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FY 2007 REQUEST: DOD BUDGET CONTINUES TO GROW, MODEST PROGRAM CUTS

By Steven M. Kosiak

The Bush Administration today announced that it will request some \$441.5 billion to cover the peacetime costs of Department of Defense (DoD) in fiscal year (FY) 2007.¹ In addition, its latest plan projects that \$50 billion will be provided as a down payment to cover the cost of military operations next year.² Thus, altogether, under the latest plan DoD is projected to receive some \$491.2 billion in FY 2007. It is likely that at some point in FY 2007, the administration will submit a supplemental request for additional war-related funding as well.

The administration's FY 2007 request also includes \$21.8 billion for Department of Energy (DoE) and other defense-related programs, bringing the total projected for national defense to \$463 billion, exclusive of war-related funding, or \$513 billion including such funding.

Exclusive of war costs, the FY 2007 budget request represents about a 7 percent nominal and a 4.4 percent real (inflation-adjusted) increase from this year's level.³ Including the projected \$50 billion in war-related funding, the FY 2007 budget for national defense would mark roughly a 50 percent real increase from FY 1998 (the budgetary low-point of the 1990s).

The administration also recently announced that it would submit a \$70 billion request for supplemental appropriations to pay for military operations in Iraq and Afghanistan in FY 2006. Since Congress already provided \$50 billion for war costs in the recently enacted FY 2006 defense appropriations act, this would bring total funding for military operations this year to \$120 billion, and total funding for national defense to some \$561.8 billion. In real terms, this would mark the highest level of funding for defense since the height of the Korean War (FY 1952). If the

¹ This and other figures for the Department of Defense (DoD) and national defense (which includes DoD, DoE and other defense activities) are from the Office of Management and Budget (OMB). At press time, DoD had not yet released the comparable budget data. In some cases, there may be small difference between OMB and DoD data. Among other things, DoD frequently cites discretionary funding totals, while the OMB data used here is for total funding—which is typically slightly (e.g., \$1-2 billion a year) higher.

² At press time, it was unclear when the administration would formally request this \$50 billion.

³ At press time, DoD had not yet released its latest inflation projections. The estimates of real change included in this analysis were derived using the latest GDP deflator.

administration were to request a similar size supplemental in FY 2007, the defense budget would be even higher (than FY 2006, not FY 1952) next year.

In conjunction with the administration's submission of its FY 2007 defense budget request, it has also released the results of the 2005 Quadrennial Defense Review (QDR). The QDR includes a substantially revised diagnosis of the challenges facing the United States, and the US military in particular (compared to the 2001 QDR and earlier reviews). Among other things, it argues for placing a greater emphasis on irregular warfare and the dissuasion of major power competitors. Consistent with these new priorities, the QDR also proposes a number of potentially important programmatic changes, including increasing the number of active duty Special Operations Forces (SOF) battalions by one-third and accelerating the fielding of a new deep strike aircraft from 2037 to 2018.

However, DoD faces a significant mismatch between its long-term force structure and modernization plans, and projected funding levels. And the QDR, as reflected in the FY 2007 budget request and the FY 2007-11 Future Years Defense Program (FYDP), would do little to improve the affordability of DoD's long-term plans. Moreover, some of the proposed shifts in priorities—such as the accelerated fielding of a new long-range strike aircraft (in 2018 rather than 2037)—are likely to be dependent, for their implementation, on the willingness and ability of a future administration to make offsetting cuts in other DoD priorities. The QDR and FY 2007 budget request have, for the most part, deferred these difficult choices.

FUNDING FOR THE MILITARY'S PEACETIME PROGRAMS AND ACTIVITIES WOULD CONTINUE TO GROW

Under the administration's new plan, the peacetime defense budget (i.e., the defense budget exclusive of funding designated as war-related) would increase in nominal terms by 7 percent in FY 2007 and by an average of 2-4 percent annually over the FY 2008-11 period. This is a much slower rate of increase than has occurred over the past five years. Nevertheless, as a result of this continued growth, by FY 2011, funding for defense would, in real terms, be comparable to the levels reached during the years of the Reagan administration—historically, the peacetime peak for the defense budget.

