

# Strategy Research Project

## Impact of the National Debt on United States Army Funding

by

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United States Army War College  
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USAWC STRATEGY RESEARCH PROJECT

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## **Abstract**

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The debt of the United States is the greatest threat to our national security. The Army must be part of the solution on bringing the national debt to a manageable level. Part two of the Budget Control Act of 2011, also known as sequestration, reduces the Army topline funding by \$125B over nine years. This equates to a 10% reduction in Army funding from a total budget of \$1.2T from FY13-FY21. Sequestration as it's currently written creates an imbalance in the Army which leads to a hollow force. This paper identifies what part of the law needs to change and shows how the Army can take these reductions and still execute the National Security Strategy. These reductions require the Army to make hard decisions about what the future force will look like. Programs must be delayed or in some cases terminated to ensure the highest priority requirements receive adequate funding.



## **Impact of the National Debt on United States Army Funding**

Debt is the biggest threat to U.S. national security.

—Admiral Mike Mullen<sup>1</sup>

The continuing accumulation of deficits can burden a country with high levels of debt which negatively impacts a country's ability to provide for the common defense, limits future investments, and restricts the country's ability to provide for the citizens in areas of education, health care and other social safety nets. High levels of debt have the potential to reduce economic growth. A study by Kevin Hall, a national economics correspondent with McClatchy News, states that when a nations' debt exceeds 60 percent of its Gross Domestic Product (GDP), its growth rate slows precipitously. When that debt to GDP ratio exceeds 90 percent, a nations' economy barely grows, and can even contract.<sup>2</sup> GDP is the value of all goods and services produced in a year. The United States debt has reached the same level of its GDP or \$16T. Among advanced economies, only Greece, Iceland, Ireland, Italy, Japan and Portugal have debts larger than their economies. Greece, Ireland, Portugal and Italy are at the root of the European debt crisis. The first three countries received bailouts from the European central bank while Italy's books are monitored by the International Monetary Fund.<sup>3</sup> Slower growth results in lower revenues for the government and reduces the ability of a country to pay off the debt or even interest on the debt. With lower revenues a country's ability to borrow money is tied to its economic health. A country with the ability to pay back its debt, can borrow money at a lower cost. Former Secretary of Defense Robert Gates said in a May 2011 speech "... as matter of simple arithmetic and political reality, the Department of Defense must be at least part of the solution."<sup>4</sup>

Despite the strategic implications of pending budget cuts, the United States Army can manage the proposed reductions and still fulfill our portion of the National Security Strategy (NSS). Reductions in defense spending require hard choices. Anytime an organization reduces spending or gets smaller, painful decisions are made on what parts to keep or grow; which parts to reduce in size; or which parts to terminate. Failure to make these difficult decisions results in not having the right type of organization and capabilities required for the future. For Department of Defense (DoD), a reduction in funding brings spending to a previous year's level. How DoD handles the reductions are critical to future success in winning our nations' wars. A similar size reduction to each program or account may not set DoD up for future success. This type of reduction is somewhat easier for DoD stakeholders, such as Congress, the Services, and defense industries, to accept because hard choices are not made. However, for DoD to fight and win our nations' wars, hard choices must be made which creates winners and losers. Managed cuts allow resources to go to higher priority programs or activities that give DoD an edge in future conflicts.

This paper shows why getting our nation's debt under control is critical to the future success of our country. To help understand the importance of debt an understanding of the definitions are required. The paper will also look at what the Federal Government has done to address the debt with the Budget Control Act (BCA) of 2011 and the America Taxpayer Relief Act (ATRA) of 2012. The paper discusses some options, by appropriation, where the Army can reduce spending levels but successfully posture itself for the future. While reduction in levels of funding require hard choices there are opportunities available to shape the force of the future. Finally, the

recommendations will state what the Army should do to posture itself for the future while executing the Army portion of NSS as part of the Joint Force. A study by Center for a New American Security shows a number of options where the Army and DoD can take a similar sized reductions and still execute our country's defense strategy.<sup>5</sup>

Budget deficits are caused when revenues, funding the government takes in as receipts, are smaller than what the government spends in a fiscal year. The government then must borrow funding to pay its bills. When the government borrows money there incurs an obligation to repay the loan with interest at a future date. The chart (Figure 1) on Surplus and Deficits, below, compiled from the Office of Management and Budget (OMB) historical tables, reveals that since the last government budget surplus in 2001 the government yearly deficits have grown substantially. The columns for 2013-2017 are OMB estimates for future deficits.<sup>6</sup> While deficits may go down slightly in the near future there is still a large bill that the Federal Government must pay.

