

Background

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A Defense Budget Strategy for Winning the Long War

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With the stakes no less than the survival of the free world, U.S. leadership is essential to winning the “Long War” now raging against the forces of Islamic fascism. Given the open-ended nature of this conflict, U.S. leadership requires a long-term commitment to making the necessary resources available to the military.

On February 6, the Bush Administration submitted its fiscal year (FY) 2007 defense budget request to Congress.¹ The request is for \$439.3 billion in budget authority for FY 2007, which represents a \$28.5 billion (7 percent) increase over the enacted level for 2006. The FY 2006 enacted level does not include a request for supplemental appropriations for defense, which the Bush Administration sent to Congress on February 16,² but the Bush Administration will likely request supplemental funds for FY 2007. Thus, the precise level of increase or decrease in the overall Department of Defense (DOD) budget from FY 2006 is uncertain.

The Administration’s request comes at a time when political pressure to reduce defense expenditures is growing. The perception is that the battle in Iraq constitutes the entirety of the war effort. With this perception comes the expectation that the American people are entitled to a new peace dividend when the battle in Iraq winds down. Furthermore, there are large budget deficits.

Polls show that the American people do not acknowledge that the economy is growing and that they are dissatisfied with economic conditions.³ The American people continue to demonstrate an insatiable

Talking Points

- Winning the Long War against Islamic fascism will require a strong commitment to fund the nation’s war requirements well into the future.
- Because projected growth in Social Security, Medicare, and Medicaid expenditures jeopardizes the nation’s ability to wage war over the long term, entitlement reform is a national security issue.
- The defense budget also faces internal pressures that, if not remedied, could undermine the effective prosecution of the war over the long term.
- A sustained annual military budget of 4 percent of GDP should be sufficient to prosecute the war on terrorism effectively without placing an unreasonable burden on the economy.
- Congress needs to keep in mind that even a single successful attack on U.S. territory by a nuclear weapon generating electromagnetic pulse would have devastating economic consequences.

This paper, in its entirety, can be found at:
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ble appetite for expanded entitlements. As a result, Congress is tempted to divert federal resources from defense to more generous entitlement benefits for health and retirement, despite the fact that even the existing benefits are unsustainable in the long term.

Although doing so may be difficult, Congress must resist these pressures and make a strong commitment to fund the nation's war requirements well into the future. Generating support for robust defense budgets means that Congress, along with President George W. Bush, must undertake the difficult task of changing public opinion, not following it. This starts with reminding the American people that the ongoing war is not over, regardless of what happens in Iraq, and that the stakes in this war extend to their lives, liberty, and future prosperity.

Congress also needs to recognize that the defense budget faces internal pressures that, if not remedied, could undermine the effective prosecution of the war over the long term. Funding demands for manpower and ongoing operations are weakening the military's ability to arm itself with the new weapons that sustain its position as the world's best fighting force. Further, the appeal of researching and developing new weapons is starting to overwhelm the process of actually fielding them.

Therefore, meeting the resource needs for winning the war includes the following requirements:

- Maintaining overall defense budgets at 4 percent of gross domestic product (GDP);
- Recognizing that the projected growth in entitlement expenditures (Social Security, Medicare, and Medicaid) jeopardizes the nation's ability to wage war over the long term and that entitlement reform is a national security issue;

- Considering opportunities for increasing the efficiency of the Department of Defense's investment in manpower;
- Rebalancing defense expenditures to increase investments in research, development, and procurement ("modernization") of weapons and equipment;
- Rebalancing the modernization budget to emphasize actually fielding new weapons and equipment.

The Defense Budget: Where It Has Been, Where It Is Now

As a nation at war, the U.S. is spending remarkably little on defense. This is particularly the case when defense spending is measured against the size of the economy or gross domestic product. For example, Department of Defense spending peaked at 34.5 percent of GDP during World War II. During the Korean War, it peaked at 11.7 percent of GDP. During Vietnam, it peaked at over 8.9 percent of GDP. In FY 2005, Department of Defense expenditures were assessed at 3.9 percent of GDP. (See Chart 1.)

