



# BUDGET BULLETIN



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## INFORMED BUDGETEER

### NOW 2007 APPROPRIATIONS BILLS CAN FINALLY MAKE SOME SENSE

Many *Bulletin* readers have likely encountered difficulty comparing the Senate and House appropriation bills because of the differing subcommittee jurisdictions – a spending program may be in one bill in the House and a different bill in the Senate. Now that all the appropriation bills in both bodies have been reported, it is finally possible to do an apples-to-apples comparison at the subcommittee level.

The other significant differences are in the area of defense. While both the House and Senate bills include a total of \$50 billion for the Global War on Terrorism, the Senate version shifts \$7.946 billion of the \$50 billion from 2007 to fiscal year 2006, ostensibly to use up most of the additional room remaining under the 2006 302(a) allocation (all but \$796 million). As the June 29, 2006 *Bulletin* described (<http://budget.senate.gov/republican/analysis/2006/bb05-2006.pdf>), emergency spending for 2007 is now capped in the Senate at \$86.3 billion. By moving \$8 billion that would otherwise count against the 2007 emergency cap into 2006, the Appropriations Committee has freed up \$8 billion under the Senate’s emergency cap in 2007.

The House funded the regular 2007 Defense Appropriations bill with \$4 billion less than the President’s request, and the Senate funded defense \$9 billion below the President’s request. This is similar to what happened in 2006, but the defense accounts were able to get healthy through emergency supplementals. Because of the fungibility of emergency and non-emergency dollars (especially in operations and maintenance accounts), this underfunding of defense is unlikely to stand all the way through 2007.

Comparison of Senate and House 2007 Appropriations			
(Senate subcommittee structure, budget authority in billions of \$)			
Subcommittee	Current Status <sup>1/</sup>		
	Senate	House	Difference
<u>Non-emergency</u>			
Agriculture	18.200	17.809	0.391
Commerce, Justice, Science	51.000	50.220	0.780
Defense	414.500	419.568	-5.068
DC	0.597	0.575	0.022
Energy & Water	30.731	30.017	0.714
Homeland Security	31.730	32.080	-0.350
Interior	26.000	25.889	0.111
Labor/HHS/Education	142.800	141.930	0.870
Legislative Branch	3.980	3.942 <sup>2/</sup>	0.038
Military Construction and VA	52.900	52.494	0.406
State, Foreign Operations	31.340	30.916	0.424
Transportation, Treasury, Judiciary, HUD	<u>69.000</u>	<u>66.840</u>	<u>2.160</u>
<b>Subtotal non-emergency</b>	<b>872.778</b>	<b>872.280</b>	<b>0.498</b>
<u>Emergency</u>			
Agriculture (Weather-related natural disasters)	4.207	0.048	4.159
Commerce, Justice, Science (NASA)	1.040	0.000	1.040
Defense	42.054	50.000	-7.946
Defense (2006 budget authority) <sup>3/</sup>	7.946	0.000	7.946
Military Construction and VA	<u>-0.001</u>	<u>0.000</u>	<u>-0.001</u>
<b>Subtotal emergency</b>	<b>55.246</b>	<b>50.048</b>	<b>5.198</b>
<b>Grand total</b>	<b>928.024</b>	<b>922.328</b>	<b>5.696</b>

### DEFENSE DETAILS MAY NOT ADD TO TOTAL (BUT IT’S NOT BECAUSE OF ROUNDING)

As shown by this use of “regular” vs. “emergency” defense appropriations and by the announcement from some appropriators this week of an effort to add \$10 billion to 2007 defense appropriations that the President did not even request in his budget, it has become easy to increase appropriations for defense through other (emergency) means. (Recall that this month the President increased his request for defense by \$60 billion.) Since 2001, the Department of Defense’s (DOD) budget has increased an average of 11.1 percent each year. But can that continue? The Administration plans for DOD’s top-line budget to grow only by 3.4 percent annually between 2007 and 2011. Is that sustainable given the underlying trends in military spending?

### Selected Acquisition Reports

There are several familiar tools of the informed budgeteer, such as the Trustees’ annual reports on the solvency of Social Security and Medicare, or the yearly *Budget and Economic Outlook* of the Congressional Budget Office. Outside the immediate circle of defense specialists, however, DOD’s quarterly *Selected Acquisition Reports* [SAR] are far less well known. That is unfortunate, because the SAR’s contents tell a significant story on the present and future fiscal position of the federal government.

