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$TRATEGY IN A YEAR OF FISCAL UNCERTAINTY

By Todd Harrison

Defense strategy is about choices. In peacetime, strategy is often expressed in the budget as choices among different types of weapon systems and force structure. Bernard Brodie, writing in a 1959 RAND report, noted, "We do not have and probably never will have enough money to buy all the things we could effectively use for our defense. The choices we have to make would be difficult and painful even if our military budget were twice what it is today." He went on to write, "In making choices among weapon systems and related systems... the military budget is always the major and omnipresent constraint."[1] Perhaps the title of the chapter in which he wrote these words says it best: "Strategy Wears a Dollar Sign."

In January, the administration unveiled its new strategic guidance, *Sustaining U.S. Global Leadership: Priorities for the 21st Century*. It places a greater focus on the Western Pacific and emphasizes air and sea capabilities. It is driven, at least in part, by the budget constraints placed on the Pentagon in the Budget Control Act of 2011. A better measure of the Pentagon's new strategy, however, is not the policy statements contained in this document but rather the real choices it makes in how resources are allocated. The President's FY 2013 budget request, to be released in a few days, will provide greater insight into the Pentagon's strategic choices.

What to Expect in the FY 2013 Request

This year's budget request comes under somewhat unusual circumstances. The Budget Control Act (BCA), passed by bi-partisan majorities in both houses, requires some $487 billion in cuts from the defense budget over the next ten years relative to the level of spending the Pentagon was anticipating a year ago. This means that the Obama administration must for the first time propose a real decrease in defense spending from the previous year's enacted budget if it is to comply with the initial budget caps in the BCA.[2]

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[1] Bernard Brodie, *Strategy in the Missile Age* (Santa Monica, CA: RAND, January 15, 1959) pp. 359-361.

[2] In each of its previous budgets, the administration proposed real increases in defense. In the FY 2012 request, for example, it took $78 billion out of the budget over five years, which still allowed for real growth, albeit at a slower rate.

The BCA also created a joint select committee to find $1.2 trillion in additional deficit reduction. Because the Super Committee, as it became known, failed to reach an agreement on further deficit reduction, the BCA now requires the initial caps on defense spending be reduced by an additional $472 billion.[3] The additional reduction must be evenly split across nine years from FY 2013 to FY 2021, resulting in roughly a $52 billion reduction in DoD's share of the budget caps for each year. Enforcement of these lower budget caps, however, does not begin until January 2, 2013, giving Congress a year to modify or repeal the law, as some have already proposed.[4] Given the schedule for when sequestration enforcement begins, the precise level of funding for FY 2013 may not be known until after the November 2012 election and well into the next fiscal year. The Pentagon's challenge is to plan for a nearly flat budget for the rest of the decade, as called for under the initial budget caps, while also preparing for the deeper cuts possible under sequestration.

Secretary Panetta and others in the administration have stated that the Department has not prepared a FY 2013 budget that fits under the lower budget caps that would be imposed under sequestration. Instead, the Department has developed a budget in compliance only with the initial caps, which for FY 2013 is $525 billion, not including war funding. As shown in the table below, this is $46 billion less than last year's projection for FY 2013 and $6 billion less than Congress enacted for FY 2012. The table also shows how the BCA will reduce the budget for each year if Congress does not act to avoid sequestration.

Table 1: Base Discretionary DoD Budget in Then-Year Dollars

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Previous Budget Request and Projection (FY 2012)	$553B	$571B	$587B	$598B	$611B	
FY 2013 Budget Request and Projection (Compliant with Initial Budget Caps from BCA)[5]	$531B	$525B	$534B	$546B	$556B	$567B
Sequestration and Reduced Budget Caps Imposed by BCA		$472B	$482B	$491B	$502B	$515B

In a preview of the budget, the Pentagon announced some of the major decisions contained in the request. Army and Marine Corps end strength will decline by 72,000 and 20,000 respectively, bringing them back to roughly the level they were in 2005. The Army will lose at least eight brigades, two of which will come from Europe. The Navy and Air Force are also not spared from cuts—the Navy will lose some 17 ships over the future years defense program (FYDP) and the Air Force will cut 10 percent of its 60 fighter squadrons. Overall, $60 billion of the proposed reductions are projected to come from unspecified "efficiencies," on top

[3] This figure represents DoD's proportionate share of the reduction. The total reduction for the 050 budget function, which includes partial funding for other departments, is $492 billion, once interest savings are deducted.
[4] Jeremy Herb, "McKeon introducing bill to reverse sequestration cuts," *The Hill*, December 14, 2011.
[5] Department of Defense, *Fact Sheet: The Defense Budget* (Arlington, VA: DoD, January 26, 2012).

of $178 billion in "efficiency" savings projected in last year's budget. DoD also announced it will propose another round of base closures. Such a move is likely to cost money in the near term and thus does not help the Department achieve the savings it needs over the FYDP.