The FY 2007 request for DoD, exclusive of war-related funding, is about \$4 billion, or one percent, below the level projected for FY 2007 in the February 2005 FYDP. However, the level of funding projected for DoD in the current plan for FY 2008-11, is essentially the same as in last year's plan. Moreover, the total for national defense (i.e., including DoE and other defense activities) over FY 2007-11 is almost identical to the amount projected for those same years in last year's plan.

"WAR" FUNDS BEING USED TO COVER SOME PEACETIME MILITARY COSTS

As noted above, the administration plans to provide a total of about \$120 billion for military operations in FY 2006, and \$50 billion as a down payment on the cost of those operations in FY 2007. Although most of this funding is needed to cover costs directly related to military operations (e.g., costs associated with activating reserve personnel, sustaining combat operations, overhauling equipment, and replacing destroyed or worn-out equipment), some of these funds are being used to cover essentially peacetime programs and activities of the Department of Defense. For example, FY 2006 costs for the Army's "modularity" initiative—which involves

increasing the number of deployable combat brigades by reorganizing the Army's current force structure—will apparently be funded through war-related appropriations, as they were in FY 2005. Since the modularity initiative is central to the Army's current plans to transform its forces, and would presumably be carried out whether or not US forces were currently engaged in military operations, arguably these costs should be funded through the regular DoD appropriations act, not emergency war-related appropriations.

Just how much of the funding designated for military operations is actually being used to cover normal peacetime force structure, readiness and modernization costs is difficult to estimate. However, the amount may be substantial. In early 2005, the Congressional Budget Office (CBO) projected that sustaining US forces in Iraq and Afghanistan at essentially today's level would require about \$85 billion in FY 2006.⁴ This suggests that the administration's proposed \$120 billion in emergency funding for military operations in FY 2006 may be too high by as \$35 billion. Some of this extra funding may be needed to cover costs associated with repairing or replacing military equipment worn out or destroyed in Iraq and Afghanistan. But it seems unlikely that these costs would absorb all of this additional funding (in March 2005, CBO estimated that DoD might have a \$13-18 billion backlog of equipment needing replacement or repair⁵).

The fact that some costs unrelated to the wars in Iraq and Afghanistan are apparently being covered by funds designated as war-related also makes it difficult to discern how seriously to take the topline projections for DoD's regular annual (i.e., peacetime) budget included in the latest FYDP. It is possible that—when funding provided through emergency appropriations ostensibly intended to cover war costs are included—substantially more funding will be provided for the US military's peacetime force structure, readiness and modernization programs and activities than is suggested in the in the FY 2007 request and the FY 2007-11 FYDP.

CHANGES IN WEAPONS PROGRAMS

The QDR recommended scaling back or terminating a number of weapons programs, including the J-UCAS unmanned combat aircraft, the E-10 surveillance aircraft and the B-52H standoff jammer. But these are relatively small programs. The largest weapons programs, such as the F-22 and F-35 fighter programs, the Army's Future Combat System (FCS), and the Navy's DD(X) destroyer survived essentially untouched. Moreover, as noted earlier, under the latest plan some new acquisition programs would be started, including the development of a new (manned or unmanned) deep strike aircraft nearly two decades earlier than previously projected.

Overall, under the new budget plan funding both for procurement and R&D would increase in FY 2007. Funding for procurement would rise from \$76 billion in FY 2006 to \$84 billion in FY 2007, while R&D funding would grow from \$71 billion to \$73.2

⁴ CBO, "An Alternative Budget Path Assuming Continued Spending for Military Operations in Iraq, Afghanistan and in Support of the Global War on Terrorism," February 2005, p. 3.

⁵ See, Douglas Holtz-Eakin, Director, CBO, Letter to the Honorable Kent Conrad concerning the cost of the occupation of Iraq and other military operations, June 25, 2004, p. 12.

billion. Reportedly, under the administration's latest plan, funding for procurement is projected to grow substantially over the FY 2008-11 period, while funding for R&D would begin to decline in real terms toward the end of the FYDP.⁶ In practice, however, it may be difficult for DoD to sustain a substantial increase in funding for procurement, given cost growth in military personnel, operations and maintenance, R&D and other areas of the defense budget.

