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CHAOS AND UNCERTAINTY THE FY2014 DEFENSE BUDGET AND BEYOND



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BY TODD HARRISON

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ABOUT THE AUTHOR

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I. THE FY 2014 DEFENSE BUDGET IN CONTEXT

The Obama Administration requested \$526.6 billion in discretionary funding and \$6.5 billion in mandatory funding in the base Department of Defense (DoD) budget for FY 2014. The budget did not initially include a request for Overseas Contingency Operations (OCO) funding and instead used a placeholder of \$88.5 billion, identical to the level of war funding in FY 2013. In May, DoD released its FY 2014 OCO budget request, which totaled \$79.4 billion. With this change, the total DoD request for FY 2014—including base and OCO—is \$612.5 billion.

The total defense-related budget, shown in Table 1, includes more than the DoD budget alone. The budget request also includes \$19.3 billion for defense-related atomic energy programs, \$8.0 billion for defense-related activities in other agencies, and \$150.0 billion for veterans' benefits and services. The treasury must also make an annual payment of \$70.3 billion to the Military Retirement Trust Fund to cover unfunded liabilities from prior years, and tax exemptions for military personnel result in \$15.2 billion in lost revenue. Together these expenses total \$875.2 billion, nearly a quarter of the total federal budget.

The FY 2014 request was developed during a period of high uncertainty in defense planning and budgeting. Congress was more than six months (193 days) late in passing the FY 2011 defense appropriations bill—the longest delay in enacting a defense appropriations bill since the budget process and start date of the fiscal year were revised in FY 1977. This delay in the FY 2011 appropriations bill contributed to a delay in the release of the FY 2012 budget request. Congress was again nearly six months late (177 days) in enacting the FY 2013 defense appropriations bill, which contributed to a delay in the release of the FY 2014 request. During each of these extended delays, the Department operated under a continuing resolution, which generally freezes funding at prior year levels and prohibits the start of new programs and the award of multi-year contracts. Congress also cut the base defense budget below the requested amount by \$20.7 billion in FY 2011 and \$22.7 billion in FY 2012, and sequestration cut \$37.2 billion from the FY 2013 request.

TABLE 1: SUMMARY OF DEFENSE-RELATED FUNDING IN THE FY 2014 BUDGET REQUEST

| Account | FY 2014 Request (in billions) |
|---|----------------------------------|
| DoD Base (discretionary) | \$526.6 |
| DoD Base (mandatory) | \$6.5 |
| DoD Overseas Contingency Operations | \$79.4 |
| DoD Total (051) | \$612.5 |
| Department of Energy | \$17.8 |
| Department of Labor | \$1.3 |
| Other Agencies | \$0.2 |
| Atomic Energy Total (053) | \$19.3 |
| Department of Justice | \$5.0 |
| Department of Homeland Security | \$1.6 |
| Other Agencies | \$1.4 |
| Defense-Related Activities Total (054) | \$8.0 |
| Department of Veterans Affairs (discretionary) | \$63.5 |
| Department of Veterans Affairs (mandatory) | \$86.1 |
| Other Agencies | \$0.4 |
| Veterans Total (700) | \$150.0 |
| Treasury Payment to the Military Retirement Trust | \$70.3 |
| Tax Exemptions for Military Personnel | \$15.2 |
| Other Total | \$85.4 |
| Total Defense-Related Spending | \$875.2 |

Effects of the FY 2013 Sequester

Perhaps the single largest contributor to the high level of uncertainty in the defense budget is the Budget Control Act of 2011 (BCA). The BCA set budget caps for defense, and these caps were automatically reduced upon the failure of the so-called Super Committee to produce an alternative for deficit reduction.¹ The BCA relies on sequestration as a mechanism to enforce spending cuts. Sequestration was initially set to go into effect on January 2, 2013 to enforce the FY 2013 budget caps. Both parties in Congress, the president, and the secretary of defense insisted that sequestration would not be allowed to go into effect, and no contingency plans were developed to mitigate the effects. On the eve of sequestration taking effect in January, Congress passed the American Taxpayer Relief Act of 2012 (ATRA), which delayed the implementation of sequestration to March 1, 2013 and reduced the amount of the FY 2013 sequester roughly in proportion to the two-month delay.

Ultimately, sequestration went into effect for FY 2013 and cut \$37.2 billion from defense accounts.² Sequestration occurred five months into the fiscal year, which meant the cuts had to be

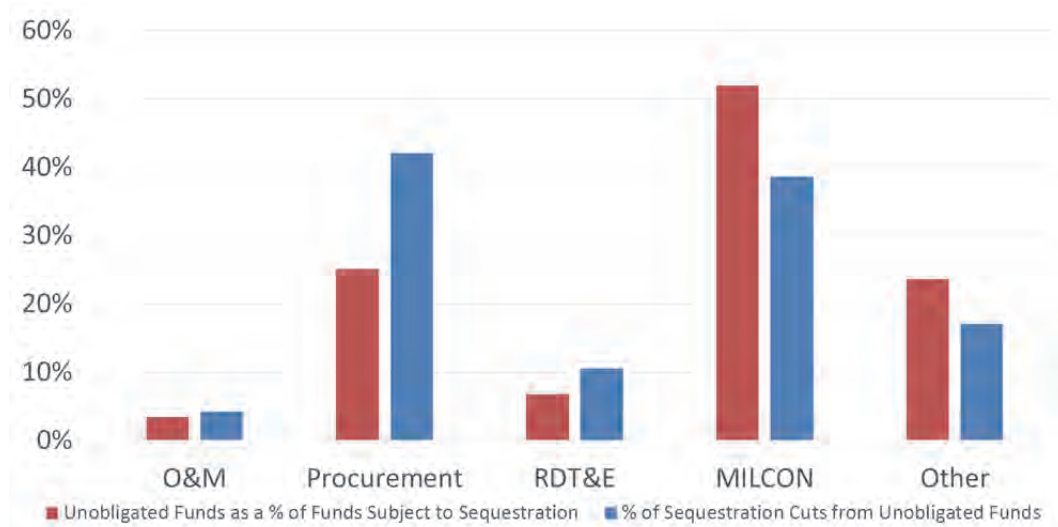
¹ The Super Committee, formally known as the Joint Select Committee on Deficit Reduction, was created by Congress in the BCA to develop an alternative deficit reduction package which would have reduced or eliminated the sequester cuts otherwise mandated by the law.

² Office of the Under Secretary of Defense (Comptroller), *Department of Defense Report on the Joint Committee Sequestration for Fiscal Year 2013* (Washington, DC: Department of Defense, June 2013) p. 1A.

absorbed in the remaining seven months of the year. While the BCA specifies that the cuts be applied as a “uniform percentage” across all applicable accounts, the actual amount of the reductions was not uniform due to various exemptions and exceptions. For example, President Obama elected to exempt military personnel accounts, which fund the pay and most benefits for uniformed members of the military. A section of the law known as the “crediting provision” prevented accounts that were already being reduced in the FY 2013 appropriations bill relative to their baseline level in FY 2012 from being reduced by more than sequestration would require. The “crediting provision” only applied to the FY 2013 sequester and will not apply in future years if sequestration is triggered again.³ The president, however, can continue to fully exempt military personnel accounts from sequestration or reduce them by a lesser percentage than sequestration would require.⁴ President Obama notified Congress on August 9, 2013 that military personnel accounts would again be fully exempt if sequestration is triggered for FY 2014.⁵

The total percentage cut from applicable accounts (excluding military personnel) in FY 2013 was 7.1 percent. The sequestration cuts applied to FY 2013 appropriated funds and prior year unobligated balances within non-exempt accounts at the program, project, and activity level. DoD had the flexibility to allocate how these cuts were applied within accounts, and it used this flexibility to cut prior year unobligated balances proportionately more than FY 2013 funds. Sixteen percent of the sequestration cuts came from unobligated balances even though unobligated balances only made up 12 percent of the total budgetary resources available for sequester.

FIGURE 1: COMPARISON OF SEQUESTRATION CUTS IN UNOBLIGATED FUNDS



Procurement and RDT&E accounts cut unobligated funds disproportionately more than their share of total funds subject to sequestrations, as shown in Figure 1. For example, while 25 percent of

³ The crediting provision is contained in §253(f)(2)(B) of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.

⁴ The authority to exempt or partially exempt military personnel accounts is found in §255(f) of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.

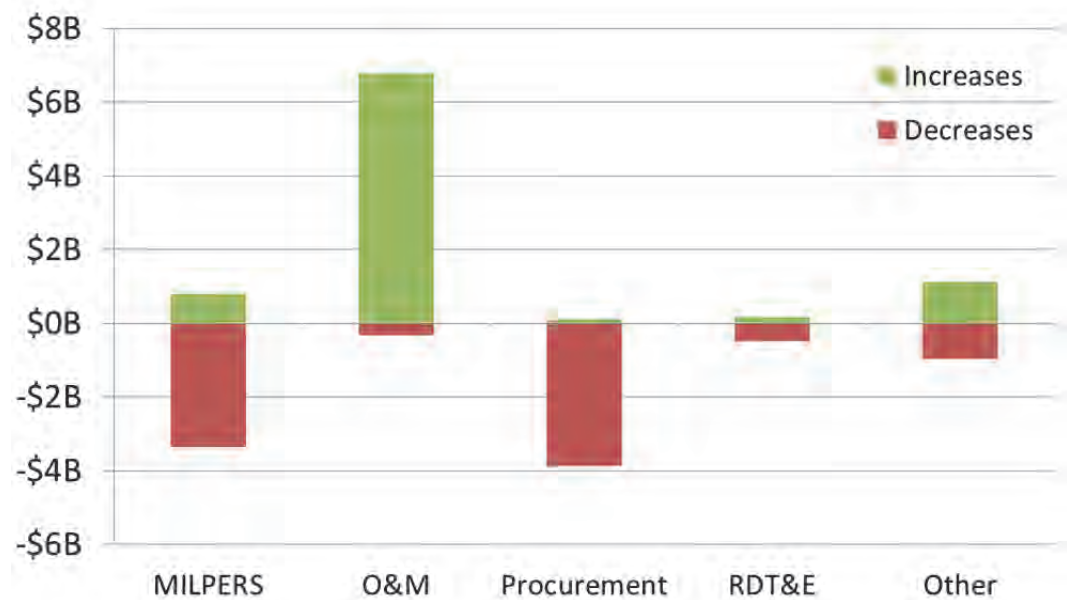
⁵ Sylvia Burwell, Director Office of Management and Budget, to The Honorable Joseph R. Biden, Jr., Washington DC, August 9, 2013, accessed on October 16, 2013 at http://www.whitehouse.gov/sites/default/files/omb/legislative/letters/military-personnel-letter-biden_080913.pdf.

When given flexibility, DoD chose to cut funding from procurement and RDT&E accounts in order to reduce cuts in O&M.

the procurement funds subject to sequestration came from unobligated funds, 42 percent of the cuts were made in unobligated funds. Cutting unobligated funds lessened the immediate impact of sequestration for FY 2013, but it did little to avert the long-term consequences. Moreover, because procurement and RDT&E accounts cut more heavily in unobligated funds in FY 2013, fewer unobligated funds will be available in FY 2014 to provide the same degree of buffer.

While Congress did not give DoD relief from the stringent rules by which sequestration is applied, DoD did receive reprogramming authority to move money among accounts after sequestration took effect. In May, DoD exercised this authority by proposing some \$9 billion in transfers among accounts. These transfers indicate how DoD intends to mitigate the across-the-board cuts of sequestration using the flexibility Congress granted it. The requested transfers call for a significant shift among accounts, with net reductions of \$2.6 billion for military personnel and \$3.8 billion for procurement, and a net increase of \$6.5 billion for operation and maintenance. The vast majority of the decrease in military personnel accounts came from the Army, which was able to reduce end strength faster than anticipated. The remainder of the transfers represents a net flow of funds from a wide array of modernization accounts (procurement and RDT&E) into operation and maintenance accounts to support near-term readiness and operational requirements.⁶ This indicates that when given flexibility, DoD chose to cut funding from procurement and RDT&E accounts in order to reduce cuts in O&M—trading future capabilities for near-term readiness.

