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Making Defense Affordable

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Making Defense Affordable

The U.S. military is the strongest in the world. It is also the most costly; currently, the U.S. defense establishment outspends any other country's military by a factor of about six to one. In the face of mounting fiscal pressures, it is necessary to reassess the defense budget. For the Department of Defense (DoD), efforts to reduce defense spending are complicated by internal costs that grow faster than inflation, including the costs of health care, of pay, and of new weapons. Unless the internal cost growth is reined in, it will erode military capacity even if budgets remain constant in real terms. Meanwhile, the shift away from the lengthy and costly wars in Iraq and Afghanistan creates a window of opportunity to restructure the armed forces strategically—by rebalancing among the military branches—to focus more on the salient threats of the future.

In a new discussion paper for The Hamilton Project, Cindy Williams of the Massachusetts Institute of Technology proposes a new approach to reducing the U.S. defense budget while maintaining a strong and well-equipped military. Williams outlines a two-part plan of action to control budget growth and create a force that is better suited to the strategy currently espoused by the DoD as well as to a more restrained strategy, one in which the United States intervenes far more sparingly in other countries and conflicts. In addition to restructuring and decreasing the size of the forces, her proposed reforms include holding down the costs of military health care, averting some of the expected cost growth in military compensation, taking control of operation and maintenance budgets, and controlling the growth of weapons costs.

The Challenge

The U.S. government faces a tough fiscal future. With federal debt increasing to concerning levels, policymakers must make difficult budget choices. In the past, efforts to reduce budget deficits have relied heavily on cutbacks to defense spending. In this vein, the Budget Control Act of 2011 (BCA) calls for significant reductions to federal spending, among them a 10 percent cut in the non-war defense budget from previously planned levels. Williams proposes that, even with reduced defense budgets, the United States can retain a very strong military that is fully ready, equipped, and capable of succeeding in an important range of missions. Achieving these budget reductions, though, will require both addressing internal cost growth and strategically reshaping military forces.

Reducing defense budgets by 10 percent from FY 2012 levels would return defense spending to its inflation-adjusted FY 2007 level. In the past decade, however, certain categories of defense costs rose significantly faster than inflation. As a result, the same level of defense spending buys less today than it did in the past. Between FY 2000 and FY 2010, non-war defense budgets rose by over 40 percent even though the size of the force increased by less than 4 percent. Although some of this budget growth came from added personnel and new equipment, other important contributors to spending increases have been rising health-care costs, military pay increases, and growing costs of operation and maintenance. These pressures, created by cost growth in these categories, have been further compounded by the mounting costs of major defense systems.

Even if growing internal costs can be restrained, reducing the defense budget will require cutting the force. Furthermore, Williams argues that U.S. military goals have become increasingly expansive since the Cold War, and that the expanded mission set is no longer appropriate either in the context of national security strategy or from a budgetary perspective. The challenge, then, is designing a more streamlined military—tailored to the future global security landscape—that can protect national security at lower cost.

A New Approach

If policymakers are willing to make tough decisions, the United States can retain a strong military that is fully ready and equipped on a budget significantly smaller than that of today. Indeed, the current fiscal crisis and the imminent end to combat operations in Afghanistan provide an opportunity for change. Williams suggests a two-pronged approach: first, tackle rising internal costs to hold DoD spending growth at the pace of inflation, and second, reduce and realign forces to achieve deeper cost savings.

I. Take Control of Internal Costs

A. Reining in the costs of military health care

Health care is the fastest-growing element of the defense budget. Unless policy changes are implemented, military health-care costs will increase by at least 25 percent in real terms in the next five years and may nearly double within the next twenty.

Though some of the growth can be attributed to rising health-care costs throughout the United States, an important share of the rapid rise in military health-care costs can be explained by three other factors. The first is the authorization of the Tricare for Life program in 2000; this program greatly expanded benefits for military retirees who qualify for Medicare and had added nearly $10 billion to the DoD's health-care bill by 2012. The second factor is the small share of health-care costs borne by military retirees compared to the share typically paid in the private sector. The third factor is the low copayments charged under Tricare and Tricare for Life for medical services and prescription drugs.

- To address these growing costs, Williams proposes that Congress agree to the changes in the cost-sharing structure that the DoD already requested. The proposal includes imposing a premium for Medicare-eligible retirees and family members, raising Tricare premiums, increasing deductibles, and increasing copayments. It would specifically exempt service members who retire for medical reasons and the survivors of service members who die on active duty, but could still result in savings of about **$10 billion annually** on average over the next decade.