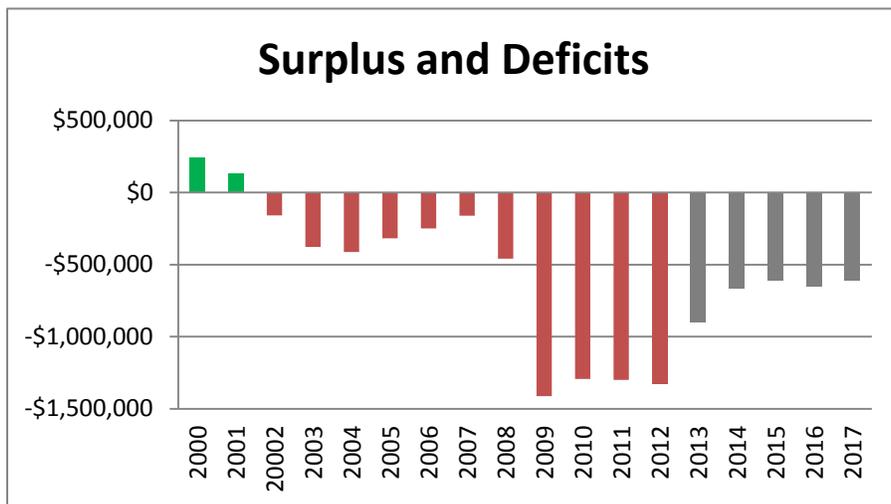


Figure 1. Surplus and Deficits

The national debt is the accumulation of yearly budget deficits. There are two types of debt; internal and external. Internal debt includes funds borrowed from sources

within the United States such as U.S. citizens, corporations, and from the excess social security trust fund. External debt is funding borrowed from entities outside the United States which include foreign individuals, corporations or governments. There is a debate in the United States on the impact of the debt on our nation's financial future. One argument states that since the majority of the debt is owned by American citizens or U.S. institutions, the nation owes itself and therefore can continue deficit spending. Economic theory states, deficit spending stimulates the country in the short term and is a critical tool when faced with an economy in recession. Government spending during a recession or slow growth is designed to inject money into the economy. This funding injection allows individuals and business to continue to spend, generating demand for goods and services. If the country stopped deficit spending and the private sector is not hiring personnel or not spending then the country may fall back into a recession. Therefore the country needs to continue deficit spending for long term health.

The other side of debate states that too much debt is unsustainable in the long term and could damage the country. Carrying too high a debt burden may limit a country's ability to respond to crisis or opportunities. A country already heavily in debt and perceived to have trouble paying back its loans, pays a much higher cost in interest to borrow, or may not be able to borrow at all. A country's failure to address a debt problem, in the near term, may force more painful reductions or higher taxes later. Future generations of Americans will have to pay off that debt without receiving the benefits of the spending. While not all debt is bad, too much debt creates a burden. A good example to explain why debt is important is to look at an individual. If you borrow to buy a house or to get a better education you incur debt. The debt incurred should

enhance your life. However, excessive amounts of debt can limit an individual's ability to have a better life. An individual who constantly spends more than they earn, soon finds more of their pay check going to pay off their debt than enhancing their life. Countries cannot continue to borrow forever without paying off their debt.

The United States national debt is over \$16T and is programmed to continue to rise over the next decade. In 2012 the government borrowed \$1.1T over receipts brought into the government, and increased the debt from \$15T at the end of FY2011 to over \$16T at the end of FY12.<sup>7</sup> To help offset the deficits the government has borrowed from accounts that are in surplus, such as social security, and issued debt instruments as a future liability to be paid when the account requires the funds. Trust funds, such as Social Security, Medicare and the Civil Service Retirement Trust Fund, own \$5.0T of the intragovernmental debt. Public debt owned by U.S. entities is in excess of \$6.4T.<sup>8</sup> Debt held by foreign entities accounts for \$5.1T, of which China (\$1.2T) and Japan (\$1.1T) are two countries holding the largest portion of foreign debt.<sup>9</sup>

As a result of the debt the United States is approaching a time when interest payments will negatively impact other government programs. Interest payments are a mandatory bill that must be paid. The chart (Figure 2) on the next page, Debt Interest vs. Discretionary Spending, shows government predictions on the payment of interest on our country's debt and impact to discretionary spending. Discretionary funding, shown on the chart as diamonds, remains relatively constant over the next decade. This line includes defense spending along with other federal programs such as education, transportation and the Veterans Administration. The square data points show interest payments increasing from \$230B in FY11 to over \$900B by 2019. The projected

increase in interest payments, due to high levels of debt, will force tax increases, cancellation of programs, or a severe reduction on discretionary programs including defense. To avoid any cancellations of programs, reduction in discretionary programs or tax increases the country would increase the amount of borrowing to maintain current spending levels. Increasing borrowing places a burden on future generations when this debt is paid off. In Robert Hormats book, *The Price of Liberty*, the writers warns,

If the United States remains on its current course it will be painting itself into a financial corner: officials charged with ensuring U.S. security and conducting these programs will find it increasingly difficult to obtain funds.... interest payments on the governments rising debt will constrain the government’s budget flexibility to meet those needs.<sup>10</sup>

