

Background

No. 2012
March 5, 2007



Published by The Heritage Foundation

Defense FY 2008 Budget Analysis: Four Percent for Freedom

Baker Spring

Fighting the war on terrorism will require a sustained commitment to fund national defense programs because it will clearly be a long war. At the same time, the U.S. needs to fund defense programs that protect the American people and U.S. friends and allies against the enduring threats posed by hostile states such as Iran and North Korea. Finally, there are looming threats, such as one posed by a hostile China.

The Bush Administration's defense budget request, released on February 5, 2007, would commit \$647 billion to national defense in fiscal year (FY) 2008.¹ At 4.4 percent of gross domestic product (GDP), this should be adequate to meet America's immediate national security needs.

However, the budget request fails to answer the question of whether or not this commitment of resources to national defense will be sustained for the remaining four years of the five-year budget period. The Bush Administration has deferred cost estimates of ongoing operations in the war on terrorism because projecting the precise costs of these operations is impossible this far in advance. Nevertheless, this omission shows defense budgets declining after FY 2008 to 3.2 percent of GDP by FY 2012.²

Congress can ensure that it is providing adequately for national security by making a firm commitment now to fund the national defense at no less than 4 percent of GDP. Protecting the lives and freedom of the American people is certainly worth 4 percent of national income. This commitment will require Congress to add roughly \$400 billion to the defense bud-

Talking Points

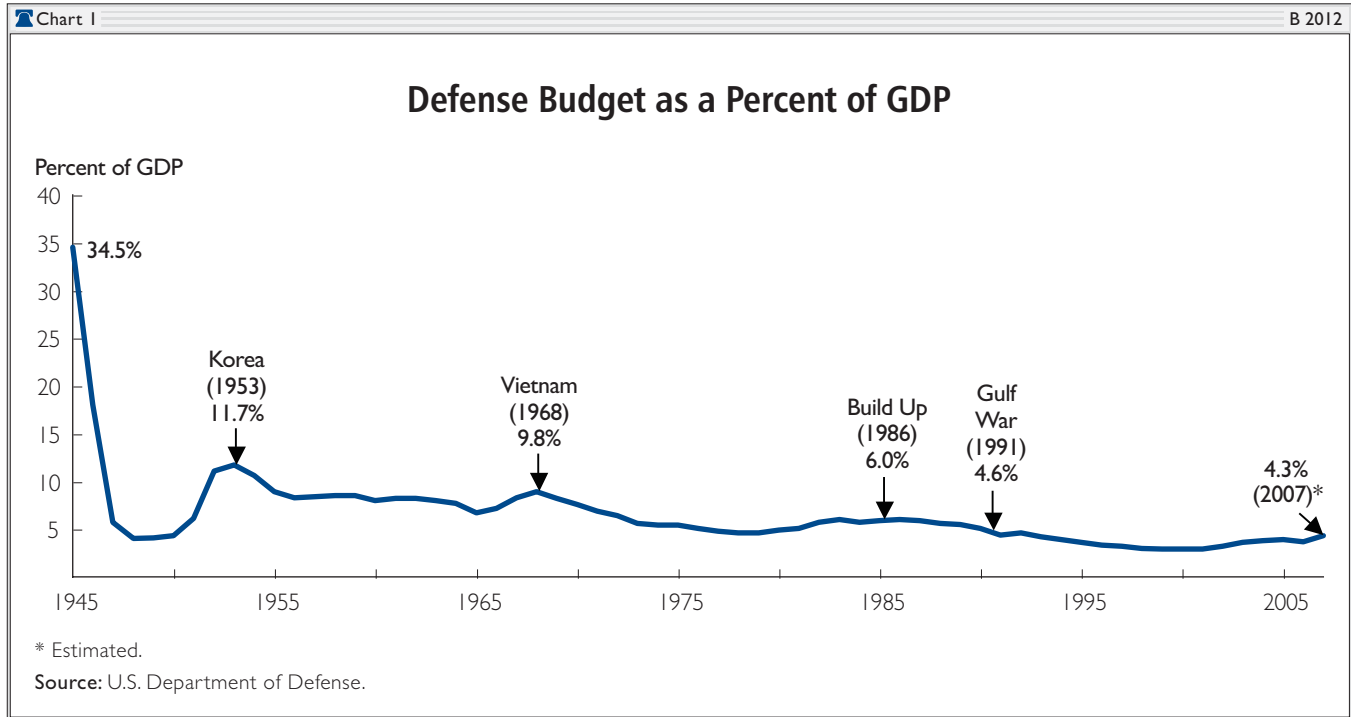
- Maintaining a healthy defense posture requires sustained funding for national defense at no less than 4 percent of GDP.
- Maintaining minimum funding levels for defense will require Congress to reform the Social Security, Medicare, and Medicaid programs.
- Unless Congress continues to separate funding for ongoing military operations to combat terrorism from the core defense program, the cost of these ongoing operations will come at the expense of necessary long-term investments for defense.
- Congress needs to examine alternative ways of compensating military personnel.
- Building a military force equipped with modern weapons will require increasing funding for the research and development account and the procurement account to \$200 billion.
- A properly balanced modernization program will allocate no less than 60 percent of the modernization budget to procurement.

