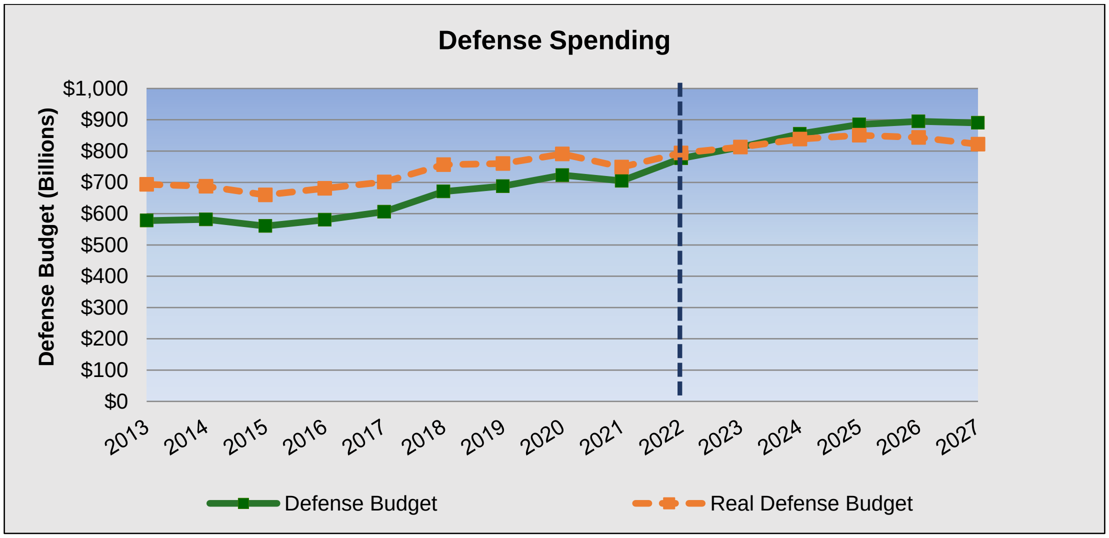
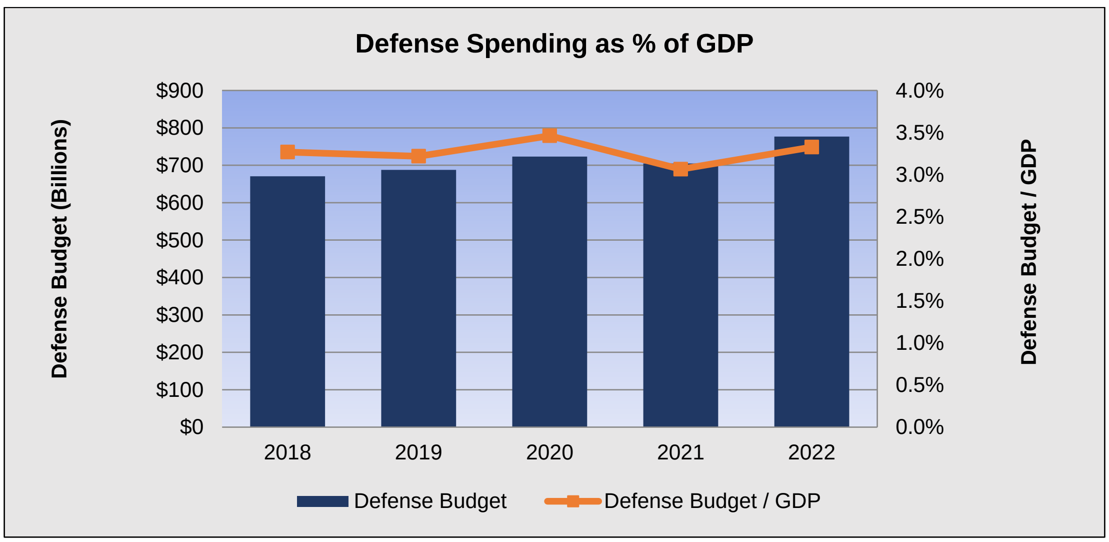
FY23 Defense Budget Analysis

Military Budget





In real terms, U.S. defense spending peaked in FY08 at $853.2 billion (FY22 dollars), a time when the military had a massive presence in Iraq and Afghanistan. The U.S. economy then took a hit during the global financial crisis, with GDP dropping by 2.5 percent in 2009. The crisis, which resulted in massive deficits caused by government stimulus and a decline in revenues, had a significant impact on defense spending, but the damage wasn't felt until passage of the Budget Control Act of 2011, implemented after the economic recovery was already underway.