## Debt Interest vs Discretionary Spending

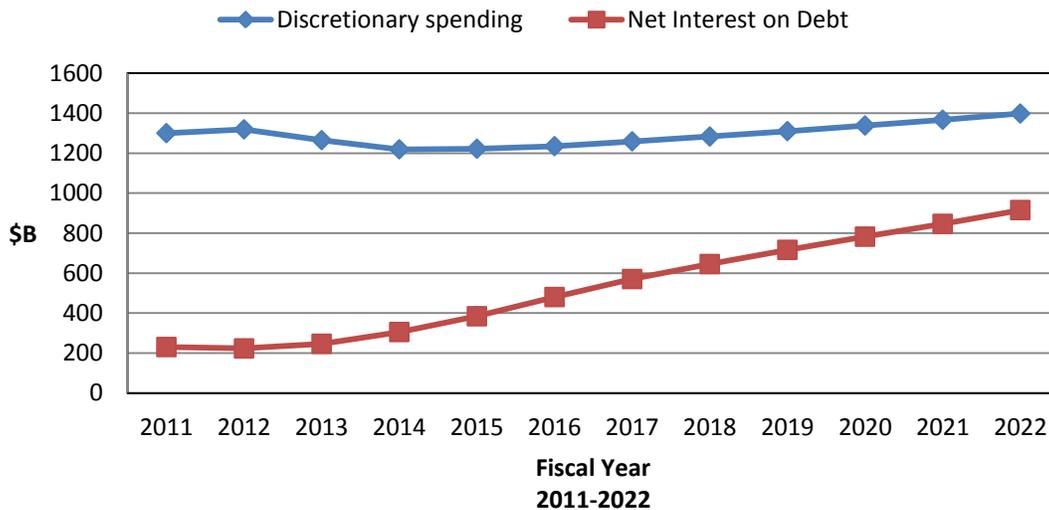


Figure 2. Debt Interest vs. Discretionary Spending<sup>11</sup>

The possibility also exists that the other countries or entities will not want to buy our debt if our financial crisis continues. The government has made some efforts to address the rising debt.

## The BCA of 2011

Members of both political parties recognize that the United States debt is a problem. However, the debate continues on which programs should be cut or how much taxes should be increased. The BCA of 2011 was a two phased bipartisan attempt to control future spending. Phase I reached a compromise on how much the Federal Government could borrow in the future, reduced federal spending by \$900B over 10 years and identified a joint commission to recommend a future \$1.5T reduction in spending or tax increases. If the joint commission's recommendation was not accepted by Congress then Phase II of the BCA of 2011 would be implemented. Phase II of the BCA mandates \$1.2T in automatic cuts, known as sequester, across 9 years starting on 2 January 2013. Majority of reductions in phase II would impact discretionary spending programs like defense.

Sequestration was designed to reduce all accounts in all programs by the same level. The specter of harmful across-the-board cuts to defense and nondefense programs was intended to drive both sides to compromise. The main complaint about sequestration, besides the reductions themselves, is the lack of ability to prioritize the reductions to ensure the most important items are funded. Additionally, from a DoD standpoint sequestration may make our current defense strategy unattainable. The Administration strongly believes that sequestration is bad policy, and that Congress can and should take action to avoid it by passing a comprehensive and balanced deficit reduction package.<sup>12</sup> However, Congress could not reach agreement on the Joint Committee recommendations or reach agreement with the Administration on spending reductions. In an effort to stop sequestration the Federal Government passed the ATRA of 2012. This bill increased generated additional revenues by increasing taxes on

individuals making over \$400K per year and delayed sequestration until March 1, 2013. This delay was designed to give both political parties time to reach an agreement to end sequestration. However, even after this two month delay sequestration went into effect on March 1, 2013.

Historically the United States significantly reduces defense spending after a conflict. With the conflict in Afghanistan winding down there have been calls for deep reductions in defense spending. However, there have been equally vocal calls for maintaining a robust defense establishment due to Islamic extremism and the rise of China as a potential threat to regional security, threat of a nuclear Iran, North Korea, and the potential spread of weapons of mass destruction. The DoD Budget Trends chart on the next page shows the historical trends for the DoD spending since 1948 and projected out to 2020.<sup>13</sup> DoD spending has increased and decreased based on the threats to the country and economic realities. In the past the United States reduced defense spending by over 30% after a war. The spending line includes both base budget and emergency supplemental funding. The dotted line in the projected area includes projected emergency supplemental funding through FY2017. Based on the chart (Figure 3) below, which includes the reductions from Phase I of the Budget Control Act of 2011, DoD is projected to have higher spending levels than after other conflicts. Additional pressure will be placed on DoD, based off historical precedents, to reduce defense spending even further as the nation's leader's deal with the debt. While the country cannot balance the national budget and reduce the debt with cuts to defense spending alone, DoD must be part of any solution to reduce the national debt.