FIGURE 2: DOD REPROGRAM REQUEST BY TITLE



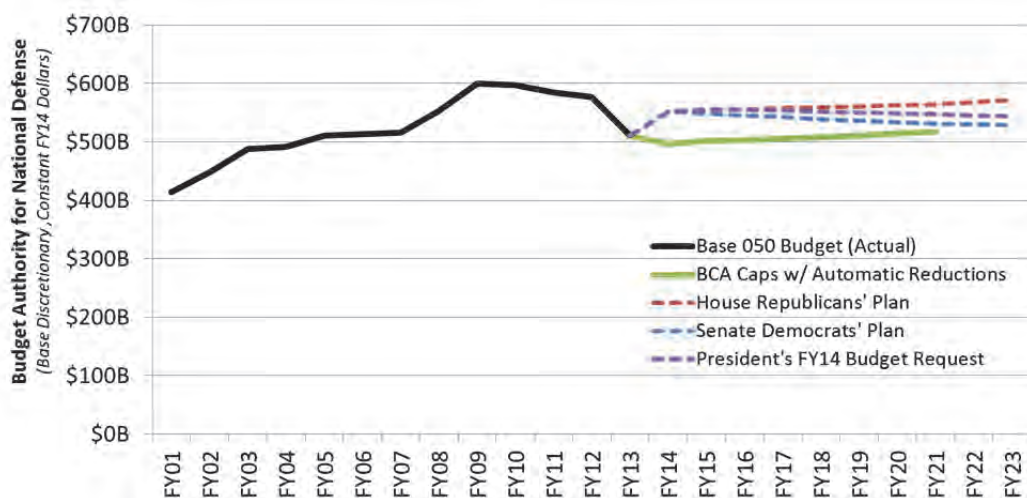
⁶ See Appendix for detailed data on sequestration cuts by budget title, Service, prior year unobligated, and current year funds.

Comparison of Budget Proposals

On April 10, less than six weeks after sequestration went into effect, the Obama administration released its FY 2014 budget request. Like the FY 2013 defense request, the new request does not comply with the BCA budget caps currently in effect for FY 2014, exceeding the caps by some \$52 billion. If Congress does not change the BCA and appropriates funding in excess of the budget caps, sequestration will again be triggered no later than January 15, 2014.

The Obama administration is not alone in failing to plan for BCA-level funding in FY 2014. The House and Senate each passed budget resolutions that propose virtually identical levels of funding for defense in FY 2014. However, they differ significantly in the remaining nine years of the projection period, as shown in Figure 3. The budget resolutions only specify funding at the level of the 050 budget function for national defense, which includes DoD as well as defense-related funding in other departments and agencies. The House budget resolution exceeds the defense budget caps by \$437 billion over the remaining eight years of the BCA (FY 2014 to FY 2021). The Senate budget resolution and the administration’s request exceed the defense budget caps by \$285 billion and \$377 billion, respectively, over the same period. All three proposals exceed the budget cap for FY 2014 by \$52 billion.

FIGURE 3: COMPARISON OF BUDGET PROPOSALS, FY 2014 TO FY 2023



II. OVERVIEW OF THE FY 2014 REQUEST

Whether sequestration goes into effect in FY 2014 or Congress provides DoD greater flexibility, as long as the budget caps remain in effect DoD will not be able to execute the budget it submitted.

Given the chaotic and uncertain budgetary environment, the FY 2014 request is not a reliable indicator of the future level of funding for individual programs and activities across the Defense Department because it exceeds the budget caps by more than ten percent. Whether sequestration goes into effect in FY 2014 or Congress provides DoD greater flexibility, as long as the budget caps remain in effect DoD will not be able to execute the budget it submitted. The budget does, however, provide insight into the priorities and direction of the Department and illustrates some of the serious challenges it must confront in a constrained funding environment.

Military Personnel

The base DoD budget request includes a total of \$177 billion in military personnel-related funding. The vast majority of this funding is through the military personnel (MILPERS) title of the budget, with the notable exception of the Defense Health Program in the operation and maintenance (O&M) title of the budget. Active component end strength in the FY 2014 base budget totals 1.36 million, down 2.9 percent from 1.40 million in FY 2013. Reserve component end strength declines slightly less from 842 thousand in FY 2013 to 834 thousand in FY 2014, a reduction of 1.0 percent.⁷

The single largest component of DoD's military personnel costs is basic pay for active duty personnel, the primary form of cash compensation service members receive. In the FY 2014 request, DoD proposes a raise of 1.0 percent in basic pay compared to the 1.8 percent that would be called for under the formula prescribed in current law.⁸ This one-time reduction in the annual pay raise would save \$0.54 billion in FY 2014 and an additional \$3 billion over the following four years.⁹ The request also includes \$28 billion in allowances for service members—the second largest component of cash compensation. The average increase in allowances is 4.2 percent for

⁷ Office of the Under Secretary of Defense (Comptroller), *Overview: United States Department of Defense Fiscal Year 2014 Budget Request* (Washington, DC: Department of Defense, April 2013), pp. A-2 to A-3.

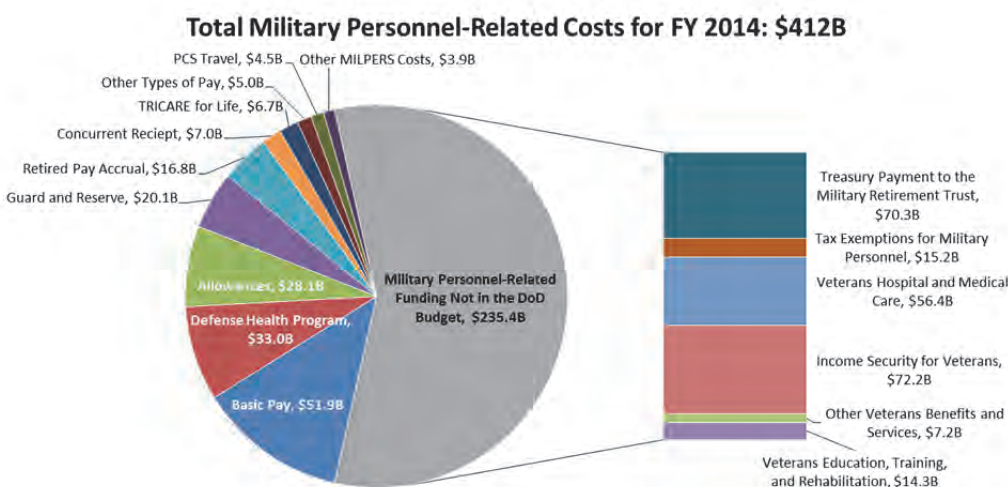
⁸ Under current law, military personnel receive an increase each year equal to the Employment Cost Index (ECI) for September 30th of the year before the budget request is submitted. The ECI for September 30, 2012 was 1.8 percent.

⁹ Office of the Under Secretary of Defense (Comptroller), *Overview: United States Department of Defense Fiscal Year 2014 Budget Request* (Washington, DC: Department of Defense, April 2013), p. 5-2.

housing and 3.4 percent for subsistence, both of which are in line with previous increases.¹⁰ Other forms of cash compensation, such as special and incentive pays, total \$5 billion in the request. This includes \$2.3 billion for recruiting and reenlistment bonuses, down by more than half from their peak in FY 2008.¹¹

The request also proposes a number of changes in military healthcare programs to reduce costs, most of which would not affect those currently serving. One of the proposed reforms is to increase the TRICARE Prime annual enrollment fee for retirees under the age of 65 over four years from the current level of \$539 annually per family to a variable fee defined as 4.0 percent of gross retirement pay, bounded between a floor of \$581 and a ceiling of \$1,200 annually. The annual fee for TRICARE for Life, which applies to military retirees over age 65, would gradually increase from the current level of \$0 annually to 2.0 percent of gross retirement pay up to a ceiling of \$613 annually. Pharmacy co-pays would increase gradually over five years, with the co-pay for a generic prescription at a retail pharmacy rising from \$5 per month to \$9, and brand-name drugs rising from \$17 per month to \$34. Prescriptions filled at a military treatment facility would remain free for active duty, retirees, and dependents.¹² In prior years, Congress has largely rejected changes to pay and benefits similar to those proposed in this year's budget. Importantly, the savings from these proposed reforms are assumed in the FY 2014 budget, which means that if these changes are again rejected by Congress the cost of military personnel will be substantially higher than the \$177 billion requested.

FIGURE 4: TOTAL COST OF MILITARY PERSONNEL IN THE FY 2014 FEDERAL BUDGET



The FY 2014 request includes some \$412 billion in total military personnel-related costs, \$177 billion in the DoD budget and \$235 billion paid through other parts of government.

Military personnel-related costs, however, are not limited to the DoD budget. When all military personnel-related expenses are taken into account, including the full cost of benefits and deferred compensation, the total cost is more than double the military personnel-related costs in the DoD budget. As shown in Figure 4, the FY 2014 request includes some \$412 in billion total military personnel-related costs, \$177 billion in the DoD budget and \$235 billion paid through other parts of government. The largest share of costs outside the DoD budget is through the Department of

¹⁰ Ibid.

¹¹ Ibid.

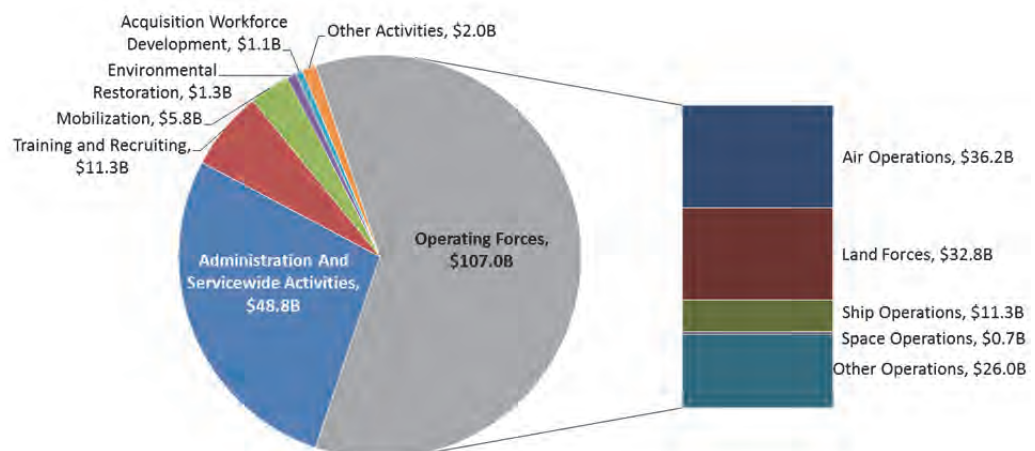
¹² Ibid, pp. 5-5 to 5-6.

Veterans Affairs, which includes \$56 billion for veterans' healthcare; \$72 billion for income security for veterans; \$14 billion for education, training, and rehabilitation benefits, such as the GI Bill; and \$7 billion in other veterans benefits and services. The Treasury Department must also make a \$70 billion payment to the military retirement trust fund in FY 2014 to cover unfunded liabilities. Finally, tax exemptions for military personnel result in a loss of some \$15 billion in annual revenue.

Operations and Maintenance

The total cost of peacetime operations and maintenance in the FY 2014 budget request, not including the Defense Health Program or war-related funding, is \$177 billion. Operating forces account for \$107 billion or 60 percent of the O&M budget, as shown in Figure 5. Within operating forces, air operations for the Air Force and Navy total \$36 billion.¹³ Land forces receive \$33 billion in the request for operations, readiness, and support, including \$2.1 billion for Marine Corps expeditionary forces. Ship operations for the Navy and Navy Reserve comprise \$11 billion of the request. The request also includes \$0.7 billion for unclassified space operations as part of the Air Force operations budget.

