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“Demystifying and “De-mythifying” the U.S. Defense Budget, Part 2”

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Kathleen Hicks: Hi, I'm Kathleen Hicks, senior vice president and director of the International Security Program at the Center for Strategic and International Studies. This is Defense 2020, a CSIS podcast examining critical defense issues in the United States' 2020 election cycle. We bring in defense experts from across the political spectrum to survey the debates over the U.S. military strategy, missions, and funding. This podcast is made possible by contributions from BAE Systems, Lockheed Martin, Northrop Grumman, and the Thales Group.

Kathleen Hicks: In this episode of Defense 2020, I continue our discussion with three experts on the U.S. defense budget. My colleague, Todd Harrison, director of Defense Budget Analysis and director of the Aerospace Security Project at CSIS. Bill Hartung, director of the Arms and Security Project at the Center for International Policy, and Mackenzie Eaglen, resident fellow at the American Enterprise Institute. We continue our discussion, begun in the last episode, on key issues surrounding the U.S. defense budget.

Kathleen Hicks: All right. We're here today to talk a little bit about the hunt for savings in the defense budget and I'm going to start on one of the trickiest issues that's plagued conversations around defense budgeting for some time, and that's the Overseas Contingency Operations [OCO] account, which from the left and the right has come under criticism. Elizabeth Warren has said that she would cut OCO in order to help invest in priorities like Medicare For All.

Kathleen Hicks: Mick Mulvaney, current White House acting Chief of Staff, in 2015 urged his colleagues to avoid using OCO, his colleagues on the Hill, as a backdoor, he called it, or "something that is off-budget." Mick Mulvaney, who's the head of OMB and the acting Chief of Staff to President Trump, back in 2015 went on in Congress, urged his colleagues on the Hill to avoid using OCO as a "backdoor," or "something that is off-budget." But in reality you've had folks like President Obama come in with a view that they were going to phase out OCO, having continued it. Again, Mick Mulvaney, is now part of an administration that has continued OCO. So maybe we'll start with you, Bill, and with the Sustainable Defense Task Force, I suspect you all had some views on what should be the future of OCO. Where do you think it should go and where do you think it's headed?

Bill Hartung: Well, we called for eliminating it, the war-fighting part of it, but we left some money in there for force protection and costs of withdrawal from the wars. And then the part that is subsidizing, that wasn't war-related, but was put there because of the caps, we deal with separately. We have detailed proposals for cuts, so we don't just say, "All of OCO, just you snap your fingers and it goes away." But I think especially during the period of the caps, it kind of greased the wheels. I was opposed to it, but I could see if you were the one trying to get a budget, it was a very convenient tool.

Kathleen Hicks: Let's break that down a little. That's because that money that goes into OCO does not fall under the Budget Control Act caps, which were in place at the time. So on the Hill and the administration, whether it was Obama or Trump,

could put money into OCO, is your point and not have it be the subject of this cap debate.

Bill Hartung: Right. I mean, it's not great planning, because it's year to year, but it was something that was attractive to both sides for their own reasons. But if you don't have caps, I don't see why you need OCO.

Kathleen Hicks: Mackenzie, is OCO staying or going?

Mackenzie Eaglen: Well, it's staying because all parties, while they generally dislike it, know that it greases the wheels, and it funds other priorities that it's entirely not intended to be used for. So whether that is Defense [Department] or even the State Department or other underfunded agencies of national security as well, it's pretty bipartisan in that everyone loves to hate it, but really secretly loves it. It's a credit card. It's just another credit card in the wallet, swipe away. Because it's completely off the books means we're debt-financing it. It's essentially debt dollars paying for other priorities.

T. Harrison: Yeah, it's a loophole, and it's convenient, and that's why people love it, even when they say they hate it. I think that we have to be careful, though, because we have put so much base budget funding into OCO now. Not just Congress doing it, but the Obama Administration did a lot of this as well. And then just a lot of base budget O&M funding, just to operate the forces that we have.

T. Harrison: Virtually all of our CENTCOM related costs are in OCO now, and to further confuse things, much of that has been labeled by DOD [Department of Defense] as being for Afghanistan, and so it has led people to think that we're spending 40 to 45 billion a year on Afghanistan, which nothing could be further from the truth. You could pull all US forces out of Afghanistan, and you're still going to be left with about 20 billion of that Afghan funding. It's for things that aren't actually related to Afghanistan that aren't actually the incremental cost of military operations. They are the peacetime functions that we would do, even if we did not have the conflict going on.

