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## **COST GROWTH IN DEFENSE PLANS, OCCUPATION OF IRAQ AND WAR ON TERRORISM COULD ADD NEARLY \$900 BILLION TO PROJECTED DEFICITS**

**By Steven M. Kosiak**

In February, the Congressional Budget Office (CBO) published “The Long-Term Implications of Current Defense Plans: Detailed Update for Fiscal Year 2004.”<sup>1</sup> The paper, which is the second update of a CBO report originally published in January 2003,<sup>2</sup> provides a concise description of the Department of Defense’s (DoD’s) plans through fiscal year (FY) 2022, and rough high- and low-end estimates of their likely cost. CBO also recently published its analysis of the President’s FY 2005 proposals for the overall federal budget.<sup>3</sup>

The cost estimates provided by CBO in its February analysis of DoD’s long-term plans, combined with the findings of its new analysis of the President’s overall federal budget submission, raise serious questions about the long-term sustainability of the current defense plan.

Specifically, CSBA finds that *based on its own analysis of data contained in the two new CBO publications*, if the current defense plan experiences the same rates of cost growth in weapons acquisition and operations and support (O&S) activities as DoD’s plans historically have:

- The administration’s defense budget projections may understate the cost of the current defense plan (including military operations) by some \$765 billion over the coming decade (FY 2005-14).
- If added to the budget, this \$765 billion in funding (i.e., appropriations) would generate additional outlays (i.e., actual spending) of about \$700 billion over the next 10 years.
- If these additional outlays were not offset by a tax increase, or cuts in entitlements or domestic spending, they would increase the size of the federal debt. In turn, this would cause interest payments on the debt to grow by roughly \$185 billion.
- Altogether, if the additional spending outlined above is needed to execute DoD’s long-term defense plans, total deficits over the next decade would increase by some \$885 billion (\$700 billion in

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<sup>1</sup> CBO, “The Long-Term Implications of Current Defense Plans: Detailed Update for Fiscal Year 2004,” February 2004.

<sup>2</sup> The new CBO analysis updates material provided in Lane Pierrot and Gregory T. Kiley, *The Long-Term Implications of Current Defense Plans* (Washington, DC: CBO, January 2003).

<sup>3</sup> CBO, *An Analysis of the President’s Budgetary Proposals for Fiscal Year 2005* (Washington, DC: US Government Printing Office, March 2004).

program costs plus \$185 billion in related interest costs) above the levels included in the administration's most recent projections.

This analysis is the third CSBA *Update* to assess the potential impact of cost growth in DoD's long-term plans, as estimated by CBO, on the size of projected deficits.

### **Projected Funding Levels and Likely Cost of DoD's Plans**

The Bush Administration's latest budget blueprint (as re-estimated by CBO) includes a total of about \$5 trillion in funding for national defense over the coming decade.<sup>4</sup> As it has in its previous reports on the same subject, the latest CBO analysis of DoD's plans provides both low- and high-end estimates of the cost of implementing those plans. Under the low-end estimate, CBO assumes that DoD will meet its current cost goals for major acquisition programs and O&S activities. This estimate also excludes the cost of military operations. Based on CBO's low-end estimate, the amount of funding projected for defense under the administration latest budget proposal would be roughly adequate to cover the cost of DoD's plans over the next decade.

However, if DoD is unable to meet its current cost goals for acquisition programs and O&S activities, and US forces remain engaged in military operations in Iraq, Afghanistan and elsewhere, substantially more funding would be required. CBO's cost estimates for DoD were presented in constant FY 2004 dollars. CBO's high-end estimate, which assumes historical rates of cost growth in DoD programs and the US military's continued involvement in military operations, projects total costs for DoD of roughly \$5.0 trillion over the period.<sup>5</sup> This includes roughly \$4.7 trillion to cover DoD's weapons programs and peacetime O&S activities, and about \$260 billion to pay for various military operations.<sup>6</sup> Assuming that another \$18 billion a year would be needed for Department of Energy and other defense-related activities, CBO's high-end estimate implies that a total of some \$5.2 trillion (FY 2004 dollars) in funding would be required for national defense over the FY 2004-13 period.

In nominal dollars,<sup>7</sup> the total funding required, based on CBO's high-end estimate, would be some \$5.8 trillion dollars. This is about \$765 billion more than the Bush Administration's 10-year budget projection assumes will be provided for national defense. This figure includes about \$480 billion to cover cost growth in weapons programs and peacetime O&S activities, and \$285 billion for military operations (see the table on page 3).

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<sup>4</sup> National defense (as defined by the 050 federal budget function) includes DoD, Department of Energy and other non-DoD defense-related activities.

<sup>5</sup> This estimate was derived by the author based on CBO data provided in graphic form in "The Long-Term Implications of Current Defense Plans: Detailed Update for Fiscal Year 2004," p. 2. CBO analysis provides high- and low-end estimates of the cost of DoD's plans over the FY 2004-22 period.

<sup>6</sup> In its high-end estimate, CBO assumes that military operations in Iraq, Afghanistan and elsewhere related to the war on terrorism would fall from this year's level of about \$65 billion to roughly \$20 billion annually for FY 2008 and later years.

<sup>7</sup> For analytical purposes, constant (i.e., inflation-adjusted) dollars are often more meaningful than nominal dollars, because projected changes in constant dollars reflect only changes in real purchasing power. By comparison, projected changes in nominal dollars reflect both changes in real purchasing power and the impact of inflation. However, most federal budget documents and budget and deficit projections are presented in nominal dollars. CBO's funding projections were converted to nominal dollars using DoD inflation estimates.