FIGURE 5: OPERATION AND MAINTENANCE FUNDING IN THE FY 2014 BASE BUDGET



The second largest component of the O&M budget is for administration and service-wide activities, which fund logistics, communications, support personnel, and other administrative activities within each of the Services. The request includes \$49 billion for these activities, including \$2.7 billion for DoD-operated K-12 schools, \$2.5 billion for service-wide communications, \$2.0 billion for the Office of the Secretary of Defense, and \$1.4 billion for the Defense Contract Management Agency. This part of the O&M budget also includes \$17 billion for classified programs, \$14 billion of which is funded through defense-wide accounts.

The request includes a total of \$11 billion for training and recruiting activities. More than half of this funding (\$6.2 billion) is for basic skills and advanced training activities, such as flight

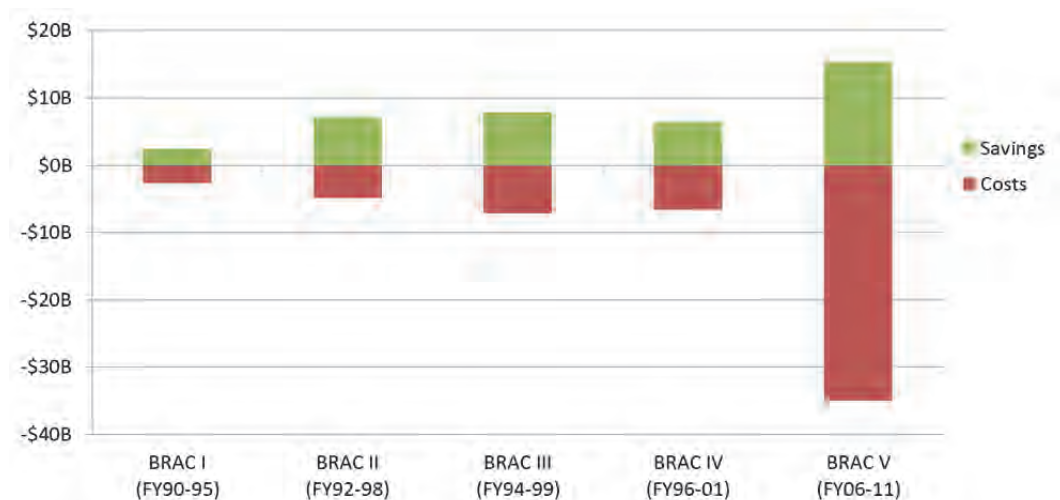
¹³ Air operations here is limited to funding classified under O&M Budget Activity 1: Operating Forces, Activity Group: Air Operations.

training, professional development education, and specialized skills. The budget allocates \$2.2 billion for accession training and \$1.0 billion for recruiting and advertising. The O&M budgets for the National Defense University and Defense Acquisition University are \$85 million and \$157 million, respectively, but exclude the cost of military personnel assigned to these institutions.

Base Closures

The request also proposes a round of base closures beginning in FY 2015. The last round of base closures began in 2005 and cost more to implement than all previous BRACs combined. The 2005 BRAC, the fifth one since the end of the Cold War, was different because it occurred during a period of increasing defense budgets and involved more realignments (moving organizations or functions from one location to another) than outright closures. As shown in Figure 6, the 2005 BRAC was also unique in that the costs greatly outweighed the savings during the implementation period. However, the recurring savings from the 2005 BRAC are estimated to be some \$5 billion annually, more than half of which is due to civilian and military positions eliminated as part of the BRAC.¹⁴ Because these savings will continue to accrue year after year, the 2005 BRAC will recoup the implementation costs and begin generating net savings on or about FY 2015.

FIGURE 6: COSTS AND SAVINGS OF PRIOR BRACS DURING THE PERIOD OF IMPLEMENTATION¹⁵



The challenge with conducting a BRAC during a budget downturn—besides the political hurdles it faces—is that closures and realignments cost money during the first few years of implementation and only begin to accrue net savings thereafter.

The challenge with conducting a BRAC during a budget downturn—besides the political hurdles it faces—is that closures and realignments cost money during the first few years of implementation and only begin to accrue net savings thereafter. Yet with the budget caps imposed by the BCA, savings are needed immediately. The FY 2014 request budgets \$2.4 billion in upfront costs for the BRAC from FY 2014 to FY 2018, and several billion more would likely be needed in the following two or three years beyond the FYDP. The proposal assumes 26,000 civilian positions

¹⁴ Department of Defense, *Base Realignment and Closure Executive Summary Program Year FY 2014* (Washington DC: Department of Defense, April 2013), p. 31.

¹⁵ *Ibid.*, pp. 11-66.

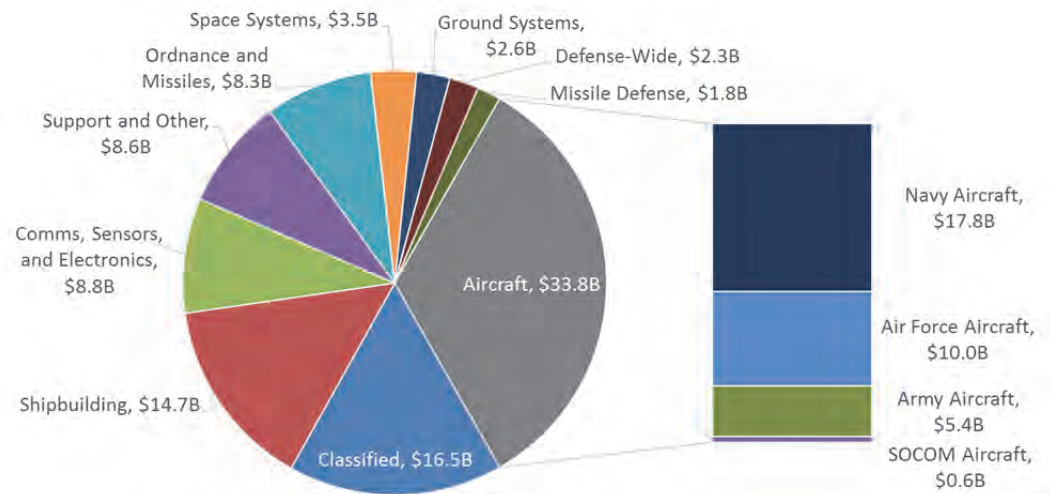
can be eliminated as part of the BRAC, which alone would generate roughly \$2.5 billion per year in recurring savings once fully implemented.¹⁶

This BRAC proposal is fundamentally different from the 2005 BRAC. DoD now appears to be proposing a BRAC much smaller in scope and more focused on producing savings by eliminating positions rather than moving jobs from one location to another. And unlike the BRAC proposed in last year's budget, which was rejected by Congress, this BRAC proposal includes an estimated level of funding for the upfront costs involved.

Modernization

The base budget for FY 2014 includes a total of \$167 billion in funding for the development, acquisition, and upgrade of military equipment, \$99 billion of which is in procurement funding and \$68 billion is in RDT&E funding. The largest category of procurement funding is for aircraft, totaling \$33.8 billion. As shown in Figure 7, more than half of the aircraft procurement funding is for the Department of the Navy, including programs such as the P-8 Poseidon (\$3.5 billion), the F-35B/C Joint Strike Fighter (\$2.8 billion), and the EA-18G Growler (\$2.0 billion). The largest items in the Air Force aircraft procurement budget are the F-35A Joint Strike Fighter (\$3.6 billion) and the C-5M modernization program (\$1.0 billion). The procurement request also includes \$16.5 billion for classified programs, nearly all of which is in the Air Force budget, and \$14.7 billion for shipbuilding and construction in the Navy budget.

FIGURE 7: PROCUREMENT FUNDING IN THE FY 2014 BASE BUDGET¹⁷



The RDT&E portion of the budget funds science and technology programs and the development and testing of new or upgraded weapon systems. Some 18 percent, or \$12 billion, of the RDT&E budget is for science and technology (basic research, applied research, and advanced technology

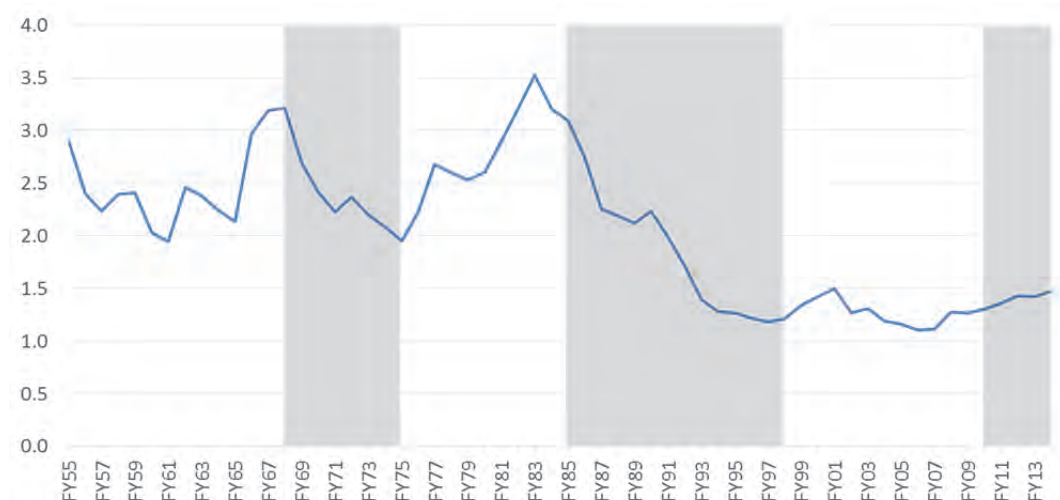
¹⁶ Annual recurring savings assumes an average cost per DoD civilian of \$95,000, which is calculated by dividing the total cost of civilians in FY 2014 request (\$76.3 billion) by the total number of DoD civilians (801,000 full time equivalents).

¹⁷ Procurement funding data is derived from Office of the Under Secretary of Defense (Comptroller), *Procurement Programs (P-1)* (Washington, DC: DoD, April 2013). Categories were assigned by the author on a line-by-line basis.

development). These projects are not directly linked to specific acquisition programs but rather are intended to advance the state of knowledge and technology in general. The remaining 82 percent of the RDT&E budget is for advanced component development (\$12.1 billion), system development and demonstration (\$13.7 billion), management support (\$4.3 billion), and operational system development (\$25.5 billion).

Since FY 1955, the ratio of procurement to RDT&E funding has averaged 2.1, meaning DoD has spent more than twice as much on procurement as on RDT&E. The ratio has declined over the past several decades, as shown in Figure 8, to reach a low in FY 2006 of 1.1. In prior downturns in defense spending, shown by the gray shaded areas in Figure 8, the ratio fell as the overall defense budget declined, meaning procurement funding was cut proportionally more than RDT&E funding. If this trend were to occur again in the current downturn, the ratio could fall below 1.0, meaning that for the first time in modern history DoD would be spending more on developing new technologies and systems than procuring equipment. Since the current downturn began in FY 2010, however, the ratio of procurement to RDT&E funding has steadily increased, meaning RDT&E funding has been cut proportionately more than procurement.