This paper, in its entirety, can be found at:
www.heritage.org/research/budget/bg2012.cfm

Produced by the Douglas and Sarah Allison
Center for Foreign Policy Studies
of the
Kathryn and Shelby Cullom Davis
Institute for International Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.



get for the four-year period from FY 2009 to FY 2012, which it can do by amending the pending budget resolution. Clearly, a portion of this money will be allocated to ongoing operations to counter terrorists. The remainder should go to the core defense program, with a special emphasis on developing and deploying the next generation of weapons and equipment that U.S. forces will need to fight effectively in the future.

The Administration's Defense Budget Request

The Bush Administration's budget request for FY 2008 through FY 2012 shows a number of external and internal pressures on the defense budget. The external pressures are posed by the continuing and projected growth in spending for the three major entitlement programs: Social Security, Medicare, and Medicaid. If these entitlement programs are not reformed, the growth in entitlement spending will crowd out needed defense funding. This comes

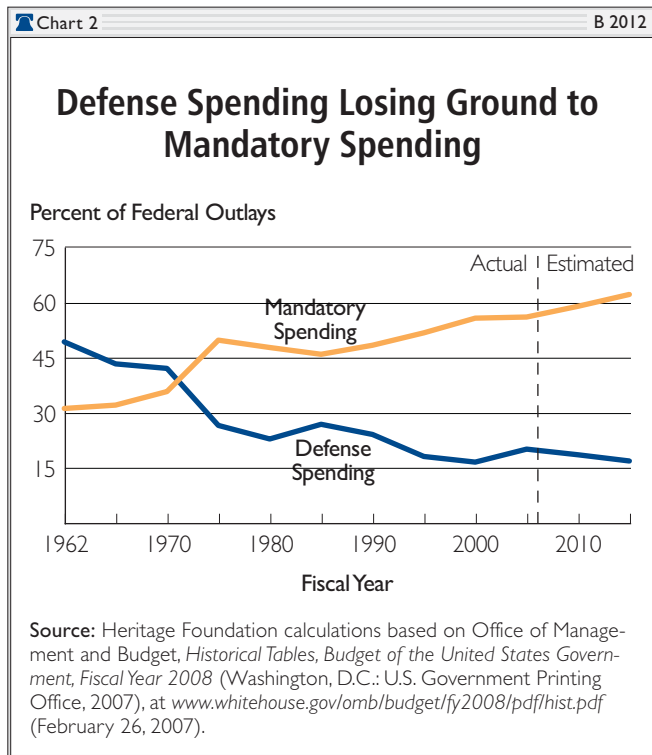
at a time when defense expenditures relative to GDP are already relatively low. (See Chart 1.)

The internal pressures stem from the high cost of military operations and the increasing costs (both gross and per capita) of compensating military personnel. While defense reform efforts will alleviate some of the internal pressure on the defense budget, these problems cannot ultimately be solved without a sustained commitment by Congress to provide at least 4 percent of GDP for defense.