T. Harrison: And so you look at the total OCO budget, which has been running about 70 [US\$] billion a year now for a while. The majority of that, it is not the incremental costs due to operations in Iraq, Syria, or Afghanistan. It's stuff that belongs in the base budget. And so the problem now is you hear folks like Senator Warren coming out and saying, "Oh, well, I'm going to eliminate OCO. In over 10 years I'll save \$800 billion." It's like, "Well, you could eliminate OCO and completely end our involvement in those countries, fine, in those wars. That's a policy decision, but when you eliminate all the rest of that base budget funding, tell me what parts of our force structure you're going to cut, because that's actually what you have to do to eliminate that funding." Don't just think that you can eliminate the OCO budget, save all that money, and not have to make choices about cutting force structure because that's not the case.

Bill Hartung: Yeah, I think Todd put his finger on it. It's not just an administrative decision. And so I think what you would have to do is look at the part of OCO that's really for the base budget, as well as the base budget. And then you look across that whole spectrum and say, "Well, what would you cut?" And you're not going to cut anything significant without a change of strategy, which will then allow you to change force structure, because that's where the savings are. So I don't think any candidate is going to go into that level of detail on the campaign trail. But if they were in office, that's what they'd have to do, I think, if they wanted to have real savings and also explain how you can save money and still provide security.

Kathleen Hicks: 06:50 So whether you're a Mick Mulvaney in a second Trump Administration or you're the head of OMB for a new Democratic president who wants to constrain some of this spending that's outside of the base budget, the way we've done that in the US government in the past is through a rule set. So listeners may not know that OCO is not guided so much by statute as it is by policy agreement between an administration and congressional committees over the rules that will guide what can go into it and what can not go in. Is there at least, Mackenzie, a prospect there of setting a norm, if you will, or a principled approach on OCO, if it's going to stay, about what goes in and what needs to be in the base?

Mackenzie Eaglen: Yes. So that's exactly what we recommended. So basically saying that the abuse of the account has reached unprecedented levels, where everybody agrees to the abuse, right? And it's just so blatant, where things that are not for counter-terror operations are labeled as such and stuck in there. This past year the Pentagon finally just coughed it up after pressure from people like Todd Harrison saying, "Look, these are base funding needs. They have nothing to do with hostilities or conflicts or even operations overseas that aren't hostile." So that's where it is.

Mackenzie Eaglen: But so how do you get rid of, or how do you reform fake OCO, as I call it? FOCO, maybe. But first of all, you have to identify and be honest about what's fake and what's real. And then you'll probably need to get rid of the fake OCO, migrate into the base budget, or stand up a separate account. So whereas this becomes not off-the-books any longer, it's a regular, annual... It's part of the annual appropriations and authorizations as part of the total defense bills. That's where you start. But the challenge here again is if Bill said, if it was the grease for the wheels to get budget deals going, and it was, particularly as earmarks went away, it got harder to grease everything without earmarks. So then OCO became the new gravy train to ride bills to passage for agreement for both parties. It also demonstrates why it's the crack cocaine of Congress and it's just going to be so hard to let it go.

Kathleen Hicks: Got it. So for sure OCO will beat NOCO, and we may still have FOCO. So I think if anyone could follow that, they'll understand the defense budget. So let's dig back into the base budget. So we've talked about OCO, but now there's the base budget piece that's the majority of funding on defense, and cost growth has been a huge challenge. And Todd, you've pointed a lot of this

out in your recent writing, so maybe we'll start with you. Where are the major sources of cost growth and how do we start to get a handle on how to control it?

T. Harrison: Yeah, this is where graphs are useful, and so I'm... Imagine people to just picture in their head the defense budget. It's kind of lumpy, going up and down over time, but the overall trend over time has been going up. You put with that a chart showing the size of the military, and what you see is it's steadily going down. So right now, our defense budget, as I mentioned before, it's a little higher in inflation-adjusted dollars, and it was at the peak of the Reagan buildup in '85, but our Air Force is half the size of it was at that time. Our Navy is half the size it was at that time. And if the Army had a common unit for force structure, we could make a similar comparison, but they keep changing what's in a brigade and divisions and all of that.