FIGURE 8: RATIO OF PROCUREMENT TO RDT&E FUNDING



War Funding

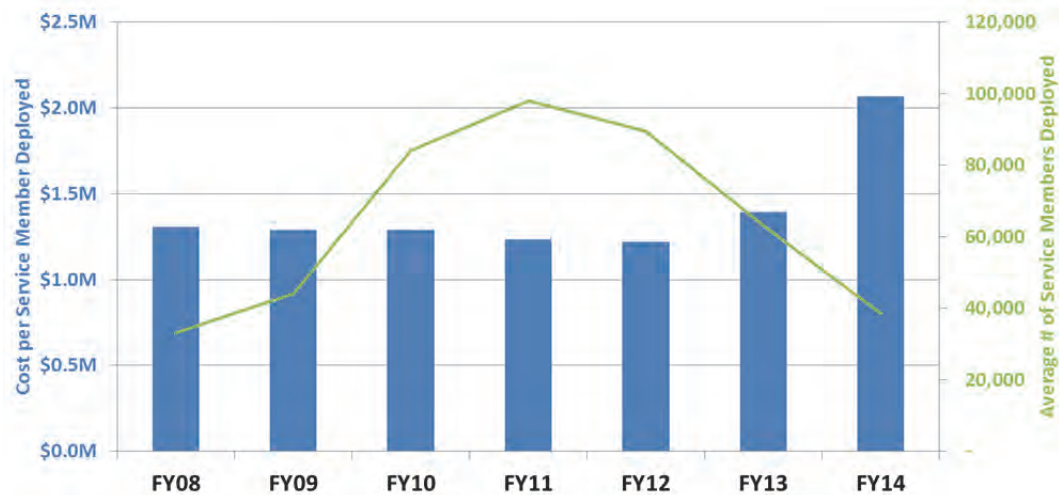
The FY 2014 OCO budget, submitted as a separate budget amendment in May 2013, requests \$79.4 billion for operations in Afghanistan, \$1.3 billion for Iraq, and \$1.3 billion in cancellations of prior year funding (which counts as negative budget authority in FY 2014). The budget assumes that the level of U.S. forces in Afghanistan will gradually decline through FY 2014 as the combat mission ends, with an average end strength of 38,431 in FY 2014 compared to 63,181 in FY 2013 and 89,446 in FY 2012.

The OCO request assumes a 39 percent reduction in U.S. forces in Afghanistan, but funding for Afghanistan declines by only 10 percent. As shown in Figure 9, the cost per service member deployed to Afghanistan rises to \$2.1 million in FY 2014, compared to an average cost of \$1.3 million per deployed service member from FY 2008 to FY 2013. One explanation offered for this apparent discrepancy is the added cost of closing bases and shipping equipment and personnel

The cost per service member deployed to Afghanistan rises to \$2.1 million in FY 2014, compared to an average cost of \$1.3 million per deployed service member from FY 2008 to FY 2013.

back to the United States as forces leave Afghanistan. However, one would also expect to have observed a similar increase in costs when these forces were initially deployed to Afghanistan. During the surge years, troops and equipment were shipped into theater, bases were built or expanded, and new equipment was purchased (such as Mine Resistant Ambush Protected vehicles). These initial deployment costs could in theory be greater than redeployment costs, especially given that large amounts of equipment are not being returned to the United States during the drawdown currently underway. As Figure 9 illustrates, however, no such increase in the cost per deployed service member was observed during the surge of forces to Afghanistan in FY 2010 and FY 2011.

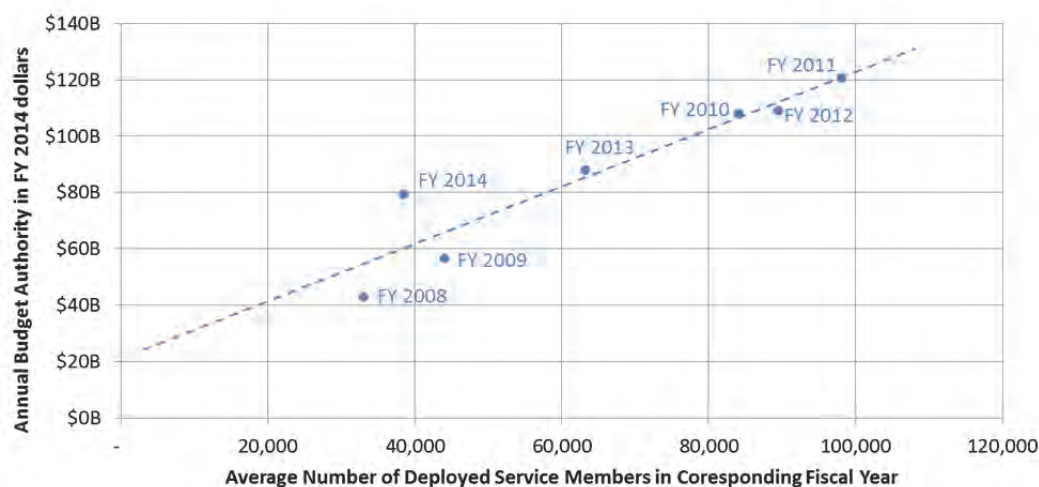
FIGURE 9: COST PER SERVICE MEMBER IN AFGHANISTAN¹⁸



Another possible explanation for the increase in the cost per service member is that not all war-related costs scale with the number of troops. Some costs should, in theory, be independent of the size of the U.S. forces in Afghanistan. For example, the cost of training and equipping Afghan security forces (\$7.7 billion in FY 2014) should depend more on the size of the Afghan forces than the size of U.S. forces. Funding for other activities, such as intelligence, surveillance, and reconnaissance operations, are not likely to decline significantly even as the level of deployed forces falls. When the annual cost of operations in Afghanistan is plotted versus the average number of deployed service members, as shown in Figure 10, a somewhat linear relationship is observed. This plot suggests that the fixed costs of operations in Afghanistan are roughly \$20 billion annually (the y-axis intercept of the trend line), although the funding requested for FY 2014 still lies well above the trend line.

¹⁸ Department of Defense, *Fiscal Year 2014 Budget Request Addendum A: Overseas Contingency Operations* (Washington, DC: May 2013) p. 2.

FIGURE 10: COSTS VERSUS NUMBER OF DEPLOYED SERVICE MEMBERS IN AFGHANISTAN



A third possible explanation is that OCO funding is being used for costs that previously had been paid using base funding. Both Congress and the Defense Department have an incentive to migrate costs from the base to the OCO budget because this helps avoid the budget caps imposed by the BCA. The Army and Marine Corps explicitly migrated a portion of their military personnel costs to the OCO budget beginning in FY 2013 when the Services announced plans to reduce end strength over the coming years. These costs total \$5.1 billion in the FY 2014 OCO request, down from \$5.8 billion in FY 2013. Because these costs were already in the OCO budget prior to the FY 2014 request, the increase in the cost per service member in FY 2014 cannot be attributed to them.

Examining the OCO request by major account and by Service reveals that O&M costs for the Army and Air Force increased from FY 2013 to FY 2014, as shown in Table 2. O&M costs in the OCO request typically include the additional cost of deploying, operating, and supporting forces above the normal peacetime level of operations. A somewhat gray area is the cost of pre-deployment training, which can overlap with normal peacetime training activities because some of this training would have occurred even if forces were not deploying.

The increase in Army and Air Force O&M costs could mean that the Services are categorizing roughly \$20 billion of peacetime training activities as pre-deployment training in the OCO request. While this budget maneuver avoids pushing the base budget farther over the budget caps prescribed in the BCA, it also means that the base budget does not have an adequate level of funding for regular peacetime training activities. As the military completes its withdrawal from Afghanistan and OCO funding diminishes over time, the OCO O&M budget may no longer be able to continue supplementing the base O&M budget. O&M funding in the base budget will need to increase to accommodate these additional costs, and in a budget capped environment that will require offsetting cuts in other accounts.

TABLE 2: COMPARISON OF OCO COSTS FROM FY 2013 TO FY 2014

| | FY 2013 Enacted (Thousands of Dollars) | FY 2014 Request (Thousands of Dollars) | % Change |
|--|---|---|-------------|
| Military Personnel | | | |
| Army | \$ 10,667,022 | \$ 7,309,104 | -31% |
| Navy | \$ 2,328,868 | \$ 1,649,798 | -29% |
| Air Force | \$ 1,265,404 | \$ 894,438 | -29% |
| Defense-Wide | \$ - | \$ - | N/A |
| <i>Total</i> | \$ 14,261,294 | \$ 9,853,340 | -31% |
| Operation and Maintenance | | | |
| Army | \$ 33,451,520 | \$ 37,527,659 | +12% |
| Navy | \$ 10,037,675 | \$ 8,320,189 | -17% |
| Air Force | \$ 9,344,854 | \$ 10,060,273 | +8% |
| Defense-Wide | \$ 9,770,652 | \$ 7,726,350 | -21% |
| <i>Total</i> | \$ 62,604,701 | \$ 63,634,471 | 2% |
| Procurement | | | |
| Army | \$ 4,087,437 | \$ 2,684,456 | -34% |
| Navy | \$ 1,407,241 | \$ 659,498 | -53% |
| Air Force | \$ 3,136,423 | \$ 2,147,498 | -32% |
| Defense-Wide | \$ 1,288,099 | \$ 126,275 | -90% |
| <i>Total</i> | \$ 9,919,200 | \$ 5,617,727 | -43% |
| Research, Development, Test, and Evaluation | | | |
| Army | \$ 29,660 | \$ 7,000 | -76% |
| Navy | \$ 52,519 | \$ 34,426 | -34% |
| Air Force | \$ 3,150 | \$ 9,000 | +186% |
| Defense-Wide | \$ 112,387 | \$ 22,061 | -80% |
| <i>Total</i> | \$ 197,716 | \$ 72,487 | -63% |
| Military Construction | | | |
| Army | \$ (120,568) | \$ - | -100% |
| Navy | \$ 150,768 | \$ - | -100% |
| Air Force | \$ (30,200) | \$ - | -100% |
| Defense-Wide | \$ - | \$ - | N/A |
| <i>Total</i> | \$ - | \$ - | N/A |
| Other | | | |
| Army | \$ 42,600 | \$ 44,732 | +5% |
| Navy | \$ - | \$ - | N/A |
| Air Force | \$ 10,000 | \$ 88,500 | +785% |
| Defense-Wide | \$ 191,000 | \$ 131,678 | -31% |
| <i>Total</i> | \$ 243,600 | \$ 264,910 | +9% |

III. PRIOR DEFENSE BUDGET CYCLES

Since the end of World War II, the U.S. defense budget has risen and fallen in irregular cycles driven by both external threats and internal politics. The budget appears to be in the drawdown phase of one of these cycles—the fourth drawdown over the past six decades—which could have important implications for future defense capabilities and U.S. foreign policy. The defense budget reached its post-World War II high in FY 2010 and has since declined 21 percent (adjusting for inflation) through FY 2013, or 12 percent if war-related funding is excluded.¹⁹ The total decline in FY 2013 alone was 13 percent (or 9.9 percent excluding war-related funding) due to sequestration and the ongoing drawdown in Afghanistan. This was the largest single-year percentage decline in the defense budget since the end of the Korean War. If prior drawdowns are any indicator, however, this drawdown may be far from over.

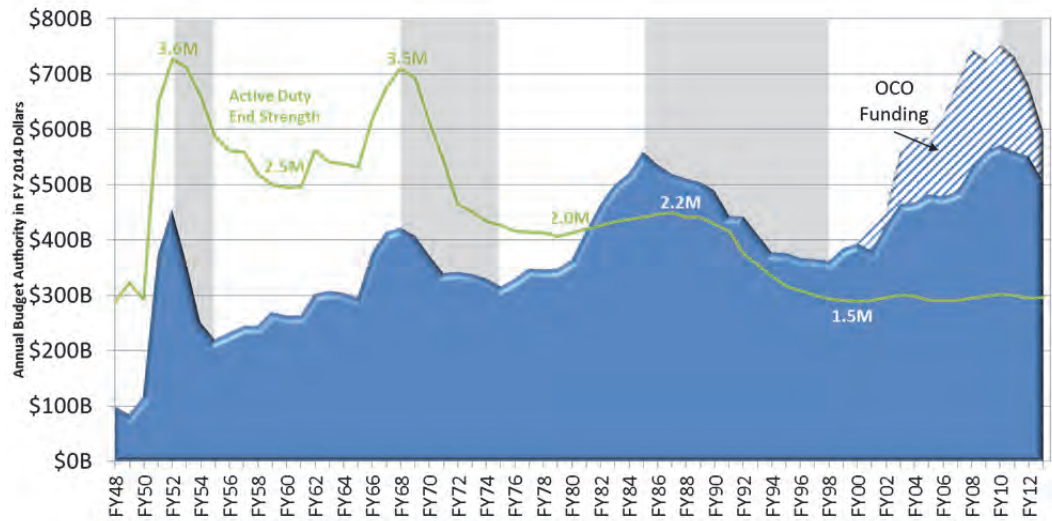
Figure 11 shows the total DoD budget and active duty military end strength over time, with the grey-shaded regions indicating the downturn phase of each budget cycle. At the end of the Korean War, for example, the defense budget fell 51 percent over three years, and total active duty end strength fell by 32 percent. Following the Vietnam War, the defense budget declined 25 percent over seven years while end strength declined 43 percent. In the 1980s, the budget peaked in FY 1985 and declined by 35 percent over the following 13 years, while end strength also declined by 35 percent. If the budget caps under the BCA stay in effect through FY 2021, as currently prescribed in law, and war-related supplemental funding is phased out by that time, the current drawdown would total 34 percent. Current DoD plans, which do not account for the cuts prescribed under the BCA, project a 7 percent decline in end strength.

