

Background

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The FY 2009 Defense Budget Request: The Growing Gap in Defense Spending

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In March 2007, the Bush Administration submitted a five-year defense budget plan that projected funding levels insufficient to provide a ready and modernized fighting force.¹ On February 4, 2008, the Bush Administration released its fiscal year (FY) 2009 defense budget request.² It would provide \$541.1 billion—3.6 percent of gross domestic product (GDP)—in budget authority for national security, not including a \$70 billion supplemental request to fund ongoing operations in the war against Islamic terrorists.³ While the budget authority would increase by roughly \$10 billion per year until FY 2013, it would decline to less than 3.2 percent of GDP in 2013.

Fighting the long war on terrorism will require a sustained commitment to fund national defense programs. However, this is not the only national security challenge that the U.S. military will face in the coming decades. The U.S. needs to fund defense programs that will protect the American people and U.S. friends and allies against the ongoing threats from hostile states (e.g., Iran and North Korea) and looming threats like the one posed by a hostile China. The FY 2009 budget request fails to provide adequate funding for the basic building blocks in the core defense program that are needed to protect the national security over the long term.⁴

Congress should ensure that it provides adequately for national security by making a firm commitment to fund core defense programs at no less than 4 percent of GDP for the next 10 years. Senator Elizabeth Dole (R-NC) and Representative Trent Franks (R-AZ) have

Talking Points

- Maintaining a healthy defense posture requires sustained funding for national defense equivalent to no less than 4 percent of GDP.
- To maintain minimum funding levels for defense, Congress must reform the Social Security, Medicare, and Medicaid programs.
- To prevent ongoing operations from undermining the necessary long-term investments in defense, Congress should continue to separate funding for ongoing anti-terrorist military operations from the core defense program.
- Congress needs to examine alternative ways of compensating military personnel, especially defined-contribution plans for retirement and health care.
- Building a military force equipped with modern weapons will require increasing modernization funding to \$200 billion by FY 2014.
- A properly balanced modernization program will allocate at least 60 percent of the modernization budget to procurement.

This paper, in its entirety, can be found at:
www.heritage.org/Research/NationalSecurity/bg2110.cfm

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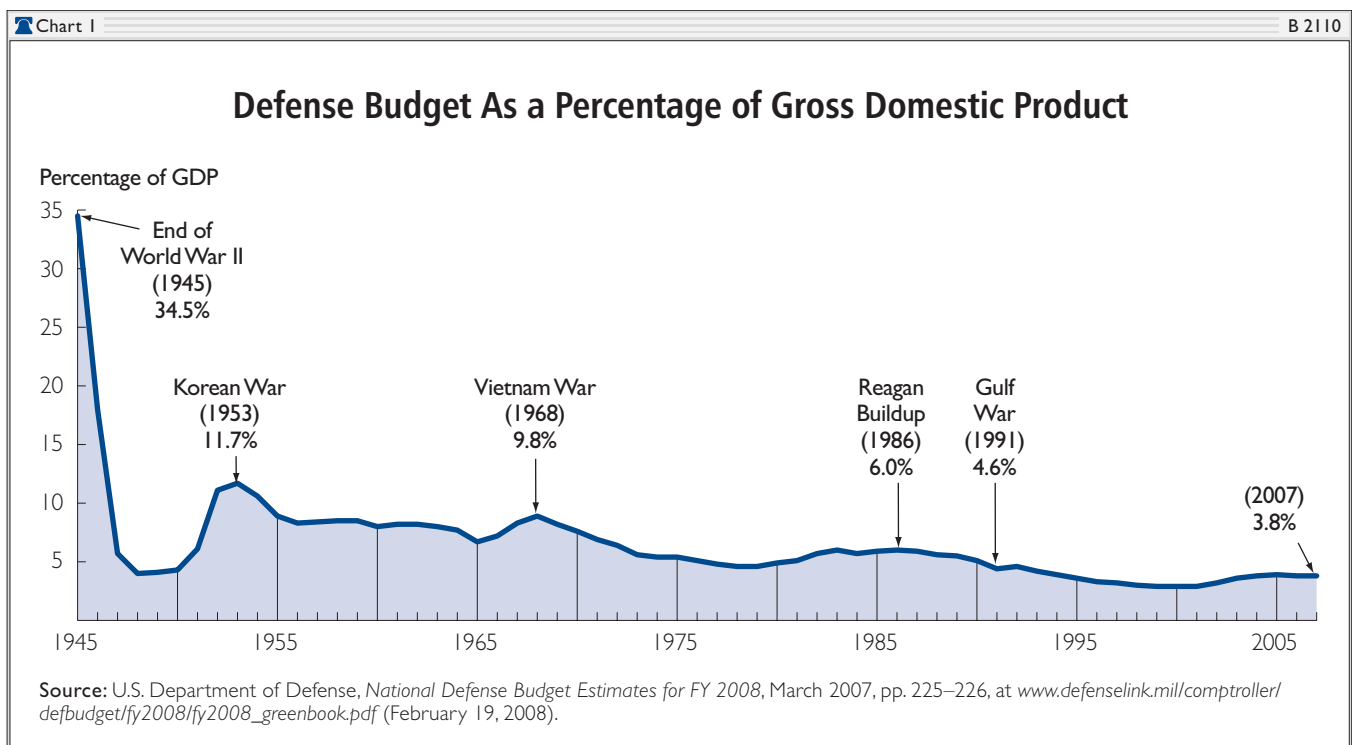
introduced companion bills (S.J. Res. 25 and H.J. Res. 67) that would make such a commitment. This commitment would require Congress to add roughly \$59 billion in budget authority to the core defense budget in FY 2009 and a total of \$532 billion over five years from FY 2009 through FY 2013. Congress can achieve this outcome by amending the upcoming FY 2009 budget resolution.

