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Moving Toward a Sustainable U.S. Defense Budget

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K. Jack Riley
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About two years ago, my colleagues Bruce Held and Jim Quinlivan identified an issue on the horizon: the looming conflict between U.S. defense spending and constraints on the federal budget (Held and Quinlivan, 2008). Specifically, they were concerned that the trajectory of defense spending was unsustainable. This talk is designed to take a renewed look at this problem and at its potential consequences.

Let's start with the basics. The fiscal year (FY) 2011 U.S. federal budget will be about $3.8 trillion, of which $2.4 trillion will be nondiscretionary. By nondiscretionary I mean that the spending is a required benefit or program for which funding is automatically provided with no intervention by the President or Congress. A substantial amount of nondiscretionary spending occurs in the area of health care and health services, where costs have been rising faster than inflation. Examples of nondiscretionary spending include

- health services for the poor and elderly (i.e., Medicare and Medicaid)
- Social Security benefits
- debt servicing.

Combined, Social Security (19 percent), Medicare (13 percent), Medicaid (8 percent), and Net Interest (7 percent) will make up almost half (47 percent) of the country’s FY11 budget.

We can expect that, absent major reforms, this nondiscretionary spending is going to remain very high. For example, the baby boom cohort (born between the end of World War II and 1964) has begun to retire in large numbers and is now drawing heavily on the Social Security and Medicare accounts. This generation will expect these benefits to remain intact.

That leaves about $1.4 trillion in the FY11 federal budget for everything else, including defense, education, justice, and all other federal activities. Interestingly, the projected size of the FY11 deficit is $1.3 trillion, which means that almost all of our discretionary programs will essentially be financed by debt in FY11. The United States currently carries a public debt of $8.6 trillion, equivalent to about 60 percent of the nation’s gross annual economic activity. Although we will continue to add to our debt, our ability to do so is not unlimited. At some point, lenders will be unwilling to lend to us, at least to the extent required. Furthermore, the roughly $300 billion in annual interest payments arising from our current debt certainly crowd out other government expenditures.

Thus, our choices at this juncture are to cut spending, raise taxes, or both. Those who have more than a passing familiarity with America know that the likelihood of a tax increase is small. Americans are simply unwilling at this point (and, truthfully, at almost any point) to raise taxes substantially before expenditures are cut.
Of the $1.4 trillion of discretionary spending, the Department of Defense (DoD) accounts for roughly $710 billion: $549 billion in the top line (basic budget) and $159 billion in extra funding (essentially, funding for the wars in Iraq and Afghanistan). So, DoD accounts for half of the discretionary dollars available to the U.S. government. If we add spending on the Department of Homeland Security and the Federal Bureau of Investigation to the mix, spending on national security accounts for over 60 percent of the discretionary budget. National security spending is greater—for greater—than the sum of spending on the Departments of Justice, Education, and State combined.

In real dollars, our defense budget has experienced large swings. It peaked (not surprisingly) during World War II at more than $900 billion in today’s dollars, and it was near a modern low of approximately $350 billion when the terrorist attacks of 9/11 occurred (Lewis 1994; Held and Quinlivan, 2008). In between, the defense budget swung in roughly 20-year cycles that reflected periods of high operational tempo and costs (the Korean War, Vietnam, the first Gulf War) and periods of resetting, modernization, and acquisition.

As we enter FY11, the budget is in one of its periodic peaks. If the historical pattern were to hold, defense spending would glide downward in real terms for a fairly lengthy period. However, the difference this time is that we are coming off a period of high operational tempo that was preceded by a period of relatively little procurement. Most of the 1990s were a procurement holiday during which the procurement budget was reduced by almost two-thirds in inflation-adjusted dollars from its level in the mid-1980s (Eaglen, 2010). The combination of the procurement holiday and the period of high operational tempo has led to demand for investment in modernization and procurement. In addition, some of the need for new weapons is a function of the fact that we are confronting new, more nimble adversaries that challenge our orientation toward major land and air combat and state-to-state conflict.

In addition to starting from a spending peak, DoD has taken on significant new commitments and identified significant new threats that did not exist during past cycles. One important new commitment is assisting some nations as they build defensive capabilities and civil systems and as they recover from conflict; another is providing increased benefits and levels of care to wounded warriors and to service personnel more generally. An example of a significant new threat that may be costly to counter is the midrange missile threat from Iran and North Korea. Another example is the improvised explosive device, which requires the development and acquisition of new equipment.

The Obama administration has signaled that the process of slowing DoD spending has begun, and, in recent speeches, Secretary of Defense Robert Gates has identified the need to reduce DoD spending. There has been a clear desire to cut systems that the administration views as unneeded, including the C-17 aircraft, the Joint Strike Fighter alternate engine, and the CG(X) cruiser. In addition, there has been a very visible and intense focus on reducing the size and number of major system cost overruns through such measures as the passage of the Weapons System Acquisition Reform Act and the accompanying establishment of a key office in the Pentagon to help identify lessons from overruns.

