 to FY 2017; however, total U.S. defense spending, including both base funding and war costs, will drop by about 22% from its peak in 2010, after accounting for inflation.
- By comparison, the 7 years following the Vietnam and Cold War peak budgets saw a similar magnitude of decline on the order of 20 to 25%.
- Cuts are a continuation of the effort begun in 2010, which identified more than \$150 billion in savings over five years allocated among the three military departments, the defense agencies,
- combatant commands, and the Secretary's staff. This left less room for additional reductions to meet the new target of \$259 billion over FY13-17.
- Nonetheless, DoD found about \$60 billion in new projected savings over FY13-17.

Different Estimates of Coming Cuts

Budget Control Act Mandated Reductions

- \$487B over 10 years (FY 2012-2021)
- \$259B over 5 years (FY 2013-2017)

Defense Budget over Time¹

\$B	FY01	...	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Base	297		528	528	531	525	534	546	556	567
OCO²	13		163	159	115	88				
Total	310		691	687	646	614			TBD	

Budget Reduction from Peak FY10 Funding¹

	\$B	FY10	FY17	\$ Change	% Change
Nominal	Base	528	567	39	7%
	OCO	163	44 ³	-119	-73%
	Total	691	611	-80	-12%
Real (\$FY13)	Base	557	529	-28	-5%
	OCO	172	41	-131	-76%
	Total	729	570	-159	-22%

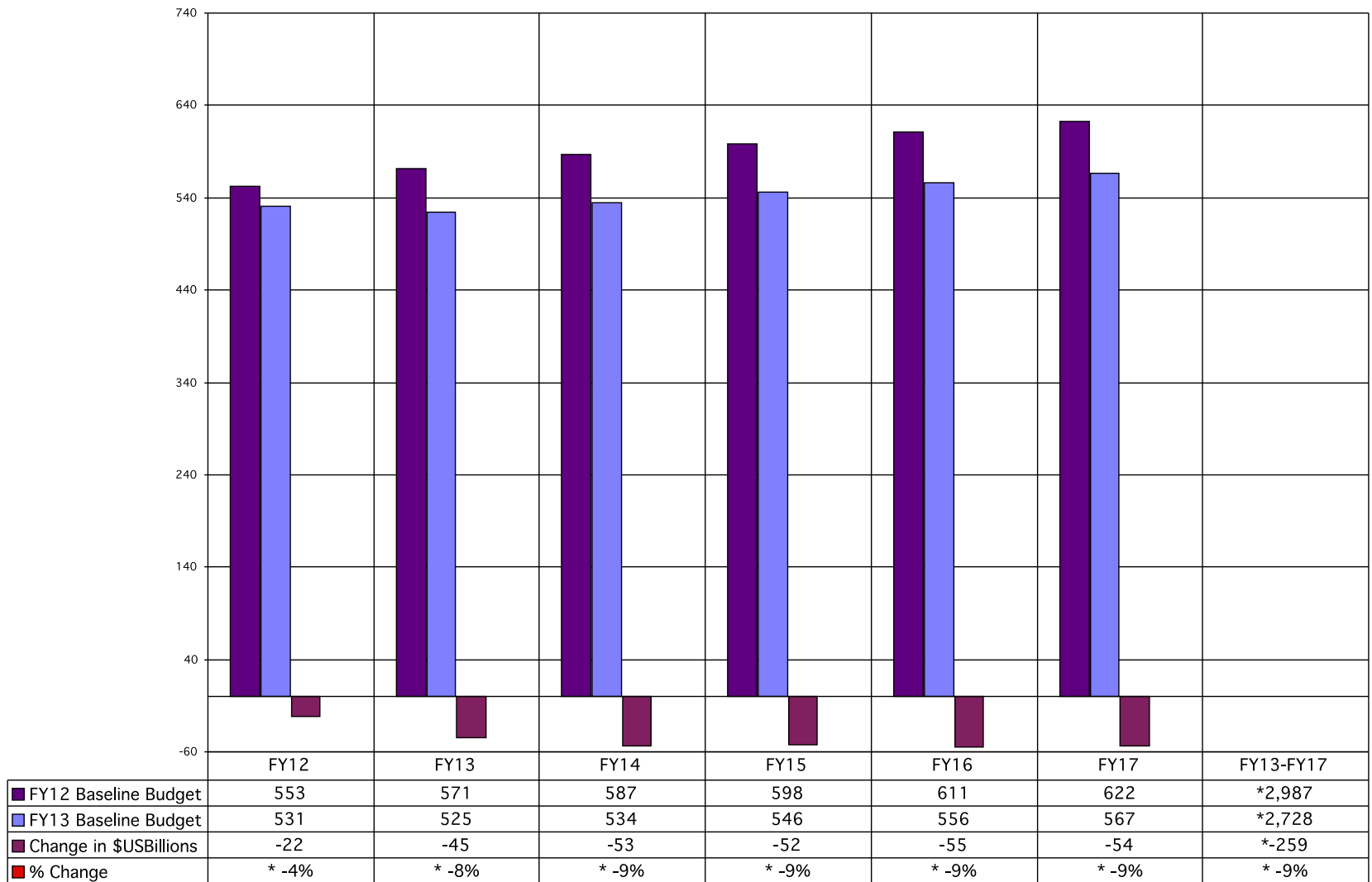
Change from the Base FY12 President's Budget¹

\$B	FY12	FY13	FY14	FY15	FY16	FY17	FY13-17
FY12 Budget	553	571	587	598	611	622	2,987
FY13 Budget	531 ⁴	525	534	546	556	567	2,728
\$ Change	-22	-45	-53	-52	-55	-54	-259
% Change	-4%	-8%	-9%	-9%	-9%	-9%	-9%

Annual Base Budget Changes¹

	\$B	FY12	FY13	FY14	FY15	FY16	FY17	FY13-17
Nominal	FY13 Budget	531	525	534	546	556	567	
	% Change		-1.0%	1.5%	2.3%	1.8%	2.1%	6.8%
Real (\$FY13)	FY13 Budget	538	525	527	531	530	529	
	% Change		-2.3%	0.3%	0.6%	-0.2%	-0.1%	-1.6%

Cuts from FY2012 President's Baseline Budget Request in FY2013 Request: (\$US in Current Billions)



Source: Adapted from DoD Factsheet issued by OSD (PA) on 26.1.12

How Much Should Be Enough? Still Roughly 4% of GDP in FY2001-FY2017:

<i>\$ in Billions</i>	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13*
Base	296.9	328.1	364.9	376.5	400.0	410.5	431.4	479.0	513.2	527.9	528.2	530.6	525.4
OCO/ Supplementals	13.4	16.8	72.5	90.7	75.6	115.7	166.2	186.9	145.6	162.3	158.8	115.1	88.5
Other**	5.8	--	--	0.3	3.2	8.1	3.1	--	7.4	0.7	--	--	--
Total	316.2	345.0	437.4	467.6	478.9	534.4	600.9	665.9	666.3	690.9	687.0	645.7	613.9

Numbers may not add due to rounding

Data is discretionary budget authority. FY 2001 through FY 2011 are actual levels. The FY 2012 is the appropriated or enacted amount.

** Budget Request.*

*** Non-war supplemental appropriations, e.g. funding needed in base budget for fuel costs, hurricane relief, and other disaster relief.*

<i>\$ in Billions</i>	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY13 – 17 TOTAL
FY 2012 PB	570.7	586.4	598.2	610.6	621.6	2,987.5
FY 2013 PB	525.4	533.6	545.9	555.9	567.3	2,728.1
Delta	-45.3	-52.8	-52.3	-54.7	-54.3	-259.4
Real Growth	*-2.5%	0.0%	+0.8%	+0.2%	+0.2%	** -0.3%

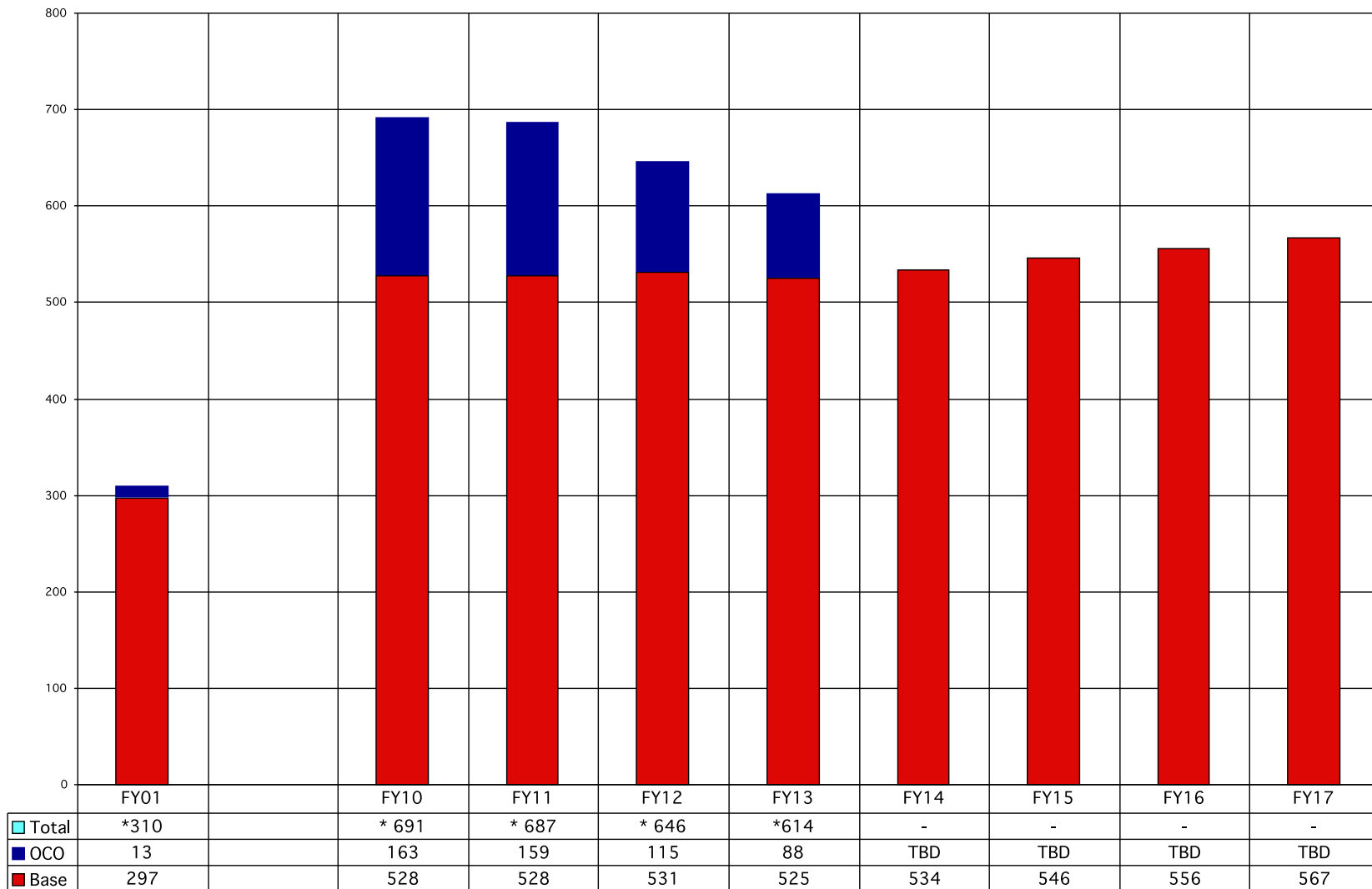
**Real growth calculated from the FY 2012 appropriation (\$530.6 billion).*