The budget request, once released, should fill in many of the remaining details behind the new defense strategy and provide insight into how various competing interests within the Pentagon will fare. Three competitions are of particular interest because they shed light on some of the difficult choices underlying the new defense strategy.

Service versus Service

One competition to watch in the budget is the perennial fight for resources among the Services. The new strategy calls for a greater emphasis on air and sea forces and a downsizing of ground forces. Last year's budget request already projected a gradual shift in the budget share among the Services over the Future Years Defense Program (FYDP), with the Air Force growing its share of the budget from 26.8 percent to 27.4 percent, the Navy remaining relative even at 29 percent, and the Army falling from 25.6 percent to 24.7 percent.[6] Will the new budget accelerate the shift in resources among the Services or will it maintain the shift already planned?

Table 2: Budget Share of the Base Defense Budget Projected in the FY 2012 FYDP

Service	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	Net Change
Army	25.6%	26.1%	25.5%	24.9%	24.7%	-1.0%
Dept. of Navy	28.9%	28.7%	28.6%	28.7%	28.6%	-0.2%
Air Force	26.8%	26.3%	26.9%	26.9%	27.4%	+0.6%
Defense Wide	18.7%	19.0%	19.0%	19.5%	19.3%	+0.6%

Active versus Guard and Reserve

Another competition is between the active and reserve components within each Service. The military has relied heavily on the guard and reserve over the past decade to support deployments to Iraq and Afghanistan. But as the military pivots away from large, protracted ground operations in the coming years, the Pentagon may also want to adjust the balance between the active and reserve components. In the FY 2012 budget, DoD planned to spend a steady eight percent of the base budget on guard and reserve forces over the FYDP.[7] Moving capabilities into the reserve component reduces costs in peacetime because personnel are paid on a part-time basis and equipment is operated less frequently. But the guard and reserve typically cannot mobilize as quickly, operate as proficiently, or support the same rotation rate as active component forces. Will the Services shift more capabilities into the guard and reserve to

[6] The Department of the Navy budget includes funding for the Marine Corps. The Air Force budget includes an unspecified amount of pass-through funding in classified programs that goes to other government agencies. The Air Force's true share of the budget is less than shown, but this metric remains useful for the purposes of identifying trends in funding.

[7] Department of Defense, *National Defense Budget Estimates for FY 2012* (Arlington, VA: Department of Defense, March 2011) p. 93.

reduce peacetime costs, or will the Services cut the guard and reserve to protect active duty force structure?

Retirees versus Active Duty

Perhaps the most politically sensitive, and often unspoken, competition within the budget is the inter-generational struggle between funding for military retirees and those who currently serve. Total military personnel costs soared over the previous decade, growing at an annual, inflation-adjusted rate of 4.2 percent. This growth was driven in no small part by the cost of new and expanded benefits for military retirees, such as TRICARE for Life, which did not exist before 2001 and now costs $11 billion annually.[8] DoD must also set aside 33 cents for every dollar of basic pay to fund the military pension system.[9] If military personnel costs continue growing at the same rate as the past decade while the overall budget remains flat, personnel costs will consume the entire defense budget by FY 2039. In reality, personnel costs are already beginning to consume a greater share of the budget, which means over time less funding will be available for research and development, procurement, readiness, training, and other priorities. This trend will only accelerate as the budget declines. In the preview of the budget, the Pentagon announced a plan to slow the growth in basic pay, raise the fees retirees pay for healthcare, and form a commission to study the retirement system. Will these changes slow the growth in military personnel costs enough over the FYDP to avoid deeper cuts in active duty end strength beyond the FYDP?

Options for Handling Sequestration

While the new strategy claims to plan for a wide array of contingencies, it fails to plan for perhaps the most likely contingency of all—sequestration. Secretary Panetta acknowledged that should sequestration occur the new strategy would have to be "thrown out the window."[10] The Super Committee had a unique opportunity to push through an alternative deficit reduction plan without amendments and without being subjected to a 60-vote requirement for cloture in the Senate. It is reasonable to expect that since the Super Committee was not able to produce a compromise the larger Congress may also not reach an agreement to forestall sequestration. Moreover, any compromise will now need 60 votes to clear the Senate.