In previous buildups, the military increased active duty end strength as its budget grew: an increase of 2 million personnel for the Korean War, 1 million for Vietnam, and more than 200 thousand during the 1980s buildup. In contrast, the most recent buildup did not involve a significant increase in the size of the force. Active duty end strength hovered around 1.5 million over the past decade as the Army and Marine Corps grew and the Air Force and Navy shed personnel. The lack of growth during the most recent buildup complicates the drawdown for DoD. If the Department reduces end strength in proportion to prior drawdowns, roughly one third or more, end strength would fall below 1.0 million for the first time since 1940.

If the budget caps under the BCA stay in effect through FY 2021 and war-related supplemental funding is phased out by that time, the current drawdown would total 34 percent.

¹⁹ Unless otherwise noted, all dollar figures in this paper are in FY 2014 constant dollars. Figures are adjusted for inflation using the GDP deflator from Office of Management and Budget Historical Table 10.1 in the FY 2014 President's Budget.

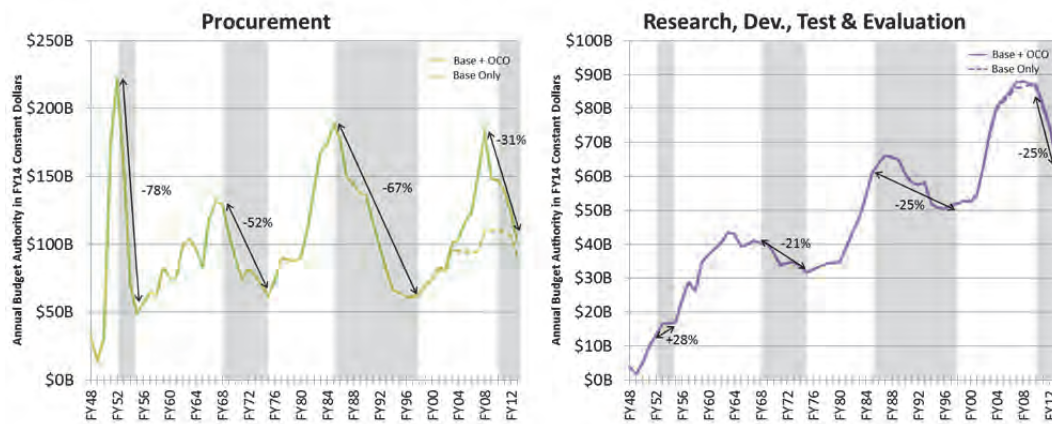
FIGURE 11: U.S. DEFENSE BUDGET CYCLES FY 1948 TO FY 2013



Analysis of Prior Drawdowns by Major Account

End strength reductions are by no means the only option for DoD in a drawdown. In prior drawdowns, reductions in end strength have been accompanied by reductions in other areas as well, such as procurement and RDT&E funding to develop and field new equipment and O&M funding to train personnel, maintain equipment, and otherwise support the force.

FIGURE 12: TRENDS IN MODERNIZATION FUNDING²⁰



Procurement funding, shown on the left in Figure 12, is most directly correlated to the overall defense budget in terms of timing. In past drawdowns, the decline in procurement funding began and ended in the same years as the overall decline in the defense budget. While some procurement costs scale with the size of the force, since more people means more equipment will be needed, procurement costs can also vary independent of end strength as technology is used to substitute for

²⁰ Data derived from *National Defense Budget Estimates for FY 2014*, Tables 2-1 and 6-8.

labor. More advanced and expensive weapons systems can sometimes do the job of multiple legacy systems and can require fewer people to operate.

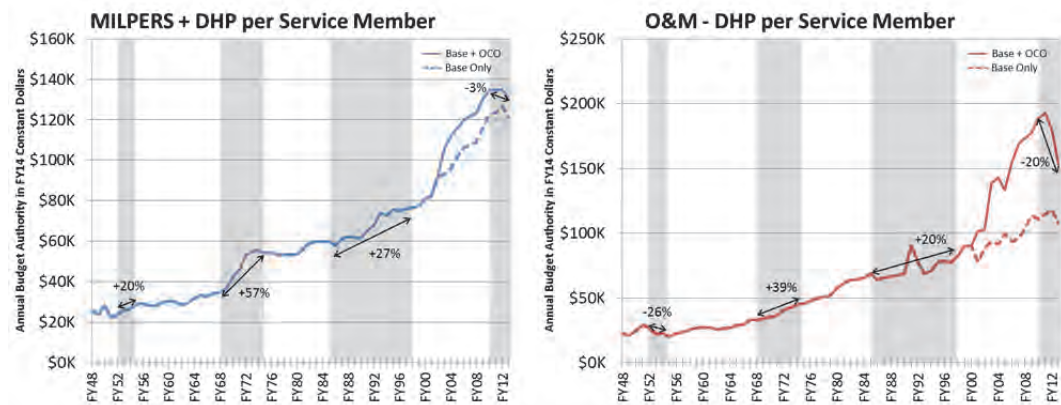
In the current budget cycle, the peak in procurement spending occurred in FY 2008, two years before the overall budget reached its high point. The FY 2008 peak in procurement funding coincided with a spike in war-related funding for the procurement of Mine Resistant Ambush Protected (MRAP) vehicles, deemed an urgent priority for on-going operations in Iraq and Afghanistan. Much of the most recent buildup in procurement spending was for war-related equipment and supplies. While the overall procurement budget increased 134 percent from FY 1998 to FY 2010, the base procurement budget increased 78 percent. Since the current downturn began in FY 2010, procurement funding has declined 31 percent overall, much of which is due to reductions in war-related procurements. It is also notable that in the both of the past two drawdowns, the procurement budget fell to roughly \$62 billion in FY 2014 dollars. If procurement funding reaches a similar floor in the current drawdown, it would mean an additional reduction of more than one third from the FY 2013 level of funding.

In contrast to the highly cyclic nature of procurement accounts, funding for research, development, test, and evaluation (RDT&E) looks more like a step function over time, as shown on the right in Figure 12. In each prior budget cycle, RDT&E funding grew more during the buildup phase than it declined during the drawdown. RDT&E costs are the upfront investment needed to develop new technologies and weapon systems. Unlike procurement funding, RDT&E costs generally do not scale as readily because the cost of development is fixed relative to the number of systems procured. For example, the Department can reduce the quantity of a particular weapon it plans to buy in a downturn and procurement funding will fall roughly in proportion, but RDT&E costs will not. In the current downturn, RDT&E funding has already fallen by as much or more than in all previous downturns. This is due to a number of major programs being cancelled while still in development, such as Future Combat Systems (FCS) and Transformational Satellite Communications (TSAT), and major programs such as the Joint Strike Fighter transitioning from development to production. Additional cuts in RDT&E funding would likely mean delayed development schedules and fewer new program starts relative to current plans.

In the past two drawdowns, the procurement budget fell to roughly \$62 billion in FY 2014 dollars.

FIGURE 13: TRENDS IN MILITARY PERSONNEL AND O&M FUNDING PER SERVICE MEMBER²¹

Military personnel costs not only grew on a per person basis during previous downturns, they grew faster during the downturns than during the buildups.



The budgets for MILPERS and O&M exhibit a distinctly different pattern than funding for procurement and RDT&E. MILPERS and O&M costs logically scale with the size of the force because a larger force means there are more people to pay, train, and otherwise support. Looking at these costs on a per person basis isolates the effects of changing the size of the force from growth in the cost of paying and supporting personnel. As shown in Figure 13, MILPERS and O&M costs on a per person basis have been rising steadily over time regardless of whether the overall budget was rising or declining.²²

Military personnel costs not only grew on a per person basis during previous downturns, they grew faster during the downturns than during the buildups. During the Vietnam buildup, for example, MILPERS per person grew at a real annual rate of 1.4 percent while during the downturn it grew at 6.7 percent. The higher rate of growth during that downturn was due in part to the transition to an all-volunteer force. Basic pay for junior personnel was increased substantially to attract a sufficient number of volunteers so that conscription would no longer be necessary. Similarly, in the 1980s budget cycle personnel costs grew at a real annual rate of 1.0 percent during the buildup and 1.9 percent during the downturn. In the current budget cycle, personnel costs grew at a real annual rate of 4.8 percent during the buildup (FY 1998 to FY 2010)—a significantly higher rate of growth than in previous buildups. This was due to a combination of higher pay raises than requested, broader use of enlistment and reenlistment bonuses, rapid growth in healthcare costs, and the enactment of new and expanded benefits. Excluding war-related personnel costs, the real annual rate of growth was 4.0 percent. In the first three years of the downturn, however, the cost per person has declined at a real rate of 0.9 percent due to reductions in war-related compensation costs.

This cycle may be different when it comes to personnel costs because the wars in Iraq and Afghanistan were the first major, protracted conflicts in American history fought with an all-volunteer force. Some of the enticements used to maintain recruiting and retention during the conflicts, such as bonuses, are inherently temporary. These measures should no longer be necessary once U.S. forces return home, making some part of the growth reversible in the

²¹ Data derived from *National Defense Budget Estimates for FY 2014*, Tables 2-1, 6-8, and 7-5.

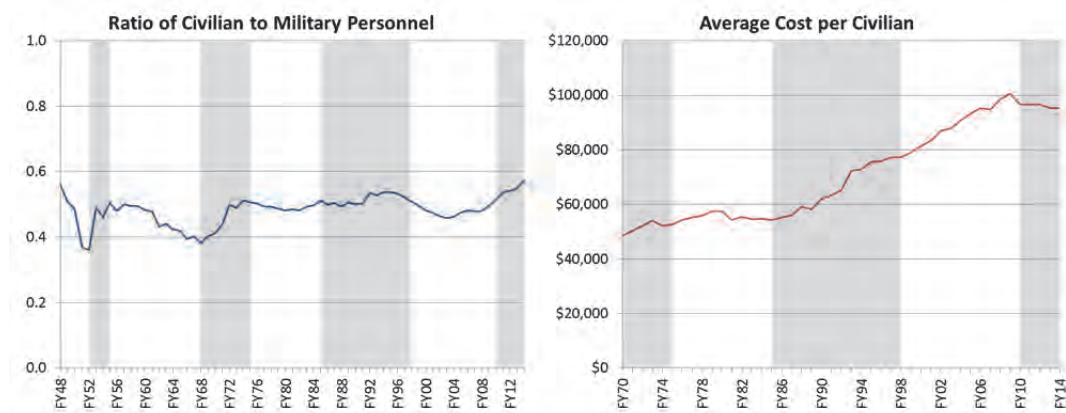
²² For the purposes of this analysis, the Defense Health Program (DHP) budget is allocated to military personnel rather than O&M. DHP funds the military healthcare system for active duty and retired service members.

downturn, as has already been observed. However, other increases in military compensation costs, such as new and expanded benefits and healthcare, are not automatically reversible in a downturn and may drive additional growth in the coming years as the cost of providing these benefits continues to grow.