In terms of claims on the total budget, the defense account is continuing to lose ground to domestic mandatory spending programs (e.g., Social Security, Medicare, and Medicaid), despite the ongoing war. This trend will continue through the entire five-year budget period. (See Chart 2.)

Regarding the internal pressures on the defense budget, the trends have been in favor of spending on today's forces rather than investing in tomorrow's forces. The funding for operations and sup-

1. Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2008* (Washington, D.C.: U.S. Government Printing Office, 2007), p. 89, at www.whitehouse.gov/omb/budget/fy2008/pdf/hist.pdf (February 26, 2007).
2. Heritage calculation based on figures from Office of Management Budget, *Historical Tables*, pp. 89 and 193.



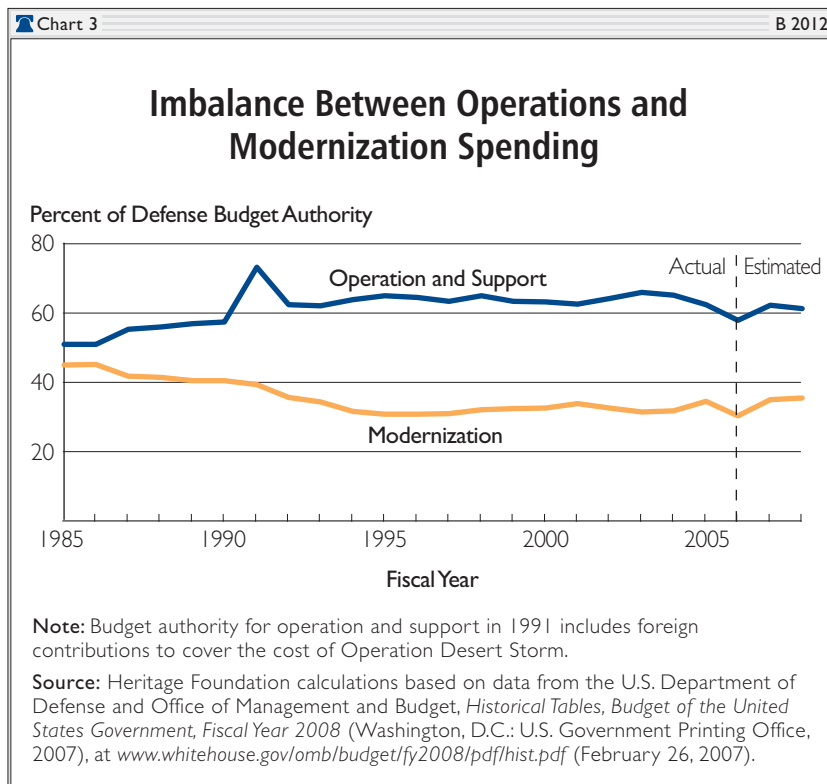
port activities, the sum of the operations and maintenance account and the military personnel account, continues to rise as an overall share of the Department of Defense (DOD) budget. At the same time, spending on modernization, the sum of the research and development account and the procurement account, has fallen as a share of the DOD budget. (See Chart 3.)

Specifically, operations and support activities continue to absorb roughly 60 percent of DOD budget authority. Modernization activities absorb only about 35 percent. By comparison, the two activities approached parity in the 1980s, when operations and support activities absorbed only slightly more than modernization activities.

The trend toward operations and support receiving higher shares of the core defense budget is driven largely by the increasing per capita

compensation cost for military personnel and the higher operational tempo. During the 1990s, the gross cost of compensating military personnel was held in check by a 24 percent reduction in manpower; but this pressure valve on manpower costs is closing because the Bush Administration has proposed adding 92,000 soldiers and Marines to the force by 2012,³ and per capita military compensation costs continue to rise, more than doubling in the past 10 years. (See Chart 4.) A major contributing factor is the cost of military health care. The FY 2008 defense budget allocates \$38.7 billion to providing health benefits to military personnel and their dependents.⁴

The trend toward modernization receiving smaller shares of the core defense budget is largely the result of the Clinton Administration's "procurement holiday" in the 1990s. The recovery from this unwise choice is still incomplete. The enduring effect of the procurement holiday is an imbalance between the procurement account (the account for purchasing new weapons and equipment) and the account for researching and developing new weapons and equipment technology.

