# HOW MUCH SHOULD WE SPEND ON DEFENSE?

**A conversation with Todd Harrison, Andrew Hunter, and Mark Cancian**

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**GLOBAL FORECAST: How is the defense budget environment facing President-elect Trump similar or different from what faced the past two presidents?**

**TODD HARRISON:** President-elect Trump will take office with budget caps already in place that extend through his entire first term. Neither George W. Bush nor Barack Obama entered office with these kinds of statutory constraints on fiscal policy. The budget caps limit the budget options available to the next president and will force him to begin negotiating with Congress right away for some sort of deal that raises the caps.

Another important difference is the deficit and economic outlook. When President Bush took office the federal government was running a surplus, which made it much easier to increase defense spending while also pursuing other policy priorities like cutting taxes. President Obama took office under an entirely different fiscal situation, with federal deficits soaring due to the recession and the Bush tax cuts. The next president will be entering office under what appears to be a better fiscal situation than eight years ago but a markedly worse fiscal situation than 16 years ago.

**ANDREW HUNTER:** The next administration will take office at a very different point in the defense budget cycle than President Obama did. DoD's budget is still bumping along near the bottom after a major budget drawdown. President Obama took office at what we now know was the top of a defense budget cycle, and President Bush took office after a budget drawdown, but one that had been over for two to three years, and with a defense budget that was already rising. The defense budget will almost certainly increase under the next administration,

but the question will be how quickly, and how that increase will be used to invest in efficiencies, a cutting-edge workforce, and new capabilities.

**MARK CANCIAN:** I'd note that what happens in defense will be a part of what the new administration proposes for the federal budget overall. The current budget agreement does not cover FY 2018, the budget that the administration will need to submit immediately to the Congress, but the caps of the Budget Control Act—which President-elect Trump has said are too low—do continue. So the new administration will need to devise a strategy immediately.

The first budget strategy decision will be whether to work toward some sort of "grand bargain," that is, a deal that includes revenue, entitlements, domestic spending, and defense, and puts the budget on a long-term sustainable path. The Congressional Budget Office's long-term projection shows increasing deficits in the future if nothing is done. Virtually every budget analysis therefore recognizes the need for such a deal, but the politics and budget tradeoffs are daunting.

The alternative would be to lift the caps on domestic and defense spending (or one and not the other) and fund them at the higher levels many believe are necessary. Deficit hawks in Congress will oppose such a deal, but it is unclear whether the Freedom Caucus will stand up to a President Trump looking to increase spending on defense.

The fallback is for short-term deals as has been the case for the last few years. One hopes, however, that a new president and a new Congress can break out of this crisis mode of operation.

### GF: What are the major budgetary decisions facing the new secretary?

**CANCIAN:** A key decision will be how to implement the president-elect's vision for force expansion. In a September speech, President-elect Trump described his proposal: a regular Army of 540,000 soldiers, a Navy of 350 ships, a Marine Corps of 36 active duty infantry battalions, and an Air Force of 1,200 active tactical fighter/attack aircraft, plus enhanced missile defense and cyber capabilities. Using CSIS's Force Cost Calculator, we estimate this will cost about $80 billion above what the Obama administration is proposing. On the one hand, that's a lot of money. On the other hand, it would increase the burden on the economy to only about 3.5 percent of GDP, below the level during the wars in Iraq and Afghanistan and far below the level of the Cold War. The challenge will be fitting this expansion into a federal budget proposal that includes other administration priorities like tax cuts and infrastructure rebuilding. The administration will also need to fill in details—which ships, which aircraft, how to recruit the additional personnel. As a complement to building forces, the new leadership in DoD will need to pursue management efficiencies both for potential savings and to convince the public that it is spending this additional money wisely. A recent article in the *Washington Post* claimed that an internal DoD study identified $125 billion in "back office" savings, and that claim engendered much comment about "waste" in DoD. The study did not actually identify any specific savings, instead recommending a process that might find savings, but the point about pursuing efficiencies is important.

**HARRISON:** Another looming budget issue is the "bow wave" of modernization programs, which includes replacement of all three legs of the nuclear triad at roughly the same time. The peak years of funding for major modernization programs occur in the early 2020s. This is just outside the five-year planning horizon now, but it will move into the five-year budget during the next administration. This bow wave in funding for major acquisition programs could be accommodated by increasing the overall DoD budget, cutting other parts of the DoD budget (such as force structure and readiness), cutting smaller acquisition programs, or making tradeoffs among major acquisition programs. However, each of these options comes with political and strategic risks. Congress does not appear ready to tackle this complex issue, but the next administration will not be able to avoid making such decisions in its budget requests.