It may be argued that comparing today with World War II, Korea, and Vietnam is not appropriate as the nation looks at future defense expenditures because the current conflict with Islamic fascists is a long-term conflict and the others were discrete, high-intensity conflicts. However, the United States supported higher defense budgets throughout the decades-long Cold War, spending an average of almost 7.5 percent of GDP for national security functions during the period from FY 1948 to FY 1991.⁴

Further, it is important to compare how defense has fared in the budget debates over the years with the major entitlement programs of Social Security,

1. For a detailed description of the defense budget request, see U.S. Department of Defense, "Fiscal 2007 Department of Defense Budget Is Released" and attached documents, February 6, 2006, at www.defenselink.mil/releases/2006/mr20060206-12435.html (February 6, 2006).
2. For a detailed description of the supplemental request, see George W. Bush, letter to J. Dennis Hastert and attached documents, February 16, 2006, at www.whitehouse.gov/omb/budget/amendments/supplemental2_2_16_06.pdf (February 23, 2006).
3. Robert J. Samuelson, "Worry While You Spend," *The Washington Post*, November 9, 2005, p. A31.
4. Heritage Foundation calculation based on DOD data. U.S. Department of Defense, *National Defense Budget Estimates for FY 2006*, April 2005, pp. 216–217, at www.defenselink.mil/comptroller/defbudget/fy2006/fy2006_greenbook.pdf (January 30, 2006).

Medicare, and Medicaid. While defense spending has been relatively restrained, expenditures on these three major entitlement programs have been exploding. In FY 1962, these entitlement programs consumed 2.5 percent of GDP. By FY 2003, they consumed 8.3 percent of GDP. (See Chart 2.)

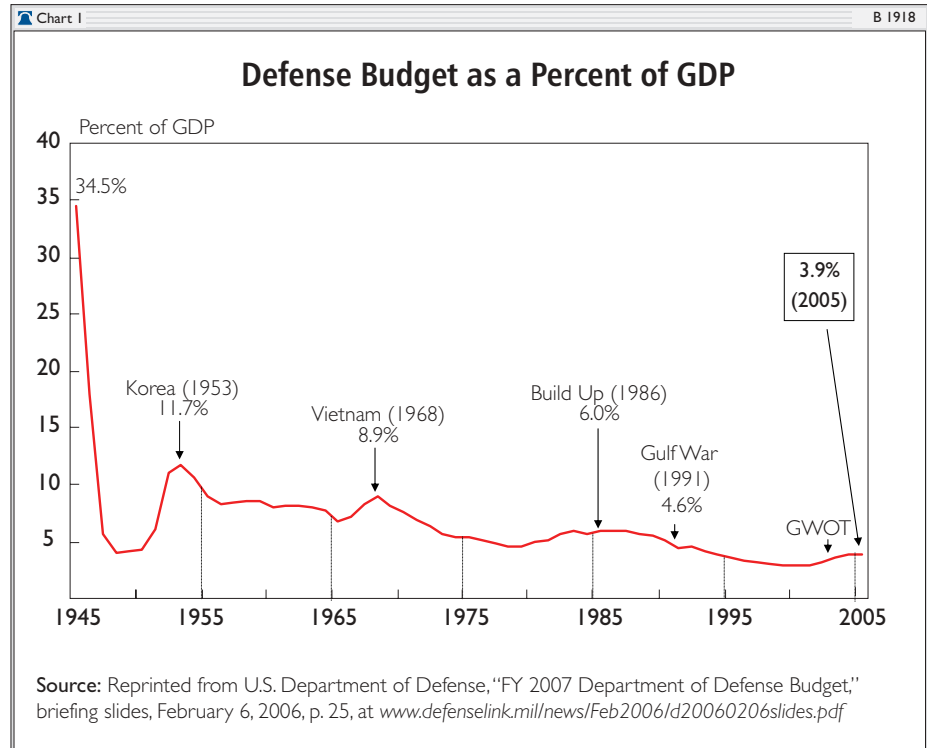
Internal Pressures on the Defense Budget

The defense budget has also experienced changes in its internal structure over the past two decades. At this point, these trends raise questions about whether the U.S. military will remain at the cutting edge of defense technology. The following are the three most important trends that increase pressure on the nation's defense capabilities.