***Average annual real growth for FY 2013 – FY 2017.*

Source: DoD FY2013 Budget Summary

FY2013-FY2017 Budget Remains High If Exclude Wartime Spending

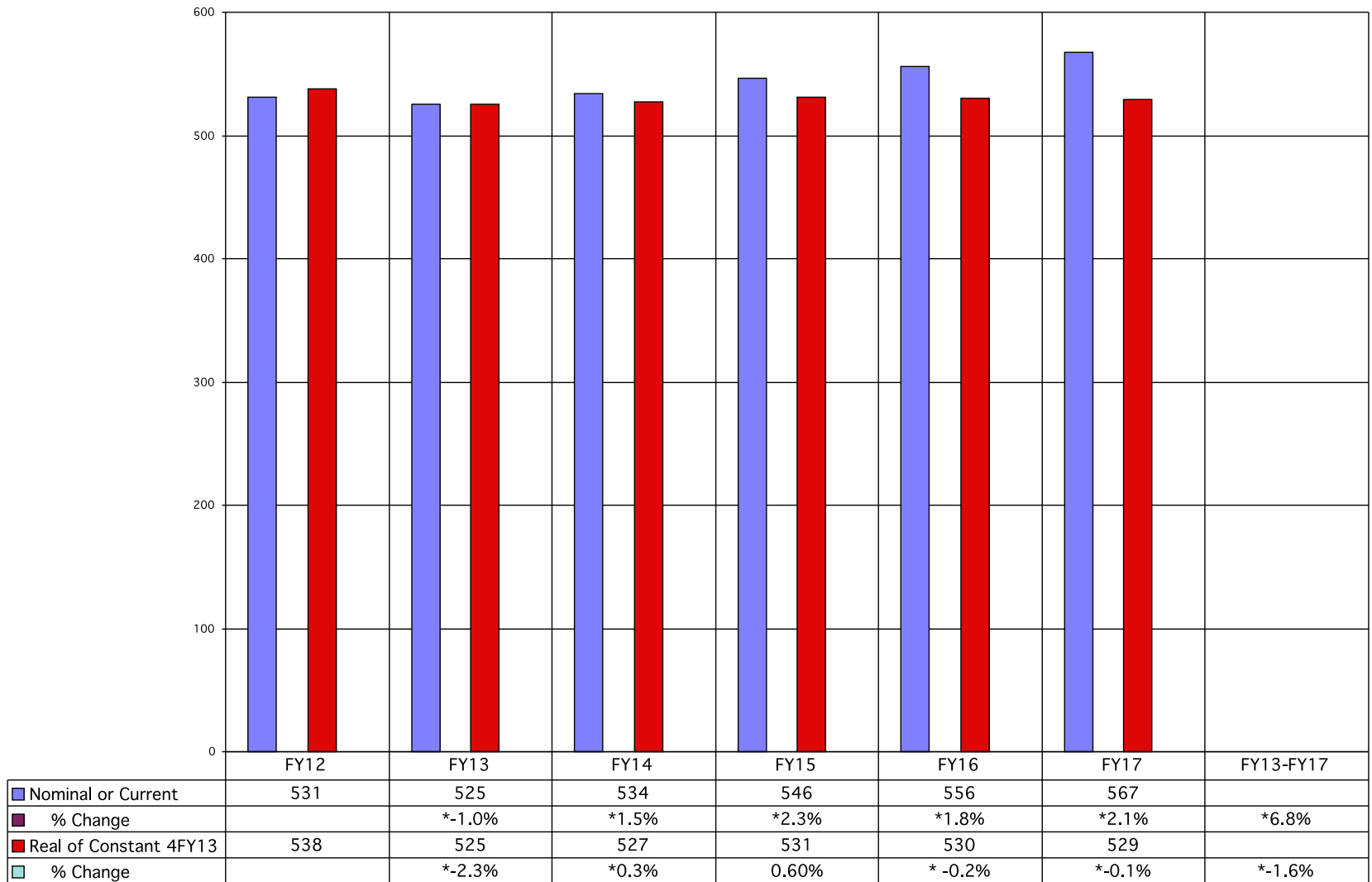
(\$US in Current or “Nominal” Billions)



Source: Adapted from DoD Factsheet issued by OSD (PA) on 26.1.12

Baseline Cuts Are Minimal Even in Constant Dollars

(\$US in Current vs. Constant Billions)



Source: Adapted from DoD Factsheet issued by OSD (PA) on 26.1.12

BUT, Once Again, Sequestration Could Cripple Defense Spending: Force \$54.6 Billion a Year Cut in Budget Caps: \$2,598B Over Five Years and \$4,878 Over Ten Years

Limits on Discretionary Budget Authority for Fiscal Years 2013 to 2021

(Millions of dollars)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Caps Set in the Budget Control Act^a									
Defense	546,000	556,000	566,000	577,000	590,000	603,000	616,000	630,000	644,000
Nondefense	501,000	510,000	520,000	530,000	541,000	553,000	566,000	578,000	590,000
Total	1,047,000	1,066,000	1,086,000	1,107,000	1,131,000	1,156,000	1,182,000	1,208,000	1,234,000
Effect of Automatic Enforcement Procedures^b									
Defense	n.a.	-54,649	-54,649	-54,650	-54,650	-54,651	-54,651	-54,651	-54,652
Nondefense	n.a.	-37,937	-37,321	-36,568	-36,218	-35,648	-34,672	-33,301	-32,910
Total	n.a.	-92,586	-91,970	-91,218	-90,869	-90,298	-89,323	-87,952	-87,562
Revised Caps									
Defense	546,000	501,351	511,351	522,350	535,350	548,349	561,349	575,349	589,348
Nondefense	501,000	472,063	482,679	493,432	504,782	517,352	531,328	544,699	557,090
Total	1,047,000	973,414	994,030	1,015,782	1,040,131	1,065,702	1,092,677	1,120,048	1,146,438

Source: Congressional Budget Office.

Note: Numbers in the table may not add up to totals because of rounding; n.a. = not applicable.

- a. Section 251A of the Budget Control Act of 2011 (Public Law 112-25) specified that a different set of caps would take effect for 2013 through 2021 to cover defense (budget function 050) and nondefense budget authority if recommendations of the Joint Select Committee on Deficit Reduction that would reduce deficits by \$1.2 trillion over that period were not enacted by January 15, 2012.
- b. The automatic enforcement procedures delineated in the Budget Control Act would reduce the caps on discretionary budget authority for 2014 through 2021. For 2013, a sequestration of budgetary resources is scheduled to take effect, but no further reduction in the caps is specified in the law. Discretionary budget authority for 2013, CBO estimates, would be reduced by \$97,469 million through that sequestration. In addition, a sequestration of mandatory spending is scheduled each year between 2013 and 2021.

The Myth of Efficiency: “More Disciplined Use of Resources” = DoD Wide Cuts Worth \$30.8 Billion in FY2013-FY2017

- Civilian Pay Raises (\$10.4 billion). The civilian pay increase for FY 2013 was limited to 0.5 percent.
- Defense Agency/Office of the Secretary of Defense (\$10.7 billion). Initiatives include reducing overhead, staffing, and expenses; more efficient contracting and acquisition; and more.
- Better Buying Power (\$5.3 billion). obtain greater efficiency and productivity in defense spending by improving the way the Department acquires critical defense goods and services.
- Ensure Compliance with the Executive Order on Promoting Efficient Spending (\$0.5 billion). Reductions were made to travel, printing and reproduction by leveraging technology to teleconference and provide information in electronic form.
- Reduce Combatant Command Support Costs (\$1.5 billion). Initiatives include reducing overhead and support costs.
- Reduce Defense Working Capital Fund Rates (\$1.1 billion). Reduce rates for supplies and printing provided by the Defense Logistics Agency, financial services provided by the DoD
- Finance and Account Service, and Pentagon space as a result of cost reductions.
- Delay and restructure various facility projects (\$0.6 billion)

“More Disciplined Use of Resources”

Budget Cuts by Service: FY2013-FY2017 -- \$30.8 Billion

Department of Army (\$18.5 billion)

- Streamline installation support functions and reduce installation support (\$5.3 billion)
- Consolidate information technology enterprise services (\$1.4 billion)
- Streamline management headquarters and administrative support functions (\$0.7 billion)
- Reduce civilians supporting overhead functions (\$0.9 billion)
- Reduce recruiting, advertising and enlisted incentives as a result of economic conditions (\$0.7 billion)
- Defer training range revitalization projects (\$1.3 billion)
- Delay MILCON projects and facility restoration and modernization (\$5.8 billion)
- Reduce equipment technical support and ammunition sustainment (\$1.7 billion)
- Streamline Personnel Security administration (\$0.4 billion)
- Other streamlining efficiencies (\$0.3 billion)

Department of Navy (\$5.7 billion)

- Implement strategic sourcing of commodities and services (\$2.2 billion)
- Consolidate information technology enterprise services (\$1.6 billion)
- Streamline organizations (\$0.7 billion)
- Reduce procurement modifications (\$0.3 billion)
- Increase buying power (\$0.7 billion)
- Other streamlining efficiencies (\$0.2 billion)

Department of Air Force (\$6.6 billion)

- Consolidate information technology enterprise services (\$1.1 billion)
- Reduce service support contractors (\$1.2 billion)
- Reduce administrative travel and permanent change of station travel (\$0.5 billion)
- Streamline contracting (\$0.4 billion)
- Reduce inventories (\$0.3 billion)
- Reduce accessions and force development and training (\$0.5 billion)
- Delay MILCON projects (\$2.4 billion)
- Other streamlining efficiencies (\$0.2 billion)

\$60B More Identified by DoD for Savings

According to the Department of Defense:

“This was a continuation of the effort begun in 2010, which identified more than \$150 billion in savings over five years allocated among the three military departments, the defense agencies ,combatant commands, and the Secretary’s staff. This left less room for additional reductions to meet the new target of \$259 billion over FY13-17. Nonetheless, did find about \$60 billion in new projected savings over FY13-17.”

- The Department specifies the following specific areas for savings:
 - More skillful contracting practices to increase competition, reduce costs, and increase buying power
 - Better use of information technology
 - Better use of business and enterprise systems
 - Streamlined staff
 - Limitations on official travel
 - Better inventory management
 - Reductions in contract services
 - Deferral of some military construction to align our facilities more closely with the size and posture of our future force
 - Reductions in planned civilian pay raises
- “Beyond the roughly \$60 billion in efficiencies and overhead savings, we eliminated a number of poorly performing programs” described earlier.

Senate Markups to the FY 2013 Defense Budget

The Senate Committee on Armed Services passed a \$631.4 billion budget on May 24, which included approximately 150 amendments. Analysis of the draft bill is limited as of yet, but according to one observer, the draft bill includes:

- Restricting assistance to the Pakistani military while Pakistan continues to prohibit the movement of supplies to Afghanistan;
- Eliminating many of the funding decreases planned for the Air National Guard;
- Sustaining M1 Abrams production;
- Eliminating higher TRICARE fees;
- Cutting the number of civilians within DOD by 5% within 5 years.

Source: Jeremy Herb, "Senate Panel Moves \$631B Defense Bill." *DEFCON Hill: The HILL's Defense Blog*. May 24, 2012. <http://thehill.com/blogs/defcon-hill/budget-appropriations/229433-senate-panel-passes-631b-defense-bill>

Amendments offered by the Armed Services Committee's Subcommittee on Readiness and Management Support, the only subcommittee to hold a markup session open to the public, include:

- Eliminating approximately \$500 million from O&M and over \$600 million from military construction;
- Increasing funding for the DOD Inspector General (\$59 million increase) and the DOD Corrosion Control Initiative (\$21 million increase);
- Improving contracting to enhance the accountability of contractors and the efficiency of programs;
- Proposing that a risk assessment be conducted prior to cutting a key Marine Corps squadron;
- Improving efficiency in supplying the mission in Afghanistan through the Northern Supply Route;
- Eliminating base realignments and closures (BRACs) for FY 2013.

Source: US Senate, Subcommittee on Readiness and Management Support, Committee on Armed Services, "Hearing to Mark Up the Readiness and management Support Programs Contained in the National Defense Authorization Act for Fiscal Year 2013.," May 22, 2012. <http://armed-services.senate.gov/Transcripts/2012/05%20May/12-39%20-%205-22-12.pdf>

As the FY2013 Defense Budget Goes Through The Legislature, Congressionally-Driven Spending Could Cause Friction With the Obama Administration

The House of Representatives recently passed a defense budget worth \$642 billion, including billions more than what was proposed by the President. It is reported by the Washington Post that the President may veto the budget. Key issues include:

- The House does not support the closing of bases in the US in FY 2013;
- Representatives have stipulated that US troops would remain in Afghanistan until 2014 with a combat force 68,000 strong. An accelerated withdrawal amendment failed in the House;
- An additional \$100 million was included for a missile defense shield on the US East Coast.

