THE HIDDEN COSTS OF MAINTAINING A POST-INDUSTRIAL U.S. MILITARY

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In order to halt the current economic slide, restart the financial and housing markets, and implement a wave of new programs, the Obama Administration has proposed massive new spending programs across almost all parts of the federal government. The big winners are health care, energy, education and transportation.

Amidst all this spending, the Obama Administration has also promised to halve the projected budget deficit in its first term. For this reason, the Administration is in desperate need of a peace dividend.

The one loser among all these winners is defense spending. The Obama Administration plans to reduce defense spending – now at nearly $700 billion, including supplementals – by approximately 20 percent over the next four years. It will achieve these goals by maintaining an essentially flat base budget while reducing supplemental spending as U.S. forces withdraw from Iraq.

Defense spending will decline from approximately 4.2 percent of gross domestic product (GDP) to around 3.5 percent. This will be the lowest level of defense spending in GDP terms since the beginning of the Korean War.

The last time a president got a dividend, the world was entirely different:

- The Soviet Union had collapsed;
- The U.S. had just finished the first Gulf War in which it led a coalition of 20 some nations including Egypt and Syria; and
- The U.S. had completed a decade-long defense buildup in which it had been buying several hundred fighters, a dozen surface combatants, four submarines and hundreds of armored fighting vehicles per year.

President Obama does not have the luxury of favorable international circumstances that existed the last time an Administration sought to cut defense spending in favor of domestic expenditures. Today the United States faces, to mention just a few problems:

- A resurgent Russia;
- A Chinese military that has benefited from more than a decade of double digit budget increases;
- Iran on the verge of acquiring nuclear weapons and well along in its development of long-range ballistic missiles;
- A nuclear North Korea about to test an Intercontinental Ballistic Missile (ICBM)-equivalent space launch vehicle;
- An increasingly militarized dictatorship in Venezuela;
- An unstable Pakistan;
- The potential of Mexico becoming a failed state;
- A protracted insurgency in Afghanistan; and
- The instability produced by a global economic recession, one that could become a true depression.

At the same time, the military capability of this country's traditional allies has declined rather precipitously. In addition, a number of those allies have proven themselves singularly incapable or unwilling to deploy effective combat power beyond national borders.

Now, $600 billion sounds like a lot of money. Yet, it will amount to about 3.5 percent of GDP in 2013 and about 10 percent of expected federal outlays. In fact, $600 billion is not a lot to spend for a military of the size and character of the one we now have.

In fact, I will argue to you that it is not enough. Just as the world has changed from the situation that prevailed in the early 1990s, so too has the state of the U.S. military.

Today, the U.S. military as a force is worn out by years of intensive operations, suffering from rampant equipment aging and confronting a built-in cost structure that makes the problems confronting an American automobile company look tractable by comparison.

Perhaps more important, today we are dealing with what I want to call a post-industrial military. This is one where, in the performance of military activities, the value of knowledge is higher than the value of physical items, specifically weapons systems. It is also one in which labor is a more important input than capital. Finally, the U.S. military today reflects the same social constructs and value sets as the rest of society. This is a good thing, but it also makes it more expensive than before to maintain and operate that military.

I intend to spend the balance of my time talking about the state of the U.S. Armed Forces and, in particular, the hidden costs associated with a post-industrial military. I will then spend a few minutes discussing the alternatives available to the Administration with respect to addressing the costs of that military. Finally, I will conclude with some observations of the consequences of not maintaining the military we need.

The U.S. Military in 2009: Worn Out, Aging and Expensive to Maintain

Most commentaries on the cost of defense tend to focus on the price of new weapons systems. The public is treated to stories that hype the rising cost of new weapons systems. In truth, these increases pale in comparison to the costs associated with bailing out AIG and a few big American banks.

More important, concern for the rising cost of weapons systems places the focus on the wrong thing. The cost of weapons is not the largest bill for the U.S. military. It runs a poor third to the price of people and the costs associated with maintaining a complex and aging force.

The U.S. military in 2009 is worn out, aging and increasingly expensive to maintain. Future expenditures will be dominated by three realities:

- The need to reset a force worn out from extensive use in the Global War on Terror;
- The requirement to pay a growing bill for an all-volunteer force; and
- The reality that a military whose weapons systems are increasingly aging and even obsolescing will require a greater share of available resources simply to maintain.