TREND #1: Unit manpower costs have been rising.

The account allocated to compensating the men and women in uniform has declined from 28.4 percent of the overall DOD budget in FY 1994 to 24.6 percent in FY 2004. However, this has occurred during a time when overall manpower levels ("end-strength") have been significantly reduced. End-strength in FY 1994 was over 3.4 million positions across the active and reserve components; in FY 2004, it was less than 2.6 million positions.⁵ This is a 24 percent reduction. As a result, compensation per person in the military has gone up dramatically. (See Chart 3.)

While significant increases should have been expected as the military sought to emphasize quality over quantity in the all-volunteer force, the



DOD may be approaching the time when it needs to ask whether it is getting its money's worth for the amount it is investing in military compensation. The problem is compounded by the generous non-cash compensation provided to military personnel. According to a January 2004 report by the Congressional Budget Office, non-cash compensation accounts for well over half of all military benefits.⁶

TREND #2: Overall operational and support costs have been outpacing the amounts invested in modernization.

The operations and support budget, which is defined as the sum of the military personnel account and the operations and maintenance account, consumed almost 65 percent of the total DOD budget as of FY 2004. (See Chart 4.) Meanwhile, the modernization budget, which is defined as the sum of the account for research and developing new weapons and equipment and the account for procuring new weapons and equipment, fell to

5. U.S. Department of Defense, *Selected Manpower Statistics, Fiscal Year 2004* (Washington, D.C.: Department of Defense, 2005), pp. 37–45, Table 2-11, and p. 156, Table 5-2, at www.dior.whs.mil/mmid/M01/fy04/m01fy04.pdf (February 21, 2006).

6. Congressional Budget Office, "Military Compensation: Balancing Cash and Noncash Benefits," January 16, 2004, p. 2.

roughly 31 percent of the total DOD budget within the same period of time. This trend raises the question of whether the nation is paying for today's military at the expense of tomorrow's military.