If DoD plans for further reductions, it could make them more likely to occur. But failing to plan for further reductions means accepting the risk of being unprepared if they do occur. The fiscal reality is that avoiding sequestration or further cuts to defense will require some combination of increased government borrowing, cuts to programs like Social Security and Medicare, cuts to other domestic programs, and higher taxes. None of these alternatives is easy or

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[8] Office of the Undersecretary of Defense (Comptroller), *United States Department of Defense Fiscal Year 2012 Budget Request: Overview* (Arlington, VA: DoD, February 2011), Figure 3-3.
[9] Department of Defense Office of the Actuary, *Valuation of the Military Retirement System* (Arlington, VA: Department of Defense, September 30, 2009) p. iv.
[10] Karen Parrish, "Panetta: 'Sequestration' Would Upend Military Strategy," *American Forces Press Service*, January 8, 2012.

popular, especially in an election year. The following section explores several options for how DoD could prepare for sequestration under the assumption that it cannot get relief from the total dollar amount of cuts required over the next ten years.

Option 1: Let Sequestration Happen

The first option would be to do nothing and let sequestration happen as currently prescribed in law. Under this approach, sequestration would cut a uniform percentage from all accounts in the DoD budget necessary to meet the sequestration target, roughly a 10 percent cut from the FY 2013 request. This would return the base defense budget to roughly the same level it was in FY 2007, adjusting for inflation. The law specifies that the cuts be applied uniformly across all accounts. Thus, sequestration would impose equal percentage cuts across air, sea, and ground forces, despite the fact that the new defense strategy calls for prioritizing air and sea forces.

Many parts of the defense budget, however, have experienced growth that is not easily reversible, such as military pay, healthcare costs, and fuel costs. The law allows the president to exempt military personnel accounts from sequestration, but all other accounts within the budget must then be cut by a greater percentage. For these reasons, allowing sequestration to occur as currently written into law is arguably the least desirable approach because the cuts would be untargeted and uninformed by strategy.

Option 2: Prepare Budget Amendment that Targets Cuts

A second option would be to develop a budget amendment and revised defense strategy detailing how the Department would implement the level of cuts required under sequestration. Rather than allowing across-the-board cuts, DoD could proactively decide how to reduce the budget to fit within the sequestration-level budget for FY 2013.[11] Congress would need to approve the amended budget prior to the January 2, 2013 sequester. Such a vote could be politically difficult since members would be going on record as voting for a significantly reduced defense budget.

Because many potential savings, such as phased reductions in end strength and base closures, take years to implement, DoD would be forced to use more blunt actions to implement cuts in FY 2013, such as immediate reductions in civilian personnel, reductions in training and peacetime operations, and cuts to selected modernization initiatives. The advantage of this approach, however, is that it

[11] As the law is written, the FY 2013 sequestration will cut $52 billion from the DoD budget even if Congress enacts a budget that already has $52 billion in cuts. To avoid a double reduction, Congress would need to appropriate $472 billion for DoD and then add a provision at the end of the act that *raises* all accounts by a uniform amount of roughly 11 percent, bringing it back up to $525 billion. Sequestration would then cut roughly 10 percent across the board, bring it back down to $472 billion. By raising all accounts by 11 percent and then cutting them by 10 percent the budget in each account would end up where Congress intended, thus allowing the cuts to be targeted without modifying the BCA.

avoids the "goofy meat-axe scenario" of across-the-board cuts.[12] It still reduces the budget abruptly, but the Pentagon would at least have a say in how the cuts are directed. It would also allow the Department to explain in detail the effect further budget cuts would have on the military and highlight what parts of the force structure, industrial base, and new defense strategy would be adversely affected.

Option 3: Use War Budget to Soften the Effect of Sequestration

Another option would be for the Pentagon to prepare a revised war budget, known in the Pentagon as the Overseas Contingency Operations (OCO) budget, that includes additional funding for the base budget. The Budget Control Act specifically exempts war funding from the budget caps, but does not specifically define what items can and cannot be funded using war money. If Congress is amenable to this approach it would allow the Department to offset some or all of the cuts in its base budget by moving this money to the war budget. Congress has already shown a willingness to use this approach, as is evident by the $10 billion Senate appropriators moved from the base budget to the OCO budget during the FY 2012 deliberations to avoid breaching the budget cap.[13]

However, this would at best be a short-term solution. As war funding declines and eventually ends, it will be more difficult for the administration and Congress to supplement the base budget with war funding. This approach would also increase the federal deficit above what it would have otherwise been by circumventing the agreed-to budget caps and the spirit, if not the letter, of the Budget Control Act. The advantage of this approach is that it would help the Pentagon avoid the abrupt cuts and immediate disruptions imposed by sequestration. While it would require Congress to enact additional war funding, it would not require Congress to amend or repeal the Budget Control Act.