B. Averting cost growth for military cash compensation and retirement pay

Between 1998 and 2012, military basic pay grew significantly faster than pay in the private sector and 62 percent faster than the consumer price index. The full amount of military cash compensation—including cash allowances for food and housing (and the associated tax advantage) in addition to basic pay—rose even faster. The housing allowance was once set to offset about 85 percent of service members' costs to rent on the open market; those who lived in government housing did not receive an allowance. In recent years, however, the housing allowance has covered the full price of housing, incentivizing service members to live off-base even as the government undertook a massive renovation project to revitalize and expand military housing.

The structure of the military retirement system also contributes to cost growth. Currently, the system of cliff vesting results in many members staying in service until they reach the twenty-year point, at which time they can retire with a generous defined benefit. This system incentivizes many service members to remain in service for more years than either they or their service personnel managers might prefer. Several alternatives could reduce this cost growth.

- To slow the growth in the costs of military pay, Williams proposes limiting across-the-board raises to the level of GDP inflation every year for four years, beginning in 2014. On average over the decade, this alternative would save **$5.6 billion annually**.
- To address the misaligned supply and demand for military housing while reining in costs, Williams suggests reducing housing allowances to reflect a still-generous 90 percent rather than 100 percent of the price of private-sector housing. This plan would save **$1.4 billion annually** over the upcoming decade.
- Rather than throwing the current retirement system overboard, Williams suggests cutting back by 30 percent the fraction of service members who stay until retirement. To achieve this, the DoD should implement a combination of measures such as early career counseling, adjustment and enforcement of up-or-out gates, and narrowing of promotion standards. This alternative could save as much as **$2.5 billion annually** on average over the next ten years.

C. Taking control of operation and maintenance budgets

For decades, spending per troop on operation and maintenance has grown by an average of 2.5 percent each year. One of the largest components of the operation and maintenance category is civilian pay. Like military basic pay, federal civilian pay rose much faster than inflation or than wages in the private sector between 1998 and 2009. As a result, DoD's civilian personnel today are still better off in comparison to their private-sector counterparts than they were fifteen years ago, despite the pay freezes of 2011 and 2012. Even so, Congress is likely to return to a practice of raising pay for civilian workers consistent with wage growth in the private sector, which would increase the defense budget by billions of dollars. The operation and maintenance budget also funds a variety of personnel and family benefits, including a subsidy of $1.3 billion a year for the DoD-run commissaries. To bring operation and maintenance costs under control, Williams suggests two changes:

- Limit across-the-board pay raises for DoD's civilian workforce to the rate of GDP inflation for four years beginning in 2014. On average each year, this measure would avert an average of **$4.6 billion** of the internal cost growth anticipated by the Congressional Budget Office (CBO).
- DoD today runs multiple retail systems that include its commissaries, or grocery stores, as well as three separate base exchange systems. Williams calls for combining the grocery system with the three base exchange systems and eliminating the $1.3 billion annual subsidy to the commissary system. This plan would offset service members' increased grocery costs through cash allowances for active-duty members of $400 per year on average. Overall, this alternative would lead to savings of about **$900 million annually** on average over the next decade.

TABLE 1.

Comparison of Options

	2012 Force	DoD's Planned Force	Option 4-1	Option 4-2
Active Army Brigades	45	37	32	26
Active Army End Strength	562,000	490,000	430,000	370,000
Navy Ships	284	300+	250	235
Active Navy End Strength	325,700	319,500	294,000	294,000
Active Marine Corps Divisions	3	3	2+	2+
Active Marine End Strength	202,100	182,100	168,000	168,000
Air Force Tactical Squadrons	60	54	47	42
Active Air Force End Strength	332,800	328,600	290,000	267,000
Total Active End Strength	1,422,600	1,320,200	1,182,000	1,099,000

D. Controlling weapons cost growth

The cost of developing and purchasing new military systems has experienced substantial growth, typically doubling or even tripling from one generation to the next. In addition to this generational cost growth, many systems experience considerable increases in cost between the first formal estimates and the actual costs to deliver them. Some of the growth in estimated costs can be attributed to production slowdowns imposed for budgetary reasons. But much of that cost growth stems from other factors, including low-balled initial estimates, immature technologies, and flawed or insufficiently detailed designs. When budgets are tight, such cost growth results in a self-reinforcing cycle in which the number of units produced must be trimmed, leading to further unit cost growth due to production slowdowns.