END STRENGTH AND FORCE STRUCTURE CUTS

The QDR has proposed some potentially significant reductions in end strength and force structure. In particular, the QDR recommends cutting about 40,000 full-time equivalent military personnel from the Air Force, reducing the number of B-52H bombers from 95 to 56, retiring 50 Minuteman ICBMs, and accelerating the retirement of the F-117 fighter and the U-2 reconnaissance aircraft. Whether these are the right areas of force structure to cut is debatable, but some such reductions are probably appropriate.⁷

Historically, the US military has frequently cut end strength and force structure in order to find sufficient funding to pay for its modernization efforts. In many cases, the acquisition of new, much more capable (and typically far more costly) weapons systems mean that less than one-for-one replacement is necessary. This approach probably makes sense for the Air Force, as well as the Navy.

However, the personnel and force structure cuts included in the QDR are, by themselves, too modest to both substantially alleviate DoD's existing plans-funding mismatch and offset the additional costs associated with the new programs and initiatives included in the QDR.

DEFENSE SPENDING BUILDUP MAY NOT BE SUSTAINABLE GIVEN BLEAK DEFICIT FORECASTS

Over the past four year years, the long-term fiscal picture for the federal government has dramatically deteriorated. In January 2001, CBO projected federal budget surpluses totaling about \$5.6 trillion over the FY 2002-11 period. By comparison, CBO now projects that the federal government will run deficits totaling some \$832 billion over the coming decade.⁸ Moreover, as CBO acknowledges, its "baseline" projection makes a number of assumptions that may be unrealistic; for example, that tax cuts currently set to expire over the coming decade will not be extended. Projections based on more realistic assumptions about tax cuts and other factors suggest that total deficits could total some \$3-4 trillion over the next 10 years.⁹ It seems unlikely that Congress will cut the administration's defense budget request for FY 2007. However,

⁶ See, Tony Capaccio, "Bush to Ask for \$439.3 Billion for Defense in 2007," Bloomberg News, February 2, 2006. At press time, DoD had not yet released the projected funding levels for procurement and R&D over the FY 2008-11 period.

⁷ It might, for example, make more sense to reduce the number of Air Force tactical fighter wings.

⁸ CBO, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*, January 2006, p. 2.

⁹ For example, according to CBO, making the tax cuts permanent and reforming the Alternative Minimum Tax, would increase deficit totals for the decade by an additional to \$3 trillion. *Ibid*, p. 14.

over the longer term, once a decision is made to address the ballooning federal deficit, history strongly suggests that cuts in defense spending—or at a minimum slower rates of growth in defense spending—will be part of the solution adopted. The 12 percent real reduction in defense spending that occurred between FY 1985 and FY 1990, before the end of the Cold War, in large part reflected a bipartisan effort to begin reducing deficits.

CURRENT PLANS MAY NOT BE AFFORDABLE

Even if DoD were able to achieve the funding levels projected in the administration's new plan over the next six years and could sustain those funding levels in the face of ballooning federal deficits, DoD would probably not be able to execute its very ambitious modernization efforts and other plans. If history is any guide, DoD's major weapons acquisition programs are unlikely to meet projected cost goals. Similarly, operations and support activities (e.g., military pay, health care, and a wide variety of operations and maintenance functions) are likely to cost more than anticipated.

Under the administration's new plan, funding for national defense is projected to reach \$526 billion in FY 2011. However, estimates by CBO, CSBA and others suggest that executing existing plans could require substantially higher defense budget levels, perhaps an additional \$50 billion or more a year over the long term. On the other hand, the United States may be able to adequately meet its security requirements with more affordable, and less expansive, modernization and force structure plans, especially if those plans focus on transforming US forces—making them better able to meet future challenges. However, DoD's plans are likely to become affordable only if and when decisions are made not only to invest in new forces and technologies, but to divest from more traditional forces and programs—decisions which the QDR and the FY 2007 have largely deferred.

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