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A Methodology for Making the Right Trade-offs in Defense for the Decade Ahead

Defense Budgeting to Beat the "Double Whammy"

By Clark A. Murdock and Ryan A. Crotty

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The president, civilian and military defense leaders, and some members of the Congress have spent the last year-and-a-half decrying the effects of budget cuts on the Department of Defense (DoD). Yet, topline reductions are only the first piece of the "double whammy" that defense faces today. Equally serious, the defense dollar has lost—and continues to lose—its purchasing power due to the aggregate impact of internal cost growth, for personnel, for operations and maintenance, and for acquisition programs. It is this second trend, on top of the budget cuts, that has driven the Defense Department to react so strongly to a sequester that, on the surface, looks like just an 8 to 10 percent cut. But it is going to feel much deeper, because it comes on top of another 8 to 10 percent cut (caused by the first set of budget caps imposed by the Budget Control Act of 2011), and at the same time, it is being hollowed out from within by internal cost growth. That is why a 20 percent reduction in the defense budget is going to feel a lot more like a 40 percent reduction.

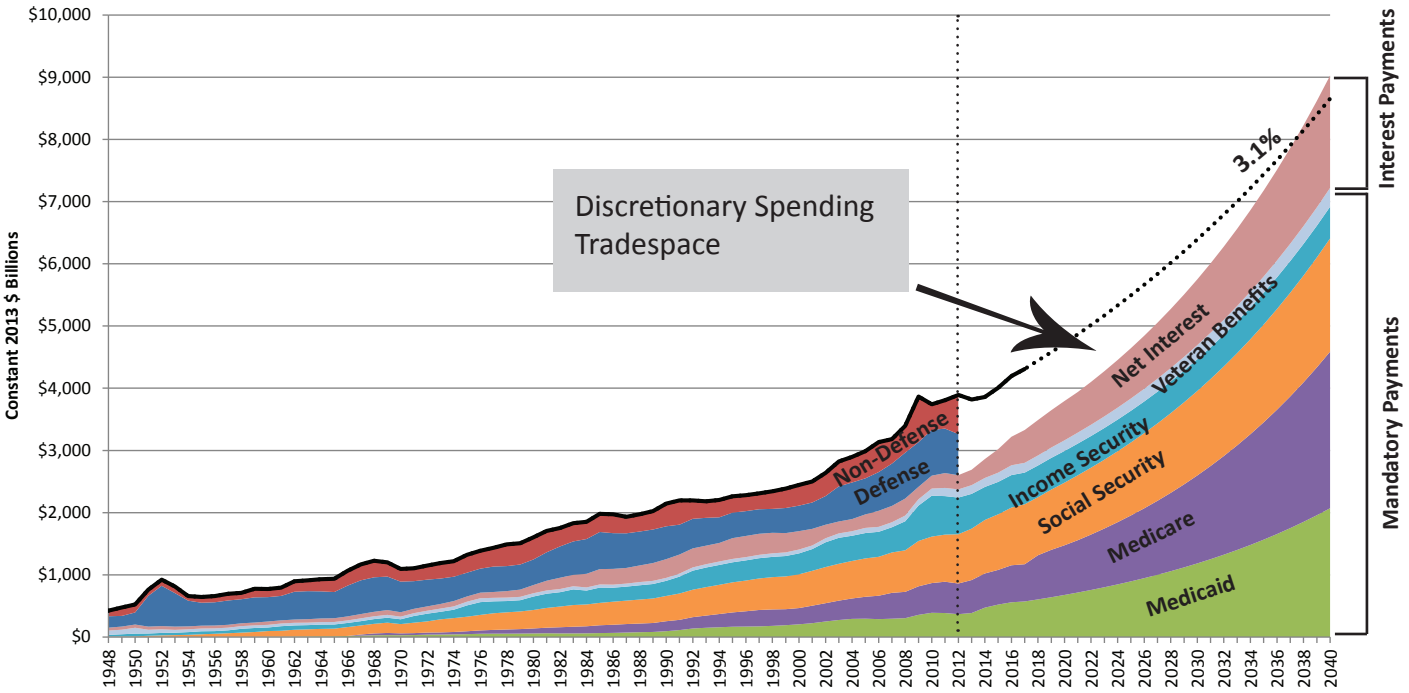
This double whammy coincides with a time when DoD's ability to incorporate strategy—ends, ways, and means—into a fiscally disciplined, constructed program has atrophied. The shifting priorities from a decade of war elevated current operations over long-range planning, as necessitated by two concurrent wars, and enabled by supplemental funding (in the Overseas Contingency Operations or OCO accounts), resulting in lost fiscal discipline. CSIS has assessed the consequences of continued inaction and the options—at the strategic level—for how better to align strategy and resources through disciplined planning.