## DoD Budget Trends FY1948-FY2020

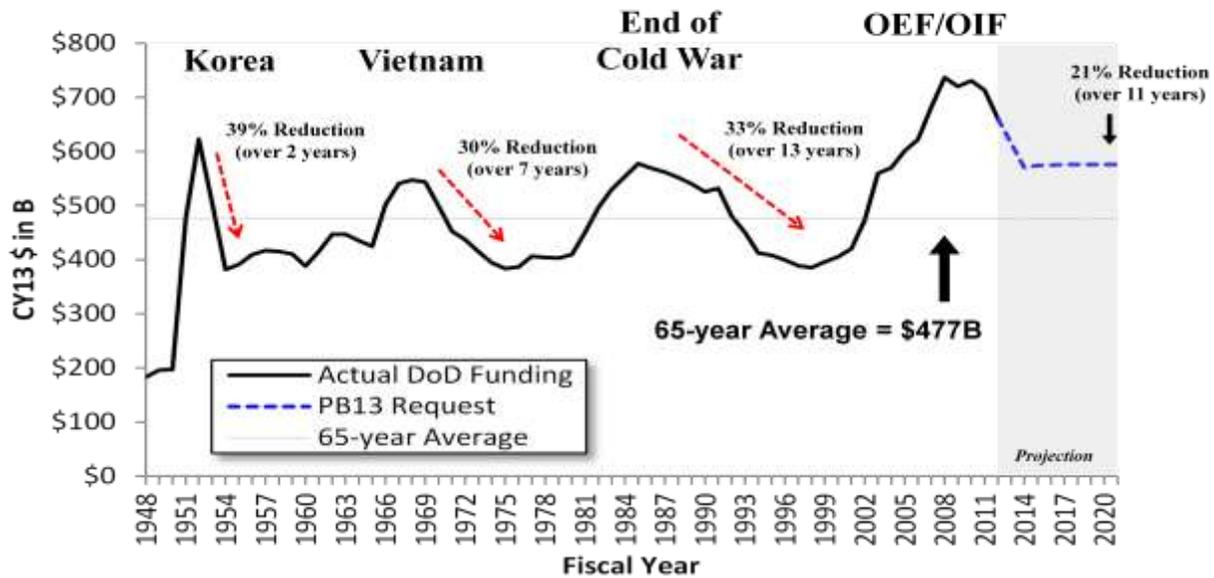


Figure 3. DoD Budget Trends FY 1948-FY2020

Phase I of the Budget Control Act of 2011 reduces DoD spending by \$487B, out of a total \$900B reduction, over ten years. This reduction equates to approximately 10% of DoD base budget. The impact to the Army was a reduction of 80,000 soldiers (from 570K to 490K) by FY17, reduction of 8 active duty Brigade Combat Teams (BCTs), from 45 BCTs to 37 BCTs, a slow-down in modernization efforts for certain weapon systems, and a reduction in Military Construction (MILCON) projects. While these cuts were hard, according to Gen Odierno the time is strategically right to reduce the Army's force structure.<sup>14</sup> At the end of the manpower drawdown in 2017 the Army will still be larger than the pre 9-11 force. Additionally, while the Army has worn down its equipment with two wars, Congress has appropriated funding to reset it. Reset includes the purchase of replacements for combat losses, where it is cheaper to buy a new one than to fix the old one as well as the repairs necessary to bring the equipment to like new or almost like new condition. When the Army buys a new piece of equipment, it gets an updated

version of the equipment that was destroyed or uneconomically feasible to fix. Reset of the Army's equipment has extended the useful life of its equipment. The \$487B DoD reduction is doable under today's fiscally constrained environment and the Army will always be ready to rapidly apply its combined arms capabilities to dominate any environment and win decisively as part of the Joint Force.<sup>15</sup>

The defense portion of Phase II of the BCA mandatory cuts is \$500B out of \$1.2T. The Budget Control Act has a provision in which the President can exempt military personnel accounts. On July 31, 2012, the President decided to do this.<sup>16</sup> Exempting military personnel accounts results in larger reductions in other military accounts such as O&M or procurement. Based on the BCA and the ATRA of 2012, as currently written, the exemption of military personnel accounts sequestration results in an 8.8 percent reduction in non-exempt defense discretionary funding.<sup>17</sup> For the DoD FY2013 proposed budget of \$614.7B, total defense spending must be reduced by \$45B.<sup>18</sup>

There are three areas that compound identifying the exact amount per appropriation being reduced in FY13 to meet the \$45B reduction. First, sequestration hits all open accounts. An open account is a program in which funding has not been placed on a contract. Certain DoD appropriations, for example procurement accounts, have funding available for multiple years. As a program reaches a certain level of maturity then additional funding is put on the contract to continue development. Under sequestration a multi-year program begun in FY2011, which does not have all its funding on a signed contract, will take the same level of reduction as a FY13 appropriation. These multi-year accounts, with unobligated funds from prior years, help

offset the \$45B amount required in FY13. Calculations to determine the reductions in these multi-year accounts will occur once sequestration takes effect. Prior year funding that is available for sequestration reduces the impact on FY13 appropriations. Second, since sequester begins five months into the fiscal year (which begins October 1<sup>st</sup>), reductions have to occur in the remaining seven months of the fiscal year. If that happens, these departments could be forced to “double and triple” their efforts to reduce spending toward the end of the year to get in line with the annual budget allotments.<sup>19</sup> Finally, the FY13 budget has not been passed and Department of Defense (DoD) is under a continuing resolution until March 27, 2013. Under a continuing resolution the Services are not allowed to exceed prior year funding levels, in this case the FY12 amounts. The FY12 enacted amounts for the Army are \$10B higher than proposed budgeted amount for FY13. The Army is spending at a higher rate than if the FY13 budget had been enacted. What Congress actually appropriates for a spending bill in FY13 impacts where the reductions occur. Despite these sequestration unknowns, a close estimation on the impacts to the Army can be determined.