The O&M budget funds military operations, training, maintenance of equipment, and support for military installations around the world. As shown in Figure 13, O&M funding on a per person basis grew at a somewhat consistent real annual rate of 2.8 percent from the end of World War II to the beginning of the war in Afghanistan. While the total O&M budget grew due to the conflicts in Korea and Vietnam, this growth was offset by a proportionate increase in military end strength, keeping the cost per person on its steady trajectory. The wars in Iraq and Afghanistan, however, did not hold to this pattern. Because the size of the military did not increase substantially over the past decade, the additional cost of operations in Iraq and Afghanistan resulted in a significantly higher cost per person. Included in the higher O&M cost per service member is the cost of contingency contractors used to perform services on the battlefield that were previously performed by uniformed military personnel, such as laundry, food service, maintenance, and some security functions. As one would expect, war-related O&M costs appear to be reversible because as the number of deployed service members has declined the O&M cost per person has also declined. If war-related costs are excluded, the annual growth in O&M costs per person from FY 2001 to FY 2013 remained steady at 2.8 percent, identical to the historical trend over the preceding five decades.

The O&M budget is also the primary source of funding for DoD's 800,000 civilian workers. DoD civilians support the uniformed military in a variety of functions, such as acquisition management, training, maintenance, and administration. Since the end of World War II, the ratio of civilian to active duty military personnel has averaged 0.48, meaning there have been roughly half as many civilian workers as uniformed military. Historically, this ratio has varied in counter cyclical manner, declining during buildups and increasing during drawdowns, as shown in Figure 14 where the gray-shaded areas represent drawdowns in the overall defense budget. In the most recent buildup, however, the size of the active force did not increase substantially while the size of the civilian workforce did. The ratio of civilian to military personnel has increased since FY 2003 as more than 120,000 civilians have been added to the workforce. In the FY 2014 request, the ratio of civilian to military personnel is projected to reach 0.57, the highest level since the end of World War II.

FIGURE 14: SIZE AND COST OF THE DOD CIVILIAN WORKFORCE



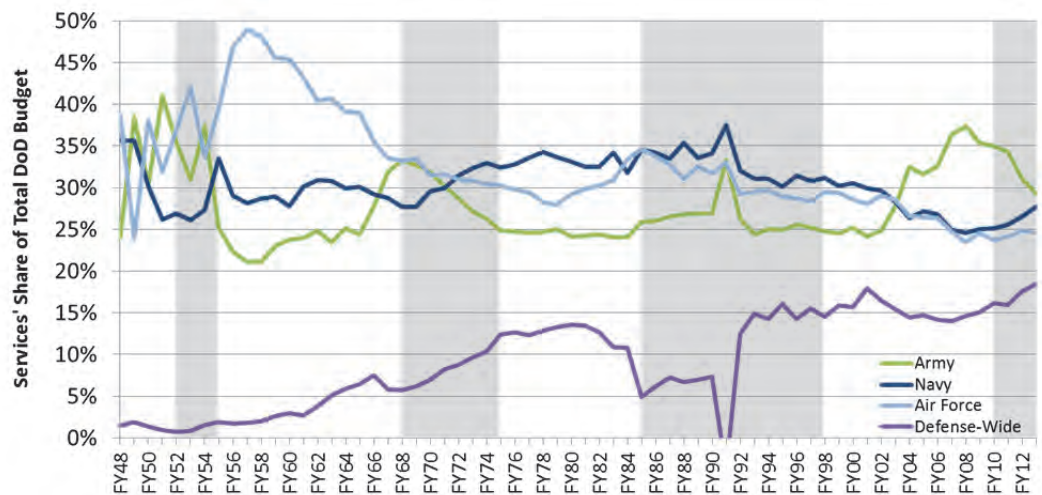
The cost of DoD civilians, much like the cost of military personnel, has risen regardless of overall budget cycles and, like military personnel costs, has accelerated during downturns. Civilian personnel costs grew at a real annual rate of 1.9 percent from FY 1998 to FY 2010, compared to 4.8 percent for military personnel over the same period (4.0 percent if war-related costs are excluded). The average cost per civilian has declined so far in this drawdown, due in part to three consecutive years without a pay raise. Even in a period of low inflation, stagnant pay amounts to a real reduction in pay. The FY 2014 request does not provide a detailed plan for reducing the civilian workforce, beyond the 26,000 personnel that would be cut as part of a BRAC. If historical trends hold true, however, the civilian workforce could be cut by one-fifth to one-third from its current level, and the cost per civilian employee could begin growing again at 1 to 2 percent above inflation.

Analysis of Prior Drawdowns by Service

A persistent myth in defense circles is that the Services' each receive equal shares of the budget, creating an equilibrium that is difficult, if not impossible, to break. In truth, the Services have never received equal shares of the budget. Moreover, the Services' shares of the budget have varied significantly over time and the defense-wide share of the budget has grown significantly. Since the end of World War II, each Service has at one point been at the top, receiving a greater share than the other two. As shown in Figure 15, the Air Force garnered the largest share of the budget from FY 1955 to FY 1967, the Navy received the greatest share for all but two years from FY 1972 to FY 2002, and the Army has received the most since FY 2003.

FIGURE 15: SERVICES' SHARE OF THE DOD BUDGET AUTHORITY, FY 1948 TO FY 2013²³

Previous drawdowns have resulted in significant budgetary shifts among the Services.



Previous drawdowns have resulted in significant budgetary shifts among the Services. In the drawdown following the Korean War, the Army budget was cut disproportionately more than the other Services, falling by 65 percent. In comparison, the Air Force budget dropped by 48 percent

²³ Data derived from Office of the Under Secretary of Defense (Comptroller), *National Defense Budget Estimates for FY 2014* (Washington, D.C., Department of Defense: May 2013), Table 6-10.

and the Navy fell by 39 percent.²⁴ Defense-wide accounts, which do not belong to a Service but report directly through the Office of the Secretary of Defense, grew by 27 percent during the post-Korean War downturn, although they remained relatively small at just 2 percent of the total DoD budget.

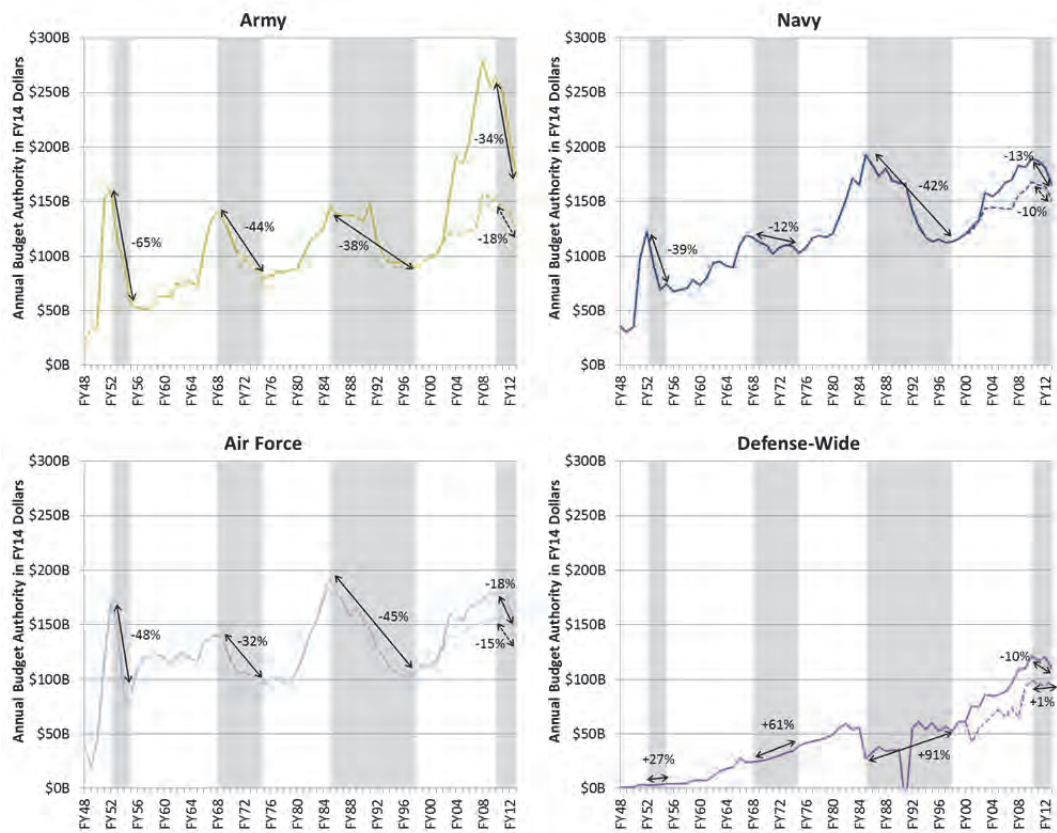
This shift in resources was in part a result of Eisenhower's "New Look" at defense, which called for a greater reliance on nuclear weapons to deter Soviet aggression rather than maintaining a large ground force to wage another large-scale, conventional conflict like Korea. This policy was formalized in National Security Council (NSC) document 162/2, which was finalized on October 30, 1953.²⁵ The first budget submitted under the new strategy was the FY 1955 request, delivered to Congress in January 1954. This budget marked the end of the drawdown and a significant shift in resources among the Services. The Air Force emerged from the Korean War drawdown with the largest share of the budget, receiving an average of 42 percent of the total DoD budget from FY 1955 to FY 1967 as it built its strategic bomber and missile forces. In comparison, the Army received an average budget share of 24 percent and the Navy 30 percent over the same period.

The Vietnam drawdown marked another shift in resources among the Services. In this drawdown, the Army and Air Force were cut by 44 percent and 32 percent, respectively, while the Navy was reduced by only 12 percent. Defense-wide accounts grew by 61 percent during the downturn, exceeding ten percent of the total budget for the first time in FY 1973. The Navy took command of the budget in FY 1972, receiving the largest share of the budget for 29 of the next 31 years, averaging 33 percent.

The 1980s budget cycle was different from Vietnam and Korea because the buildup was not driven by an armed military conflict. As a result, the 1980s buildup focused more on procurement of weapon systems, many of which had their technological roots in the RDT&E investments of the 1970s, such as space-based capabilities, precision-guided munitions, and stealth. The 1980s buildup favored the Air Force, increasing its budget by 102 percent compared to an 84 percent increase for the Army and an 88 percent increase for the Navy. At the peak of the buildup, the Air Force briefly regained its place at the top of the budget. The downturn that followed was more evenly distributed, with the Army and Navy being cut by 38 percent and 42 percent, respectively, and the Air Force by 45 percent. As in previous downturns, defense-wide accounts experienced an increase in funding even as the overall budget declined.

²⁴ The Marine Corps budget is included in the Department of the Navy's budget and thus is not analyzed separately.

²⁵ A digital copy of NSC 162/2 can be found at: <https://www.fas.org/irp/offdocs/nsc-hst/nsc-162-2.pdf>.

FIGURE 16: TRENDS IN SERVICE BUDGETS²⁶

In the drawdown underway for the past three years, the Services' budgets have declined at dissimilar rates. The Army budget has seen the greatest decline, 34 percent, due primarily to the reduction in war-related funding, while the Air Force and Navy budgets have declined 18 percent and 13 percent respectively. Even defense-wide accounts have declined by 10 percent during this drawdown, driven by a reduction in war-related funding for activities such as the Joint Improvised Explosive Device Defeat Organization (JIEDDO). Even if war-related funding is excluded, the reductions in this drawdown follow a similar pattern, with the Army base budget declining the most (18 percent), followed by the Air Force (15 percent) and the Navy (10 percent). The defense-wide base budget, however, has increased 1 percent over the past three years.

²⁶ Data derived from Office of the Under Secretary of Defense (Comptroller), *National Defense Budget Estimates for FY 2014* (Washington, D.C., Department of Defense: May 2013), Tables 2-1 and 6-10.