Part I: Scoping the Problem of Decreasing Toplines

The problem of budget decline is not simply a knee-jerk reaction to the austerity politics of the moment but rather the result of a persistent and structural problem within the federal budget. Figure 1 below demonstrates that extrapolating the expected total federal budget growth in the current budget (3.1 percent per year) leaves no room for *any* discretionary spending by the mid-2030s. That is not just defense—it is domestic discretionary spending as well. No matter how the short-term issues of sequester, government shutdown, or debt ceilings play out, long-term federal budget trends dictate the persistence of this pressure on the defense topline.

There has been much speculation and negotiation over where the defense budget topline will eventually end up, but CSIS uses current law as the basis for its analysis. The baseline includes the caps instituted by the Budget Control Act (BCA) in August 2011 and the

Figure 1. Unrelenting Pressure on the Topline



Sources: Congressional Budget Office, *Budget and Economic Outlook: Fiscal Years 2011 to 2021,* January 2012; Office of Management and Budget, Historical Tables, February 2012; Department of Defense, *National Defense Budget Estimates for Fiscal Year 2013* (Green Book), Office of the Under Secretary of Defense (Comptroller), March 2012. Independent analysis based on CBO federal spending projections from 2022 to 2040.

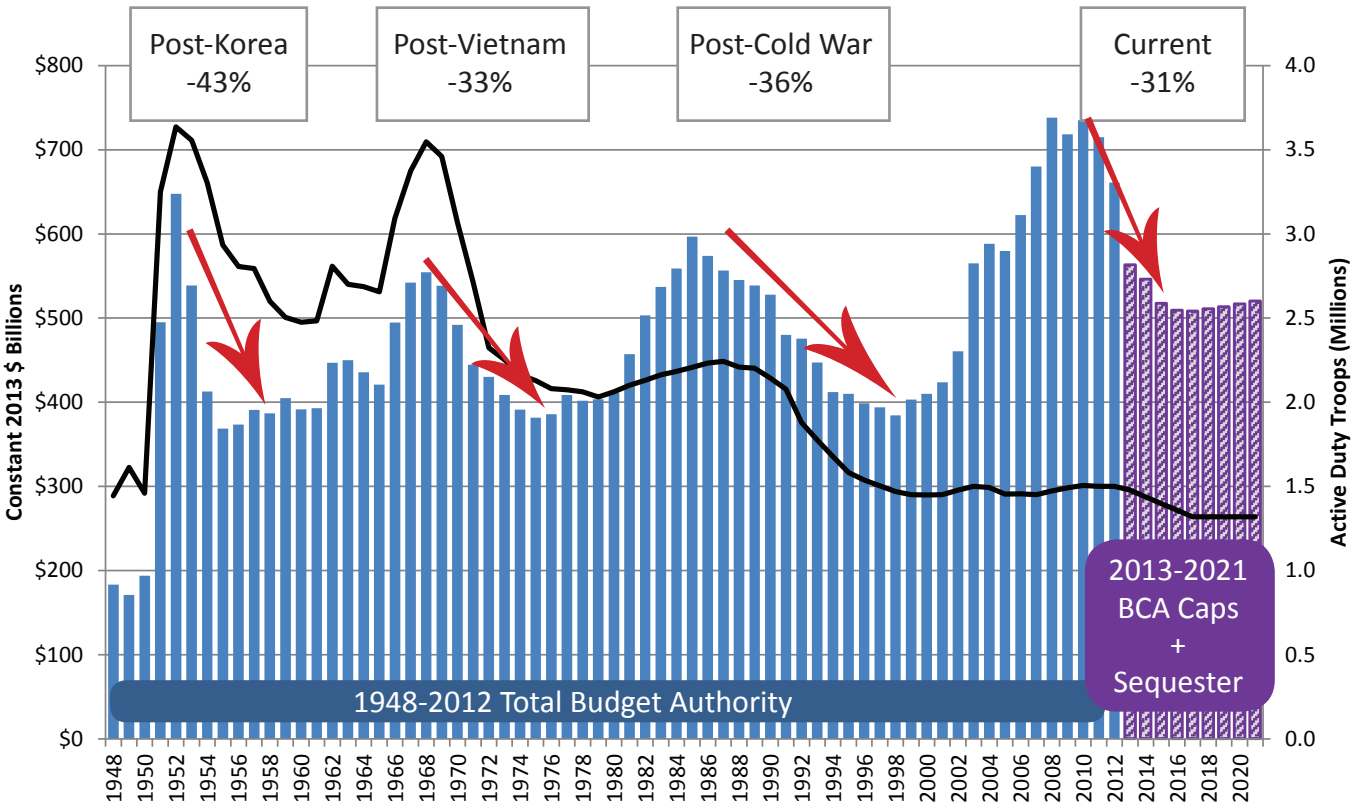
sequester cuts, and then adds a small wedge for continuing overseas contingency operations out to 2021. This projection starts at the $660 billion of enacted defense funding for Fiscal Year 2012 and declines to $520 billion in FY 2021 (in constant 2013 dollars). This represents a 31 percent decrease from the peak in FY 2010, but how does this compare to past defense drawdowns?