DoD’s FY13 sequestration impact is \$45B<sup>20</sup> with the Army’s portion of this reduction estimated to be \$8.7B<sup>21</sup> or 19% of the total DoD reduction. Since we are five months into the year, the Army plans to take a 10.5%<sup>22</sup> reduction from each appropriation, minus military personnel accounts. The \$8.7B sequestration number includes prior year unobligated balances so the full amount is not directly tied to FY13 funding. The Army portion of the FY13 budget is \$184.6B out of a total DoD budget of \$614.7B, which includes emergency supplemental funding. Before sequestration the Army budget was 30% of the DoD total budget authority. Exemption of military

personnel accounts increased the amount other Army appropriations are reduced, but as a percentage of DoD total budget authority, the Army is paying a smaller portion for sequestration as it relates to what it is receiving in total budget authority.

The Army's budget decreases from 30% of DoD's total budget authority in FY13 (includes emergency supplemental funding) to 23% of the DoD total budget authority in FY17.<sup>23</sup> With current supplemental funding the Army averages 25% of DoD's total budget authority through FY17. A \$125B reduction in Army spending equates to 25% of the total DoD \$500B sequestration reduction. To get a \$125B reduction over nine years the Army's reduction percentage goes from 10.5% in FY13 to 19% of available funding, minus personnel accounts, in FY14 and out. This percentage increase is primarily due to a reduction in supplemental funding in the outyears and exemption of the military personnel accounts. Looking at Army projected base budget topline the Army goes from \$134B in FY13 to \$116.0B by FY17 under sequestration or an average \$14B reduction per year to Army topline. If we look at Army topline in FY00, we still see an increase in funding from \$101.8B<sup>24</sup> in FY00 to \$116B by FY17. Despite reductions in these planned reductions in funding the Army is still above pre-9/11 amounts.

Table 1. Army Base Budget Total Budget Authority (FY13-FY17)

(\$B)	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
Original Topline	134.0	132.8	130.4	128.9	129.6
Sequestration Topline	119.5	117.6	116.7	113.9	116.0

However, with the country's debt problem, if sequestration does not occur as currently written, the Army's budget will most probably still experience a similar topline decrease.

How the Army handles the budget reductions begins with decisions made in FY13. The Army FY13 budget submitted to Congress is \$184.5B of which \$50B is emergency supplemental funding and \$134.5B is the base budget. Military personnel accounts for 42% of funding which is exempt. This results in other Army appropriations taking a higher percentage of reductions. Other Army accounts impacted by sequestration include pass-through funding for Afghanistan security and infrastructure funds, Joint Improvised Explosive Device Defeat Organization (JIEDDO), and the Chemical Demilitarization Program. Pass-through accounts are not directed Army programs but can impact Army capabilities. For example, JIEDDO's mission is to identify, develop and field systems to defeat improvised explosive devices, which continue to be the biggest causality producer in Afghanistan. The two Afghanistan funds are important to increase the capability to the Afghan security forces as the U.S. prepares to depart the country. Exempting military personnel accounts results in the Army taking a higher percentage from other accounts to protect our Soldiers from being downsized due to sequestration. The biggest account impacted by sequestration is the O&M account. In FY13 the Army proposed O&M base budget is \$47.2B,<sup>25</sup> which includes the National Guard and Army Reserve amounts. Current sequestration reductions in O&M accounts are \$4.7B out of the \$8.7B<sup>26</sup> or 54% of the total Army sequestration amount. O&M funds Ground Operating Tempo, aircraft flying hours, fuel, supplies, maintenance of vehicles, aircraft, and weapon systems. Additionally, O&M

funds quality of life programs, over 166,000 Department of the Army (DA) civilians, educational programs, and operations at Army bases. Table 2 below shows the impact of sequestration on the Army O&M accounts.

Table 2. Army O&M Projections FY13-FY17

(\$B)	FY13	FY14	FY15	FY16	FY17
O&M	47.2	46.5	44.3	43.9	44.7
O&M After Sequestration	40.5	37.6	35.9	36.2	37.6
O&M Reduction	<b>(6.7)</b>	<b>(8.9)</b>	<b>(8.4)</b>	<b>(8.5)</b>	<b>(8.9)</b>

A subset of O&M is Active Component Operating Forces with a proposed FY13 budget of \$22.4B. Sequestration of 10.5% results in a \$2.4B reduction to the Operating forces which includes; training accounts, flying hour program, depot maintenance and support to Combatant Commanders. If sequestration affected each account equally at 10.5% and the Army leadership was unable to prioritize activities, a unit preparing to deploy takes a 10.5% reduction just as a unit returning from deployment. However, Army leadership, based on SECDEF guidance, has started to prioritize some of the O&M missions. In a 10 January 2013 memo DoD issued guidance to fully protect wartime operations, wounded warrior projects and projects tied to the new strategy.<sup>27</sup> To protect those accounts the Army has alerted some commands that their O&M budgets may face reductions up to 40%.<sup>28</sup> The Army's main focus should be on the units preparing to deploy while reducing funding for other units that have additional time to train up prior to deployment. To protect deploying units or high priority activities the

Army reduces other lower priority accounts, such as non-deploying units, depot maintenance or other base operations accounts to ensure the deploying units are fully prepared for deployment. For the out years Army officials have not identified the six BCTs and other units which will deactivate based on the current downsizing construct. These unit reductions can cover part of the future O&M bill. Taking training dollars from lower priority units to fully fund the next deploying unit requires additional funding needed to train up the lower priority units or activities as they become next in priority. As the training skills decay from reduced use, additional funding is required to bring units up from a lower readiness rating in a shorter time frame. This can become a downward spiral for unit readiness unless more funds can be identified. Another area of concern within the O&M appropriation is DA civilians and contractor employees.