Sources: AP, "Disputed Issues in the House Defense Budget," *The Washington Post*, May 18, 2012. http://www.washingtonpost.com/national/disputed-issues-in-the-house-defense-budget/2012/05/18/gIQAvzUqXU_story.html

Key political issues in the budget going forward:

- **BASE CLOSURES:** Both the House and the Senate are seemingly in agreement with regards to closing bases in the US. The decisions against the closings on both sides appear to be driven by the costliness of past closings;
- **BUDGET INCREASES:** The House bill and Senate draft bill call for spending in excess of what is permitted under the Budget Control Act of 2011. In fact, the House has approved a budget that adds several billion dollars to the Obama Administration's planned expenditures. Significantly more expenditures than planned by the administration raises the prospect of a presidential veto;
- **MISSILE DEFENSE:** A key point of disagreement in reconciling the bills will be the missile defense shield on the US East Coast, which is supported by the House but not the Senate. In terms of overseas defenses, both the House and the Senate are in agreement on strengthening missile defense in Israel;
- **INDEFINITE DETENTION:** Both the House bill and the draft bill that left the Senate Committee on Armed Services do not alter the section of the defense budget that allows for indefinite detention, although it is reported that Senator Udall will propose an amendment for the Senate floor when the bill is debated in June or July.

Sources: AP, "Disputed Issues in the House Defense Budget," *The Washington Post*, May 18, 2012. http://www.washingtonpost.com/national/disputed-issues-in-the-house-defense-budget/2012/05/18/gIQAvzUqXU_story.html and US Senate, Subcommittee on Readiness and Management Support, Committee on Armed Services, "Hearing to Mark Up the Readiness and management Support Programs Contained in the National Defense Authorization Act for Fiscal Year 2013.," May 22, 2012. <http://armed-services.senate.gov/Transcripts/2012/05%20May/12-39%20-%205-22-12.pdf> and Jeremy Herb, "Senate Panel Moves \$631B Defense Bill." *DEFCON Hill: The HILL's Defense Blog*. May 24, 2012. <http://thehill.com/blogs/defcon-hill/budget-appropriations/229433-senate-panel-passes-631b-defense-bill>

Other Key Issues in the FY2013 House Authorization and Draft Senate Authorization Bills

- **FACILITY UPKEEP AND OVERHAUL:** The House authorization bill contains just under \$600 million (just over \$770 million in the appropriations bill) for facility upkeep and overhaul. This has been described by a defense budget analyst as a “slush fund” for de facto pork barrel spending on programs yet to be defined. Republicans in the House however say it is necessary due to the administration’s attempts to save money on maintenance by simply extending the lifespan of facilities.
- **AIR NATIONAL GUARD:** Both the House and the Senate bills eliminate planned scale-backs for the Air National Guard.
- **VIRGINIA-CLASS SUBMARINE:** Procurement of a second vessel has been supported by both the House and Senate. This sub class was identified by SECDEF as playing a key role in advancing US area-denial penetration capabilities in East Asia.
- **TRICARE:** Rises in fees have been eliminated by the House and Senate.
- **M1 ABRAMS:** The House and Senate call for sustaining production.
- **MILITARY ASSISTANCE TO PAKISTAN:** Assistance is restricted in both the House and Senate bills. In both cases, the restrictions were the result of Pakistan continuing to prohibit the movement of supplies to Afghanistan. The House restriction puts a hold on \$650 for Pakistan – this hold is incumbent upon the supply route being closed.

Sources: Shaun Waterman, “House Republicans Add Half-Billion Dollars to Pentagon Budget,” *The Washington Times*, June 1, 2012. <http://www.washingtontimes.com/news/2012/jun/1/house-republicans-add-half-billion-pentagon-budget/>; Austin Wright, “House, Senate Face Off Over Defense Bill,” *Politico*, May 30, 2012. <http://www.politico.com/news/stories/0512/76886.html>; Roxana Tiron and Tony Capaccio, “Senate Panel Backs Defense Bill Keeping With Obama Budget,” *Bloomberg*, May 25, 2012. <http://www.bloomberg.com/news/2012-05-24/senate-panel-backs-defense-bill-keeping-with-obama-budget.html>; Jane Perlez, “Panetta Outlines New Weaponry for Pacific,” *New York Times*, June 1, 2012. <http://www.nytimes.com/2012/06/02/world/asia/leon-panetta-outlines-new-weaponry-for-pacific.html>; Rick Maze, “Senate Panel Kills Big Tricare Fee Hikes,” *Army Times*, May 24, 2012. <http://www.armytimes.com/news/2012/05/military-senate-panel-kills-tricare-fee-hikes-052412w/>; Agencies, “US House Puts Pak Aid on NATO Trucks,” *The Nation*, May 19, 2012. <http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/national/19-May-2012/us-house-puts-pak-aid-on-nato-trucks>

The Impact of Sequestration on Defense and National Security

“...every dollar the United States spends on old and unnecessary programs is a dollar we lose from new, necessary strategic investments...Sequester was designed to be irrational...a sequester would have devastating effects on our readiness and our workforce and disrupt thousands of contracts and programs.” –Deputy Defense Secretary Ashton Carter, May 30, 2012.

- It was recently determined that sequestrations could have a direct impact on war fighting. While initially thought that overseas contingency operations (OCO) would be insulated from sequestration, a DOD statement from May 2012 indicates that OCO funds are in fact vulnerable to scale-backs.
- While DOD has sought cost-saving measures such as boosting TRICARE premiums and closing bases through BRACs, Congress has opposed these measures. Congressional resistance to DOD efforts to conserve resources threatens the department’s ability to adapt to the constraints of fiscal austerity.
- According to Scott Lilly with the Center for American Progress, roughly 30% of a sample of DOD program managers claim that the sequestration threat has impacted their contract planning decisions.
- Lilly further states that, “[s]ince about 30 percent of all government contracts are consummated in the fourth quarter of the fiscal year (the three months between July 1 and September 30), a potentially large chunk of the \$160 billion that would otherwise be going out the door into the broader economy won’t be in 2012.”
- The Aerospace Industries Association estimates that over 950,000 job cuts could come from small businesses in ten years from sequestration. By September 2012, Northrop Grumman already had 600 buyouts agreed by employees.

Sources: Top quote from US Department of Defense, “Deputy Secretary of Defense Carter Speech to the American Enterprise Institute Washington, DC,” News Transcript, May 30, 2012. <http://www.defense.gov/transcripts/transcript.aspx?transcriptid=5044>; Other sources Roxana Tiron, “War Funds Face Automatic Cuts In January, Pentagon Says,” *Bloomberg News*, May 30, 2012. and Charles S. Clark, “Pentagon’s No. 2 Leader Criticizes Lawmakers’ Add-Backs To Defense Bill,” *GovExec.com*, May 30, 2012; Third and fourth bullets, including quote, from Scott Lilly, *Sequestration Is a Swiftly Ticking Time Bomb*, Center for American Progress, June 18, 2012. http://www.americanprogress.org/issues/2012/06/sequestration_damage.html; David Lerman, “Pentagon Offers Hints of Sequester’s Impact,” *Bloomberg Government*, September 24, 2012.

Department of Defense Still
Cannot Control Its Costs or
Accurately Plan Future
Spending – With and Without
the impact of the BCA
– *But it will still place a lower
burden on the economy in
“worst case”*

The Self-Destructive Behavior of the Department of Defense is also Part of the Threat

The Department of Defense needs to make a major new effort to deal with its own, self-inflicted non-traditional threats.

- Lack of adequate cost control and realistic planning of future budgets cited earlier.
- A quarter century of posturing (?), failed efforts to develop effective procurement programs and cost controls.
- A fundamental breakdown in the ability to tie strategy to feasible, affordable programs.
- Massive rises in the cost per soldier on active duty.

CBO Warning in July 2012 - I

According to the Congressional Budget Office:

- To execute its base-budget plans for 2013 through 2017, DoD would need five years of appropriations totaling \$53 billion (or 2.0 percent) more in real, or inflation-adjusted, terms than if funding for the base budget was held at the 2012 amount of \$543 billion
- For the entire projection period of 2013 through 2030, DoD's base-budget plans would require appropriations totaling \$1.2 trillion (or 12 percent) more than if funding for the base budget was held at the 2012 amount in real terms.
- To execute its base-budget plans for 2013, the department would require appropriations of \$535 billion, 1.4 percent less than the \$543 billion appropriated in 2012. That figure for 2013 is \$9 billion higher than DoD's request because CBO includes the cost of all active-duty personnel (whereas the department proposes to shift the cost of some of those personnel out of the base budget) and because CBO assumes that the Congress will continue its history of rejecting DoD's proposals to shift some health care costs to the military beneficiaries receiving the care. To execute its base-budget plans after 2013, DoD's appropriations would need to nearly return to their 2012 level in 2014 and grow at an average annual rate of 2.0 percent between then and 2017, all in real terms.
- From 2017 to 2030, DoD's appropriations would need to grow at an average annual rate of 0.9 percent in real terms. The cost of the department's plans would rise to \$574 billion in 2017 and to \$645 billion in 2030 in real terms.
- The primary cause of growth in DoD's costs from 2013 to 2030 would be rising costs for operation and support (O&S), which accounts for 64 percent of the base budget in 2012. In particular, under DoD's plans, there would be significant increases in the costs of military health care, compensation of the department's military and civilian employees, and various operation and maintenance activities. O&S costs would grow from \$356 billion in 2013 to \$460 billion in 2030, for an average annual growth rate of 1.5 percent per year, all in real terms.

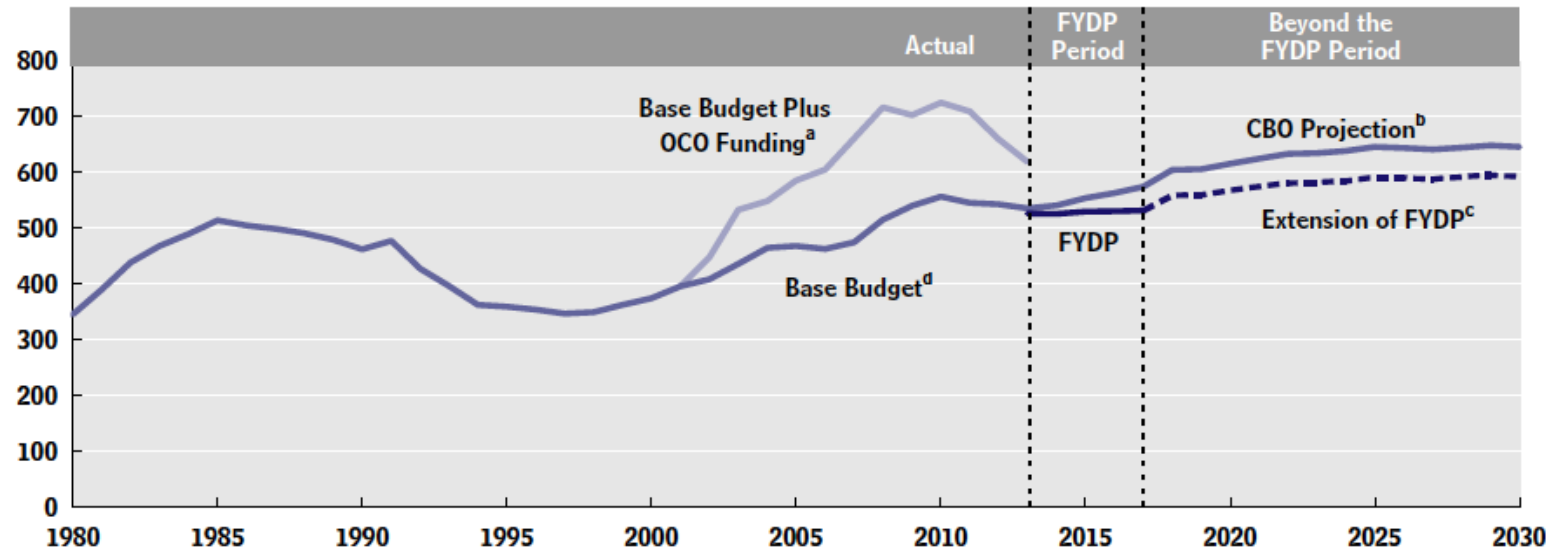
CBO Warning in July 2012 - II

According to the Congressional Budget Office:

- The costs of replacing and modernizing weapon systems would grow sharply in the near term, from \$168 billion in 2013 to \$212 billion in 2018 in real terms—an increase of 26 percent. However, acquisition costs would remain fairly steady at that level until 2025 before declining.
- The growth in DoD's costs would be less than CBO's projection of the growth of the economy, so costs would decline as a share of gross domestic product (GDP). Spending for DoD's base budget was 3.5 percent of GDP in 2010 and would decline to 3.0 percent of GDP in 2017 and to 2.5 percent in 2030.