IV. WHAT TO EXPECT IN THE CURRENT DRAWDOWN

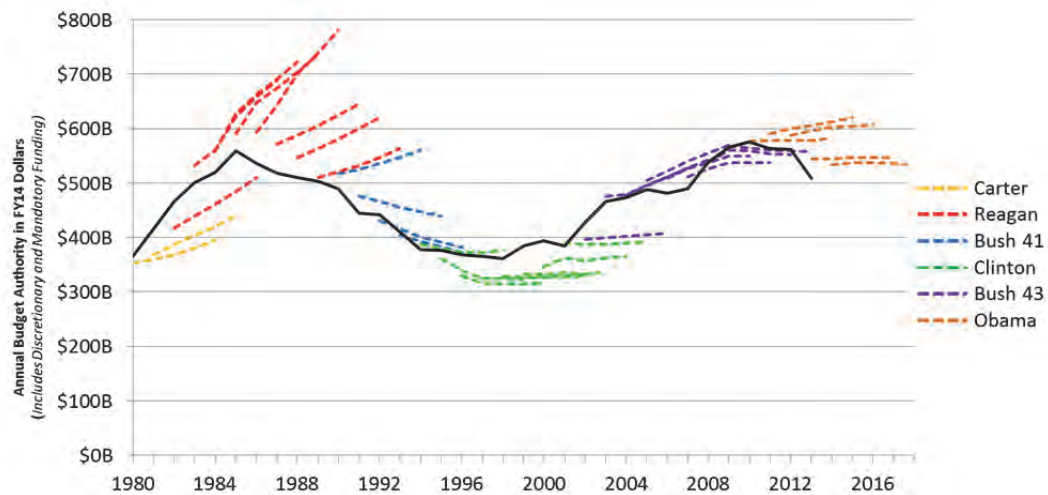
What is not yet known is how much more the defense budget will decline during this drawdown and what shape that decline will take. While prior drawdowns are useful to understand the type of change this drawdown could portend, historical trends are not a reliable predictor of future decisions regarding the defense budget's size and shape. The current drawdown is unique in many ways, just as each of the prior drawdowns analyzed were unique in their own ways. The current drawdown is fundamentally different because the buildup was driven by two large-scale, simultaneous, protracted wars fought with an all-volunteer force. Moreover, the military did not grow its active duty end strength significantly in response to these conflicts, as was the case in prior buildups. While the Army and Marine Corps added some 100,000 troops—an increase they are already beginning to roll back—the Air Force and Navy cut personnel and force structure. Throughout the past decade of conflict, the number of ships in the Navy declined from 344 to 288; the number of aircraft in the Air Force declined from 6,228 to 5,244; and the average age of Air Force aircraft increased from 19.6 years to 24.4 years.²⁷ Rather than getting larger and more expensive, in this buildup the military became smaller, older, and more expensive.

Each year the administration submits a five-year plan, known as the Future Years Defense Program (FYDP), with its budget request. While the FYDP projects future defense spending for every program, project, and activity within DoD, these projections have often proven to be overly optimistic (or pessimistic) in the past. Figure 17 compares the FYDPs released with each budget request (shown in dashed lines) to the actual funding appropriated by Congress (shown in the solid black line). In the drawdown that began in the late 1980s, the FYDPs submitted each year projected continued growth in defense spending even as the budget declined year after year. A similar, albeit less pronounced, discrepancy appears to be occurring at present. In this drawdown, as in the 1980s, the budget is declining faster and deeper than the FYDP planning process anticipates. Thus, the FY 2014 budget request and FYDP is at best a lagging indicator of where the defense budget may be headed in the coming years.

Rather than getting larger and more expensive, in this buildup the military became smaller, older, and more expensive.

²⁷ The reductions cited are from FY 1998 to FY 2010. Ship counts are from the Navy History and Heritage Command web site: <http://www.history.navy.mil/branches/org9-4.htm>. Air Force aircraft inventory and average age are derived from Air Force Magazine Almanacs from May 1999 and May 2011, which can be found at: <http://www.airforcemag.com/Almanacs/Pages/default.aspx>.

FIGURE 17: FYDP BUDGET SUBMISSIONS COMPARED TO ACTUAL BUDGET AUTHORITY²⁸



The current budget caps prescribed for defense under the BCA may provide a more likely scenario for the future direction of the budget than the FYDP. As shown in Figure 18, these budget caps require an additional reduction in the base budget for FY 2014, after which the budget would begin growing slightly faster than inflation. Assuming war-related funding continues to decline at a steady pace through FY 2021, this drawdown scenario would span 11 years and involve a total decline of 34 percent in the annual DoD budget to roughly \$500 billion by FY 2021 (in FY 2014 dollars).

A much deeper decline would occur if the current drawdown more closely mimics previous budget cycles. In such a scenario, shown in Figure 19, procurement funding could fall to roughly \$62 billion, the level reached at the end of the 1980s and Vietnam drawdowns. RDT&E funding has already been reduced as much as in any previous cycle and thus could stay near the FY 2013 level of \$65 billion. End strength could be cut by roughly one third from its peak, as in previous drawdowns, leaving 1.0 million service members on active duty. It is unlikely the growth in military personnel costs per person could accelerate during this downturn, given the unusually high rate of growth experienced during the buildup, but real growth of 2 percent annually would be in line with the 1980s drawdown. O&M costs per person in the base budget could continue growing at their historical rate of 2.8 percent annually, and war-related supplemental funding could be gradually phased out by FY 2021. Assuming a steady \$10 billion level of funding for military construction, family housing, and other accounts, the annual DoD budget under this scenario would fall to roughly \$415 billion in FY 2014 dollars, 17 percent lower than under the BCA drawdown scenario.

²⁸ Data derived from annual President's Budget Requests from FY 1980 to FY 2014. Inflation adjustment accounts for differences between the rate of future inflation predicted in each budget request and the actual rate of inflation experienced.

FIGURE 18: BCA DRAWDOWN SCENARIO²⁹

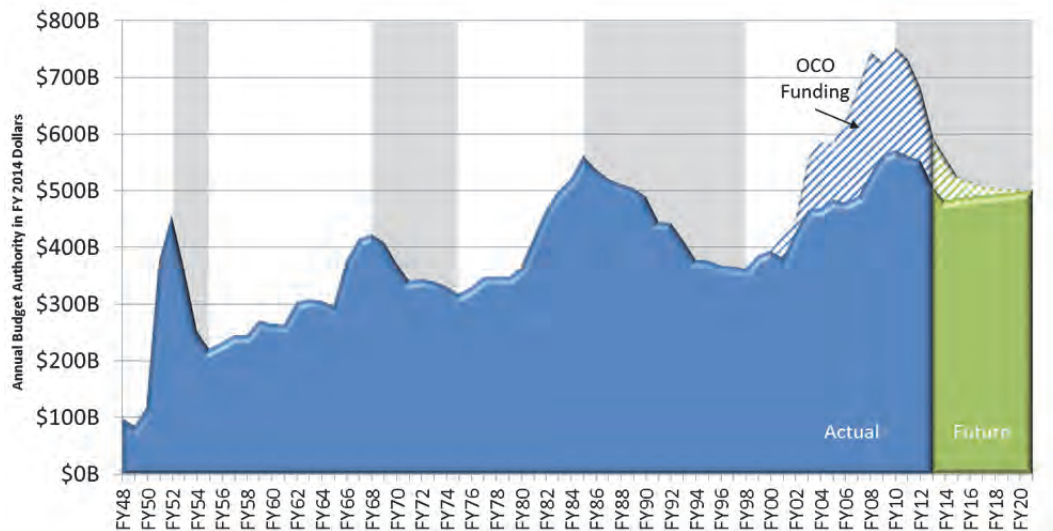
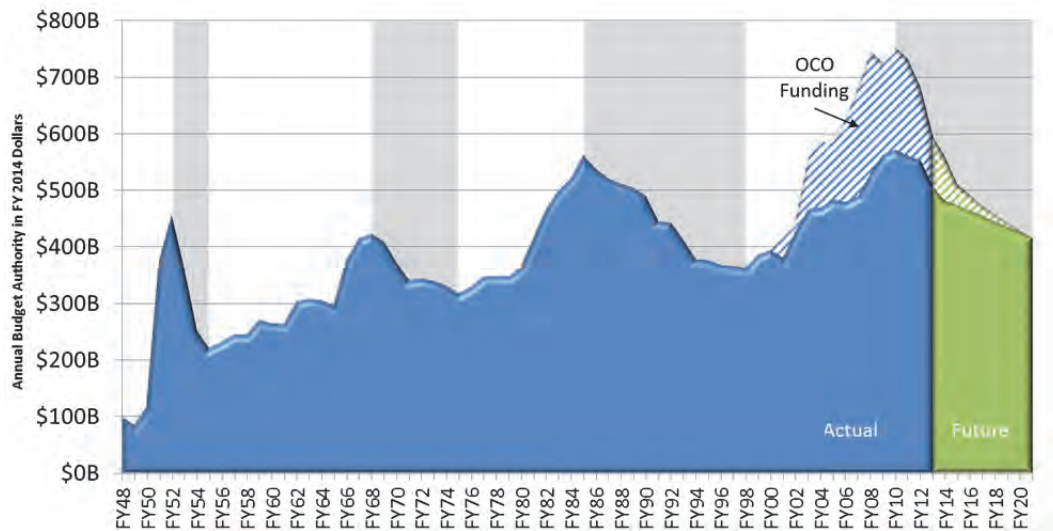


FIGURE 19: NOTIONAL HISTORICAL TRENDS SCENARIO³⁰



²⁹ Assumes the BCA budget caps remain in effect without any revisions and that war-related funding (which the BCA allows to exceed the budget caps) declines gradually as follows: FY14 \$79 billion (B), FY15 \$40B, FY16 \$30B, FY17 \$20B, FY18 \$15B, FY19 \$10, FY20 \$5B, FY21 \$0B. This is not intended to be a prediction but rather a plausible scenario for how these costs could gradually decline.

³⁰ Assumes the drawdown occurs evenly over the same period as the BCA budget caps (for the purposes of comparison) and assumes the same pace of reduction in war-related costs as the BCA drawdown scenario.

While the Defense Department has yet to release a detailed plan for the reductions required under the BCA scenario, it conducted the Strategic Choices and Management Review (SCMR) to explore the options available. The SCMR framed the range of available options as a choice between preserving near-term capacity or future capability. Preserving capacity would limit reductions in the size of the force, although end strength would still be cut by up to 70,000 in the Army and 12,000 in the Marine Corps and the number of carrier strike groups could be reduced by two. It could also result in major acquisition programs being cancelled or delayed, such as the Joint Strike Fighter, the next-generation bomber, and the expanded payload module for Virginia-class submarines, which would adversely affect the future capability of U.S. forces, particularly in a more contested environment than that experienced in either Iraq or Afghanistan. In contrast, the “preserve capability” option presented in the SCMR would maintain key acquisition programs and instead take deeper cuts in near-term capacity: Army and Marine Corps end strength would be reduced by up to 110,000 and 32,000, respectively, from the levels currently planned; the number of carrier strike groups could be cut by three, leaving a total of eight; and the number of amphibious assault ships (small deck carriers for Marines) could be cut by three, resulting in a total of eight.³¹

The SCMR, however, only considered cuts as deep as the BCA. Under the notional historical trends scenario where the cuts are deeper, there would be less of a choice between cutting capacity or capability—DoD would have to do both. Cutting total active end strength by one third, as this scenario assumes, would require significant reductions in force structure beyond just ground forces. Likewise, reducing the procurement budget to \$62 billion would require wide-ranging terminations of current and planned modernization programs, both large and small. Regardless of precisely how these cuts would be administered, the Defense Department would not have enough people or equipment to support its current level of commitments around the world to the same degree it does today, nor would it be able to make the requisite investments in new technologies needed to generate future capabilities.

³¹ For a more complete analysis of the Strategic Choices and Management Review and a comparison to the results of the Joint Think Tank Strategic Choices Exercise conducted by CSBA in May 2013, see: <http://www.csbaonline.org/wp-content/uploads/2013/08/Comparison-to-SCMR.pdf>.