The Army guidance of 16 January 2013 states that units and agencies look at 22 day discontinuous furloughs, starting 16 April 2013, for all DA civilians, reducing overtime and releasing of all temporary employees.<sup>29</sup> Twenty-two days is the extent under law that the Army can furlough civilian personnel. For the Army these furloughs save almost \$1.5B in FY13 funding. The Army is using furloughs for two reasons; it saves FY13 funding and preserves the work force in case the Federal Government changes the sequestration law. Furloughs lasting into FY14 and beyond are not the right answer. The best civilian employees will end up leaving the workforce and productivity will decrease for the remainder of the workforce. In the short term permanently reducing the DA civilian work force costs the Army. This cost is due to authorities with certain benefits that help organization in downsizing. These programs provide incentives and help for DA civilians as they transition out of the workforce. While

these programs can be costly in the near term it is the right thing to do for our civilians. Once the reductions are fully implemented significant savings are realized.

FY13 proposed Army budget plans a civilian workforce or full time equivalent of 256,000<sup>30</sup> workers going down to 253,000 workers by FY17. The majority of DA civilians are paid out of O&M accounts. Table 3 below compares the changes in the Army civilian work force with the active duty end strength. Under the current plan both civilians and active duty numbers are larger than in FY00. While we see a large reduction in active duty end strength there is no corresponding decrease in the size of the civilian workforce. The funding to pay a DA civilian is included in the budget appropriation as part of the overall budget and not a specific civilian pay funding line.

Table 3. Active Duty and DA Civilian End Strength

(K)	FY00	FY13	FY17
Active Duty End Strength	484	542	490
DA Civilians	220 <sup>31</sup>	256	253

A 10.5% reduction in funding equates to at least 26,565 personnel reduction for DA civilians. Using a cost factor \$92.5K<sup>32</sup> per DA civilian work year in pay and benefits then reducing 10.5% of the DA workforce saves \$2.4B a year in O&M cost or \$19B over eight years. These savings are based on eight years rather than nine due to the furloughs in FY13 taking the place of permanent reductions. To reduce the DA civilian workforce to the FY00 levels an additional 6400 DA reduction could occur to free funds up for higher priority missions. Using \$92.5K per DA civilian, then an additional 6400 DA

civilian reduction saves \$592M per year or \$4.7B over eight years. These savings can fund higher priority requirements and bring the Army DA civilian workforce into line with force structure sizing at pre-9-11 numbers.

The Army contractor work force is at 214,000, of which 72,000 are supporting OIF/OEF.<sup>33</sup> Personnel Service contracts for FY12 were at \$40.5B.<sup>34</sup> A reduction in contractor support is an additional area that provides a source of funding for other accounts. Focusing on the 142,000 contractors not supporting OIF/OEF a 10.5% reduction in the number of contractors, based on an average of \$189K per contractor, results in savings of \$2.8B per year or over \$25B in nine years. For minimal reductions in contractor workforce the Army finds substantial savings for other activities.

Reductions in both DA civilians and contractors are in line with Congressional concerns about the size of the civilian workforce.<sup>35</sup> As we right size the civilian workforce the Army must relook MILPERS.

In July 2012, the President exempted Military Personnel Accounts (MILPERS) from sequestration. Continuing to exempt MILPERS after FY13 will cause an imbalance between readiness and force structure. This mismatch results in a hollow force if we have too many Soldiers but not enough funding for training, research or procurement.

Table 4 below shows MILPERS account over the next few years.

Table 4. Army MILPERS Funding FY13-FY17

(\$B)	FY13	FY14	FY15	FY16	FY17
MILPERS	56.4	55.4	55.6	55.9	56.0

The Army needs to relook its force structure under the current budget sequestration reductions and the new NSS. In the outyears the Army cannot maintain current readiness and force structure with the current cuts under sequestration. If sequestration does not occur but the Army's future budget is reduced by a smaller amount the Army still needs to relook our force structure in the future. Since MILPERS accounts are so large any reductions must look at this account. Manpower cuts of 10%, which is in line with the sequestration reductions in FY13, reduces the Army by another 49K bringing end strength down to 441K for the active force. This equates to a reduction of five BCTs with enablers, bring the total down Active Component BCT number to 32 and 28 Reserve Component BCTs. This should be the extreme end of any reductions. Under the current priorities for the 21<sup>st</sup> Century the Army does not need as robust an active force. These MILPERS reductions save over \$4.5B per year, when fully enacted, reducing cuts to other appropriations. The Army can look at ways to keep end strength without becoming a hollow force.