In addition, the Secretary of Defense recently announced the goal of creating a more agile, more flat, and more efficient organization (Department of Defense, undated). The projected savings from this effort are not really budget cuts, since DoD has committed to turning the savings over to the military departments for investment in personnel, readiness, force structure, and capabilities. Essentially, this is an effort to cut overhead and move more of the dollars into programs that directly support the warfighters. If DoD makes the expected cuts,
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totaling a cumulative $102 billion off the nearly $3 trillion top line between 2012 and 2106, they will help the department slow the rate of budget growth.

Despite these changes, it is important to note that the plans proposed to date only slow the rate of growth above inflation. At this point, DoD budget plans still assume both annual increases to accommodate inflation and real growth in the base budget.

Making real cuts to the defense budget, so that growth is limited to inflation or below, will be an entirely different matter. At this point, the national conversation on this topic is only just beginning. To understand why I am skeptical that these true cuts will occur in the near future without a change in missions, objectives, and commitments, let’s look briefly at the individual components of the DoD budget, which can be grouped into four large categories: acquisition, personnel, operations and maintenance, and research and development (R&D).

**Acquisition.** Acquisition is projected to be a $113 billion activity in FY11. The services are requesting for new equipment. That said, major weapon systems seem to be in the Secretary of Defense’s and Congress’s crosshairs. There is renewed focus on understanding and preventing cost overruns on major weapon systems. However, DoD’s track record at controlling cost escalation in such systems is poor. Even with the administration’s admirable emphasis on limiting cost overruns, significant overruns are likely. One risk associated with cutting overhead is that doing so could limit or reduce the department’s ability to prevent overruns. In short, in the absence of major mission changes, the combination of the procurement holiday over the last decade or two and the cuts to overhead may make it hard to make significant, real cuts to this account in the near future.

**Personnel.** The personnel account is expected to run to $139 billion in FY11. This is the account that reflects all the costs of retaining and compensating service personnel. For example, it includes the costs associated with the enlistment and reenlistment bonuses that have been required to attract and retain servicemembers in specific military occupations. These pay incentives have been important as the department has sought to increase the size of the force to support operations in Afghanistan.

At the same time, given the strain that extended deployments in Iraq and Afghanistan have caused, it is unlikely that we will make big cuts in the number of personnel without a corresponding reduction in security commitments. Reducing the number of servicemembers without changing security commitments would only increase the strain on those remaining in the force.

Finally, it is unlikely that we can let compensation erode in real terms. It is difficult enough in this environment, with two ongoing wars, to recruit and retain the needed personnel. Here too, cuts to overhead can make it more difficult to effectively contain costs. In short, it is unlikely that personnel is an area ripe for large savings over the next few years, absent a major change in commitments.

**Operations and Maintenance.** The operations and maintenance budget is $200 billion, plus $17 billion for construction. This budget sustains the readiness levels of the military services, providing for tank miles, flying hours, ship operations, and other readiness-related programs. Given that we are engaged in two wars, it is highly unlikely that there will be major cuts to these activities.

This account also includes the costs of military and family health and support-service benefits provided to more than 9 million beneficiaries. It is this latter category where costs are rising and commitments have been made. For example, a recent RAND Corporation book demonstrated that a large fraction of servicemembers who experienced combat were returning
with undiagnosed traumatic brain injury, depression, and post-traumatic stress disorder. Since that landmark work was published, DoD has committed billions of additional dollars to help diagnose and treat servicemembers. Thus, the trajectory of this account is trending up as well.

**Research and Development.** The R&D budget is $76 billion. This budget item funds the development and testing of new generations of weapons and materiel to protect and support the troops. It includes basic and applied research. Although it is the smallest of the four large accounts, it is unlikely to suffer major, disproportionate cuts. This is because it is so vital to the development of future capabilities.

I submit that, if we are going to succeed in making real reductions in the defense budget, we need to identify major structural changes in our missions and commitments. Only if we achieve substantive structural changes can we expect corresponding changes in these broad areas of spending.

There are a number of ways in which we could structurally reduce national security expenditures that would facilitate cutting programs, but the two most obvious are

- reducing global commitments, obligations, and guarantees
- relying on allies and others to provide more direct assistance in combat, operational support, and weapon development.

Let’s consider each of these options.

**Reducing Global Commitments, Obligations, and Guarantees.** Significantly reducing our global commitments will be challenging. Taiwan, Japan, and the rise of China as a regional—and potential global—challenge all demand U.S. commitments. The North Korean threat to South Korea has underscored the U.S. commitment to South Korea. Each of these commitments entails either the forward presence of personnel or power projection, which requires significant investment in air and sea assets. Elsewhere around the globe, we have picked up commitments, including, by virtue of the wars there, to Afghanistan and Iraq. Israel remains the beneficiary of U.S. security guarantees. With approximately 65,000 U.S. troops deployed in Asia, some reduction there may be possible.