The core defense budget would go toward maintaining the structure of the military, 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.⁵ Protecting the lives and freedom of the American people is certainly worth 4 percent of national income.

The Administration's FY 2009 Defense Budget Request

The Bush Administration's budget request for FY 2009 through FY 2013 continues to reflect a number of external and internal pressures on the defense budget. The external pressures are posed by the rapid projected growth in spending for Social Security, Medicare, and Medicaid. If these entitlement programs are not reformed soon, they will crowd out needed defense funding even though defense expenditures as a percentage of GDP are already near a post-World War II low. (See Chart 1.)

The internal defense budget pressures are primarily the result of the high cost of military operations and the increasing costs (both gross and per capita)

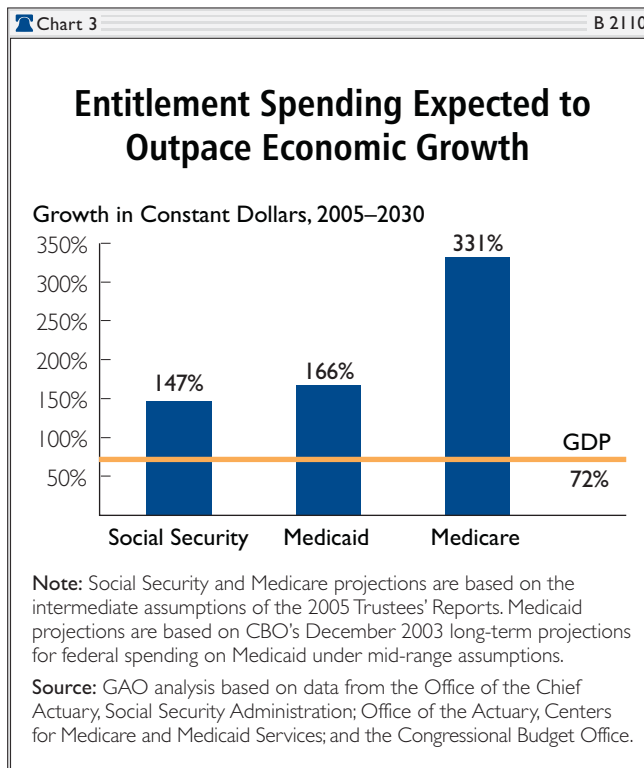


1. Baker Spring, "Defense FY 2008 Budget Analysis: Four Percent for Freedom," Heritage Foundation *Backgrounder* No. 2012, March 5, 2007, p. 5, at www.heritage.org/Research/Budget/bg2012.cfm.
2. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2009*, February 4, 2008, at www.whitehouse.gov/omb/budget/fy2009/pdf/budget.pdf (February 5, 2008).
3. Office of Management and Budget, *Historical Tables, Budget of the United States Government, Fiscal Year 2009*, February 4, 2008, p. 90, at www.whitehouse.gov/omb/budget/fy2009/pdf/hist.pdf (February 5, 2008).
4. Heritage calculation based on budget figures. *Ibid.*, pp. 90 and 194.
5. James Jay Carafano, Baker Spring, and Mackenzie M. Eaglen, "Providing for the Common Defense: What 10 Years of Progress Would Look Like," Heritage Foundation *Backgrounder* No. 2108, February 19, 2008, at www.heritage.org/Research/NationalSecurity/bg2108.cfm.

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 the core defense programs.

In the total federal budget, despite the ongoing war, the defense account is continuing to lose ground to domestic mandatory spending programs (e.g., Social Security, Medicare, and Medicaid). The FY 2009 budget request would continue this trend through the entire five-year budget period. (See Chart 2.)

External Pressures. 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, but this trend cannot continue indefinitely. Indeed, the United States is facing a fiscal crisis because spending on Social Security, Medicare, and Medicaid is forecast to grow faster than the overall economy between 2005 and 2030. (See Chart 3.)



Outlays for Social Security, Medicare, and Medicaid currently total 8.7 percent of GDP.⁶ By comparison, the proposed defense benchmark (4 percent of GDP) is less than half of what will be spent on the three major entitlement programs in the foreseeable future.

The implications for national defense are clear. Spending 4 percent of GDP on national defense will quickly become impossible unless Congress reforms Social Security, Medicare, and Medicaid. Some Members of Congress will likely argue that any reform of these programs is tantamount to a draconian cut, but 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.