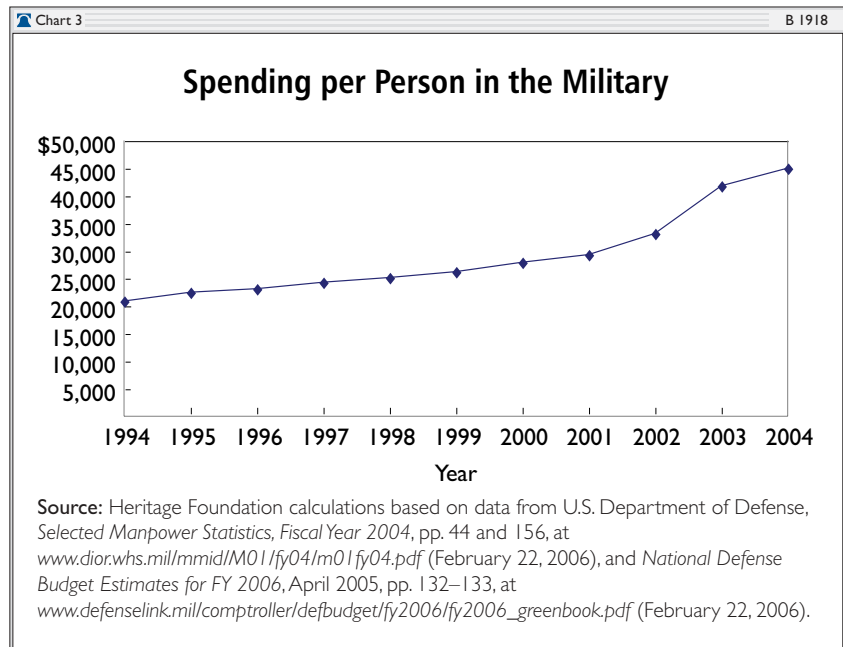
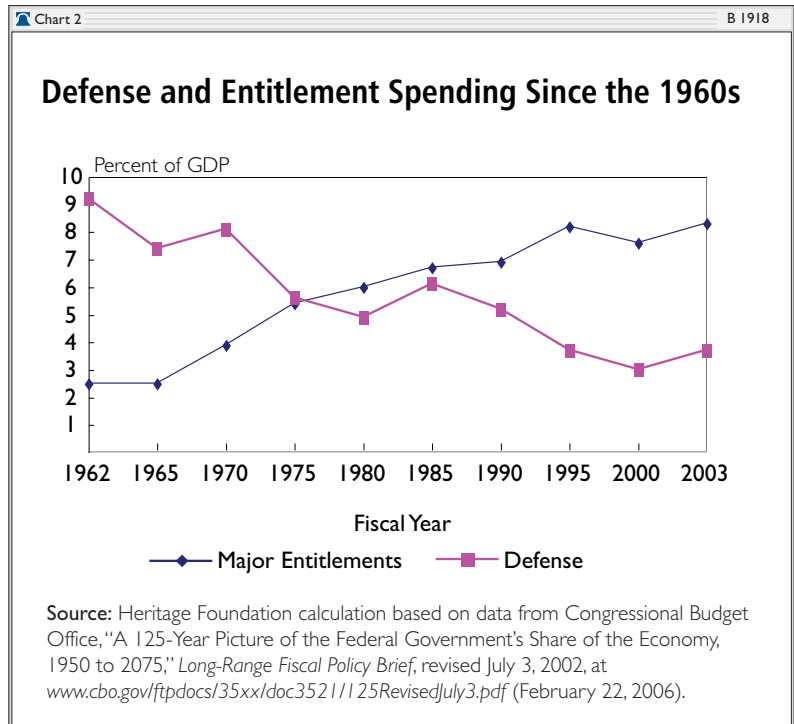
TREND #3: Funding for researching and developing new weapons and equipment has outstripped funding for procurement of the same.

In FY 1985, procurement was 75 percent of the overall modernization budget. In FY 2004, procurement stood at 56 percent of the modernization budget. (See Chart 5.) This trend raises two questions. The first is whether the procurement budget is too constrained to absorb effectively the technology that the research and development budget is producing. The second is whether the defense industry now sees research and development as an independent profit center and has been given an incentive to research defense technology to death.

Accounting for and responding to both the external and internal pressures on the defense budget is necessary to sustain the overall capabilities of the U.S. military throughout what could be a decades-long conflict. Because these pressures, if ignored or otherwise not addressed, will weaken U.S. military capabilities only incrementally, Congress is all too likely to ignore the problems until they become undeniable and the U.S. suffers a major military setback. Now is the time to start remedying these problems, recognizing that the solutions may take years of consistent effort.

Five Goals for Funding Victory in the Long War

The problems currently emerging regarding the defense budget have been years in the making. The solutions, therefore, are found in reversing long-term trends. The need for this long-term approach



is made more apparent by the present circumstance of facing a long-term conflict. Congress needs to sustain the war effort over many years, much as it did during the Cold War.⁷ Specifically, Congress

needs to commit itself to fulfilling five goals regarding the defense budget.