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**HUNTER:** The next secretary needs to present the president and Congress with a compelling case for a future years' defense program that meets current global challenges while preparing DoD for the future. This will require significantly more funding that is available under the BCA [Budget Control Act] caps, and so the caps must be negotiated upward. While an overall federal budget solution is a matter outside of the secretary's control, the secretary can and must make the case for what additional defense funding would deliver for our national security now and in the future. The budget dynamics of the last several years have made this nearly impossible, as the political imperative has been to build budgets that maintain maximum negotiating leverage. Because the FY 2018 caps have near zero political support, a window exists for the secretary to lay out this case.

### GF: How should the new administration handle the Overseas Contingency Operations, or OCO, budget?

**HARRISON:** Because OCO funding does not count against the BCA budget caps, it has become a convenient tool for Congress and DoD to skirt the budget caps. In the 2017 request, the administration identifies $5.2 billion in OCO funding as being used for base budget activities, but my analysis indicates that an additional $25 billion in funding identified as being for Afghanistan is actually being used for base budget activities. Thus, roughly half of the $59 billion OCO request appears to be used for activities that were previously funded in the base budget. For comparison, base budget funding in OCO under the Bush administration peaked in FY 2008 at $12.1 billion, according to a DoD study.

The problem with using OCO funding to support the base budget, as both Congress and the adminis-



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tration are doing, is that OCO funding does not come with a plan for future years. This means that DoD's current programs and force structure cost more than is shown in its base budget request. If $30 billion in OCO-for-base funding is not made available in the future, deeper cuts in force structure, readiness, and acquisitions will be necessary than what is already projected. A second policy implication is that the higher level of defense spending DoD is assuming in its plans means that overall federal spending and deficit projections will be higher than the administration's FY 2017 budget materials indicate. These additional "enduring" costs would add roughly $120 billion to the $2.6 trillion in deficit spending the budget projects for the next five years (FY 2017 to FY 2021).

It is useful to keep the variable costs of contingency operations separate from the base budget to provide a more accurate picture of what contingency operations cost. For that reason, the next administration should be more disciplined in designating which costs are truly war-related and which costs are not. Ideally, all base budget costs would be moved to the base budget and the budget caps would be adjusted accordingly. But if such a deal is not possible, DoD should at a minimum identify in its budget materials how much of the OCO request is actually being used for activities that belong in the base budget and provide a five-year projection for these costs so policymakers can plan accordingly.

**CANCIAN:** When war funding began 15 years ago, no one thought it would still be continuing today, but it is and has become a semi-permanent part of the budget landscape. The ideal situation would be a "grand bargain," as discussed earlier. Then the enduring elements of OCO—that is, the elements that would continue after all troops are withdrawn—could be transferred to the base budget. That would align the remaining OCO more closely with the incremental cost of conflicts.

If a grand bargain does not occur, then it's probably not worth expending the political capital trying to move the enduring OCO costs to the base as a standalone effort. Democrats in Congress will want commensurate increases in domestic spending. That will be unacceptable to Republicans. Further, as a matter of practical politics, having an OCO "relief valve" that is unconstrained by the budget caps can be helpful in making deals. Instead, the White House might update the criteria that guide what goes into OCO. The criteria could be narrowed to ensure that only the most relevant costs are included in OCO.

**HUNTER:** In a healthy defense budget, the base budget would be large enough to handle known costs and would also include some flexibility for addressing likely contingencies on a small scale. It would also continue to have OCO or something similar to address truly unforeseen contingencies and major unplanned expenses. The current size of the OCO account is driven by the inadequacy of the budget caps. The incoming administration should seek to shift recurring expenses out of OCO to the base budget, but also, to retain OCO at a smaller level as a vital tool in handling an unpredictable world.

**GF: What future investments should DoD be making now that it has not been able to make?**

**HUNTER:** Three major areas for increased investment come to mind: rapidly evolving enablers, infrastructure, and people. The big modernization programs get all the attention, but often the critical difference comes from the less visible systems such as command, control, and communications and ISR (Intelligence, Surveillance, and Reconnaissance). The next secretary must ensure that the services create the budget space and the buying processes necessary to modernize these enablers at the speed that the underlying technologies are advancing. Investing in science and technology and in essential warfighting platforms must also remain priorities. DoD needs to get more out of its infrastructure. Given the overall budget situation, there is a strong case for leveraging private capital to invest in a more efficient and capable physical plant. DoD made a major investment in its people by shifting to an all-volunteer force, an investment every bit as important as the high-end technology developments undertaken at the same time that get more attention. Today's budget process doesn't really consider people investments. The military must develop a solid framework for investing in people to ensure continued excellence.