Reset: Fixing a Broken Military

Part of the difficulty for the U.S. military in meeting the challenges of the wars in Iraq and Afghanistan was the need to reverse the damage wrought during the period from 1985-1997. For those12 years defense spending was reduced by nearly a third in constant dollars. In that period, procurement funding fell from 35 percent to less than 15 percent of overall defense spending. The result was an aging force with insufficient resources to adequately maintain training standards, infrastructure or stocks of war material. Secretary of Defense Robert Gates spoke recently about the impact of past underfunding on current readiness:

> America's ground forces have borne the brunt of under-funding in the past and the bulk of the costs – both human and material – of the wars of the present. By one count, investment in Army equipment and other essentials was under-funded by more than $50 billion before we invaded Iraq. By another estimate, the Army's share of total defense investments between 1990 and 2005 was about 15 percent. So resources are needed not only to recoup from the losses of war, but to make up for the shortfalls of the past and to invest in the capabilities of the future.

Iraq and Afghanistan have imposed tremendous costs on the military, most notably the U.S. Army. The Army is engaged in a massive effort to address both wear and tear on and technological obsolescence (reset/recapitalization) of much of the current force. Since 2003, the Army has reset over 2,000 aircraft, nearly 20,000 tracked vehicles and

more than 100,000 wheeled vehicles. Through 2008 the Army has spent some $60 billion on reset, placing nearly 290,000 major items of equipment into reset. The Army estimates that at least $13 billion will be required annually for the duration of this war and for another two to four years beyond the withdrawal of U.S. combatants from Iraq.

Currently, virtually all reset and recapitalization of existing equipment is funded through supplemental appropriations. In addition, the Department of Defense (DoD) has sought billions of dollars for the procurement of new equipment including medium and heavy trucks, aircraft and missiles. The fiscal year (FY) 2008 Global War on Terror Supplemental budgeted $37.6 billion for reset, nearly $9 billion for repair of damaged equipment and $28.7 billion for recapitalization and new procurements. If included in the base budget these expenditures would amount to an increase of $75.3 billion, or nearly 20 percent.

The Rising Cost of People

What is the most expensive single cost element in a post-industrial economy? The answer is people. This is as true for the military as it is for any modern sector of the economy.

During the campaign, then-Senator Barak Obama made keeping faith with the men and women of the all-volunteer military a central tenet of his national security platform. This meant improved pay and benefits – not only for Active service persons, but for the National Guard and veterans as well.

The decision to grow the Army and Marine Corps by 97,000 is expected to carry with it a price tag of approximately $108 billion, exclusive of long-term personnel costs (retirement and veterans benefits).

Personnel costs involve much more than just paychecks. But even here, costs have been rising sharply. Pay for Active and Reserve service members rose 32 and 47 percent, respectively, between 2000 and 2006 at a time when the median income level in the U.S. was stagnating.

The costs of recruiting and retention for the all-volunteer force also have increased significantly in recent years, to more than $4 billion. Selective reenlistment bonuses are now being offered to personnel who reenlist while serving in Afghanistan, Iraq or Kuwait. Bonuses of as much as $150,000 are offered to special operation forces personnel with 19 or more years of experience who reenlist for an additional six years. The Army now offers individuals willing to enter hard-to-fill military occupations bonuses as high $20,000. College scholarships for new active duty recruits have been increased from $50,000 to $70,000 and for those joining the National Guard from $10,000 to $20,000. The Army alone spent some $650 million in FY2006 on retention.

One of the major contributors to rising personnel costs is that of military health care. Between 2000 and 2009, spending on military health care increased from $17.4 billion to over $42 billion, or 144 percent. The factors contributing to this rapid increase in health

costs include medical care inflation and benefit enhancements required by law, including TRICARE for Life, an increased number of beneficiaries who have chosen to use TRICARE and health care costs for mobilized reservists and their families. DoD estimates that health care costs will rise to $65 billion by 2015, nearly a four-fold increase over 2000. Efforts to increase modestly the individual deductibles and co-payments in order to offset some of these rising costs have been repeatedly rejected by Congress.

According to the Government Accountability Office, it costs about $126,000 per service member each year to provide pay, benefits and health care. More ominous than the cost today is the rate of increase. According to the Congressional Budget Office (CBO), the costs of pay and benefits for every service person have increased by 40 percent since 1999.