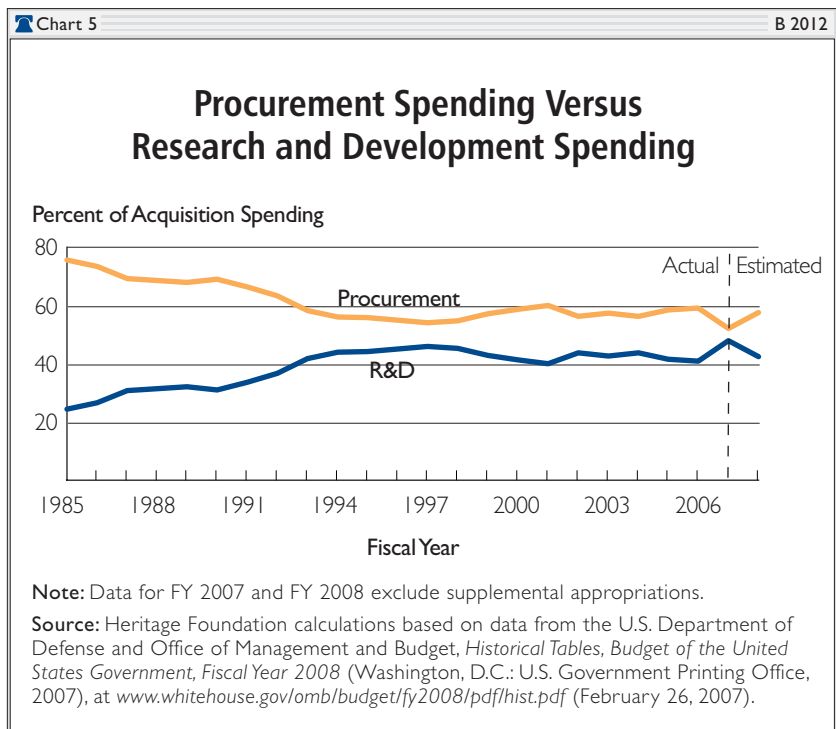
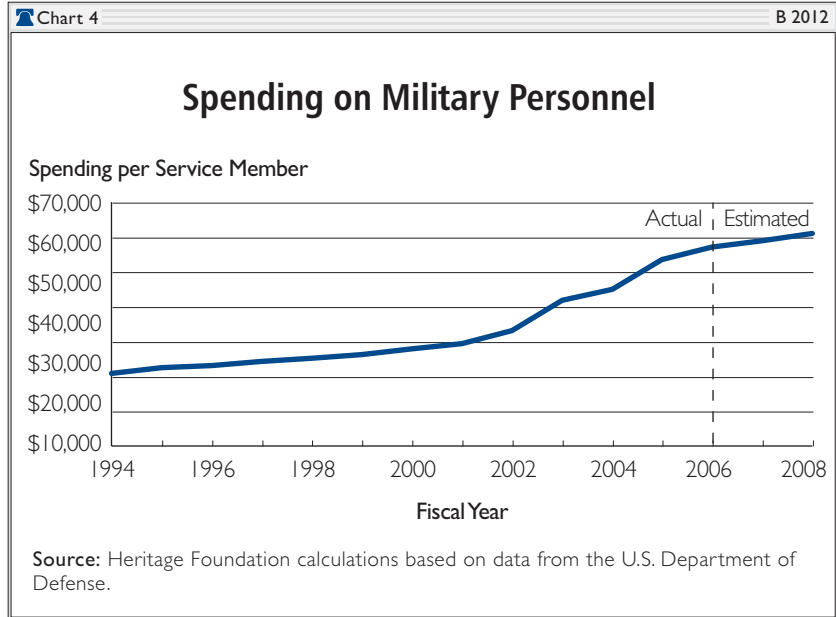