Figure 2 (opposite) shows the total defense budget, adjusted for inflation, since 1948. The black line indicates active-duty troop levels. The relationship between these two data points demonstrates key changes from the first two spending cycles—the Korean and Vietnam Wars—to the two more recent cycles—the Cold War and the post-9/11 conflicts in Iraq and Afghanistan. In the first two buildups, with a draft-based military, end strength increases drove the buildup costs. But in the Cold War, active-duty manpower fell behind spending, with only a modest increase in active-duty troops, but a greater increase in spending. Then, during the post-9/11 buildup, active-duty military personnel only increased about 3 percent, while spending jumped nearly 75 percent. In the post-9/11 buildup, costs were driven by increases in defense civilian personnel, contractors, and active-duty manpower costs for reserve military personnel, not just increases in active-duty personnel end strength.[1]

While a postwar budget decline of 31 percent is well within the realm of historical expectation, the sheer size (in dollars) of the post-9/11 buildup means that the steady state budget after the drawdown sinks to just over $500 billion, compared with a historical trough of less than $400 billion. So, the same military personnel end strength costs $100 billion more in constant dollars. What did this extra $100 billion buy?

1. Maren Leed and Brittany Gregerson, *Keeping Faith: Charting a Sustainable Path for Military Compensation* (Washington, DC: CSIS, October 2011), vii.

Figure 2. Defense Drawdowns Compared



Note: Topline in out-years includes the Congressional Budget Office (CBO) estimate of overseas contingency operations (OCO) based on a phased drawdown to 30,000 troops in 2017 and remaining flat thereafter.

Sources: Department of Defense, *National Defense Budget Estimates for Fiscal Year 2013* (Green Book), Office of the Under Secretary of Defense (Comptroller), March 2012; Congressional Budget Office, *Long-Term Implications of the 2013 Future Years Defense Program,* July 2012. Analysis by CSIS Defense and National Security Group.