Option 4: Alter Sequestration to Backload the Cuts

A final option is for the Pentagon to propose a modification to the annual budget caps that achieves the same level of savings from defense over ten years by redistributing the planned reductions so that they are phased in more gradually. This approach would allow the Department time to implement longer-term savings, such as closing bases and reducing personnel through natural attrition as opposed to a reduction in force—the government equivalent of a lay off.[14] In order to achieve the same level of total savings, however, the budget in the later years of the decade would drop below the level currently required under sequestration.

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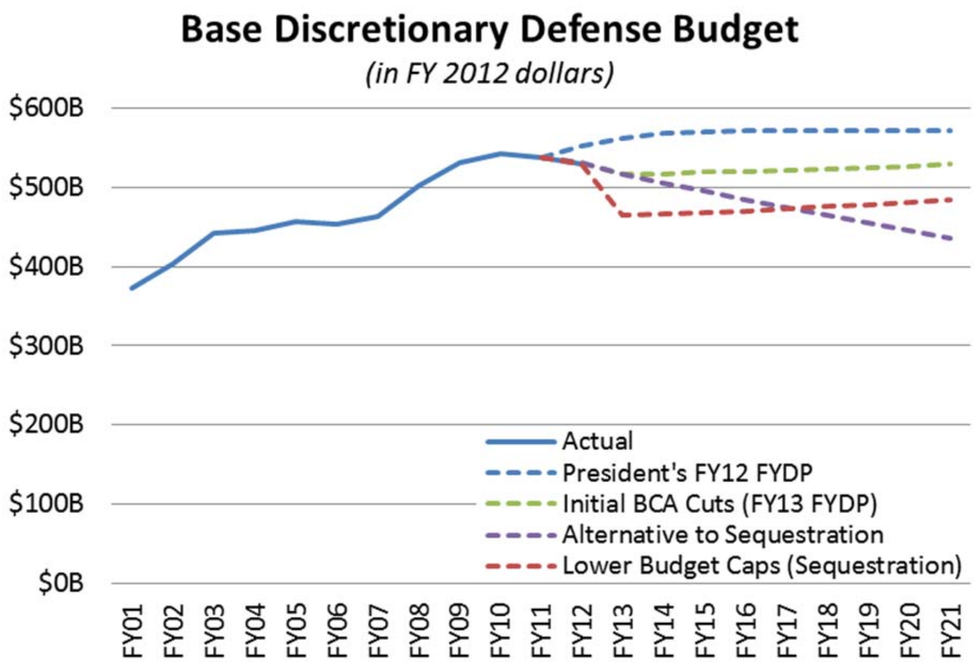
[12] Kristina Wong, "Panetta to Service Members: 'You Will Get What is Promised to You'," *ABC News*, available at: http://abcnews.go.com/blogs/politics/2011/10/panetta-to-service-members-you-will-get-what-is-promised-to-you/, accessed February 1, 2012.

[13] Russell Rumbaugh, "A $10B Move," *The Will and the Wallet*, available at: http://thewillandthewallet.squarespace.com/blog/2011/9/16/a-10b-move.html, accessed January 24, 2012.

[14] Office of Personnel Management, *Summary of Reduction in Force Under OPM's Regulations*, available at: http://www.opm.gov/rif/general/rifguide.asp, accessed February 6, 2012.

The figure below graphically represents one approach for redistributing the budget cuts. Instead of dropping the budget abruptly in FY 2013 and then remaining relatively flat the rest of the decade, as sequestration would do, a more gradual reduction of 2.2 percent annually in real terms would achieve the same amount of total savings over the decade. Under this plan, the defense budget would steadily decline to $434 billion by FY 2021 (in FY 2012 dollars), some 18 percent below the current level of funding and 10 percent below what it would have been under sequestration in that year. Because the Budget Control Act does not allow funding to be moved between years, this approach would require Congress to amend the BCA but in a deficit-neutral manner.



