The Softened Slope for Defense

Special Topics: Murray-Ryan Budget Deal

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The just-announced Murray-Ryan budget deal softens the fall of the defense budget,* likely keeps defense spending well above historical levels, and does so by at least partially shifting funds from personnel costs to operations and modernization, as many have called for.

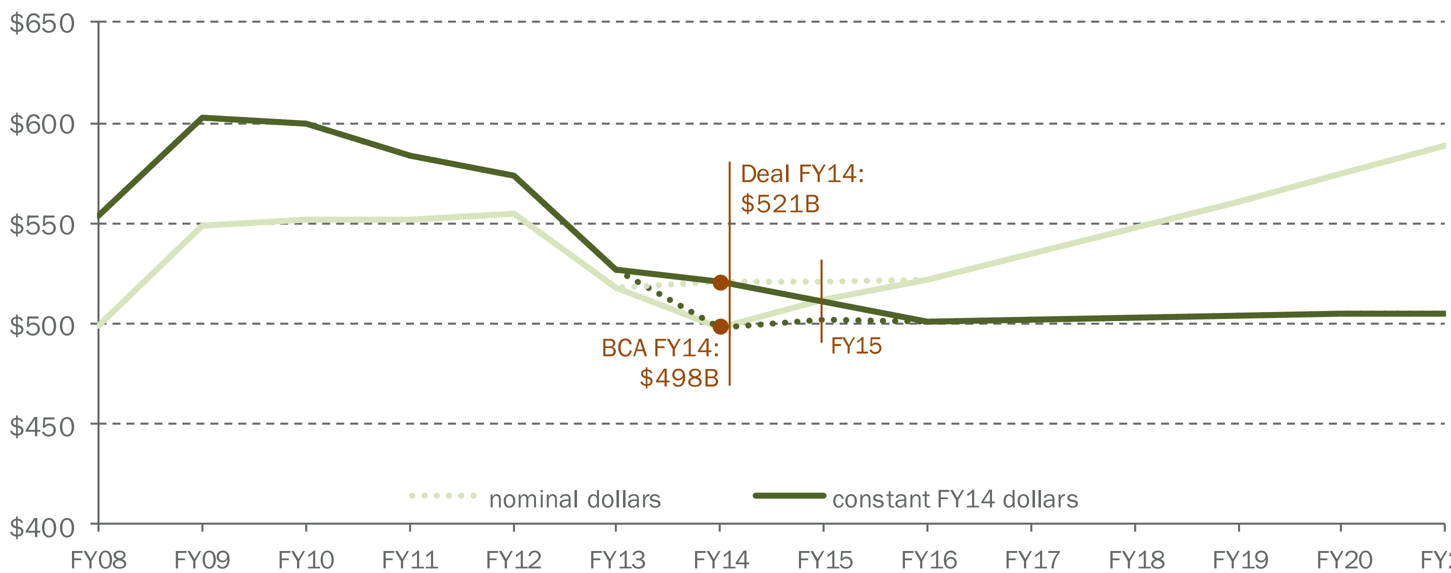
The deal—officially the Bipartisan Budget Act—does not change the expected low point for the base defense budget in real dollars, as shown in the accompanying chart. The base budget will still fall to about $500 billion in real terms, a 17 percent drop from its peak in FY09/10. But the deal moves that nadir out to FY16, seven years after the defense budget stopped growing. That shift significantly eases the implementation of further reductions by spreading them over more years.

The sequester in FY13 now represents the steepest year-to-year drop at 8 percent, or $46 billion in FY14 dollars. Instead of another 6 percent drop in FY14, the deal now cuts the FY14 budget by only 1.2 percent from FY13. This reduction is less than the drops from FY10 to FY11 or from FY11 to FY12, when the defense budget was essentially frozen for both years. Under the deal, the FY15 and FY16 budgets will contract slightly in real terms, although at about the same pace as every recent year other than the FY13 sequester cut. And from FY17 on, the post-sequester Budget Control Act caps keep the defense budget at pace with projected inflation, so changes in inflation will determine whether the budget increases or decreases slightly each year.