There are a number of initiatives that DoD is contemplating that may save MILPERS funding if enacted. First initiative is to reduce the rate of pay raises to below the Employment Cost Index (ECI). Congress has provided Service Members a pay raise percentage above the ECI over the past 10 years. DoD's budget request for 2014 will include a proposed pay increase of 1 percent for 2014, 0.7% below projected ECI.<sup>36</sup> Second, make Basic Allowance for Housing (BAH) equal to 80% of the cost vs. 100% of cost of living off post. Indexing the DoD health care program, known as TRICARE, co-pays for active and retirees reduces the growth of health care cost by charging higher ranking individuals and families' higher co-pay for visits and prescription drugs

compared to lower ranking Service Members and retirees. Finally, changing retirement benefits could save the Army additional funding. The FY13 National Defense Authorization Act established a retirement commission to look at retirement benefits. If these changes are implemented each should help reduce the MILPERS bill. Reducing the MILPERS bill allows the Army to keep end strength and force structure. In the past, Congress has been reluctant to address these initiatives, but under the current fiscal constraints an opportunity to readdress these initiatives exists. MILPERS is the Army's biggest account and must share in the reductions. Saving funding from a lower MILPERS requirement could allow smaller reductions other appropriations such as Research, Development, Testing and Evaluation (RDT&E).

In the proposed FY13 budget, the Army has budgeted \$8.9B for RDT&E but has a projected sequestration amount of \$1.0B.<sup>37</sup> RDT&E is a two year appropriation. This reduction in FY13 not only includes the FY13 request but also any prior year unobligated balances.<sup>38</sup> RDT&E funds from FY12 not obligated by March 1, 2013 are available for sequestration. Army RDT&E has 188 different projects that will have a reduced level of effort if sequestration takes effect as currently written. This forces each project lead to identify additional efficiencies or reduce the requirement as funding levels are reduced. Table 5 on the next page shows the reduction of RDT&E programs for each year.

The Army must use its reprogramming authority and focus on the highest priority items. Reprogramming authority allows the Army to move funding from one appropriation to another appropriation or project. While the Army has limited

Table 5. Army RDT&E Projections FY13-FY17

(\$B)	FY13	FY14	FY15	FY16	FY17
RDT&E	8.9	8.4	8.3	7.1	6.3
RDT&E After Sequestration	7.9	6.8	6.7	5.7	5.1
Reduction	(1.0)	(1.6)	(1.6)	(1.4)	(1.2)

reprogramming authority, once that authority is exceeded, Congress approves the movement of funds. For example the Army is trying to develop the Ground Combat Vehicle (GCV) to replace the Bradley Fighting Vehicle (BFV). In FY13 the Army has budgeted \$640M which increases to over \$1B by FY16. By reducing the funding amounts to GCV by an additional 15% over sequestration \$94M in FY13 funding would be available for higher priority programs. This causes the Army to delay the development of the CGV by a few years. The BFV is still a good vehicle and variants are expected to be in the Army inventory until 2040. So the trade off for using CGV RDT&E funding for higher priority programs is keeping a viable vehicle in the inventory for a few years longer. Also, the majority of the BFV fleet has been reset back to zero miles coming out of Iraq. With the Army also facing future force structure reductions, a few years delay in development will allow the Army to solidify the requirements for the GCV. Sequestration or similar size cut forces the Army to prioritize their RDT&E efforts and uses reprogramming authority to move funding from lower RDT&E project to resource the critical projects appropriately. Tied closely to RDT&E are the procurement appropriations.

Procurement will take a \$1.8 B reduction in FY13 out of a proposed budget of almost \$16.7B base budget. Procurement accounts are active for three years. This means that funding appropriated in FY11 and FY12 and not obligated at the time of sequestration, are available for the 10.5% reduction. Because of the arbitrary nature of the reductions, Army officials are rightly concerned that a 10.5% reduction results in higher cost in the outyears because contracts are broken resulting in additional penalties or higher per unit cost than has been negotiated. While these concerns are valid the Army must work with Congress to minimize any excess penalties and inefficiencies due to sequestration. FY13 shows a smaller reduction due to the continuing resolution amounts being assessed against the higher FY12 procurement accounts.

Table 6. Army Procurement Projections FY13-FY17

(\$B)	FY13	FY14	FY15	FY16	FY17
Procurement	16.7	18.7	18.9	19.1	19.9
Procurement After Sequestration	15.9	15.1	15.3	15.5	16.1
Reduction	(1.8)	(3.6)	(3.6)	(3.4)	(3.8)