The SAR is a statutory requirement (10 U.S.C. 2432). The Secretary of Defense must submit a SAR to Congress for all Defense Acquisition Category I programs. Category I programs are defined as requiring a total expenditure for research, development, test and evaluation of more than \$365 million in FY 2000 constant dollars or, for procurement, more than \$2.190 billion in FY 2000 constant dollars. The SAR for the quarter ending December 31 is the annual SAR. Annual SARs reflect the President’s Budget and supporting documentation. The annual SAR is mandatory for all programs that meet SAR reporting criteria.

The SAR reports the status of total program cost, schedule, and performance, as well as program unit cost and unit cost breach information. Each SAR includes a full, life-cycle cost analysis of the reporting program, and, if applicable, of its antecedent program in each of its stages. The SAR gives summary data for each major weapons system. For instance, the Future Combat System, the Army’s planned ground combat vehicle, is a program whose development began in 2003, when its cost was estimated at \$92 billion. Its current cost estimate in the December 31, 2005 SAR is \$165 billion, increasing by 80 percent in just two years.

1/ Current status reflects the scoring of the bill at its most recent stage, whether reported, passed, or conference report. In the House, all bills in current status have been passed by the House except Labor-HHS. In the Senate, all bills have been reported, but only Homeland Security has been passed.

2/ For comparison purposes, the total for the House includes Senate-only items as provided in the Senate-reported Legislative Branch bill, even though the House bill omits Senate-only items as a matter of comity.

3/ The Senate-reported defense bill includes \$7.946 billion for the Global War on Terrorism (GWOT) that is made available immediately upon enactment, and is scored as 2006 budget authority. Though the spending is part of the \$50 billion provided for GWOT, it is technically not designated as an emergency for Congressional scorekeeping purposes, because the purpose of the shift is to use up the remaining room under the 302(a) allocation for 2006.

Source: CBO, generated by putting House appropriations data in the Senate subcommittee jurisdictions.

The table above displays the Senate and House current status by Senate appropriations subcommittee. Emergency spending is the most glaring difference between the bodies. The Senate Appropriations Committee designated over \$4 billion of agriculture spending in 2007 as an emergency to provide more funding to farmers affected by weather-related natural disasters, primarily for crop losses and energy assistance. This agriculture emergency bears a striking resemblance to the agriculture emergency appropriations the Senate unsuccessfully sought to include in the 2006 supplemental appropriations conference report earlier this year.

The Senate also included over \$1 billion in emergency funding for NASA in the Commerce, Justice, Science bill for “repairs” to return the shuttle to flight (three years after the Columbia disaster and after two successful shuttle flights), and hurricane damage to NASA facilities (resulting from last year’s hurricane season).

While the full SAR is a classified document, DOD releases an unclassified summary that is entirely sufficient for the lay person attempting to track cost changes in DOD's major acquisition programs. These summary reports (dating back to December 1969) are posted on DOD's website at: <http://www.acq.osd.mil/ara/am/sar/>

### **SAR Costs Double in Four Years**

An examination of the most recently-posted SAR, dated December 31, 2005, provides data for 85 programs totaling \$1.585 trillion in combined R&D and procurement costs. The SAR of September 2001 – the last SAR to reflect pre-9/11 acquisition decisions – reported 71 programs totaling \$790 billion. In only four years, the Department's total cost of major acquisition programs doubled.

### **Other Defense Costs Increasing in Tandem**

This sharp increase in DOD acquisition cost is not a unique trend in the DOD budget, particularly in the context of the ongoing Global War on Terrorism. It is to be expected that personnel-intensive military operations overseas are likely to cause a sharp increase in spending on the personnel and operations and maintenance (O&M) accounts. According to the Office of Management and Budget's *Historical Tables*, budget authority for military personnel rose from \$84 billion in 2001 to \$121 billion in 2005 (both as measured in 2005 constant dollars), for a 45 percent real increase in salaries and benefits going to military personnel. Budget authority for O&M increased from \$127 billion to \$179 billion (both as measured in 2005 constant dollars), meaning that real resources for O&M increased by 41 percent over the same period.