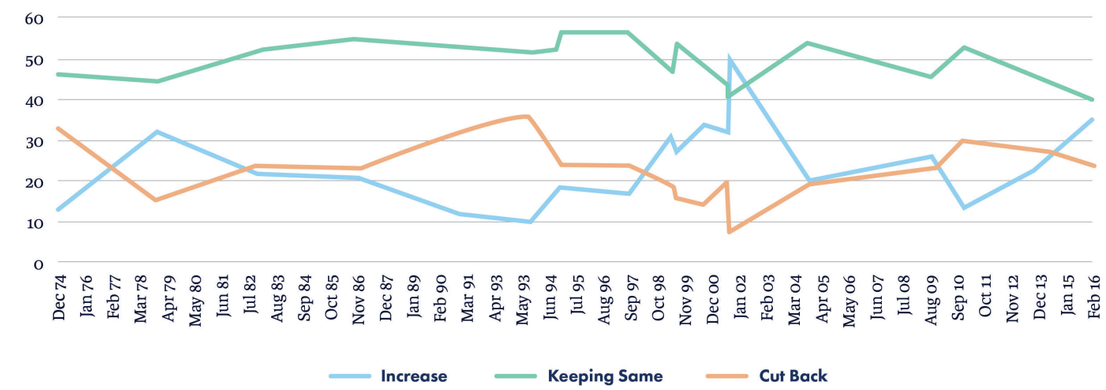
**CANCIAN:** As the department has recognized, it will need to increase its investments in advanced capabilities for use against peer-competitors like Russia and China. That's a shift from the focus on counterinsurgency and regional conflicts that the department has had since the end of the Cold War. The Third Offset, which pursues next generation technologies and concepts to assure military superiority, is intended to develop such capabilities. On the other hand, the department will also need to maintain enough "standard" quality capabilities to fill out its force structure. Not all adversaries will need to be countered with advanced capabilities. That will drive the department to a high/low mix.

**HARRISON:** In recent years, DoD has placed a greater emphasis on protecting and improving the resilience of national security space systems. While funding for space has increased, missile warning and protected satellite communications systems are overdue for follow-on programs. The next administration should make investments in these systems a high priority. It should also increase investments in stealthy unmanned aircraft. The current fleet of unmanned aircraft, such as the MQ-9 Reaper, is consistently in high demand, but the proliferation of advanced air defense systems means that these nonstealthy aircraft may have limited utility in the future. The next generation of unmanned aircraft needs to be stealthy to penetrate defended airspace and built with modularity in mind to carry a wide array of sensors and munitions for strike and surveillance missions.

**GF: Innovation is the word of the moment. What can the new administration do to work with the private sector to harness the best of U.S. innovation for the defense sector?**

**HUNTER:** The key is presenting the private sector with a business case for investing in innovation that is compelling. Making a range of small bets makes sense. This approach must be accompanied, however, by a system to capitalize on the "wins" that also meaningfully rewards the private sector. But the positive reward of high profits is limited by the relatively small size of the defense market, and the negative incentive of eroding defense market share is complicated by the mutual dependency between DoD and its large suppliers. The best incentive mix

**Do you think we should increase our spending on national defense, keep it about the same, or cut it back?**




SOURCE: PEW RESEARCH CENTER, APRIL, 2016, "PUBLIC UNCERTAIN, DIVIDED OVER AMERICA'S PLACE IN THE WORLD"

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is likely to be found in providers of emerging technologies like autonomy and artificial intelligence, where DoD investment can potentially enhance competitiveness outside of the defense market, and where there is less risk to existing supply chains.

**CANCIAN:** Looking for additional venues to engage the private sector is helpful, but adding more liaison offices, executive exchanges, and industry conferences has diminishing returns. The key will be getting innovation out of the lab and into operation, and that's where the next administration should focus. As Andrew indicates, it should initiate a lot of small bets that put new capabilities into the field to see how they work. Some will succeed, some will fail, most will need some sort of modification, but there's no substitute for actual experience.

**HARRISON:** Companies tend to mirror their customers. If DoD is not satisfied with the level of innovation it is getting from current defense companies, it should first look in the mirror and try to become a better customer. For example, the current contracting process with DoD is slow, cumbersome, and inefficient. It creates a high barrier to entry for nondefense companies, especially small businesses that cannot afford the overhead it adds to their operations. Being a better customer can help entice more commercial companies to work with the military. But more importantly, it can enable current defense firms to be more innovative, agile, and responsive to the military's needs. □

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