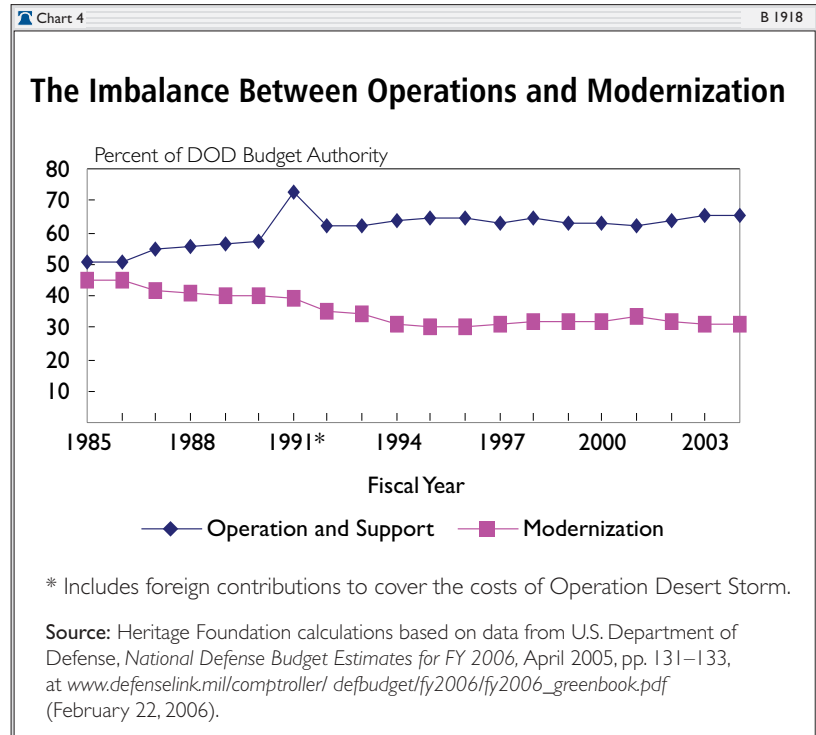
GOAL #1: Sustain annual defense budgets at an average of 4 percent of GDP.

After accounting for the defense supplemental appropriations, the overall defense budget now absorbs roughly 4 percent of GDP. Depending on the military circumstances in Afghanistan and Iraq, the special supplemental appropriations to fund the operations in these two countries could shrink dramatically or go away altogether. In the meantime, supplemental appropriations should be used to fund these operations.

By the same token, both the Administration and Congress should look to the day when the operations in Afghanistan and Iraq become small enough in scope and predictable enough that large-scale defense supplemental appropriations will no longer be necessary. However, if the supplemental appropriations become dramatically smaller or disappear, Congress will be tempted to simply subtract an arbitrarily calculated value of forgone future supplemental appropriations from future defense budgets.

This “subtract out” approach to the defense budget would be a serious mistake. Rather, Congress should recognize that the core defense program, which excludes activities not directly related to the conduct of contingency operations, needs increased funding. From this perspective, Congress should recycle the funds “saved” from winding down operations in Afghanistan and Iraq back into the core defense program.

Congress needs to recognize that devoting 4 percent of GDP to defense imposes a reasonable



burden on the U.S. economy. This level of commitment to defense is not at all like that made by the Soviet Union during the Cold War. Indeed, it is significantly below the mean of roughly 7.5 percent of GDP that the United States spent on defense during the Cold War. Spending only 4 percent of GDP will not risk losing the war because of economic collapse brought on by excessive defense spending.

Further, Congress needs to keep in mind the economic costs of military failure. Military power trumps economic power in the short term. Even a single successful attack on U.S. territory by a nuclear weapon generating electromagnetic pulse (EMP) would have devastating economic consequences.⁸ The economic impact of several EMP attacks or direct nuclear strikes would be catastrophic.