The legislation initially eliminated $487 billion in planned defense budget growth over the course of 10 years. The BCA also resulted in a second round of cuts, slashing $1.2 trillion in federal spending over the same 10-year period, split evenly between defense and non-defense programs. The newly established spending caps included a sequestration mechanism that would automatically cut spending across the entire budget if any budget exceeded the caps. FY21 represented the final year of BCA caps.

Although the term "sequestration" was often used to refer to the revised spending caps, the mechanism itself was only actually used once under the BCA, and that was in the FY13 budget. The FY13 budget exceeded BCA spending

FY23 Budget Analysis

limits, and so across-the-board cuts were applied to bring spending in line with the caps. As long as Congress passed a budget that fell within BCA caps, the sequestration penalty remained dormant.

The BCA caps applied the broader national security budget function 050, which includes the Pentagon's base budget, defense programs within the Department of Energy, and defense-related programs in other agencies. Department of Defense spending falls under subfunction 051. The Pentagon base budget accounts for around 95.6 percent of function 050 spending each year, but the exact amount varies with each budget. Overseas Contingency Operations funding and emergency supplemental funding were not subject to BCA spending caps, and were often used as loopholes to increase defense spending.

Congress passed four modifying pieces of legislation since the BCA was signed into law: the Bipartisan Budget Act of 2013 (BBA13), the Bipartisan Budget Act of 2015 (BBA15), the Bipartisan Budget Act of 2018 (BBA18), and the Bipartisan Budget Act of 2019 (BBA19). These deals increased spending limits for defense and non-defense programs for two years each. This approach placed the DoD in a state of near constant budget uncertainty, exacerbated by the regular use of continuing resolutions when lawmakers were unable to pass budgets on time. CRs fund the government at the previous year's levels until a new budget is passed, creating havoc for program managers and budget planners.

The first of these deals, BBA13, provided $19 billion in additional funding in FY14 and around $10 billion in FY15. The next deal, BBA15, added $26 billion for defense in FY16 and $16 billion in FY17. In FY17, the Trump administration also funneled a supplemental budget request through the OCO account, thereby avoiding the sequestration mechanism.

The two-year budget deal covering FY18 and FY19 increased national security spending by a massive $167 billion ($81 billion in FY18 and $86 billion in FY19). The FY18 increase alone was larger than all of the increases over the previous four years combined. The legislation helped increase the federal deficit to $779 billion in FY18 and $1.1 trillion in FY19. The final deal added approximately $91 billion for defense in FY20 and $81 billion in FY21. All told, the various BCA-modifying deals added $435 billion in defense spending above the original caps.

In the wake of the financial crisis, the base defense budget remained flat at around $530 billion between 2010 and 2012. In FY13, the one year the sequestration mechanism was actually used, the base budget dropped to $496 billion. The base budget remained flat through FY15. Meanwhile, OCO funding began a steady decline starting in FY11 as operations in Iraq and Afghanistan were winding down. The declining war budget and a flat defense budget resulted in an overall drop in topline defense spending. The most significant declines were in FY12 and FY13, when topline spending fell by 6.0 percent and 10.5 percent, respectively.

The second pair of budget deals, BBA18 and BBA19, had a significant impact on the defense topline. BBA18 raised the floor for defense spending in FY18, resulting in budget growth of 10.7 percent that year. The topline saw nominal increases of 2.6 percent in FY19 and 3.6 percent in FY20. While those growth figures are below the 3-5 percent real growth called for by some lawmakers and leaders at the Pentagon, they still resulted in a defense budget topping $700 billion in FY20. The FY21 topline actually declined slightly, which can be attributed to emergency hurricane relief funding provided in FY20. If not for the emergency funding, the FY21 topline would have been flat in nominal terms, but the Pentagon still lost buying power in FY21 after adjusting for inflation.

A number of key variables have since impacted the U.S. defense spending calculus, including the COVID-19 pandemic, a change in administration, congressional intervention, inflation, and Russia's invasion of Ukraine.

The FY21 budget request, the last budget developed solely under the previous Republican administration, showed the defense budget growing by just over 2 percent per year over the course of the Future Years Defense Program (FYDP), meaning the Pentagon's real buying power would remain flat after inflation. That spending plan, released in February 2020, would have resulted in a defense budget totaling $768 billion by FY25. Those projections were generated before the COVID-19 pandemic wreaked havoc on the economy. The subsequent economic slowdown and trillions of dollars in stimulus spending were expected to have a negative impact on the defense topline, but that has not been the case so far. In fact, the FY23 budget request of $773 billion already exceeds the projected spending for FY25 under the previous administration – but higher inflation will eat away at some of that money. In some ways, the pandemic has bolstered support for defense spending as it created an increased urgency to support a struggling defense industrial base and prevent weapons programs from falling behind.