Though Congress and the DoD have rewritten and tightened the acquisition rules in recent years, there are still key problems that, if left unchecked, will continue to propel weapons costs upward. Because the restrictions are often not well enforced, systems continue to move into the development phase before key technologies are demonstrated in realistic environments and to continue through the acquisition process with immature designs. They also often start into production before developmental testing is complete. Such concurrency between testing and production leads to expensive redesigning and rebuilding after units are produced. Unless the regulations are enforced more stringently, these unnecessary costs will continue to spiral upwards. In her proposal, William lays out a plan to address this growth:

- In order to stem unnecessary cost increases during weapons development, the DoD needs to more strictly enforce its acquisition procedures and to cancel systems whose cost estimates grow by more than 10 percent over a period of five years. If these actions can avert even one-half of the anticipated growth in the cost of acquisitions, then savings could be as much as $**6 billion annually** on average.

II. Options to Strategically Reduce Forces

Though the alternatives described above can stem the DoD's internal cost growth, they will not push defense spending below the FY 2012 level in real terms. Reducing defense budgets below the levels requested for FY 2013 will require structural changes such as force cutbacks. Williams considers two possible future paths for the defense budget: one that reflects the spending cuts mandated by the BCA, and a second that makes deeper reductions.

Significant changes in force structure can be beneficial beyond the clear fiscal implications. In the process of reducing the force size, the DoD can adopt a more focused and selective approach to national security. This new approach would shift the emphasis from today's stabilization and counterinsurgency operations to developing the capacity to handle conflict against a rising power. Like the strategy the DoD unveiled in January 2012, the new approach would emphasize missions in the Asia and the Pacific region, which many experts believe would be fought primarily at sea and in the air.

Roadmap

Part 1. Take control of internal costs

- To rein in the rapidly growing costs of military health care, the DoD would again request the changes it proposed in its FY 2013 budget. These changes include raising existing premiums, imposing new premiums on plans without premiums, increasing deductibles, and increasing the copayments charged for prescription drugs. Congress should include the relevant changes in the National Defense Authorization Act.
- In order to limit the size of military pay raises, the DoD for four years would request a military pay raise consistent with GDP inflation, which Congress should include in annual National Defense Authorization Acts.
- The service chiefs and secretaries of the military departments, in consultation with the secretary of defense and congressional committees, would work to reduce the number of uniformed personnel who remain in service long enough to retire. Measures would include early career counseling for individual service members, the adjustment and enforcement of up-or-out gates, and the narrowing of promotion standards.
- To lower the cost of housing allowances and encourage use of existing on-base housing, Congress and the secretary of defense should work together to reduce housing allowances to reflect 90 percent rather than 100 percent of the price of private-sector housing.
- The secretary of defense, the Office of Management and Budget, and the Office of Personnel Management would work together to request across-the-board pay raises for federal civilians limited to the rate of GDP inflation.
- The DoD would streamline its retail establishment by combining the grocery and base exchange systems, ending the commissary subsidy, and providing a grocery allowance to active-duty service members.

Part 2. Strategically reduce the size of the force

- In order to reduce defense budgets in line with the BCA, forces will have to be cut back. One option is to distribute the BCA reductions proportionately among the military departments by decreasing the budgets of the Army, the Department of the Navy, and the Air Force by 10 percent from requested FY 2013 levels. Another option is to reduce defense budgets in real terms by 16 percent from the president's request for FY 2013 and to rebalance forces to prepare for the types of operations likely to unfold in Asia and the Pacific.

Learn More About This Proposal

This policy brief is based on The Hamilton Project discussion paper, "Making Defense Affordable," which was authored by:

CINDY WILLIAMS
Massachusetts Institute of Technology

Additional Hamilton Project Proposals

National Defense in a Time of Change

The current international order provides an opportunity for U.S. policymakers to put the defense budget in order, and the long-term federal budget outlook makes seizing this opportunity essential. Responsible reductions in defense spending should be designed to strategically focus on the threats we are likely to face and to address internal pressures in the defense budget. This paper lays out a strategy to address these challenges in three parts: (1) design a force better aligned to face future challenges, (2) improve the efficiency and efficacy of the acquisition system, and (3) control rising personnel costs. Together, these reforms set the stage for a sustainable defense budget—one that preserves our capability both to face challenges in the near future and to rebuild as new challenges arise.

15 Ways to Rethink the Federal Budget

As policymakers face an unsustainable federal deficit, The Hamilton Project asked leading experts from around the country, from a variety of backgrounds—the policy world, academia, and the private sector and from both sides of the political aisle—to develop policies that are good for the budget and have broader benefits for the economy by encouraging employment, strengthening safety-net programs, or promoting productivity-enhancing investments. Touching on topics as wide-ranging as immigration, transportation, health care, and tax expenditures, the proposals include options to reduce mandatory and discretionary expenditures, raise revenues, and improve economic efficiency.