T. Harrison: But the Army is much smaller than it used to be as well. So what that tells us is that we're spending more and more for a smaller and smaller force. And it's great that we're using technology in many areas to have a much more effective and capable force. But our adversaries are also using technology. And so really, we have to take into account, we may have a more sophisticated, technologically-advanced force, but it's going up against more sophisticated threats as well. So you got to stop and ask yourself, the planes that we have today, are they twice as effective as the planes we had 20 years ago? And keep in mind that 75% of the planes in the Air Force inventory today are the same planes we had 20 years ago. Right? So tell me, are they really twice as effective against the threat?

T. Harrison: And subjectively, I think most people would agree no, but yet we're spending so much more. So you dig into why we're spending more. Our personnel costs are much higher. Labor costs. We have made big increases in military compensation that a lot of people don't recognize. An 18-year-old right out of high school coming into military today is going to make about \$45,000 a year in cash compensation, plus they get free health care and all sorts of educational benefits and things like that. Someone graduating from college, going in from ROTC or from a service academy, going in 22 years old as an officer in the military, they're going to be making over 70,000 a year in cash compensation, in addition to all their benefits as well. These are high-paying jobs, by today's standards. And yet we keep putting more and more money into military compensation. And what we're doing is we're pricing ourselves out of the ability to afford an active duty military of significant size. So personnel costs are a big part of it.

T. Harrison: Also, if you look at our operation and maintenance part of the budget... So that goes for things like training for peacetime operation of our forces, for maintenance of our equipment. Those costs have been growing faster than inflation. Year after year, we see about 3% real growth in our cost of operating forces. What that means is that just to maintain the same number of planes, ships, tanks, et cetera in our military, you have to have operation

and maintenance funding that's going to grow about 3% a year above inflation, just to maintain the same equipment that we have.

T. Harrison: And so these are negative trends, and in the long run it'll be unsustainable. Even if we continue to grow the defense budget, that growth will be consumed by higher personnel cost, higher operating costs, and as a result we'll get a smaller and smaller force over time, and less and less money will be available to invest in new technologies and new weapon systems that we need to remain competitive in the future.

Kathleen Hicks: So, Bill, does this track with what you have found as well, and what are some ways to get a handle on cost growth in the defense budget?

Bill Hartung: Well, I think Todd's right about the trends and the processes going on. We argued that we could cut the force about 10%, if we weren't preparing to fight large-scale counterinsurgency wars, doing nation-building, if we looked at Russia and China slightly differently, not strictly as military planning confrontation... Kelly Magsamen said earlier, on another version of this podcast, she said, "Well, maybe the military isn't the most important tool in terms of confronting China." Of course, she also said she was going to get hate emails for saying that. But nonetheless I think it's a good point. So...

Kathleen Hicks: So you're thinking cut, cut. Maybe [it's] not an ability, [it's] a recognition that we can't control cost growth, it sounds like, or can't reasonably get there, but what we can do is cut... It sounds like what you're saying, cut the size of the military.

Bill Hartung: Yes. But I think, still, if your costs are growing, you may end up in a similar place. If compensation is still going up, maybe that 10,000, 10% cut goes away, because everything else is spiraling. So at some point I think you have to deal with compensation, but that might be the hardest thing in the budget. Even harder than procurement to go after.

Mackenzie Eaglen: I want to foot-stomp that point and just say that's right. So you would end up in the exact same place. So each year as defense dollars, presumably when they're rising, rise above inflation, that money's all eaten up to fund the smaller force, just because given the cost growth of personnel. Why? Well, we have a volunteer group of professionals that could do something else, and so therefore we've been using them a lot, therefore there's a lot of good reasons why this has been happening. But the trend-

Kathleen Hicks: This being the compensation.

Mackenzie Eaglen: Yes. The cost of labor, just in general, for the military. For the Defense Department, since there are also many civilians. And so the implicit agreement that leaders of depending on have made in the last... Since 9/11, essentially, whether or not they consciously made this choice, is that the Defense Department will cut billets to grow compensation. Because that's where we are. That's the deal. You want to keep paying people more in cash

and benefits. You have fewer people period. And so they would come out, it's exactly that place that Bill is talking about.