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

Internal Pressures. The military faces a variety of internal budget pressures ranging from increasing personnel costs to the imbalance between the

6. Office of Management and Budget, *Historical Tables*, p. 95.

operations and support accounts and the modernization account.

Military Retirement Benefits. The success of the all-volunteer military depends on a well-designed compensation package that attracts highly qualified people to military service. It also depends on capping the spiraling increases in manpower costs. (See Chart 4.)

While offering a generous compensation package will meet recruitment needs, a well-designed package would focus on compensating military servicemembers in ways that meet their needs most directly. This tailored and more affordable approach would also ensure that taxpayers get the best return on their investment in the military. Such a modern military compensation package would recognize that military service personnel, like their civilian counterparts, are part of a highly mobile national labor force.

Above all, the military compensation package that best supports the all-volunteer force in the 21st century will be flexible. In general terms, this flexibility is best achieved by favoring cash compensation over in-kind and deferred benefits and designing the remaining benefits around defined-contribution plans. Labor mobility makes trying to design benefit packages to meet the unique needs of every servicemember difficult and inefficient. Cash compensation, however, would provide servicemembers more freedom to decide how to use their benefits in ways that best meet their needs.

The military should reform its current retirement system by adopting a new structure in which the military contributes to each servicemember's retirement account. The plan should also permit both the servicemember and civilian government and private employers to make contributions. Finally, the plan should allow the servicemember to bequeath the assets to the servicemember's heirs upon his or her death without paying estate or death taxes.⁷

Military Health Care. A key problem with the U.S. health care system is that it often precludes individuals from assuming at least some responsi-



bility for making decisions about their own care. The military health care system takes this to an extreme by encouraging beneficiaries to treat health care as a free good or service and consume it at whim rather than according 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.⁸ Greater individual control would also impose more discipline with respect to how servicemembers and their dependents use the system's resources.

Pentagon leaders should seek congressional authorization to move health care coverage for dependents to the Federal Employees Health Benefits (FEHB) system on terms consistent with the benefits available to federal civilian employees. This would permit the military health care system to focus on serving members of the military and meeting the unique needs of military medicine.

