

# WebMemo



Published by The Heritage Foundation

No. 3417  
December 21, 2011

## An Unacceptable Squeeze on Defense Modernization

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Following the enactment of the Budget Control Act earlier this year, the budget for the core defense program is already operating under stringent spending caps. At the same time, per capita expenditures for paying military personnel and operating the force are high and growing rapidly. Under these circumstances, funding for the procurement of new weapons and equipment and for research and development on new defense technologies will be squeezed to a dangerous degree.

**A Looming Disaster for the Military and U.S. Security.** Both the Obama Administration and Congress will be tempted to leave the defense spending caps in place—if not to go to even lower caps—now that the sequestration process could be applied to the defense budget under the Budget Control Act. This is a result of the failure of the Joint Select Committee on Deficit Reduction (“super committee”) to agree on an alternative deficit-reduction plan and adopt a policy of “people over platforms” in slicing up the defense budget pie. Given the uncertainties in the application of the sequestration process, it is impossible to calculate precisely how much more the modernization accounts will be squeezed if that process kicks in. Suffice it to say that the problem is likely to become dramatically worse.

The implications of the coming squeeze on defense modernization under the existing spending caps should cause great alarm for all concerned,

particularly since it comes on the heels of the “procurement holiday” of the 1990s. The result will be a military that lacks the modern weapons and equipment it needs, loses its technological edge over future enemies, and finds itself dependent on a seriously eroded defense industrial base.

Congress will have to take two essential steps to avoid a disastrous outcome for the military and U.S. security. First, it will have to increase the existing caps on spending for the core defense program and find savings elsewhere in the federal budget to offset this change, in accordance with Heritage’s December 5 recommendations.<sup>1</sup> Second, it will have to take steps to constrain per capita growth in the cost of compensating military personnel.

**The Sources of the Modernization Squeeze.** There are two sources of the squeeze on military modernization. First, the Budget Control Act has established caps on spending for national security and discretionary spending over the next 10 years that translate into inadequate defense budgets under any circumstance. These caps will constitute

This paper, in its entirety, can be found at:  
<http://report.heritage.org/wm3417>

Produced by the Douglas and Sarah Allison  
Center for Foreign Policy Studies

Published by The Heritage Foundation  
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Washington, DC 20002-4999  
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top-down pressure on the modernization accounts (procurement and research and development) within the defense budget.

This top-down pressure will be accompanied by significant pressure from underneath by growth in both the overall and per capita costs of compensating military personnel. These increasing costs are largely driven by the array of defined benefits offered by the Department of Defense to military service members and their dependents, which fall mostly in the areas of military retirement and health care. These would be more effective and efficient if they were converted to defined-contribution plans.

According to the Department of Defense (DOD), its overall military manpower costs will rise from roughly \$148 billion today to more than \$160 billion in fiscal year (FY) 2016. This increase will come in spite of proposed reductions in the number of people serving in the active-duty military. Although the number of active-duty military personnel is projected to drop by about 5 percent from FY 2012 through FY 2016, military personnel spending will rise, thanks to growing per capita compensation costs. Per capita compensation for active-duty personnel is projected to rise by more than 13 percent during the same five-year period.

The reduction in the number of active-duty military personnel, as currently projected by the Obama Administration, will create a force that is too small to defend the vital interests of the United States. The Heritage Foundation has recommended that this reduction not be imposed. Accordingly, DOD's projection of total military manpower costs is well below what is prudent. It is also appropriate to point out that while, according to the Congressional Budget Office, the overall per capita costs for operation and maintenance will come down with the withdrawal of U.S. forces from Iraq and Afghanistan, the per capita costs for operations and maintenance within the core defense program will continue to rise as well.

### **The Scope of the Modernization Squeeze.**

As a result of the twin pressures of the estimated spending caps on the core defense program derived from the Budget Control Act—which still excludes the more stringent caps that would result from the imposition of a partial or full sequestration under the Act—and the rising cost of military compensation, the level of funding for military modernization will necessarily fall to unacceptably low levels. (See chart.) Under this scenario, funding for defense modernization within the core defense program (defined as the sum of DOD's procurement account and research, development, test, and evaluation account) could fall to roughly \$145 billion in current dollars in FY 2016.

By way of comparison, \$188.4 billion was to go to these accounts under President Obama's original budget request for FY 2012. Thus, the level of modernization funding is estimated to decline by about \$43 billion in current dollars, or 23 percent, over the four-year period. In terms of inflation-adjusted dollars, the decline will be roughly \$54 billion (in FY 2012 dollars), or about 29 percent. In other words, President Obama's original request for the core DOD budget would have devoted roughly 34 percent of that budget to modernization. By 2016, modernization funding could fall to about 26 percent of total DOD funding for its core program.