## Implications for Projected Federal Deficits

Adding \$765 billion in funding to cover cost growth in the administration's defense plans would generate an additional \$700 billion in outlays over the coming decade, above and beyond the levels assumed in the administration's long-term budget projections.<sup>8</sup> Unless changes were made to the administration's long-term budget plans to either raise taxes, or cut domestic discretionary programs or entitlement spending, the additional spending noted above would increase the size of the federal debt. In turn, this would increase debt service costs. Altogether, it would cause interest payments on the debt to grow by around \$185 billion over the coming decade. Thus, based on CBO's high-end cost estimate, it appears that executing the current defense plan might increase the size of projected deficits over the FY 2005-14 period by a total of some \$885 billion above the levels forecast in the President's latest budget proposal.

### Potential Impact of DoD Cost Growth on FY 2005-14 Federal Deficits

Source of Cost Growth	Additional Outlays
Higher Weapons Acquisition and O&S Costs	\$435 billion
Military Operations	\$265 billion
Higher Interest Costs	\$185 billion
<b>Total</b>	<b>\$885 billion</b>

Source: CSBA estimates based on CBO data.

### Worsening Deficit Forecasts

The long-term federal budget picture has dramatically worsened over the past three years. In early 2001, CBO projected a 10-year surplus of about \$5.6 trillion over the FY 2002-11 period.<sup>9</sup> By contrast, CBO's baseline estimate now projects *deficits* totaling \$2.012 trillion over the next decade (FY 2005-14).<sup>10</sup> The dramatic change in the government's fiscal outlook has resulted from the enactment of large tax cuts, as well as a weak economy and other factors.

Unfortunately, it is likely that the outlook will deteriorate still further in coming years. In addition to further increases in funding for defense, in its most recent budget request, the administration has proposed to extend the expiring provisions of the 2001 and 2003 tax cuts, and to increase funding for homeland security. According to CBO, enactment of the President's proposed budget would push total federal deficits to some \$2.75 trillion over the FY 2005-14 period, and keep the government in the red throughout the entire decade.<sup>11</sup> The unbudgeted cost growth in DoD programs and activities discussed

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<sup>8</sup> The CBO report provides its estimates in the form of *funding* requirements. Funding (Budget authority and Total Obligational Authority) represents the amount of money appropriated by Congress, generally through its annual appropriations bills. *Outlays* represent the amount actually spent each year (e.g., paid out in the form of salaries or progress payments to contractors). Typically, funding appropriated in a particular year is spent (i.e., converted to outlays) over a period of several years. Projections of overall federal spending and deficit (or surplus) levels are made based on outlays rather than the budget authority. Unless otherwise noted, in this analysis "spending" refers to outlays.

<sup>9</sup> CBO, *The Budget and Fiscal Outlook: Fiscal Years 2002-2011* (Washington, DC: CBO, January 2001), p. 2.

<sup>10</sup> Douglas Holtz-Eakin, Director, CBO, Letter to the Honorable Ted Stevens summarizing CBO's forthcoming analysis of the President's budget request, February 27, 2004, p.1.

<sup>11</sup> *Ibid*, table 1.

above suggests that, in fact, fully implementing the administration's plans could cause federal deficits to reach some \$3.635 trillion over the coming decade.<sup>12</sup>

Moreover, the fiscal picture is likely to grow substantially worse in the years after 2014 in part because of the retirement of the baby boomer generation (which will necessitate significant increases in spending on Social Security and Medicare). The administration's own budget documents project that the federal government will run deficits continuously over the next 50 years, and that the size of the deficit will grow from about 1 percent of gross domestic product (GDP) in 2014 to 1.7 percent in 2020, 5.0 percent in 2030, and 8.7 percent by 2040.<sup>13</sup> Others have projected that deficits could increase to as much as 6.2 percent of GDP by 2020, 12.3 percent by 2030 and 21.1 percent by 2040.<sup>14</sup>

### **A More Affordable Defense Plan May Provide Adequate Security**

The fact that the Bush Administration's current long-term defense plan could cost substantially more to execute than is assumed in the administration's budget plan does not, of course, necessarily mean that additional funding should be provided. There is good reason to believe that by adopting a scaled-back and more transformation-oriented defense plan the United States could avoid (or offset) much of the cost growth assumed in CBO's high-end cost estimate and still adequately meet US security requirements.<sup>15</sup> On the other hand, so long as a large US military presence is required in Iraq and elsewhere, it will be difficult or impossible to make reductions in some programs and activities—especially Army force structure. In any event, as noted above, the administration's own budget projections show that—even without any cost growth in DoD's plans—federal deficits will increase to very high, and almost certainly unsustainable, levels over the next several decades. Thus, providing sufficient funding to support even a smaller and less ambitious defense plan may prove difficult. As such, ensuring that adequate resources are available for defense over the long run will likely require, at some point down the road, either raising taxes or cutting entitlements (e.g., Social Security and Medicare), or a combination of both revenue increases or program cuts.

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<sup>12</sup> National defense is only one of several areas in which the administration's budget projections may make unrealistic assumptions about spending requirements. For a discussion of other areas of possible costs growth, see Joint Statement issued by the Center for Budget and Policy Priorities (CBPP), the Committee for Economic Development, and the Concord Coalition, "Mid-Term and Long-Term Deficit Projections," September 29, 2003, and Ed McKelvey, "The Federal Deficit: a \$5.5 Trillion Red Elephant," Goldman Sachs, September 9, 2003.

<sup>13</sup> Office of Management and Budget (OMB), *Fiscal Year 2005 Budget of the US Government, Analytical Perspectives* (Washington, DC: US Government Printing Office, 2004), p. 191.

<sup>14</sup> CBPP, p. 15.

<sup>15</sup> For a discussion of some changes that could result in cost savings, see, for example, Steven Kosiak, Andrew Krepinevich and Michael Vickers, *A Strategy for a Long Peace* (Washington, DC: CSBA, 2001).