The sequestration impacts to the Army procurement can be mitigated. For example in FY13-FY15 the Army budgeted \$430.6M for 58 Stryker Nuclear Bio-Chemical Reconnaissance Vehicles (NBCRV)<sup>39</sup> which will complete the current production of the Stryker family of vehicles. According to the House of Representatives Appropriation Committee (HAC) sequestration will result in the Army purchasing 11

fewer Stryker's which hurts the ability to keep Stryker brigades fully outfitted.<sup>40</sup> The Army has a number of options how to handle each procurement issue. In the Stryker example, the first option is to extend production of Stryker's another year to ensure all 58 vehicles get purchased, assuming the Army doesn't decide to deactivate a Stryker brigade, which is a low probably event. Extending the production line for another year is an expensive operation to produce eleven vehicles. A second option, since the Army is almost at the end of the procurement run for Stryker vehicles, move funding from other programs to finish the Stryker procurement. Ending the need to keep a production line open for an extra year for a handful of vehicles saves funding in the long term. To fully fund the Stryker NBCRV the Army could take funding from the CH-47. The same HAC report referenced above states sequestration will force the Army to purchase five fewer CH-47s in FY13.<sup>41</sup> The Army plans to purchase 44 CH-47s for \$1.4B in FY 13 and between 28-39 aircraft per year between FY14-FY17.<sup>42</sup> After FY17 the Army will continue to purchase additional CH-47s to modernize the fleet to the F model. Since the Army will continue to purchase the CH-47 into the future, there is room to decrease production.

The Army has not announced the number or types of units that will be deactivated to get down to the 490K endstrength. The number of CH-47s may go down in the event a Combat Air Brigade or two are deactivated. Since the Army is buying so many in FY13, with a unit cost of over \$30M, a reduction of a few aircraft per year, to a steady state of 20 aircraft a year would free up additional funding to be reprogrammed to other areas. Depending on the year, a steady state buy of 20 CH-47's could save from \$120M-\$270M per year over and above sequestration. If the requirement for the

CH-47 is not reduced, Army keeps all the CABs, then the reduced buy extends the production line a number of years, which is good for the manufacturer and the Army as it allows for future modifications to the aircraft. Additionally, the multi-year contract for the CH-47 procurement ends in FY13, so it's a good time to relook that contract vehicle. The Army needs to take a multi-year look at procurement and sequestration and identify areas for opportunity to set the Army up for future success. The Army's use of reprogramming assists the Army in funding higher priority items that minimizes longer term inefficiency and disruption to programs. Working with Congress to minimize excess cost due to sequestration can help the Army avoid costly penalties due to breaking contracts. Another way the Army can reduce outyear procurement funding is to continue development of new initiatives using RDT&E appropriations but not procure the item. This allows the Army to develop new systems but puts these items on the shelf until future funding is available.

MILCON FY13 sequestration reduction totals \$294M out of a program of \$2.8B. MILCON funding has reduced over next few years as a result of the Budget Control Act of 2011. In prior year budgets, the Army decided to limit the number of MILCON projects to save funding for other appropriations. To offset the reduction in MILCON projects, the Army provided additional funding in the FY12 budget to Base Operations account (O&M funding) to better main older buildings to ensure those buildings last longer. The funding for the Base Operations is impacted by sequestration, as lower levels of building maintenance funding results in buildings needing replacement sooner. Partially reducing MILCON projects is harder to calculate when reductions affect all projects at the same amount. Redesigning MILCON projects to meet lower funding levels is a timely and

costly operation. However, if sequestration goes into effect, this is one area that Congress is most likely to provide relief for in future appropriations. Congress likes to build in their home districts. There will be a desire and pressure from local constituents to fully fund these home projects. To offset funding shortfalls Congress can redirect funding from overseas projects to home projects. In FY13 that equates to \$209M<sup>43</sup> in overseas MILCON funding that can be reprogrammed for projects in the United States.

### Conclusion

The Army is taking a reduction of \$125B in lost spending authority out of a \$1.2T budget over nine years. Sequestration, as currently written, creates an imbalance across the Army which leads to a hollow force. The Army needs to work with Congress to get more flexibility to prioritize and develop the force of the future. As our nations' leaders deal with debt reduction, the Army should not expect any relief from the planned funding reductions. Starting in FY14 the Army can expect an average of \$14B reduction each year over the next eight years. Providing the Army flexibility to manage \$125B in reductions will result in a balanced force able to execute the NSS. The MILPERS account, initially exempt from sequestration, must be part of the solution. Without a reduction in MILPERS a mismatch between all other accounts will result in a hollow force. With O&M reductions of over \$75B, RDT&E reductions total over \$11B, and procurement accounts reduced by \$30B over nine years, the Army requires the freedom to prioritize to ensure the right balance exist for the future force.

### Recommendations

The Army must be part of the solution of reducing our national debt. To get the Army back in balance hard choices must be made. First, after the majority of Army forces are out of Afghanistan the Army should ask the President to lift the MILPERS

exemption. If health care, TRICARE, pay, and retirement reforms do not produce adequate savings; the Army should reduce active duty end strength by up to 49K, resulting in savings of \$4.5B per year. Next, a reduction in the DA civilian work force to FY00 numbers saves \$19B or almost 15% of the total reduction. Tied closely to the DA civilian reduction is a reduction in the number of contractors. Finally, use of reprogramming authority allows the Army to take a multi-year look at reductions in RDT&E and procurement accounts. The Army should delay development of certain programs, such as the GCV, to provide adequate funding for higher priority programs. The Army must ensure any reprogramming is designed to minimize excessive cost and maximize future efficiencies. A smaller Army adequately equipped and trained is more use to the nation than a large force without the equipment or training required. If Congress provides the flexibility, under the current debt crisis the Army can manage these cuts, develop the future force, and execute the current NSS.

#### Endnotes

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