Mackenzie Eaglen: But what does this... Let's step back a second. Look at the big picture. What does this reflect? The single most expensive covered group of people in the United States of America are military beneficiaries and retirees, military retirees. We have a national healthcare problem, and it's simply reflected in the defense budget. So when you look at the cost of labor under the Pentagon umbrella, healthcare is the largest driver of those costs, and same thing with our federal entitlements. There are food stamps primarily, a little bit, but that's actually under the appropriations process. But under the automatic spending is essentially Medicare, Medicaid, and social security primarily, which... Those are health care entitlements. So this is an issue that, frankly, I think everyone should jump off the cliff and solve it together, and DOD would have to be a part of that discussion.

Bill Hartung: I'm curious about the Space Force. We've come out in our Sustainable Defense Task Force for not going forward, arguing that it's excess bureaucracy and may also put more of a focus on military space than is needed. And I know Todd has a different view, but also I'm curious what you both think about where it stands in Congress. What are the positions that are coming forward? Is it going to be controversial?

T. Harrison: So it's interesting that it's one of the most consequential reorganizations the Department of Defense has had since the 1980s, and it is one of the least controversial issues in this bill this year. So what the President ended up proposing is a new military service for space. He calls it a Space Force. It would be within the Department of the Air Force, much like the Marine Corps is within the Department of the Navy. That's what they proposed. The Senate version of the bill did something similar. It's a service within the Department of the Air Force, with a chief that I think they call it a commander, that would sit on the Joint Chiefs, just like all the others, and then the House version of the bill, under Democratic leadership, what they put in there is also a new service under the Department of the Air Force. They call it a Space Corps and the head of it is called a commandant, but for all practical purposes it's the same.

T. Harrison: So the White House proposed it. It's in both bills, the House and Senate versions of the NDAA. So we are very likely to see that included in the final version of the NDAA [National Defense Authorization Act]. My understanding is that's been part of the negotiations, just working out the differences in implementation between the House and Senate versions of the bill, but it's very likely to go forward.

Kathleen Hicks: So, Mackenzie, on Space Force, do you anticipate budget implications in terms of those changes that both the Department have put forward and that the President has sought?

Mackenzie Eaglen: So it's relatively cheap right now, although I agree with Bill. I think it's bureaucratically unnecessary and more overhead. And if the point was to get the Air Force's attention, check. I think, actually, mission accomplished. But so it's pennies on the defense dollar this year. It's about 70 million, mostly reorganizational at this point. But I think what members of Congress aren't expecting is the tail that will come, and it will have lots and lots of dollars associated with it, because they're going to want more capability to build up this force in particular.

Mackenzie Eaglen: In fact, just this morning I was at the Pentagon and this was a point of discussion. Lots more money is going to end up being poured into this as a priority, which is probably a net good thing. But the deal, I think, in members' minds, is this is pretty much a net neutral cost, and I don't think that's going to be the case over the next five years.

Kathleen Hicks: Let's dig also into the operations and maintenance account point that Todd raised, and in particular tying it to the way in which historically DOD has essentially sacrificed the future. Let's be honest, that's the trend. And how O&M [operations & maintenance] has been difficult to nail down what is going into actual readiness improvements and maintenance improvements, and what is uncontrollable spending, if you will. I may have wildly mischaracterized that, but Todd, let me turn to you first. How do we get a handle on O&M? And if you're on Capitol Hill and trying to oversee DOD O&M, what is your best hope?

T. Harrison: Yeah. This is something that I dug into in a recent report I published on the Air Force of the future, just looking at the Air Force, but dug in pretty deep on the O&M funding. And what I found is if you look at the data and the operating cost of different types of aircraft, that a lot of things that you think might be at work are not really apparently the problem. Do older aircraft cost more to operate? Yes, but so do new aircraft. It's not just something that's correlated with age. Is it because we're using our aircraft more? No, we're actually not. OPTEMPO [Operational tempo] is actually down, despite what you hear from the Air Force. Overall, flying hours are down. So it's not because we're using them more, and most of the flying hours that we have in the Air Force every year are not related to operations in Iraq, Syria, or Afghanistan.