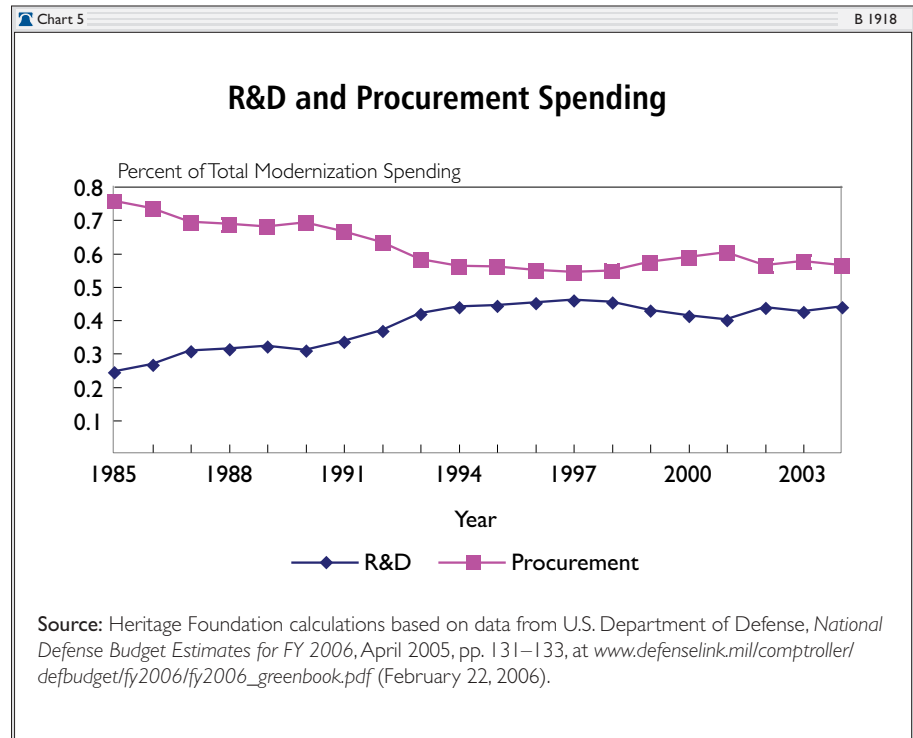
7. For a general description of the balanced approach to defense spending during the Cold War, see James Jay Carafano and Paul Rosenzweig, *Winning the Long War: Lessons from the Cold War for Defeating Terrorism and Preserving Freedom* (Washington, D.C.: The Heritage Foundation, 2005), pp. 128–151.
8. William R. Graham, Ph.D., et al., *Executive Report*, vol. 1 in *Report of the Commission to Assess the Threat to the United States from Electromagnetic Pulse (EMP) Attack*, 2004, at armedservices.house.gov/openingstatementsandpressreleases/108thcongress/04-07-22emp.pdf (February 8, 2006).

GOAL #2: Limit the future growth in spending on Social Security, Medicare, and Medicaid.

All of the federal government's other responsibilities and programs, including defense, face an uncertain future unless the three major entitlement programs—Social Security, Medicare, and Medicaid—are reformed. Comptroller General David M. Walker has calculated that federal spending will consume roughly 40 percent of GDP by 2040 if spending is left unconstrained and revenue is held constant.⁹ Driving this projection is the expected growth in spending on Social Security, Medicare, and Medicaid. Walker calculates that spending on each of these three programs will far exceed economic growth between 2005 and 2030.¹⁰ (See Chart 6.)

While defense specialists should have no particular interest in entitlement programs, their projected spending growth is making the reform of these programs a national security issue. President Bush announced in his State of the Union address that he plans to appoint a commission to consider ways to resolve this daunting problem.¹¹

Those who are concerned about the future of the nation's security cannot afford to sit on the sidelines as policymakers begin to address the issue of entitlement reform. While defense specialists need not insist on one particular approach to reform over others, they can and should state that the goal of the reform effort should be to structure Social Security, Medicare, and Medicaid such that they leave sufficient room to fund national security programs at 4



percent of GDP for both the near and long terms, with total federal outlays not exceeding 20 percent of GDP and taxes not exceeding 18 percent of GDP.

GOAL #3: Find more efficient ways to invest in military manpower.

Congress spends considerable effort overseeing defense acquisition programs to ensure that the taxpayers receive their money's worth for the weapons and equipment purchased by the Department of Defense. While it is justly concerned that members of the military receive adequate compensation and enjoy a good quality of life, it is not clear that Congress is paying appropriate attention to the question of whether DOD's investment in manpower is as efficient and effective as possible.