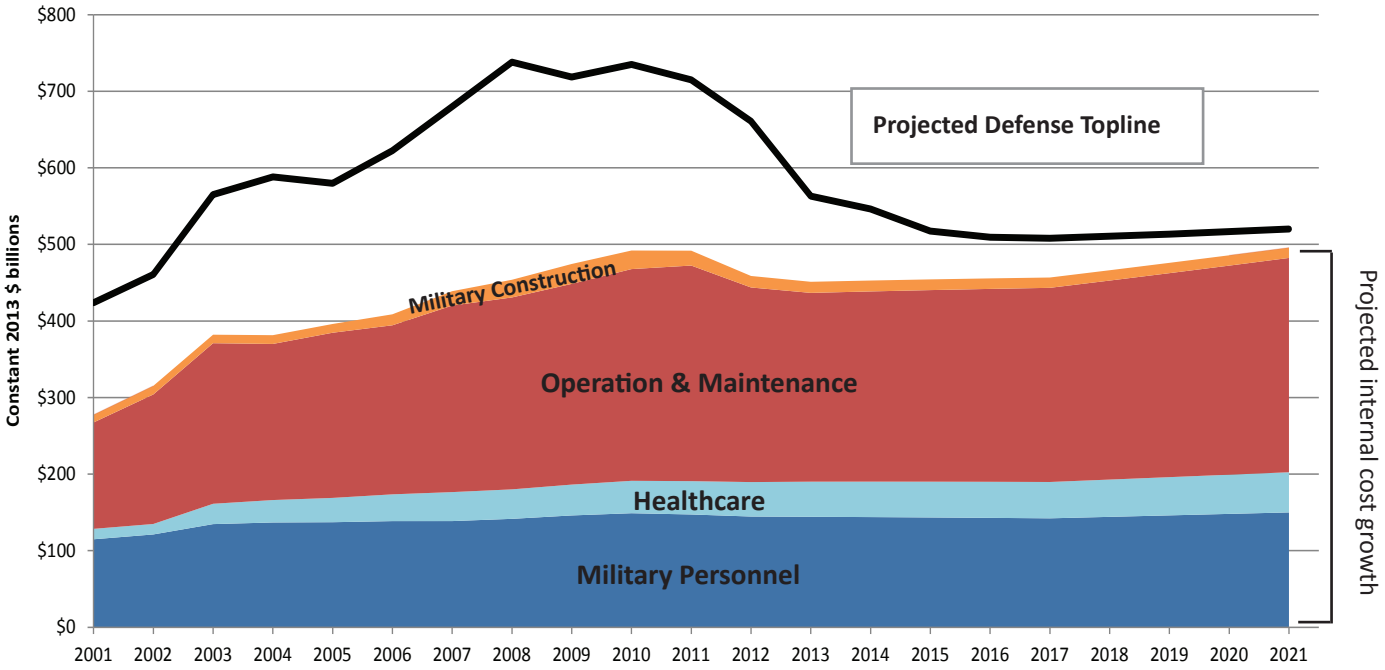
Part II: Scoping the Problem of Internal Cost Growth

The answer is: not much, because of the second challenge facing DoD—internal cost growth. The costs of both operations and maintenance (O&M) and personnel have been on an unsustainable trajectory for decades and, when combined with the declining topline due to budgetary and economic pressures, paint a stark picture for DoD.

Figure 3 shows the consequences of this unchecked cost growth, using the BCA caps and sequester cuts to set the baseline of the projected defense budget (the blue line). Even including the 100,000 end strength cuts planned in the FY 2013 budget proposal, by 2021 this cost growth will crowd out nearly the entire modernization budget (Procurement and Research, Development, Test and Evaluation—RDT&E) by 2021.

DoD has recognized this problem but has thus far failed to reign in the significant internal growth in costs. As DoD's own white paper in January 2012 noted, "personnel costs increased by nearly 90 percent or about 30 percent above inflation [since 2001], while the number of

Figure 3. Internal Cost Growth against the Projected Topline



Note: Projected internal cost growth excludes modernization and includes 100k troop reduction in FY13 FYDP.

military personnel has increased by only about 3 percent."[2] O&M costs continue to expand by about 2.5 percent per active-duty service member per year, as they have for half a century.[3]

This is why $520 billion in inflation-adjusted dollars in 2021 buys an active-duty force that's 34 percent smaller than it was in 1978 for $100 billion dollars more. This growth of costs within the department sets up an unforgiving trade-off between maintaining end strength, sustaining readiness, or continuing technological investment.

Historically, modernization accounts have accounted for nearly a third of the defense budget—funding the military's hardware and weapons programs and all research and development. But by 2021, if costs in other accounts are allowed to continue to grow at current rates, less than 5 percent of the budget—$25 billion—will remain for modernization.