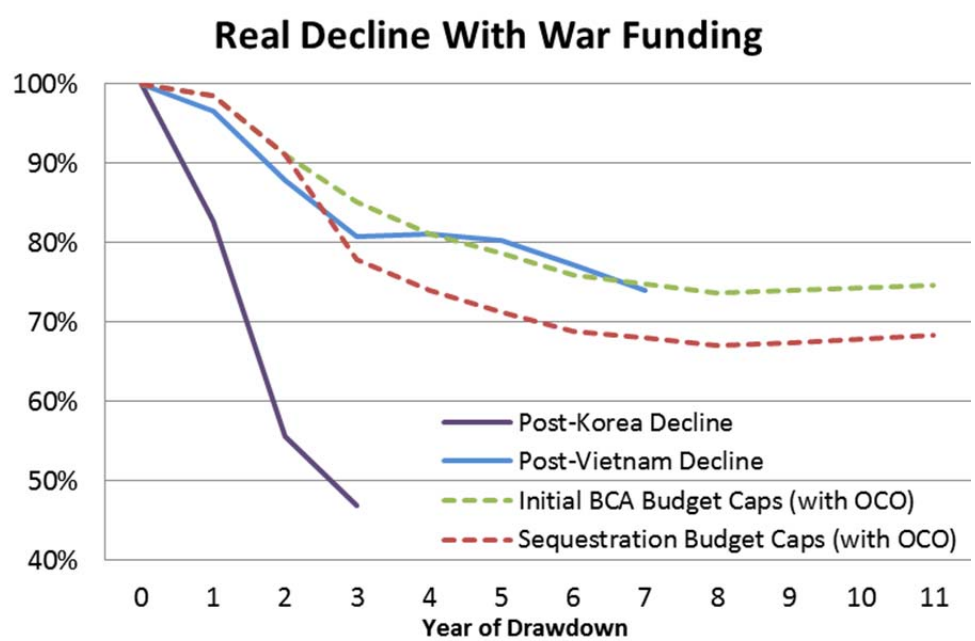
Historical Perspective

Throughout American history, defense spending has risen and fallen in irregular cycles driven in part by changes in the security environment. Since the end of World War II, the defense budget has experienced three such cycles following the end of the Korean War, Vietnam War, and the Cold War. Each of these previous budget cycles offers lessons and insights into what the future may hold for DoD.

At the end of the Korean War, defense spending fell by 53 percent in real terms from peak to trough (FY 1952 to FY 1955). Much of this decline was due to the end of hostilities on the Korean peninsula, which was funded in part by supplemental appropriations. End strength fell in the years that followed, from 3.6 million to 2.5 million, as troops came home and the Eisenhower administration shifted its strategic focus from fighting major ground wars to relying more on the nation's nuclear deterrent. Army procurement funding fell precipitously, while the Air Force and Navy procurement budgets nearly doubled over the years the followed.

Defense spending during the Vietnam War peaked in FY 1968 and fell 26 percent before it bottomed out in FY 1975. End strength fell from 3.5 million at its peak to 2.0 million at the end of the war, but a corresponding decline in military personnel costs was tempered by the transition to an all-volunteer force. Basic pay for the two most junior enlisted ranks, E-1 and E-2, doubled overnight on January 1, 1972 as part of an effort to attract more volunteers and reduce the military's dependence on conscription.[15]