In the 1980s, procurement consumed more than 70 percent of the modernization budget. (See Chart 5.) The core defense budget for FY 2008, despite a generous addition to the procurement account over FY 2007 levels, would still leave procurement at well below 60 percent. As a result, important new weapons programs must be stretched out, which increases unit costs, decreases the numbers of new weapons available to the military, and prevents their timely delivery. For example:

- The Navy has been forced to reduce construction of *Virginia*-class submarines to one per year even though constructing two per year could have reduced the unit cost to \$2 billion per boat.⁵
- The Air Force has been forced to scale back dramatically its purchasing of F-22 Raptor tactical fighters. It is now slated to obtain just 183 F-22s despite its requirement for 381.⁶
- The Army has been forced to extend the production time for its Future Combat System by five years.⁷

Sustaining Resources for National Security

Maintaining a healthy national defense program has three prerequisites. The first is a sustained commitment to robust funding for national defense. This is axiomatic. A robust defense program cannot be maintained without a sustained commit-



3. U.S. Department of Defense, "President Bush's FY 2008 Defense Budget Submission," February 5, 2007, p. 2, at www.dod.gov/comptroller/defbudget/fy2008/2008_Budget_Rollout_Attachment.pdf (February 26, 2007).

4. U.S. Department of Defense, "FY 2008 President's Budget for Defense," February 5, 2007, at www.defenselink.mil/news/d20070205slides1.pdf (February 26, 2007), in U.S. Department of Defense, "DoD News Briefing with Secretary Gates and Under Secretary Jonas from the Pentagon," transcript, February 5, 2007, at www.defenselink.mil/Transcripts/Transcript.aspx?TranscriptID=3881 (February 26, 2007).

ment to provide the necessary funds. Congress should therefore establish a floor of 4 percent of GDP for national defense and firmly commit to resisting all attempts to go below this floor.

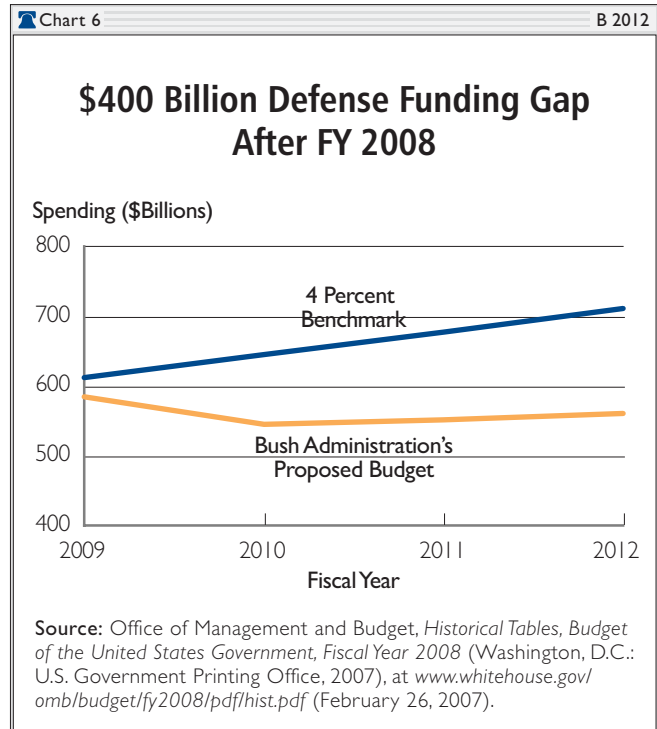
The second prerequisite is to reform Social Security, Medicare, and Medicaid. In the long run, projected growth in spending on these three entitlement programs will make it impossible for Congress to honor its commitment to provide at least 4 percent of GDP to national defense. Even in the near term, entitlements will make allocating adequate resources to national defense incrementally more difficult.