In recent Congressional testimony Joint Chiefs Chairman, Admiral Michael Mullen observed that rising personnel costs could make it impossible to support current end-strength levels. The Admiral went on to declare:

> I don't see us, as a country, being able to afford the kind of cost increase at the rate they've occurred over the last several years. We've got to have this right for our people, or essentially we will not have a military to support our national security efforts.

Like any post-industrial sector, there are structural issues that raise the costs of doing business. One of the biggest of these is lawyers. To borrow a phrase from Secretary of Defense Gates, the U.S. military has more lawyers – the Judge Advocate General Corps – than the next 17 militaries in the world.

This is also a military that relies heavily on outsourcing to improve its agility, responsiveness and cost structure. The Administration's seeming vendetta against private contractors will only make the situation worse. Companies such as KBR, Boeing, General Dynamics, DRS, etc. have done fabulous work to support U.S. forces abroad. Reports of waste, fraud and abuse have been remarkably few in number and small in size.

In addition, in cooperation with military depots, private companies have done a lot to transform the way in which maintenance and support is done, providing additional capabilities to the warfighter at reduced costs to the Nation. Under something called Performance-Based Logistics, the partnership between the private sector and the public or organic defense industrial base has proven successful. Efforts to undo this change are misguided.

Operations and Maintenance

The personnel account is only one source of cost growth in the defense budget. Operations and maintenance (O&M) costs are also growing at what many observers believe is an unsustainable rate.

Many factors contribute to the growth in the O&M account. The most significant is the state of military hardware. Another factor is the aging of equipment. For example, O&M funding for aircraft, after an adjustment for inflation, increases by one percent to three percent for every additional year of age. New generations of weapons systems also contribute to increased O&M costs. They tend to be more complex than their predecessors, requiring more training for their crews and greater expense in ensuring their proper function.

CBO figures indicate that O&M costs have been rising at a rate of approximately 2.5 percent per annum since the 1950s. The CBO projects that over the longer term carrying out current plans would push this funding to $366 billion in 2025. If unbudgeted costs are included, that figure would rise to $426 billion. Unless defense spending was to increase accordingly, other accounts, but primarily procurement and research and development would have to be "taxed to pay for rising O&S *[operations and sustainment]* costs." According to one recent study:

> For more than 40 years we have seen steady growth in defense O&M costs above the rate of inflation, despite continued efforts of several administrations to constrain that growth. .... Left unchecked, these inexorable O&M growth trends will generate more funding demands than the current FYDP *[Future Years Defense Program]* can support. Therefore, unless the defense top line rises accordingly, funding will likely have to migrate from materiel investment to O&M to cover the cost growth.

The nation is spending twice as much in O&M on a force that is half the size it was 30 years ago. Even for wartime, the costs are unusual. In 1952, the defense budget of spent 25 percent on O&M. In 1967, during the escalating Vietnam War, 27 percent of the budget went for O&M. In FY2004, O&M was 40 percent of the budget.

The Need for Modernization

I would be remiss in my responsibilities to the topic of this presentation if I did not say something about the need for modernization. There is a continuous need to recapitalize equipment. This is as true for the private sector as it is for the military.

The military is confronted by the problem of an aging equipment stock. More than half of what the military now has was bought during the Reagan-Bush years. Most of the Reagan era increases were for procurement and research and development programs. The procurement budget leapt to $147.3 billion in 1987 from $71.2 billion in 1980. Annual procurement rates for major platforms in the Reagan era far exceeded those for the Bush era. In this period the Army initiated its "Big Five" program (the Abrams, Bradley, UH-60 Blackhawk, AH-64 Apache, and Patriot). The Air Force began recapitalization of its fighter fleet with acquisition of both the F-15 and F-16. Reagan also built 100 B-1 bombers, procured the C-5 and aggressively pursued the stealthy F-117 and B-2. The Reagan Administration went on a crash program to build a 600 ship Navy (actually

reaching 591 ships in 1989). In addition, Reagan era research and development led to major advances in stealth engineering, the use of composite materials, satellite systems, computer software and the development of "smart" munitions.

The build up under the Bush Administration was different insofar as the procurement bump up expected for this cycle never happened. In the Bush build up, DoD spent more and procured less. Even large supplemental expenditures failed to provide procurement funds sufficient to ensure adequate modernization.

For this reason, the Bush defense build up must be judged a failure. U.S. forces will continue to age and become more expensive to operate. The next Administration will have to choose between a significantly smaller but modern force, and one that is larger but obsolescing.