CBO Projection of Real Cost of FY2013 Plan vs. DoD Projection - I

(Billions of 2013 dollars)



Source: Congressional Budget Office.

Note: FYDP = Future Years Defense Program; FYDP period = 2013 to 2017, the years for which the Department of Defense's (DoD's) plans are fully specified.

- For 2002 to 2013, supplemental and emergency funding for overseas contingency operations (OCO), such as those in Afghanistan and Iraq, and for other purposes is shown separately from the base-budget data.
- The CBO projection of the base budget incorporates costs that are consistent with DoD's recent experience.
- For the extension of the FYDP (2018 to 2030), CBO projects the costs of DoD's plans using the department's estimates of costs to the extent they are available and costs that are consistent with CBO's projections of price and compensation trends in the overall economy where the department's estimates are not available.
- Base-budget data include supplemental and emergency funding before 2002.

CBO Projection of Real Cost of FY2013 Plan vs. DoD Projection - II

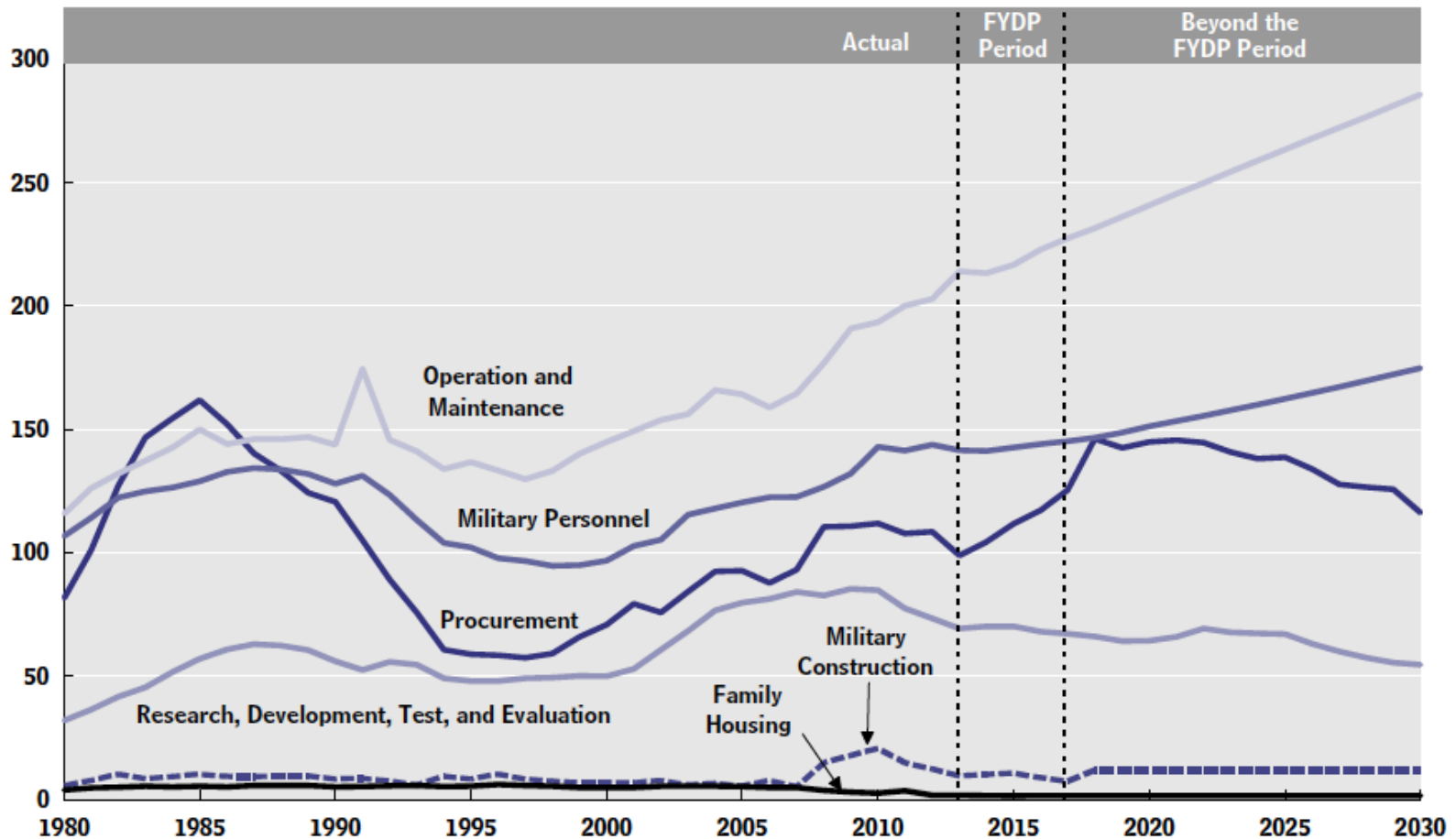
Comparison of the CBO Projection of DoD's Future Years Defense Program and DoD's Own Projection

(Billions of 2013 dollars)

	FYDP Period						Total, 2013- 2017
	2012	2013	2014	2015	2016	2017	
CBO Projection, Base Budget	543	535	541	553	563	574	2,766
DoD's 2013 FYDP, Base Budget	543	526	525	529	530	532	2,643
Difference Between the CBO Projection and DoD's FYDP	0	9	16	24	32	43	123

O&M Drives Cost Escalation In Spite of Escalation in Procurement

vi (Billions of 2013 dollars)



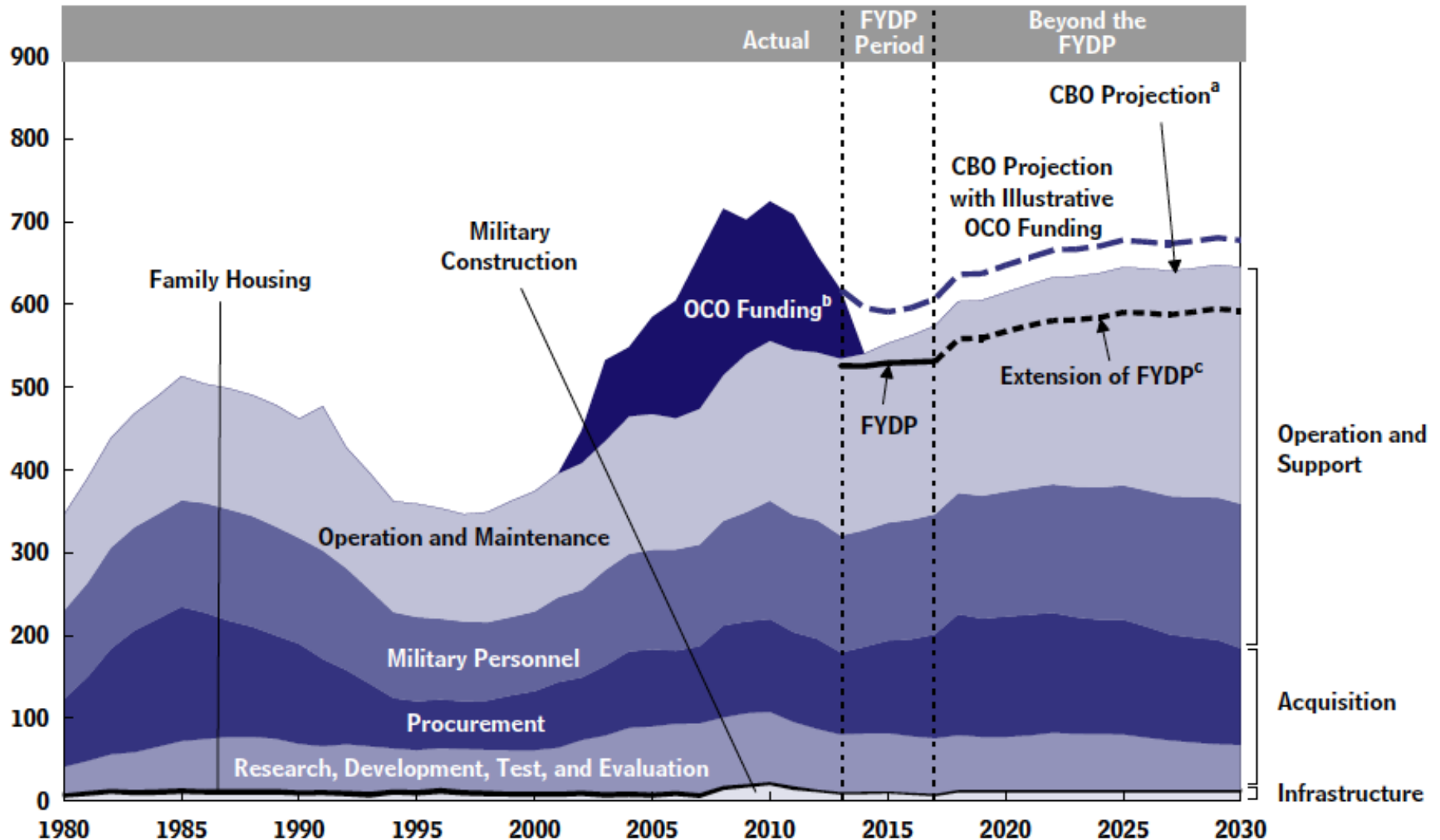
Source: Congressional Budget Office.

Notes: Base-budget data include supplemental and emergency funding before 2002.

FYDP = Future Years Defense Program; FYDP period = 2013 to 2017, the years for which the Department of Defense's (DoD's) plans are fully specified.

CBO Projection is for Higher Gap if Real World Contingency Funding is Provided

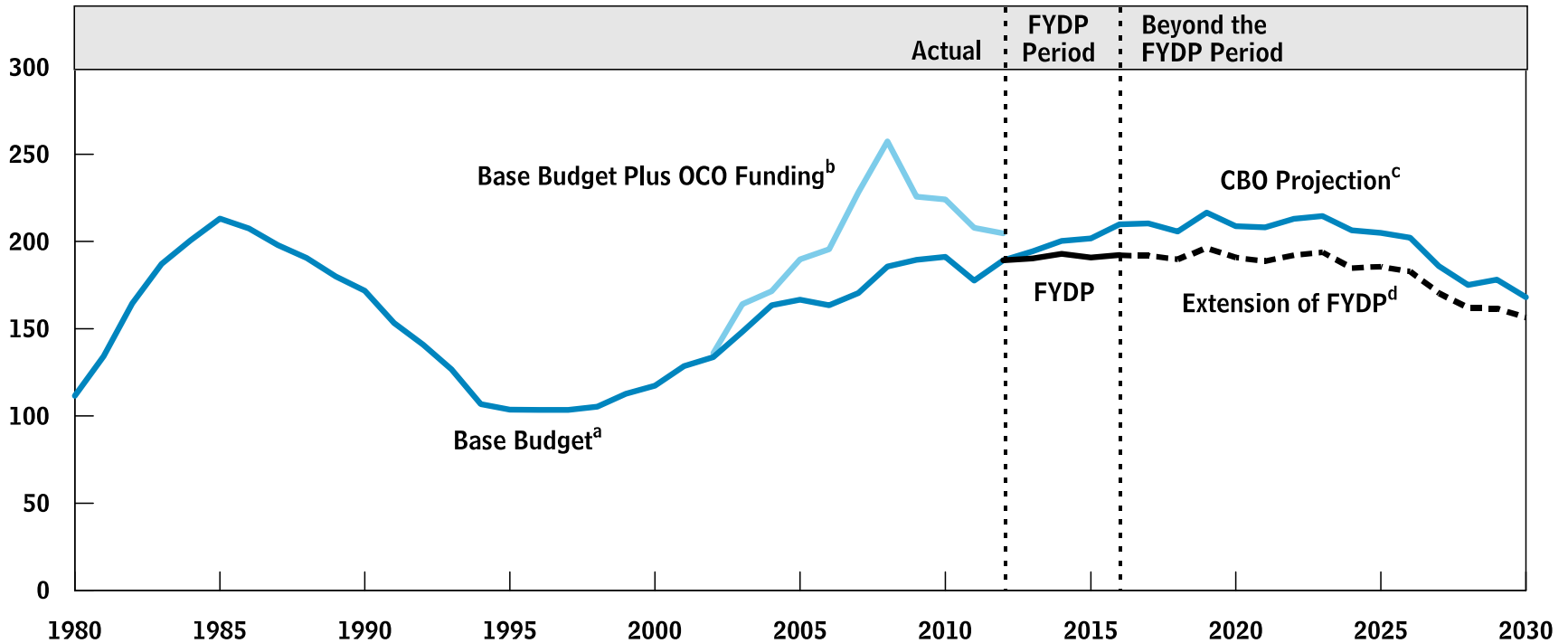
(Billions of 2013 dollars)