The third prerequisite is to spend the resources provided to national defense wisely. This entails rebalancing the internal defense accounts to meet long-term needs. Specifically, this means increasing funding for the core defense programs if and when supplemental appropriations to support ongoing contingency operations decline, shifting resources from the operations and support accounts to the modernization accounts, and increasing the share of the modernization accounts devoted to procurement.

Providing the Necessary Resources for National Defense. Providing adequate funds for national defense starts with recognizing that the Bush Administration's five-year defense budget request provides sufficient resources in FY 2008 but falls short in the next four years.⁸ Thus, the Administration's budget from FY 2009 through FY 2012 reflects a roughly \$400 billion defense funding gap in budget authority. (See Chart 6.)

Congress should:

- **Fill this gap by drafting a budget resolution that adds the necessary budget authority to the five-year national defense account.** The relevant defense budget targets should be



\$612.3 billion for FY 2009, \$644.5 billion for FY 2010, \$677.5 billion for FY 2011, and \$711.4 billion for FY 2012.

- **Make a clear commitment to sustain funding for national defense beyond the five-year budget period.** It can do this by including report language that pledges Congress to allocate no less than 4 percent of GDP to national defense for the indefinite future.

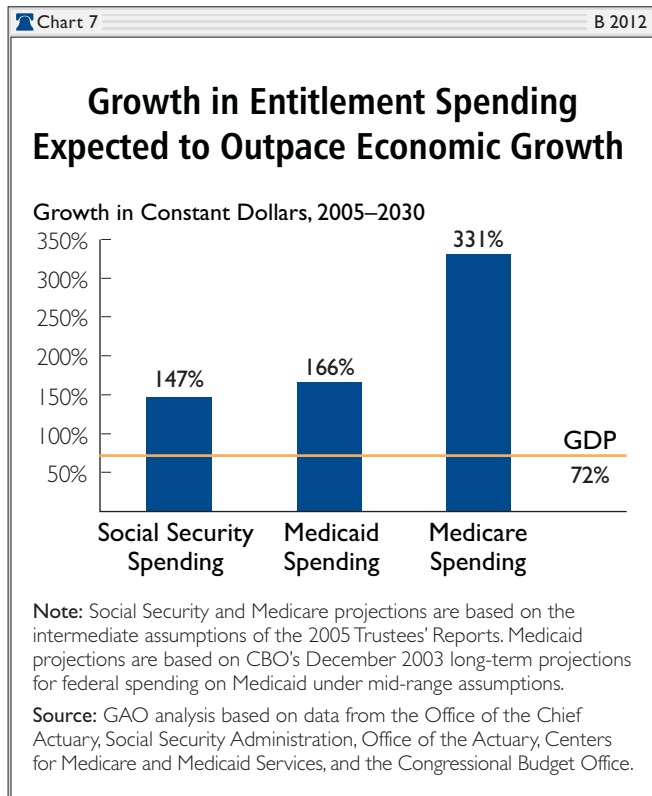
Reforming Social Security, Medicare, and Medicaid. Social Security, Medicare, and Medicaid spending has absorbed ever higher portions of the federal budget since the 1960s. In general terms, this growth has come at the expense of the defense budget. This trend cannot continue indefinitely. Indeed, the United States is facing a fiscal crisis because spending on Social Security, Medicare, and

5. Baker Spring and David D. Gentilli, "Congress Should Accelerate Submarine Procurement," Heritage Foundation *WebMemo* No. 1084, May 17, 2006, at www.heritage.org/Research/NationalSecurity/upload/97341_1.pdf.

6. Defense Daily Network, "Bush Defense Budget Adequate Next Year, But Then Falls \$400 Billion Short," February 7, 2007, at www.defensedaily.com/VIP/dd/previous/dd0207.htm#A10 (February 9, 2007; subscription required).

7. Megan Scully, "Army Trims FCS, Stretches Program to Meet Current Needs," *Congress Daily AM*, February 8, 2007.

8. Baker Spring, "An Adequate Defense Budget That Must Be Sustained into the Future," Heritage Foundation *WebMemo* No. 1342, February 5, 2007, at www.heritage.org/Research/NationalSecurity/upload/wm_1342.pdf.