The Choices We Face: Spend More or Lose Capabilities

The military we have today has served us well for more than 20 years. It has responded to demands both large and small. It has maintained a strategic deterrent, provided global presence, conducted both conventional and counter-insurgency operations, supported the defense of the homeland, conducted numerous humanitarian operations and engaged in countless collaborative activities with friends and allies around the world. It is a true full-spectrum force.

It is also a force that is based on the premise that quality is more important than quantity. We build fighter planes, armored vehicles, surface ships and submarines that are better than potential adversaries (actually, they are better than the systems deployed by our friends). We do so for two reasons. First, because superior weapons systems give us a good chance of winning quickly and decisively. Second, and more important, because better systems give our warriors a better chance of coming home alive. That is the logic behind the F-22 fighter, the Virginia-class submarine, the Mine Resistant Ambush Protected (MRAP) vehicles and the V-22 Osprey, to name just a few.

We pay our men and women in uniform relatively well and support them even better. We do far more for them than almost any military in the world. We would not change this approach for anything.

So, if this is the force we like and use, and its structure and costs are in accordance with our way of approaching post-industrial social demands, the only question remaining is will we pay for it. Maintaining this force requires approximately 4 percent of GDP a year to be sustained. I could go into the reasons for this, but it would take too long. Take it as a fact for the moment.

So, we can either pay the price or see our capabilities dwindle.

Conclusions: The Consequences of Cutting Defense Spending

The consequences of decreased real defense spending are both immediate and long-term. Usually, a decline in defense spending is experienced immediately as less support for the troops manifested in such things as reduced training time or flight hours, aging military facilities and less support for dependents. If the cuts are large and sustained they can be achieved only by reducing the size of the Armed Forces and canceling or decreasing the buy rates for new weapons programs.

The consequences of a smaller military to the current Global War on Terror have been experienced as stop-loss orders, the need to deploy National Guard units in combat, and extended tours of duty overseas for both Active and Reserve component units.

The long-term consequences of reduced defense spending can be a military that is obsolescent and less relevant to the challenges of the future. In order to stay modern and relevant, military establishments must continuously replace existing systems and technologies with new ones. Since most military assets have operational lifetimes of 25 to 40 years, the recapitalization process generally takes several decades to complete.

When reduced defense spending results in cancellations and delays in the acquisition of new weapons systems, this means that older systems must be maintained in the force longer, often beyond their planned operational life. These older systems are usually less capable than those intended to replace them, have much higher maintenance costs and may have to operate with safety restrictions that decrease their operational utility. Moreover, once recapitalization is delayed for a number of years or even decades it creates a "bow wave" in future defense spending as the necessity of replacing old systems grows.

In addition, once capabilities are lost, they may be difficult or even impossible to reconstitute. It takes years to train competent mid-level Service personnel and to meld those individuals into effective combat units. The ability of U.S. forces to successfully perform complex missions and tasks such as carrier air operations, combined arms maneuver warfare, close air support, or theater air and missile defense requires constant practice and a cadre of long-serving individuals with the specialized knowledge and experience in these activities.

This also holds true for the industrial base that supports national defense. From a high of approximately 20 major defense prime contractors serving DoD, only six now remain. The result can be less competition to provide goods and services to DoD, higher prices for those products and services, and less capacity to increase production in the event of a crisis in national security.

Nations that have experienced rapid and sustained declines in their defense establishments have most often had to abandon their leading role in world politics and to rely on others for the protection of overseas interests. This is what happened to Great Britain in the 1970s when that nation, facing a fiscal crisis, chose to radically shrink the

size of its armed forces and withdraw its military from all positions and commitments east of the Suez Canal. Then the U.S. was able to take over for Great Britain, providing security for Western interests across the globe. Today, who would provide that security in the absence of the U.S. military?

Making the decision to reduce defense spending is often characterized as a choice to accept greater risk to the nation's security. In a period of relative international peace and stability, this risk can be quite low. However, in a period of great political, economic, technological and social change, the risk can be quite great. The last sustained decline in defense spending took place at a time when the Cold War was ending and a so-called "New World Order" or relative peace and economic prosperity seemed imminent. Today, while the dangers of world war and/or a large-scale exchange of nuclear weapons are remote, the range of threats to U.S. national security and to the homeland itself has grown.

Thank you for your time and attention.