V. FINAL THOUGHTS

A saying often attributed to Mark Twain is that “history doesn’t repeat itself, but it does rhyme.” Given the current turmoil in the overall federal budget, it is impossible to predict with any certainty how or when the current defense drawdown will end. The fiscal uncertainty that began in 2011 with the enactment of the BCA has only grown worse over time with the failure of the Super Committee, sequestration going into effect, and the government shutdown. The BCA-level budget caps with the automatic reductions currently in effect once seemed like a worst-case scenario for the defense budget. Now that sequestration has gone into effect and the deepest part of the decline from FY 2012 to FY 2013 has already occurred, the BCA budget caps may be more of a ceiling than floor in the coming years.

The 2012 Defense Strategic Guidance calls for rebalancing to the Asia/Pacific region and maintaining U.S. military presence in the Middle East. This guidance, however, was issued before sequestration went into effect. If history is any indicator, the U.S. military is not likely to emerge from this drawdown with the capacity or capability to both increase its presence in the Asia/Pacific region and maintain its current level of presence in the Middle East. While U.S. forces could still be swung from one theater to another as needed in the event of a conflict, the military may not be able to address successfully two major, overlapping conflicts in different theaters. Moreover, forces engaged in forward presence missions cannot be swung as easily from one theater to another, and yet they can be a key factor in deterring a conflict from occurring in the first place.

Ultimately, a significant reduction in the defense budget means the United States will have to make a number of critical strategic choices in how it prepares for the future. Uncertainty in the budget does not absolve defense planners from making these difficult choices because future funding levels are never certain—Congress only appropriates one year at a time. Moreover, the current budget impasse may not be resolved until the drawdown is effectively over, at which point many of the critical decisions will have already been made for the Department by incremental reductions that chip away at programs and force structure year-by-year or, worse, by the blunt and indiscriminant mechanism of sequestration.

The 2014 Quadrennial Defense Review (QDR) and the FY 2015 budget request are an opportunity for the Defense Department to address the rapidly evolving budgetary and strategic situation. If the Department plans for the reduced budget caps in its FY 2015 request and uses the QDR as an opportunity to revise its strategic guidance according to these more realistic budget constraints, it

Now that sequestration has gone into effect and the deepest part of the decline from FY 2012 to FY 2013 has already occurred, the BCA budget caps may be more of a ceiling than floor in the coming years.

will give DoD greater say in how cuts are implemented in the future. To be sure, this approach is not without risks. Proposing cuts makes it difficult to also argue against the cuts, and the specific cuts proposed are likely to meet stiff political resistance regardless of how they tie into a broader strategy. But the risk of inaction—continuing to propose unrealistic budgets that do not account for the cuts required by law—is arguably worse. As the past year has shown, the Pentagon’s failure to plan for sequestration and its repeated warnings of the consequences did not prevent the cuts from taking place—it only served to limit the number of options available once sequestration went into effect. The Department now has a window of opportunity, albeit a small one, to revise its budget and strategic guidance to fit within more realistic resource constraints. In these uncertain and chaotic times, a strategic choice deferred can quickly become a choice denied.

APPENDIX

Sequestration Cuts by Title³²

| Account | FY13 Total Enacted | Prior Year Unobligated Funds | Total Budgetary Resources | Sequester from Prior Year Funds | Sequester from FY13 Funds | Total Sequester | % Cut from Sequestration | % of Sequestration Cuts from Unobligated Funds |
|--------------------|--------------------|------------------------------|---------------------------|---------------------------------|---------------------------|-----------------|--------------------------|--|
| MILPERS | \$149,651,297 | \$0 | \$149,651,297 | \$0 | \$0 | \$0 | 0.0% | N/A |
| O&M | \$272,763,132 | \$9,485,065 | \$282,248,197 | -\$859,594 | -\$19,467,335 | -\$20,326,929 | -7.2% | 4.2% |
| Procurement | \$109,769,635 | \$36,748,595 | \$146,518,230 | -\$4,119,184 | -\$5,670,856 | -\$9,790,040 | -6.7% | 42.1% |
| RDT&E | \$69,592,266 | \$4,973,013 | \$74,565,279 | -\$633,157 | -\$5,421,673 | -\$6,054,830 | -8.1% | 10.5% |
| MILCON | \$8,961,948 | \$9,649,418 | \$18,611,366 | -\$316,390 | -\$504,523 | -\$820,913 | -4.4% | 38.5% |
| Other | \$4,404,494 | \$1,361,291 | \$5,765,785 | -\$38,274 | -\$185,832 | -\$224,106 | -3.9% | 17.1% |
| Total | \$619,547,266 | \$63,578,673 | \$683,125,939 | -\$6,004,873 | -\$31,436,051 | -\$37,440,924 | -5.5% | 16.0% |

³² Data derived from Office of the Under Secretary of Defense (Comptroller), *Department of Defense Report on the Joint Committee Sequestration for Fiscal Year 2013* (Washington, DC: Department of Defense, June 2013).

Sequestration Cuts by Service and Title³³

| | FY13 Enacted Total | Prior Year Unobligated Funds | Total Budgetary Resources | Sequester from Prior Year Funds | Sequester from FY13 Funds | Total Sequester | % Cut from Sequestration | % of Sequestration Cut from Prior Year Funds |
|---------------------|----------------------|------------------------------|---------------------------|---------------------------------|---------------------------|----------------------|--------------------------|--|
| Army | \$178,853,245 | \$17,214,972 | \$196,068,217 | -\$667,509 | -\$6,935,959 | -\$7,603,468 | -3.9% | 8.8% |
| MILPERS | \$66,894,422 | \$0 | \$66,894,422 | \$0 | \$0 | \$0 | 0.0% | N/A |
| O&M | \$79,466,592 | \$4,890,288 | \$84,356,880 | \$0 | -\$5,489,221 | -\$5,489,221 | -6.5% | 0.0% |
| Procurement | \$20,521,578 | \$7,137,419 | \$27,658,997 | -\$544,634 | -\$667,632 | -\$1,212,266 | -4.4% | 44.9% |
| RDT&E | \$8,651,909 | \$850,689 | \$9,502,598 | -\$92,765 | -\$656,701 | -\$749,466 | -7.9% | 12.4% |
| MILCON | \$2,675,850 | \$4,187,770 | \$6,863,620 | -\$30,110 | -\$80,936 | -\$111,046 | -1.6% | 27.1% |
| Other | \$642,894 | \$148,806 | \$791,700 | \$0 | -\$41,469 | -\$41,469 | -5.2% | 0.0% |
| Navy | \$173,115,697 | \$18,750,772 | \$190,851,374 | -\$2,582,180 | -\$8,129,134 | -\$10,711,314 | -5.6% | 24.1% |
| MILPERS | \$46,714,993 | \$0 | \$46,714,993 | \$0 | \$0 | \$0 | 0.0% | N/A |
| O&M | \$61,870,765 | \$15,101 | \$61,885,866 | \$0 | -\$4,361,038 | -\$4,361,038 | -7.0% | 0.0% |
| Procurement | \$44,666,429 | \$15,481,446 | \$59,132,780 | -\$2,272,526 | -\$2,339,630 | -\$4,612,156 | -7.8% | 49.3% |
| RDT&E | \$16,746,608 | \$1,161,044 | \$17,907,652 | -\$191,738 | -\$1,279,440 | -\$1,471,178 | -8.2% | 13.0% |
| MILCON | \$1,898,082 | \$1,871,538 | \$3,769,620 | -\$101,146 | -\$107,340 | -\$208,486 | -5.5% | 48.5% |
| Other | \$1,218,820 | \$221,643 | \$1,440,463 | -\$16,770 | -\$41,686 | -\$58,456 | -4.1% | 28.7% |
| Air Force | \$153,602,801 | \$15,844,940 | \$148,443,732 | -\$1,442,750 | -\$8,575,071 | -\$10,017,821 | -6.7% | 14.4% |
| MILPERS | \$36,041,882 | \$0 | \$36,041,882 | \$0 | \$0 | \$0 | 0.0% | N/A |
| O&M | \$54,346,990 | \$497 | \$54,347,487 | \$0 | -\$4,254,787 | -\$4,254,787 | -7.8% | 0.0% |
| Procurement | \$36,898,704 | \$12,775,549 | \$28,670,244 | -\$1,188,220 | -\$2,282,910 | -\$3,471,130 | -12.1% | 34.2% |
| RDT&E | \$25,251,393 | \$1,701,855 | \$26,953,248 | -\$233,047 | -\$1,983,908 | -\$2,216,955 | -8.2% | 10.5% |
| MILCON | \$425,696 | \$1,058,284 | \$1,483,980 | \$0 | -\$13,682 | -\$13,682 | -0.9% | 0.0% |
| Other | \$638,136 | \$308,755 | \$946,891 | -\$21,483 | -\$39,784 | -\$61,267 | -6.5% | 35.1% |
| Defense-Wide | \$109,569,246 | \$10,175,893 | \$119,745,139 | -\$1,274,160 | -\$7,600,675 | -\$8,874,835 | -7.4% | 14.4% |
| O&M | \$77,078,785 | \$4,559,286 | \$81,638,071 | -\$859,594 | -\$5,360,132 | -\$6,219,726 | -7.6% | 13.8% |
| Procurement | \$7,682,924 | \$1,354,181 | \$9,037,105 | -\$113,804 | -\$380,684 | -\$494,488 | -5.5% | 23.0% |
| RDT&E | \$18,942,356 | \$1,259,425 | \$20,201,781 | -\$115,607 | -\$1,501,624 | -\$1,617,231 | -8.0% | 7.1% |
| MILCON | \$3,962,320 | \$2,531,726 | \$6,494,046 | -\$185,134 | -\$302,557 | -\$487,691 | -7.5% | 38.0% |
| Other | \$1,902,861 | \$471,275 | \$2,374,136 | -\$21 | -\$55,678 | -\$55,699 | -2.3% | 0.0% |
| Total DoD | \$615,140,989 | \$61,986,577 | \$655,108,462 | -\$5,966,599 | -\$31,240,839 | -\$37,207,438 | -5.7% | 16.0% |

³³ Ibid.

Budget Cycles by Title³⁴

| | Korea | | Vietnam | | 1980s | | Present | |
|---------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|
| | <i>Buildup FY49-52</i> | <i>Drawdown FY52-55</i> | <i>Buildup FY55-68</i> | <i>Drawdown FY68-75</i> | <i>Buildup FY75-85</i> | <i>Drawdown FY85-98</i> | <i>Buildup FY98-10</i> | <i>Drawdown FY10-13</i> |
| MILPERS | 127% | -3% | 46% | -6% | 14% | -26% | 74% | -6% |
| O&M | 186% | -40% | 98% | -17% | 57% | -10% | 133% | -19% |
| Procurement | 1458% | -78% | 163% | -52% | 206% | -67% | 134% | -31% |
| RDT&E | 572% | 28% | 137% | -21% | 93% | -15% | 67% | -25% |
| Total | 434% | -51% | 91% | -25% | 77% | -35% | 108% | -21% |
| % Change in End Strength | 125% | -32% | 143% | -43% | 10% | -35% | 4% | -2% |
| Absolute Change in End Strength | 2,022K | -1,159K | 1,071K | -1,516K | 213K | -795K | 57K | -104K |
| O&M (-DHP) per person | 27% | -26% | 64% | 39% | 52% | 20% | 128% | -20% |
| MILPERS (+DHP) per person | 1% | 20% | 20% | 57% | 10% | 27% | 76% | -3% |

³⁴ Data derived from Office of the Under Secretary of Defense (Comptroller), *National Defense Budget Estimates for FY 2014* (Washington, D.C., Department of Defense: May 2013), Tables 2-1, 6-8, and 7-5. Defense Health Program budget data from OMB Public Budget Database in the FY 2014 President's Budget, available for download at:

<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/budauth.xls>.



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