Medicaid is projected to increase rapidly. Each of these three programs is forecast to grow faster than the overall economy between 2005 and 2030. (See Chart 7.)

The implications for national defense are clear. Spending 4 percent of GDP for national defense will quickly become impossible unless Congress reforms Social Security, Medicare, and Medicaid.

Given the size of the Social Security, Medicare, and Medicaid programs, reforming them will take time. Thus, Congress should start now.

Some Members of Congress will argue that any reform of these programs is tantamount to a draconian cut. It is nothing of the sort. None of the current entitlement reform proposals would cut spending on these programs; they would only limit future growth.

Outlays for Social Security, Medicare, and Medicaid currently total 8.7 percent of GDP.⁹ By compar-

ison, the defense budget proposal in this paper would allow future defense spending to decline slightly as a share of GDP from the proposed FY 2008 level and asks only that defense spending keep pace with economic growth after 2008. Further, the proposed defense benchmark (4 percent of GDP) is less than half of the percentage of GDP that will be spent on the three major entitlement programs for the foreseeable future.

Continuing to Fund Anti-Terrorist Operations Separately. In times of war, there is always the challenge of not letting the requirements for current operations undermine the military's ability to field first-rate forces in the future. The Bush Administration has recognized this challenge and responded by using supplemental appropriations to fund ongoing operations in fighting the war against Islamic terrorists. This has served the purpose of keeping these expenditures from crowding out core investments in future defense programs. If the costs of current operations were incorporated in the annual defense budget, the temptation to rob future military capabilities to fund current operations would have been overwhelming.

Congress should therefore continue this practice of funding current contingency operations through supplemental appropriations. Ultimately, the 4 percent benchmark is intended to protect the core defense program and future defense capabilities. This means that the roughly \$400 billion that Congress should add to the defense budget in the latter years of the budget period will go to both supplemental appropriations and the annual defense appropriations bill. If the funding requirements for ongoing operations start to decline, the resources should be shifted to the core program.

By the same token, the Bush Administration and Congress should resist the temptation to fund elements of the core defense program out of supplemental appropriations bills. Doing so will tie enduring defense programs to a funding source that could easily decline in future years.

9. Baker Spring, James Jay Carafano, Ph.D., Alison Acosta Fraser, Brian M. Riedl, and Will Packer, "Protecting Homeland Security and Defense by Reining in Entitlements," Heritage Foundation *WebMemo* No. 1352, February 8, 2007, p. 2, at www.heritage.org/Research/Budget/upload/wm_1352.pdf.

Rebalancing Military Compensation. Without reform, future increases in the per capita cost of military compensation will crowd out needed spending on military modernization in the core defense budget because the overall size of the military will increase. Ultimately, rebalancing military compensation will require a number of significant reforms. Evidence suggests that the current compensation system is weighted too heavily in favor of in-kind and deferred compensation over direct cash compensation.¹⁰

To begin this rebalancing effort, Congress should:

- **Apply reforms similar to those that have been proposed regarding the indexing of Social Security benefits.** If retirees receiving Social Security benefits are asked to accept less generous indexing of those benefits, it is entirely appropriate to ask the same of military retirees. This does not mean that a new indexing formula for military retirement benefits must be exactly the same as the one applied to Social Security benefits. The military retiree community is much smaller than the population of Social Security recipients and has unique characteristics.
- **Move the military health care system away from a defined benefit plan and toward a defined contribution plan.** While the DOD touts its \$38.7 billion system that provides benefits to 9.2 million people “as one of the best healthcare programs in the world,” this claim is far from obvious.¹¹ While the system is clearly one of the most generous, it may be one of the most inefficient.

A key problem with the U.S. health care system overall is that it often precludes individuals from assuming at least some responsibility for making

decisions about their care. The military health care system is more extreme in this regard because it encourages beneficiaries to treat health care as a free good or service and consume it on the basis of whim as opposed to need.