The House and Senate Armed Services Committees would serve the interests of the military and the nation by holding focused hearings on the effective-

9. David M. Walker, "Saving Our Future Requires Tough Choices Today," October 31, 2005, p. 7.

10. *Ibid.*, p. 8. Heritage analysis has reached the same conclusion as David Walker. See Brian M. Riedl, "Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected," Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, at www.heritage.org/Research/Budget/bg1897.cfm.

11. George W. Bush, "State of the Union Address," January 31, 2006, at www.whitehouse.gov/stateoftheunion/2006 (February 8, 2006).

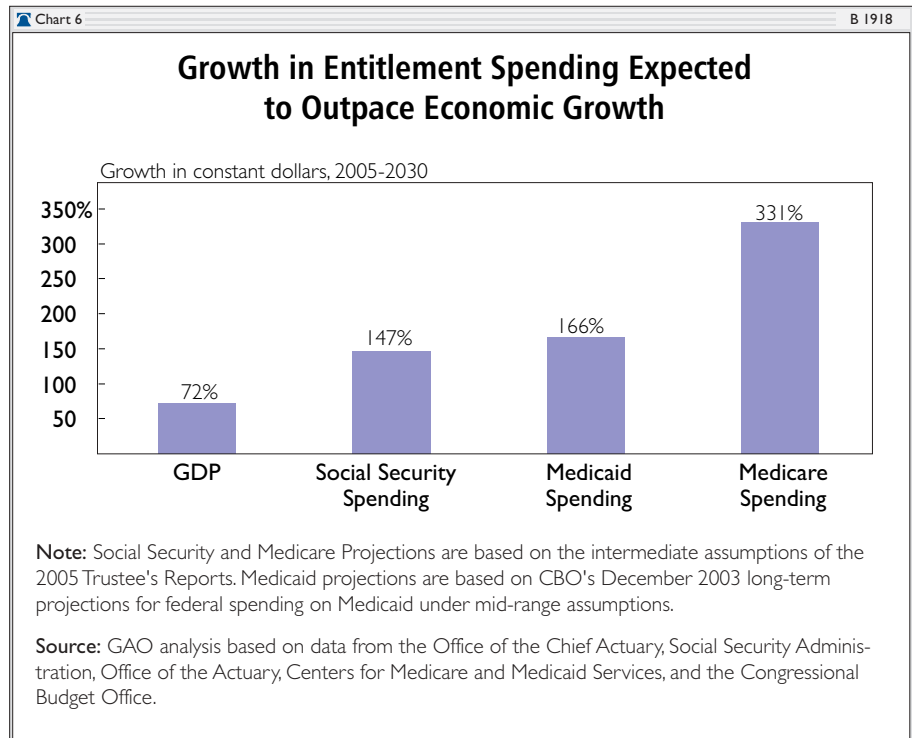
ness of the investment in manpower. Left unaddressed, there is the distinct possibility that the compensation requirements per member of the military will force manpower levels lower than currently projected. While the desire for high-quality military personnel under the all-volunteer force has justified previous and currently planned reductions in manpower, budget pressures derived from compensation requirements should not become the driver in determining endstrength.

Two issues deserve special attention. The first regards the balance between compensation that service personnel now receive and compensation that they receive on a deferred basis. The second regards the balance between cash compensation and in-kind benefits, such as housing benefits. While it is unclear at this time which would be the best options, Congress needs to examine whether it is better to emphasize current compensation over deferred compensation and cash compensation over in-kind benefits in the future.

Finally, a debate over compensation and manpower levels runs the distinct risk of devolving into an argument that pits the active component against the reserve component of the overall force. Trading off manpower between the active component and the reserve component may be the wrong way to look at this issue. Rather, Congress should consider means for improving the “tooth-to-tail” ratio. From this perspective, manpower tradeoffs should be considered among the combat, combat service, and combat service support elements.

GOAL #4: Set a goal of allocating at least \$200 billion annually to the military modernization budget by the middle of the next decade.