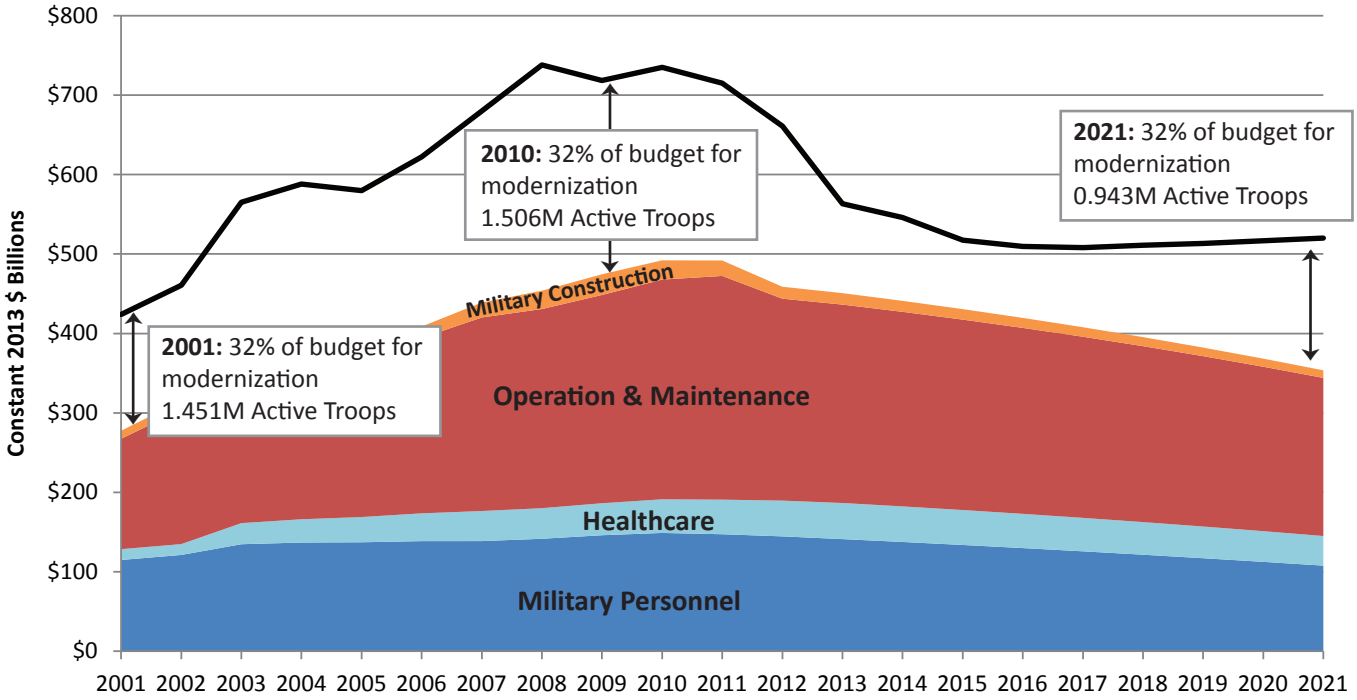
Figure 4 (opposite) illustrates the end strength/modernization trade-off. In order to maintain the 32 percent of the budget for modernization that's been the historical average since 1980 (including throughout the post-9/11 buildup), and hold readiness constant, DoD would have to cut 455,000 more active-duty end strength than is currently planned.

Part III: Methodology for Making Trade-offs

So how do we deal with the "double whammy" of a decreasing defense topline and increasing cost growth? This era of budget austerity and rising costs requires asking two questions. First, what's affordable—a question that would be a departure from the traditional practice of first outlining a strategy. Then, asking what capabilities are best suited to execute this resource-capped strategy. Therefore, the first

2. Department of Defense, *Defense Budget Priorities and Choices* (Washington, DC: Department of Defense, January 2012).
3. Stephen Daggett, "Resourcing the National Defense Strategy: Implications of Long-Term Defense Budget Trends," statement to the House Committee on Armed Services, November 18, 2009.