This means that all categories of the Pentagon's budget have experienced sharp increases since 2001, consuming larger portions of the federal budget and US economic output. But even if contingency operations in Iraq, Afghanistan, and elsewhere begin to slacken in the next few years, O & M and personnel budgets are unlikely to moderate accordingly. Why?

### **Operation and Support Expenditures Will Keep Rising**

One of the persistent fallacies about weapons systems is the belief that replacing older platforms with newer ones will reduce operation and support costs for those platforms. It is true that as a system ages, maintenance generally becomes more expensive. But replacement of that system would only lower operation and support costs if it were replaced by the same or a substantially similar technology – e.g., if an F-16 that had reached its flight hour limit were replaced by a new F-16. But it is much more likely that the older system would be replaced by a newer, more complex, and frequently more immature (and often more expensive to operate and maintain) technology.

Historical data on jet fighter aircraft bear this out. In evolving from the F-100D to the F-4E to the F-15C, the Air Force experienced a constant dollar increase in the operation and support costs per flight hour from \$2,500 per hour to \$5,200 per hour to \$8,000 per hour, respectively. It is to be expected that the in-service flight hour cost of the new F-22 will show a similar increase. Since it is likely that the new generation of weapons systems outlined in the SAR will result in increased operation and support costs, DOD's ability to control future readiness expenditures – even in the absence of large scale overseas contingencies – may be limited.

At the same time, another major component of O & M spending – DOD health care – is growing rapidly. According to a September 9, 2003 CBO study, “[a]djusted for the overall rate of inflation in the

U.S. economy, the department's annual spending on medical care almost doubled from 1988 to 2003, rising from \$14.6 billion to \$27.2 billion. Furthermore, because DOD cut the size of the active-duty force by 38 percent over that same period, medical spending per active-duty service member nearly tripled, rising from \$6,600 to \$19,600.” An October 2005 CBO update of that study projects medical costs growing by 2024 to an inflation-adjusted \$66 billion, or perhaps to almost \$80 billion if DOD cannot limit medical inflation as much as it hopes.

### **Personnel Expenses Will Increase Too**

Spending in military personnel accounts may also show little moderation, since compensation directly related to Iraq (such as imminent danger pay) is a relatively minor component of the budget, whereas recruitment and retention bonuses and other special pays and benefits, which have been significantly increased since 2001, may be politically difficult to scale back – even in the absence of a war.

At the same time, across-the-board military pay raises are expected to continue. For example, the House-passed defense authorization bill included a 2.7 percent pay raise – one half percent higher than the administration's proposal. While that action does not guarantee an appropriation at that level, it does indicate significant Congressional sentiment in favor of increasing administration proposals on military pay now and probably in the future.

### **It May Be Difficult to Control Cost of Weapons Systems**

These O & M and Military Personnel trends will likely be in place even as the newest generation of weapons systems – such as the Joint Strike Fighter, the Future Combat System, and the DDG-1000 (formerly DD(X)) destroyer – reaches full production at the end of this decade. CBO estimates that DOD's current plans would require annual appropriations over the 2012-2024 period that are 18-34 percent more in real terms than the amount appropriated in 2006.

Given the relative inflexibility of O & M and personnel costs, it would seem the main option for living within DOD's top-line is in controlling the cost of weaponry, especially those programs that the Pentagon has said it does not need. But there are some apparent disincentives for eliminating programs. For example, if the military services receive fewer new weapons systems to replace their worn-out systems, it would have the effect of increasing the aging of the U.S. weapons inventory. In addition, all weapons-system contracts contain a termination liability clause to indemnify the contractor should the government prematurely end the contract for reasons other than default by the contractor. The termination liability payment is often larger than the amount the government would have had to pay in the budget year had it chosen to continue production. In using a myopic outlook that considers only the “next” year, it appears to cost less to continue paying for an unneeded system than to end production altogether.

When these factors are added to the ramifications of weapon system politics – every project has local employment implications – it becomes clear that controlling the long-term costs of the Pentagon's arsenal are very nearly as complex as restraining the cost of government entitlements like Social Security and Medicare. Controlling such costs will require expertise in military requirements, knowledge of contracting and industrial base considerations, and an informed perspective on the federal government's long-term fiscal problems.