7. Carafano *et al.*, "Providing for the Common Defense."

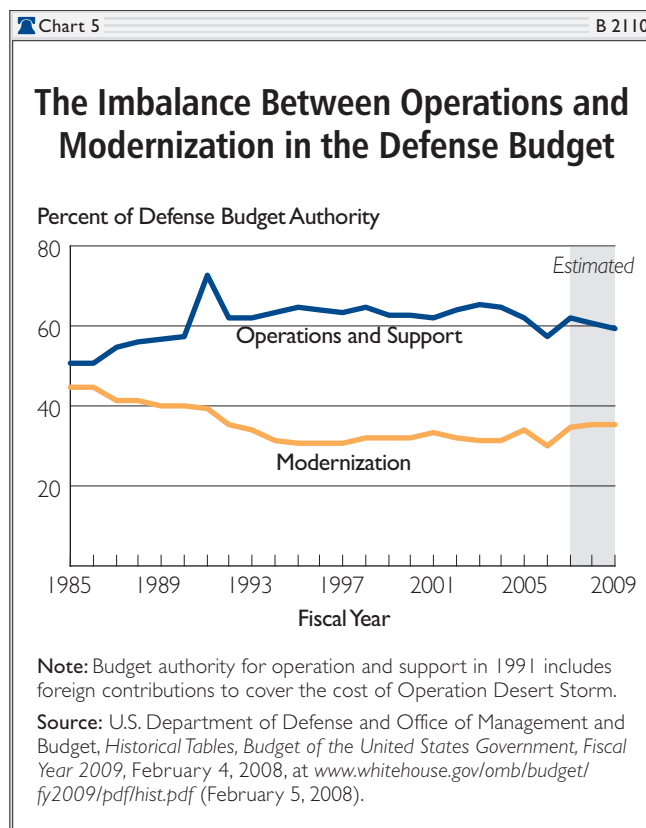
8. James Jay Carafano, "A 'Rucksack' for U.S. Military Personnel: Modernizing Military Compensation," Heritage Foundation *WebMemo* No. 1020, February 14, 2007, at www.heritage.org/Research/NationalSecurity/em1020.cfm.

For future military retirees, the military should seek congressional authorization to create a system of defined-contribution plans with individual accounts for military members. The funds in these accounts should be used to pay private health insurance premiums, deductibles, and out-of-pocket medical expenses. As with the defined-contribution retirement system, servicemembers, retirees, civilian government employers, and private employers should be permitted to contribute to these accounts. Eventually, all military dependents would be covered under the FEHB system, and all new recruits would be in a defined-contribution health care plan.⁹

Today's Needs Versus Tomorrow's Military. In recent years, spending on today's forces has tended to crowd out investment in tomorrow's forces. The funding for operations and support activities (the operations and maintenance account plus the military personnel account) has taken an increasing share of the overall Department of Defense (DOD) budget. Conversely, spending on modernization (the research and development account plus the procurement account) has received an increasingly smaller share of the DOD budget. (See Chart 5.)

Specifically, operations and support activities absorb roughly 60 percent of DOD budget authority for the core program, not including the FY 2009 request for supplemental appropriations. Modernization activities absorb only a little over 35 percent. By comparison, the two activities approached parity in the 1980s, when operations and support absorbed slightly more than modernization.

The trend toward operations and support's 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 America's soldiers, sailors, airmen, and Marines was held in check by a 24 percent



reduction in manpower. However, this pressure valve on manpower costs is closing because the Bush Administration has proposed adding 92,000 soldiers and Marines to the force by 2012.¹⁰ In fact, the planned increase in ground forces is ahead of schedule.¹¹

Meanwhile, 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 2009 defense budget allocates \$41.6 billion to providing health care benefits to military personnel and their dependents.¹²

The trend toward modernization's receiving smaller shares of the core defense budget is largely

9. Carafano *et al.*, "Providing for the Common Defense."

10. 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).

11. U.S. Department of Defense, "Fiscal Year 2009 Budget Request," February 4, 2008, p. 11, at www.defenselink.mil/comptroller/budget.html (February 14, 2008).