The distribution of budget cutbacks among the services will determine the future shape and capabilities of the military. Since at least the middle of the Cold War, the share of defense spending allocated to each service has barely budged, and even leaders who plan on shifting resources have found themselves stymied by politics and custom. Williams argues, however, that shifting resources among the services would allow for larger budget savings while preserving important capacity. The paper considers two choices, as summarized in table 1: Option 4-1, which reduces total defense spending in accordance with the BCA while holding the share of defense spending devoted to each military department about where it was in FY 2012; and Option 4-2, which cuts the defense budget more deeply than the BCA would, but adjusts the shares of the budget devoted to each military department to reflect an increase in the relative relevance of maritime forces in a strategic shift toward Asia and the Pacific.

Option 4-1 would reduce quickly each military department's non-war budget by 10 percent in real terms relative to the DoD's FY 2013 plan. Under this option, the BCA reductions would be distributed proportionately among the military branches. These cuts translate into 13 percent reductions from FY 2012 levels for the Army, the Department of the Navy, and Air Force non-war budgets. This option would cut the Army's combat brigades by about 14 percent relative to current plans. It would not reduce the Army's reserve component appreciably, but it would require resolving medical disability cases and creating a leaner, more efficient program for research and development. Additionally, it would require downsizing the Marine Corps and reducing the size of the Navy's fleet by 17 percent compared to the current plan for 2032. This option would require the Air Force to shed about 13 percent of the fighter and attack squadrons the service hoped to keep.

Option 4-2 achieves deeper budgetary savings, but preserves and enhances the forces that are most strategically important for future operations. This option would cut budgets by 16 percent in real terms by 2015 and refocus on future missions in Asia and the Pacific. This would entail reducing the Army and parts of the Air Force more sharply and shifting more resources to the Navy, particularly to those elements that would be most useful in a maritime war against a rising power in Asia. Under this option, the Air Force would also be reenvisioned, resulting in a force that is better suited to operations in the access-challenged environments expected in that region and capable of supporting ground operations in a major war. Overall, by shifting some of the total defense budget away from the Army and into the Department of the Navy and by reshaping forces within the services, this option will result in a military better suited to addressing potential future threats than to fighting in a long counterinsurgency war.

Both options are consistent with a foreign policy more focused and restrained than that of the past two decades. Even so, the United States will retain the strongest, best-funded, best-equipped, and best-trained armed force in the world. Though neither option provides a military able to sustain a long, sizeable occupation or counterinsurgency operation, either option would result in a force that is fully capable of winning decisively in one major theater war, while helping an ally defend against attack at the same time.

Conclusion

Taking control of an ever-growing defense budget requires concrete steps. Williams provides a course of action to curtail internal cost growth and to strategically restructure the force. By cutting the cost of health care, weapons spending, compensation, and operation and maintenance, the DoD can stabilize the budget and help stem the annual growth that has contributed to the nation's fiscal concerns. Likewise, scaling back the size of the force and strategically reallocating resources among the military branches would allow the DoD to meet the requirements for future budget cuts while sustaining a strong national security posture.

Questions and Concerns

1. Will reductions in defense spending result in a military too weak to defend the nation?

Critics of reduced military spending argue that steadily growing U.S. military budgets are necessary to preserve U.S. influence by dissuading rising powers from building up their militaries. In fact, as rising powers enter the economic sphere, it is unlikely that they can be held back from entering the military one. The reality is that growing military budgets will increase fiscal and economic pressures that can ultimately weaken our nation. Moreover, even at lower levels of defense spending, the United States will retain the strongest armed forces in the world for decades. For example, China's military spending today is less than 20 percent of the U.S. non-war defense budget. Even if China could outspend the United States on defense two decades from now—a questionable hypothesis—it could take many years to build up the sort of military power the United States will still enjoy—assuming that we can get and keep our economic house in order. Russia's military spending is less than 12 percent of what the United States spends, and trends for that country are generally downward. All of the other big military spenders in the world are U.S. allies.

2. What will be the impact of reductions in equipment investment on the industrial base?

While it is true that wholesale cancellation of multiple equipment programs runs the risk of closing production lines and ending research and development programs that the services count on to preserve a healthy industrial base, the budget reductions proposed avoid that risk. Instead of cancelling acquisition programs or forgoing them altogether, Williams's proposal reduces production in a manner consistent with the elimination of force structure. The savings estimates also assume that the services will choose to cut back on research and development programs that no longer fit with their expectations for the future.