CBO., *Long-Term Implications of the 2013 Future Years Defense Program*, July 2012. http://www.cbo.gov/sites/default/files/cbofiles/attachments/07-11-12-FYDP_forPosting.pdf, p. 5

CBO FY2012 Warning of “Acquisition Squeeze” from Cost Escalation

(Billions of 2012 dollars)

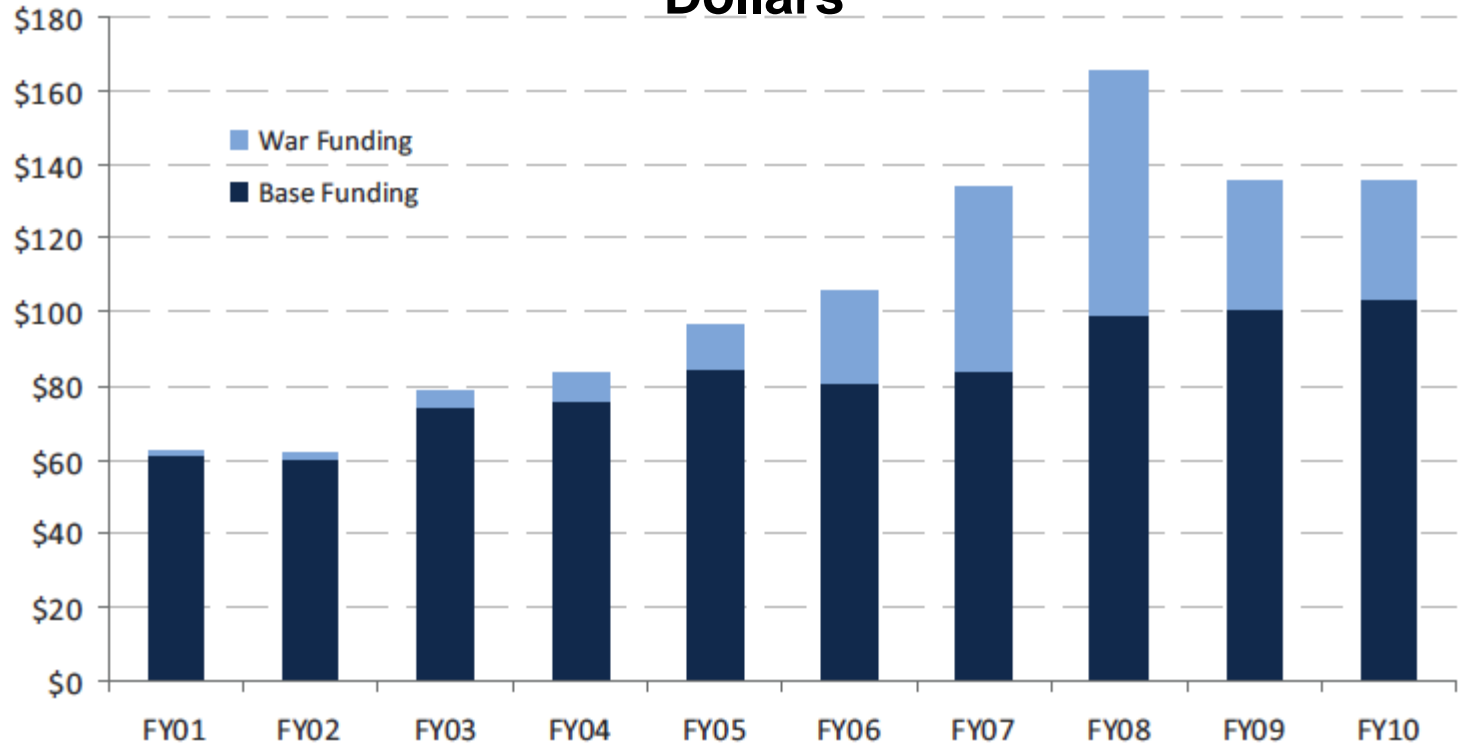


Source: Congressional Budget Office.

Note: FYDP = Future Years Defense Program; FYDP period = 2012 to 2016, the years for which the Department of Defense’s (DoD’s) plans are fully specified.

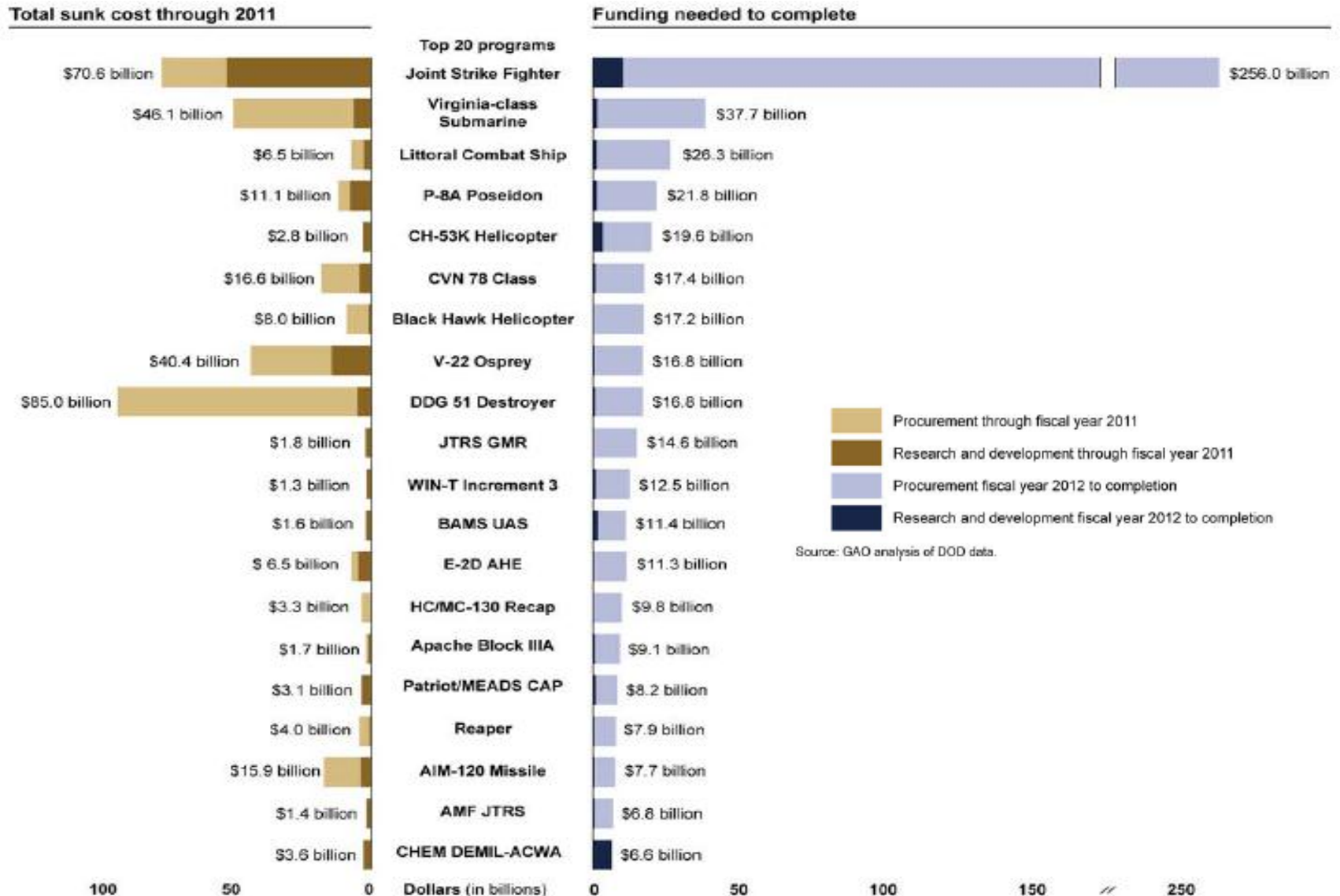
Building Down From \$1 Trillion in Procurement Over the Last 10 Years

Defense Procurement Funding in Billions of Dollars



Source: Data from the Department of Defense. Greenbook for FY2012. Table 2.1. Graph from the Stimson Center.

Procurement Cost Drivers Actually Shaping US Strategy:



Source: GAO, Assessments of Selected Weapon Programs, GAO-12-400SP, Mar 29, 2012, <http://www.gao.gov/products/GAO-12-400SP>

Living with a History of Critical Procurement Problems and Failures That Shape Real-World Forces

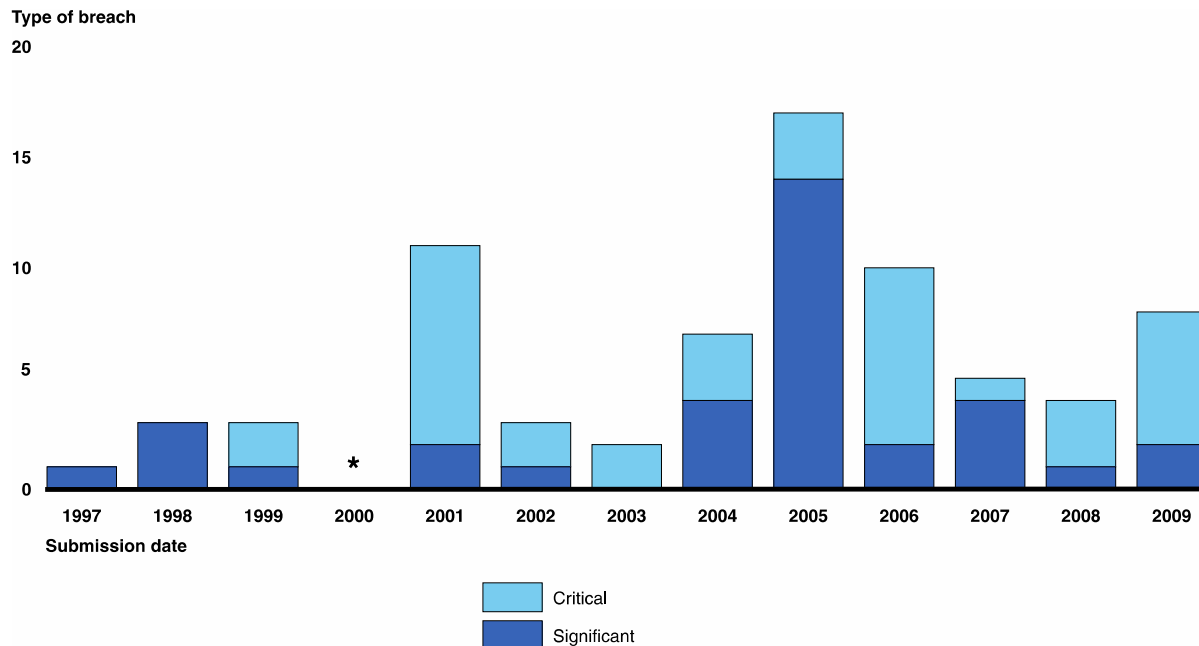
- Force multiplier = force reducer
- GAO documents constant history of cost escalation; violations of Nunn-McCurdy. DTOE reflects similar problems in test and development.
- Configuration creep (leap?); engineering cost vs. regression realism, State of the art = advanced development.
- Steady history of cost-performance drive force cuts.
- Army failure of FCS program and key follow-ons
- Navy failure to create affordable ship building and maintain air strength.
- USAF mortgaged to F-35, low-balling cost of new bomber, cost problems with tankers and enablers.
- Marine Corps tied to high cost air and amphibious lift; F-35.
- Bottom Up Accountability: Never fire the Chief and the Secretary first.