12. *Ibid.*, p. 7.

the result of the Clinton Administration's "procurement holiday" in the 1990s. The recovery from this unwise choice is still incomplete. An enduring effect of the procurement holiday is the 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.

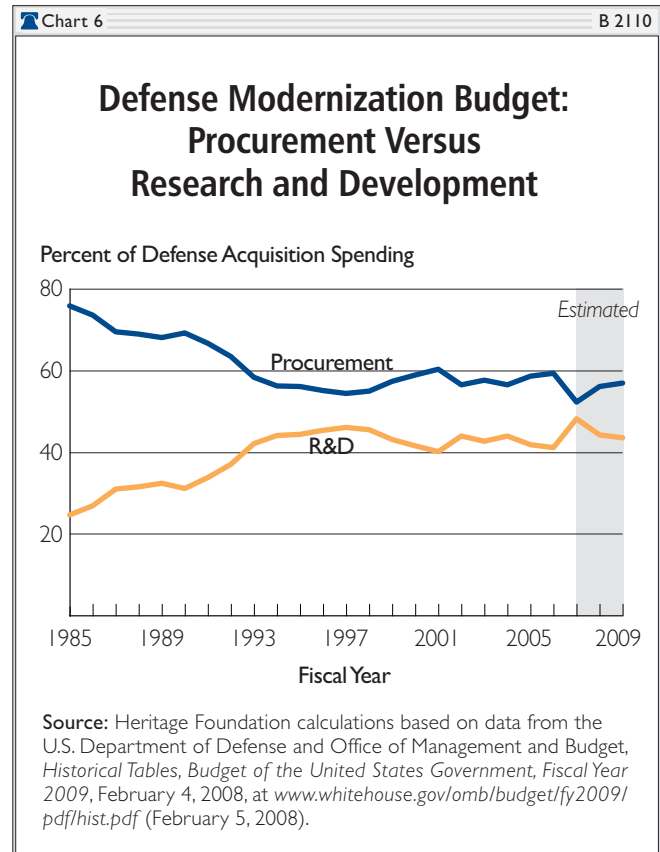
In the 1980s, procurement consumed more than 70 percent of the modernization budget. The core defense budget for FY 2009 would still leave procurement at only slightly more than 60 percent. (See Chart 6.) As a result, essential new weapons programs must be stretched out, which increases unit costs, reduces the numbers of new weapons available to the military, and prevents their timely delivery. For example:

- Although Congress is seeking to remedy this problem, the Navy has been forced to reduce construction of *Virginia*-class submarines to one per year even though constructing two per year would reduce the unit cost to \$2 billion per boat.¹³
- The Air Force has been forced to scale back its purchasing of F-22 Raptor tactical fighters dramatically. It is now slated to obtain just 183 F-22s despite its requirement for 381.¹⁴
- The Army has been forced to extend the production time for its Future Combat System by four years.¹⁵

Prerequisites for Sustained Defense Funding

Maintaining a healthy national defense program involves three prerequisites.

First, Congress must make a sustained commitment to robust funding for national defense. This is



axiomatic. A robust defense program cannot be maintained without sustained funding. Congress should therefore establish a floor of 4 percent of GDP for national defense and firmly resist all attempts to go below this floor for the next 10 years.

Second, Congress must reform Social Security, Medicare, and Medicaid. In the long run, projected spending growth in these three entitlement programs will make it impossible for Congress to provide at least 4 percent of GDP to national defense. Even in the short term, entitlements will make allocating adequate resources to national defense incrementally more difficult.

13. Baker Spring, "The Navy Needs to Close the Projected Gap in the Attack Submarine Fleet," Heritage Foundation *WebMemo* No. 1432, April 26, 2007, at www.heritage.org/Research/nationalsecurity/wm1432.cfm.

14. The Honorable Michael W. Wynne, "Strategic Initiatives," testimony before the Committee on Armed Services, U.S. House of Representatives, October 24, 2007, and 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).

15. Mackenzie M. Eaglen and Oliver L. Horn, "Future Combat Systems: A Congressional Guide to Army Modernization," Heritage Foundation *Backgrounder* No. 2091, December 11, 2007, p. 8, at www.heritage.org/Research/NationalSecurity/upload/bg_2091.pdf.