FY23 Budget Analysis

While running for office, then-presidential candidate Joe Biden said he had no intention of slashing the defense budget, despite pressure from the progressive wing of his party to cut defense by 10 percent. President Biden's first budget was released in May 2021 and sought $715 billion for the Pentagon in FY22, a marginal increase of 1.6 percent over the FY21 enacted level of $703.7 billion. Congress ultimately added another $30 billion to that figure in order to address unfunded requirements and improve defense capabilities.

The FY22 topline is also being heavily impacted by Russia's invasion of Ukraine. By April 2022, the U.S. had already committed $14.3 billion in security assistance for Ukraine. In May 2022, President Biden signed a $40 billion aid package, of which $20.1 billion would flow through the Pentagon for additional military assistance, further inflating the FY22 defense totals. The aid money is being used to buy new equipment for Ukraine and to replenish stocks of U.S. gear sent to the conflict. The scope of weapons being sent to Ukraine has gradually expanded to include systems like the HIMARS rocket launcher, and a number of lawmakers have called on the Biden administration to provide even more advanced weaponry. A prolonged war with continued military aid from the U.S. could result in further increases in the Pentagon's topline budget via supplemental spending packages. However, even in the event of a prolonged conflict, the White House may face resistance from growing voices in the Republican Party to limit additional aid to Ukraine.

Moscow's actions in Ukraine will also have an impact on the DoD's base budget. While Russia's aggressive tactics in recent years have certainly been on the radar of onlookers in Washington, the invasion of Ukraine has created a renewed sense of urgency for the U.S. to invest in advanced military capabilities. There are also some parallels between what is happening in Ukraine and the ongoing situation between China and Taiwan, which puts more weight behind the Pentagon's effort to procure new weapons in support of its Indo-Pacific shift. While President Biden's $773 billion budget request was higher than many expected, lawmakers are already seeking to add upwards of $45 billion to that figure.

Woven into these strategic concerns are high inflation rates, which are threating to eat away at the U.S. military's buying power. The FY23 budget request assumed an inflation rate of 3.9 percent in FY22 and 2.2 percent in FY23, meaning the Pentagon may require additional funding in order to keep pace.

There will likely be strong support for defense heading into the midterm elections. The Republicans are currently expected to make significant gains in the House – it's practically a tradition for the incumbent president's party to lose seats in the midterms. Control of the Senate is less certain, but regardless of the Sente outcome, a shift in the House would give more sway to Republicans that have been calling for 3-5 percent real growth for the DoD budget. That isn't to say there will be a night and day change for the Pentagon, as there is already support among Democrats for higher defense budgets, as seen by proposed FY23 spending bills coming out of the Democrat-controlled armed services committees. At the same time, lawmakers on the far right have grown more vocal about their opposition to U.S. involvement in overseas conflicts, including support for Ukraine, which could serve as a potential roadblock to higher defense spending.

The longer-term future is more uncertain. While recent economic and fiscal challenges have not caught up to the defense budget, thanks largely to a dynamic security environment, only time will tell if that remains true down the road. Defense spending remains high by historical standards, especially considering the U.S. is not directly engaged in a major conflict, suggesting there is room to fall. Further, if the U.S. were to enter a major war, defense spending would skyrocket to record levels.

FY23 Budget Analysis

Defense Spending, 2017-2022 Actual; 2023-2027 Projected											
	Historical					Enacted	Forecast				
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Defense Budget	$606.0	$670.6	$687.8	$723.2	$704.7	$776.7	$813.0	$855.0	$885.0	$895.0	$890.0
Defense Budget % Chg	4.4%	10.7%	2.6%	5.2%	-2.6%	10.2%	4.7%	5.2%	3.5%	1.1%	-0.6%
Real Defense Budget*	$701.1	$756.4	$760.0	$791.0	$748.9	$793.8	$813.0	$838.1	$850.5	$843.2	$822.0
Real % Chg	2.9%	7.9%	0.5%	4.1%	-5.3%	6.0%	2.4%	3.1%	1.5%	-0.9%	-2.5%
% of GDP	3.1%	3.3%	3.2%	3.5%	3.1%	3.3%	-	-	-	-	-
% of Nat. Budget	15.2%	16.3%	15.5%	11.0%	10.3%	13.3%	-	-	-	-	-

Currency scale: billions

Table represents budget subfunction 051 and includes base and OCO funding.