Nunn-McCurdy Breaches in Cost Escalation

According to the Government Accountability Office: Office:

- Since 1997, there have been 74 Nunn-McCurdy breaches involving 47 major defense acquisition programs...nearly 40 percent of Nunn-McCurdy breaches occurred after a production decision had been made...Of the 47 programs that breached, 18 programs breached more than one time... Thirty-nine were critical breaches and 35 breaches were significant breaches.
- Other GAO studies showed 1 In 3 major programs escalated in cost by 50% or more since 1977 – 47 of 134 programs at a cost of \$135 billion with \$70 billion over the last two years.

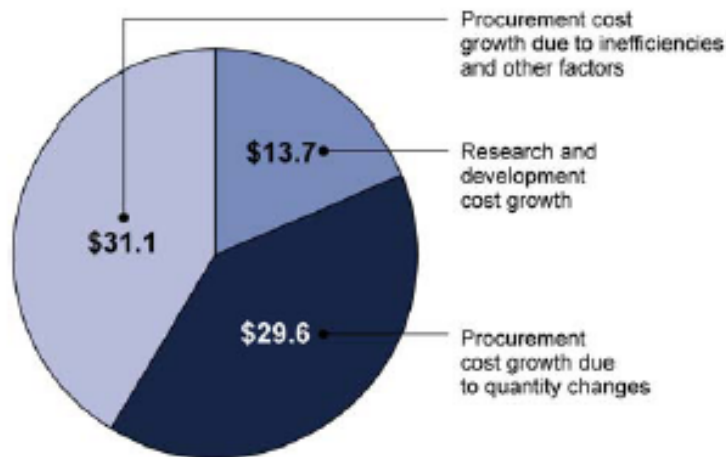
Figure 1: Critical and Significant Breaches by Calendar Year, 1997-2009



Source: GAO analysis of DOD data.

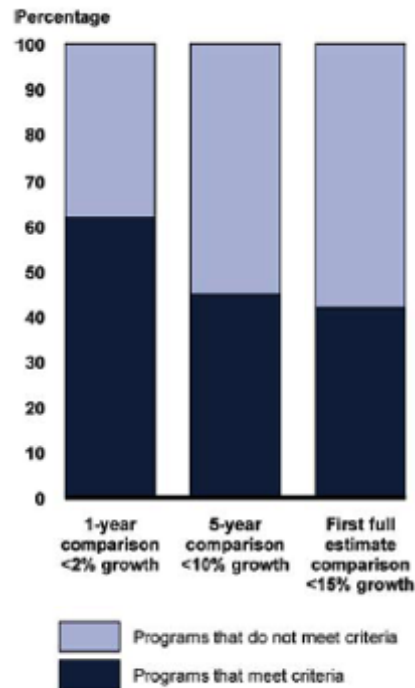
GAO as of 3/12: Cost Growth is Easing But Still Critical

Cost Growth over the Past Year for DOD's 2011 Portfolio of Major Defense Acquisition Programs (Fiscal Year 2012 Dollars in Billions)



Source: GAO analysis of DOD data.

Figure 3: Programs Meeting High-Risk Cost Metrics



Source: GAO analysis of DOD data.

“The total estimated cost of the Department of Defense’s (DOD) 2011 portfolio of 96 major defense acquisition programs stands at \$1.58 trillion. In the past year, the total acquisition cost of these programs has grown by over \$74.4 billion or 5 percent, of which about \$31.1 billion can be attributed to factors such as inefficiencies in production, \$29.6 billion to quantity changes, and \$13.7 billion to research and development cost growth.”

Source: GAO, Assessments of Selected Weapon Programs, GAO-12-400SP, Mar 29, 2012, <http://www.gao.gov/assets/590/589695.pdf>. Quote from “What GAO Found” page, graphics from “What GAO Found” page and p.16.

Total Cost Growth Case Studies (3/12) *

Fiscal year 2012 dollars in millions

*Does not reflect savings from cuts in total weapons numbers to be procured over time

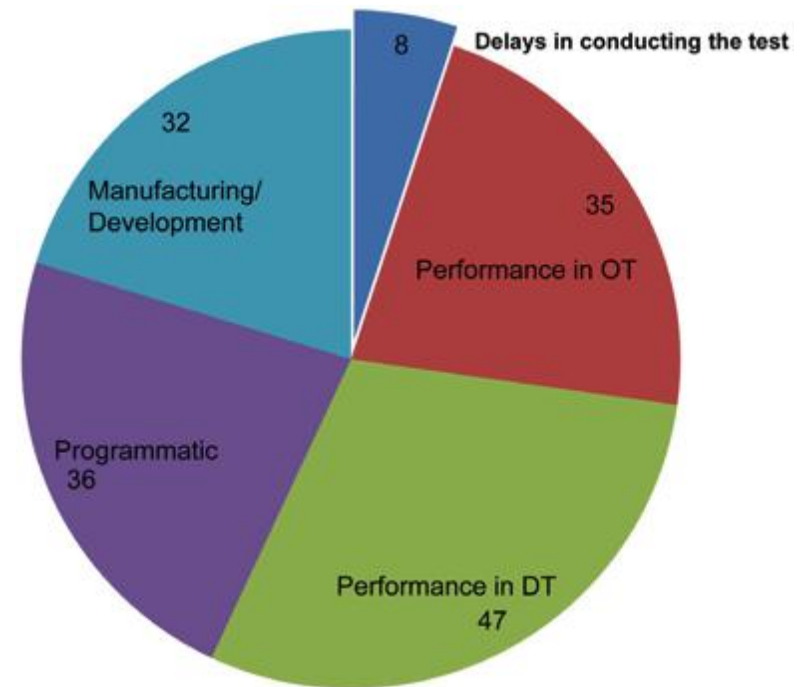
Program	Current total acquisition cost	First full total acquisition cost	Change in total acquisition cost from first full estimate (percent)	Change in total acquisition cost within the past year (percent)	Change in total acquisition cost within the past 5 years (percent)
Advanced Extremely High Frequency (AEHF) Satellite	\$14,083	\$6,370	121.1%	7.4%	106.6%
AH-64D Longbow Apache	14,773	6,132	140.9	0.3	34.8
AIM-120 Advanced Medium Range Air-to-Air Missile (AMRAAM)	23,582	10,931	115.7	-2.8	38.2
Black Hawk (UH-60M)	25,169	12,970	94.1	13.0	19.9
Block IV Tomahawk (Tactical Tomahawk)	6,943	2,116	228.1	-0.1	54.8
C-130J Hercules	15,397	949	1522.5	-1.0	79.5
Chemical Demilitarization-Assembled Chemical Weapons Alternatives (Chem Demil-ACWA)	10,173	2,642	285.0	26.2	118.3
DDG 51 Destroyer	101,819	15,186	570.5	6.3	29.3
F-35 Lightning II (Joint Strike Fighter)	326,535	213,708	52.8	13.4	34.1
Family of Medium Tactical Vehicles (FMTV)	20,048	10,447	91.9	-7.3	13.7
Force XXI Battle Command Brigade and Below (FBCB2)	4,147	2,827	46.7	-0.7	51.8
Global Hawk (RQ-4A/B)	13,992	5,392	159.5	1.5	68.4
Guided Multiple Launch Rocket System (GMLRS)	5,827	1,768	229.5	-0.4	-57.5
H-1 Upgrades (4BW/4BN)	12,557	3,627	246.3	4.3	55.5
Joint Air-to-Surface Standoff Missile (JASSM)	7,509	2,318	224.0	2.7	49.9
Joint Direct Attack Munition	6,578	3,419	92.4	1.6	11.6

Critical Failures in Performance in Operational Test & Evaluation

FY 2011 Annual Report by DoD Director, Operational Test and Evaluation:

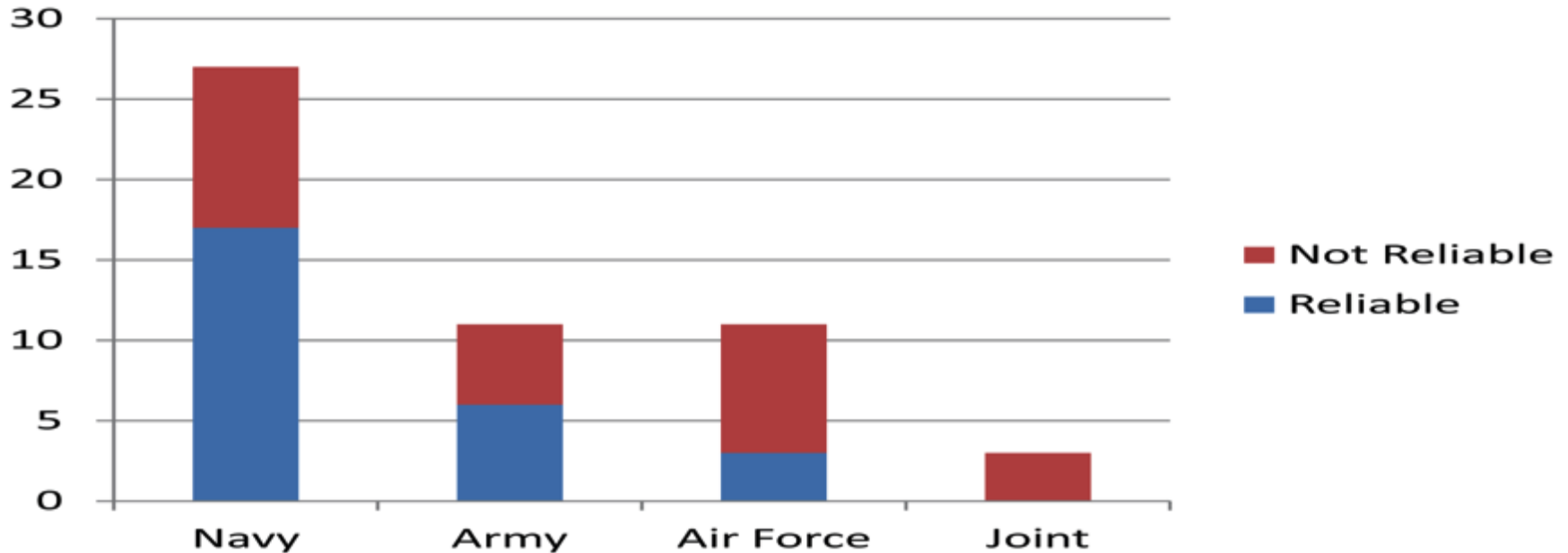
- There were 158 instances of delays for the 67 programs in five categories (many of the programs had more than one reason for delays).
- Of the 67 programs, 56 programs (or 84 percent) had performance problems in testing (either DT, OT, or both) while only eight programs (or 12 percent) had issues conducting the tests that led to delays.
- The length of delays for the programs examined varied from none (for two of the Nunn-McCurdy programs) to 15 years.
- Thirty-seven programs were delayed greater than 3 years. The delays were measured against the most recent previously published schedule; so, in a sense the total delay experienced is likely to be even longer relative to the original planned schedule.
- Six of the programs were eventually cancelled, and one had its Milestone B approval rescinded.