3. What can history tell us about the likelihood of Congress supporting such changes?

In the past, Congress has supported repeated expansions of pay and benefits for military personnel and retirees, sometimes even against the advice of the DoD. Three important factors are changing the calculus on Capitol Hill, however. The first is the end of the Iraq war and the imminent conclusion of combat operations in Afghanistan, which will ease the disproportionate burden carried by military personnel and their families. The second is the nation's troubling fiscal picture, which puts all expenditures in the mix for evaluation. The third factor is the sentiment of the service chiefs and the uniformed military. In today's fiscal environment, the service chiefs support changes that would shrink the growth of personnel and acquisition costs to free up money for force structure, readiness, and modernization. With the credibility of their expertise and experience, uniformed and civilian defense leaders can play an important role in convincing Congress to make the changes that will be necessary to put the department on a sound footing for the longer term.

4. Will the personnel-related components of the proposal break faith with service members and retirees who served honorably and sacrificed for their country?

The men and women who volunteer to serve in uniform make great sacrifices on behalf of our country. With the nation still at war, some will argue that the personnel-related proposals would shortchange the members and retirees who have sacrificed so much to keep us secure. On the contrary, the dramatic expansion of service member and retiree compensation since 1998 means that pay and benefits for those who serve will still be very generous, even after the rapid spending growth is slowed. The changes proposed to health-care cost sharing specifically exclude the survivors of service members who sacrificed their lives and service members who retire because of medical disabilities incurred while in service. Finally, in time of war, it is not easy to slow the growth of pay and benefits for those who serve. But the answer is not to avoid the changes that must be made if the DoD is to live within its means during the coming decade. Rather, Williams argues, the answer is to stop asking the nearly impossible of the nation's men and women in uniform. This means not reaching for them as the first tool of foreign policy; not entering into long wars that demand that individuals deploy to difficult and uncertain missions two, three, four, or even five times in the course of a few years; not routinely recalling reservists who had reason to believe their service obligations were behind them; and not requiring individuals to remain in service for months after they become eligible to leave.

Highlights

Cindy Williams of the Massachusetts Institute of Technology proposes reining in the costs of military health care, averting cost growth for military cash compensation and retirement pay, taking control of operation and maintenance budgets, and controlling weapons cost growth. In addition to these internal cost measures, she suggests downsizing and restructuring the armed forces.

The Proposal

I. Take control of internal costs

- Change the structure of cost-sharing for military health care by imposing a premium for Medicare-eligible retirees and family members, raising Tricare premiums, increasing deductibles, and increasing copayments. This proposal specifically exempts service members who retire for medical reasons and the survivors of service members who die on active duty.
- Limit both military and civilian pay raises to the rate of GDP inflation for the next four years.
- Reduce military housing allowances to reflect 90 percent rather than 100 percent of the price of private-sector housing.
- Implement a combination of measures aimed at lowering the fraction of military personnel who remain in service until retirement. Measures might include early career counseling, adjustment and enforcement of up-or-out gates, and narrowing of promotion standards.
- Streamline the DoD's retail establishment by combining the commissary and base exchange systems, eliminating the $1.3 billion annual commissary subsidy, and offsetting increased costs through cash allowances for active-duty members.
- Enforce existing acquisition rules and cancel systems that incur cost growth in excess of 10 percent over a period of five years.

II. Strategically reduce the size of the force

- To bring defense budgets into line with or below the levels mandated by the BCA, the DoD will need to make significant cuts to force structure. How the cuts are distributed among the armed services will determine the shape of the future force and the missions for which it is best suited. Williams considers two options. The first is to reduce defense budgets in line with the BCA and to distribute the cuts proportionately among the military departments. The second option is to reduce defense budgets in real terms by 16 percent from the president's request for FY 2013, but to spread the cuts unevenly among the military departments so as to create a force more suited to future operations in Asia and the Pacific.

Benefits

Williams' suggestions for controlling internal costs will allow the DoD to save an average of $31 billion annually over the next decade, thus potentially holding the line against cost growth above inflation. In addition to these savings, the DoD can cut the budget below today's levels by downsizing and reshaping the forces in line with strategic aims. This will result in a force that is better suited to core missions of the future and fully capable of protecting national security.

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1775 Massachusetts Ave., NW
Washington, DC 20036

(202) 797-6279

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