Figure 4. Restoring Modernization to the 2021 Budget



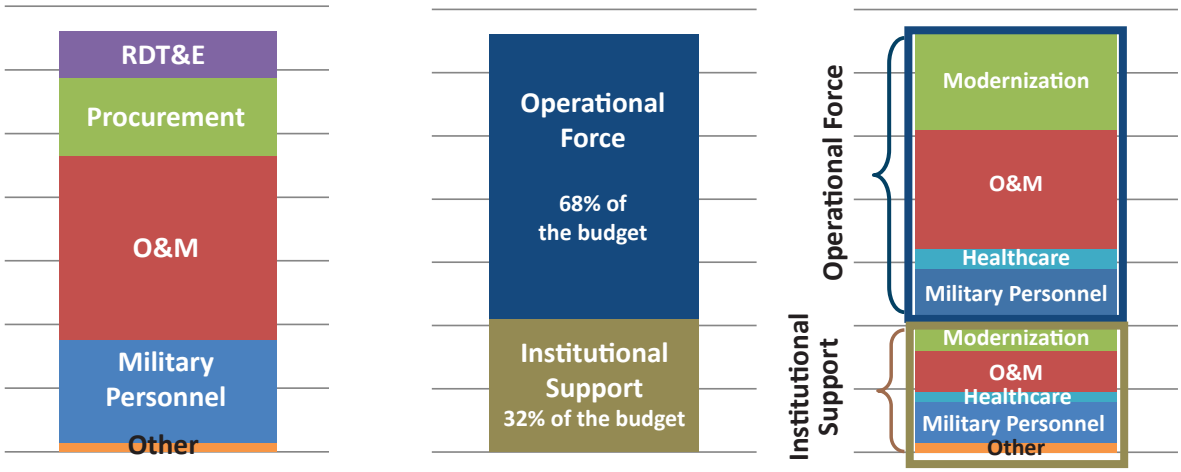
step of any approach to aligning strategy and resources must fully account for the resource constraints, both external and internal, facing the department.

After determining the defense budget topline, defense planners need to move beyond the traditional accounting in order to understand better the trade-offs being made. The CSIS methodology applied below reconceptualizes the defense budget in terms of Institutional Support and Operational Forces, as shown in Figure 5. Institutional support is the Title 10 function of organizing, training, and equipping the operational forces. An analysis of the FY 2012 budget authority, looking into each budget account, reveals about 32 percent of the budget being spent on these support functions. This approach then incorporates the "should cost" concept of DOD's Better Buying Power initiatives and applies it to the institutional support segment of the budget, capping it at 30 percent. This gives the services the flexibility to determine where money can be saved in their support structures and incentivizes them to get below the cap.

The remaining 70 percent of the budget, the operational forces, also gets further dissected. Defense planners first must identify their common core capabilities—the people and equipment required to address the most pressing future security challenges. Between 35 and 50 percent of the budget would be available for funding these core missions, no matter what the overarching strategy.

Finally, the remaining 20 to 35 percent of the budget can be devoted to "Strategy." Strategy comes last in this analytic approach because, in a time of austerity, strategy is discretionary spending. This discretionary spending is where planners can evaluate different options, different priorities for how to spend the last portion of the budget. Once a strategy and its associated priorities have been determined and resourced, the critical

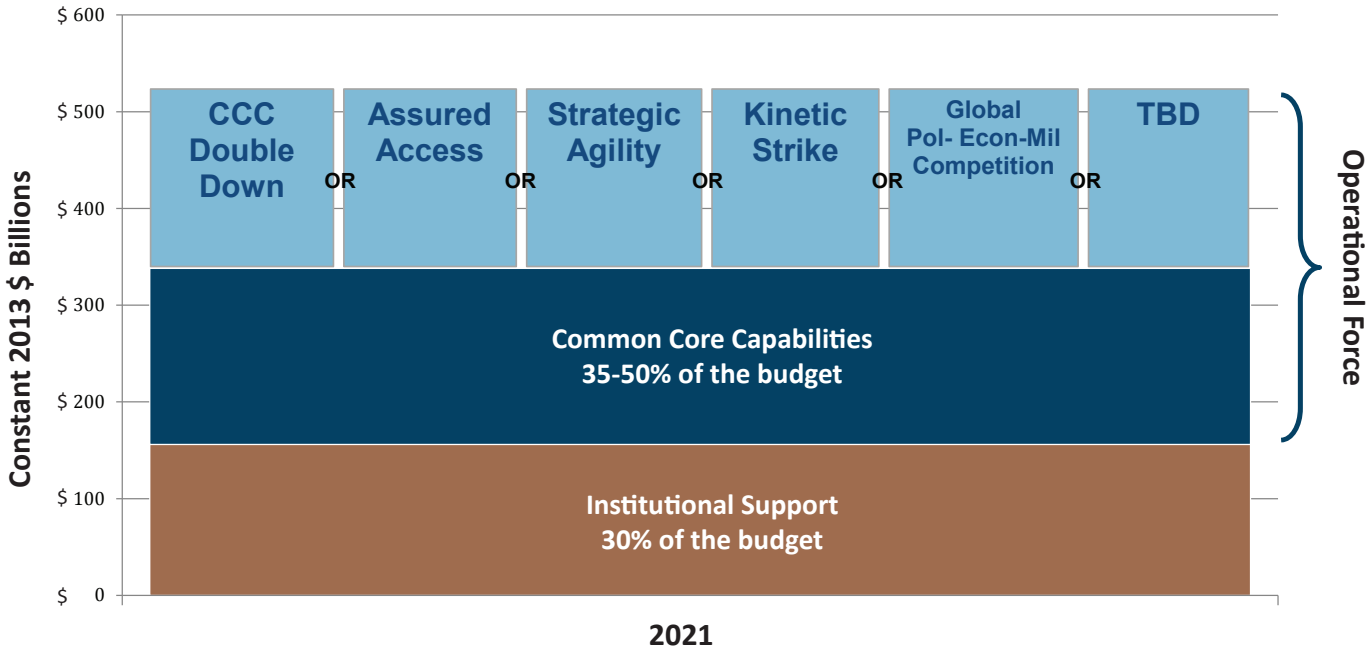
Figure 5. Reconceptualizing the Defense Budget