Reasons for Program Delays



Low New Equipment Reliability Thresholds: 2006-2011

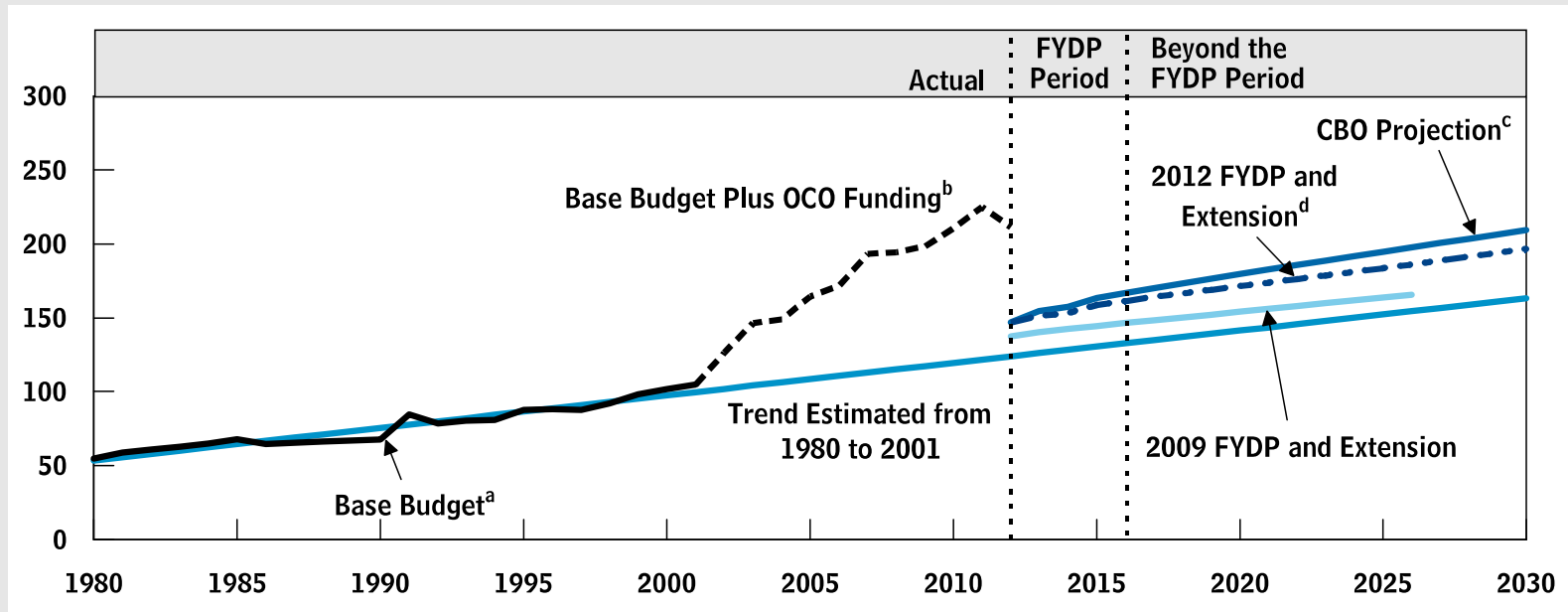
Number of Programs Meeting Reliability Thresholds at IOT &E, by Service (from DOT &E Reports to Congress 2006 – 2011)



- The standard used to require that weapons systems were built with 30 percent reliability, meaning there was, at most, a 70 percent chance that replacements or updated elements would be needed after the systems had entered into operational use. Contractors' adherence to reliability standards is now voluntary, in part because reliability is seen as so difficult to predict.
- Only six of 11 Army programs that faced testing by the agency met their reliability thresholds. Among those that “did not do well” were unmanned systems and communications networks, even though the Army had stipulated in engineering and manufacturing development contracts that those programs should meet an early reliability test threshold.
- The Navy, which established a high-level director of reliability and maintainability and several other working groups to address reliability issues, had 17 of 27 systems meet their thresholds. The most reliable systems were aircraft and submarines, but “ships and software-intensive systems” did not fare as well.
- The Air Force had the worst record for reliability, with only three of 11 systems tested by DOT&E meeting the reliability threshold. The Air Force has produced a guidebook to identify risks and had courses on reliability built into levels of its acquisition and test personnel.

CBO Breakdown of O&M Cost Per Active-Duty Service Member

(Thousands of 2012 dollars)



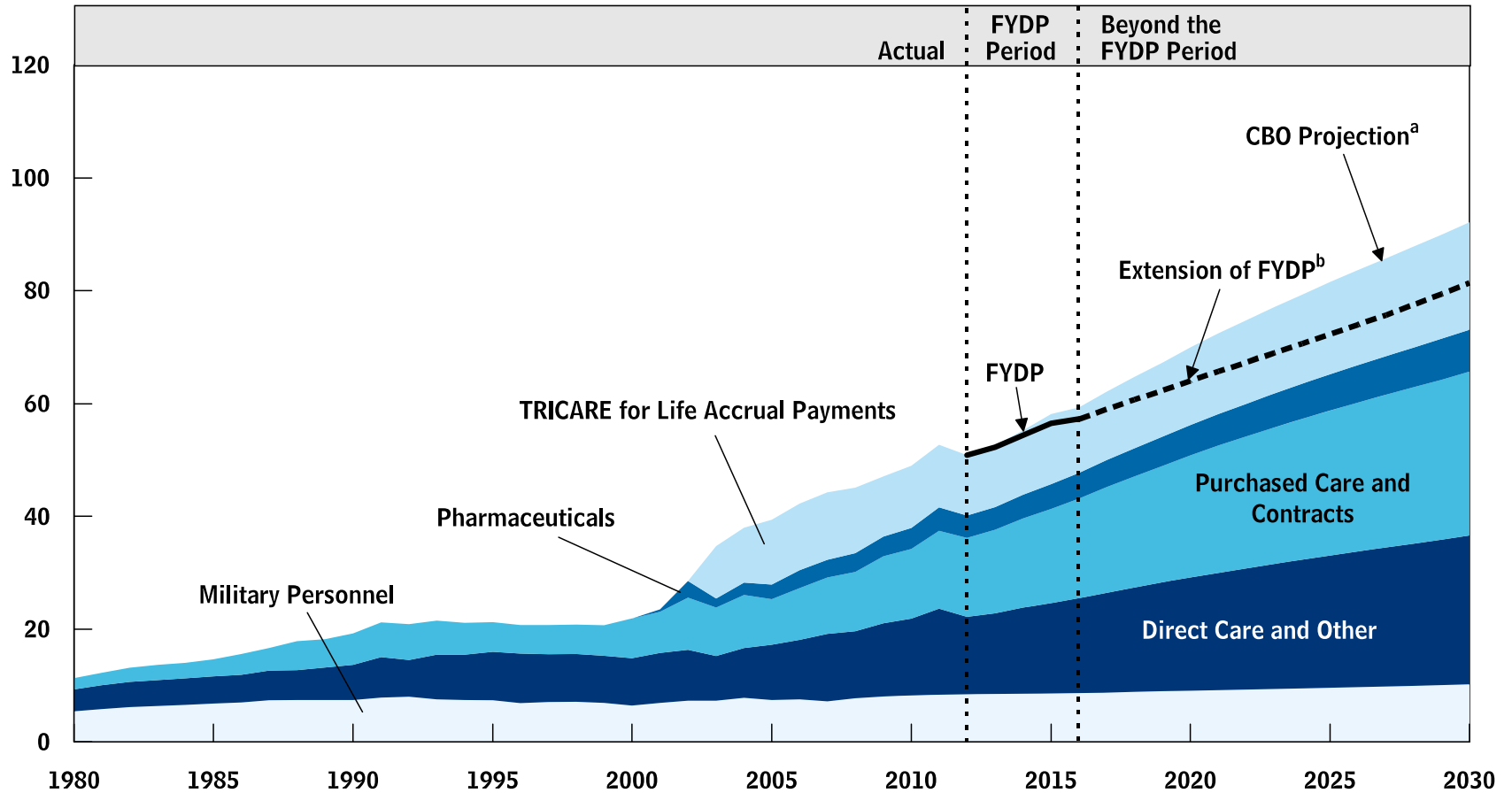
Source: Congressional Budget Office.

Note: FYDP = Future Years Defense Program; FYDP period = 2012 to 2016, the years for which the Department of Defense's (DoD's) plans are fully specified.

- Base-budget data include supplemental and emergency funding before 2002.
- For 2002 to 2012, supplemental and emergency funding for overseas contingency operations (OCO), such as those in Afghanistan and Iraq, and for other purposes is shown separately from the base-budget data. The amount shown for 2012 has been requested but has not been appropriated.
- The CBO projection of the base budget incorporates costs that are consistent with DoD's recent experience.
- For the extension of the FYDP (2017 to 2030), CBO projects the costs of DoD's plans using the department's estimates of costs to the extent they are available and costs that are consistent with the broader U.S. economy if such estimates are not available.

The Tricare Threat to US Strategy

(Billions of 2012 dollars)

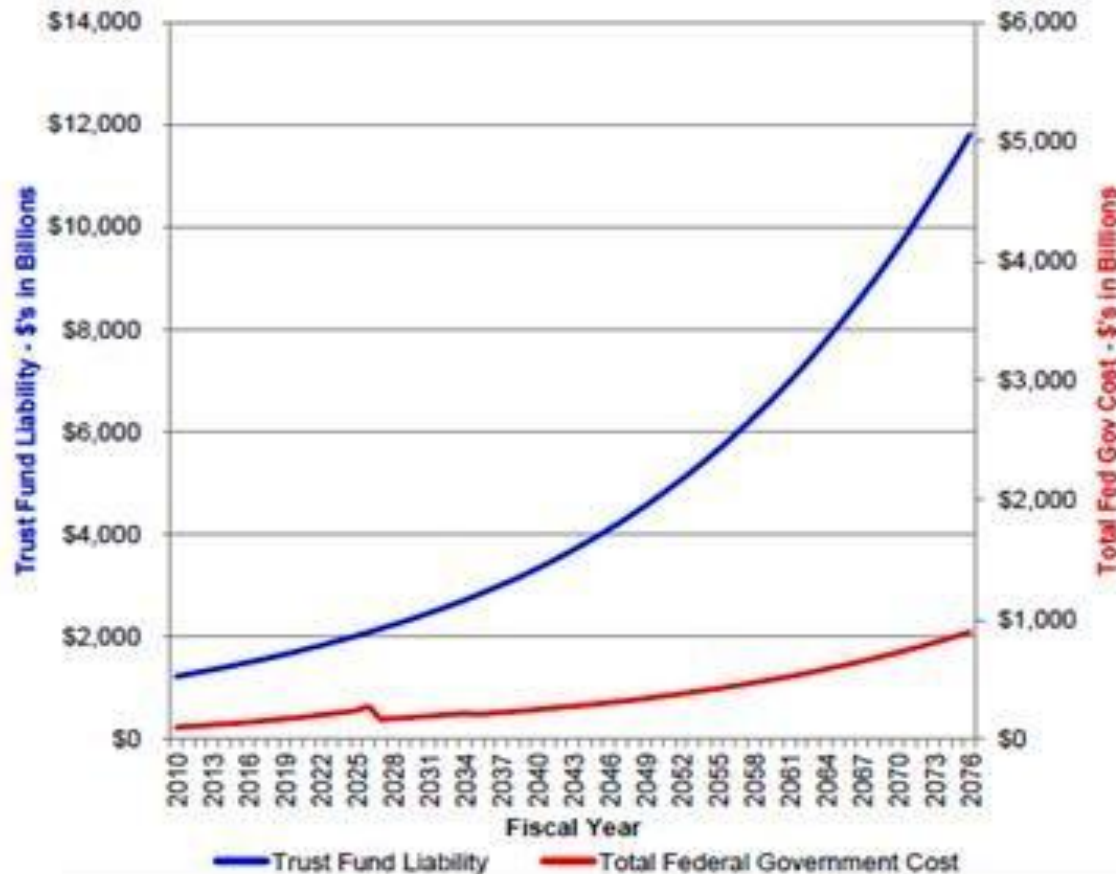


Source: Congressional Budget Office.

Notes: Supplemental and emergency funding for overseas contingency operations (OCO), such as those in Afghanistan and Iraq, is included for 2011 and earlier but not for later years.

The Military Retirement Threat to US Strategy

Military compensation and healthcare expenses have expanded by nearly 80 percent since 2001, despite a comparatively small 5 percent increase in force size.