Buying and fielding new weapons and equipment is necessary to keep the U.S. military the best



in the world. However, the modernization budget fights an uphill battle within the current budget debates. While it is reasonable to expect that the ongoing requirement to maintain a high operational tempo will temporarily tilt the defense budget in favor of operations over modernization, such an imbalance cannot be sustained for an extended period. Congress must rebalance the defense budget, support larger overall defense budgets, or pursue a combination of both.

However, given the need for meeting current operational demands, simply requiring the allocation of higher percentages of established overall defense budgets to the modernization budget is imprudent. The better approach is for Congress to establish a dollar figure as a goal for the modernization budget. This goal must account for the fact that a high operational tempo will itself demand higher modernization funding, particularly for procurement. Barring the need for an additional large-scale military operation, this goal for the modernization budget should be at least \$200 billion annually by the middle of the next decade.

GOAL #5: Set a goal of allocating 60 percent of the modernization budget to the procurement account.

The Bush Administration's FY 2007 proposal allocates \$84.2 billion to procurement, which is \$8 billion more than the enacted level for FY 2006. While an \$8 billion increase may seem generous, the Bush Administration's FY 2006 budget request projected a procurement account of \$91.6 billion for FY 2007. Further, the FY 2006 supplemental request includes over \$16 billion in procurement funding.¹² Depending on the size of procurement funding in an expected FY 2007 supplemental funding request, the procurement budget could actually decline in FY 2007 from the FY 2006 level. Without the expected supplemental appropriations, the current request will reduce procurement's share of the overall modernization budget to less than 54 percent.

In this case, Congress should look to set a goal that allocates a specific share of the modernization budget to procurement. The goal should be a minimum of 60 percent of modernization funds allocated to the procurement account. Since this goal will take years to achieve, Congress needs to get started by establishing the goal now.

Some may argue that this goal is unwise for two reasons. The first argument is that the military should favor quality over quantity in modernization and adjust to buying smaller quantities of weapons. The second argument is that large-scale buys will drive defense contractors to offer artificially low bids on research and development projects in the expectation that they will profit from large-scale procurements at a later time. While these arguments have some merit and considerable surface appeal, they point the Department of Defense in the wrong direction at this time.

A modernization budget that is unbalanced in the direction of research and development over procurement will not absorb technology efficiently and effectively. An indicator of this inefficiency is

higher unit costs for the weapons and equipment that ultimately are procured and fielded.

The same imbalance will drive both DOD acquisition authorities and defense contractors to adopt an approach that is just as counterproductive as adopting unrealistically low cost projections at the outset of a program in order to make up the difference in procurement. This approach is to search for technological silver bullets, which provides an incentive to research programs to death. One such example is the Space-Based Infrared-High early warning satellite, which seems stuck in the development phase and has repeatedly generated cost overruns.¹³

As research and development becomes an independent profit center for defense contractors, a different perverse incentive emerges. Put crassly, the military and acquisition executives use the requirements process to set performance requirements at the outer reaches of what is possible. The contractor responds by "promising the moon." The contractor profits by performing the research and development and has little incentive to push the system into the field. The program may be canceled in the end, but the contractor earns a nice profit. In the end, the military and the taxpayers get the benefit of some neat research but no fielded military capability.

Conclusion

In human, political, and economic terms, the price of losing a major war is steep. One can only speculate as to what would have happened to the United States if it had lost the Cold War. It is clear what happened to the Soviet Union, however: It ceased to exist. The stakes in the current war, another open-ended conflict, are equally high.

Today, American civilians are very much on the front line. This means that their lives, liberty, and prosperity are directly at stake in this conflict. It is very much in the interest of the American people to make the investments that are necessary to pre-

12. Bush, letter to J. Dennis Hastert.

13. Michael Sirak, "Air Force Begins Search for SBIRS Alternative, Decision Planned by '08," *Defense Daily*, January 10, 2006, at www.defensedaily.com/VIP/common/pub/dd/dd01100602.html (February 9, 2006; subscription required).

vail. Given that this will be the Long War, these investments must be sustained. The American people are depending on Congress to make the right choice and allocate the necessary resources to the military.

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