

I appreciate the chance to talk to you today about defense budgets. I work for the Congressional Budget Office (CBO), which is a small congressional agency that performs a lot of number crunching for the Congress. As only one person, CBO's Director, speaks formally for CBO, please view these comments as unofficial.

When Jim O'Bryon asked me to speak to you today he told me that you would want to know how much DoD would spend on test, evaluation and development. I can't tell you that—in fact, I doubt that anyone can—an accurate answer depends on too many uncertain factors—imponderables. But let's at least look at some of those factors, or as my boss terms it—ponder the imponderables.

First, let's talk about total defense budgets. Defense budgets are increasing. This is the second period of defense budget increases in the last 20 years. The first occurred in the early 1980s. Outlays—the funds the government spends annually—equaled \$260 billion in 1981. They reached a peak in 1989 of about \$430 billion. Then they declined. They reached a trough of about \$300 billion in the late 1990s. The second period of increases began several years ago, about 20 years after the first one. In 2003, the outlays associated with Congressional action in both the House and the Senate total about \$370 billion or about 20 percent above that 1990s low point. The Administration projects that defense outlays would continue to grow through 2007, the last year of detailed plans in this year's budget submission. If those plans are realized, defense outlays would approach \$420 billion by then or more than 10 percent real growth from today.

A number of factors lead to those spending totals. They include: the level of the threat, the national security strategy, demands from other programs, and the availability of federal funds. Let's talk through several of those factors.

THREAT

A major driving factor for defense budgets is the threat. The level of threat from conventional adversaries is lower than it was during the cold war. Much of the force driving down defense budgets in the 1990s related to the breakup of the Soviet Union and the resulting decline in conventional threats. But certain regional powers remain a concern today because they are antagonistic to U.S. interests. Iran, Iraq, and North Korea have been the focus of defense planning since the early 1990s.

From the standpoint of conventional capabilities, these adversaries pose much more limited challenges to the U.S. military than did the Soviet Union. In fact I think most defense analysts would argue that the U.S. military has no peer today. The capabilities of its forces surpass those of any other country in the world, especially if the sophistication of their weapons are factored in. U.S. forces also are ready to fight. They receive excellent training and are equipped with weapons that are in good repair.

But the country is approaching the one-year anniversary of the terrorist attacks on the Pentagon and the World Trade Center. According to the intelligence community and many military leaders, unconventional threats—for example, chemical, biological, radiological, and nuclear (CBRN) weapons, many of which have enormous destructive capability—may come into the hands of our adversaries. Some U.S. government sources suggest that the regional powers of concern to U.S. analysts may be developing or expanding their stocks of such

weapons. Moreover, threats to use unconventional weapons could come from individuals or hostile groups as well as other nation states. Adversaries could also target the internet and seek to disrupt commercial and military computer networks, on which the United States and DoD increasingly rely. Such threats are difficult to counter, in part because most current weapons focus on more conventional threats. In fact much of the recent increase in spending on “homeland security” has not been in the defense budget but rather in other parts of the federal budget.

Another driver of defense budget is national security strategy. The current national security strategy rests on a policy of engagement in the world’s affairs, not only during crises but in peacetime as well. The makeup of U.S. combat forces is determined by the need for at least two kinds of capabilities: fighting major wars and executing so-called contingency operations and other peacetime activities. The Bush Administration is still debating the details of the capabilities it wishes the military to have. The eventual outcome of that debate will determine not only the numbers of forces that the U.S. will continue to operate, but also who they are to be equipped. One aspect of the current strategy that will affect those desired capabilities is what the desire to transform forces, expressed by the Secretary of Defense and other administration leaders, will mean in practice. Proponents of transformation have taken a number of different tacks, and we’ve heard several today. Areas of emphasis include command, control, and communication, smaller, lighter weapons that can be more easily transported, precision targeting and precision guided weapons, and unmanned versus manned systems. Those desires influence and nature of current weapons and forces and their readiness. But they also will influence spending on future weapons—the spending you are most interested in.

Another factor that influences defense spending is the availability of federal funds. The federal budget is currently in deficit, that is spending more than it take in. But only a little while ago it was in surplus.

Defense spending is more likely to grow, or at least not decline so much, in periods of surplus and decline, or at least not grow so much, in periods of deficit. The cuts in DoD's budget during the 1990s were related to the end of the cold war—but desires to decrease federal spending also exerted downward pressure. And DoD received large increases around the turn of the century—when federal spending went into surplus. Those increases related to concerns about funding having dropped too low and to concerns about threats. But they also probably related to the availability of federal funds. It is quite possible that the current return to deficit spending could constrain future defense spending as well.

Having shown that I'm unable to tell you how big defense budgets will be, let's move on to the next question of how these unknown sums will be allocated. Budgets can be divided into operating spending and investment spending. Investment spending absorbs about a third of current defense budgets. Its share has cycled up and down and up again over the past 20 years. Investment's share of budgets grew from about 37 percent in 1981 to more than 40 percent by the mid to late 1980s. It's share declined precipitously during the 1990s, reaching less than 30 percent at the end of that decade. Shares spent on investment have grown again recently and Bush budget plans project continued growth. But the rate of growth during this period of build up is slower than it was during the last

one and investment spending would not reach as large a share of total budgets through 2007 as it did in the 1980s even if current plans are realized.

Many factors influence those shares. Among them is budget pressure to spend on DoD's operations. Those budget needs are influenced by resources to support desired military forces and pay for their readiness. Spending on DoD's infrastructure—including military construction and family housing also influences costs for operations. Spending on operating costs has grown on a per capita basis for the past 20 years. Attempts to cut that spending in the 1990s failed and it may be unrealistic to expect to add significantly to investment spending at the expense of operations. Hence increases in top line budget may be required to realize large increases in investment.

Development spending makes up a varying percentage of investment—right now a bit less than half. It has been less variable than the procurement funding that comprises the rest of the category. Development spending grew somewhat less rapidly than procurement spending during the 1980s and it declined much less sharply in the 1990s. But development spending has increased by a larger percentage in the recent funding up turn—growing by about 45 percent from its 1990 low. The Bush administration expects it to grow a bit more over the next two years. But under current plans it would decline modestly as procurement takes the lead.

So how likely are these plans to actually work out? I don't know of course, that's why I called these issues imponderables when I started. But if history is a guide—and there are some who seriously question whether it is in the post 9/11 world—development spending for defense can expect some strong

budget pressures both as a result of constraints on the defense budget as a whole, and as a result of pressures from other parts of the defense budget.