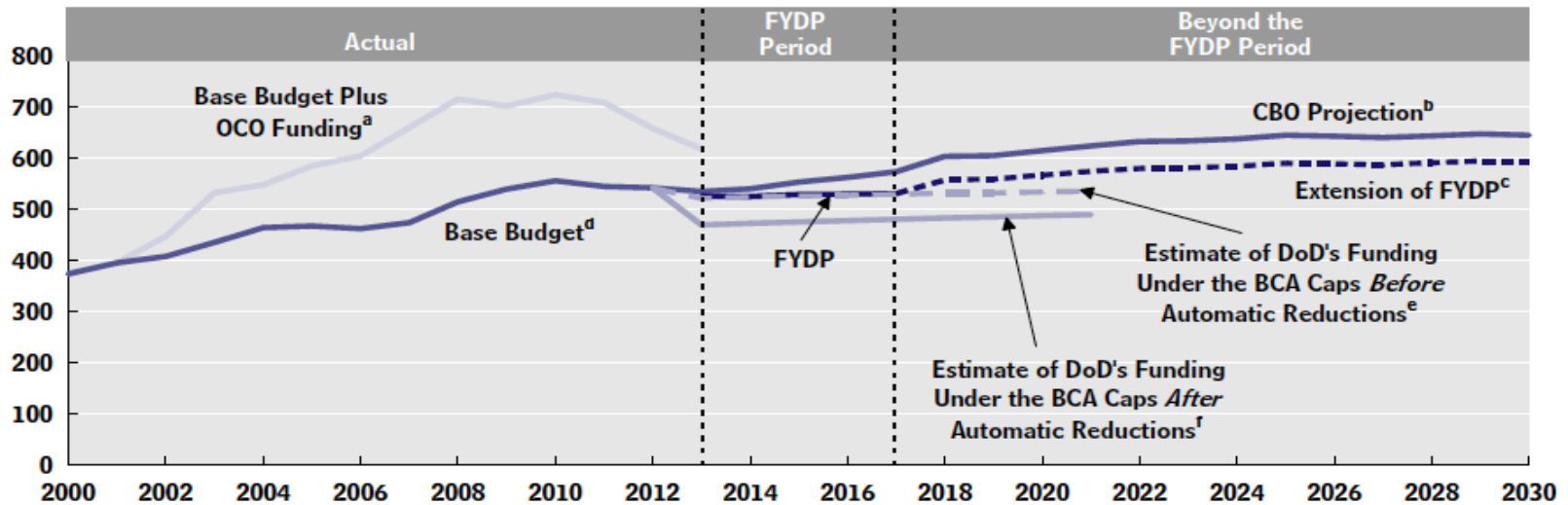


Source: Defense Business Board, "Recommendations to Optimize the Department's Military Retirement System," October 2011.

**The Defense Budget
Challenge is Much Worse if
Both Sequestration and Cost
Escalation are Considered**

This Would Make the Impact of Budget Control Act (Sequestration) Much Worse

(Billions of 2013 dollars)

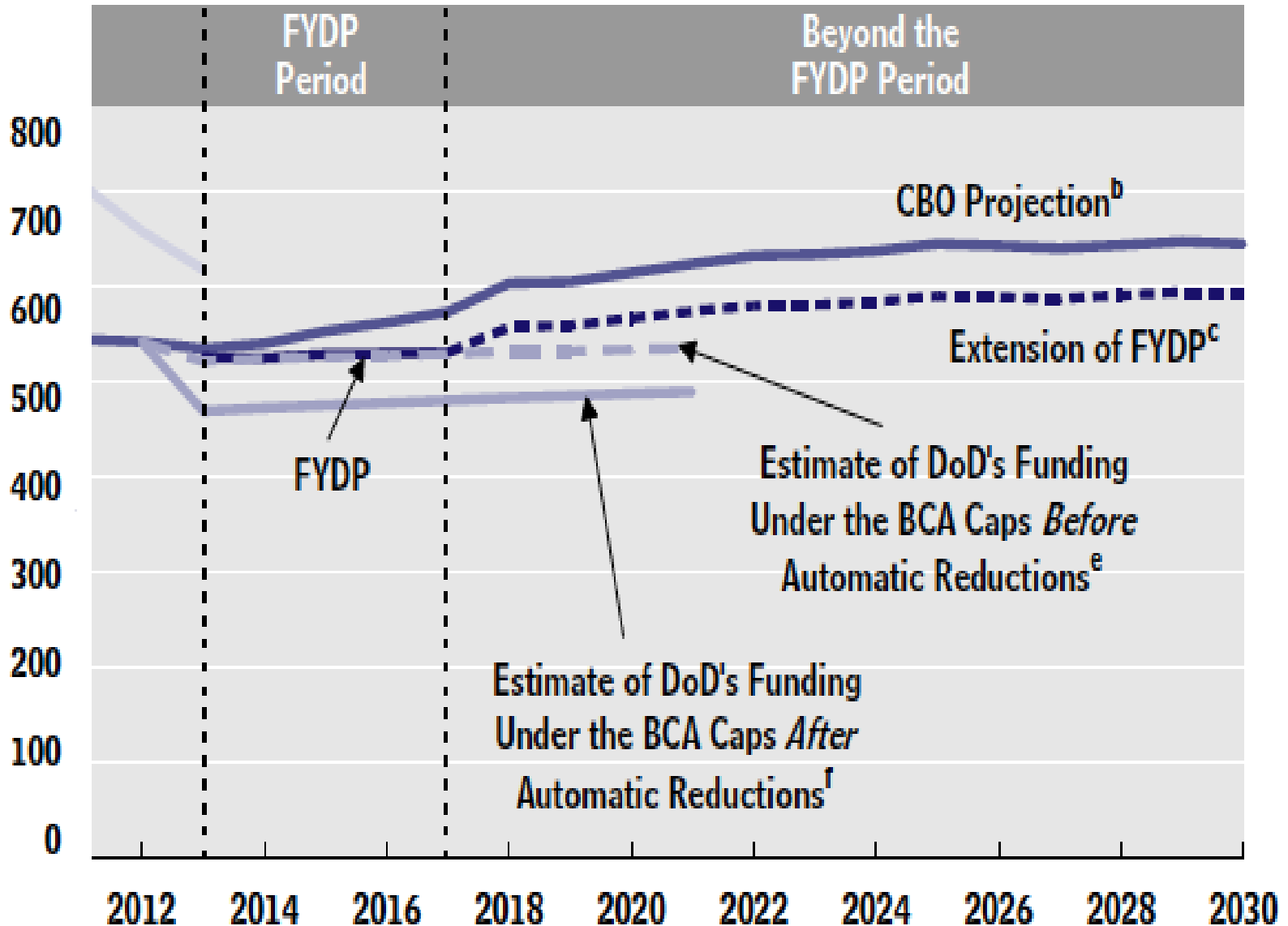


Source: Congressional Budget Office.

Note: FYDP = Future Years Defense Program; FYDP period = 2013 to 2017, the years for which the Department of Defense's (DoD's) plans are fully specified; BCA = Budget Control Act of 2011.

- For 2002 to 2013, supplemental and emergency funding for overseas contingency operations (OCO), such as those in Afghanistan and Iraq, and for other purposes is shown separately from the base-budget data.
- The CBO projection of the base budget incorporates costs that are consistent with DoD's recent experience.
- For the extension of the FYDP (2018 to 2030), CBO projects the costs of DoD's plans using the department's estimates of costs to the extent they are available and costs that are consistent with CBO's projections of price and compensation trends in the overall economy where the department's estimates are not available.
- Base-budget data include supplemental and emergency funding before 2002.
- This estimate assumes that DoD would receive 95.5 percent of the funding limit for national defense *before* reductions due to the BCA's automatic enforcement procedures, on the basis of DoD's average share of that funding in base budgets from 2002 to 2011.
- This estimate assumes that DoD would receive 95.5 percent of the funding limit for national defense *after* reductions due to the BCA's automatic enforcement procedures, on the basis of DoD's average share of that funding in base budgets from 2002 to 2011.

Zooming In On The Future: FY2013-F2030



Looking at the DoD/BCA Reality Gap by Year: FY2013-F2022:

\$14B in FY2013 without BCA; \$66B with BCA

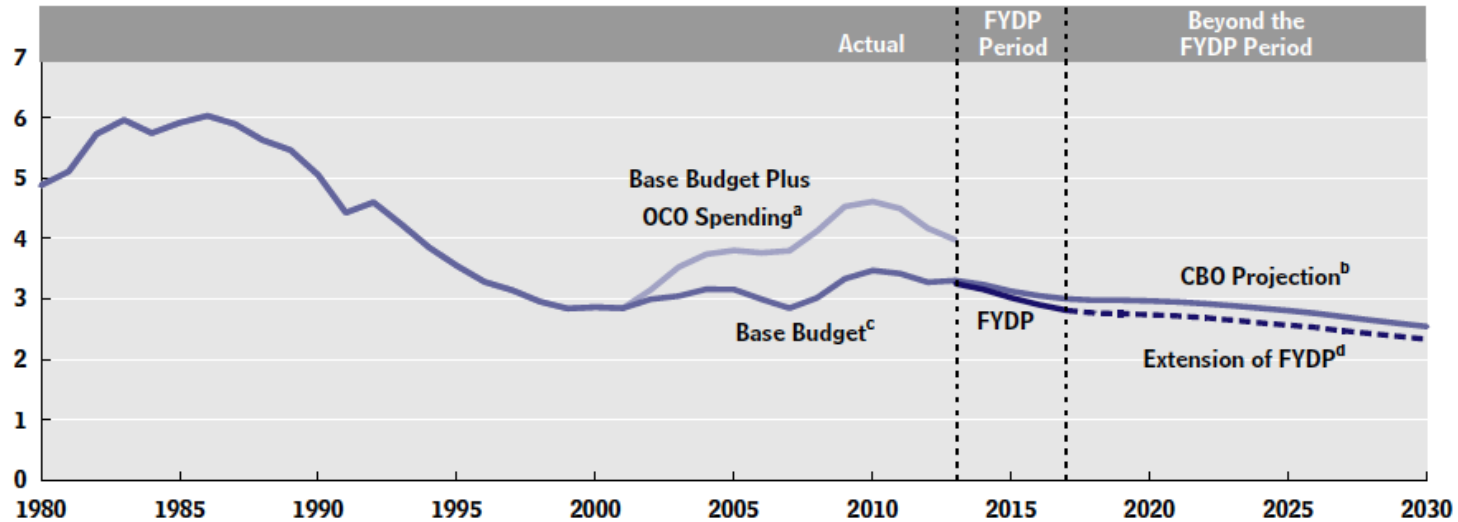
(Billions of dollars)

	Budget Control Act									
	Future Years Defense Program					2018	2019	2020	2021	2022
	2013	2014	2015	2016	2017					
	Nominal Dollars									
CBO Projection ^a	535	549	570	590	613	657	670	694	718	742
FYDP and Extension ^b	526	534	546	556	567	607	620	641	661	680
Estimate of DoD's Funding Under the BCA Caps <i>Before</i> Automatic Reductions ^c	521	531	540	551	563	576	588	602	615	632 ^d
Estimate of DoD's Funding Under the BCA Caps <i>After</i> Automatic Reductions ^e	469	479	488	499	511	524	536	549	563	578 ^d
	2013 Dollars									
CBO Projection ^a	535	541	553	563	574	604	605	615	624	633
FYDP and Extension ^b	526	525	529	530	532	558	559	568	575	581
Estimate of DoD's Funding Under the BCA Caps <i>Before</i> Automatic Reductions ^c	521	524	525	527	529	531	532	533	535	539 ^d
Estimate of DoD's Funding Under the BCA Caps <i>After</i> Automatic Reductions ^e	469	472	475	477	480	483	485	487	489	493 ^d

Yet, CBO Still Projects Burden on GDP (and Federal Spending) With Still Shrink

Costs of DoD's Plans as a Share of Economic Output

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: For this figure, estimates describe outlays (as opposed to total obligational authority).

FYDP = Future Years Defense Program; FYDP period = 2013 to 2017, the years for which the Department of Defense's (DoD's) plans are fully specified.

- For 2002 to 2013, supplemental and emergency spending for overseas contingency operations (OCO), such as those in Afghanistan and Iraq, and for other purposes is shown separately from the base-budget data.
- The CBO projection of the base budget incorporates costs that are consistent with DoD's recent experience.
- Base-budget data include supplemental and emergency spending before 2002.
- For the extension of the FYDP (2018 to 2030), CBO projects the costs of DoD's plans using the department's estimates of costs to the extent they are available and costs that are consistent with CBO's projections of price and compensation trends in the overall economy where the department's estimates are not available.