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Opinion: Why Defense Bulls May Be Disappointed

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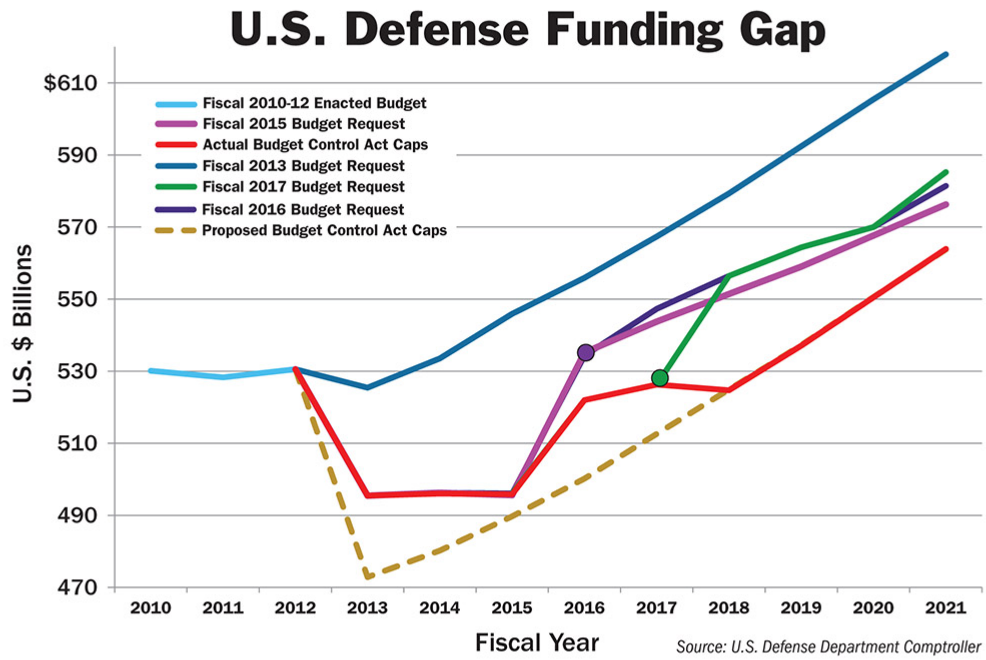
Signs of spring abound in the U.S. The crack of a baseball bat on opening day resounds, and for defense wonks, the Pentagon comptroller's "Green Book" issues forth. The National Defense Budget Estimates for fiscal 2017—the Green Book, so called because of its cover—is a 300-page volume of dense tables that express to the nearest millionth dollar every obligation, authority and outlay associated with the U.S. defense budget and program the administration submitted to Congress in February. And yet, I confess, I welcome its annual publication.

Here's why: The Green Book helps put to rest all the silly talk about defense spending that typically is thrashed about before Congress gets down to the serious business of passing a budget resolution and marking the administration's budget proposal. Among the notable silly talkers this winter have been the defense-sector bulls of Wall Street, who are hailing 2016 as the front end of a sustained growth cycle. At the other end of the spectrum are Republican presidential candidates whose talking points about the Obama administration's defense spending plans are seasoned with the campaign-tested declarations that the military has been "gutted."

So, what's real about the outlook for defense spending today? In a just-released annual assessment of world military spending, the serious Swedes at the Stockholm International Peace Research Institute dryly observe, "U.S. military spending is projected to remain roughly level in real terms in 2016." It's a fair characterization, but one that the Green Book's precision would score as understated. In fact, the constant-dollar measure of growth in the Pentagon's budget authority from 2015 to 2016 actually clocks in at 1.5%. Regardless, looking out beyond this year through the defense program that now extends to 2021, we can see that what appears to be a modest budget bump is really just what the financial world would call a "dead cat bounce" off the 2015 nadir of the sequestration-era. Inflation-adjusted defense spending through the end of this decade will fall off that 2016 blip into what I've come to call "the long bottom," a sustained period of roughly level annual budgets—the base budget plus supplemental "overseas contingency operations" appropriations—at about $600 billion.

However, this long bottom of the Defense Department's topline should not obscure what is sure to be a frantic churn in the composition of spending within it. Plans described in the 2017 budget and future years defense program are going to be buffeted mightily by the wringing out of the last five years of the Budget Control Act, by a reluctance to make structural changes to military forces that could be afforded but for that law—and of course, by a new presidential administration next January.



The procurement account in particular is set up for a perilous run. The gloss of "innovation" that the administration extolled with its rollout of the 2017 defense budget request was an impressive feat belying the substantial reductions it made to overall acquisition spending—procurement plus spending on research, development, test and evaluation. Compared to the levels appropriated for 2016, the investments the White House requested for fiscal 2017, which begins Oct. 1, would be 2.1% lower. More tellingly still, compared to what last year had been planned for investment accounts, the 2017 request is lower by 5.6%, of which procurement alone bears a $10.2 billion reduction. Indeed, procurement was the only meaningful programmatic bill payer in the comptroller's exercise to digest the $22 billion reduction off its programmed top line imposed in late October by the Bipartisan Budget Act.

And procurement is most likely to suffer disproportionately again in fiscal 2018 when the gap between the administration's future years defense plan and congressional deficit hawks' budget control caps rebounds to $30 billion (see graph). Even if Congress backs off halfway again from the strictures of the Budget Control Act in a "lame duck" session after the election, procurement cannot be spared. The administration that inherits this fiscal hand most probably will not enjoy the fortuitous economic adjustments for inflation and fuel prices. Nor will it have a new Congress's willful bleed of base program costs into the unconstrained appropriation for overseas contingency operations, which limited planned reductions to "investment" spending to $10 billion. Instead, I would have to guess that those in the Pentagon now crafting a fail-safe 2018 budget are working to reduce planned procurement spending by $15 billion.

Of course, hope springs eternal, and doubly so in a presidential election year. There may yet emerge a fiscal green thumb to promote the growth of defense spending. In the meantime, however, we have the Green Book to keep our feet planted firmly on the ground.

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