T. Harrison: So what is causing it? What I was able to find, building on the research of others like folks at MITRE Corporation, is that it looks like our problem is that we have lots of small fleets of aircraft, that we maintain aircraft in very small numbers, and you have high fixed costs with every type of aircraft that you have. So you have to have a whole separate maintenance line, a whole separate training line, not just for the flight crews, but for the maintainers as well, and those costs are fixed regardless of how many of that aircraft that you have.

T. Harrison: What we have done in the past is when we've tried to downsize, instead of eliminating whole fleets, we just eliminate part of the fleet, and then now

we're left with lots of small fleets, and they are very expensive to maintain. If we want to get out of this, I think one of the things we can do is start eliminating whole fleets. Some of these small fleets of aircraft that we have that we may... Some of them we just have two aircraft of a particular type, or we have like a dozen or two dozen of them. So I'm talking very small numbers. If you can take the missions, the functions that are performed by those aircraft and give that to other aircraft that we already keep in larger numbers, and then eliminate that small fleet, we could actually save a lot of money.

T. Harrison: So I think there are more examples like that throughout the force where we just need to dig into the data and find what are some of the big drivers of this, and we could try to turn this curve around on operating costs. Problem, though, is politically, their constituent groups for all of those small fleets of aircraft... Because those aircraft are at a certain base somewhere, and there are contractors who have maintenance contracts for them, and there are veterans' groups that are former pilots of these types of aircraft that are going to lobby, and so you've got to overcome that. So there are a lot of political barriers to doing this.

Kathleen Hicks: This has come up from everyone. Let me just start with Bill on this. The difficulty of going at the defense budget, I think, is really mystifying to most Americans. They see the big number, they hear stories like Todd just told that point to management challenges, maybe is the politest way to put it. Point to political influence, however you want to put that. But they're really hard to go after. It's hard to go after compensation. It's hard to go after what is getting built and creating jobs and districts, and Bill, what we see instead DOD does time and again, and they're doing right now, is going after things they can go after. That's like civilians and headquarters and defense agencies. And how do you think we... Is there a point we can get out of this and into a more constructive conversation on Capitol Hill around how to bring the defense budget into a more efficient process?

Bill Hartung: Well, I think, certainly going after headquarters, it's a small enough part of the budget. It's not going to get you that far. There's been periods in the past when we've reduced, substantially reduced the Pentagon budget, but there's been a big political push to do so, after Vietnam, to some degree after the Cold War, and people just had to sort it out. Southern California took a big hit, but the cuts were made regardless.

Bill Hartung: But I think there should be some understanding across the spectrum that this system is dysfunctional, because whether you're a peacenik and you want to reduce and get rid of some of these weapons, or whether you're kind of an intelligent hawk and you want to spend on different things, to spend on different things, you still have to get rid of legacy systems. So that system of pork barrel politics is a problem for almost anyone who's trying to craft a rational defense strategy. So that to me is the only hope, is that you would have some sort of across-the-board push that says, "This process isn't

working, and if we can't change the process, we can't have a rational debate about how we should be investing the funds."

Mackenzie Eaglen: I think Bill's right. You need a larger conversation about, really, the unspoken elephant in the room here, which is Congress. Congress needs reform. To reform Congress gets you defense budget reform, but what I mean by that, I mean bi-annual budgeting, for example, something to where you have two-year budget spending bills for DOD, for example. That gives them more flexibility and authority, saves money, and therefore you can maybe even reduce spending. Committee jurisdiction, the issues that are covered, the size of the national defense policy bill, which is in the thousands of pages, staffers as program manager equivalents, all these types of nominations, confirmation processes. I mean, the list is endless. If you really want to get at the Defense Department and the executive branch, I think the conversations just start across the river in the legislative branch.

Kathleen Hicks: Great. Well, Mackenzie Eaglen, Todd Harrison, Bill Hartung, I think you've done a great job of helping to demystify the defense budget today. Thanks very much.

Kathleen Hicks: On behalf of CSIS, I'd like to thank our sponsors, BAE Systems, Lockheed Martin, Northrop Grumman, and the Thales Group for contributing to Defense 2020. If you enjoyed this podcast, check out some of our other CSIS podcasts, including Smart Women Smart Power, The Truth of the Matter, The Asia Chessboard, and more. You can listen to them all on major streaming platforms like iTunes and Spotify. Visit [csis.org/podcasts](https://www.csis.org/podcasts) to see our full catalog, and for all of CSIS's defense-related content, visit defense360.csis.org.