The U.S. commitment to the European nations in the North Atlantic Treaty Organization raises, in my mind, the biggest question. Our experience in attempting to get additional Allied support in Afghanistan has been sobering. There is still a great reluctance on the part of our European allies to commit the force levels we requested. This reluctance can be seen in the imbalance between European nations’ NATO spending ($300 billion) and U.S. spending on defense. Some, such as former Ambassador Jack Matlock, have criticized the expansion of NATO to 27 countries, seeing it as a significant increase in risk for the United States with no commensurate increase in benefits (Mandelbaum, 2010). The primary justification for sustaining U.S. troop levels and posture in Europe is that they support rapid deployment to other theaters, such as the Middle East. As NATO struggles for a mission, this is the one area in which it is possible to imagine the United States making a significant change at some point in the future, although what that change would be, let alone what savings it might generate, is only now being specified (Sustainable Defense Task Force, 2010).

**Relying on the Allies to Pick Up More of the Costs.** The Japanese have been more active collaborators in the international arena over the last decade, and Japan’s military budget is among the world’s ten largest. However, there is also growing opposition in Japan to the U.S. presence in Okinawa and to the costs of the support services the Japanese provide. These ten-
sions can cut both ways. That is, they can play themselves out within the existing security framework or they can result in the creation of a new framework in which the Japanese assume a significantly increased share of the costs of defense. Given U.S. strategic interests in the region, particularly relative to China, it seems likely that the United States will want to maintain a strong role in providing for the region’s defense. South Korea and Taiwan seem capable of bearing more of the cost of their defense, although both will be in extremely difficult positions if their principal adversaries decide to engage in military conflict.

There may be more opportunities to rely on our European allies, although perhaps not in the sense of expecting them simply to send more troops to Afghanistan. One idea advanced by William Drozdiak in *Foreign Affairs* suggests creating a new division of labor between the United States and the NATO allies (Drozdiak, 2010). Europe lacks the capability to project power, and it may not be interested in doing so. As a practical matter, for example, the European countries do not have transport aircraft for moving equipment out of the European theater. Under the proposed division, the allies would assume more responsibility for nation-building and combat (or postcombat) support. I frankly think that such an arrangement would be difficult to structure. It would introduce an imbalance in the exposure to combat risk that the alliance would likely not survive. So, although I think that we might coax marginal additions to missions out of our NATO allies, we are unlikely to see large increases that absorb a lot of the burden of Afghanistan and future conflicts.

We have experimented with collaboration to reduce acquisition costs. Allies have participated in the development of the Joint Strike Fighter. Their participation has helped defray some of the cost of developing and producing the aircraft, and it may have jump-started the potential export market. A number of different nations have participated in the effort, including the United Kingdom, Italy, the Netherlands, Canada, and Australia. However, it is unclear how many other systems could be developed under this kind of partnership. It is also not clear whether the partnership has saved the United States any money.

Finally, it is important to remember that European budgets, like the U.S. budget, are under enormous strain. Indeed, the European allies are already reducing their budgets, including their defense accounts.

In short, these structural changes, while perhaps intuitively appealing and ultimately necessary, offer no short term fix. Where does that leave us?

I can identify three policy shifts that, if implemented, could take some of the strain off of defense budgets. Although they are not sufficient to completely forestall future defense cuts, they could lead to deeper structural changes in the future.

First, it seems likely that we will see an increased emphasis on intelligence and law enforcement cooperation against terrorism. Such cooperation may move terrorism away from the realm of force and conflict—and, thus, out of military institutions—and toward efforts to manage the issue within civil frameworks, such as courts, and paramilitary institutions, such as intelligence agencies.

Second, it is conceivable that aid institutions could begin to play a more prominent role in the counterterrorism mission, helping host governments implement strategies and programs to prevent the establishment and spread of radicalization.

Aid is linked to the third trend: placing more emphasis on training allies, with the goal of preventing conflict. Here, I pick up on a concept that Secretary Gates has underscored in recent speeches and writings, and particularly in his *Foreign Affairs* article, “Helping Others Defend Themselves” (Gates, 2010b). The idea is that the United States must invest more in
building partner capacity—both civil and military—so that other nations are better able to prevent or handle their own conflicts and thereby reduce the likelihood that they will evolve into crises that threaten the United States and its allies.

In short, these three policy shifts could well emerge as leading indicators of future structural changes and thus, ultimately, of future Pentagon budgets. An increase in the success of intelligence activities against, and the strength of civilian agencies’ ability to deal with, terrorist threats can contribute to our ability to alter our security commitments and reduce troop commitments overseas. Investment in human capital and allies’ greater capability to prevent and manage conflicts on their own can similarly lead to the ability to restructure security and troop commitments. In essence, these policy shifts could facilitate defense spending reductions by assuring our allies that we are not abandoning our commitments but merely trying to maintain them using a more cost-effective mix of approaches. However, if the policy shifts are not implemented, and relatively quickly, I believe that we will need to consider significant structural changes to our national security strategy and commitments.