Third, Congress must spend the defense budget wisely. This will require rebalancing the internal defense accounts to meet long-term needs. Specifically, Congress should:

- Increase funding for the core defense programs if and when supplemental appropriations to support ongoing contingency operations decline,
- Shift resources from the operations and support accounts to the modernization accounts, and
- Increase the share of the modernization accounts devoted to procurement.

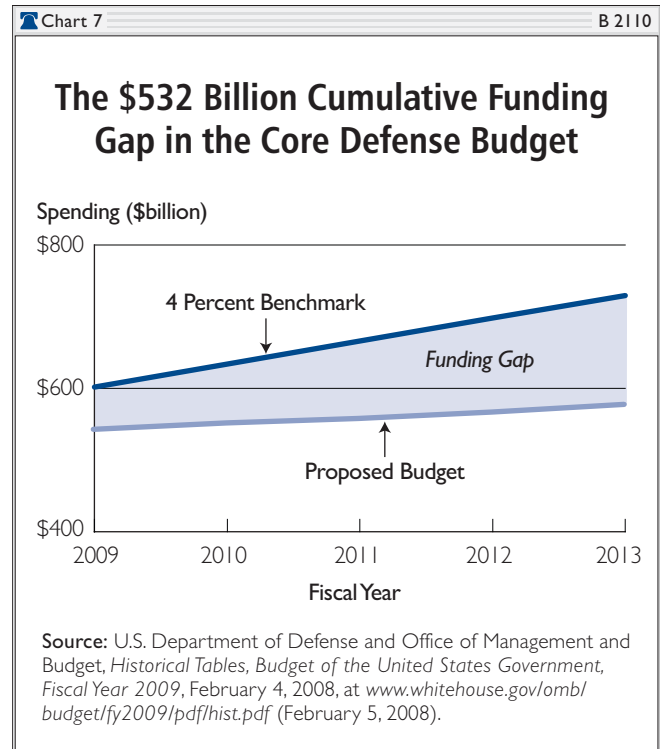
What Congress Should Do

To close the growing gap between defense needs and defense budget authority, Congress should address the external and internal pressures on the defense budget in five broad areas.

Providing the Necessary Resources. Providing adequate funding for national defense starts with recognizing that the Bush Administration's five-year defense budget request falls short. The Administration's budget from FY 2009 through FY 2013 would create a roughly \$532 billion defense funding gap between budget authority in the core defense program and the 4-percent-of-GDP benchmark. (See Chart 7.)

To remedy this problem, Congress should:

- **Close this gap by adding the necessary budget authority to the five-year national defense account.** The relevant defense budget targets should be \$600 billion for FY 2009 (not including the Bush Administration's \$70 billion supplemental appropriations request); \$632 billion for FY 2010; \$664 billion for FY 2011; \$696 billion for FY 2012; and \$728 billion for FY 2013. These targets reflect the investments needed to sustain the core defense program. They do not include supplemental appropriations to fund ongoing operations in the war against Islamic terrorists.
- **Make a clear commitment to sustain adequate defense funding beyond the five-year budget period.** Congress can do this by including report language that pledges Congress to allocate at least 4 percent of GDP to the core national defense program for the foreseeable future. Such



a step would be a logical follow-on to enacting either S.J. Res. 25 or H.J. Res. 67.

- **Reform 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. Spending 4 percent of GDP on national defense will quickly become impossible unless Congress reforms Social Security, Medicare, and Medicaid.

Funding Major Combat Operations Separately. In wartime, the military always faces the challenge of not letting the requirements for current operations undermine its ability to field first-rate forces in the future. The Bush Administration, recognizing this dilemma, has responded by using supplemental appropriations to fund ongoing operations in the war against Islamic terrorists. This has appropriately served the purpose of keeping these expenditures from crowding out investments in the core defense program. If the costs of current operations were incorporated into the annual defense

budget, the temptation to rob future military capabilities to fund current operations would be overwhelming.