Structuring the military health care system as a defined contribution plan would give its 9.2 million participants greater freedom of choice and more control over their health care decisions.¹² Greater individual control is also likely to impose more discipline on the system with respect to how it uses its resources.

Increasing Military Modernization Funding to \$200 Billion by FY 2014. The Bush Administration’s FY 2008 budget request gives a significant boost to the modernization program in the core defense budget. If Congress approves the request, the 13 percent increase over FY 2007 would bring modernization funding to \$176.8 billion.¹³

Modernization funding after FY 2008 is less certain because the Bush Administration provided neither a budget authority estimate for the core defense program nor estimates for modernization funding in the latter years of the budget period. This is a cause for concern because of the \$400 billion funding gap from FY 2009 through FY 2014.

Congress should approve the Bush Administration’s military modernization funding request for FY 2008 and thereby establish the foundation for future increases. Congress should also fill the gap in the proposed five-year defense budget, which should leave sufficient room to reach the \$200 billion target for modernization in FY 2014. This kind of sustained funding for modernization will provide the military with the new weapons and equipment that it will need to be a fully capable force a generation from now.

10. Congressional Budget Office, “Military Compensation: Balancing Cash and Noncash Benefits,” *Economic and Budget Issue Brief*, January 16, 2004, at www.cbo.gov/ftpdocs/49xx/doc4978/01-16-DoDCompensation.pdf (February 27, 2007), and Cindy Williams, “Paying Tomorrow’s Military,” *Regulation*, Vol. 29, No. 2 (Summer 2006), pp. 26–31, at www.cato.org/pubs/regulation/regv29n2/v29n2-1.pdf (February 27, 2007).

11. U.S. Department of Defense, “FY 2008 President’s Budget for Defense.”

12. James Jay Carafano, Ph.D., “A ‘Rucksack’ for U.S. Military Personnel: Modernizing Military Compensation,” Heritage Foundation *WebMemo* No. 1020, February 14, 2007, at www.heritage.org/Research/NationalSecurity/em1020.cfm (March 2, 2007).

13. U.S. Department of Defense, “President Bush’s FY 2008 Defense Budget Submission,” p. 10.

Increasing the Procurement Account's Share of Modernization Spending to at Least 60 Percent by FY 2014. The Bush Administration's FY 2008 budget request for the core defense program also takes a major step toward rebalancing the internal structure of the modernization program. All of the increase in the modernization accounts for FY 2008 over the FY 2007 estimate goes to the procurement account.¹⁴ The \$101.7 billion for procurement in budget authority therefore constitutes over 57 percent of the entire modernization program. Clearly, this represents a major step forward in recovering from the procurement holiday of the 1990s.

Congress should approve the Bush Administration's procurement request for the core defense program and resist all temptations to shift resources away from procurement and toward research and development. Further, it should be prepared to sustain this rebalancing action in future defense authorization and appropriation bills by making sure that procurement is greater than 60 percent of total modernization budget in 2014. Again, filling the gap in the budget for the core defense program in the latter years of the budget period should provide sufficient room in the overall budget to accommodate this goal.

Conclusion

The United States was founded on the basis of individual liberty. As a result, the Constitution assigns to the federal government the primary responsibility to "provide for the common defence." It is entirely reasonable to expend 4 percent of national income in the defense of freedom. Nevertheless, the federal government is now allocating a smaller share of national income to defense than the average for the past four decades, despite the ongoing war against terrorism.

Projected growth in entitlement spending, not defense spending at this level, is at the core of the looming fiscal crisis facing the federal government. Defense expenditures at this level will jeopardize neither the health of the economy nor the prosperity of the American people, but a sustained commitment to defense is necessary to sustain liberty. Paying 4 percent for freedom is worth the price. Indeed, it is a bargain.

—*Baker Spring is F. M. Kirby Research Fellow in National Security Policy in the Douglas and Sarah Allison Center for Foreign Policy Studies, a division of the Kathryn and Shelby Cullom Davis Institute for International Studies, at The Heritage Foundation.*

14. *Ibid.*