Importantly, these levels also provide clarity for both the Pentagon and the appropriators providing the funding. The Pentagon was already planning for the FY15 budget to be significantly lower than projected because of sequester. Now that the budget deal provides some clarity, DoD planners can presumably craft a defense budget for release this coming February that is aligned with the new levels set in the deal.

Moreover, if this new deal provides stability for discretionary spending in the coming years, it could also mean defense spending will stay significantly higher than it has in past builddowns. We will provide more in-depth analysis with more exact comparisons in the coming days.

National Defense in Murray-Ryan Budget Deal



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Transferring Costs from Personnel to Operations and Modernization

The Congressional budget chairmen have explicitly justified the deal as a deficit reduction measure, offsetting the extra funding provided both defense and non-defense discretionary spending. Yet the deal does more than that. The provisions that create offsetting savings and revenue also transfer defense costs from personnel to operations and modernization.

Many, including not only Stimson's Defense Advisory Committee and myself but also the Secretary of Defense, have called for reforming personnel compensation within the Department of Defense. This reform is usually justified by arguing that if personnel costs become too great a proportion of defense spending, there will not be enough money left to buy the weapons and equipment needed to make personnel effective and well-protected in combat. Only by redirecting funding from personnel to other defense spending, like operations and modernization, will the United States' defense be assured.

The budget deal does exactly that. Two specific provisions reduce the cost of defense personnel. One reduces the annual cost of living adjustment for military retirees under the age of 62 to one percent less than inflation. Over time, this gradual reduction means real savings of more than a billion dollars a year by FY21. And, though such a reform does degrade the value of the military pension, it does so gradually and at an age when most military retirees have embarked on a second career. When a retiree reaches age 62, the pension is adjusted to its full annual amount as if the retiree had received the usual annual increases.

CBO says this specific provision will save the US government $6.2 billion in the next ten years and will keep reaping savings after that. But besides these savings, it also reduces how much the Defense Department must pay into the retirement fund for its current servicemembers, saving the Department about $8 billion over the next ten years. Since these savings are in the discretionary part of the budget, they can now be spent on operations and modernization as long as the Defense Department receives appropriations up to the defense cap.

The deal includes a second provision that could eventually serve much the same function, although it will not do so for a while. The deal requires civil servants to pay a greater share of the cost of their retirement annuity, though their share is still only about a third of the cost of the total annuity. The rest is paid by the agencies, and therefore the taxpayers. CBO projects that for the whole US government, this provision will raise $6.0 billion over the next ten years. Since DoD employs 37 percent of US government civilians, its employees will provide a large chunk of those revenues—a rough estimate of about $2 billion.

Since the Defense Department and other government agencies cover whatever share of the retirement annuities employees have not paid for, increased employee contributions could free funds for other uses. For DoD, that could mean another transfer to operations and modernization spending. The budget deal, however, explicitly prevents this, instead redirecting the new revenue to pay off unfunded liabilities for existing civil service retirements. However, once those unfunded liabilities are eventually paid off, the agencies regain those savings and could theoretically transfer funding from civilian personnel spending to operations and modernization. In practice, the unfunded liability before this new provision was not projected to be paid off until after 2070. This provision will hasten the pay-off, but it still will not be completed any time soon .

The Murray-Ryan deal softens the decline in defense spending, likely stabilizes defense spending well above historical levels, and begins the process of one of the reforms many thought would be the toughest politically—transferring spending from personnel costs to operations and modernization. That's a heck of a present for the defense establishment this holidays.

** The "defense budget" in this brief is the entire national defense budget, budget function 050, which besides the Department of Defense includes the National Nuclear Security Administration funding for nuclear weapons and their clean-up, some FBI national security funding, and other small amounts. The Defense Department budget is likely to be roughly $20 billion less in every year than the total national defense budget, although the exact proportions will depend on how future appropriations allocate funding within the statutory caps across these agencies.*