* Real figures are at constant 2023 prices.

Economy and Federal Budget

The COVID-19 pandemic presented the U.S. with its greatest economic challenge since the Great Depression in the 1930s. The pandemic hit the U.S. in early 2020. As the virus spread, states began to implement quarantine measures that required non-essential workers to stay home. With some exceptions, entire industries were effectively shut down, including travel, restaurants, and retail. These shutdowns caused the economy to contract by an astounding 31.4 percent in the second quarter. There was a third quarter rebound of 33.4 percent as portions of the country began to open up and the government injected trillions of stimulus dollars. The economy grew by 4.3 percent in the fourth quarter of 2020, which was not enough to recover the damage done earlier in the year. GDP ultimately shrank by 3.4 percent in 2020, representing the first full-year contraction since 2009 after the financial crisis, and the largest decline since after the end of World War II.

Economic conditions generally improved through 2021. The unemployment rate fell to 5.9 percent in 2021, and was around 3.7 percent as of mid-2022. In fact, many industries were facing a labor shortage. The injection of trillions of dollars of stimulus money into the population also resulted in a sharp rebound in consumer spending, particularly as more businesses opened their doors and Americans started traveling in large numbers again. In the end, the economy grew by around 5.7 percent in 2021.

The situation was less stable heading into the second half of 2022. Inflation has soared in the face of pandemic-induced supply chain issues and booming consumer demand. Russia's invasion of Ukraine only made matters worse by disrupting global energy markets. Inflation reached 8.6 percent between May 2021 and May 2022. Further, an affordability crisis in the housing and rental markets has only exacerbated the issue. At the same time, stock markets have tumbled.

In the hope of slowing inflation, the Federal Reserve began quickly raising interest rates following years of historically low rates, but it remains to be seen if the Fed can lower inflation without triggering a recession. As of June 2022, the International Monetary Fund (IMF) was predicting that the U.S. would still be able to avoid a recession, but the 2022 economic growth forecast was lowered to 2.3 percent, down from an original estimate of 3.7 percent.

COVID-19 also remains a lingering concern. New strains continue to surface and spread, while the possibility of more aggressive or deadly variants remains. Many safety measures have been rolled back in the U.S., and complacency and "COVID fatigue" will make it difficult for any of these measures to be re-implemented. The continued spread of the disease could have lasting impacts on worker shortages and supply chain issues, and these problems will only be exacerbated if a more deadly variant surfaces.

FY23 Budget Analysis

The U.S. consistently posts large annual deficits, but the COVID-19 pandemic has exacerbated the issue and pushed shortfalls beyond even those during the global financial crisis. The federal deficit exceeded $1 trillion for the first time in 2009 in the wake of the financial disaster, and averaged around $1.3 trillion between 2009 and 2012. Shortfalls fell for a few years after that, but began increasing again in 2016 and continued to rise throughout the Trump administration. A combination of tax cuts and increased spending pushed the deficit to $984 billion in 2019, or about 4.6 percent of GDP.

The pandemic struck the U.S. in early 2020, temporarily grinding the economy to a halt. A $2 trillion stimulus bill called the Coronavirus Aid, Relief, and Economic Security (CARES) Act was passed in March 2020. The legislation provided direct payments to individuals, corporate and small business loans, aid to state and local governments, and support for public services, including hospitals. This single piece of legislation increased the national debt by 10 percent overnight, but the government deemed it a necessary step to provide support to individuals and companies reeling from the economic shutdown.

Another $1.6 trillion worth of stimulus measures were passed through the end of 2020, including a $920 billion package in December. A separate $1.9 trillion stimulus bill, called the American Rescue Plan Act of 2021, was passed in Congress via the budget reconciliation process and signed into law in March 2021. The various COVID-19 stimulus and relief bills passed between March 2020 and March 2021 totaled approximately $5.7 trillion.

These stimulus efforts resulted in outlays increasing to a staggering $6.6 trillion in 2020 and $6.8 trillion in 2021 and deficits totaling $3.1 trillion and $2.8 trillion, respectively. With the bulk of stimulus efforts now in the past, deficits are coming back down out of the stratosphere. However, FY23 budget documents project that shortfalls will remain above $1 trillion per year for the foreseeable future. Deficit hawks haven't been as vocal in recent years, but their resurgence down the road could put pressure on overall federal outlays, which may have an impact on defense spending.

* * *