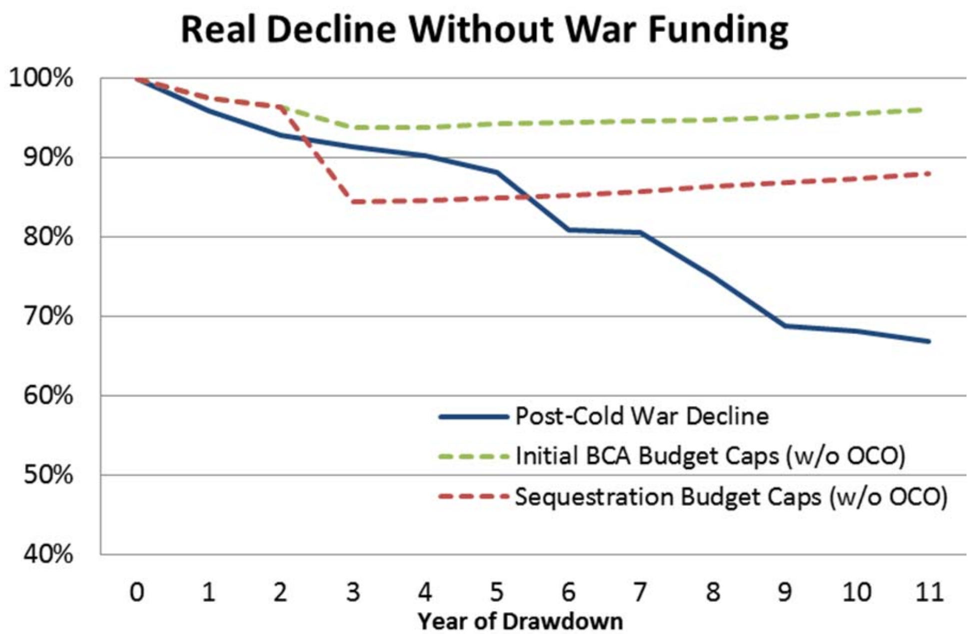
Because both the Korean and Vietnam downturns involved an end to active hostilities, they can be most accurately compared to the present day situation that includes both the base DoD budget and war funding. The chart below shows the post-Korea and post-Vietnam drawdowns compared to two scenarios for the current decline: the initial budget caps from the BCA and the reduced sequestration-level budget caps. Both scenarios for the current drawdown begin with Year "0" in FY 2010—the peak of defense spending this cycle—and assume a gradual reduction in war funding in the coming years: $88 billion in FY 2013, $60 billion in FY 2014, $40 billion in FY 2015, $20 billion in FY 2016, and $10 billion in FY 2017. The initial budget caps and sequestration scenarios are both closer in magnitude to the post-Vietnam War decline than the post-Korean War decline.



In contrast, the Cold War drawdown occurred entirely in the base defense budget because there was no war-related budget at the time. The decline began in FY 1986 as part of a broader effort in Congress to reduce what was then a record budget deficit. The Gramm-Rudman-Hollings Balanced Budget and Emergency

[15] Data derived from the Defense Finance and Accounting Service military pay tables, available at: http://www.dfas.mil/militarymembers/payentitlements/militarypaytables.html, accessed on January 24, 2012.

Deficit Control Act of 1985 set deficit targets for the coming years and required a sequestration of resources if these deficit targets were breached. Thus, the Cold War decline in defense spending actually began with sequestration—an across-the-board cut of five percent from non-exempt portions of the defense budget in FY 1986.[16] By the time the Berlin Wall fell in November of 1989, the base defense budget had already declined by some 12 percent in real terms. By the time the Soviet Union dissolved in December 1991, the base defense budget had fallen by 20 percent.



The post-Cold War drawdown continued steadily over more than a decade, as shown in the figure above. Procurement funding fell by some 68 percent in real terms from its peak in FY 1985, and end strength fell from 2.2 million to 1.4 million. The first five years of the decline were a sharp departure from DoD's plans at the time. The enacted funding for FY 1986 to 1990 was 28 percent less than projected in the FY 1986 FYDP.[17] In comparison, the initial budget caps in the BCA call for a 9 percent reduction from the FY 2012 FYDP.

It is too soon to tell which of the three previous downturns the current cycle will most closely resemble. While the shift in strategic direction following the Korean War bears at least a superficial resemblance to the new defense strategy, such a precipitous reduction and shift in defense spending seems unlikely to occur. A Vietnam-sized drawdown in the budget seems plausible when the likely reduction in war funding for Iraq and Afghanistan is included. But perhaps more worrisome for the Pentagon are parallels to the post-Cold War decline—a deficit-driven drawdown enforced by sequestration.

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[16] Congressional Budget Office and Office of Management and Budget, *Sequestration Report for Fiscal Year 1986: A Summary* (Washington DC: GPO, January 15, 1986) p. 9.
[17] Data derived from Office of Management and Budget annual budget submissions.

Conclusion

The Department is entering a period of acute and likely protracted fiscal uncertainty. The new strategic guidance issued by the Pentagon prioritizes air and sea power and shifts focus to the Asia-Pacific region. But strategy is reflected in the real choices the Department makes. The FY 2013 budget request will serve as a test of whether the Pentagon's decisions are consistent with its rhetoric.

If this downturn in defense spending is like previous downturns, the FY 2013 budget projection the administration is about to release may prove to be highly optimistic. History suggests that defense spending will decline steadily over the decade, not remain flat as the budget plan projects. The failure to plan for the possibility of additional reductions in defense spending is a major shortfall in the new defense strategy. The Pentagon can and should begin preparing for the possibility of more reductions, especially the prospect of sequestration, lest it be caught unprepared by a perfectly foreseeable contingency.