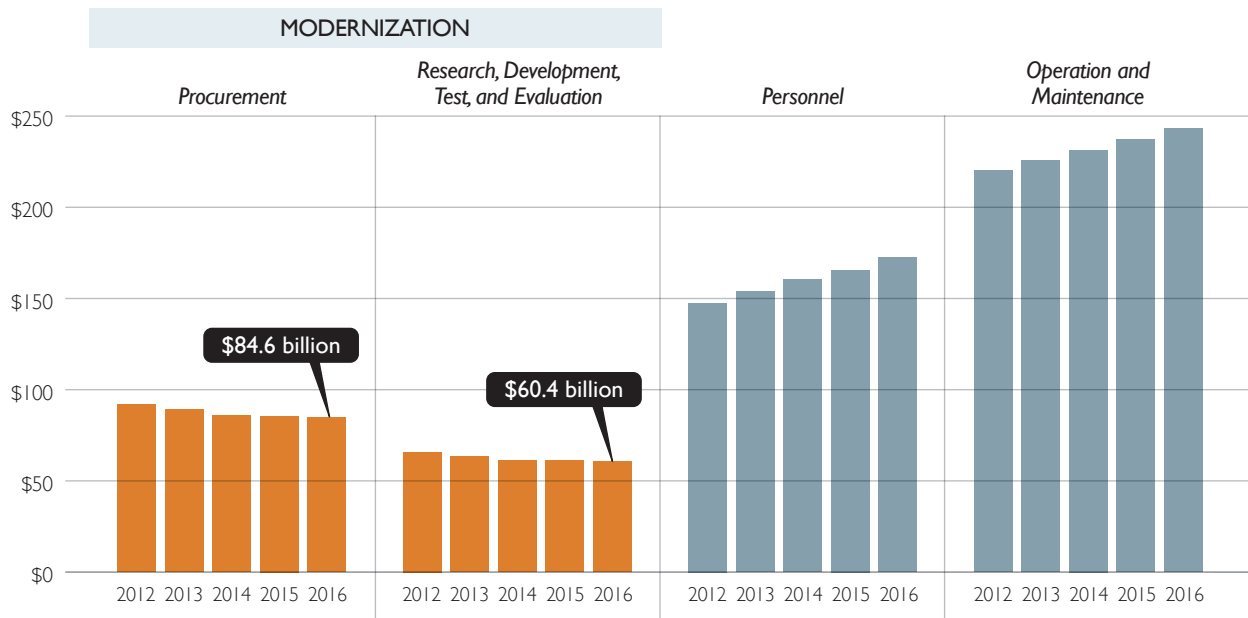
When these comparisons are expanded to provide a broader perspective, the situation becomes even more alarming. For example, the Department of Defense spent more than \$226 billion on modernization in FY 1985 (in FY 2012 dollars). This was 39 percent of the total DOD budget. That means DOD could be on a path to cutting modernization's share of its total budget to little more than one-half of what it was in FY 1985.

**Escaping the Modernization Squeeze.** Maintaining a U.S. fighting force that possesses modern weapons and equipment and retains its technological advantage is essential to the nation's global lead-

1. Mackenzie Eaglen and Diem Nguyen, "Super Committee Failure and Sequestration Put at Risk Ever More Military Plans and Programs," Heritage Foundation *Backgrounder* No. 2625, December 5, 2011, at <http://www.heritage.org/research/reports/2011/12/debt-ceiling-deal-puts-at-risk-ever-more-military-plans-and-programs>.

# Defense Modernization Poised to Drop

Projected Defense Spending Caps Due to Budget Control Act of 2011, in Billions of Dollars



Source: Author's calculations based on figures provided by Diligent Innovations VisualDOD®.

Chart 1 • WM 3417 [heritage.org](http://heritage.org)

ership. Accordingly, the DOD will have to depart from the projected budget path that has been established for it by the Budget Control Act. This is the case even if the threatened sequestration under the Act is not triggered for the defense budget. This will require two steps:

**Step #1: Prevent application of the national security and discretionary spending caps under the Budget Control Act to the DOD budget.** The Obama Administration's FY 2012 defense budget request, submitted in February, was inadequate even before the enactment of the Budget Control Act. Even without the dramatically lower defense budgets that could result from the sequestration following the failure of the Joint Committee to adopt an alternative deficit-reduction plan, the Budget Control Act imposes spending caps on what is called the national security category of the federal budget in both FY 2012 and 2013. The DOD budget is defined as a portion of this broader category. For

the years that follow FY 2013, the caps are imposed on discretionary spending. Again, the DOD budget is a portion of this broader category.

From FY 2012 through FY 2016 under the caps, the defense budget will be roughly \$2.7 trillion—if DOD's historical share of the broader categories of national security and discretionary spending is maintained. By comparison, The Heritage Foundation is recommending more than \$3.4 trillion for the DOD budget over the same period.

**Step #2: Restructure the military health care and retirement systems to free money inside the DOD budget for application to the modernization account.** While increasing the DOD budget by the sum recommended by The Heritage Foundation, as described above, would go a long way toward easing the modernization squeeze, an additional step is needed. DOD must reduce the currently projected rate of growth in the cost of compensating service members. Major contributors to this cost growth

are the currently defined benefits of health care coverage to service members, retirees, and dependents and for military retirement. These systems can be reformed by making them defined-contribution plans while still honoring the government's obligations to service members.

The Heritage Foundation released its plan for these reforms on November 17.<sup>2</sup> The savings derived from reforming military health care and retirement would provide the final increment of funds needed—as much as \$39 billion cumulatively over the five-year period—to put the military's modernization programs on a healthy trajectory.

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The author would like to thank the leaders of Diligent Innovations for permitting him to use their VisualDOD® tool in the drafting of this paper. This tool permitted the author to organize Department of Defense budget data to quantify the scope of the impending modernization squeeze in an efficient and effective manner. In particular, the author would like to thank Michael Cadenazzi and Chris Daehnick of Diligent Innovations for providing direct assistance in the use of this tool.

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2. Baker Spring, "Saving the American Dream: Improving Health Care and Retirement for Military Service Members and Their Families," Heritage Foundation *Backgrounder* No. 2621, November 17, 2011, at <http://www.heritage.org/research/reports/2011/11/saving-the-american-dream-improving-health-care-and-retirement-for-military-service-members>.