- **Congress should continue to fund current contingency operations through supplemental appropriations.** The 4 percent benchmark is intended to protect the core defense program and future defense capabilities. The spending goal therefore assumes that supplemental appropriations will be in addition to the 4 percent spent on the core program. This means that the roughly \$532 billion that Congress should add to the core defense program during the five-year budget period would go exclusively to the annual defense appropriations bill.
- **Similarly, Congress and the Bush Administration should resist the urge to fund elements of the core defense program out of supplemental appropriations bills.** Doing so would tie enduring defense programs to a funding source that could easily decline or disappear in the near future.

Rebalancing Military Compensation. Absent reform, future increases in the per capita cost of military compensation will crowd out needed spending on military modernization because the overall size of the military is increasing. Ultimately, rebalancing military compensation will require a number of significant reforms. Ample evidence suggests that the current compensation system is weighted too heavily in favor of in-kind and deferred compensation over direct cash compensation.¹⁶

To begin rebalancing military compensation, Congress should:

- **Reform military retirement benefits as outlined in various proposals to adjust 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 identical to 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.

- **Phase in a new defined-contribution retirement program over the next 10 years.** The military should change from its defined-benefit system to a defined-contribution program in which the military would contribute to each servicemember's retirement account.¹⁷ The plan should also permit the servicemember and his or her civilian government and private employers to make contributions. Finally, the plan should contain an inter-generational element that allows the servicemember to bequeath the assets in the account to the servicemember's heirs upon his or her death without paying estate or death taxes. After the 10-year transition period, all new military recruits should be covered under this new retirement system.
- **Move the military health care system away from a defined-benefit plan and toward a defined-contribution plan.** While the DOD touts its \$41.6 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.¹⁸ The system is clearly one of the most generous and may be one of the most inefficient. The military should seek congressional authorization to move health care coverage for dependents to the Federal Employees Health Benefits system on terms consistent with what is available to federal civilian employees.

Increasing Military Modernization Funding. The Bush Administration's FY 2009 budget request provides almost \$184 billion to the modernization program in the core defense budget.¹⁹ Moderniza-

16. 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).

17. Carafano *et al.*, "Providing for the Common Defense."

18. U.S. Department of Defense, "Fiscal Year 2009 Budget Request," p. 7.

tion funding after FY 2009 is uncertain because the Bush Administration did not provide budget authority figures for modernization in the latter years of the budget period. This is a cause for concern because of the \$532 billion funding gap from FY 2009 through FY 2013 and the ongoing pleas from the service chiefs for more modernization dollars.

- **Congress should incrementally increase the Bush Administration's military modernization funding request for FY 2009** and thereby establish the foundation for future increases. Closing the gap in the proposed five-year defense budget would leave sufficient room to reach the \$200 billion target for modernization in FY 2014. This kind of sustained funding for modernization would provide the military with the new weapons and equipment that it will need to be a fully capable force a generation from today.

Increasing the Procurement Account's Share of Modernization Spending. It is unclear whether or not the Bush Administration's FY 2009 budget request for the core defense program would rebalance the internal structure of the modernization program, because the request does not specify funding levels for these accounts beyond FY 2009. The \$104.2 billion in FY 2009 budget authority for procurement constitutes just under 57 percent of the entire modernization program.

- **Congress should incrementally increase the Bush Administration's procurement request for the core defense program** and resist all temptations to shift resources away from procurement to research and development. It should sustain this rebalancing action in future

defense authorization and appropriation bills by ensuring that procurement receives at least 60 percent of modernization budget. Closing the budget gap 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, and the Constitution assigns to the federal government the primary responsibility to "provide for the common defence."²⁰ In this context, expending 4 percent of GDP in the defense of freedom is entirely reasonable. Nevertheless, and despite the ongoing war against terrorism, the federal government is now allocating a smaller share of national income to defense than the average for the past four decades.

Projected growth in entitlement spending, not defense spending, is at the core of the looming fiscal crisis facing the federal government. Current defense expenditures—or even spending equivalent to 4 percent of GDP—will not jeopardize either the health of the economy or 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.

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19. *Ibid.*, p. 6.

20. U.S. Constitution, Preamble.