final step is to step back and look at the budget as a whole and evaluate whether, if this is all the capability and capacity the budget can support, is that strategy still valid?

With the twin challenges of declining toplines and entrenched internal cost growth, the Department of Defense will face very difficult choices in the coming years regarding defense strategy, force development, and force employment issues. The 2014 Quadrennial Defense Review (QDR) provides an opportunity to rationalize the alignment of strategy and resources for a sustainable defense plan. The CSIS framework and methodology in this paper are intended to provide the Pentagon, legislators and their staffs on Capitol Hill, and the broader defense community with a new set of analytical tools, because defense planners are still talking about learning to do more with less, when the reality is that it is quickly becoming about doing less with much less. ▪

Figure 6. 2021 Affordable Force Alternatives



About the Authors

Clark Murdock is senior adviser for the Defense and National Security Group at CSIS and director of the Project on Nuclear Issues (PONI). Joining CSIS in January 2001, Murdock has completed studies on a wide range of defense and national security issues, including strategic planning, defense policy and governance, and U.S. nuclear weapons strategy and policy. He directed the four-phase study on Defense Department reform, Beyond Goldwater-Nichols: USG and Defense Reform for a New Strategic Era, which released reports in 2004, 2005, 2006, and 2008. Murdock is currently leading several "track two" dialogues on nuclear policy issues—one involving the United States, United Kingdom, and France, and the other involving the United States, South Korea, and Japan. He has also recently completed studies on methodological approaches to building force-planning constructs and on nuclear posture implications of U.S. extended deterrence and assurance. He is the principal author of *Improving the Practice of National Security Strategy: A New Approach for the Post–Cold War World* (CSIS, 2004) and *The Department of Defense and the Nuclear Mission in the 21st Century* (CSIS, 2008). He also coauthored *Revitalizing the U.S. Nuclear Deterrent* (CSIS, 2002) and *Nuclear Weapons in 21st Century U.S. National Security* (AAAS, 2008).

Before joining CSIS, Murdock taught military strategy, the national security process, and military innovation at the National War College. Prior to that, from 1995 to 2000, he served in the Office of the Air Force Chief of Staff, where, as deputy special assistant to the chief for long range planning, he helped develop a strategic vision for the 2020 Air Force. Then, as deputy director for strategic planning, he institutionalized the Air Force's strategic planning process and spearheaded the development of new planning products. Before joining the Air Force Chief of Staff's Office, he was special assistant to the under secretary of the Air Force, providing analytic support to the secretary and under secretary on broad issues of concern, including the future of air power and Air Force missions. Before joining the Air Force, Murdock served in the Department of Defense, where he headed the Policy Planning Staff in the Office of the Under Secretary of Defense for Policy and held responsibility for mid- to long-range analysis and planning on strategy and defense policy issues. Prior to joining the Department of Defense, he served for several years on the House Armed Services Committee as a professional staff member and as a senior policy adviser to then-Chairman Les Aspin. Murdock's experience in defense planning and policy also includes service on the National Security Council as senior director for Africa affairs and in multiple roles in the Central Intelligence Agency. Before turning to government service, Murdock taught for 10 years at the State University of New York at Buffalo. He is an honors graduate of Swarthmore College and holds a Ph.D. in political science from the University of Wisconsin at Madison.

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